
Do Neoliberal Policies Deter Political Corruption?

John Gerring and Strom C. Thacker

Abstract This article probes the relationship between neoliberal economic policies and political corruption, focusing in particular on the impact of trade and investment policies, regulatory policy, and the overall size of the public sector on corruption. Using a large cross-national data set from the mid- to late 1990s, we test the neoliberal hypotheses that market-oriented economic policies are associated with lower levels of political corruption, and state intervention in the economy with higher levels. Consistent with the neoliberal argument, we find that open trade and investment policies and low, effective regulatory burdens do correlate with lower levels of political corruption. However, we find no consistent relationship between the aggregate size of the public sector and political corruption. While the neoliberal hypothesis on political corruption has initial empirical support, its lessons cannot be applied wholesale. Market-oriented states may be less corrupt, but interventionist states, as measured by public spending, are not necessarily more corrupt.

Why are some countries more corrupt than others? Many have attempted to answer this question in recent years, and the subject of political corruption has rightly captured a rapidly growing share of public and academic attention, in part because of the recognition of its intrinsic importance and also because of its close relationship with economic growth, investment, the rule of law, political accountability, political institutions, and democratic governance more generally. In fact, few issues are more important than corruption when it comes to questions of economic development and effective governance, yet still relatively little is known about the causes (and cures) of corruption. We focus in this article on political corruption, which

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we define as an act by a public official (or with the acquiescence of a public official) that violates legal or social norms for private or particularistic gain.¹

Several kinds of factors have been used to explain rates of corruption. We focus on the role of public policies. What kinds of public policies are likely to be associated with higher or lower rates of corruption? Which specific policies matter most, and how? While several public policies may play a role, we focus on the possible effects of neoliberal economic policies on political corruption. Do neoliberal policies deter political corruption?²

This article employs a statistical analysis of 181 countries in the mid- to late 1990s to test the general hypothesis that market-oriented, neoliberal economic policies are associated with lower levels of political corruption. Our analysis of political corruption broadly—but not unanimously—confirms the general neoliberal argument. More specifically, we find strong evidence of a relationship between “catch-all” measures of neoliberalism, trade and investment policies, and regulation on the one hand, and political corruption on the other. But we find no evidence of a link between the size of the public sector and political corruption. While the causal pathways linking neoliberal economic policies and political corruption are little known and underdeveloped in the literature, this evidence is strong enough to merit more empirical and theoretical treatment.

In the following sections of the article, we address the broad neoliberal argument and its three specific components that we test, present our method of analysis, summarize our specific statistical specifications and empirical findings, and offer our conclusions.

Hypotheses

There are myriad public policies that might influence levels of political corruption around the world, but there is little theoretical work that delineates the ways in which this might occur. Our task in this article is to identify a series of potentially important policies, assess their causal logic, and test their explanatory power empirically. We offer one general hypothesis and three more specific ones:

1. Gerring and Thacker 2004. Note that we use a purposefully broad definition of “political corruption,” a term that some might interpret more narrowly as corruption within the electoral or legislative spheres. But corruption within the government more generally, including the bureaucracy, is certainly a political phenomenon, as it involves public officials who have either been elected themselves or appointed by elected politicians. For these reasons, we prefer the term “political corruption,” which encompasses both the narrow concept of electoral or legislative corruption as well as what others may call “bureaucratic” or “administrative” corruption. This broad definition of political corruption is also consistent with the empirical measures used in this article.

2. For an excellent summary and intellectual history of neoliberalism, see Colclough 1991.

H1: Market-oriented, neoliberal economic policies help reduce political corruption.

H1a: Openness to foreign trade and investment promotes lower levels of political corruption.

H1b: Lower and more market-friendly regulations inhibit political corruption.

H1c: Smaller public sectors lead to less corruption than larger ones.

This section presents the causal logic behind each of these hypotheses.

Neoliberalism and Political Corruption

According to the broad neoliberal hypothesis H1, less government involvement in the economy and in civil society should result in less corruption. Certainly, there would appear to be less opportunity for corruption, since political corruption can only occur in a policy area where government has substantive powers. Fully market-based systems, almost by definition, should be less prone to governmental graft, all else being equal. By the same token, widening the scope of the free market and enhancing its competitiveness should dampen at least some of the demand for political corruption, since corruption itself is often a response to blocked market transactions. Despite the intuitive nature of these arguments, there is little empirical work that tests this hypothesis in a systematic fashion. Furthermore, there is little analytical or empirical work that draws distinctions between different elements of government economic policy or assesses their relative causal impacts.

For neoliberals, one critical, perhaps fundamental (preceding other important policies and outcomes) element of sound economic management is price stability. Without stable and relatively low rates of inflation, economic actors face tremendous uncertainty over relative prices, asset values and real wages tend to erode, and prosperity suffers. In particular, high rates of inflation shorten actors' time horizons and increase their discount rate, potentially increasing the expected utility of corruption for politicians. While the private benefits of corruption will often be garnered in the short term, its public costs (as seen in slower rates of growth, for example) are borne out over a longer period of time. By the time the public costs of corruption become evident, its culprits will likely be long out of office in a context of high instability.

