

Why doesn't Capitalism flow to Poor Countries?

Rafael Di Tella*
Harvard Business School

and

Robert MacCulloch
Princeton University

First Draft: August 27, 2002. This draft: February 14, 2004

Abstract

We find evidence consistent with the hypothesis that governments in poor countries have a more left wing rhetoric than those in OECD countries. A possible explanation is that corruption, which is more widespread in poor countries, reduces the electoral appeal of capitalism more than that of socialism. The empirical pattern of beliefs within countries is consistent with this explanation: people who perceive corruption to be high in the country are also more likely to lean left ideologically and to declare to support a more intrusive government in economic matters. Finally, we show that the corruption-left connection can be explained if corruption is seen as unfair behavior on the part of capitalists. Voters then react by moving left, even if this is materially costly to them. There is a negative ideological externality since the existence of corrupt entrepreneurs hurts good entrepreneurs by reducing the general appeal of capitalism.

JEL: P16, K42, E62,

Keywords: beliefs, corruption, fairness, legitimacy, ideological externality.

* Rafael Di Tella, Harvard Business School, Boston MA 02163, Tel 617 4955048, rditella@hbs.edu Robert MacCulloch, Princeton University, Princeton NJ 08544, Tel 6092587387, rmaccull@Princeton.edu. For comments and suggestions, we thank Pedro Dal Bo, Steve Davis, Oded Galor, Amihai Glazer, Dani Kaufmann, Rafael La Porta, Howard Rosenthal, Julio Rotemberg, Andrei Shleifer, Antoinette Schoar, Enrico Spolaore and seminar participants at Brown, the Capri Conference on Institutions, Chicago (applied economics), Colorado, Columbia, the 2003 LACEA Conference in Puebla, Melbourne, the NBER Behavioral Macro Conference, Princeton, UdeSA, UTDT and the Wallis Conference on Political Economy (Rochester).

I. Introduction

Casual examination of right wing political rhetoric reveals large differences across countries. Right wing parties in poor countries extol the virtues of capitalism less often than their counterparts in rich countries. Instead, they appear tolerant of government intervention to regulate markets, of subsidies to contain income disparities and of industrial policy to promote growth. An intriguing possibility is that few voters in poor countries want to have a US-style capitalist system. Since economists believe that such a system is the most conducive to growth, a puzzle is, why isn't capitalism, as a way to get a country out of poverty, a more attractive idea in poor countries?

The first objective of the paper, then, is to explore the possibility that political parties in poor countries are in fact less capitalist than those in rich countries. There is some suggestive historical evidence available. For example, a standard informal justification for military coups in Latin America in the 1970's is that they were the only way that right wing ideas could get to be implemented, given their small electoral appeal.¹ The case of Argentina, where the center-left Radical and Peronist parties have alternated in government during the last century, is another case in point.² A more systematic approach involves using data on the platforms of political parties around the world. The closest we have available is a recent database on political institutions created by Beck *et al* (2001) at the World Bank. Of particular interest are data on the pre-electoral rhetoric of political parties (including their names and platforms) and data on their relative electoral performance. Although the data are rough and approximate given our purposes, the basic patterns suggest that right wing, pro-capitalist political parties are in government less frequently in developing countries than in the industrial nations. Controlling for democratic differences, differences in levels of inequality, differences in the level of prevailing violence and differences in country size does not seem to affect the conclusion that pro-capitalist parties appear to have trouble getting elected in poor countries.

¹ See, for example, Jauretche (1947). The involvement of the "Chicago boys" with the military dictatorships of Chile and Argentina is sometimes discussed in these terms (e.g., Green (1995)). An alternative explanation is that some degree of authoritarianism is consistent with economic liberalism when pressure groups break the law (see Skidelsky (1988)). See section II for the general patterns in the dictatorship and ideology data across countries.

² Peronists are often labeled right wing given the role of fascism in shaping Peron's ideology. Yet, over the last century, the labor share has been highest with Peronist administrations and the Peronist march intones "*the Peronist lads will fight capital*". Likewise it is claimed that the Menem administration in the 1990's turned right wing, which is plausible, but does not deny the fact that Menem was elected on a populist platform that included a massive wage hike or "*salariozo*".

One potential explanation for these patterns in the data is cultural differences across poor and rich countries. For example, it has been argued that capitalism spread in the countries that are rich today because the prevailing religious culture approved of success and the accumulation of individual wealth, whereas in today's poor countries other cultures (such as Catholicism) stood in the way of capitalism.³ An alternative explanation, economic in nature, is that voters in poor countries are choosing left wing governments to redistribute the little income there is. More inequality, in this view, moves average income up relative to the median, and may introduce a desire for redistribution. A number of authors, however, have emphasized that, at least amongst advanced industrial nations more unequal countries seem to distribute less, not more.⁴ And since countries can move to the center, and redistribute within a market economy, it does not explain why many countries loose faith in the private sector altogether.⁵

An alternative explanation can be found by taking at face value what political parties say. Simple inspection of the traditional platforms of established parties, such as the PT in Brazil and the PRI in Mexico, reveals that corruption of the capitalist class is often invoked when justifying a more paternalistic role of government. Thus, a striking difference in the rhetoric of politicians that support redistribution across rich and poor countries is how often those in the latter group make reference to corruption. Thus, in the second part of the paper we explore empirical evidence bearing on the hypothesis that support for left wing parties originates in perceptions of corruption. We discuss three types of evidence. The first is simply a reinterpretation of the work of Djankov *et al* (2002) on the regulation of entry. They find that countries with more regulation on the entry of firms, in terms of delays and money spent in the process, also have more corruption. This, we argue, is also consistent with the idea that corruption invites regulation (and other left wing policies). The second type of evidence concerns corruption levels aggregated at the country level. We show that there is a positive correlation within countries between the total amount of corruption today and how left the government becomes in later years. Finally, analysis of subjective data within countries reveals that individuals who believe that there is more corruption are also more likely to be in favor of more

³ In some extreme cases, wealth was indicative of a person's moral standing (and likely after-life performance). A classic reference for the role of cultural affinities in the spread of capitalism is Weber (1958). For discussions and evidence, see Iannaccone (1998), Grier (1997), La Porta *et al* (1997) and Guiso *et al* (2003).

⁴ See Peltzman (1980). In section II we show that inequality is *positively* correlated with the election of right wing parties. See also work on inequality and growth (e.g., Alesina and Rodrik (1994), Persson and Tabellini (1994), Perotti (1996)).

government intervention in the economy. Interestingly, there is no evidence that corruption is correlated with non-economic attributes of ideology.

In the third and final part of the paper we present a simple model that can help explain why people who see more corruption in government are more left wing. It is based on the idea that corruption reduces the “moral legitimacy” of business because voters are concerned with fairness. When they observe corruption, voters react by moving left, even if this is costly to them, much as there are rejections of positive offers in the ultimatum game (see in particular the evidence in Hoffman *et al* (1994)). There is a negative externality in the sense that the existence of corrupt entrepreneurs hurts good entrepreneurs by reducing the general appeal of capitalism.

Our paper builds on the literature studying the role of the social contract and how economic organization is built on beliefs (e.g., Denzau and North (1994) and Putterman (1996)). Two important papers are Piketty (1995) and Benabou (2000). The former shows that an initial distribution of beliefs concerning the importance of effort in determining performance can lead to two different types of equilibria, one (the other) with low (high) taxes and a belief, which holds in reality, that individual effort is (is not) important in determining income.⁵ Benabou (2000), on the other hand, shows that for a class of interventions that increase output, such as public education when capital markets are imperfect, multiple steady states can arise. Finally, Alesina and Angeletos (2002) show how fairness can influence the choice of taxes: if a society believes that luck or corruption (rather than effort) determine wealth, it will choose high (rather than low) taxes, thus distorting allocations and making these beliefs self-sustaining. Putterman, Roemer and Sylvestre (1998) and Alesina, Glaeser and Sacerdote (2002) review the contributions to this growing literature. In our model, different beliefs on the importance of corruption determine how much government intervention voters will support. Since such intervention can increase corruption levels, it can be shown that this class of models also has the potential for multiple equilibria.

⁵ A standard *definition* for a Center party (used in Beck *et al* (2001)) is one that advocates both redistribution and strengthening the private sector. Korea, for example, has increased public funding for education and health within a pro-capitalist system with respect to the organization of production. Interestingly, Korea is classified as *Right* in our sample.

⁶ A recent paper by Benabou and Tirole (2002) shows how multiple equilibria can arise out of a distribution of beliefs when individuals have self-control problems. One advantage over Piketty’s approach is that beliefs have more “texture” in the sense that some individuals will believe that mainly luck determines performance and will still want to persuade themselves that effort is important. Hochschild (1981) discusses this and other aspects of American beliefs on distributive justice. See also Klugel and Smith (1986) and Ladd and Bowman (1998). In the same spirit, we try to incorporate how perceptions of corruption are a component of beliefs about distributive justice.

We also draw on the corruption literature.⁷ Some authors have emphasized how corruption has undermined popular support for economic reforms.⁸ Our work can be seen as formalizing these ideas in the context of general economic ideology (and not to views solely about reforms). A number of economists have shown how corruption may reduce growth (see Rose-Ackerman (1978), Shleifer and Vishny (1993); for empirical evidence see Mauro (1995) and Knack and Keefer (1995)). An important early paper by Andvig and Moene (1990) describes how multiple equilibria in corruption can arise. Work in this literature has also studied how government interventions may improve social welfare even when corruption originates in these very same interventions (see Banerjee (1997), Ades and Di Tella (1997), Acemoglu and Verdier (2000) and Djankov *et al* (2003)). An implication of this approach is that it may be hard to justify interventions in very poor countries that cannot afford to pay the high salaries necessary to control corruption, a point made explicitly in Acemoglu and Verdier (2000). Our paper is closer to Glaeser and Shleifer (2002). They explain the rise of regulation in America as the efficient response to the subversion of justice by robber barons during the Gilded Age, when the scale of business can be assumed to have grown (see also Djankov *et al* (2003)). Finally, a large literature has studied how countries may get to have bad institutions that retard growth (e.g., North and Thomas (1973), De Long and Shleifer (1993), Acemoglu, Johnson and Robinson (2001), *inter alia*), or get to choose bad policies (e.g., Alesina and Drazen (1990), Fernandez and Rodrik (1990), *inter alia*). But in these models voters want to have good policies (and capitalism), and there is some impediment to their adoption. We are focused on the case where voters do not want capitalism.

Section II presents evidence consistent with the idea that poor countries elect governments that tend to use left-wing rhetoric. Section III explores the empirical connection between corruption and ideological position in three settings, across countries; within countries over time; and across individuals (within countries). Section IV presents a model where the observation of corruption

⁷ A large literature in political science has focused on the determinants of legitimacy in political representation. The literature on the legitimacy of commercial institutions is more limited, but see the discussion in Rose-Ackerman (2002). della Porta (2000) and Seligson (2002) discuss empirical evidence based on exposure to corruption. See also Dahl (1956), Huntington (1968), and Weatherford (1992). Political scientists have also studied how party identification moves over time in the US (see, for example, Jennings and Markus (1984)).

⁸ See Stiglitz (2000). Rajan and Zingales (2003) emphasize how economic downturns can allow capitalists to exploit public anger to restrict competition and access to capital.

changes citizens' beliefs about a characteristic of capitalists (their fairness level) and increases the desire for government intervention. Section V concludes.

II. The Color of Government Across Countries

II.a. Data Source

We are unaware of the availability of data on political rhetoric across countries. An examination of voting records of legislators could be a useful proxy, but unfortunately, data with that level of detail are not available beyond OECD countries. Furthermore, politicians sometimes change their “ideology” once in office (and we are interested in their proposed policies *while* they are running for office. See Cukierman and Tommasi (1996)). Closer to our needs is the data set compiled by Beck *et al* (2001). They use a two-step approach. First, they record the party identification of a country's political leaders. These include the chief executive (prime minister or president), the largest government party and the three largest parties in the government coalition. Second, they classify the parties following preferences regarding greater or less state control of the economy – the standard left-right scale. This is inferred by their name and by the information contained in a set of sources. Thus, parties that contain terms such as “conservative” or “Christian democratic” in their names are classified as right-wing. Similarly, they are classified as left-wing if their name includes the words communist, socialist, or social democratic. The category center is reserved for parties that are called centrist. Parties that cannot be classified in these categories are recorded as “other” and not included in our study (these are frequently parties in non-competitive electoral systems).⁹ When the orientation of the party was not immediately obvious from the name, Beck *et al* checked a set of sources, again with the criteria of greater or less state control of the economy. Parties are classified as center if these sources reveal them to advocate the strengthening of private enterprise but also to support a redistributive role for government. These sources included *The Europa Handbook* and Banks' *Political Handbook of the World* as well as *Political Parties of Africa and the Middle East: A Reference Guide* (1993), *Political Parties of Eastern Europe, Russia and the Successor States: A Reference Guide* (1994) as well as the website <http://www.agora.stm.it/elections/parties.htm> maintained by Agora Telematica which provides short definitions of parties. In the rare case sources disagreed, Beck *et al* noted it in

⁹ Beck *et al* also code governments as nationalistic, regional, rural and religious. They state “*These dimensions were chosen because they do not necessarily correlate with each other: religious or nationalistic parties adopt both left and right wing economic policies;...*”

their database (and we exclude them here). The sample includes a maximum of 136 countries over the period 1975-97.

