

Uslaner, Eric M.

**Working Paper**

**Corruption and inequality**

WIDER Research Paper, No. 2006/34

**Provided in Cooperation with:**

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*Suggested Citation:* Uslaner, Eric M. (2006) : Corruption and inequality, WIDER Research Paper, No. 2006/34, ISBN 9291908029, The United Nations University World Institute for Development Economics Research (UNU-WIDER), Helsinki

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Economics Research

Research Paper No. 2006/34

## Corruption and Inequality

Eric M. Uslander\*

April 2006

### Abstract

Economic inequality provides a fertile breeding ground for corruption and, in turn, leads to further inequalities. Most corruption models focus on the institutional determinants of government dishonesty. However, such accounts are problematic. Corruption is remarkably sticky over time. There is a very powerful correlation between cross-national measures corruption in 1980 and in 2004. In contrast, measures of democracy such as the Freedom House scores are not so strongly correlated over time, and changes in corruption are unrelated to changes in institutional design. On the other hand, inequality and trust-like corruption are also sticky over time. The connection between inequality and the quality of government is not necessarily so simple. The aggregate relationships between inequality and corruption are not strong. The path from inequality to corruption may be indirect, through generalized trust, but the connection is key to understanding why some societies are more corrupt than others. This study estimates a simultaneous equation model of trust, corruption, perceptions of inequality, confidence in government, and demands for redistribution in Romania, and shows that perceptions of rising inequality and corruption lead to lower levels of trust and demands for redistribution.

Keywords: corruption, inequality, trust, transition

JEL classification: I31, K42, P37, Z13

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\*Department of Government and Politics, University of Maryland–College Park

This study is a revised version of the paper presented at the 17-18 June 2005 UNU-WIDER anniversary conference, 'WIDER Thinking Ahead: The Future of Development Economics', directed by George Mavrotas and Anthony Shorrocks.

UNU-WIDER gratefully acknowledges the financial contributions to the research programme by the governments of Denmark (Royal Ministry of Foreign Affairs), Finland (Ministry for Foreign Affairs), Norway (Royal Ministry of Foreign Affairs), Sweden (Swedish International Development Cooperation Agency—Sida) and the United Kingdom (Department for International Development).

ISSN 1810-2611

ISBN 92-9190-802-9 (internet version)

## Acknowledgements

This paper represents joint work with Gabriel Badescu of Babes-Bolyai University, Cluj-Napoca, Romania, who is responsible for much of the material on Romanian politics and society and who directed the surveys and provided the data. I am grateful to the Starr Foundation, through the Institutional Research and Exchanges Board of the United States Department of State for a grant in conjunction with Paul Sum of the University of North Dakota, Mihai Pisica, and Cosmin Marian, all of Babes-Bolyai University under the IREX Caspian and Black Sea Collaborative Programme (2001) to conduct a survey that formed the basis of our current work. I am also grateful to the Russell Sage Foundation and the Carnegie Foundation for a grant under the Russell Sage programme on The Social Dimensions of Inequality and to the General Research Board of the Graduate School of the University of Maryland—College Park. Some data reported here come from the Inter-University Consortium for Political and Social Research (ICPSR), which is not responsible for any interpretations. Mark Lichbach made many helpful suggestions on an earlier draft, as did an anonymous referee for this study.

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UNU World Institute for Development Economics Research (UNU-WIDER)  
Katajanokanlaituri 6 B, 00160 Helsinki, Finland

Camera-ready typescript prepared by Lorraine Telfer-Taivainen at UNU-WIDER

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## 1 Introduction

Successful (or well-ordered) democracies are marked by high levels of trust in people and in government, low levels of economic inequality, and honesty and fairness in the public sphere. Trust in people, as the literature on social capital has shown, is essential for forming bonds among diverse groups in society (Uslaner 2002). Trust in government is essential for political stability and compliance with the law. Corruption robs the economy of funds and leads to less faith in government (perhaps also to less faith in fellow citizens) and thus lower compliance with the law. And institutions seen as biased (unfair) cannot secure compliance and may exacerbate inequalities in society. Transition countries are short on both trust in people and trust in government (Badescu et al. 2003; Hayoz 2003). Under totalitarian regimes, there was little sense of social solidarity. The state was feared rather than legitimate (Howard 2003). Transition countries are also lacking in honest and fair institutions. And they have more than their share of corruption and an underground economy. Many citizens have little faith in their leaders or their fellow citizens.

