Introduction

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Corruption occurs where the private search for economic advantage and personal advancement clashes with laws and norms that condemn such behavior. Further complicating the picture, some illegal corrupt transactions accord with social norms favoring one's family, friends, and ethnic group. Other actions may be formally legal but have harmful effects similar to outright bribery. Reformers often label practices 'corrupt' simply because they disapprove of them, but economists seek a more objective concept that they can study theoretically and empirically and then evaluate for its normative characteristics.

As many of the chapters in this volume demonstrate, one must study corruption in context. Understanding the consequences of corrupt transactions requires one to know what is being bought with a bribe and how the behavior of public and private actors has been affected. What will happen if corruption is reduced? Will other forms of favoritism and self-dealing of marginal legality substitute for outright payoffs and kickbacks, or will the result be an honest and well-functioning system? Reformers must address the underlying institutional and social conditions that encourage this behavior. Is corruption the side-effect of a larger problem of monopolistic behavior or entrenched organized crime influence? If so, eliminating corruption may simply benefit the bribe payers who may continue to operate with impunity.

This volume complements Susan Rose-Ackerman's first *International Handbook on the Economics of Corruption* (2006). That volume began by introducing readers to debates over the value of cross-country indices that aggregate perceptions of corruption to permit international comparisons. These indices appear to capture the extent of dysfunctional relations between state and society, including the international business community. However, they are very vague and poorly defined. They do a good job of differentiating states that are deeply dysfunctional from those countries where corruption exists in particular locations and sectors but is not systemic. However, for the wide range of countries in the middle range, the indices tell us nothing about the relative importance of bribery, extortion, and other forms of self-dealing in different sectors. Yet, in fact, there appears to be wide variation in the types of corruption that are most prevalent in different countries. To progress, more disaggregated research

is needed. The first Handbook concentrated on the results of such disaggregated research, ranging from theoretical contributions to clever efforts to find and use micro-data to study the details of corrupt deals. In this second Handbook we go further. The contributors emphasize how the economic analysis of corruption must take account of the broader context within which bribery and self-dealing operate. Corruption as an economic phenomenon is related to several economic subfields – for example, public finance, industrial organizations, and the economics of crime. Exploring these links demonstrates that sensitivity to corrupt opportunities can help enrich our overall understanding of the interactions of markets and state bureaucracies.

The volume begins in Part I with two general reviews, one dealing with the impact of corruption and the second with the political institutions that facilitate or limit its reach. The first wave of contemporary economic work on corruption documented the close relationship between low income levels and high corruption. However, subsequent research cast doubt on the robustness of this association, especially for income growth, rather than income levels. For some, this lent credence to the old claim that corruption could fuel economic growth by permitting entrepreneurs to circumvent both restrictive laws and tight control of the economy by political elites. Although, of course, one can build models and find real-world examples of such functional corruption, this possibility cannot be converted into a general plea for tolerance because its validity is dependent upon very specific conditions. Toke S. Aidt takes on this claim in Chapter 1, ‘Corruption and sustainable development’, with the theoretical observation that corrupt public officials may maximize their gains by supporting too much short-term growth at the expense of investments that pay off over the long run, including investments in projects with environmental benefits. Hence, short-term growth may, indeed, be higher in corrupt states, but this is not a sustainable outcome. The country’s own growth rate will eventually fall because of underinvestment in projects with long-term benefits, especially education and healthcare. Furthermore, there may be global effects caused by a lack of concern for environmental values that can have both local and global impacts. Although the data problems are obviously daunting, Aidt makes a first cut at an empirical test using cross-country data that are generally supportive of his claim. This effort represents a promising line of research that could both refine macro-cross-country research and delve into the details of investment distortions at the country level. The general idea that corruption distorts investment priorities is a common theme of many of the volume’s chapters. We shall return to it below.

Aidt’s chapter concentrates on the effects of corruption on long-term economic well-being. To understand how these effects occur inside

individual states one needs to understand how public institutions interact with the private sector. In Chapter 2 ‘Curbing corruption with political institutions’, Joshua D. Potter and Margit Tavits review the literature as it applies to democratic states. Their focus is on the importance of clarity of responsibility – a factor that can only serve to deter corruption if citizens punish political actors who are held responsible for corrupt acts. Thus, the authors do not emphasize purely economic factors such as the officials’ monopoly power caused by the lack of competition for government benefits and the impossibility of avoiding costs without payoffs. Instead, they stress the importance of mechanisms that permit outsiders to monitor state officials and to assign blame or praise and that provide a way for citizens to punish wrongdoers, for example, by failing to re-elect them. This ability to monitor and to discipline officials is a key background condition for many of the more specific institutional settings discussed in subsequent chapters. It requires citizens not only to be knowledgeable about and capable of punishing corrupt officials, but also to be motivated to do so. They must believe that they will be better off if corrupt incumbents leave office. This may not be true if citizens are very cynical and believe that all politicians are corrupt or that they themselves benefit from the corrupt regime even if others benefit much more.