II.b. Results

Perhaps the simplest measure to study initially is the color of the party to which the chief executive is affiliated. In 1997 there are data on 105 countries. If we divide this group of countries by income within the sample (real purchasing power), we find that within the richest third 44% are classified as left, 3% as center and 53% as right wing. Within the bottom (poorest) third, 63% are classified as left, 6% are center and 31% are right. If we use the world distribution of income, which gives us 49 (25) countries in the top (bottom) third, we find that within the richest group countries are evenly split with 24 left and 24 classified as right. Within the bottom group, 68% of countries are classified as left, 8% as center and 24% as right. Moving to a simple table of frequencies for the full 1975-97 sample presents similar results. There are 2,311 country/year observations. Of the 488 for OECD countries, 39% (50%) have a chief executive affiliated to a party classified as left (right) by Beck *et al.* Of the 1,823 observations for Non-OECD countries, 61% (33%) are classified as left (right).

Table A1 in appendix 1 adopts a definition of government that follows more closely electoral appeal (as opposed to political maneuvering) based on the color of the largest government party (and not on that of the chief executive). It partitions the sample symmetrically by thirds on the basis of within-sample income. Again the data suggests that successful right wing parties are more frequent in rich countries. Their frequency relative to left wing governments is monotonically increasing in income. This is not affected when the data is analyzed at two points in time in Table A2. Although during the early part of the sample (1975-80) left wing governments were more common than later on (1992-7), in both periods right wing governments are relatively more common in rich countries.

Table A3 compares three alternative definitions of color of government available from Beck *et al.*, chief executive, largest government party and 3 main parties in government. We also assign a cardinal scale to the parties (assigning 1 to right wing parties, 0 to center parties and -1 to left wing parties) so as to simplify comparisons. For all definitions of government a simple t-test strongly suggests that right wing parties are more common in richer countries. In other words, the data give a

similar picture to that presented in Table A1.¹⁰ This is still true even when we weigh data on party ideology by the proportion of the total available seats obtained.

Other variables may affect the relationship between government ideology and level of development. An obvious candidate is inequality. The frequencies of political color using data on the Gini from Deininger and Squire (1996) to partition the sample is presented in Table A4. Availability of inequality data limits the sample (asymmetrically with respect to income). Again it seems poor countries are more left wing and, if anything, more unequal countries seem to be more right wing.

The previous tables treat each country/year observation in our data set as independent. However since our data include repeated observations on the same country over time it is of interest to relax this assumption and give more weight to changes in government. A simple approach is to look at random effects regressions that allow for serial correlation in the error term.¹¹ Table A5 reports the results. We also include other controls. We include *Freedom*, a country's level of political rights as measured by Freedom House, a control for whether the countries were experiencing civil war (from Doyle and Sambanis (2000)) and a control for inequality (see appendix 2 for data definitions). This is desirable given the correlation between redistribution, democracy and inequality predicted in theories of the growth of government (Peltzman (1980)), of the Kuznets curve and extension of the franchise (Acemoglu and Robinson (2000)) and in theories of capital-skill complementarities during development (Galor and Moav (2003) and Galor, Moav and Vollrath (2003)). Data availability on these new controls reduces the sample to 80 countries. For clarity we also eliminate countries in the Soviet block prior to 1990 (so that only 75 remain) although the results are unaffected by this choice.

Rich countries (i.e., in the top third of the income distribution in our original sample) are again associated with more right wing governments across all definitions, even after controlling for other variables that could be associated with different color of government. It is worth noting that more unequal countries tend to have more right wing parties. This point, which has been made informally contrasting the US and European experiences, is the starting point of Piketty (1995) and Benabou

¹⁰ There do not seem to exist significant trends over time. For example, using the “*Chief Executive*” definition the biggest difference between OECD and non-OECD occurred in the 1980’s (difference equals 0.57), while the smallest was in the 1990’s (difference equals 0.21). In all periods the OECD had significantly more right-wing governments.

¹¹ The need to eliminate the role of serial correlation may seem obvious. But rational voters in a democracy typically *intend* the government to stay the full length of the term.

(2000) and, to our knowledge, has not been documented before. The coefficient on *War* indicates a positive and statistically weak association between right-wing government and there being a civil conflict in the corresponding country. Results remain similar if we exclude the smallest 25% of countries based on population size.

There is no correlation between *Freedom* and the ideological orientation of the government. One could still argue that controlling for democratic differences in this way is insufficient to study the robustness of the left/poor correlation and that one should only look at countries with perfect degrees of freedom. This would be misleading for two reasons. First, countries that are perfectly democratic that are not in the richest third are still very rich relative to the rest of the sample. Thus, we would be studying if capitalism flows to countries that are rich (but not in the richest third). Second and more importantly, our *Freedom* variable concerns how democratic are governments once in power, not if they got there through democratic means. Thus, a finding that dictatorships lean left more often than right would still be consistent with right wing parties being unattractive to voters. The reason behind the left/authoritarian correlation may be found in the left-wing view of pressure groups (the “forces of reaction”) as using violence and misinformation through the media (and not just offering bribes). Thus, repression of individual rights is necessary to carry out socialist reforms (Fidel Castro is a case of a left-wing politician that is initially popular and then justifies becoming increasingly autocratic in these terms).

III. Ideological Orientation: Evidence on the Role of Corruption

As noted in the introduction, informal evidence suggests that the rhetoric of left wing parties in less developed countries is closely connected to corruption. See also Jauretche (1947). In this section we explore evidence bearing on the hypothesis that the resistance to adopting capitalism in the third world is correlated with the public’s perception of corruption. We propose three pieces of evidence. The first comes from re-examining the evidence on the regulation of entry presented in Djankov *et al* (2002). The second comes from examining the relationship between aggregate levels of corruption and political orientation of government within countries (using the Beck *et al* (2001) data set). And the third piece of evidence comes from examining subjective opinions on corruption and the role of government across individuals using World Values Survey data.

III.a. A Reinterpretation of "The Regulation of Entry" by Djankov et al (2002)

In their comprehensive study, Djankov *et al* collect data on the procedures regulating firm entry across countries, including the number of procedures, the time for putting the firm into operation, and total cost.¹² They report that they cannot reconcile the evidence available with public interest theories of regulation. Instead their evidence is consistent with "tollbooth" theories whereby regulations are put into place to allow rent extraction by bureaucrats. For example, a basic finding is that the number of procedures enters positively in bad-performance regressions (i.e., where the dependent variable is water pollution, deaths from intestinal infection, etc). They then present corruption regressions where the number of procedures, time and cost measures all enter positively. They state, "*While the data are noisy, none of the results support the predictions of the public interest theory*" (page 25), favoring instead the "tollbooth theory". Lastly they find that lack of political rights in the country enter positively in regulation regressions (dependent variable=number of procedures). Thus, regulation is heavy in autocratic countries, "*consistent with the public choice theory that sees regulation as a mechanism to create rents for the politicians and the firms they support*" (page 34).

This evidence can also help explain why capitalism doesn't flow to poor countries. When business people are perceived to be failing to deliver on their social contract, either because they are polluting the environment or because they are corrupting bureaucrats, offended citizens vote for more controls in the forms of more regulations. A simple way to distinguish this explanation from the "tollbooth" theory is to look at evidence at the individual level. A finding that people who perceive corruption to be widespread also want more government regulation would be difficult to explain if regulations were simply facilitating rent extraction by bureaucrats. This kind of evidence is discussed in section III.c. As for the finding that autocrats regulate more, there seems to be an equally appealing interpretation to the one proposed by Djankov *et al*, namely that they are passing these laws and regulations to "buy" the legitimacy that they lack from a democratic electoral process. Remember that their paper focuses on written regulations. By increasing the amount of written regulations, more autocratic leaders strengthen the bargaining position of bureaucrats *vis a vis* firms. But why would they do that? One possibility is that they are simply trying to buy the support of the bureaucracy. But this approach would risk alienating the - typically - more powerful business community. A more plausible story, then, is that autocrats are regulating as a way to discipline

¹² The procedures include screening (to certify business competence, a clean criminal record, check name for uniqueness, etc), tax related requirements, safety as well as environment related requirements. See Table I, in Djankov *et al* (2002).

business and get the support of the general population, because as Djankov *et al* emphasize, few dictators have a secure position.¹³

III.b. Corruption and Ideology at the Aggregate level

A simple approach to see if corruption is playing a role in the appeal of capitalism is to examine the within-country correlation of measures of aggregate corruption and ideology of the government. Table B looks at the correlation between the Beck *et al* (2001) measure of government ideology and the International Country Risk Guide (ICRG) corruption index introduced into economics by Knack and Keefer (1995). The corruption variable is available since 1984 and indicates the opinion of analysts on each country regarding how widespread is corruption. We focus on OLS fixed effect panel regressions and three different definitions of color of government (chief executive, largest government party and three main government parties). The results show that high levels of corruption are correlated with less right wing governments (with a three year lag), across all definitions of government. The relationship is statistically significant. Columns (4) and (5) show that the correlations are robust to weighting the largest government party and three main government parties by the proportion of seats that each of them controls. The analysis is not designed to deal convincingly with problems of endogeneity, so it has to remain illustrative. (As a small step towards addressing these issues, we have lagged the right-hand variables three years).¹⁴

If we also control for an index of development in the above regressions (for example, GDP per capita adjusted for purchasing power parity) then the coefficients on corruption become more negative and significant across all specifications. Interacting the level of corruption with the level of income in these regressions gives a positive and significant interaction term, indicating that the correlation between corruption and how left the government is gets larger in size at low levels of income. This is consistent with the idea that a given level of corruption is more effective in moving the electorate left in poor countries.

¹³ Djankov *et al* argue, “dictators need the political support of various interest groups, and use the distortionary policies to favor their friends”. They then assert “the choice of distortionary policy is not mitigated by public pressure since he faces no elections.” (page 28). An alternative explanation is that there is little exit and at the same time equilibrium industry profits with regulation are so much higher that they compensate for the firm’s lower bargaining power.

III.c. Evidence on Individual Beliefs from the World Values Survey

The source of the data for this section is World Values Survey Series (see Appendix 2). A large random sample of individuals are interviewed and asked a series of questions to "contribute to a better understanding of what people all over the world believe and want out of life". The 1995-7 wave includes a question to 67,416 people in 51 nations on corruption. It asks, "How widespread do you think bribe taking and corruption is in this country?" The four relevant response categories are: 1. *Almost no public officials are engaged in it.* 2. *A few public officials are engaged in it.* 3. *Most public officials are engaged in it.* 4. *Almost all public officials are engaged in it.* Accordingly, four dummy variables capturing each of these responses are created: *Perception of Corruption – almost none, - few officials, - most officials, - almost all officials.*

Ideology and Perceptions of Corruption

Table C1 uses this variable to study ideological inclination. This is possible because individuals also answer a question on ideological self-placement: "In political matters, people talk of "the left" and "the right". How would you place your views on this scale, generally speaking?" The interviewer then shows a scale with numbers 1 to 10 written down with the word "Left" written below the number 1 and the word "Right" below the number 10. Accordingly, the variable *Right Wing* is created taking the values 1-10. A total of 51,810 people across 48 countries answer both questions of interest.

Regressions (1-2) in Table C1 present ordered probit regressions, of the form:

$$Right_{ij} = a Perception\ of\ Corruption_{ij} + b Personal\ Controls_{ij} + Country_j + \varepsilon_{ij}$$

where $Right_{ij}$ is the ideological position of individual i living in country j , $Perception\ of\ Corruption_{ij}$ is the perception of corruption of individual i living in country j , while ε_{ij} is a standard error term (i.i.d.) and $Country_j$ is a country dummy. We also include a large set of personal controls, $Personal\ Controls_{ij}$, (including gender, age, marital status, income, education, country of residence and employment status of the respondent). When we use all this information the sample reduces further to 40,028 people across 43 nations.

¹⁴ Granger causality tests reject the hypothesis that corruption is correlated with lagged left wing government. Results available upon requests.

Regression (1) in Table C1 shows that individuals who perceive corruption to be widespread are less likely to identify themselves as right-wingers. Regression (2) shows that the result survives the inclusion of personal controls. They enter with the expected signs: people on higher income, men, the self-employed, those that are not divorced or separated, all tend to lean ideologically towards the right. In both regressions the effect of *Perception of Corruption* is monotonic and large. To obtain a measure of the size of the effect, note that a person who perceives corruption to be widespread (almost all officials engaged in it) is predicted to move toward the left-end of the scale by 0.14 units of the underlying continuous variable relative to the base category (*Almost no public officials are engaged in it*). The size of this effect is bigger than a fall from the top to the bottom income quintile, and suggests that an aggregate corruption shock of this size would move 4.5% of the electorate to the left (i.e., from an even split to 54.5% vote left and 45.5% vote right).