It is also possible that the policies that generate inflation themselves promote corruption. Loose, expansionary fiscal policies, for example, offer greater opportunities for graft by giving government bureaucrats access to greater volumes of

government resources, the distribution of which may be influenced by bribes, kickbacks, and the like.³

Trade and Investment Policies

There are good reasons to suspect that trade and investment policies might be tied to political corruption.⁴ First, barriers to international market transactions can create material and bureaucratic incentives for corrupt behavior. Countries that erect high barriers to trade (tariff and nontariff) and investment fight the natural propensity of individuals to truck and barter. By raising the price of goods above their market price, trade barriers may induce businesspersons to bribe their way to exemptions or special treatment (including high levels of effective protection). Similarly, restrictions on foreign investment may encourage would-be investors and their domestic allies to seek extra-legal exemptions to prevailing limits on foreign participation. By the same token, trade and investment restrictions are complicated to administer, involving an intricate set of rules and procedures that tend to inflate the size of the government bureaucracy and that must be delegated to bureaucrats to enforce. The combination of complexity, particularism, and delegation can encourage corrupt practices on the part of government officials. Rule-making powers of this nature, when coupled with the material resources of would-be foreign traders and investors, can be a recipe for malfeasance.

A second argument stems from the constituencies formed over time by closed-market policies. While an open-economy regime is likely to foster an outward-looking business class, a closed system is likely to foster an inward-looking, inefficient private sector whose prosperity rests on close ties to the state and rents provided by protectionist policies.⁵ Groups dependent on protection from foreign producers and investors are unlikely to criticize corrupt practices by governmental actors upon whom their livelihood depends, or may even be beneficiaries of those practices themselves. Thus a protectionist regime can buy political silence or even complicity on the part of middle-class groups who might otherwise participate in anticorruption campaigns. Closed-economy policies may hinder the formation of a constituency for political accountability amongst the business community and other elites.

Third, an outward trade and investment orientation should enhance links to the international economy and foreign business groups, and from thence to “Western” notions of acceptable business and political practices, for the sake of business expediency if nothing else. Even if no sort of “cultural diffusion” takes place between

3. We address various fiscal factors in greater detail below, in the discussion of the public sector.

4. See, among others, Ades and DiTella 1997 and 1999; Bhagwati 1982; Krueger 1974; Leite and Weidmann 1999; Sandholtz and Koetzle 2000; Smith 1937 [1776]; and Treisman 2000. But see also Knack and Azfar 2000.

5. See Thacker 2000a and 2000b; and Ranis 1990.

foreign and domestic groups, internationally oriented groups may find it in their material interest to adopt business and political practices consistent with those of their primary foreign trade and investment partners. An inward orientation, by contrast, may give business and government alike a more domestically oriented perspective, one relatively insulated from foreign influences. This is not likely a propitious political environment for fighting domestic corruption.

Finally, to the extent that foreign investors prefer transparent bureaucracies and strong rule of law, the increase in capital mobility seen in recent decades would be expected to “discipline” governments in open economies to combat corruption in an effort to capture larger shares of increasingly mobile foreign investment (and—to the extent that foreign trade and investment are linked via intrafirm trade, vertical integration, and other mechanisms—trade as well). If firms prefer clean government, and if they are able to move from one political jurisdiction to another at a relatively low cost, corrupt governments may have to clean house if they wish to attract foreign capital.⁶ Closed economies, on the other hand, (1) face less pressure from capital mobility (precisely because their capital markets are more tightly restricted), and (2) are less likely to place a high value on investors’ interest in clean government. Greater openness should impose greater discipline on countries to reduce corruption.

Regulatory Policy

Governments frequently use regulatory policy to influence the functioning of markets. Among myriad motivations for such policies, governments may want to correct market failures, to compensate losers from other realms of economic policy, or to make indirect transfer payments to politically influential social actors. The neoliberal hypothesis argues broadly for minimal regulatory policies that foster competitive markets and market-clearing prices. This should not be confused with the absence of regulation. Indeed, recent work has underlined the vital role governments play in establishing and enforcing market rules and thereby enhancing trust.⁷ For example, several East Asian countries that were long the darlings of the popular press, international institutions, and envious developing-country governments around the world learned the hard way the need for effective financial regulations in their financial crises of 1997–98.⁸ The neoliberal hypothesis simply stipulates that the primary aim of regulatory policy should be to promote effective, efficient markets rather than to achieve other policy goals (for example, redistribution).

6. Among other sources, see Smarzynska and Wei 2002 for a treatment of corruption and foreign investment.

7. North 1990.

8. Krause 1998.

The logic of market-friendly regulatory policies follows closely on the logic of the market-friendly foreign trade and investment policies just reviewed. Unencumbered domestic markets, like openness to international markets, should enhance clean government. Regulatory policies vest policymaking power in government bureaucrats to direct market relations, thus offering incentives to businesspersons to cultivate special relations with government officials, who in turn may depend politically on support from key interest groups and actors.⁹ The complex nature of such regulations, and the need for rule interpretation, makes decision-making transparency difficult to achieve. Moreover, the concentrated nature of the private good, coupled with the diffuse nature of the public good, present difficult collective action and free-rider problems that translate into political incentives that augur poorly for the protection of the public interest. As with trade and investment policies, regulatory policies can create powerful political constituencies for or against corruption. Specific regulatory policies that might be expected to influence levels of corruption include, among others, restrictions on financial markets, wage and price controls, and business licensing requirements.