The chapters in Parts II and III consider linked issues of infrastructure procurement, privatization, and regulation. Chapters 3, 4 and 5 concentrate on a common locus of corruption worldwide – investment in new infrastructure, such as roads, bridges, tunnels, port facilities, and public buildings. The key common features of infrastructure projects are: large and long-term financial commitments that loom especially large in poor, small countries; a relatively small number of bidders capable of carrying out each project; specialized project-specific features that may make international price comparisons difficult; and the need for post-construction oversight, a feature discussed later in the chapters on regulation.

Before the formal procurement process begins, the government must decide what projects it wants to support and must produce preliminary designs and cost estimates to help it set priorities. In Chapter 3, ‘Delusion, deception and corruption in major infrastructure projects: causes, consequences and cures’, Bent Flyvbjerg and Eamonn Molloy argue that even in the absence of kickbacks and bribes, procurement officials in both wealthy and poor countries have an incentive to underestimate both costs and technical difficulties and to overestimate benefits. If they are in competition with others for scarce public funds, they will have an incentive to make ‘their’ projects look better than the competition. Infrastructure projects are usually *de facto* irreversible once begun because governments are likely to be punished politically for leaving big holes in the ground and

unfinished buildings to blight the landscape. Because everyone expects everyone else to issue overly optimistic projections, even those who would never think of paying or accepting an outright bribe play along or exit the sector. Because there are no good objective measures of costs and benefits, this also opens the door to corrupt operatives who exploit the unreliability of the data to enrich themselves and to further the interest of their firms.

This result can be read as an application of the framework developed by Potter and Tavits. If officials, both bureaucrats and politicians, are not held responsible *ex post* for their optimistic projections *ex ante*, they are likely to continue to act in this fashion. Waste and corruption are facilitated by the lack of clear lines of responsibility. The analysis suggests how Potter and Tavits's results can be generalized beyond purely political actors to procurement bureaucrats and other non-elected officials, although in doing so one needs to take account of the possibly different motivations of career civil servants and politicians seeking re-election in the short term.

Over and above inflated net benefit projections, the bidding process itself can be undermined by firms that act as a cartel to share government business. Here too corruption can thrive, but in this case as a counterpart of the collusive behavior of the cartel. In Chapter 4 'Corruption and procurement: strategic complements in procurement', Ariane Lambert-Mogiliansky shows how instead of competing with each other, firms may organize a cartel and pay off the procurement official to keep the collusive arrangement operating, giving the official a share of the excess profits from the project. If a reform simply targets the payment of kickbacks, the official has less power to extort payoffs, but the firms can still collude to share the market. If corruption is attacked with no concern for collusion, there may be no social benefits from a crackdown. An anti-corruption drive might simply make the cartel cheaper and more lucrative to organize, so that the firms still present a united front that forces the state to continue overpaying for public projects. Therefore, the state must target the risks of corruption and collusion simultaneously – both in the reform of overall procurement procedures and in the implementation of specific procurement projects.

Finally, in Chapter 5, 'A fighting chance against corruption in public procurement?', Gustavo Piga broadens the concept of corruption in procurement to include aspects of organized influence, patronage and cronyism that persist over time and involve large firms, industry cartels and high-level politicians and bureaucrats. Corruption arrangements under this extended rubric may operate like close-knit organized crime bodies. Piga also points out that, even under this broad definition, not all waste in procurement is due to corruption. Indeed, bad procurement

legislation might have arisen from the sheer incompetence of the policy maker, and waste can also result from incompetence in the drafting of tenders. However, incompetence could be the result of entrenched corruption. In a country with high levels of corruption, acquiring technical competence in procurement skills may not be a worthwhile investment. Much higher benefits can be obtained through networking activities that give one access to the dominant, corrupt crony and patronage-dominated environment. In return, the resulting, pervasive technical incompetence would make the corrupt system run much more smoothly because of the absence of accurate and precise monitoring and the ease of capture. High corruption and incompetence go hand in hand, reinforcing one another. Piga imagines a corresponding 'good' equilibrium where competence and honesty go together. However, as Flyvbjerg and Molloy show, what looks like incompetence in drafting tender documents may simply reflect the officials' struggle for strategic advantage. If their scenario prevails, no good equilibrium will exist, and honest processes may be subject to capture. Piga himself canvasses a number of suggested reforms and finds difficulties with many of them in light of his analysis. His own preferred policies would give procurement officials a good deal of discretion *ex ante* and subject them to heavy monitoring based on performance *ex post*. He would also affirmatively favor contracting with small and medium-sized firms. Thus, he takes a policy that is often condemned as a recipe for inefficient public procurement and argues that it favors efficiency by increasing competition and making corrupt collusion between big firms and public officials less likely.