A similar estimate, although smaller in size, obtains when we limit the sample to countries in the OECD. When the analysis is carried out at the individual country level an interesting exception occurs: India. In this country there is a positive and significant correlation between the perception of corruption and placing one's views on the right end of the political spectrum, not the left. This suggests that corruption that is the product of extortion by bureaucrats and corruption that is initiated by firms seeking favors may be viewed quite differently by the public. Given India's history of interventionist governments up to the early 1990's, this result suggests that it may be interesting to compare the effect of observing corruption on ideological inclination for countries with different starting ideology. This is done by including the variable *Largest Government Party* (equal to one when the largest government party is right and -1 when it is left, see the Appendix) averaged over the previous five years into regression (2) as well as an interaction term, which leaves a sample of 33,244 observations in 35 countries. Standard errors are clustered at the country level. Specifically, the coefficient on perception of corruption (cardinalized with equal distance between the categories) is -0.033 (s.e. 0.016), the coefficient on *Largest Government Party* (right) equals 0.198 (s.e. 0.080), while the interaction between *Largest Government Party* (right) and *Perception of Corruption* equals -0.055 (s.e. 0.20). Thus, individuals who perceive there to be more corruption within the country are more likely to be left and on average people are more right in countries that have had a right wing government over the past five years. Importantly, the observation of corruption turns people left more when the government has been ideologically to the right (the size of the coefficient is almost 3-times larger in

countries that had a right wing government). Similar results obtain with other definitions of government ideology (chief executive and three largest government parties).

Perceptions of Corruption and Economic Attitudes

The correlation uncovered in Table C1 could reflect that observing corruption causes people to move left. Or it could reveal that observing corruption is a fixed left wing trait. It is then of some interest to study if corruption is correlated with other beliefs that are correlated with ideology. There is a vast literature in political science discussing the nature of political beliefs (e.g., de Tocqueville (1955), Lipset (1979), *inter alia*; see also the discussions in Rokeach (1973), Feldman (1988), Inglehart (1990) and Zaller (1991)). Some of this work emphasizes how left right political choices reflect the basic cleavages in society. Lipset and Rokkan (1967), for example, argue for the importance of the religious and the class (or economic) cleavage. A large part of the variation in the latter that explains party choice can be captured by an individual's belief concerning three basic economic questions: beliefs concerning the role that individual needs should play in determining income, beliefs concerning the role of merit in determining income, and the beliefs concerning how desirable is private ownership of property. We define beliefs as the combination of the available information with a set of more stable individual values (that condition the acceptance/rejection of particular arguments). See Zaller (1991) for a recent discussion.

Table C2 uses a similar regression to the one above but with different dependent variables that capture these different dimensions of ideology. We start with the role of needs as captured by attitudes towards poverty. For ease of exposition we treat the variable *Perception of Corruption* as cardinal (assigning the value 1 to "almost no officials" and 4 to "almost all officials"). We also attach the letter R (L) if, in the natural interpretation, higher values are associated with a right wing (left wing) ideological placement. The dependent variables in the first three columns deal with attitudes towards poverty. Column (1) in Table C2 uses the answer to the question "Why, in your opinion, are there people in this country who live in need? Here are two opinions: which comes closest to your view?" The two relevant options are 1. *They are poor because of laziness and lack of willpower*, OR 2. *They are poor because society treats them unfairly*. The variable, which is called *Not Lazy-L* is positively associated with *Perception of Corruption*, suggesting that people who perceive corruption to be widespread are more likely to reject the idea that poverty is due to laziness in favor of the idea that the poor are unfairly treated by society, compared to those that do not think that corruption is widespread.

Column (2) explores a different framing. It asks *"In your opinion, do most poor people in this country have a chance of escaping from poverty, or there is very little chance of escaping?"* The two relevant answers are 1. *They have a chance* or 2. *There is very little chance*. Again those who perceive high levels of corruption also express a left wing view. Column (3) focuses on the question *"Do you think that what the government is doing for people in poverty in this country is about the right amount, too much, or too little?"* The relevant answers are 1. *Too much* or 2. *About the right amount*, or 3. *Too little*. It reveals that people who perceive corruption to be widespread are also more likely to say that the government is doing too little to alleviate poverty. This result is interesting for theories that see corruption arising from government intervention. One possibility is that individuals understand that the optimal intervention maybe larger when the bureaucrats implementing them are corrupt, as there may be leaks.¹⁵ Thus, the result in column (3) is consistent only with a sophisticated version of what Djankov *et al* (2002) call the "public interest" view and is inconsistent with the "tollbooth theory" where regulation is put into place to extract fees.

Column (4) asks about beliefs concerning the role of merit in determining income (interpreting merit as payment in proportion to individual output). The dependent variable is the answer to *"Imagine two secretaries, of the same age, doing practically the same job. One finds out that the other earns considerably more than she does. The better-paid secretary, however, is quicker, more efficient and more reliable at her job. In your opinion, is it fair or not fair that one secretary is paid more than the other?"* Individuals who perceive corruption to be widespread are more likely to say that it is not fair to pay more to the more efficient secretary.

Column (5) in Table C2 turns attention to individual beliefs concerning how desirable is private ownership of property. The dependent variable is the answer to the question, *"There is a lot of discussion about how business and industry should be managed. Which of these four statements comes closest to your opinion? 1. The owners should run their business or appoint the managers; 2. The owners and the employees should participate in the selection of managers. 3. The government should be the owner and appoint the managers; 4. The employees should own the business and should elect the managers."* Individuals who perceive corruption to be widespread are also less likely to say that business should be managed in ways that are typical of capitalism.

¹⁵ Ales and Di Tella (1997) call these "super-pigouvian" interventions (see also Banerjee (1997), Acemoglu and Verdier (2000) and Djankov *et al* (2003)).

Columns (1b-5b) run a similar set of regressions, but also including the same set of personal characteristics used in Table C1. The results remain similar.

Perceptions of Corruption and Non Economic Attitudes

It is less clear from this literature what is the core set of “moral” beliefs that drive left and right choices. Political scientists have argued for the increasing importance of values that emphasize a libertarian/authoritarian dimension as well as “post materialist” values that focus on quality of life (rather than economic preservation). See Inglehart and Klingemann (1976), Flanagan (1987), Kitschelt (1994), *inter alia*. For example, a representative recent paper is Knutsen and Kumlin (2003) who identify moral values (religious versus secular), libertarian/authoritarian and ecology versus growth orientation as the three central (non-economic) values used in party choice. We focus on these three categories in Table C3.

Column (1) presents results using *Homosexual-L* as the dependent variable, where this is a variable that attempts the moral core value of ideology by asking “Please tell me if homosexuality can always be justified, never be justified or something in between”. The scale reveals that 1 equals “Never justifiable” while 10 equals “Always justifiable”. The correlation with *Corruption* is negative and, once personal controls are included, significant at the 1% level. Since justifying homosexuality is positively correlated with left wing ideology, we have a non-economic proxy for left-wing ideology. People who perceive corruption to be widespread are more likely to report the standard right-wing answer, not the left-wing one. This is contrary to what was found in Table C2 where economic attitudes were used.

Using other attitudinal non-economic aspects of ideology yields more mixed results. This is due to the fact that sometimes the association of the question with left-right positions is not as clear, or because the results sometimes have the opposite sign. For example, columns (2-3) focus on the idea that “authoritarian” views are negatively correlated with left wing ideology. Column (2) uses *Tolerance-L* and yields similar results to column (1) in the sense that the observing corruption is associated with the typical right wing view. In contrast column (3), which uses an alternative approach to capture authoritarian tendencies, namely one that focuses on intolerance to minorities (defined as *Capitalists-L*) exhibits the opposite correlation with corruption as the first two variables. A simple explanation is that the reference to capitalists evokes sentiments for economic justice

(rather than tolerance to a minority), so that this really belongs to Table C2. Yet, columns (4-5), which focus on nature versus growth orientation, also present equally mixed results. The two questions used, *Technology vs Tradition-L* and *Nature-L*, are negatively correlated with right wing self-placement, but the association is not always significant statistically (in contrast to all previous variables used).

In summary, there are two ways of interpreting the evidence in Tables C1-3. The first is that observing corruption *causes* people to become left-wing. This explains why people who perceive there to be widespread corruption are more likely to be on the left of the political spectrum (Table C1) and to have left-wing views on economic matters (Table C2). It also explains why the picture is so much more mixed when it comes to non-economic aspects of ideology (Table C3). The second interpretation is that belief in widespread corruption is *a part* of a core left-wing ideology. In other words, left-wingers have some core identity that leads them to believe simultaneously that firms should be managed by workers or the state (rather than owners and managers), for example, and to see corruption everywhere. Table C4 supports the first interpretation comparing the effect of corruption perceptions on right wing inclination under three different specifications. The first involves only one right-hand variable: corruption. The second involves corruption as well as a set of economic beliefs. And the third involves corruption and a set of non-economic beliefs. The effect of corruption is unchanged when moving from the first to the third specification, whereas it is halved when we move from the first to the second specification (equality of the corruption effect in regressions (1) and (2) is rejected at the 10% level). This is suggestive of the idea that part of the effect of corruption on ideology operates through its impact on economic beliefs.

Note that even this non-causal interpretation would explain the findings in table B and those concerning how capitalism doesn't flow to poor and corrupt countries. To see this assume that left and right compete for votes. The left wing rhetoric includes the word corruption whereas the right does not. Then it is reasonable to assume that the observation of corruption leads voters to think that the left-winger is more likely to be correct on other aspects of political debate (like managing the economy). Then, shocks that increase the perception of corruption would lead voters to choose left wing parties, and for capitalism not to flow to this country making it remain poor. It is still hard to explain, under this interpretation, why the evidence in Table C3 looking at the correlation between corruption and non-economic attributes at the individual level is so mixed. But since the

evidence is not overwhelming, and these questions are less precise than the questions designed to elicit economic beliefs, one could attribute this to noise.

IV. Corruption and Ideological Orientation: Theory

In this section we try to explain the patterns present in the data. We ask that it can account for why is it that right wing parties often fail to convince voters that they will be tough on capitalists. An example of this is the failed presidential bid of novelist and liberal candidate Mario Vargas Llosa in Peru in 1990. His candidacy had everything one would expect is needed to achieve a “separation” between the right and bad capitalists (e.g., his wealth was not derived from contracts with the state). We propose a model where corruption reveals information about the type of capitalists (how “fair” or deserving they are). Appendix 3 develops a model based on rational preferences where capitalists have different productivities. In it, the decision of the public to adjust bureaucratic wages is absent. This is done without serious loss of generality as long as in equilibrium technology (in particular monitoring ability) and preferences (moral costs) are such that it is not optimal for the public to deter all forms of corruption. See Besley and McLaren (1993) and Mookherjee and Png (1993).

IV. a. A Link between Corruption and Ideology based on Fairness Considerations

A simple reason why there often is a “separation failure” as described above is that people vote by emotional association. If capitalism in the past has been implemented by a ruthless dictator or by a colonial power, then voters in subsequent elections would find it hard to associate capitalism with freedom and respect for human rights. Likewise, voters in corrupt countries may emotionally associate the capitalist party with bad entrepreneurs, regardless of the policies the party proposes. This can be interpreted as a form of fairness motives in the utility function. Interestingly, an important case where separation between the pro-capitalist party and bad capitalists was achieved is Theodore Roosevelt’s presidency in the US.¹⁶ The standard account of how he achieved this appears to be consistent with a (variant) of fairness motivations as the need for regulating big business was connected to morality in some of his writings (see Morris (2001), which reports that he explicitly claims that trust owners had become “disproportionately” prosperous relative to the employees). In

¹⁶ Fairness helps with the separation failure because is based on previous information. Thus, voters are not attracted to a party that credibly promises to stop corruption from now on as what they want is someone that can reduce the payoff of the (corrupt) capitalists. In this view, capitalism can only succeed only after the capitalists are “punished”.

our setup workers do not fully confiscate the rich because they would regard that as “unfair” (e.g, Akerlof and Yellen (1991), Rabin (1993)). In particular individuals are assumed to have “reciprocal preferences”, as in Levine (1998) and Rotemberg (2003), and the setup is a “dictator” game augmented with a prior signal concerning the corruption of the capitalists and the bureaucrats. On how laws conceive the corporation as a moral actor, see Rose-Ackerman (2002).