Public Sector Size

Much contemporary academic work suggests that a large public sector is more conducive to corruption. *Ceteris paribus*, the larger a role the government plays in the market—as producer and/or consumer—the greater its capacity to engage in corrupt activity. By this logic, adding functions to government cannot reduce its level of corruption; by the same token, whatever functions are not entrusted to government cannot be as easily abused by government. The semimythical, night-watchman state has few levers by which to pry money from its citizens. As a rule, proffers Scott, “the larger is the relative size and scope of the public sector, the greater will be the proportion of [corrupt] acts.”¹⁰

This view implies a positive, perhaps linear relationship between the size of government and political corruption; improvements are achieved by cutting the total size of government. But one might also speculate that leaner government is cleaner government, inch by inch and pound for pound. Cuts in the size of the public sector may not only lower corruption by reducing the size of a corrupt government, but also by making the resulting entity itself less corrupt. When government is actively engaged in producing economic goods, it must adjudicate claims among different interests within the public sector. What is a fair price for goods and services produced by state-run enterprises? (Should the same price be charged

9. The classic Stigler-Peltzman theory of regulation, in which utility-maximizing interest groups offer political support to regulators in exchange for favorable treatment, is apropos here. See Stigler 1971; and Peltzman 1976.

10. Scott 1972, 9. See also Benson and Baden 1985; Buchanan and Tullock 1962; Goel and Nelson 1998; Klitgaard 1988, 87; Krueger 1974; Lapalombara 1994, 338; Sandholtz and Koetzle 2000, 37; Scully 1991; Tanzi 1995 and 1998, 562; and Theobald 1990.

to state and nonstate consumers?) What is an optimal wage for state employees? Wherever market mechanisms are weak or nonexistent, the prices set for goods, services, and labor will be, by definition, “political,” and are likely to reflect the extant balance of political forces. Losers in these decisions are apt to consider such decisions corrupt.

Yet there are also reasons to doubt the neoliberal view on the size of government. Even the most ardent neoliberal likely acknowledges the need for certain basic functions of government. The literature on the rule of law, for example, points to the importance of law and contract enforcement and effective judicial systems for effectively functioning markets.¹¹ As in the case of regulation, neoliberals prescribe a minimal but effective role for the state. Although it may be costly to construct an effective state, especially in a context of lawlessness such as that exemplified in fractious countries ruled by warlords, guerrillas, or illegal drug and arms traffickers, such expenses tend to be nonrecurring over the long term and relatively small in comparison to entitlement programs and other instruments of the modern state.

Additionally, larger states may be more effective (and therefore less corrupt). The northern European countries, which typically rank at the top of most measures of corruption control, come to mind. Citizens may be more tolerant (or even supportive) of big government where such government is clean. In that context, governments may become larger in part precisely because they have less corruption. Relatedly, a state with greater capacity to intervene in society may also be more able to withstand pressures emanating from civil society.¹² A state with few funds, by contrast, may have little leverage in the state–civil society relationship and in combating the forces of corruption.¹³ Similarly, government retrenchment may result in the loss of valued personnel, a loss that may undermine state capacity and promote corruption. Grindle notes that public service cutbacks had “important and often negative consequences for public sector capacity,” since those with the best opportunities for private sector employment were the most likely to defect.¹⁴

Analysis

To date, most empirical work on these questions is of the case-study variety. Much of this research centers on neoliberal reforms of the past two decades. Manzetti and Blake find that recent market reforms have changed, but not eliminated, the

11. Kaufmann, Kraay and Mastruzzi 2003.

12. Phongpaichit and Piriyaarangsarn 1994, 86.

13. Kang 2002.

14. Grindle 1998, 43. See also O’Donnell 1993; and Tendler 1997, 5.

politics of corruption in Latin America.¹⁵ The partial character of neoliberal reform in most African countries may have enhanced rent-seeking activity on the part of privileged actors.¹⁶ Market reforms in communist and postcommunist countries have elicited similar comments from observers of these cases.¹⁷ By contrast, other studies demonstrate support for the notion that neoliberal reforms ultimately reduce political corruption.¹⁸ Moreover, work focused on socialist regimes almost invariably supports the neoliberal argument.¹⁹

Cross-national studies with larger samples are less common and have obtained mixed results on these questions. Tanzi and Davoodi find public investment (as an indicator of government intervention) to be slightly correlated with corruption, but short of statistical significance at usual thresholds.²⁰ Looking at industrial policies, Ades and DiTella also find a weak connection between government behavior and aggregate system-level corruption.²¹ Sandholtz and Koetzle find a reasonably strong connection between economic freedom and clean government.²² Treisman, however, with a somewhat larger data set, is agnostic on this point.²³

This study offers the most comprehensive and thorough test of the neoliberal hypothesis on political corruption. The indicator of political corruption that we use was compiled from a wide variety of international corruption polls by Kaufmann, Kraay, and Zoido-Lobaton, and later by Kaufmann, Kraay, and Mastruzzi (KKM).²⁴ The advantages of the KKM measure over others are its enormous breadth of coverage (184 cases, of which we include 181 in our analysis) and the variety of sources employed in compiling it, rendering it less susceptible to poll- or question-specific idiosyncrasies.²⁵ Our analysis centers on the mid- to late 1990s and encompasses a wide range of control variables, some of which we do not report in this study, in addition to several measures of neoliberal policy.

The KKM index is a “poll of polls,” conducted every two years, that asks respondents to rate the general level of corruption among public officials, the effectiveness of anticorruption initiatives, the frequency of additional payments necessary to “get things done,” and corruption as an obstacle to foreign investment and domes-

15. Manzetti and Blake 1996, 668. The privatization process, for example, has been fraught with abuse. See also Lapalombara 1994, 340; Snyder 1999; and Tanzi 1998, 563.