Privatization and private firm malfeasance raises some similar themes. Thus, Part III begins with Chapter 6, 'Public versus private governance and performance: evidence from public utility service provision', by Maria Vagliasindi. This chapter uses case studies from World Bank projects to illustrate the differences between private and public utilities in the water, electricity and rail sectors and to compare the performance of public utilities across sectors and countries. In spite of the privatization of utilities worldwide, the public sector remains the dominant provider in many countries. Compared to the private sector alternatives, their performance varies widely, from well-run bodies that perform well, to wasteful, inefficient providers operating with obsolete capital and incompetent patronage employees. Although Vagliasindi presents no direct evidence of corruption in these latter cases, they are obviously prime candidates for corrupt self-dealing by politicians and bureaucrats and by those who use the service and supply inputs. She argues that governance reform should not only focus on corruption detection and punishment, but should also incentivize politicians, bureaucrats, and managers to improve service provision

inside the firm. A combination of internal incentives, coming from incorporation and strong oversight by the firm's board, and external checks, such as public stock listing, result in better performance. Such governance mechanisms improve public firms' performance, in part, by controlling corruption that takes the form of self-dealing by public firm managers and of political favoritism. This chapter also proposes innovative ways to align incentives, by publicly monitoring the performance of state enterprises through regulatory contracts that are subject to third-party monitoring and scrutiny by the general public.

Vagliasindi takes the pattern of public and private firms as given and analyzes their performance. In contrast, Chapter 7, 'Privatization of rent-generating industries and corruption', by Emmanuelle Auriol and Stéphane Straub, considers the motivations behind decisions to privatize. They stress the interplay between corruption and competition in the privatization process and show how corruption can introduce two types of distortions. The first and the most straightforward is a corrupt process that reduces the price received by the government and leads the privatized firm to set prices and sell quantities that are not socially optimal, perhaps because it has been given a monopoly. Note, however, that this monopoly result could arise not from corruption but simply from a revenue-maximizing government that does not factor in the social benefits of competition or of effective natural monopoly regulation.¹ Second, the hope of corrupt gains might lead government officials to privatize the wrong firms, that is, to select the firms that are operating at a high level as state firms and so appear valuable to private bidders. Very inefficient state-owned enterprises do not produce many corrupt rents to share and may stay in public hands, perhaps as a repository for patronage appointments of incompetent but politically connected people.² Once again, pure revenue maximizers might make the same socially harmful choices, but the prospect of personal enrichment can be an additional spur to distort the privatization process, thus limiting the social gains it can produce. Note that if the dynamic isolated by Auriol and Straub operates, then the management problems isolated by Vagliasindi are especially likely to arise. Weak firms stay in state hands because some individuals or groups benefit from the very inefficiency and possible corruption that she documents. If the situation is as they describe it, then Vagliasindi's policy recommendations, although still valid in principle, will be politically difficult to implement without a broad commitment to limit corrupt self-dealing and to improve management for firms that stay in public hands. If the reform agenda is pushed too hard, those who benefited from the status quo may switch sides and support privatization because that may allow them to preserve some of their illicit rents. This result is especially likely for public utilities that retain their monopoly status as private firms.

The final chapter in this part – Chapter 8, ‘Risks of wrongdoing in public companies and ways to cope with them: the case of Brazil’ by Dante Mendes Aldrighi – takes a quite different approach to corporate wrongdoing. Rather than asking how the procurement or privatization processes might be corrupted, it focuses on various kinds of self-dealing in public companies, most of which are already in private hands. Using data and examples drawn from the Brazilian case, Aldrighi shows how dominant shareholders may act to disadvantage minority shareholders. Even though these forms of malfeasance are not corrupt under strict definitions that require the direct participation of a public official, they share a pivotal characteristic: misappropriation of ‘public’ resources (funds, assets, or opportunities) by agents who are trusted to take care of them.