Preferences

Giving the subscripts b, f and v to variables corresponding to the bureaucrat, firm and worker respectively, and denoting U their material payoffs (i.e., their payoffs aside of any altruistic feelings) we denote their preferences as

$$W_b = U_b + \lambda_b U_v \tag{1}$$

$$W_f = U_f + \lambda_f U_v \tag{2}$$

$$W_v = U_v + \lambda_{vf}(\hat{\lambda}_f)U_f + \lambda_{vb}(\hat{\lambda}_b)U_b \tag{3}$$

where λ_s is a parameter denoting the unconditional level of altruism of the $s=firm, bureaucrat$ towards the agent and $\lambda_{vs}(\hat{\lambda}_s)$ is the worker’s altruism, assumed to be an increasing function of $\hat{\lambda}_s$, the worker’s best estimate of the firm’s (or bureaucrat’s) altruism.¹⁷ Without loss of generality we assume that there are no altruistic feelings between firms and bureaucrats. This formulation assumes that workers would want to respond like with like. As stressed by the above authors, this function has to adopt some positive values in order to explain voluntary contributions in public goods experiments, and negative values in order to explain rejections of positive offers in ultimatum games. For the purposes of this application, it is sufficient to assume that it is an increasing function of $\hat{\lambda}_s$. For simplicity, it is assumed that all firms have the same altruism parameter, which can take only two values, $\lambda_f \in \{\lambda_{fg}\} = \{\lambda_1, \lambda_2\}$ (where $g=1,2$). The ex ante probability that altruism is λ_{fg} is given by k^g and is common knowledge. Bureaucrats are assumed to be of only one type, say λ_1 . Interestingly all our results hold even when they are assumed to have two types of altruism (similarly to firms).

¹⁷ An alternative interpretation is that the perceived merits of the capitalists and bureaucrats drives the “altruism” of the worker, as in the Hoffman *et al* (1994) experiments where the property right of being the first mover is “earned” by scoring high in a general knowledge quiz and first movers with high scores exhibit more “self regarding” behavior.

Government

Individual workers are endowed with an amount R of resources each period that is put into the custody of the bureaucrats (e.g., for national defense). Firms pay a lump sum tax t to workers.

Technology and Contracts

There are an equal number of firms, bureaucrats and workers. Production by the firm yields p . Firms keep $\alpha_f p$, bureaucrats keep $\alpha_b p$ while workers keep $\alpha_v p$.¹⁸

Corruption

When the firm is honest and produces, the players receive their payoffs described in (1-3), which we now index with superscript “honest”, $W_s = W_s^{honest}$. When there is corruption they receive $W_s^{corrupt}$.

In this case the worker’s material payoff is 0, and the firm and bureaucrat each obtain $\frac{R}{2} - m_i$. The second term is a moral cost that is privately known. Its distribution is common knowledge and is denoted $F(m_i)$.

Timing

At the beginning of each period all bureaucrat-firm-worker trios are formed. Workers remember last period’s outcome (if the firm was corrupt or not). And the probability that the worker is the median voter is sufficiently small so that firms ignore signaling considerations (see Rotemberg (2003)). A worker then estimates $\hat{\lambda}_s$ and decides a level of taxes that maximizes expected utility. Firms and bureaucrats find out the (common) value of the moral cost. They then produce or engage in corruption and output is shared.

Results

For a given level of taxes, it is possible to define a cutoff moral cost (for each altruism parameter) such that all firms with lower moral cost are corrupt. In other words, all firms for which

¹⁸ A standard assumption is that bureaucrats derive an enjoyment from the size of the public sector. Note that this effect is already present in the model, arising indirectly since higher taxes increase the payoff to workers who bureaucrats care

$$\alpha_f p - t + \lambda_{fg} U_v (R + \alpha_v p + t) \geq R/2 - m_i \quad (4)$$

produce, where $U(0) = 0$ and U_f is assumed linear for simplicity. Otherwise they are corrupt. Call the level of m_i for which the equation above holds with equality, m^{fg} . We restrict attention to situations where the material payoff of the bureaucrat is lower than that of the firm, $m^{fg} < m^{b1}$.¹⁹

After observing a corrupt firm, the voter's best estimate of the firm's altruism parameter is

$$\hat{\lambda}_f = \lambda_{f1} z(\lambda_{f1} |_{\text{corruption}}) + \lambda_{f2} z(\lambda_{f2} |_{\text{corruption}}) \quad (5)$$

Where the values of $z(\cdot)$ are obtained using Bayes rule as

$$z(\lambda_{fg} |_{\text{corruption}}) = \frac{k^g F(m^{fg})}{k^1 F(m^{f1}) + k^2 F(m^{f2})} \quad (6)$$

The voter's problem after observing last period the state r , where $r \in \{\text{Corruption}, \text{Honesty}\}$ is to set the level of taxes to maximize this period's expected utility:

$$\text{Max}_t \quad EW_v |_r = \left(\sum_g z(\lambda_{fg} |_r) (1 - F(m^{fg})) \right) W_v^{\text{honest}} + \left(\sum_g z(\lambda_{fg} |_r) F(m^{fg}) \right) W_v^{\text{corrupt}} \quad (7)$$

The first order condition is given by:

$$\left(\sum_g z(\lambda_{fg} |_r) (1 - F(m^{fg})) \right) \left(\frac{\partial U_v}{\partial t} - \lambda_{vf}(\hat{\lambda}_f) \right) - \left(\sum_g z(\lambda_{fg} |_r) (1 - \lambda_{fg} \frac{\partial U_v}{\partial t}) f(m^{fg}) \right) (W_v^{\text{honest}} - W_v^{\text{corrupt}}) = 0 \quad (8)$$

about. Thus, our results can also be derived assuming bureaucrats care directly about the size of the public sector by letting $U_b = g(t)$ where g is an increasing function.

¹⁹ When bureaucrats can take on two types, the binding cutoff moral type will not always be that of the firm (e.g., when the altruist bureaucrat is paired with a non-altruist firm). As mentioned above, our results do not change in this case.

Equation (8) suggests that workers balance the income from taxes with their desire to be fair to firms and the “incentive” costs of high taxes (captured here through the size of the black economy). The following proposition can be established:

Proposition 1:

1. The observation of corruption increases desired taxes on account of fairness considerations (as it reduces the belief that firms are altruistic towards workers).
2. Countries where firms are productive and government is small have less corruption
3. If the party of low taxes credibly promises to control corruption, its appeal may still be lower than that of the high tax party.
4. When taxes are high, corruption does not change the voter’s estimate of the firm’s altruism.
5. There is a negative externality from corrupt entrepreneurs to honest entrepreneurs.

Proof:

To see 1., note that $z(\lambda_{f2}|_{corruption}) < k^2$. Then, note that when fairness considerations dominate tax-setting, we have that $t^*|_{Corruption} > t^*|_{Honesty}$, where $t^*|_r = \arg \max EW_v|_r$. (The FOC reduces to $\frac{\partial U_v}{\partial t} - \lambda_{vf}(\hat{\lambda}_f) = 0$ as $f \rightarrow 0$ where the limit captures the importance of fairness relative to size-of-the-shadow-economy considerations. Hence if corruption is observed, $\lambda_{vf}(\hat{\lambda}_f)$ drops which implies that taxes must rise, assuming $\frac{\partial^2 U_v}{\partial t^2} < 0$).

To see 2., define a rich country as one that has a large $\frac{P}{R}$. Calculate the total amount of corruption

as $\sum_g k^{fg} F(m^{fg})$ and then note that $\frac{\partial m^{fg}}{\partial (\frac{P}{R})} < 0$ for all g .

To see 3., note that having observed corruption, reciprocal preferences mandate higher taxes (first term in equation (8)). Since future corruption levels will be controlled, there are no incentive effects

of higher taxes in terms of driving entrepreneurs into the shadow economy (and the second term drops out, reinforcing the effect).²⁰

To see 4., note that $\lim_{t \rightarrow p} F(m^{f2}) / F(m^{f1}) = 1$.

To see 5., note that profits for an honest firm are lower after the worker observes a corrupt firm. #

The model emphasizes the idea that incomes of the different members of society depend on a “social contract”, summarized in the model by the degree of mutual respect (altruism).²¹ In particular, the main variable of interest (the level of taxation) is determined by a combination of self-interest, a sense of fairness towards others and an incentive constraint arising from the difficulty of producing output in a highly taxed economy.²² This is related (but not identical) to a class of efficiency problems generated by high taxes that prevent the poor from fully taxing the rich. More precisely, in this model the main cost of taxes from the point of view of the voters is that firms hide more (i.e. join the unofficial economy). Formally this plays a similar role to having the standard efficiency costs of high taxes.²³ One advantage of the present set up is that voters see corruption as more “justifiable” when taxes are high (and thus, react less when firms are corrupt in the face of high taxes). The setup can accommodate cases where voters perceive corruption to be a form of extortion on the part of bureaucrats (rather than as a profit seeking activity by firms) and end up voting for lower taxes (to compensate firms). Appendix 3 develops a model based on standard preferences where voters update on the productivity of private business.

A difficulty in the fairness models is that outcomes are judged according to how close they are to a target or “fair” outcome, but there is no natural way to define this. We follow Levine (1998) and

²⁰ This result is robust to modeling the incentive effects of taxes in more traditional ways (e.g., when incentive effects are derived from reduced individual effort rather than lower profit reporting).

²¹ This formalizes the idea that “corporations have an obligation to refrain from illegal payoffs as part of the quid pro quo implied by the laws that permit corporations to exist and operate”, Rose-Ackerman (2002).

²² As in work on why the poor do not expropriate the rich (e.g., Putterman (1996), Roemer (1998) and Benabou (2001)). Note that, even if these efficiency considerations were absent, a sufficiently high desire for fair outcomes would bring about an interior solution. This is desirable given that, broadly speaking, the correlation between income and taxation across Europe and the US is weak. Moreover, the multiple equilibria arising in previous models seeking to explain the economic systems in the two regions are usually GDP-rankable (if not Pareto-rankable). See, for example, Piketty (1995), Benabou (2000), Alesina and Angeletos (2003). Note also that these considerations are secondary; we are ultimately more interested in the correlates of the equilibrium level of taxes than what this level is.

²³ See Johnson *et al* (2000), Svensson (2001) and Choi and Thum (2003). Extending the set up to include firm investment shows that corruption is more damaging than taxes (as long as moral costs are discovered after investments), consistent with the arguments in Shleifer and Vishny (1993) and Wei (1997). An emphasis on tax evasion as a response to tax increases (e.g. versus labor supply responses) is consistent with the empirical evidence in Auerbach and Slemrod (1997).

Rotemberg (2003) in assuming that an agent's feelings towards others are affected by what they believe others feel towards them. Thus, a bigger weight is put on money in the hands of an individual who is thought to be more altruistic. This naturally leads to a dynamic signaling game, as a player's actions potentially reveal their altruism. While we wish to retain the basic notion of fairness, the idea that an individual firm will change their (secret) corrupt behavior to affect these perceptions is implausible, even if these secret acts sometimes get caught. The set up we analyze, a dictator game augmented to allow for some prior information gathering, reflects this.

Finally, the observation of corruption is more damaging to capitalists than to bureaucrats. The reason is that, other things equal, an act of corruption against workers carried out by a rich firm and a poor bureaucrat is more telling (contains more information) about the firm's level of altruism towards workers than about the bureaucrat's altruism.²⁴ The reason is that, for similar assumptions about firm and bureaucratic morality, a poor bureaucrat is always ready to be corrupt when a rich firm is ready to be dishonest, but the opposite is not true. This predicts that a person that sees corruption amongst public officials as widespread will declare to dislike capitalists (as in Table C3).

Finally, there is an ideological externality in the sense that the individually rational acts of corrupt entrepreneurs lead to the belief that capitalists are undeserving, hurting the rest of society (good entrepreneurs and workers). The profits of entrepreneurs are inter-dependent as corrupt acts give a bad name to capitalism and hurt good entrepreneurs (see Velasco and Tornell (1992) for a different type of externality in a model with interest groups). This result depends on the degree of correlation of altruism levels across capitalists that is assumed. This provides some justification for the preoccupation of corporations to have other firms adopt forms of corporate social responsibility. See also the discussion in section 4 of Rose-Ackerman (2002).

V. Conclusion

Anecdotal evidence suggests that political rhetoric in the developing countries is tilted to the left of the ideological spectrum. Thus, right-wing rhetoric is *less* extreme in poor countries than in rich countries while the rhetoric of left-wing parties appears *more* extreme in poor countries than in rich

²⁴ This is true even if bureaucrats are assumed to be of two types and corruption sometimes leads to updating on bureaucratic altruism.

countries. Overall, this suggests that US-style, pro-capitalist political parties have electoral difficulties in the third world. We do not have formal systematic evidence on electoral rhetoric, but data on the ideological identification of political parties around the world from Beck *et al* (2001) is consistent with this view. Empirically, governments in rich countries tend to be classified as right-wing more often than in poor countries. Controlling for the level of democratic rights, the levels of inequality or if there is civil unrest, does not seem to affect this conclusion.

We conjecture that corruption plays a role in shaping ideologies. The second part of the paper provides empirical evidence that is consistent with the hypothesis that corruption moves the electorate to the left. We discuss three types of evidence.