16. van de Walle 2001, 179–80. See also Lewis and Stein 1997; and Reno 1995.

17. See Hellman 1998; and White 1996.

18. Krueger 1993.

19. See Kramer 1989; DiFranceisco and Gitelman 1989; Liu 1989; Lu 2000; and Varese 1997. But also see Riley 1998.

20. Tanzi and Davoodi 1997.

21. Ades and DiTella 1997. See also Elliott 1997; and Shleifer and Vishny 1998.

22. Sandholtz and Koetzle 2000.

23. Treisman 2000.

24. See Kaufmann, Kraay, and Zoido-Lobaton 1999a and 1999b; and Kaufmann, Kraay, and Mastruzzi 2003.

25. We excluded three cases from the KKM data set because of excessive missingness in the independent variables and/or lack of sovereignty: Puerto Rico, Samoa, and West Bank and Gaza. Note also that we invert the scale of the KKM “control of corruption” variable so that higher scores indicate more corruption.

tic business enterprise. Naturally, questions and coverage varied from poll to poll.²⁶ Respondents were roughly evenly divided between two groups: (1) businesspeople and residents of a country, and (2) experts (who were asked to rank countries on various dimensions). The authors construct the composite index from these individual surveys using an unobserved components model, which allows them to include reliable estimates for countries excluded from other data sets, such as Transparency International's Corruption Perceptions Index (CPI).²⁷

Much has been written about the validity and utility of cross-national corruption polls.²⁸ What deserves emphasis, in the final analysis, is the tremendous advance that such indices offer to current understandings of the subject. Even studies based on the analysis of single countries or regions cannot avoid a comparative evaluation of the dependent variable. (To say that corruption is rife in Country A is to say, implicitly, that Country A is more corrupt than other countries.) Analysts have been implicitly judging the extent of corruption across national borders for some time. Perhaps the safest interpretation of cross-national indices of corruption is thus as a codification and systematization of this standard wisdom, allowing one to plumb the implications of this evidence more systematically. (Many of the respondents in these corruption surveys are the same country-experts responsible for the rich set of case studies on these countries.) In addition, we argue that cross-national indicators should not be intended to replace case-study research, but rather to complement it. The proper employment of such indicators is to measure what can reasonably be measured, and to systematize those judgments that are broadly comparative in nature.

Because cross-national corruption polls are a relatively recent phenomenon (earlier polls are less reliable, offer much smaller samples, and are not generally comparable over time), we conduct a cross-sectional analysis of corruption data from 1997–98. The methodological challenge of first order is the issue of specification. A widely accepted, benchmark equation specifying the causes of corruption does not yet exist. In order to assess accurately the hypotheses under consideration in this study, we must take into account a host of control variables that may influence the dependent variable. In previous work, we identified six structural-level variables of causal significance to political corruption.²⁹ These include Protestant-

26. Regrettably, it was not possible to obtain disaggregated survey results (question by question). Most of the data was obtained by KKM from consulting agencies, which have proprietary interests in keeping the results in aggregate form.

27. See Appendixes A and B at (<http://www.bu.edu/sthacker/data.html>) for a complete list of countries analyzed, their corruption scores, descriptions of the dependent and independent variables used in the analysis, and data sources. Tests conducted on Transparency International's CPI yielded results substantively similar to those presented here. Because of the KKM index's greater coverage and the availability of estimates of the uncertainty of its measures for a large number of cases, we limit our presentation here to the KKM data.

28. See Elliott 1997; Heywood 1997; Jain 1998; Johnston 2000; and Robinson 1998. We discuss our views in Gerring and Thacker 2004.

29. Gerring and Thacker 2004. See also Sandholtz and Koetzle 2000; and Treisman 2000.

ism (percentage of Protestants in a country), English legal origin, socialist legal origin (current or former), energy imports (net), per capita gross domestic product (GDP) (natural log), and democracy (years democratic in the twentieth century).³⁰ We also include in every estimation a series of unit-level and regional controls that include population size (natural log), land area, latitude (absolute value, scaled to 0–1), and dummy variables for Africa, East Asia, South Asia, Latin America, the Middle East, and the Organization for Economic Cooperation and Development (OECD).³¹ The inclusion of this wide range of controls creates more difficult tests for the neoliberalism variables. The core equation displayed in the first column of Table 1 serves as the point of departure for all subsequent specifications.

There is likely some degree of endogeneity between per capita GDP and corruption. Wealthier countries are likelier to be less corrupt, and less corrupt nations are also more apt to perform well economically. In order to minimize this problem, we measure the per capita income variable as a lagged, twenty-five-year average (1970–95). Even so, these coefficients may overstate the true causal impact of economic growth on political corruption. Because we are interested in this variable only as a control, we may regard the inclusion of per capita GDP as establishing a most-difficult scenario for our variables of interest. In addition, the inclusion of the GDP per capita variable helps establish a more direct causal link between neoliberal policies and corruption. Neoliberal policies should, according to their proponents, promote higher rates of economic growth and therefore higher levels of per capita income over the long term. Those higher rates of growth, in turn, should also contribute to lower levels of corruption. By controlling for per capita income, we can better capture the direct effects of neoliberal policies on political corruption. This also implies that the regression coefficients presented in Tables 1 and 2 may underestimate the causal import of the neoliberal policy variables because they do not capture this putative growth-inducing effect.

