# PAFTAD

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## *Political and Cultural Determinants of Predictable Corruption*

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**Abstract**

Corruption has been put forth as a possible determinant for the middle-income trap, in that it discourages investment, shifts resources to unproductive industries, limit capital development and so on. Yet there is disparity in the experience of across the Asia-Pacific region, as some countries continue to grow in spite of endemic corruption. This paper posits that the character of corruption is nuanced, and the effects of predictable and unpredictable forms of corruption are different. The assumption is that transaction costs associated with uncertainty would be reduced if corruption is predictable, and correspondingly less detrimental to growth. Using cross-country data, this study attempts to assess different determinants for their strength in creating predictable and organized schedules of corruption. Principally, we construct an index of corruption predictability, and then test a number of political and cultural determinants for their explanatory power.  Our findings indicate that Individualist societies, as well as societies where corruption is endemic and structurally permissible, are more likely to develop predictable forms of corruption.  Additionally, this paper also corroborates previous literature in finding that predictable forms of corruption pose less of a constraint to economic activity.

# 1. Economic Effects of Corruption

A widely used definition of corruption is the "use of public office for private gain". (Bhargava 1996, Campos & Bhargava 2007, Rock & Bonnet 2004, Lim & Stern 2002, Bardhan 2006). In examining the impact of corruption on economic activity, academics are largely divided into the "greasers" and "sanders" camps (Aidt 2009, Ertimi and Saeh 2013). According to the "greasers", some levels of corruption can improve efficiency and productivity. For example, Leff (1964) and Huntington (1968) posit that corruption can help to "grease the wheels" in systems rife with bureaucratic inequities - bribery essentially helps expedite processes when substantial red tape is present. Lien (1986) compares bribery to competitive bidding practices, which promote efficiency since only competitive firms are able to bear such costs. Using the Queue Model, Lui (1985) imagines a situation where bribery can induce officials to make decisions quicker so as to increase their rent-seeking opportunities derived from service provision. Similarly, Acemoglu and Verdier (1998) argue that corruption functions as a form of efficiency wage for public officials to provide services, thus some level of corruption is desirable, especially in less developed countries. Gomez (2005) and Wedeman (2002) describe how corrupt states might actively promote growth to increase kickbacks appropriated from business partners.

Such arguments notwithstanding, the majority of contemporary academic literature fall decidedly in the "sanders" category, showing that corruption is detrimental to growth and investment (eg, Knack and Keefer 1995, Mauro 1995, Wei 2000, Svensson 2005, Salinas-Jiménez & Salinas- Jiménez 2011, Hodge et al 2011, Blackburn and Forgues-Puccio 2009). For example, in a widely cited essay, Mauro

(1995) contend that corruption has a negative impact on growth, regardless of bureaucratic complexity. Studying Uganda and Peru, Hunt and Lazslo (2012) argue that the "greasing" effect of corruption is not present as there is no improvement in service quality. Meon and Sekkat (2005) also reject the "greasing" hypothesis, and instead find that the negative impact of corruption is more pronounced when governments are ineffective. In extreme cases, corruption can cripple the growth of the national economy through massive redistribution of wealth (Jain 1998). In terms of productivity, a negative relationship with corruption levels has also been observed (Lambsdorff 2003, Salinas-Jiménez & Salinas- Jiménez 2011). By investigating the transmission channels, Dridi (2013) discovers that corruption's main effect is to hamstring human capital development and induce political instability. For investment, Campos et al (1999) and Lambsdorff (2002) show that unregulated corruption negatively impacts gross investment levels. On the supply side of Foreign Direct Investment, Wheeler and Mody (1992) assert that corruption, together with political risk and bureaucratic inefficiency, factor negatively into the overseas investment decisions of American firms. As such, some scholars have put forth that corruption is responsible, at least in part, for the middle in come trap (eg Aiyar et al 2013).

Corruption has been approximated to having similar effects as taxation, discouraging investment and business activity in much the same way (Kreps 1997, Smarzynska and Wei 2002, Blackburn & Forgues-Puccio 2009). Shleifer and Vishny (1993) describe how in the case of customs goods, bribes are similar to commodity tax in discouraging trade. In a cross-country study involving 18 source and 45 host countries, Wei (2000) demonstrated that corruption perception had an adverse effect

on foreign direct investment (FDI) comparable to taxation. For example, the difference in corruption perception between Singapore and Mexico had a negative effect on FDI inflows equivalent to raising taxes by 18 to 50 percentage points. However, a key difference between taxation and corruption is that the illicit nature of latter necessitates a level of secrecy. This creates distortionary effects on the allocation of resources as officials encourage activity in industries where bribe-taking is easier to conceal (Shleifer and Vishney 1993). Furthermore, comparatively higher levels of bribes are required if funds have to be channelled back to keeping such transactions covert .

And yet, the Asian-Pacific experience appears inconsistent with expectations. Some of these economies achieved high growth rates in spite of endemic corruption (Wei, 2000, Wedeman 2002, Lim and Stern 2002, Rock and Bonnet 2004). Wedeman (2002) calls this the "East Asian Paradox". For example, prior to the Asian Financial Crisis, Thailand and Indonesia ranked among the most corrupt and yet fastest growing economies in the world (Lim and Stern 2002). These economies were able to progress through the various stages of industrialization and attract high degrees of FDI while contending with systemic corruption (Rasiah 2010). This pattern is also seen in China (Wei 2000) and South Korea (Moran 1999, Booth 1997). For Malaysia, Aw and Tang (2010) show that increases in corruption perception is correlated with increases in FDI. Indeed, some scholars  find that corruption did not have a significant impact on investment (Dridi 2013, Wijeweera and Dollery 2009) or productivity (Faruq and Telaroli 2011). Others suggest that higher levels of corruption were in fact correlated with higher levels of investment (eg.  Vadlamannati et al 2009, Aw and Tang 2010).