1. First, we argue that some of the cross-country evidence showing that more regulation is correlated with more corruption, as presented in Djankov *et al* (2002), is consistent with the idea that corruption reduces the appeal of capitalism (as well as with the “tollbooth” theory presented by these authors).
2. Second, we present evidence on the link at the aggregate level between corruption and ideology within countries. We show that there is a negative correlation between a country’s aggregate level of corruption and how much to the right is the government in later years.
3. Third, we look at data on beliefs across individuals within countries. We show that people who think that corruption amongst public officials is widespread in the country tend to report themselves on the left of the political spectrum. The effect is monotonically increasing in corruption, well defined statistically, and comparable in size with other determinants of left-wing preferences, such as being on low income. We partition ideology into economic and non-economic attributes of ideology, and document their correlation with perceptions of corruption. People who perceive there to be widespread corruption also tend to think that the government is doing too little to fight poverty or to think that the government should run firms (rather than owners and managers). Attributes of ideology that are not economic in nature, such as views on homosexuals, exhibit a somewhat different pattern: often the attitude that is associated with right-wing ideology (e.g., homosexuality not being justifiable) is positively correlated with the perception of widespread corruption. This is suggestive of the view that an exogenous increase in corruption leads to more left-wing views in the electorate, particularly in economic matters.

In the third and final part of the paper, we present a simple model that can account for these correlations. We ask that the model is consistent with the observation that even right-wing parties that credibly promise to control corruption often have electoral difficulties (i.e., there is failure to separate bad capitalists from right wing parties). The root assumption is that voters are willing to pay to punish corrupt capitalists for fairness considerations (as in the ultimatum game). The existence of corrupt entrepreneurs hurts good entrepreneurs by reducing the general appeal of capitalism. Accordingly, perhaps the most important message of the model is that they point out that corrupt entrepreneurs can have a negative effect on *all* entrepreneurs by undermining the electorate's faith in markets. A limitation of our model is that good entrepreneurs have no way of disciplining corrupt entrepreneurs. In reality there may be ways of making these entrepreneurs internalize the costs of their actions (perhaps through social norms).

Overall, the paper suggests that corruption could be an important determinant of economic performance through its influence on the electoral performance of pro-capitalist parties. The case of Korea, one of the few poor countries in our sample that adopted capitalism, is illustrative. After the 1961 military coup, Korea's new leader Major General Park Chung Hee passed the Illicit Wealth Accumulation Act. He then arrested the country's more prominent businessmen and paraded them through the streets of Seoul carrying placards with legends such as "*I am a corrupt swine*". During the next 40 years Korea grew rich operating under what is, by world standards, a pro-capitalist system. The main argument in this paper is that capitalism in Korea was possible only after bad capitalists had been punished and it was easier to believe that the system was not run for the benefit of a few corrupt businesspeople. This belief may have made right-wing policies more attractive and his regime more stable, in turn making economic growth more likely.

Table A1: Frequency of Political Color of Government by Income

	Top income (1 st)	Middle Income (2 nd)	Bottom Income (3 rd)
<i>Left</i>	244 (37.7 %)	290 (45.0 %)	436 (67.6 %)
Center	78 (12.1 %)	59 (9.2 %)	62 (9.6 %)
Right	325 (50.2 %)	295 (45.8 %)	147 (22.8 %)
Total	647 (100 %)	644 (100 %)	645 (100 %)

Note: Frequencies of government (definition used is "largest government party") for 136 countries over the period 1975 to 1997. Percentiles within income group in parentheses.

Table A2: Frequency of Political Color, Beginning and End of the Sample Period.

1975-80	Top income (1 st)	Middle Income (2 nd)	Bottom Income (3 rd)
<i>Left</i>	65 (44.2 %)	69 (50.4 %)	73 (67.6 %)
Center	21 (14.3 %)	10 (7.3 %)	7 (6.5 %)
Right	61 (41.5 %)	58 (42.3 %)	28 (25.9 %)
Total 1975-80	147 (100 %)	137 (100 %)	108 (100 %)
1992-97	Top income (1 st)	Middle Income (2 nd)	Bottom Income (3 rd)
<i>Left</i>	68 (36.1 %)	92 (40.2 %)	143 (64.7 %)
Center	14 (7.5 %)	23 (10.0 %)	34 (15.4 %)
Right	106 (56.4 %)	114 (49.8 %)	44 (19.9 %)
Total 1992-97	188 (100 %)	229 (100 %)	221 (100 %)

Note: Same as Table A1 above.

Table A3: Political Color of Government: Three Alternative Definitions

	Chief Executive	Largest Government Party	3 Main Government Parties
<i>Richest (Top Third)</i>	0.13	0.13	0.11
<i>Poorest (Bottom Third)</i>	-0.44	-0.45	-0.42
t-statistic	11.4	11.6	11.8
significance	<0.1%	<0.1%	<0.1%

Note: Averages are obtained assigning value 1 to the right wing party, 0 to the center party and -1 to the left wing party. *t*-statistic refers to the difference in means test between Top Third and Bottom Third.

Table A4: Frequency of Political Color, by Income and Inequality Levels

		Top income (1 st)	Bottom Income (3 rd)
Low Inequality	<i>Left</i>	111 (44 %)	43 (96 %)
	Center	24 (10 %)	0 (0 %)
	Right	116 (46 %)	2 (4 %)
	Total	251 (100 %)	45 (100 %)

		Top income (1 st)	Bottom Income (3 rd)
High Inequality	<i>Left</i>	19 (27 %)	68 (58 %)
	Center	24 (34 %)	8 (7 %)
	Right	27 (39 %)	42 (35 %)
	Total	70 (100 %)	118 (100 %)

Note: Political color defined with color of *Largest Government Party*. *Top (Bottom) Income* denotes that the country is in the richest third of the sample *Inequality* is measured by the Gini coefficient, Deininger and Squire (1996).

Table A5: Political Color, Random Effects Regressions, 75 Countries, 1975-1997.

	(1) Chief Executive	(2) Largest Gov't Party	(3) 3 Main Gov't Parties	(4) Largest Gov't Party - Seats	(5) 3 Main Gov't Parties - Seats
<i>Middle (center third)</i>	-0.41* (0.17)	-0.39* (0.16)	-0.38** (0.15)	-0.29** (0.11)	-0.24** (0.10)
<i>Poorest (bottom third)</i>	-0.46* (0.20)	-0.50** (0.19)	-0.44** (0.18)	-0.26* (0.12)	-0.17 (0.11)
Freedom	-0.02 (0.03)	-0.01 (0.04)	0.01 (0.03)	-0.01 (0.02)	0.01 (0.02)
War	0.21 (0.23)	0.24 (0.20)	0.37* (0.17)	0.24 (0.14)	0.23 (0.13)
Inequality	0.02** (0.01)	0.02** (0.01)	0.02* (0.01)	0.01** (5e-3)	0.01* (5e-5)
<i>R² overall</i>	0.06	0.07	0.07	0.05	0.06
<i>Number of observations</i>	662	694	694	654	664

Notes: [1] Standard errors in brackets. Bold-face denotes significant at 10 per cent level, starred-bold at 5 percent level, double-starred bold at 1 per cent level. [2] In Column (1) *Chief executive* is a variable that takes value -1 if chief executive is left wing, 0 if center, 1 if right wing. Column (2) same but orientation of largest government party and column (3) that of the 3 main government parties. Column (4) dependent variable measures the proportion of seats of the largest party in government and multiplies it by -1 if the party is left wing, 0 if center and 1 if right wing. Column (5) does the same but is an average across the orientation of each of the 3 main government parties. [3] *Middle (center third)* is a dummy denoting if real (PPP) income is in the centre-third of the sample, *Poorest (bottom third)* is a dummy denoting if it lies in the poorest one-third of the sample. The base category is the top third of incomes. *Freedom* rates political rights on a scale from 1 (least rights) to 7 (most rights). *War* is defined as a civil war of over 1,000 battle deaths per year. *Inequality* is measured by the Gini coefficient. See Appendix 2 for more information about these variables.

Table B: Political Color and lagged Corruption within 80 Countries: 1975-1997.

	(1) Chief Executive	(2) Largest Gov't Party	(3) 3 Main Gov't Parties	(4) Largest Gov't Party - Seats	(5) 3 Main Gov't Parties - Seats
<i>Corruption (t-3)</i>	-0.07 (0.04)	-0.08* (0.04)	-0.11** (0.04)	-0.05** (0.02)	-0.05** (0.02)
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes
<i>Adjusted R²</i>	<i>0.66</i>	<i>0.69</i>	<i>0.67</i>	<i>0.75</i>	<i>0.74</i>
<i>Number of observations</i>	<i>843</i>	<i>843</i>	<i>843</i>	<i>843</i>	<i>843</i>

Notes: [1] Regressions are OLS with country fixed effects. Standard errors in brackets. Bold-face denotes significant at 10 per cent level, starred-bold at 5 percent level, double-starred bold at 1 per cent level. [2] In Column (1) *Chief executive* is a variable that takes value -1 if chief executive is left wing, 0 if center, 1 if right wing. Column (2) same but orientation of largest government party and column (3) that of the 3 main government parties. Column (4) dependent variable measures the proportion of seats of the largest party in government and multiplies it by -1 if the party is left wing, 0 if center and 1 if right wing. Column (5) does the same but is an average across the orientation of each of the 3 main government parties. See Appendix 2 for more information about these variables. [3] *Corruption* is the ICRG corruption measure. *(t-3)* indicates the variable has been lagged by three years. See the Appendix for more information.

Table C1: Corruption Perceptions and Ideology

Dependent Variable: Right Wing Voter	(1)	(2)	
		Coefficients	Std. error
<i>Perception of Corruption</i>			
- Few officials	-0.03 (0.03)	-0.04	(0.03)
- Most officials	-0.07** (0.03)	-0.09**	(0.03)
- Almost all officials	-0.13** (0.03)	-0.14**	(0.03)
<i>Personal Income Quintile</i> - Second		-0.03*	(0.01)
- Third		-0.01	(0.02)
- Fourth		0.04*	(0.02)
- Fifth (top)		0.12**	(0.02)
<i>Work Status</i> - Unemployed		-0.003	(0.02)
- Self employed		0.10**	(0.02)
- Retired		-0.06**	(0.02)
- Student		0.05*	(0.02)
- Housewife		0.11**	(0.02)
- Other		0.04	(0.04)
<i>Marital status</i> - Married		0.03*	(0.02)
- Divorced		0.01	(0.03)
- Separated		-0.02	(0.04)
- Widowed		0.07**	(0.03)
Age		-0.01**	(0.002)
Squared Age		9.5e-5**	(2.5e-5)
Male		0.04**	(0.01)
<i>Age Finished School:</i> 12-14 years old		0.01	(0.03)
15-18 years old		-0.04	(0.03)
19-21 years old		-0.04	(0.03)
> 21 years old		-0.08	(0.03)
Country Dummies	Yes	Yes	
No of Observations	51,810	40,028	
Pseudo R ²	0.02	0.02	

Note: [1] All regressions are Ordered Probits. [2] Standard errors in parentheses. [3] Bold-face denotes significant at the 10 percent level; Single-starred bold-face at the 5 per cent level; Double-starred bold face at the 1 percent level. [4] The cut points (standard errors) for column (1) are: $_cut1=-1.58$ (0.08), $_cut2=-1.18$ (0.08), $_cut3=-0.77$ (0.08), $_cut4=-0.46$ (0.08), $_cut5=0.38$ (0.08), $_cut6=0.74$ (0.08), $_cut7=1.03$ (0.08), $_cut8=1.39$ (0.08) and $_cut9=1.62$ (0.08). The cut points for column (2) are: $_cut1=-1.58$ (0.11), $_cut2=-1.32$ (0.11), $_cut3=-0.90$ (0.11), $_cut4=-0.59$ (0.11), $_cut5=0.24$ (0.11), $_cut6=0.61$ (0.11), $_cut7=0.90$ (0.11), $_cut8=1.28$ (0.11), $_cut9=1.52$ (0.11). [5] Appendix 2 gives data definitions [6] Dependent variable is the answer to the question *In political matters, people talk of "the left" and "the right". How would you place your views on this scale, generally speaking?* Interviewer shows scale with numbers 1 to 10 written down with the word Left written below the number 1 and the word Right below the number 10. [7] *Perception of Corruption* is the answer to the question *How widespread do you think bribe taking and corruption is in this country?*

1. *Almost no public officials are engaged in it*
2. *A few public officials are engaged in it*
3. *Most public officials are engaged in it*
4. *Almost all public officials are engaged in it*

Table C2: Corruption Perceptions and Economic Attributes of Ideology

<i>Dep. Variable has L (R) extension if higher numbers mean more Left (right)</i>	Needs/Poverty			Merits	Ownership
	(1) Not Lazy-L	(2) Escape-L	(3) Govern. Poor-L	(4) Fair Pay-L	(5) Business Own-L
<i>Perception of Corruption</i> 1= almost no official 4= almost all officials	0.15** (0.03)	0.25** (0.03)	0.33** (0.04)	0.14** (0.03)	0.05** (0.02)
Personal Controls	No	No	No	No	No
No of Observations	52,446	58,180	55,103	58,810	56,873
Pseudo Rsq	0.098	0.111	0.105	0.079	0.041
	(1b)	(2b)	(3b)	(4b)	(5b)
<i>Perception of Corruption</i> 1= almost no official 4= almost all officials	0.17** (0.04)	0.26** (0.04)	0.37** (0.04)	0.13** (0.02)	0.05* (0.02)
Personal Controls	Yes	Yes	Yes	Yes	Yes
No of Observations	37,864	43,673	39,995	44,392	41,184
Pseudo Rsq	0.087	0.110	0.114	0.092	0.049

Note: [1] Name of dependent variable has L (R) extension if higher numbers mean more Left (Right) [2] All regressions are Ordered Probits and include country dummies [3] Standard errors in parentheses [4] Single-starred bold-face at 5 per cent level; Double-starred bold face at 1 percent level. [5] *Perception of Corruption* is the cardinal version of the question defined in the note to Table C1. [6] Dependent variables are the answers to the question:

Now I'd like you some questions about the problem of poverty, in this country and in other countries:

Column (1) Why, in your opinion, are there people in this country who live in need? Here are two opinions: which comes closest to your view? 1. They are poor because of laziness and lack of willpower, or 2.They are poor because society treats them unfairly.