Shortcomings in the regulatory framework and poor enforcement create openings for controlling shareholders to make decisions that provide them with private benefits but harm the firm as a whole and especially minority shareholders. This chapter is a reminder to those who urge that a general solution to the problem of corruption is to shrink the state. Self-dealing and rent-seeking are practices that also occur outside the governmental sphere. If corporate insiders’ opportunistic behavior is not constrained by a sound institutional framework – which includes strong competitive forces, independent and efficient private- or government-led monitoring and surveillance bodies, and well-designed laws and regulation as well as their effective enforcement – there is no reason to think that they will behave any better than corrupt officials or private firms that bid on government procurement contracts or participate in auctions of state assets.

After public utilities have been privatized, they will still likely require regulatory oversight to prevent them from exploiting their monopoly position. As Auriol and Straub argue, there is a distinct possibility that firms will be privatized with their monopoly power intact to maximize the rents generated by the sale which can be divided between the buyer, the state, and any corrupt officials. One way to counter this problem is for the state to create a credible regulatory structure that limits monopoly profits and, perhaps, imposes other socially beneficial conditions on the private firm. However, if the regulatory system imposes costs, it too can be a locus for corrupt deals as firm representatives try to manipulate agency decisions regarding price, service quality, capital investment, and the entry of new firms, for example. Part IV contains two related discussions of these issues, one theoretical, the other based on case studies.

In Chapter 9, ‘Anti-corruption policy in theories of sector regulation’, Antonio Estache and Liam Wren-Lewis demonstrate how corruption can distort the choices of regulatory agencies. They echo the chapters

on privatization in pointing out that its potential social benefits can be undermined by poor implementation; their focus is on the regulation of firms already in private hands. An underlying claim is that the cost of corruption in regulated industries is not equal to the frequency or the size of bribes. Here as elsewhere, one must consider the impact of corruption on the policy choices of officials, not the amount of money that changes hands. A relatively small bribe paid by a powerful regulated firm can induce more distortions than a multitude of bribes paid by competitive firms seeking advantage *vis-à-vis* a powerful official. Furthermore, the most serious distortions may not be easy for the public to observe. High prices have great public salience; quiet subsidies may be hard to see.

Anti-corruption policy ought to reflect a sophisticated understanding of the way firm executives and regulators interact and the information available to each. If there is asymmetric information, extra information that improves the government's oversight ability may lead it rationally to spend less on preventing corruption precisely because payoffs are less damaging. Certain benefits can no longer be bought. Policies that improve competition may help produce better information about the industry. If so, corruption may occur more often as firms compete, but it may be less damaging. Similarly, reducing an interest group's ability to influence the regulatory process legally may reduce capture and improve performance, even if corruption increases as firms seek alternative means of influence. For example, instead of implicit promises to regulators of future jobs with the regulated industry, some firms may pay outright bribes. But these may be risky and less effective. The key question is whether a policy that limits legal capture and increases illegal bribes undermines the agency's overall credibility and cancels out the anti-capture reform or whether the agency mostly operates under the new formal rules with only occasional individual lapses.

Frédéric Boehm adds context with his case studies in Chapter 10, 'Is there an anti-corruption agenda in regulation? Insights from Colombian and Zambian water regulation'. The chapter first develops a set of 'green flags', that is, measures likely to reduce the risks of corruption in regulation. Against this benchmark, Boehm then analyzes two cases that illustrate his general points. Water regulation in Zambia and Colombia are both relative success stories even though both countries face substantial problems of corruption elsewhere, and neither country has an explicit anti-corruption regulatory agenda. However, many of their water regulation programs implicitly deal with corruption risks. Boehm's analysis suggests how good institutional design can shield regulators from corrupt influences even when corruption is pervasive elsewhere. Furthermore, a well-designed regulatory system may have anti-corruption effects even if it is carried with no explicit focus on corruption.

The *Zambian* case shows how integrating many different interests helps to check and balance a regulatory system. Multi-stakeholder involvement – including government, private sector, civil society, as well as foreign donors – helped to bind the hands of the government. This occurred because *Zambia* created a simple, transparent framework that was easily understood by all stakeholders. Good data available to the public were also fundamental. *Colombia* is weaker along this dimension. Available information could have been better disseminated and used, especially by water users, but also by the media.

Inside the agency, both cases indicate the importance of a small, highly professional agency. Civil servants with a strong sense of integrity and pride in the social importance of their work, together with fair remuneration, acted as strong shields against capture both by the industry and by narrow political interests.

The weaknesses in both *Zambia* and *Colombia* stemmed from the lack of an explicit anti-corruption agenda. There is no effective protection for whistleblowers, which means that information is difficult to collect from insiders. In addition, both countries need to go beyond traditional cost accounting to train some officials in forensic accounting techniques so that they can conduct random, forensic audits of firms' books, thereby raising the costs of fraud.