Robertson and Watson (2004) explain that this paradox could be due to higher levels of FDI creating more opportunities for bribe-taking.

Thus, why is it that peculiarities exist within Asia-Pacific economies, in that some countries continue to prosper in spite of corruption while others do not? We suggest that understanding the character of corruption in these countries is crucial for untangling the puzzle. Principally, we should distinguish the forms that corruption can take. It can manifest in organized, coordinated ways according to established rules, or in an unorganized, anarchic fashion, characterized by bargaining and uncertainty (Cartier-Bresson 2000). Therefore, some scholars argue that the predictability of corruption is as important as its extent (Campos et al 1999, Cartier-Bresson 2000, Malesky and Samphantharak 2008, Blackburn and Forgues-Puccio 2009). To elaborate, transaction cost models predict that uncertainty has a dampening effect on investment and growth (Williamson 1971, 1979). Knack and Keefer (1995) explain that this uncertainty translates to increased business costs, as well as unreliability in the enforcement of contracts and property rights. Lambsdorff (2002) arrives at a similar conclusion. Kaufman and Wei (1999) add that unpredictable corruption has the effect of increasing the time that businesses waste in negotiations with bureaucrats. Therefore, if firms could somehow mitigate such uncertainties associated with corruption, the ill effects of graft on growth may be somewhat reduced.

## 2. Why Predictability Matters

Instances of illicit activity can be understood within the principal-agent paradigm proposed by Becker and Stigler (1974), and subsequently adopted in a

number of corruption studies (Banfield, 1975, Rose-Ackerman 1975, Groenendijk 1997). This model describes how public office mechanisms require an agent, such as an official or politician, to act on behalf of the principal, such as the ruling party (in an authoritative state) or citizenry (in a democracy). The agent is assumed to have a measure of discretionary authority to permit or disallow some form of economic activity (Rose-Ackerman 1975). In a corruption scenario, a private individual (or firm) might be compelled to offer the agent a bribe if the benefits exceed his opportunity costs. For example, suppose that a criminal faces a penalty of X dollars if he is prosecuted. He would then be willing to offer up to X-Y dollars in bribes to the agent to avoid punitive measures (Becker & Stigler 1974). It is in the interests of the principal that the agent performs his duty, but the agent might not be properly incentivised to do so, especially if he considers his net utility to be greater if he receives the bribe (Rock 2009). Of course, an agent may refuse a bribe even if his economic utility is high if his own moral values restrain such actions (Banfield 1975, Bardhan 2006).

This does not mean that an agent's bribe-taking activity is necessarily independent of the principal. As Bardhan (2006) notes, there are instances where political (principal) and bureaucratic (agent) corruption are intertwined, such as in an authoritarian regime where officials are embedded within the ruling party. If the agent acts for private gain in opposition to the interests of his principal, he is "personally corrupt". If he acts in an unethical or dishonest fashion to benefit his principal, he is "officially corrupt" (Banfield 1975). Therefore, if the principal is able to control the corrupt activity of individual agents, or if multiple agents collude their bribe-taking

activities, then corruption can be said to be organized and predictable (Blackburn and Forgues-Puccio 2009).

Shleifer and Vishny (1993) elaborate on the logics of predictability in corruption, using a buyer (bribe-giver) and seller (bribe-taker) model. They draw from the examples of Marcos-era Philippines and Soviet-era Russia, where bribery is highly-centralized and coordinated by a single authority, and rent is disbursed to different corrupt bureaucrats accordingly. Organization thus creates a corruption regime that is stable; bribes become calculable, services are rendered accordingly and as a result, corruption is less detrimental to growth. Alternatively, if entry into bribe-taking is free and uncoordinated, then the multiple sellers would work against their collective interest – as each seller tries to maximise his individual profit in this competitive scenario. Businesses would thus face multiple instances of being asked to pay bribes, sometimes for redundant services. Here, total bribe level potentially rises to infinity, along with cost to buyers. Since the price levels of bribes exceed the utility for the bribe payer, no investments nor accompanying bribery occurs. Consequently, bribe revenues fall to zero.

Extending this argument, Blackburn and Forgues-Puccio (2009) devise an econometric model to describe how levels of organization in corruption networks affect growth. They propose two scenarios, one where each official acts as an independent monopolist, seeking to maximise his own profit independently of. The second scenario assumes a concerted effort among corrupt bureaucrats, which then function like a joint monopoly. An organized "bureaucracy takes account of the fact that an increase in the

amount of bribe payment to each of its members reduces the number of firms from which bribes can be extracted", and therefore tries to optimize bribe amounts (Blackburn & Forgues-Puccio, 2009). This results in lower levels of bribes overall, compared to the case of many independent monopolists. An organized corruption regime is also conceivably more stable (Mueller 2012). Additionally, services promised are more likely to be delivered and duplication of bribes for the same service is reduced due to coordination. Taken together, the implication of these arguments is that an organized and predictable form of corruption will be more sustainable and palatable to businesses and investors, thus having less impact on investment and growth.