Column (2) In your opinion, do most poor people in this country have a chance of escaping from poverty, or there is very little chance of escaping? 1. They have a chance or 2. There is very little chance.

Column (3) Do you think that what the government is doing for people in poverty in this country is about the right amount, too much, or too little? 1. Too much or 2. About the right amount, or 3. Too little.

Column (4) Imagine two secretaries, of the same age, doing practically the same job. One finds out that the other earns considerably more than she does. The better paid secretary, however, is quicker, more efficient and more reliable at her job. In your opinion, is it fair or not fair that one secretary is paid more than the other? 1. Fair or 2. Not fair.

Column (5) There is a lot of discussion about how business and industry should be managed. Which of these four statements comes closest to your opinion?

1. The owners should run their business or appoint the managers
2. The owners and the employees should participate in the selection of managers.
3. The government should be the owner and appoint the managers
4. The employees should own the business and should elect the managers.

Columns (1b-5b) run the same set of regressions, but also controlling for the identical set of personal characteristics included in Table C1. See Appendix 2.

Table C3: Corruption Perceptions and Non-Economic Attributes of Ideology

<i>Dep. Variable has L (R) extension if higher numbers mean more Left (right)</i>	Moral	Authoritarian		Nature	
	(1) Homosex-L	(2) Tolerance-L	(3) Capitalists-L	(4) Technology vs Tradition-L	(5) Nature-L
<i>Perception of Corruption</i> <i>1= almost no official</i> <i>4= almost all officials</i>	-0.04 (0.02)	-0.09** (0.02)	0.05** (0.02)	-0.05* (0.02)	0.08** (0.02)
Personal Controls	No	No	No	No	No
No. Observations	61,165	54,969	55,567	52,342	56,731
Pseudo R ²	0.087	0.065	0.183	0.063	0.114

	(1b)	(2b)	(3b)	(4b)	(5b)
<i>Perception of Corruption</i> <i>1= almost no official</i> <i>4= almost all officials</i>	-0.07** (0.02)	-0.07** (0.02)	0.05** (0.02)	-0.05* (0.02)	0.09** (0.03)
Personal Controls	Yes	Yes	Yes	Yes	Yes
No. Observations	49,777	39,903	41,582	38,030	41,144
Pseudo R ²	0.127	0.070	0.217	0.092	0.104

Notes: [1] Name of dependent variable has L (R) extension if higher numbers mean more Left (Right) [2] All regressions are Ordered Probits and include country dummies [3] Standard errors in parentheses. [4] Bold-face denotes significant at the 10 percent level; Single-starred bold-face at the 5 per cent level; Double-starred bold face at the 1 percent level. [5] *Perception of Corruption* is the cardinal version of the question defined in the note to Table C1. [6] Dependent Variables:

Column (1) Please tell me if homosexuality can always be justified, never be justified or something in between, using this card. Card shows a scale from 1 to 10 where 1= Never justifiable, 10= Always justifiable.

Column (2) For the following pair of statements, please tell me which one comes closest to your own views. To build good relationships, it is most important to express one's own preferences clearly; OR 2. 1. To build good human relationships, it is most important to try to understand other's preferences.

Column (3) I'd like to ask you about some groups that some people feel are threatening to the social and political order of society. Would you please select from the following list the one group or organization that you like least? 1. Jews; 2. Capitalists; 3. Stalinists/hard line communists (or country equivalent); Immigrants; 5. Homosexuals; Criminals; Neo-Nazis/Right extremists (or country equivalents). Variable equals 1 if answer is 2 and zero otherwise.

Column (4) For the following pair of statements, please tell me which one comes closest to your own views. 1. We should emphasize tradition more than high technology, OR 2. We should emphasize high technology more than tradition.

Column (5) For the following pair of statements, please tell me which one comes closest to your own views. 1. Human beings should master nature; OR 2. Humans should coexist with nature.

Columns (1b-5b) run the same set of regressions, but also controlling for the identical set of personal characteristics included in Table C1.

Table C4: Right Wing, Corruption and Economic vs Non-Economic Attributes of Ideology

Dependent Variable: Right Wing	(1)	(2)	(3)	(4)
Perception of Corruption <i>1= almost no official</i> <i>4= almost all officials</i>	-0.05** (0.01)	-0.02** (0.01)	-0.05** (0.01)	-0.02* (0.01)
<i>Economic Attributes</i>				
<i>Poverty:</i> Not Lazy - L		-0.16** (0.02)		-0.14** (0.02)
Escape - L		-0.10** (0.01)		-0.10** (0.02)
Government Poor - L		-0.13** (0.01)		-0.11** (0.02)
<i>Production:</i> Business Ownership - L		-0.09** (0.01)		-0.08** (0.01)
<i>Incentives:</i> Fair Pay - L		-0.05** (0.02)		-0.03 (0.02)
<i>Non-Economic Attributes</i>				
<i>Moral:</i> Homosexuals - L			-0.03** (0.003)	-0.02** (0.003)
<i>Authoritarian:</i> Tolerance - L			-0.05** (0.01)	-0.05** (0.01)
Capitalists - L			-0.20** (0.03)	-0.18** (0.04)
<i>Nature:</i> Tradition vs Technology - L			-0.004 (0.01)	-0.002 (0.01)
Nature - L			-0.003 (0.02)	0.01 (0.02)
<i>Personal Controls</i>	Yes	Yes	Yes	Yes
No of Observations	27,925	27,925	24,805	20,345

Notes: [1] Dependent variable: *Right Wing*. *Perception of Corruption* is the cardinal version of the question defined in the note to Table C1. Independent variables defined in tables C1-3. Variables are given L (R) extension if higher numbers mean more Left (Right) [2] All regressions are Ordered Probits and include country dummies [3] Standard errors in parentheses. All Pseudo R²=0.02 [4] Bold-face denotes significant at the 10 percent level; Single-starred bold-face at the 5 per cent level; Double-starred bold face at the 1 percent level.

Appendix 2: Data Definitions and Sources

Country Level Variables

Survey Descriptions

The ideology variables *Right*, *Left* and *Center*, are defined Beck *et al* in two steps. First, they identify the party of key political players. Then they asked whether the orientation of a party (regarding greater or less state control of the economy) was immediately obvious from the name. Otherwise they checked sources, including *The Europa Handbook* and Banks' *Political Handbook of the World*. Information on party orientation comes from *Political Parties of Africa and the Middle East: A Reference Guide* (1993), *Political Parties of Eastern Europe, Russia and the Successor States: A Reference Guide* (1994) and the Web site maintained by Agora Telematica (www.agora.stm.it/elections/parties.htm). Countries: Afghanistan, Albania, Algeria, Angola, Argentina, Australia, Austria, Bahamas, Bangladesh, Barbados, Belarus, Belgium, Belize, Benin, Bolivia, Botswana, Brazil, Bulgaria, Burkina Faso, Cambodia, Canada, Cape Verde, Central African Republic, Chile, China, Colombia, Comoro Islands, Congo, Costa Rica, Croatia, Cuba, Cyprus, Czech, Denmark, Dominican Republic, Ecuador, El Salvador, Ethiopia, Fiji, Finland, France, Gambia, East Germany, West Germany, Georgia, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea Bissau, Guyana, Haiti, Honduras, Hungary, Iceland, India, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Korea, Laos, Latvia, Lebanon, Lesotho, Liberia, Lithuania, Luxembourg, Macedonia, Madagascar, Malawi, Mali, Malta, Mauritius, Mauritania, Mexico, Moldova, Mongolia, Morocco, Mozambique, Myanmar, Namibia, Nepal, Netherlands, New Zealand, Nicaragua, Niger, Norway, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Portugal, Romania, Russia, Senegal, Sierra Leone, Slovakia, Slovenia, Solomon Islands, South Africa, USSR, Spain, Sri Lanka, St Lucia, Sudan, Suriname, Sweden, Switzerland, Taiwan, Tajikistan, Tanzania, Thailand, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, USA, Uganda, Ukraine, United Kingdom, Uruguay, Uzbekistan, Vanuatu, Venezuela, Vietnam, Western Samoa, Yemen, Yugoslavia, Zambia.

Right: Parties on the right are those with the terms “conservative” or “Christian democratic” in their names, or are labeled right-wing in their sources.

Left: Similarly, parties classified as left if their names reveal them to be communist, socialist, or social democratic or if the sources label them as left-wing.

Center: Similarly, centrist parties are those called centrist by their sources or if their proposed policies can best be described as centrist (e.g., because the party advocates strengthening private enterprise but also supports a redistributive role for government).

Chief Executive: A discrete variable that refers to the political orientation of the party of the chief political decision-maker in the country. Assigned three numerical codes: -1 if the *Chief Executive* is left wing, 0 if center and 1 if right wing.

Largest Government Party: A discrete variable that refers to the political orientation of the Governing party with most seats in the legislature. It is assigned three numerical codes: -1 if the largest government party is left wing, 0 if center and 1 if right wing.

Largest Government Party (by seats): A continuous variable capturing the political orientation of the largest Governing party as above, but now weighted by the proportion of seats it occupies in the legislature.

Three Main Government Parties: The political orientation of the government parties with the first, second and third largest number of seats in the legislature, obtained by taking a simple average across the political orientation of each of these parties. The government parties are assigned three numerical codes: -1, 0 and 1 depending on whether they are left, center or right-wing assigned equal weights.

Three Main Government Parties (by seats): A continuous variable capturing the political orientation of the three largest government parties as above, but where each one is weighted by the number of seats it occupies in the legislature.

Freedom: A scale from 1 to 7 measuring the extent of political rights. Nations with a rating of 7 come closest to the ideals of free and fair elections. Those who are elected rule, there are competitive parties or other political groupings, and the opposition plays an important role and has actual power. Nations with the lowest numbers have systems ruled by military juntas, religious hierarchies, or autocrats. A

rating of 1 means political rights are virtually nonexistent. The data is produced in an annual survey produced by regional experts, consultants, and human rights specialists. Source Freedom House.

War: A dummy variable equal to one when there is a civil war in that country/year. A civil war is defined as a domestic conflict involving of over 1,000 battle deaths per year. From Doyle and Sambanis (2000).

Inequality: The Gini Ratio, obtained from the Deininger and Squire (1996) World Bank “high quality” data set.

Corruption: The International Country Risk Guide (ICRG) corruption index has been produced annually since 1982 by Political Risk Services, a private international investment risk service. It is measured on a 0 to 6 scale. The index is based on the opinion of experts, and intends to capture the extent to which “high government officials are likely to demand special payments” and “illegal payments are generally expected throughout lower levels of government” in the form of “bribes connected with import and export licences, exchange controls, tax assessments, police protection, or loans”.

GDP per head: GDP per capita, in 1992 US\$, from the World Development Indicators of the World Bank.

Individual Level Variables:

Survey Descriptions

World Values Survey and European Values Survey (Third wave: 1995-7). The Combined World Values Survey is produced by the Institute for Social Research, Ann Arbor, MI, USA. The series is designed for cross-national comparison of values and norms. Both national random and quota sampling were used. All of the surveys were carried out through face-to-face interviews, with a sampling universe consisting of all adult citizens, aged 18 and older. The countries surveyed in the 1995-7 wave which have data on both corruption and ideology include: Argentina, Armenia, Australia, Azerbaijan, Bangladesh, Belarus, Bulgaria, Bosnia-Herzegovina, Brazil, Chile, Colombia, Croatia, Dominican Republic, Estonia, Finland, Georgia, Germany, India, South Korea, Latvia, Lithuania, Macedonia, Mexico, Moldova, Nigeria, Norway, Peru, Philippines, Poland, Puerto Rico, Russia, Moscow, Slovenia, South Africa, Spain, Andalusia, Basque, Galicia, Valencia, Sweden, Switzerland, Taiwan, Turkey, Ukraine, United States of America, Uruguay, Venezuela, Serbia-Montenegro.