Turning the causal arrow around, good-quality regulation has apparently helped to mitigate corruption risks in both cases. Competent regulation can substitute for competition. Thus, benchmarking in *Zambia* led observers to ask why certain utilities underperformed despite operating in basically the same environment. The involvement of users in regulatory processes and the monitoring of the handling of user complaints likely reduced the scope for petty corruption related to connections and repair work. In *Zambia*, the mere presence of the regulator and its analytical work shed light – that is, information – on areas that were previously opaque and corruption prone.

We now turn from a collection of chapters on procurement, privatization and regulation that all deal with large-scale economic activities conducted at the border between the public and the private sector and that involve large firms often operating in uncompetitive environments. In Part V we collect studies that analyze micro-analytic data to help one understand how corruption operates in the context of service provision to large numbers of citizens such as university scholarships and welfare eligibility and in the procurement of standardized products such as petroleum and pharmaceuticals. The chapters illustrate a range of methodological approaches and a variety of techniques for gathering data. Of particular interest is the way in which researchers located or generated their own

data. The chapters on ordinary people review field experiments, and assess the link between the discovery of oil in São Tomé and Príncipe and corruption at the household level. In the three chapters on business corruption, one uses data on the Iraq Oil-for-Food program to assess cross-country differences in willingness-to-bribe, the second analyzes a unique dataset from an Asian country on firms' recorded bribe payments, and the third critiques survey data from enterprises in Nigeria.

The first Handbook published in 2006 contained chapters by Klaus Abbink that reviewed laboratory experiments and by Jennifer Hunt using household survey data from Peru. Abbink also reported on a quasi-field experiment involving nursing students in Ethiopia instead of the usual university students from the researchers own university based in a wealthy country. To avoid some of the problems with both techniques, researchers are beginning to design field experiments to test the prevalence of corruption and the efficacy of certain policies. In Chapter 11, 'Field experimentation and the study of corruption', Leonid V. Peisakhin reviews the small number of studies that have been carried out so far and discusses the strengths and the limitations of the technique, including the moral question of whether it is appropriate for researchers to design a study where some subjects will pay bribes to get benefits. Peisakhin reports a number of interesting results that show, for example, police in Mexico making class distinctions in asking for payoffs that favor the well-off, and poor households in India obtaining a public welfare benefit without bribery if they file a freedom of information request under a new transparency law. Field experiments are difficult and time consuming to set up in a convincing way, and there are certain types of corruption that one cannot study in this fashion. For example, field experiments cannot illuminate kickbacks paid in connection with large, one-of-a-kind public contracts and privatization deals or for infrequent regulatory decisions, such as the allocation of telecoms licenses or the setting of pollution standards for an industry. Nevertheless, they are a welcome addition to the toolkit, especially because they highlight everyday corruption that affects the lives of ordinary people and small businesses.

A mixed-methods approach, which both exploits existing data in innovative ways and gathers original material, will continue to be the technique of choice for many researchers. An example is Chapter 12, 'Oil, corruption, and vote-buying: a review of the case of São Tomé and Príncipe', by Pedro C. Vicente. Vicente asks what happens when a low-income country suddenly finds a valuable natural resource, in this case the discovery of oil at the end of the 1990s. The 'natural resource curse' holds that such resources can, under some conditions, harm a country's overall growth prospects by diverting energy into rent-seeking in connection with the

new-found resources. Because the argument for the resource curse is conditional on the nature of public institutions, one needs to study each case on its own terms. Vicente does this for São Tomé and Príncipe using household surveys on perceived corruption, archival data on university scholarship allocations, and a field experiment on vote-buying. Survey evidence showed that perceptions of corruption did increase, and hard evidence on favoritism in the award of scholarships confirmed the perceptual data. The field experiment on vote-buying found that some types of corruption affected political outcomes.