Democratic governance is more than a set of institutional arrangements, a legislature, an executive, and courts. Establishing a constitution is the easy part. 'Making democracy work' is the more difficult task (Putnam 1993). Democratic governments need legitimacy (trust in institutions and their leaders) to enforce their laws. They also need an 'underbelly' of social solidarity to foster a co-operative spirit of tolerance and compromise (Putnam 1993; Uslaner 2002). Legislators must enact laws that people will obey; courts must enforce the laws impartially; and citizens must provide the supportive culture that demands both good governance and justice. Citizens must trust the government and each other and they must support the development of a market economy.

Under communism, all citizens were theoretically equal and the overall distribution of income was, in comparison with other countries, fairly equitable.<sup>1</sup> Transition led to increases, often sharp, in inequality and this threatened both the social order and the legitimacy of government. I shall present some aggregate analyses of the consequences of inequality among countries in transition in Central and Eastern Europe and the former Soviet Union. However, the availability of data for my desired measures is often rather sparse, so these analyses are merely suggestive rather than conclusive. My main focus will be the social psychology of transition economies, or how people reason about the linkage among inequality, trust (in both people and government), corruption,

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<sup>1</sup> The mean score on the Gini index of inequality for former and current (China) communist regimes in the Deininger and Squire (1996) dataset is 0.295; for the West, the mean is 0.316 and for other nations it is 0.464. The East-West differences are not significantly different from zero, but they are at  $p < 0.03$  if China is excluded.

and outlooks for the future. Drawing upon a recent survey of how people think about economic inequality in one country, Romania, I shall consider whether perceptions of inequality lead to lesser social cohesion, illegitimacy for the state, perceptions of corruption, and demands for transfer of wealth from the rich to the poor. At the end of the causal chain, these demands for the transfer of wealth from the rich to the poor are likely to work *against* the reduction of poverty and inequality. Economic programmes that focus benefits on one class may lead to persistent inequality and create their own social strains. Hence there is an inequality trap.

My concerns in this paper are to show how economic inequality and corruption inhibit political legitimacy (trust in government), social solidarity (trust in people), and support for a market economy. First, I show some aggregate results for transition countries that support my general arguments about the deleterious effects of inequality and corruption. Then I outline a more general framework that posits government performance and optimism for the future as the foundations for a more trusting citizenry. Performance and optimism in turn depend upon perceptions of corruption and rising inequality and I show support for these arguments using a survey of Romanians in October 2003. Neither confidence in government nor trust in people leads to greater support for a market economy (measured in the survey by opposition to limiting the incomes of the rich). Belief in the market is most directly tied to perceptions of corruption (and to a lesser extent to growing inequality).

I estimate a simultaneous equation model (by two-stage least squares) of government performance on the quality of life, whether the country is moving in the right or wrong direction, trust in other people and in government, and whether the government should limit the incomes of the rich. I find that people who perceive increasing income inequality are less likely to approve of government performance and to trust other people and are more likely to support limits on incomes of the rich. More generally, when people see the government as corrupt and the country moving in the wrong direction, social solidarity (trust in other people) and confidence in the state will decline—and there will be increasing demands for curtailing market forces and placing limits on incomes. Most notably, people are largely inured to the petty corruption of everyday life; it is larger scale corruption—by business people and especially government officials—that threatens social solidarity and support for the state. Rising inequality threatens economic inequality in at least two ways. First, growing inequities directly threaten the society's social fabric. Second, when people attribute growing inequality to rising corruption (as they do), this threatens the legitimacy of the state and the development of a market economy.

Rising inequality is not the only problem facing countries in transition. Persistent corruption is also problematic. Like inequality, it tears apart the social fabric and leads to a lack of confidence in government and demands for redistribution of income from the 'dishonest' rich to the powerless poor. Corruption also makes people less likely to

be optimistic for the future. When elites rob the public purse and when people must help elites to line their own pockets (by extra payments for routine services), ordinary citizens will have negative views of government performance in improving the quality of life and will have less hope that the country is heading in the right direction. It is 'elite corruption' rather than dishonesty among ordinary citizens that leads people to become pessimistic about the future, government performance, and even whether to trust each other.