Several studies have evaluated the plausibility of predictable corruption having a smaller detrimental impact on growth. A 1997 World Bank report showed that for a given level of corruption, predictability had a significant impact on prevailing levels of investment. Countries with high levels of corruption and low levels of predictability had an Investment to GNP ratio of 12.3%, compared to situations of high corruption and high predictability, which yielded an Investment to GNP ratio of 19.2% (Cartier-Bresson 2000). Using an index created from the same World Bank data, Campos et al (1999) find that predictability is significantly correlated to investment, concurring with the World Bank findings. Wei (2000) reports similar discoveries.

Country-level research add further credence to the importance of predictability. MacIntyre (2001) describe how in Suharto-era Indonesia, the central government would clamp down on uncoordinated corruption, not for any altruistic motive, but rather so that corruption remained tightly controlled by Suharto's cronies. As a result,

this provided a certain amount of predictability and assurance to investors, sustaining fairly high levels of FDI, even as corruption remained prevalent. Also studying the experience of Indonesia, Kuncoro (2006) show that with a centralized corruption regime, confidence that services would be rendered post-bribery encouraged more instances of corruption, possibly to the effect of "greasing the wheels". Malesky and Samphantharak (2008) conducted a natural experiment across Cambodian provinces to verify the effects of predictability. Their results show that a change of governor introduces unpredictability, as firms do not know the newcomer's expectations regarding bribe amounts, nor his willingness to renege on promises after bribes have been paid. This uncertainty reduces investment in the immediate term.

That said, while the logics of predictability are intuitively compelling, it is not without detractors. Kaufman (1998) argues that the quantitative incidences of corruption (i.e. extent) have a more significant effect than predictability. Instead, it is the predictability of government administration in general, rather than corruption in particular, that has a substantial impact on investment.

Nonetheless, this paper assumes the assertions of previous researchers who argue for the significance of predictability. While the impact of predictable corruption has emerged as an engaging strand of economic research, investigation into the actual causes of this predictability has received much less attention, at least to this author's knowledge. Therefore, this paper's goal is a study into why predictable corruption structures evolve in some countries but not others. The next section of this paper will

discuss some plausible political, economic and socio-cultural determinants of corruption predictability and organization.

## 3. Methodology

### 3.1 Constructing a Predictability Index

Thus far, academic measures of corruption predictability have used data from the World Bank's firm-level survey, conducted as part of the *World Development Report for 1997- The State in a Changing World* (eg. Campos et al 1999, Lambsdorff 2002). In this survey, questions 15 to 17 ask respondents to assess various dimensions of uncertainty with regards to corruption. The nomenclature for bribery used in this survey is "additional payments", which is "sufficiently close to 'bribery and corruption" (Lambsdorff 2002). The questions are appended below.

Question 15: "Firms in my line of business usually know in advance about how much `additional payment' is." This is true

(1)     Always
(2)     Mostly
(3)     Frequently
(4)     Sometimes
(5)     Seldom
(6)     Never

Question 16: ``Even if a firm has to make an `additional payment' it always has to fear that it will be asked for more, e.g., by another official.'' This is true

(1)     Always
(2)     Mostly
(3)     Frequently
(4)     Sometimes

(5)     Seldom

(6)     Never


Question 17: ``If a firm pays the required `additional
payment' the service is usually also delivered as agreed.''
This is true

(1)     Always

(2)     Mostly

(3)     Frequently

(4)     Sometimes

(5)     Seldom

(6)     Never


Question 15 measures unpredictability in the size of bribes. Question 16

measures the level of organization, while Question 17 measures the certainty that

services will be rendered accordingly. However, both Campos et al (1999) and

Lambsdorf (2002) found that the ambiguous wording of Question 16 creates problems

of construct validity. Essentially, while the question's intent is to discover if other

officials request additional bribes for the same service, the way the question is phrased

could lead respondents to misunderstand that it refers to additional bribes for

differentiated transactions (Lambsdorf 2002). Therefore, both groups of researchers

chose to omit this question when computing their predictability index. We follow their

methodology, but with an updated dataset from the World Business Environment

Survey (WBES), conducted between 1999 – 2000 (The World Bank 2013, Batra et al

2003). In this survey, the relevant questions are numbered 14 – 16. Also, what

distinguishes WBES from the *World Development Report* is that Question 16 is worded

differently, as below.

Question 16: ``If a firm pays the required additional payment to a particular government official, another government official will subsequently require an additional payment for the same service...''' This is true

(1)     Always

(2)     Mostly

(3)     Frequently

(4)     Sometimes

(5)     Seldom

(6)     Never

In this case, the re-wording of Question 16 sufficiently removes the ambiguity associated with the previous phrasing. Therefore, unlike the aforementioned researchers, we include Question 16.

The predictability index is constructed following the methods established by Campos et al (1999). Individual survey results are assigned a score of 1 to 6, corresponding with their answers to the questions, and a country average is then calculated. Question 16 is reverse scored. The dependent variable, designated **CORPRD** (corruption predictability), for individual countries is constructed as follows:

CORPRD = 7 – (Q14 country average + Q15 country average + Q16 country average)/3

A higher score represents more predictable corruption. Country data sets with missing answers to any of the 3 questions are discarded.