Turning to the studies of business behavior, Chapter 13, ‘Conflict and corruption in international trade: who helped Iraq circumvent United Nations sanctions?’ by Yujin Jeong and Robert J. Weiner, shows how data collected through forensic investigations can be used in creative ways to tease out the incidence and implications of corruption. This is a key strategy for researchers because of the secret nature of most corrupt deals. The exceptions are cases where payoffs to middlemen have become so acceptable that they are made openly and without fear of punishment, as in some of the field experiments reported by Peisakhin. In other situations, one needs to be clever in seeing the connections between data gathered for other purposes and estimates of corruption. The first volume included several examples, including chapters by Dean Yang and by Ritva Reinikka and Jakob Svensson. Here Jeong and Weiner use transaction-level data on bribe requests and bribe payments from the UN Iraq Oil-for-Food program, publicly available as a result of subsequent inquiries that produced detailed reports. Corruption was systematic and widespread as most firms paid surcharges to the Iraqi government for the privilege of purchasing and exporting oil. The authors use these data to show that economic factors were key to the illicit behavior of the firms. The level of bribery is strongly and significantly affected by economic gains from making a payoff. Thus, it appears that the Iraqi government and the firms were behaving in an economically rational way, with bribes rising and falling in line with market conditions. However, the law matters as well. Firms from countries that had implemented the OECD Anti-Bribery Convention were less likely to make payoffs. That treaty requires countries that ratify it to make it an offense for their domestic firms to pay bribes to get business abroad. The treaty has no hard enforcement mechanism at the international level; its enforcement depends upon the initiatives taken by signatory states, overseen only by an OECD Working Group. However, Jeong and Weiner’s results suggest that the treaty has, nevertheless, had an impact on behavior. Firms must have anticipated that home-country law enforcement against foreign bribery was at least a possibility. In the United States, of course, where

firms have been subject to the Foreign Corrupt Practices Act since 1977, that belief is not a mere guess but is a reality based on numerous past prosecutions. It is interesting to note, however, that domestic corruption levels have no independent impact on firm behavior. Of course, the countries that have implemented the OECD convention are also mostly low-corruption countries, so the separate impact of each variable is difficult to disentangle.

Jeong and Weiner's chapter reflects the fact that firms do not usually voluntarily reveal the level of payoffs. They only are revealed in special cases such as the inquiries into the Oil-for-Food program. This general lack of data makes Shawn Cole and Anh Tran's research especially noteworthy. In Chapter 14, 'Evidence from the firm: a new approach to understanding corruption', they analyze data from three private firms in a Southeast Asian country. The data report actual bribe payments by firms that sell industrial parts, pharmaceuticals, and construction services. The firms keep one set of books for the tax authorities and a second set to keep track of illegal payments. They do this to be sure that payoffs are not undermining firm profitability and, one assumes, to counter further extortion demands from purchasing agents and procurement officials. The data open a window into payoffs in both the public and the private sectors in a country with extensive government ownership of business and with a multitude of both public and private construction projects. Although we have no way of knowing whether the firms are representative or whether there are special features of the country that affect the outcomes, the results are, nevertheless, extremely interesting. Cole and Tran suggest that, particularly in developing countries with a statist tradition, one ought to pay particular attention to private sector corruption. Even though corruption is very prevalent in the public sector, it is present in the private sector as well for all three firms included in this research. This is troubling because public sector bureaucrats may be easier to monitor and control than purchasing agents and those in charge of construction in private firms. True, the owners and board of directors of private firms have an incentive to limit the kickbacks earned by their employees, but they may be inexperienced or naive or even in on the deal, along the lines of the Brazilian firms discussed by Aldrichi. In the case of hospitals' purchases of drugs, corrupt payoffs were higher in the private than in the public sector, leading one to wonder whether there might be some self-dealing by doctors with an ownership stake in the firm. In addition, one firm, a supplier of industrial parts, was more likely to pay kickbacks to firms with foreign ownership than to domestic firms or to government agencies. Perhaps this is the result of those firms' weaker ties to domestic social institutions. The lower incidence of kickbacks for domestic compared to foreign firms may

indicate, not a better functioning market, but the existence of substitutes in the form of close personal ties that are similarly devoid of free market logic.

Finally, we return to the vexed question of whether survey responses concerning corruption are reliable. Even if they are underestimates of actual corruption, are they, at least, consistent in a relative sense? In Chapter 15, 'Does respondent reticence affect the results of corruption surveys? Evidence from the World Bank Enterprise Survey for Nigeria' Bianca Clausen, Aart Kraay and Peter Murrell ask whether data from a survey in Nigeria is reliable. Their answer is troubling. They find that over 13 percent of respondents are highly likely to be reticent, that is to underreport their experience with corruption. They are especially likely to be reticent when questions ask about individual wrongdoing. In Nigeria the degree of reticence varies across regions, suggesting that using surveys to measure interregional differences in corruption may not reflect the underlying reality. In fact, the overall distortion in relative rankings does not appear to be large, but there are a few regions that stand out for the high number of reticent respondents. As a result, if these interregional differences are ignored, some states will be ranked better than they should be if one takes into account the residents' high levels of reticence. Clausen et al.'s survey only concerned Nigeria, but the results suggest caution in using any survey that ranks nation-states or other geographical regions on the basis of enterprise or household surveys. Cross-country differences in reticence may well be many times larger than the cross-region variation seen even in an ethnically diverse country such as Nigeria.