The socialism dummy raises interesting specification issues. The statistical significance of this variable (which enhances corruption, as expected) may be regarded as fodder for the neoliberal hypothesis. Yet few would regard this as a contested hypothesis. Socialism is an extreme case of market intervention, one not seriously supported in many mainstream academic or policy circles at the present time. This variable also overlaps conceptually with other variables, which may raise doubts about its relevance in the present context. Again, we choose to include it in all specifications to establish a higher empirical threshold for the causal hypotheses

30. We do not include other political-system variables such as parliamentarism, unitarism, and electoral system (PR/non-PR), as these are of questionable significance in the broader sample explored here, a sample that includes democratic and nondemocratic regimes. The role of these political-system variables is uncertain where no semblance of democracy exists. (In regression tests conducted on a smaller sample composed exclusively of democratic cases, the inclusion of these political-system variables does not alter the substantive results presented here.) For a study of the role of such factors in political corruption in more democratic contexts, see Gerring and Thacker 2004.

31. We also tested variables on ethnic, linguistic and religious fractionalization (and their squares), with no significant results or changes in the substantive results (not reported).

and variables of interest. If neoliberalism matters while controlling for socialism, then we have stronger evidence for the free-market argument. If, on the other hand, the causal effects of neoliberalism disappeared when socialist cases were controlled for, then we would have an empirical finding of rather little theoretical interest in the present context. Thus we err on the side of Type I errors in retaining a wide range of control variables.³²

Results and Interpretations

We have striven to operationalize each hypothesis in a variety of ways, subject only to limitations of data availability.³³ Given the likely inefficiency and bias introduced by missing data, we employ the multiple imputation technique developed by King and his associates to estimate values for missing data.³⁴ We then use CLARIFY software (a set of downloadable commands available for use in Stata) to run regressions on the imputed data that take into account not only the additional imputed information but also the inherent uncertainty surrounding the estimates of the missing data.³⁵

Because of the variable quantity and quality of the polls used to construct the KKM index (not all polls are available for all countries, nor do they all agree with each other), we employ weighted least squares (WLS) estimation, using the inverse of the standard error provided by KKM for each observation as the analytic weight to give greater weight to those cases with more reliable data on the dependent variable. Given the underdeveloped and somewhat ambiguous nature of theory in this area, as well as the potentially complex relationship between our dependent and independent variables, we must interpret results cautiously. Our intent in this study is not to provide definitive proof of a causal relationship between neoliberalism and political corruption. Rather, we aim to provide an initial round of hypothesis testing, to highlight a series of potentially compelling relationships that may spur further theoretical development and empirical testing to explore causal pathways more precisely than we are able to do here. In this regard, the overall results of the estimations presented in Tables 1 and 2 are encouraging. As measured by the adjusted R^2 , the statistical models presented in this study account for more than 80 percent of the variation in the dependent variable. The estimations are

32. The exclusion of these control variables does not alter our substantive conclusions.

33. We have tested several other possible indicators of neoliberal policy performance, such as various indicators of political risk (which have a strongly neoliberal orientation), and several separate indicators used in some of the aggregate indices presented below. In each case, results were consistent with those reported here and the inclusion of additional variables did not disturb the other results.

34. The alternative, casewise deletion of cases with missing data in one or more independent variables, generates biased results (when compared to those obtained through multiple imputation) under almost all circumstances that might be anticipated. See Honaker et al. 2001; and King et al. 2001. Regression using casewise deletion generates substantively similar results.

35. See King, Tomz, and Wittenberg 2000; and Tomz, Wittenberg, and King 2001.

TABLE 1. Estimation results

Variables	Core	Summary		Trade and FDI		Regulation		
	Equation 1	Equation 2	Equation 3	Equation 4	Equation 5	Equation 6	Equation 7	Equation 8
PROTESTANTS/ POPULATION	-0.004** (0.002)	-0.004** (0.002)	-0.004* (0.002)	-0.005** (0.002)	-0.004** (0.002)	-0.004** (0.002)	-0.004* (0.002)	-0.003* (0.002)
ENGLISH LEGAL ORIGIN	-0.177* (0.094)	-0.067 (0.080)	-0.203** (0.094)	-0.131 (0.093)	-0.146 (0.094)	-0.105 (0.094)	-0.152 (0.093)	-0.148 (0.094)
SOCIALIST LEGAL ORIGIN	0.432*** (0.149)	0.341*** (0.126)	0.313* (0.161)	0.446*** (0.146)	0.460*** (0.149)	0.398*** (0.145)	0.421*** (0.147)	0.418*** (0.148)
ENERGY IMPORTS (NET)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002* (0.0001)
GDP/CAP, ln (1970-95)	-0.318*** (0.049)	-0.261*** (0.042)	-0.290*** (0.047)	-0.289*** (0.048)	-0.314*** (0.049)	-0.259*** (0.053)	-0.297*** (0.050)	-0.301*** (0.050)
DEMOCRACY (1900-95)	-0.011*** (0.002)	-0.009*** (0.002)	-0.010*** (0.002)	-0.012*** (0.002)	-0.011*** (0.002)	-0.011*** (0.002)	-0.011*** (0.002)	-0.011*** (0.002)
POPULATION, ln	0.042* (0.024)	0.041** (0.020)	0.034 (0.024)	0.007 (0.026)	0.030 (0.024)	0.035 (0.024)	0.038 (0.024)	0.042* (0.024)
LAND AREA	1.37e-07 (1.72e-07)	1.23e-07 (1.45e-07)	1.49e-07 (1.68e-07)	8.53e-08 (1.7e-07)	1.44e-07 (1.7e-07)	1.08e-07 (1.68e-07)	1.6e-07 (1.7e-07)	1.24e-07 (1.7e-07)
LATITUDE	-1.321*** (0.380)	-0.973*** (0.323)	-1.401*** (0.369)	-1.299*** (0.371)	-1.462*** (0.391)	-1.206*** (0.379)	-1.290*** (0.374)	-1.331*** (0.375)
REGULATORY QUALITY		-0.332*** (0.040)						