**3.2 Political Determinants of Predictability**

The emergence of predictable and organized corruption might be conditioned on the existence of a strong central authority. An indicator of this would be the number of veto players present in political processes, where veto players are defined as actors with the ability to affect or reject political outcomes (Tsebelis 2002). A strong and stable state would be better suited to coordinate corrupt activity, and punish officials who deviate from established norms (Shleifer and Vishny 1993). Conversely, weak states are unable to organize or control corrupt officials. This is also true if state power is dispersed (Fan et al 2009). The implication is that predictable corruption will emerge in countries where authority is centralized with few veto players. This applies to countries where corruption is prevalent (measured by corruption extent, see below).

We adopt the widely used CHECKS variable from the Database of Political Institutions to measure state strength (Keefer 2013, Beck et al 2001, Bagashka 2014). The CHECKS variable counts the number of veto players in a legislative system, taking into account the independence of these actors. The average scores from 1996 to 2002 are taken to coincide with the timeframe of the WBES data above. We call this variable **STASTR**, and a higher score represents a weaker central authority as more veto players are present. Therefore, we arrive at the following hypothesis.

H1: Countries with less veto players will have high levels of corruption predictability.

Unpredictability could originate from political instability. Campante et al (2012) discuss how corruption is affected by decision-making horizons. Following from the work of Olson's (1991) "roving bandit", the researchers reasoned that officials who are in unstable positions are inclined to "steal more today instead of letting the pool of resources accumulate into the future". Extending this logic to predictability, officials in politically unstable countries will engage in independent, self-maximizing corruption activities since their decision horizons are short. Meanwhile, officials in politically stable countries are more likely to coordinate bribe-taking to preserve long term rent-seeking opportunities.

We calculate political stability using the "Political Stability and Absence of Violence" score from the Worldwide Governance Indicators (WGI). This indicator refers to the likelihood that "governments will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism" (The World Bank 2013). Country averages from 1996 to 2002 are taken and we call this variable **POLSTB**. We predict the following:

H2: Countries with high levels of political stability will have high levels of corruption predictability.

Regulatory stability could also affect corruption predictability. As stated earlier, rule changes could be indicative of officials generating more bribe-taking opportunities. This results in firms not knowing when they will be asked for bribes, and bribes amounts are likely to change constantly. To measure this, we look at Question 26 of the

WBES survey. This question asks firms if regulations affecting their businesses have become more or less predictable in the last 3 years. Scores range from 1 (much more predictable) to 5 (much less predictable). We then subtract the country average from 6; so that a higher score corresponds to increased regulatory stability. This variable is called **REGSTB**.

H3: Countries with high levels of regulatory stability will have high levels of corruption predictability.

Limited availability of legal recourse is indicative of collusion. If firms have means of legal appeal when asked for bribes, this shows that officials are cooperating or maintaining an organized corruption regime. To gauge this attribute, we use Question 17 of the WBES, which measures whether or not a firm is able to appeal to another official for recourse. If recourse is available, corruption will be more discreet and unpredictable. If recourse is unavailable, it is likely that officials are colluding and corruption will be more open and predictable. This statistic, **OFFREC,** is calculated as 7 – (country average), with a higher number representing a higher likelihood for recourse.

H4: Countries with low levels of official recourse will have higher levels of corruption predictability.

In an experiment, Barr and Serra (2010) found that undergraduates from countries with high corruption rates are more likely to engage in corrupt practices. The implication is that a public frequently exposed to corruption will gradually become more tolerant of it (Cule and Fulton 2009). With regards to predictability, we argue extensive corruption and less public accountability means that corrupt officials can be more open and forthright in their transgressions. With less need for discretion, agents are better able to collude, leading to more organized and predicable forms of corruption. Similarly, it increases the likelihood that requisite bribe amounts would be open knowledge. Therefore, higher levels of corruption will lead to higher levels of predictability. To keep our research consistent, we will use Campos et al's (1999) method for measuring corruption extent. They use Question 13 of the WBES survey, which measures how often firms are asked for payments. We subtract the country average from 7, so that scoring for this variable **COREXT**, ranges from 1 (low extent) to 6 (high extent)

H5: Countries with high levels of corruption extent will have higher levels of corruption predictability.

### 3.3 Socio-Cultural Determinants of Predictability

Apart from political factors, the social and cultural roots of corruption also warrant discussion. Hooker (2009) argued that cultural perspectives on corruption differ as they are rooted in diverging conceptions of human nature. He explained that the "practices that Westerners consider questionable, such as cronyism and nepotism, may be functional in other cultures". For example, Bierstaker (2009) explained how

accountants in Western societies typically possess a much dimmer view of bribes and gifts than their Asia-Pacific counterparts. Chen (2005) explains that in China, officials are *expected* to exploit their positions for personal gain, such that corruption is seen as a "legitimate compensational measure". Lipset and Lenz (2000) suggest that the propensity towards group obligation in Asian societies encourages corruption. The argument therefore is that social acceptance increases predictability because corrupt officials can be more open and forthright in their transgressions. Consequently, culture has been proposed as a a possible explanation for the East Asian Paradox, which Chang and Chu (2006) calls "Asian Corruption Exceptionalism"

Since we are concerned with collusion amongst corrupt bureaucrats, culture can also explain predisposition towards cooperation and organization. Cultural dimensions have been applied to a variety of research into organizational behaviour and leadership, with the work of Hofstede being particularly important (Hofstede 1983, Hofstede et al 1990, House et al 2002, Smith and Peterson 1998, Lund et al 2013). Hofstede's cultural framework consists of several dimensions, elaborated below.