A puzzle: there ought to be a link between rising income inequality and corruption. Corruption transfers resources from the mass public to the elite, and generally from the poor to the rich (see especially Onishi and Banerjee 2001). It acts as an extra tax on citizens, leaving less money for public expenditures (Mauro 1997: 7; Tanzi 1998: 582-3). Corrupt governments have less money to spend on their own projects, pushing down the salaries of public employees. These lower-level staffers will be more likely to extort funds from the public purse. Government employees in corrupt societies will spend more time lining their own pockets than serving the public. Corruption leads to lower rates of economic growth.<sup>2</sup> Yet, in both the aggregate data and the survey, the link between inequality and corruption is minimal.<sup>3</sup>

## **2 Inequality, social solidarity, and the transition to a market democracy**

The post-communist societies in Central and Eastern Europe and the former Soviet Union all underwent severe economic shocks after transition. Most people were worse off than they were under communism. As transition countries open their markets, a growing income gap is inevitable. As the security of state employment and low-cost services vanishes and as some people get rich quickly, there will inevitably be jealousy, mistrust, and a loss of confidence in public institutions. The sociopsychological foundations of trust are optimism and control, were lacking under communism. After transition, people increasingly became convinced that it was impossible to get rich honestly. Inequality makes the transition to democracy difficult because:

- Economic equality is the foundation of social solidarity (generalized trust) and trust in government. Generalized trust leads to greater investment in policies that have longer term payoffs (education spending and transfer payments) as well as more directly leading to economic growth. A weak state with an

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<sup>2</sup> Using Penn World Tables data on the gross domestic product in 1993 and 2000, I calculate GDP growth; the  $r^2$  between GDP growth and the 2001 Transparency International measure of corruption is 0.509 for 12 transition countries, but it is only 0.050 for economic inequality.

<sup>3</sup> Across 12 nations the  $r^2$  between the TI 2001 index of corruption and the Gini index of inequality is just 0.024 (0.048 for change in inequality). In the survey, none of the 'gift' measures has a correlation with perceived increasing inequality exceeding 0.02; the correlations for the various corruption measures are slightly higher, with the strongest being for perceptions that the government is doing much to control corruption (0.175), but most are around 0.10 or below.

ineffective legal system cannot enforce contracts; a government that cannot produce economic growth and the promise of a brighter future will not be legitimate (Kluegel and Mason 2000b: 201).

- Unequal wealth leads people to feel less constrained about cheating others (Mauro 1997: 12) and about evading taxes (Oswiak 2003: 73; Uslaner 2003).
- Inequality leads to unequal treatment by the courts, which leads to less legitimacy for the government.

I shall present some preliminary evidence (based upon small samples) that economic inequality makes transition rocky. Every country for which there are data on changes in economic inequality, save Slovakia, showed an increase in economic inequality from 1989 to the mid 1990s (Rosser et al. 2000). All but Hungary of the 17 countries for which there are data had a sharp increase (from 0.3 to 42 per cent) in the size of the shadow economy (Schneider 2003). The greater the share of the economy beyond the reach of the state, the more difficult it will be for a government to marshal the resources to gain public confidence that the state can provide essential services. And here we get into a vicious circle. If people have no confidence that politicians can pursue policies that will lead to prosperity and economic justice, they will hide their income from the tax collector (Uslaner 2003). Overall, the average share of the shadow economy more than doubled from 1989 to 1999-2000 (from 17 per cent to 38 per cent) and the average increase in the Gini index of inequality was 33 per cent.

Corruption is similarly a plague on good government. It is associated with higher rates of crime and tax evasion, closed markets, lower economic growth, and less efficient government institutions (Leite and Weidemann 1999; Mauro 1997; Tanzi 1998; Treisman 2000; Uslaner 2004). Corruption is widespread in former communist countries. The mean score on the Transparency International (TI) corruption indicator for East Bloc countries is more than half the size of that for the West (with higher scores indicating greater honesty). Romania is in 69th place out of 91 countries in the 2001 TI rankings. Of the 16 transition countries TI has ranked for corruption, Romania ranks twelfth.

### **3 The economic psychology of transition**

My focus is on how people in one transition country (Romania, October 2003) think about inequality, trust, political institutions, corruption, and hope for the future. These survey results permit a much finer test of my argument about how people reason about what makes transition a success or failure.<sup>4</sup> Of 21 transition countries in the World Values Survey, only Moldova ranks lower than Romania.