INFLATION (1985–95)			0.090*** (0.029)					
M2/RESERVES (1970–95)			0.001 (0.003)					
GOVERNMENT DEBT/GDP (1970–95)			0.001 (0.002)					
BUDGET/GDP (1970–95)			–0.025 (0.021)					
IMPORTS/GDP (1970–95)				–0.006*** (0.002)				
FDI/GDP (1970–95)					–0.045* (0.026)			
REGULATION						0.166*** (0.049)		
FINANCIAL REGULATION							0.092** (0.041)	
PRICE REGULATION								0.103** (0.046)
Constant	2.448***	1.819***	1.956***	3.057***	2.696***	1.488**	2.041***	1.990***
<i>Observations</i>	181	181	181	181	181	181	181	181
<i>F</i>	56.23	79.36	47.97	55.96	53.85	57.22	54.61	54.38
<i>Probability > F</i>	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
<i>Adjusted R²</i>	0.82	0.87	0.83	0.83	0.82	0.83	0.83	0.83

Notes: Estimator: weighted least squares (WLS) regression. Standard errors are in parentheses. Missing data are imputed via multiple imputation. Regional variables are omitted from table. FDI = Foreign direct investment.

*** significant at 1%.

** significant at 5%.

* significant at 10%.

TABLE 2. *Estimation results*

Variables	Public sector					Full
	Equation 9	Equation 10	Equation 11	Equation 12	Equation 13	Equation 14
PROTESTANTS/ POPULATION	-0.004* (0.002)	-0.004** (0.002)	-0.004** (0.002)	-0.004* (0.002)	-0.004** (0.002)	-0.004* (0.002)
ENGLISH LEGAL ORIGIN	-0.172* (0.095)	-0.170* (0.094)	-0.179* (0.094)	-0.174* (0.095)	-0.168* (0.096)	-0.143 (0.092)
SOCIALIST LEGAL ORIGIN	0.437*** (0.151)	0.446*** (0.150)	0.417*** (0.151)	0.428*** (0.151)	0.415*** (0.153)	0.283* (0.147)
ENERGY IMPORTS (NET)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002** (0.0001)	-0.0002* (0.0001)
GDP/CAP, ln (1970-95)	-0.316*** (0.050)	-0.313*** (0.049)	-0.316*** (0.048)	-0.322*** (0.051)	-0.317*** (0.049)	-0.254*** (0.048)
DEMOCRACY (1900-95)	-0.011*** (0.002)	-0.011*** (0.002)	-0.011*** (0.002)	-0.011*** (0.002)	-0.011*** (0.002)	-0.011*** (0.002)
POPULATION, ln	0.039 (0.025)	0.035 (0.025)	0.040* (0.024)	0.043* (0.024)	0.045* (0.024)	-0.001 (0.025)
LAND AREA	1.41e-07 (1.72e-07)	9.7e-08 (1.73e-07)	1.46e-07 (1.73e-07)	1.35e-07 (1.72e-07)	1.25e-07 (1.73e-07)	8.96e-08 (1.65e-07)
LATITUDE	-1.303*** (0.383)	-1.221*** (0.386)	-1.304*** (0.379)	-1.342*** (0.386)	-1.311*** (0.381)	-1.375*** (0.354)
INFLATION (1985-95)						0.087*** (0.027)
IMPORTS/GDP (1970-95)						-0.005*** (0.002)
PRICE REGULATION						0.108** (0.047)
PUBLIC CONSUMPTION/ GDP	-0.002 (0.006)					
CENTRAL GOVERNMENT EXPEND/GDP		-0.006 (0.004)				
STATE ENTERPRISE (1975-95)			0.014 (0.021)			
GOVERNMENT EMPLOYEES/ POPULATION				0.005 (0.016)		
GOVERNMENT INTERVENTION					0.021 (0.042)	
Constant	2.513***	2.658***	2.513***	2.440***	2.340***	2.327***
<i>Observations</i>	181	181	181	181	181	181
<i>F</i>	52.48	53.51	52.75	52.47	52.51	55.24
<i>Probability > F</i>	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
<i>Adjusted R²</i>	0.82	0.84	0.82	0.82	0.82	0.84

Notes: Estimator: weighted least squares (WLS) regression. Standard errors are in parentheses. Missing data are imputed via multiple imputation. Regional variables are omitted from table.

*** significant at 1%.

** significant at 5%.

* significant at 10%.

also all highly significant, as measured by F tests, all of which are significant at better than the .0001 level.