Several studies have considered culture in the study of corruption (Lopez and Santos 2013, Sanyal and Guvenli 2009, Seleim and Bontis 2009, Mensah 2013). Lopez and Santos (2013), using a metric derived from Hofstede's framework, conclude that cultural dimensions are important determinants of corrupt practices. The researchers find that higher Power Distances and Collectivism scores are positively and significantly correlated to corruption levels. They find no significant relationship for Masculinity/Femininity or Uncertainty Avoidance. Sanyal and Guvenli (2009) also find

that high Power Distance is correlated to more corruption. Masculinity and Uncertainty Avoidance similarly return insignificant results. They add that the relationship between cultural determinants and corruption diminish with increasing per capita income, perhaps indicating that increased personal wealth reduces the marginal utility of accepting bribes.

Seleim and Bontis (2009) use data from the Global Leadership and Organizational Behaviour (GLOBE) program in their research on corruption. The GLOBE project is adapted from Hofstede's framework, with some refinements. GLOBE differentiated between "cultural values" (what should be) and cultural practices (what is). Also, GLOBE divides Collectivism into "Institutional" and "Individual Collectivism", in that institutional collectivism refers to organizational loyalty, while individual collectivism is concerned with in-groups, such as friends and family (House et al 2004). Seleim and Bontis (2009) find no explanatory power in Power Distance, but significant correlation between Collectivism practices and corruption. In other words, collectivistic societies are more corrupt. Also, the researchers return a significant result for Uncertainty Avoidance, in that countries with higher scores in this dimension have lower levels of corruption.

However, it should be pointed out that the aforementioned scholars were concerned with the extent of corruption, rather than the organizational or predictability aspects which we are interested in. As such, we agree that Power Distance will be positively correlated to corruption predictability, especially in instances where it is organized by a central authority. Furthermore, in hierarchical

societies, the powerful might feel entitled to personal gain as a result of their position (Getz and Volkema 2001) or perceive less risk of being caught (Bentzen 2012), or be less concerned with secrecy. Individualism/Collectivism is a little more difficult, and we should distinguish between corruption extent and predictability. Individualistic societies are characterized by low-context communication styles, in which intentions are explicitly and directly stated (Hofstede and Hofstede 2005). Also, individualist societies tend to be more rules-based. Therefore, bribe requests are likely to be forthright and follow established rules, as described by Cartier-Bresson (2000). Further, contrary to the results of Seleim and Bontis (2009), we argue that high Uncertainty Avoidance will encourage more predictable corruption, as bribe-takers and payers are inclined to avoid ambiguity in their transactions. Again, bribe requests in this case will be in accordance to established rules.

We adopt Hofstede's framework for our analysis, using figures derived from the Hofstede Center. Power Distance measures whether members of society accept the unequal distribution of power and their obedience toward superiors (Hofstede 1983). We predict that societies with high deference to authority will have higher levels of corruption predictability and organization, since agents are more likely to submit to their superior's control of bribery activity.  Conversely, in societies where the hierarchy is flat, subordinates might feel as equally entitled to personal profit as their superiors, and hence corruption would be more *laissez-faire.*  Power Distance is designated by the variable **PWRDST**. Scores range from 0 (expect completely equal distribution of power) to 100 (expect completely unequal distribution of power).

H6: Countries with high Power Distance will have high levels of corruption predictability.

Collectivist societies possess high-context communications styles, in which meaning is often implied. Individualist societies are low-context, where intent is more explicitly stated and obligations are rules-based rather than relationship-based. In terms of corruption, we can expect that bribe-taking will be more organized and coordinated in  individualist societies, and bribe requests more forthright. Individualism/Collectivism is measured by the variable **INCOLL**, derived from Collectivism scores from the Hofstede Centre. In this case, scores range from 0 (strongly collectivist societies) to 100 (strongly individualist societies)

H7: Countries with high Individualism will have high levels of corruption predictability

Societies with high uncertainty avoidance will try to mitigate ambiguous situations. For the bribe payer, this means that they prefer corruption to be predicable. Bribe-takers will also prefer less uncertainty, and be inclined towards formalized corruption structures. The Hofstede Center provides country data for Uncertainty Avoidance, from which we shall derive the variable **UNCAVD**. Scores range from 0 (low uncertainty avoidance) to 100 (high uncertainty avoidance).

H8: Countries with high levels Uncertainty Avoidance will have high

levels of corruption predictability.



We exclude Masculinity/Femininity since previous studies returned no

significant results.



### 3.3 Model and Results



Accounting for the above variables, our base model to determine the predictable

nature of corruption in a given country is as follows:



$CORPRD_C$ = a + b1*$STASTR_C$ + b2*$POLSTB_C$ + b3*$REGSTB_C$ + b4*$OFFREC_C$
+ b5*$COREXT_C$ + b6*$PWRDST_C$ + b7*$INCOLL_C$ + b8*$UNCAVD_C$ + e

* where $_C$ denotes country variable.