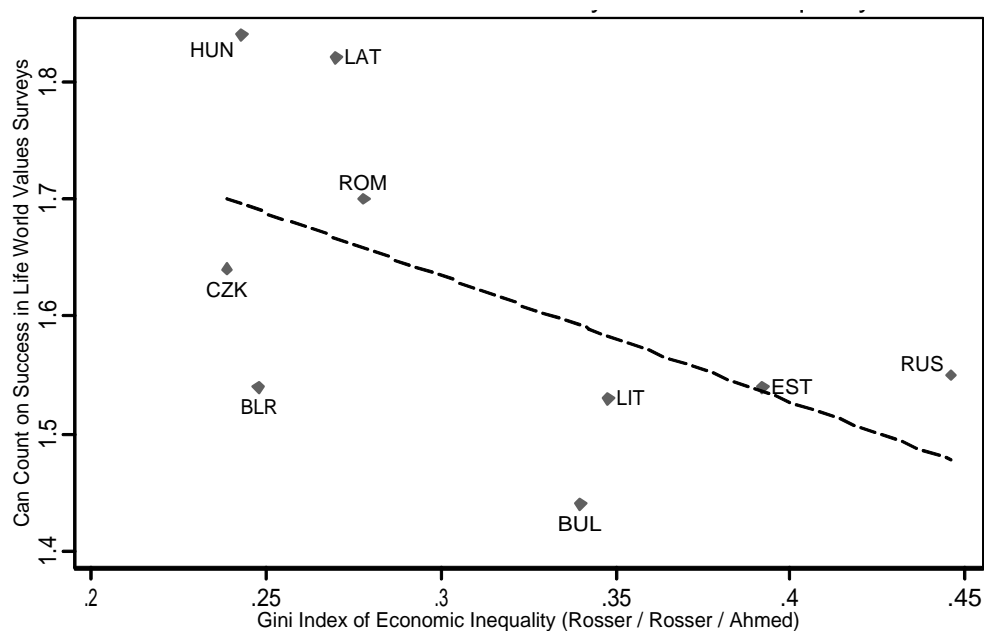
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<sup>4</sup> I focus on Romania for two reasons. The practical reason is simple: a colleague is Romanian and designed this survey to reflect our interests. Second, Romania is considered one of the more troubled

### 3.1 How inequality and corruption matter

I begin with some aggregate results on how inequality matters in transition economies. I express my results simply, through graphs, because of data limitations. For some of my analyses, limited data restricts the number of cases to as few as 12, so clearly any complicated modelling is impossible. These simple results do not represent a comprehensive theoretical argument but rather a suggestive list of the consequences (and some determinants) of inequality in transition countries. My focus here is structured by the available data; I focus on the ties between inequality and optimism for the future, the perception that courts are fair, and the size of the shadow economy.

Figure 1: Can count on success in life by economic inequality



Note:  $r^2 = 0.326$

Where economic equality is lower, a larger share of the public believes that they can count on success in life (see Figure 1). So economic equality will provide some basis of legitimacy for the state. And where I find economic inequality, I also find a greater perception (by the elite) that courts are generally fair. In Figure 2, we present a plot of the share of a country's business elite who believe that the courts are generally *not* fair against economic inequality. Here the relationship is stronger ( $r^2 = 0.452$ ). Countries with more equality have stronger legal institutions that have the legitimacy to punish lawbreakers, since they are perceived as fair. Tyler (1990) argues that people obey the law when they believe that there is procedural justice. Direct experience with the courts has less to do with whether the law is obeyed than the belief of being treated fairly if brought to justice. An equal distribution of wealth goes hand-in-hand with perceptions