Part VI concludes the volume with four chapters that have an explicit policy focus. Although they come at the issue of corruption control from very different directions, each concentrates on proposals to control corruption that are part of a toolkit of international aid and lending bodies. One chapter examines law enforcement that concentrates on the link between corruption and organized crime. The second is a comprehensive review of the experience of anti-corruption agencies that balances the pros and cons. The remaining two emphasize the problem of corruption in procurement, and critically assess some recent initiatives carried out with the support of international donors.

The impact of the UN Convention against Corruption is the focus of Chapter 16, 'On best and not so good practices for addressing high level corruption worldwide: an empirical assessment' by Edgardo Buscaglia. Buscaglia asks whether the treaty has had an impact on the overall system of justice in countries that have ratified the treaty, including the police, prosecutors, and the courts. To make this assessment he surveyed judicial systems, financial intelligence infrastructure, auditing capacities, and civil

service capacities. In other words, his focus is on the ability and willingness of states to detect and punish crimes linked to corruption such as bribery, money laundering, and organized criminal offenses. Highly corrupt countries tend to have poorly operating courts, high levels of organized crime, and weak financial intelligence and auditing capacities, as well as poor international cooperation in law enforcement. Of course, as Buscaglia realizes, all of these variables may interact so that it is difficult to disentangle their separate effects. Furthermore, the causal arrow probably runs both ways. Thus, for example, a weak judicial system encourages corruption, but a high level of corruption can undermine the judiciary as the court system itself operates corruptly. Buscaglia himself argues that if corruption is entrenched, reform in one dimension, say with respect to forensic auditing, may mean little if organized crime has infiltrated the state and can influence judicial decisions. Nevertheless, although the empirical results do not decisively establish cause and effect linkages, his four reform pillars associated with improvements in institutional performance. They are a more effective court system with respect to the prosecution of bribery and related crimes; better financial intelligence systems; and preventive programs of civil service reform and auditing. His chapter is a useful complement to the institutional and structural approach taken in most of the other chapters. Only in Jeong and Weiner's chapter did the authors touch on the deterrent effect of the law – in their case the OECD Anti-Bribery Convention as implemented in signatory countries. Clearly, enforcement of the criminal law is not sufficient if corruption arises from the systemic factors central to the other chapters. However, it is a necessary part of any anti-corruption strategy, and Buscaglia reminds us that it should not be taken for granted but requires specialized skills and competent, honest officials and judges.

Infrastructure contracts are a major part of World Bank lending and have frequently been plagued by corruption. The Bank realizes that control of waste and malfeasance cannot succeed unless groups and powerful individuals inside the borrowing country take an active role. This is not easy to accomplish. The difficulties are made clear both in Chapter 17, 'Why multi-stakeholder groups succeed and fail' by Rory Truex and Tina Søreide and in Chapter 18 'Red flags of corruption' in World Bank projects: an analysis of infrastructure contracts' by Charles Kenny and Maria Musatova.

Truex and Søreide review the experience of groups set up to monitor the implementation of infrastructure projects after the contract has been approved. These bodies are broad-based groups that include public officials, businesspeople, and representatives of civil society groups. They aim to provide ongoing oversight to supplement the state's own monitoring

and that of the World Bank or other donors. The chapter considers the experience of a number of such groups and finds that, in practice, they are not a strong check on waste and malfeasance. The main problems with multi-stakeholder groups (MSGs) were ensuring sufficient commitments of time and energy from busy people with many other responsibilities and, conversely, taking care that the process was not co-opted by private contractors or by bureaucrats seeking to avoid aggressive oversight. Furthermore, civil society groups that participate in an MSG have to balance the benefits of this collaborative process against their ongoing roles as gadflies and critics. They will want to be sure that they do not sacrifice their future effectiveness as an independent voice.

Kenny and Musatova concentrate on checklists developed at the World Bank to flag potential problems in infrastructure contracts that may signal high risks of corruption. A long list of risk factors has been identified by various analysts at the Bank with contracting experience. The problem is that many such 'flags' occur in almost all projects and cannot be used to set priorities for further investigation. Others only occur in some projects but are hard to connect to actual problems. Their validity as red flags may be in doubt. In the admittedly small sample of World Bank-financed water and sanitation projects that the authors reviewed, measurable red flags were ubiquitous but did not seem to be correlated with each other or to be more prevalent in projects that retrospectively appeared to have the most serious corruption and self-dealing problems. The authors suggest that the red flag checklist may help direct investigative efforts once a project gets into trouble, but that they are not very useful as a stand-alone diagnostic tool. If corrupt officials and firms learn about the checklist, they may be able to design their transactions to stay out of sight, and even without such knowledge, the flags may overlook certain types of corrupt dealings.