After matching for country statistics across our data sources, we are left with 41

countries as our sample. Following the examples of Sanyal and Guvenli (2009) and

Seleim and Bontis (2009), we include personal wealth as a control variable, expressed

as GDP per capita, using the average from 1996 to 2002. We take the natural logarithm

of the average GDP per capita to normalize the data. Next, we conduct a multi-

regression analysis with Corruption Predictability (CORPRD) as the dependent

variable. We regressed this against the political variables (STASTR, POLSTB, REGSTB,

OFFREC and COREXT) and cultural variables (PWRDST, INCOLL and UNCAVD)

separately, then all variables together. The different regressions are done with and
without controlling for lnGDP. Our results are as follows:

| Sample size = 41 | Corruption Predictability (CORPRD) as Dependent Variable | | | | | |
|---|---|---|---|---|---|---|
| **Variables** | **Political Variables** (no GDP) | **Political Variables** (control for GDP/Cap) | **Cultural Variables** (no GDP) | **Cultural Variables** (control for GDP/Cap) | **All Variables** (no GDP) | **All Variables** (control for GDP/Cap) |
| STASTR State strength by veto players | -0.0233 (0.6708) | -0.0369 (0.5344) | - | - | -0.0588 (0.2659) | -0.0438 (0.4275) |
| POLSTB Political Stability | 0.1677* (0.0528) | 0.1334 (0.1887) | - | - | 0.0346 (0.7118) | 0.0556 (0.5653) |
| REGSTB Regulatory Stability | 0.0408 (0.8691) | 0.0879 (0.7359) | - | - | 0.1199 (0.6030) | 0.0583 (0.8081) |
| OFFREC Availability of Official Recourse | -0.1763*** (0.0082) | -0.1775*** (0.0084) | - | - | -0.1403** (0.0250) | -0.1308** (0.0387) |
| COREXT Extent of Corruption | 0.3023*** (0.0013) | 0.3462*** (0.0036) | - | - | 0.3085*** (0.0007) | 0.2409** (0.0346) |
| PWRDST Power Distance | - | - | 0.0063 (0.1059) | 0.004 (0.245) | 0.0039 (0.2299) | 0.0036 (0.2748) |
| INCOLL Individualism-Collectivism | - | - | 0.0077** (0.0168) | 0.0157*** (0.000) | 0.0097*** (0.0046) | 0.0115*** (0.0042) |
| UNCAVD Uncertainty Avoidance | - | - | -0.0034 (0.3353) | -0.0009 (0.7688) | 0.0010 (0.7437) | 0.0010 (0.7296 |
| lnGDP GDP per Capita at Current USD (Nat. Log) | - | 0.0602 (0.5215) | - | -0.270 (0.001) | - | -0.0977 (0.3536) |
| $R^2$ | 0.391 | 0.399 | 0.186 | 0.402 | 0.529 | 0.542 |
| Adjusted $R^2$ | 0.304 | 0.293 | 0.120 | 0.337 | 0.412 | 0.410 |

\* Significant at 10% level of confidence      \*\* Significant at 5% level of confidence      \*\*\*Significant at 1% level of confidence
Fig. 3 Results of variable testing for corruption predictability

### 3.4 Impact of Predictability on Firm Behaviour

We also considered another test to verify the impact of corruption on the economy. Thus far, a number of researchers have tried to uncover the relationship between corruption and growth by studying either gross investment (eg. Campos et al 1999, Lambsdorf 2002) or FDI inflows (eg. Vadlamanati et al 2009, Wei 2000, Wijeweera and Dollery 2009). As discussed earlier in this paper, the outcomes have been inconclusive, with results vacillating between negative, positive or no relationships. Furthermore, the determinants of FDI are complex and variegated, with host country wealth, infrastructure, macroeconomic stability and human capital development all being important factors in FDI growth (Majeed and Ahmad 2009, Vogiatzoglu 2008, Boasson et al 2012). In this case, the impact of corruption on FDI could be diluted due to the presence of more powerful determinants. Wei (2000) also points out that often, FDI flows are determined by intangible factors, which undermine the effects of corruption. For example, FDI flows could originate from migrants who have historical roots to the destination country; they will invest with little regard of prevailing corruption. By this logic, it would be difficult to do cross-country comparisons based on FDI unless we account for migrant populations.

Thus, we argue that investment might not be the best indicator of corruption's effects. To determine corruption predictability's impact on growth, we propose looking at business sentiments instead of investment numbers. The reasoning is that this relationship is more direct; if corruption is unpredictable and disruptive to growth as this paper assumes, then firms would report this as a source of major constraints to

their business operations. Conversely, if corruption is predictable, then firms would find it manageable.

**3.5 Defining Impact Variables**

The dependent variable is constructed using Question 38H of the WBES. Firms are asked to rank how much of an obstacle corruption poses to their business functions. We call this variable **CORCON.** Scores for CORCON range from 1 (no obstacle) to 4 (major obstacle)**.** The independent variables will be corruption predictability (**CORPRD**), calculated previously, as well as corruption extent (**COREXT**). If the relationship holds, then we expect the following

H9a: Firms will find corruption to be less of a constraint if it is more predictable

H9b: Firms will find corruption to be more of a constraint if it is more pervasive.