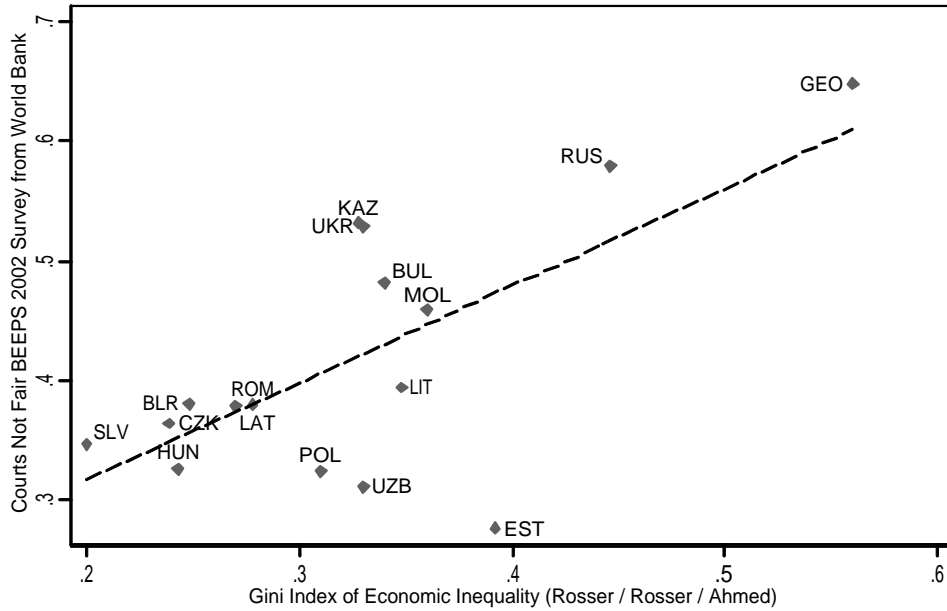
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new democracies. It ranks low on trust and tolerance as well as on corruption. See Badescu et al. (2003); Uslaner and Badescu (2004).



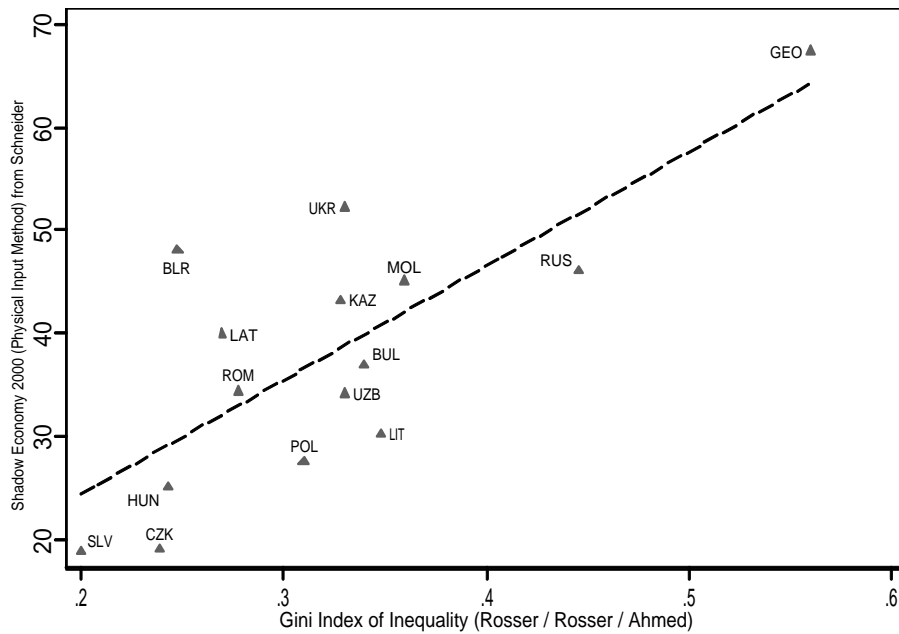
of equal treatment before the law.<sup>5</sup> It is, of course, possible that the direction of the causal link could go the other way: A fair court system could lead to greater economic inequality. However, the causal chain for this argument is less clear.