Personal Income Quintile: This heading refers to a set of 4 dummy variables which take the value 1 depending on which income quintile the respondent's family income belongs to. The base category is the lowest income quintile (from World Values Survey).

Right Wing Voter: Dependent variable is the answer to the question "In political matters, people talk of "the left" and "the right". How would you place your views on this scale, generally speaking?" Interviewer shows scale with numbers 1 to 10 written down with the word "Left" written below the number 1 and the word "Right" below the number 10. (from World Values Survey).

Perception of Corruption: A categorical variable that is the answer to the question "How widespread do you think bribe taking and corruption is in this country?. The answers are (1) *Almost no public officials are engaged in it* (2) *A few public officials are engaged in it.* (3) *Most public officials are engaged in it.* (4) *Almost all public officials are engaged in it.* (from World Values Survey).

Work Status: A set of dummy variables taking the value 1 depending on the respondent's employment status: "Unemployed", "Self-employed", "Retired", "Student", "Housewife" or "Other". The base category is "Employed" (from World Values Survey).

Marital Status: A set of dummy variables taking the value 1 depending on the respondent's marital status: "Married", "Divorced", "Separated" or "Widowed". The base category is "Never Married".

Age: A set of dummy variables corresponding to the respondent's age: "Middle" which corresponds to 26-50 years old, "Old" which corresponds to greater than 50 years old. The base category is "Young" which corresponds to less than 26 years old (from World Values Survey).

Male: A dummy variable equal to 1 if the respondent is male and 0 otherwise (from World Values Survey).

Age Finished School: This heading refers to a set of dummy variables which take the value 1 depending on the age at which the respondent finished full-time education: up to "12-14 years old", "15-18 years old", "19-21 years old" or up to "more than 21 years old". The base category is education up to, but not including, 12 years old (from World Values Survey).

References

- Acemoglu, Daron and Thierry Verdier (2000) "The Choice Between Market Failures and Corruption" *American Economic Review*, vol 90, 194-211.
- Acemoglu, Daron and James Robinson (2000) "Why did the West extend the Franchise? Democracy, Inequality, and Growth in Historical Perspective," *Quarterly Journal of Economics*, 463, 4, 1167-200.
- Acemoglu, Daron, Simon Johnson and James Robinson (2001) "The Colonial Origins of Comparative Development: An Empirical Investigation", *American Economic Review*, 91, 1369-401.
- Ades, Alberto and Rafael Di Tella (1997) "National Champions and Corruption: Some Unpleasant Interventionist Arithmetic", *Economic Journal*, 107, 443, 1023-42.
- Akerlof, George and Janet Yellen (1990) "The Fair Wage-Effort Hypothesis and Unemployment", *Quarterly Journal of Economics*, 105 (2), 255-83.
- Alesina, Alberto and George-Marios Angeletos (2002) "Fairness and Redistribution: US versus Europe", mimeo.
- Alesina, A. and A. Drazen (1991) "Why are Stabilizations Delayed?", *American Economic Review*, 81(5), 1170-88.
- Alesina, Alberto and Dani Rodrik (1994) "Distributive Politics and Economic Growth", *Quarterly Journal of Economics*, 109:465-90.
- Alesina, Alberto, Ed Glaeser and Bruce Sacerdote (2002) "Why Doesn't the US have a European Style Welfare State?", *Brookings Papers on Economic Activity*, 2, 187-277.
- Andvig, Jens Christopher and Karl Ove Moene (1990) "How Corruption May Corrupt" *Journal of Economic Behavior and Organization*, 13, pp.63-76.
- Auerbach, Alan and Joel Slemrod (1997) "The Economic Effects of the Tax Reform Act of 1986," *Journal of Economic Literature*, 35, 589-632.
- Banerjee, A. V. (1997) "A Theory of Misgovernance", *Quarterly Journal of Economics*, 112, 4, 1289-332.
- Beck, Thorsten, George Clarke, Alberto Groff, Philip Keefer, and Patrick Walsh (2001) "New tools in comparative political economy: The Database of Political Institutions." *World Bank Economic Review*.15: 1, 165-76.
- Besley, T. and J. McLaren (1993) "Taxes and Bribery: The Role of Wage Incentives", *The Economic Journal*, 103, 416, 119-41.
- Benabou, Roland and Efe Ok (2001) "Social Mobility and the Demand for Redistribution: The POUM Hypothesis", *Quarterly Journal of Economics*, 116(2), 447-487
- Benabou, Roland (2000) "Unequal Societies: Income Distribution and the Social Contract" *American Economic Review*, 90, 96-129.
- Benabou, Roland and Jean Tirole (2002) "Belief in a Just World and Redistributive Politics", mimeo Princeton University.
- Burkart, Mike, Fausto Panunzi and Andrei Shleifer (2002) "Family Firms", Harvard mimeo.
- Choi, Jay Pil and Marcel Thum (2003) "The Dynamics of Corruption with the Ratchet Effect", *Journal of Public Economics*, 87, 3-4, 427-43.
- Cukierman, Alex and Mariano Tommasi (1998) "When does it take a Nixon to go to China?" *American Economic Review*, 88, 1, 180-97.
- Dahl, Robert (1956) A Preface to Democratic Theory, Chicago: University of Chicago Press.
- Deininger, K. and L. Squire (1996) "A New Data Set Measuring Income Inequality", *World Bank Economic Review*, September, 10(3), 565-91.
- De Long, Brad and Andrei Shleifer (1993), "Princes and Merchants: City Growth Before the Industrial Revolution," *Journal of Law and Economics*, 36 (October), pp. 671-702.
- Denzau, A. and D. North (1994) "Shared Mental Models: Ideologies and Institutions", *Kyklos*, 47, 1, 3-31.
- della Porta, Donatella (2000) "Social Capital, Beliefs in Government, and Political Corruption" in Disaffected Democracies: What's Troubling the Trilateral Countries? eds. Susan J. Pharr and Robert D. Putnam. Princeton: Princeton University Press.
- Djankov, Simeon Rafael La Porta, Florencio Lopez de Silanes and Andrei Shleifer (2002) "The Regulation of Entry", *Quarterly Journal of Economics*, CXVII, February, 1, 1-38.
- Djankov, Simeon, Ed Glaeser, Rafael La Porta, Florencio Lopez de Silanes and Andrei Shleifer (2003) "The New Comparative Economics", *Journal of Comparative Economics*, forthcoming.
- Doyle, Michael W. and Nicholas Sambanis. (2000) "International Peacebuilding: A Theoretical and Quantitative Analysis", *American Political Science Review*, 94(4): 779-802.
- Drazen, A. (2000), Political Economics in Macroeconomics, New Jersey: Princeton University Press.
- Fernandez, R. and D. Rodrik (1991), Resistance to Reform: Status Quo Bias in the Presence of Individual Specific Uncertainty, *American Economic Review*, 81, 1146-55.

- Feldman, Stanley (1988) "Structure and Consistency in Public Opinion: The Role of Core Beliefs and Values," *American Journal of Political Science* 32, 2, 416-40.
- Flanagan, Scott (1987) "Value Changes in Industrial Societies", *American Political Science Review*, 81, 1303-19.
- Galor, Oded and Omer Moav (2003) "Das Human Kapital: A Theory of the Demise of the Class Structure", mimeo Brown University.
- Galor, Oded, Omer Moav and Dietrich Vollrath (2003) "Land Inequality and the Origin of Divergence and Overtaking in the growth Process: Theory and Evidence", mimeo Brown University.
- Gersick, Kelin John Davis, Marion McCollom Hampton and Ivan Lansberg (1997) Generation to Generation: Life Cycles of the Family Business, Harvard Business School Press: Boston.
- Glaeser, Ed and Andrei Shleifer (2002) "The Rise of the Regulatory State", mimeo, forthcoming *Journal of Economic Literature*.
- Green, Duncan (1995) The Rise and Crisis of Market Economics in Latin America- 2nd Edition, NYU Press.
- Grier, R. (1997) The Effect of Religion on Economic Development: A cross-national study of 63 former colonies, *Kyklos*, 50, 1, 47-62.
- Guiso, Luigi Paola Sapienza and Luigi Zingales (2003) "People's Opium? Religion and Economic Attitudes", forthcoming *Journal of Monetary Economics*, 50, 225-82.
- Hoffman, Elizabeth, Kevin McCabe, Keith Schacht and Vernon Smith (1994). "Preferences, Property Rights, and Anonymity in Bargaining Games", *Games and Economic Behavior*, 7(3), 346-80.
- Hochschild, Jennifer, (1981) What's Fair? American Beliefs about Distributive Justice, Cambridge, Harvard University Press.
- Huang, Yasheng (2001) "Korea: On the Back of a Tiger", HBS case 1-700-097.
- Huntington, Samuel (1968) Political Order in Changing Societies. New Haven: Yale University Press.
- Iannaccone, L (1998) "Introduction to the Economics of Religion" *Journal of Economic Literature*, 36, 3, 1465-96.
- Inglehart, Ronald (1990) Culture shift in advanced societies, Chicago University Press: Chicago.
- Inglehart, Ronald and Hans-Dieter Klingemann (1976) 'Party Identification, Ideological Preference, and the Left-Right Dimension among Western Mass Publics', chap. 13 in Ian Budge, Ivor Crewe and Dennis Farlie (eds.) Party Identification and Beyond. London: John Wiley.
- Jauretche, Arturo (1947) "FORJA", en Jauretche Inedito, compilation, Corregidor 2002.
- Jennings, Kent, and Gregory Markus (1984) "Partisan Orientations Over the Long Haul: Results From the Three-Wave Political Socialization Panel Study", *American Political Science Review*, 78, 1000-18.
- Johnson, Simon, Daniel Kaufmann, John McMillan and Chris Woodruff (2000) "Why do Firms Hide? Bribes and unofficial Activity after Communism", *Journal of Public Economics*, 76, 3, 495-520.
- Kaufmann, Daniel and Shang Jin Wei (1999) "Does Grease Money Speed up the Wheels of Commerce?", NBER working paper 7093.
- Keefer, Philip (1999) and Stephen Knack (1997). "Why don't poor countries catch up? A cross-national test of an institutional explanation", *Economic Inquiry*, 35:3, 590-602.
- Kitschelt, Herbert (1994) The Transformation of European Social Democracy, Cambridge: Cambridge University Press.
- Klugel, James and Eliot Smith (1986) Beliefs About Inequality, Americans Views of What is and What Ought to be, Aldine de Gruyter: New York.
- Knack, Stephen and Philip Keefer (1995), "Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures." *Economics and Politics*, 7 (3), pp. 207-27.
- Knutsen, Oddbjorn and Staffan Kumlin (2003) "Value Orientation and Party Choice", mimeo.
- Lambsdorff, Johann Graf (2003) "How Corruption Affects Productivity", *Kyklos*, 56, 4, 457-74.
- Laver, Michael and Kenneth Shepsle (1996). Making and Breaking Governments. New York: Cambridge University Press.
- Ladd, Everett Carl and Karlyn Bowman (1998) Attitudes Towards Economic Inequality, AEI Press: Washington.
- Lipset, Seymour Martin and Rokkan Stein (1967) "Cleavage Structures, Party Systems, and Voter Alignments: An Introduction", in Lipset and Rokkan (eds.) Party Systems and Voter Alignments. New York: Free Press.
- Lipset, Seymour Martin (1979) The First New Nation, New York: Norton.
- La Porta, Rafael, Florencio Lopez de Silanes, Andrei Shleifer and Robert Vishny (1997) "Trust in Large Organizations", *American Economic Review*, 187, 2, 333-8.
- Mauro, P. (1995) "Corruption and Growth", *Quarterly Journal of Economics*, 110, 3, 681-712
- Mookherjee, D. and I. Png (1995) "Corruptible Law Enforcers: How Should They Be compensated?", *Economic Journal*, 105, 145-59.
- Morris, Edmund (2001) Theodore Rex, Random House: New York.
- North, Douglass and Robert Thomas (1973) The Rise of the Western World: A New Economic History, Cambridge, UK: Cambridge University Press.