**3.6 Model and Results**

Thus, the above relationship is expressed as follows:

$$CORCON_C = a + b1*CORPRD_C + b2*COREXT_C + e$$

Taking business constraints resulting from corruption as the dependent variables, we regress this against corruption predictability (CORPRD) and corruption extent (COREXT), controlling for GDP. Our results are as follows:

| Sample Size = 41 | Constraint of Corruption as dependent variables | |
|---|---|---|
| **Variables** | **Without GDP per capita** | **Controlling for GDP per capita** |
| CORPRD<br>Corruption Predictability | -0.4164**<br>(0.0194) | -0.302*<br>(0.0542) |
| COREXT<br>Corruption Extent | 06353***<br>(0.000) | 10.368***<br>(0.0027) |
| LnGDP | - | -0.2627<br>(0.0009) |
| R2 | 0.553 | 0.670 |
| Adjusted R2 | 0.530 | 0.644 |

* Significant at 10% level of conf.  ** Significant at 5% level of conf.   *** Significant at 1% level of conf.

### 3.7 Analysis

From our regression analysis, when examining political factors alone, we find that there is a negative relationship between the number of veto players and the predictability of corruption as expected by H1, but this is not significant. Therefore we cannot accept H1. There is also a positive relationship between political stability and predictable forms of corruption, significant at 10%. This significance disappears when we account for GDP per capita. The P-Value (0.1887, political variables only, controlled for GDP per capita) for the **POLSTB** variable is low enough that if we allow for the error term, it is plausible to suppose a discernible relationship between political stability and

corruption predictability. At this point however, we find that there is not enough evidence to support H2, pending further studies. For H3, which says that regulatory stability accompanies predictable corruption, we find a positive but non-significant relationship. Hence, we do not accept H3, and state that there is not enough evidence to demonstrate correlation between regulatory stability and corruption predictability. This result holds when we controlled for GDP per capita.

With regards to H4, our results show a negative and very significant relationship between official recourse and predictability of corruption. Thus, there is cause to accept H4, which means that societies with fewer avenues for official recourse to address corruption will support more predictable corruption structures. This result is present when we control for GDP. With regards to H5, we find a positive and significant relationship between the extent of corruption and its predictability. This leads us to accept H5, which states that corruption will be more predictable in societies where it is also more pervasive.

Testing cultural factors alone, pertaining to H6, we find that there is a positive but non-significant relationship between Power Distance and predictable corruption. Therefore, we cannot accept H6, which posits that societies that accept unequal distribution of power will experience more predictable levels of corruption. As for H7, we find that there is a positive and significant relationship between Individualism and corruption predictability. These results are consistent with our prediction that individualistic societies possess higher levels of corruption predictability. Therefore, this allows us to accept H7. With regards to H8, we find that there is a negative but

insignificant relationship between Uncertainty Avoidance and corruption predictability. Thus we do not accept H8 as there is not enough evidence to show correlation between Uncertainty Avoidance and predictable forms of corruption. All these results hold when controlling for GDP per capita.

When the political and cultural variables are studied together, the relationships outlined above are consistent, with some slight changes in the levels of significance. Therefore, the results allow us to accept H4 and H5, while there is not enough evidence to accept the others. Overall, the conclusion is that societies where corruption is pervasive, with fewer avenues for recourse, will experience more predictable forms of corruption. Plausibly, this is due to the less need for secrecy, which allows graft to be more open and organized.

H9a and H9b study the relationship between corruption predictability, corruption extent and constraints that businesses feel due to corruption. H9a posits that more predictable forms of corruption will be less harmful to businesses. H9b suggests that firms face more obstacles in societies where corruption is more pervasive. From our results, we see that there is a negative and significant relationship between corruption predictability and the constraints that firms feel. Therefore, we accept H9a. We also see positive and significant correlation between the extent of corruption and constraints to businesses. This also leads us to accept H9b. When we control for GDP per capita, we find a change in the significance level in the relationship between corruption predictability and business constraints, but results are consistent

nonetheless. Considered together, this implies that societies with less predictable and more pervasive forms of corruption will be more harmful to firms' interests.

## 4. Discussion

Overall, we accepted 5 out of 10 hypotheses tested. Importantly, some of our cultural determinants did not return expected results in our tests, and are not consistent with previous works that showed some correlation between Power Distance, Uncertainty Avoidance and corruption extent (e.g. Lopez and Santos 2013, Sanyal and Guvenli 2009, Park 2003). To explain, we suggest that the role of Power Distance is difficult to generalize. Considering the case of a high Power Distance culture, if the ruling party is corrupt, then we would expect corruption to be more organized as subordinate agents get subsumed into the corrupt structure. However, if the ruling party is honest, than any corrupt agent would have to act independently, creating more incidences of unpredictability.

Individualism showed positive and significant results as predicted by our model, meaning that individualistic societies engender more predictable forms of corruption. We argue that this is related to the way bribe requests would be communicated in individualist societies that emphasize clarity. Also, obligations in collectivist societies are relationship-based. Hence, we expect that bribe amounts and *ex post* service provision are founded on personal relationships, which would create inconsistencies. Individualist societies tend to be rules-based, which might encourage rigidity in corruption structures and induce predictability. Overall, our study indicates that cultural dimensions alone are insufficient to explain predictable corruption, and

support for the cultural perspective of "Asian Corruption Exceptionalism" is inconclusive.

To account for other determinants, we included state strength, political and regulatory stability, availability for official recourse and extent of corruption in our study. We find that the availability of recourse reduces the predictability of corruption. This supports our argument that it is easier to organize corrupt practices in the absence of effective law enforcement. Also, we find positive correlations between corruption extent and predictability. This agrees with the assertion that societies with higher levels of corruption could encourage more open and organized forms of corruption.  Also , if we consider Game Theory, where repeated iterations build trust between players (Aggarwal and Dupont 2011), officials in countries with pervasive corruption will deliver on promised services to encourage future incidences of bribery.