Figure 2: Fairness of courts by economic inequality



Note:  $r^2 = 0.452$

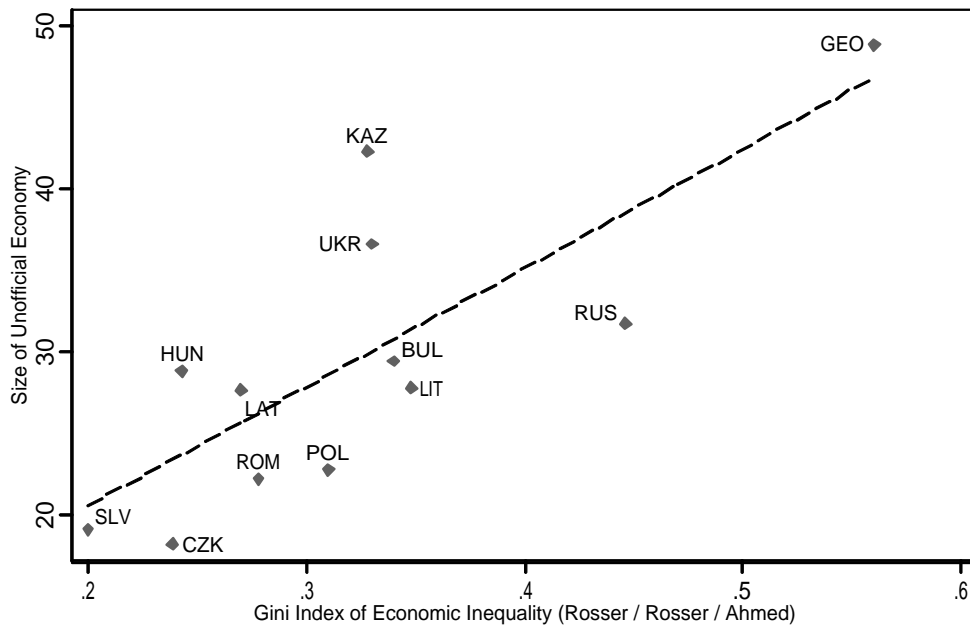
Figure 3: Shadow economy (physical input method) by Gini index of economic inequality



Note:  $r^2 = 0.578$  N=15.

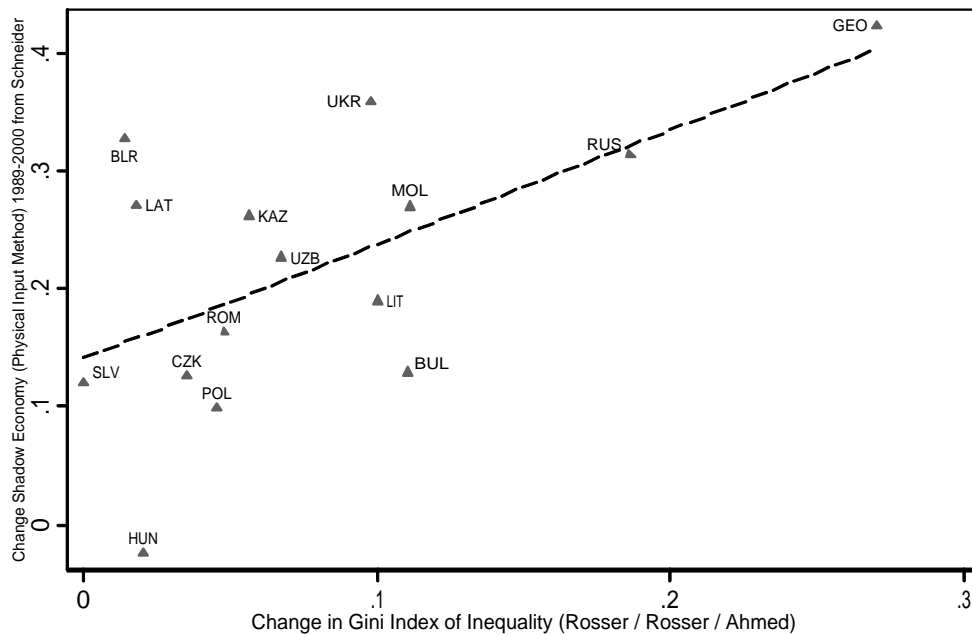
<sup>5</sup> The data on business elite perceptions of justice come from the BEEPS 2002 survey of business executives in transition countries conducted by the World Bank. There are no comparable data for the mass public for more than a handful of societies.

Figure 4: Size of the unofficial economy by economic inequality



Note:  $r^2 = 0.603$ .

Figure 5: Change in shadow economy (physical input method) by change in Gini index of economic inequality