With respect to our control variables, the Protestantism, socialism, energy imports, GDP per capita, and democracy variables all emerge significant and robust

across the various specifications, suggesting that countries with larger proportions of Protestant populations, no history of socialist rule, higher levels of energy imports (and, hence, lower levels of energy exports and production), higher incomes, and longer tenures of democracy tend to exhibit lower levels of perceived political corruption. Having an English legal origin may reduce corruption, though this effect is not particularly robust across different specifications. With respect to geographical variables, only latitude yields significant results on a consistent basis, with countries farther away from the equator exhibiting lower levels of corruption. Countries with larger populations may have more corruption, though the relationship is not robust.³⁶ The regional dummies, while significant collectively in an F-test, were inconsistent on an individual basis.³⁷

With respect to our variables of interest, we use two broad indicators of “neoliberalism.” The first is KKM’s measure of regulatory quality, which incorporates a broad range of regulatory factors, including those related to market openness.³⁸ The results for this variable are highly significant and robust, suggesting that those countries with more market-friendly policies exhibit less corruption.³⁹ Because this variable does not parse out the various aspects of market-oriented policies, we rely on it solely as an indicator of a general trend toward neoliberalism in a given country. (The fact that it overlaps with our measures of trade and foreign investment policies, among others, makes it impossible to distinguish between the effects of specific policies with this variable.)

Our second summary indicator of neoliberalism is inflation, as suggested above in the hypotheses section. We test the relationship between price levels and corruption with the Heritage Foundation/*Wall Street Journal*’s multiyear measure of inflation, in order to flatten out periodic fluctuations and address the issues of endogeneity and causal direction.⁴⁰ We simultaneously tested the impact of money supply (as a proportion of foreign reserves), government debt (as a proportion of GDP), and budget balance (as a proportion of GDP), in an attempt to parse out the possible effects of inflation itself (for example, time-horizon and discount rate effects) from the potential effects of its underlying macroeconomic policy causes (for example, the effects of large fiscal deficits), as discussed above. Regression results are consistently significant for the inflation variable: high rates of long-term inflation tend to be associated with higher levels of political corruption. They are equally consistently weak for the money supply and fiscal variables, neither of which

36. This does not change if land area is omitted from the estimation.

37. Because their substantive import is unclear, we conserve space by not reporting the results for the regional dummy variables.

38. Kaufmann, Kraay, and Mastruzzi 2003.

39. We found similarly strong results for the Heritage Foundation and *Wall Street Journal*’s Economic Freedom Index, but it includes various measures of corruption that preclude its use as an independent variable to explain corruption. See Johnson, Holmes, and Kirkpatrick 1999.

40. The measure of inflation compiled by Johnson, Holmes, and Kirkpatrick 1999 and the one we use here covers 1985–95 and gives greater weight to recent years. We also ran tests using an unweighted, twenty-five-year (1970–95) average that produced similar, though less consistent results (not reported).

approach statistical significance. This suggests that the unstable and uncertain atmosphere of high inflation may be more important in the relationship between macroeconomic stability and corruption than a country's underlying monetary and fiscal policies.

We capture trade openness with imports as a share of GDP, averaged over the previous two and a half decades (1970–95) to minimize endogeneity problems (see below).⁴¹ Statistically, the results in Tables 1 and 2 are clear: with greater than a 99 percent degree of confidence, we can conclude that openness to international trade appears to be associated with lower levels of political corruption.

We capture foreign investment policy using a measure of net foreign direct investment (FDI), expressed as a fraction of GDP and averaged over the 1970–95 time period. The results, while somewhat less significant than those for trade, suggest that greater openness to FDI may be linked to lower perceived levels of political corruption.

These results are open to several possible objections. First, one might object that trade and investment outcomes are not adequate measures of trade and investment policies per se. Thus a government might pursue open trade and investment policies but not achieve a great deal of trade or foreign investment. Conversely, a country may have a high level of trade, but not a particularly open economy.⁴² (Statist, outward-oriented economies like those of the East Asian tigers come to mind.) Using imports rather than total trade to measure openness avoids some of these problems. We also tested measures of import duties and mean tariff rates for trade, and Johnson, Holmes, and Kirkpatrick's measure of foreign investment restrictions for foreign investment, with no change in the substantive results presented in this article.⁴³ Over the long term it is reasonable to assume that high levels of imports and foreign investment reflect generally open trade and investment policies, *ceteris paribus*.

Finally, corruption itself may discourage foreign trade and investment; hence, the association between openness and noncorrupt government could be, at least partly, circular.⁴⁴ Future work may explore this bidirectional relationship in greater detail. For now, we employ lagged averages in the independent variables to better track the direction of causality.

We employ three indicators of regulatory policy, each a component of the Heritage Foundation/*Wall Street Journal's* Index of Economic Freedom. The first, termed REGULATION, attempts to capture the overall regulatory environment. Results

41. A measure of overall trade (imports plus exports, divided by GDP) yielded similar results.

42. High levels of FDI are probably less likely under restrictive conditions.

43. Johnson, Holmes, and Kirkpatrick 1999. The foreign investment restriction variable is significant, while the measures of import duties and mean tariffs are not, likely because data coverage is poor for these variables and because they do not include nontariff barriers to trade, often the most important policy instruments for restricting imports (not reported).

44. Treisman 2000.

for this variable in Table 1 are strongly significant. This variable, however, includes as one of its six factors corruption within the bureaucracy. Two narrower variables from the same data set allow us to capture two critical aspects of regulatory policy. Banking and finance (FINANCIAL REGULATION) captures various elements of the government's role in regulating banks and the financial sector more generally. Wages and prices (PRICE REGULATION) includes government regulations in labor laws, price controls, and business subsidies. Each of these variables is statistically significant at the .05 level and signed in the expected direction, suggesting a link between heavy government regulation and political corruption.