A somewhat more hopeful prognosis is provided in Chapter 19, 'Anti-corruption authorities: an effective tool to curb corruption?' by Francesca Recanatini who summarizes her extensive World Bank study of anti-corruption authorities. Such agencies were at first highly touted as a solution for all affected countries, drawing on the positive cases of Hong Kong under British rule and Singapore. In both city-states entrenched corruption was greatly reduced through the creation of stand-alone anti-corruption agencies reporting to the British governor-general in Hong Kong and the head of state in Singapore. Criminal law crackdowns with severe penalties were combined with widespread structural reforms in the bureaucracy and a practice, especially in Singapore, of paying civil servants high wages so that losing one's job as a result of suspected malfeasance imposed a real penalty even if no court case was ever brought. The

initial enthusiasm cooled as agencies were created in many countries where they seemed to have little impact on corruption and where they were often politicized and ineffective. That produced a backlash in which donors encouraged other strategies such as the initiatives outlined in the previous two chapters. Recanatini tries to right the balance by showing that the anti-corruption agencies are neither a panacea nor a bugbear, but can play a constructive role if the conditions are right. She argues that the problem lies not with the concept of anti-corruption agencies but with the way they operate in practice. They need clear mandates, political support that assures independence, and the possibility of either bringing cases themselves or referring cases to sympathetic prosecutors. In addition, if the agency has a reform agenda outside of ferreting out wrongdoing, it must have a clear mandate and the tools to carry out policies over the opposition of rank and file officials. The wide variety of institutions that fall under the heading of anti-corruption agencies suggests that neither general enthusiasm nor overall pessimism is an appropriate response. Recanatini's project promises to help countries contemplating the establishment of such an agency by isolating the factors that ought to be considered and the pitfalls to avoid.

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Corruption is pervasive, damaging, and difficult to control. In some parts of the world it still takes courage to investigate and reveal corruption, especially when it goes along with organized crime influence or with authoritarian rulers. We searched for recent heroes in the fight against corruption, and it was a depressing list, with many of the most courageous and outspoken either paying with their lives or forced into exile.³ Immersed in the neutral language of economics, it can be easy to forget the real danger facing those who investigate corruption in major infrastructure projects, in privatization deals, in the regulation of public utilities, and in the provision of basic services to ordinary people and small enterprises. Even when physical threats are not present, investigating corruption as a law enforcement matter is difficult and time consuming. In less than transparent and honest systems, a corrupt crackdown can be used as a tool against one's enemies and political rivals. Anti-corruption movements are always unpopular with someone, so that activists may be targeted and accused of corruption themselves in a bid to silence them.

These difficulties bring us back to the economic analysis that frames this volume. Although economists have frequently studied bribery and

extortion as a branch of the law and economics of crime, our focus is different.⁴ We concentrate instead on the underlying conditions that create corrupt incentives and argue for policies that address these factors. The ideal policy is one that limits sources of rent in public–private interactions. If there is little to be gained from payoffs and kickbacks, few private actors may risk paying them, and officials may not resort to extortion. Enforcement of the criminal law against corruption needs to be a background condition, but the lesson of this Handbook is that it must not be the only line of attack. Furthermore, targeting bribery and extortion in isolation will often fail to address the underlying pathologies that produced corrupt incentives in the first place. If the basic problem is monopoly power, policy should address that issue directly. If the problem is a lack of transparency and accountability in government activities, one should find ways to open up the public sector to oversight from outsiders. If the problem is an opaque and confusing regulatory structure, rules should be simplified and clarified. And so on. This volume supplements the first Handbook volume with more recent scholarship and with a focus on the reinforcing links between corruption and other aspects of state–society relations. The authors have used a wide variety of methods to approach the subject, and we applaud this eclecticism. We hope that this volume will encourage others to take a broad view of the subject and to find creative ways to build models of corrupt behavior and to test them with data collected from a mixture of surveys, experiments and the clever reinterpretation of data gathered for other purposes that can reveal hidden patterns of corruption.

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Notes

1. On this point, see Bjorvatn and Søreide (2005).
2. See also Shleifer and Vishny (1993) who make a similar point using a different theoretical approach.
3. Thanks to Eirik Søreide Hansen who provided us with a comprehensive list of anti-corruption heroes globally: lawyers, journalists, human rights activists, and others who have either lost their lives in their efforts to reveal corruption or been seriously threatened –

often with exile as the result. We also thank Eirik for his great help in setting up the computer Dropbox for the project.

4. For a review of law and economics work on bribery and extortion, see Rose-Ackerman (2010).

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