- Peltzman, Sam (1980) "The Growth of Government", *Journal of Law and Economics*, 23, 209-87.
- Perotti, Roberto (1996) "Growth, Income Distribution and Democracy: What the Data Say." *Journal of Economic Growth* 1(2): 149-87.
- Persson, T. and G. Tabellini (1994) "Is Inequality Harmful? Theory and Evidence", *American Economic Review*, 48:600-21.
- Persson, T. and G. Tabellini (2000) Political Economics, MIT Press.
- Putterman, L. (1996) "Why have the Rabble not Redistributed the Wealth? On the Stability of Democracy and Unequal Property" in Property Relations, Incentives and Welfare, John Roemer (ed), London: MacMillan.
- Putterman, Louis, John Roemer and Joaquim Sylvestre (1998) "Does Egalitarianism have a Future?" *Journal of Economic Literature*, 36, 861-902.
- Picketty, Thomas (1995) "Social Mobility and Redistributive Politics." *Quarterly Journal of Economics*, 110(3): 551-84.
- Rabin, Mathew (1993) "Incorporating Fairness into Game Theory and Economics" *American Economic Review*, 83(5): 1281-302.
- Rajan, Raghuram and Luigi Zingales (2002) Saving Capitalism from the Capitalists: Unleashing the Power of Financial Markets to Create Wealth and Spread Opportunity, Crown Publishing.
- Roemer, John (1998) "Why the Poor do not Expropriate the Rich: An Old Argument in New Garb", *Journal of Public Economics*, 70, 399-424.
- Rokeach, Milton (1973) The Nature of Human Values, New York: Free Press.
- Rose-Ackerman, Susan (1978) Corruption: A Study of Political Economy, New York: Academic Press.
- Rose-Ackerman, Susan (2002) "Grand Corruption and the Ethics of Global Business", *Journal of Banking and Finance*, 26, 1889-918.
- Seligson, Mitchell (2002) "The Impact of Corruption on Regime Legitimacy: A Comparative Study of Four Latin American Countries", forthcoming *Journal of Politics*.
- Shleifer, Andrei and Robert Vishny (1993) "Corruption", *Quarterly Journal of Economics*, CVIII, 599-617.
- Skidelsky, Robert (1988) *Thatcherism*. Editor, Oxford: Basil Blackwell.
- Stiglitz, Joseph (2002) Globalization and its Discontent, Columbia University Press.
- Svensson, J. (2001) "Who Must Pay Bribes and How Much? Evidence from a Cross-Section of Firms", forthcoming *Quarterly Journal of Economics*.
- Tornell, Aaron and Andres Velasco (1992) "The Tragedy of the Commons and Economic Growth: Why Does Capital Flow from Poor to Rich Countries?", *Journal of Political Economy*, 100, 6, pp. 1208-31.
- Weatherford, S. (1992) "Measuring Political Legitimacy", *American Political Science Review*, 86,1, 149-66.
- Weber, Max (1958) The Protestant Ethic and the Spirit of Capitalism, New York: Scribner's Press.
- Wei, Shang-Jin (1997) "Why is Corruption so much more Taxing than Tax: Arbitrariness Kills", NBER working paper 6255.
- Zaller, John (1991) "Information, Values and Opinions," *American Political Science Review*, 85, 4, 1215-37.

Appendix 3

In this appendix we present a model based on standard preferences. Given a certain distribution of "moral costs" in society, capitalism and socialism are assumed to provide equal expected returns to voters. There is uncertainty regarding productivity under both systems. The observation of corruption under capitalism reveals information about firm productivity: voters' beliefs concerning productivity are updated when firms are observed to choose lobbying over production. In a socialist system, in contrast, the observation of corruption does not reveal information about socialist productivity (just about the officials implementing it). If officials can be changed more easily than private sector productivity, socialism provides voters with higher expected returns. There is also a negative externality in the sense that corruption by bad entrepreneurs reduces the returns to all entrepreneurs.

A link between Corruption and Ideology based on Standard Preferences

Interestingly, even with standard preferences, more corruption may move the electorate to the left. This is the case in the following model of corruption as a confession of low productivity.

Preferences

The economy consists of a large number of individuals with preferences over income, y . Whenever they engage in corrupt activities they incur a moral cost m_i , which is private information. This cost is distributed with cumulative function $F(m_i)$.

Government

All individuals pay a lump sum tax to fund a total R of national defense expenditures.

Technology

A fraction of individuals become managers (running firms) and the rest are employed as workers. Under capitalism, a firm has to choose whether to produce private goods or public goods. The productivity of a firm producing private goods can be either high or low, $p \in \{l, h\}$. The ex ante probability that productivity is p is given by q^p . When producing public goods, the firm has productivity $s + e$, where s can be appropriated by the firm and e is an externality that can be big or insignificant, $e \in \{i, b\}$. The ex ante probability that the externality is e is given by g^e .

Under socialism the firms are ordered to produce the public good. We have that $s < l$ and that $s + b > l$. In other words, the firm never chooses voluntarily to produce the public good, and private good production is less valuable than social good production when the firm has low productivity, at least in the case of big externalities.

Contracts and Information

The managers of the private firms can produce or lobby the government. When a manager chooses to produce she obtains αp . As an alternative she can lobby the government and obtain $R - m$.

Assume that some workers remember last period income (are informed) and some do not remember anything (are uninformed), and care only about the present. This is without loss of generality.

Timing

At the start of each period a random worker chooses the system of production. Workers are then randomly matched to the firms. Firms then choose to produce or to lobby the government, and payoffs are made.

Results 1: Capitalism in Practice

Under capitalism, all managers for whom moral costs are lower than $m^p = R - \alpha p$, for $p \in \{l, h\}$, prefer to abandon production and lobby the government. In that case voters are left with 0 to consume. Otherwise they get $(1 - \alpha) p$.

Thus, voters experience one of three levels of utility (outcomes), $U(0)$ or $U((1 - \alpha)h)$ or $U((1 - \alpha)l)$. The last two are fully revealing concerning the level of p . They also know that a firm would never try out public good production voluntarily. Thus, when $U(0)$ is experienced, voters know with certainty that the manager was corrupt. Using Bayes rule, voters estimate the probability that the firm has productivity p in the production of private goods as

$$z(p|_{\text{corrupt}}) = F(m^p) \frac{q^p}{q^h F(m^h) + q^l F(m^l)} \quad (9)$$

Thus, $z(h|_{\text{corrupt}}) < q^h$.

Results 2: Socialism in Practice

Under socialism, public good production is ordered to the firm. All managers for whom moral costs are lower than $m^s = R - \alpha s$ prefer to abandon production and lobby the government. In that case voters are left with 0 to consume. Otherwise they get $(1 - \alpha) s + e$.

Thus, voters experience one of three levels of utility (outcomes), $U(0)$ or $U((1 - \alpha)s + b)$ or $U((1 - \alpha)s + i)$. The last two are fully revealing concerning the level of e . When $U(0)$ is experienced, voters know that the manager was corrupt with certainty, so the fact that it has $m < m^s$ is fully revealed. Voters estimate the probability that the firm has productivity $s + e$ in the production of public goods as g^e .

Results 3: Voter Strategy

Uninformed voters maintain their priors concerning productivity levels in the two economic systems. Expected income under capitalism is given by

$$q^h(1 - F(m^h))(1 - \alpha)h + q^l(1 - F(m^l))(1 - \alpha)l \quad (10)$$

While expected income under socialism is given by

$$ER(S) = g^b(1 - F(m^s))((1 - \alpha)s + b) + g^i(1 - F(m^s))((1 - \alpha)s + i). \quad (11)$$

It is assumed that they are equal so there is no reason for the uninformed voter to lean in any particular way ideologically.²⁵

Informed workers remember last period outcome. When they experience anything different than $U(0)$ they know the productivity levels under either production system. If they get an honest manager, they can be certain to achieve the corresponding levels of income. For example, income when the manager is honest and

²⁵ Our results still hold when we assume that capitalism offers higher returns ex ante.

productivity is high is $(1 - \alpha) h$, which can be assumed to be equal to $(1 - \alpha) s + b$, so the worker is equally well off under a highly productive capitalist system as in a highly productive socialist system.

When the informed experience $U(0)$ under capitalism they know that they can expect to get

$$z(h|_{\text{corrupt}})(1 - F(m^h))(1 - \alpha)h + z(l|_{\text{corrupt}})(1 - F(m^l))(1 - \alpha)l . \quad (12)$$

When the informed experience $U(0)$ under socialism they know that they can expect to get

$$g^b(1 - F(m^s))((1 - \alpha)s + b) + g^i(1 - F(m^s))((1 - \alpha)s + i). \quad (13)$$

The following results can be established.

Proposition 2:

1. The probability of voting for the right wing party is lower when corruption is perceived to be widespread in a capitalist system.
2. The effect of observing corruption on voting behavior is larger for the observation of corruption in a capitalist system than for the observation of corruption in a socialist system.
3. If the right wing party credibly promises to control corruption it's appeal may still be lower than that of the left wing party.
4. There is a negative externality from corrupt entrepreneurs to highly productive entrepreneurs.

Proof:

To see 1., check that (12) < (10).

To see 2., check that (12) < (10), whereas (11) = (13).

To see 3., note that expected income under a capitalist system after observing corruption and after a (credible) promise to control corruption is given by

$$z(h|_{\text{corrupt}})(1 - \alpha) h + z(l|_{\text{corrupt}})(1 - \alpha) l . \quad (14)$$

Consider the case of low productivity. Calculating the difference in expected income under a left wing party versus (14) and taking limits, we have

$$ER(S) - \lim_{z(h|_{\text{corrupt}}) \rightarrow 0} \{z(h|_{\text{corrupt}})(1 - \alpha) h + z(l|_{\text{corrupt}})(1 - \alpha) l\} > 0. \quad (15)$$

To see 4., note that the structure of information assumed is also formally identical to assuming that at any point in time both high and low productivity managers coexist, in the ratio $q^h : q^l$ (prior to updating). That is, equation (10) stays unchanged but one must reinterpret the probability weights as proportions. Now simply note that part 1 of the proposition and $s < h$ means that profits of a highly productive firm are lower after the observation of corruption if the voters decide to abandon capitalism.²⁶ #

²⁶ Note that even without two types of entrepreneur co-existing, the (past) observation of corruption imposes an external cost on (future) productive entrepreneurs since the latter will be forced to drop production from b to s if voters decide to abandon capitalism.

Discussion

The model highlights one possible channel through which the observation of corruption reduces the appeal of capitalism. It emphasizes the fact that disclosure on lobbying and corruption efforts by the firm reveal information about their production possibilities.²⁷ More precisely, the fact that the firm has preferred to ignore production and concentrate on lobbying, together with information on the size of the potential gains from lobbying and the distribution of moral costs in society, allows the firm to update (down) their prior beliefs concerning the productivity under a capitalist system. This is true even if we assume that $s < l$, so that corruption is always higher under socialism.

Corruption is assumed to reduce voter welfare of both capitalism and socialism. Welfare would be higher under both systems if corruption were to be controlled. The model, however, shows that corruption may be more harmful for the electoral prospects of capitalism than for socialism. This is appealing because it predicts that, on average, in places where there is widespread corruption (e.g., the third world) capitalism will be less popular with voters. This is the result of *assuming* an asymmetry in the set up. The dimension over which there is asymmetric information (productivity levels) in the two economic systems can be appropriated in capitalism but not in socialism. Since the externality e does not affect managerial actions in socialism, observing corruption tells us nothing about whether the externality is high or low.

This asymmetry is connected to two types of phenomena. First, it captures the idea that corruption in a capitalist economy reflects something about the technology whereas corruption under socialism reflects something about people who work in the state. Firms, their technology and their corporate culture, seem to be quasi-permanent features, with very slow patterns of change. People who work in politics can be changed in elections. Thus, parties can always claim that they represent change, that *this time* they will bring honesty and integrity to the public sector.

Second, the asymmetry built into the model is connected to the idea that capitalist economies differ in the degree to which the productivity of private firms is connected over time. The productivity of large family firms can be expected to have a higher degree of persistence than managerial firms where shareholders can easily get rid of under-performing managers.²⁸ Compare a corruption scandal in a case such as Enron with a corruption scandal in a family-owned conglomerate in a Latin American country. After the scandal erupts and if management is changed in both cases, it seems that the new Enron manager will have an easier time arguing that they are now a highly productive firm than the family conglomerate.

Private sector performance can also be expected to be more serially correlated than public sector performance because incentive contracts are more prevalent in the private sector. Thus, one would expect that the behavior of managers is unlikely to change if the circumstances were similar because they are income-maximizers. Thus, a promise of change is not really credible if the way incentives are provided does not change also. Of course, the right wing party can promise to reduce the size of government (reduce R in our model) so the temptation to engage in lobbying would fall. But the one receiving the proceeds from lobbying is the (right wing) politician, so this is not necessarily credible. And, as part 3 of the proposition shows, productivity levels have already been revealed.

²⁷ This is consistent with Lambsdorff (2003), who shows that aggregate measures of productivity (such as the ratio of GDP to the country's capital stock) are negatively correlated with corruption; and Kaufmann and Wei (1999), who show that the amount of time that managers spend with bureaucrats is correlated with corruption.

²⁸ In Burkart *et al* (2002), for example, the founder of the firm is more likely to leave the management in the hands of a less able heir (than in those of a professional manager) in environments with weak legal protection to investors (which is more common on less developed countries).