Public sector size is perhaps the most problematic concept in this inventory of neoliberal hypotheses. The difficulty stems not from an absence of viable indicators, but from their abundance and divergence. Although the concept of the public sector is well known, there is no generally acknowledged way of measuring it. Given its complexities, we present five indicators of public sector size. These include (1) public consumption (as percent of GDP), (2) total central government expenditure (as percent of GDP), (3) state-run enterprise (as share of the total economy), (4) government employees (as share of the general population), and (5) government intervention. The latter is a Heritage Foundation/*Wall Street Journal* composite of government consumption, government ownership of business, and government economic output.

The results of these various tests do not verify the neoliberal hypothesis. In no case do any of these variables attain statistical significance at conventional levels (.10 or better). The general conclusion is inescapable: public sector size has little or no relationship with political corruption. This result is not necessarily surprising. As noted above, there are strong counter-arguments to the neoliberal proposition on this point, and there is even room within neoliberalism for a minimal state role (though such a role would likely not register high on the indicators used in this study).

To this point, we have tested alternate hypotheses by adding variables individually to the core model—equation (1) presented in Table 1. In order to see how the primary causal variables of interest perform when the others are also present in the specification, we construct a “full” specification in equation (14) in Table 2. This specification includes, in addition to our control variables, the strongest-performing and most-representative variable from each theoretical hypothesis: inflation (summary measure), imports to GDP (trade and investment), and price regulation (regulation).⁴⁵ Results are consonant with findings reported in previous equations in Tables 1 and 2. Market openness and low regulatory burdens are asso-

45. Results for other variables that reached statistical significance in narrower specifications, such as FDI/GDP, regulatory quality, or financial regulations, were either not significant in the fuller specification (likely because of inadequate degrees of freedom and/or colinearity problems) and/or duplicative with other variables.

ciated with lower levels of political corruption, while the size of the public sector has no apparent effect.

Conclusion

The findings we present in this article demonstrate a strong, consistent statistical correlation between trade, investment, and regulatory policies and political corruption across a sample that includes most sovereign nation-states in the world. Though the nature of these relationships is likely far more complex than current theorizing on the subject, it is certainly plausible to argue that this statistical relationship reflects an underlying causal relationship.

But the pathways of these causal relationships are complex and difficult to specify. Many factors are probably operating in tandem, as discussed above, and current scholarship offers only initial hints as to how to go about sorting out these pathways. But the patterns that emerge from the data analyzed in this study call for further research into these relationships and the potential causality that resides in them. In the meantime, regardless of the precise nature of these causal pathways, and the precise weight to assign to each, a general theoretical argument emerges from the empirical patterns observed in our study: undue restrictions on foreign and domestic economic exchange appear to be linked, perhaps causally, to higher levels of perceived political corruption. Insofar as minimizing political corruption is an overall policy objective, states may be well advised to consider neoliberal trade and regulatory policies. The same cannot be said, however, for limits on the size of the public sector. Cutting back the economic size of the state may offer benefits (and costs), but a reduction in corruption does not appear to be among them.

This last result suggests an important qualification of the neoliberal hypothesis, at least insofar as that paradigm may be viewed as antistatist. Big government is not necessarily corrupt government. A brief comparison of regulatory and fiscal policies and their variable impact on political corruption is instructive. For a variety of reasons, we suggest that regulatory policy (whether directed at foreign or domestic activities) is more amenable to corrupt practices than fiscal policy. It is easier to cloak illicit actions that require no outlay of funds. Foregone expenditures (as when a bribe induces a bureaucrat to overlook a violation of a regulatory code) are both less easily detected and easier to justify, at least in the minds of the corrupt actors, than outright theft. Regulatory corruption is also more likely to be the product of bureaucratic malfeasance, while expenditures generally flow through the legislature—where corrupt arrangements may be more difficult to engineer, if for no other reason than that they require the knowledge and acquiescence of a greater number of actors. Spending decisions are easier to track, as there is a financial trail. Spending measures, finally, are more likely to address matters of broad public concern (for example, health, education, welfare, and public works), and

consequently, more likely to be monitored by watchdog groups and by the general public. Regulatory measures, by contrast, often address narrow concerns and constituencies. Social security, in this respect, may be contrasted with business licenses.

Of course, minimizing corruption is not the sum bonum of good governance; other goals, such as redistribution, might challenge neoliberal prescriptions in these policy areas. By the same token, however, one ought not assume that egalitarian goals necessarily conflict with market-friendly policies.⁴⁶ (There is ample evidence, for example, that high levels of inflation harm the poor disproportionately.) We leave this matter open for further investigation.⁴⁷

We interpret these findings as neither a vindication nor refutation of neoliberalism, but rather as a qualification of it. All too frequently, neoliberal hypotheses have been overaggregated, and too few distinctions drawn between neoliberal prescriptions. Rather than adopting sets of policies wholesale, policymakers would be wise to consider the potentially divergent effects of different types of measures. Neoliberalism, we suggest, is best understood as a promarket approach, not an antistate one.⁴⁸ It is rightly applied to policies that have greatest impact on the behavior of markets, such as trade, investment, and regulatory policies. Its application should be much more tentative with respect to policies that have ambiguous effects on markets, such as those related to the size of government.

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46. de Soto 1989.

47. See Gerring, Thacker, and Moreno 2004.

48. Our conclusions thus dovetail with Tanzi, who writes “The way the state operates and carries out its functions is far more important than the size of public sector activity.” Tanzi 1998, 566.

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