State Strength, Political Stability and Regulatory Stability did not return significant results. We can possibly explain this when we consider that these factors could have confounding effects on organized corruption. While we imagined that a strong and centralized political institutions would create more organized forms of corruption, this is conditioned on the state being corrupt to begin with. A politically strong state with goals to eradicate corruption would instead succeed in driving it underground, and as previously discussed, furtiveness would induce unpredictability. Also, we proposed that frequent changes in regulations are indicative of corrupt policy makers trying to increase their rent-seeking opportunities. However, rule changes can exist in both competitive and joint/single monopoly systems of corruption, as we see

when we compare the cases of Nigeria (Agbiboa 2012) and Suharto-era Indonesia (MacIntyre 2001), depending on the ability of agents to formally amend rules. Thus, these factors are likely to be more useful for micro-level studies than broad cross-country comparisons due to the many possible permutations.

Support for H9a and H9b are consistent with the arguments of many previous works on corruption predictability (Shleifer and Vishny 1993, Campos et al 1999, Wei 2000, Lambsdorff 2002), in that corruption predictability is at least as important as extent when considering the impact on the economy. It also agrees with anecdotal studies which demonstrate how organized and predictable corruption can coexist with business interests, even mutually supporting each other in countries like Indonesia, China, South Korea and Taiwan (Robertson-Snape 1999, Macintyre 2001, Chang 2001, Chen 2005, Yu and Liu 2005). This provides support for the argument that predictable corruption is less of an impediment to businesses.

However, this is not to imply that we should be sanguine about organized forms of corruption since it has limited effects on growth. We agree with academics who argue for reduction in corruption regardless of present economic impact. After all, as Rock and Bonnet (2004) suggest, even if formalized corruption fostered growth in East Asia previously, it might still diminish capacity building in the long term. Instead, the point we wish to make is that moves to eradicate corruption founded on economic concerns are less salient in countries where it is organized and predictable, since the presumed negative impact on the economy is less than expected. This is compounded by the proposition that as the level of corruption decreases, it becomes more costly to

reduce further, (Ertimi and Saeh 2013), hence diminishing the impetus to combat corruption for economic reasons alone. Furthermore, if corruption is deeply entrenched in the state system and tolerated by the populous, it would be persistent and difficult to eliminate. Reform would require significant external pressure, perhaps from the international community, or some sort of political change (Tarling 2005). An example would be IMF conditionality which diminished *chaebol* cronyism in South Korea following the Asian Financial Crisis (Lho and Cabuay 2005). Or, rather than being state-led, anti-corruption initiatives have to germinate at the grass-roots (Wiehen 2000) and firm level (Gordon and Miyake 2000). This has implications for reformist policy-makers who are attempting to effect positive change within regimes where corruption is socially and politically accepted.

## 5. Conclusion

This study is an attempt to contribute to the on-going scholastic investigation of corruption. In doing so, we specifically studied the sources of predictable and organized forms of corruption, accounting for political and cultural factors. In the end, we discovered that some political factors and national culture dimensions could explain the development of institutionalized corruption regimes. The impression is that corruption becomes more predictable when there is less need for discretion, either due to its pervasiveness or lack of available punitive action. Certain political conditions could create such a scenario, for example if political elites are themselves highly involved in illicit activity, thereby limiting avenues for recourse. Also, our study finds that 1 out of 3 cultural determinants (Individualism) is correlated with predictability. We conclude that Hosftede's cultural dimensions alone are not enough to explain

"Asian Corruption Exceptionalism", or why more organized and predictable forms of corruption might emerge in some Asia-Pacific countries and not others.

We also recognize the limitations of this study, due to the availability of data to establish a comprehensive measure of predictability. While the overall sample size of the WBES was large (over 10,000), the number of individual responses varied greatly across countries. For example, Question 16 returned 10 responses for Singapore and 421 for Thailand, which might create sampling bias. Moreover, responses to certain questions were absent for several countries. This resulted in us having to omit some countries altogether, including key economies like China and India. Therefore, we suggest that a more extensive and intensive study could be conducted to determine the predictable nature of corruption across countries. This would be pertinent considering how corruption predictability impacts growth, investment and business behaviour, as shown in our study and previous others. We also imagine that such a survey would be restricted to specific industries (e.g. manufacturing) to reduce mismeasurements, and should account for disparate cross-country perceptions of corruption. A potential way to do this is to assign weights to categories of corruption accordingly, as some scholars have suggested (e.g. Knack 2007). To reduce ambiguity, a set of primer questions to determine what respondents consider to be corrupt activity could be asked prior to any such studies. Additionally, our study shows that determinants of corruption predictability can be difficult to generalize. Thus, micro-level studies should be conducted to understand what the drivers of organized corruption in individual countries are.

Ultimately, this paper corroborates previous research showing that predictability and organization are germane components of corruption's growth effects. At the same time, the roots of this predictability might be difficult to uncover or generalize due to the disaggregated ways that corruption structures can evolve. Nonetheless, future studies of corruption and its economic impact should take care to distinguish between the different forms that corruption can take. This means that composite corruption datasets, such as those published by Transparency International, might not always be useful since it does not reveal such nuances. Also, the implication is that any subsequent efforts to eradicate corruption in different countries have to be targeted in nature, and informed by investigations into their origins.

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