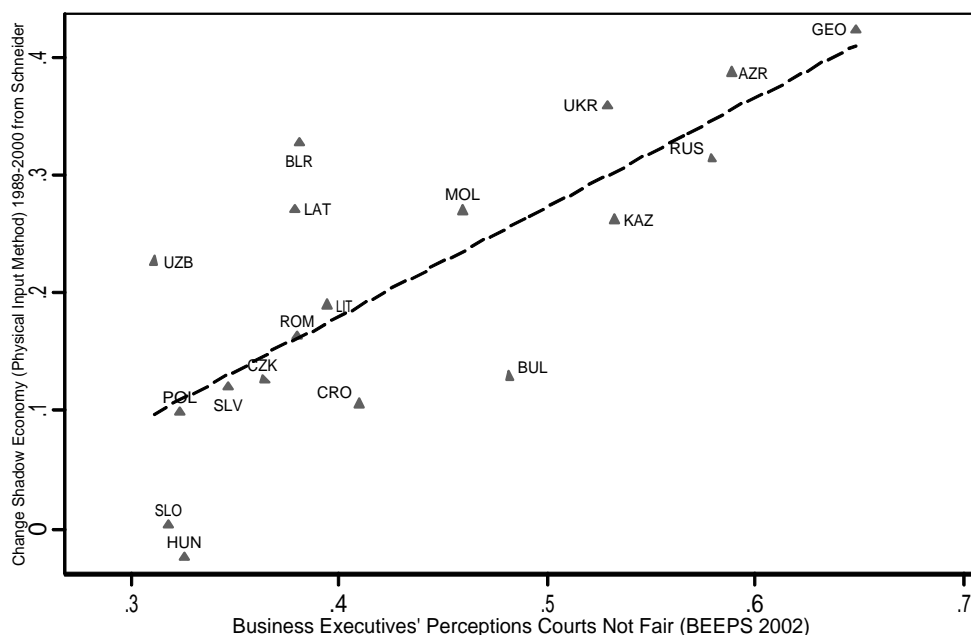


Note:  $r^2 = 0.356$  N=15.

There is even stronger support for the claim that a more equal distribution of wealth in transition countries leads to a lower level of flouting the law. First, I look at two related measures of the size of the unofficial economy. I find a strong relationship between Schneider's (2003) measure of the shadow economy in transition countries for 1999-2000 and the level of economic inequality in the 1990s ( $r^2 = 0.578$ , see Figure 3). For a

slightly different indicator of the ‘unofficial economy’, I find almost as powerful a relationship—partly based upon Schneider’s calculations and reported in Djankov et al. (2001)—( $r^2 = 0.603$ , see Figure 4). Countries with greater disparities between the rich and the poor have larger informal sectors. This likely occurs for at least two reasons. First, the poor will find it difficult to get jobs in the formal economy and will thus be forced to forage for whatever sources of income they can get. Second, much of the unofficial economy comes from tax evasion—in countries with high levels of economic inequality, people may become wealthy (or wealthier) by evading taxation (Feld 2003). The informal economy will thus capture people at both extremes.

Figure 6: Change in shadow economy (physical input method) by business executives’ perceptions of courts not fair

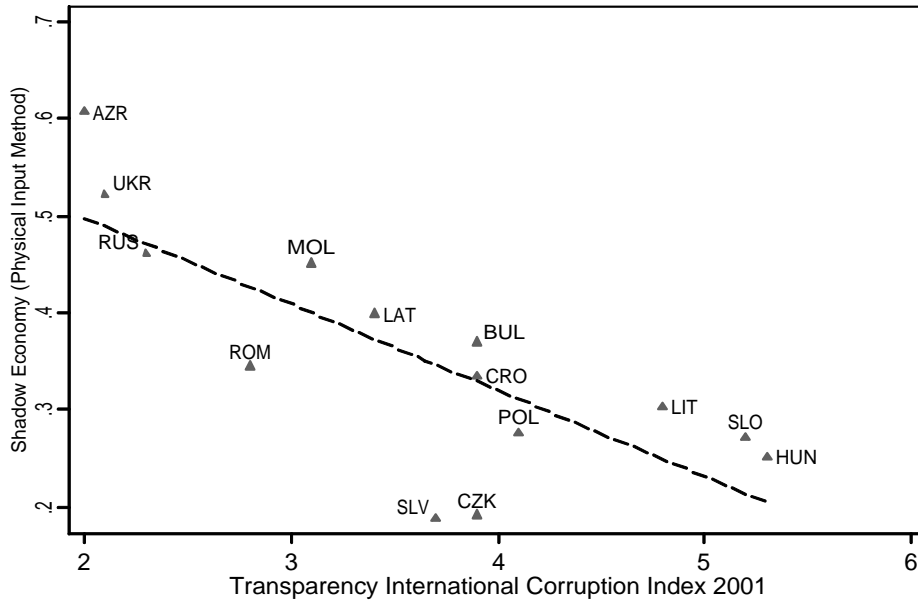


Note:  $r^2=0.580$  N=18 BEEPS data <http://info.worldbank.org/governance/beeps/2002>.

Most critically, changes in the level of economic inequality are strongly related to changes in the shadow economy ( $r^2 = 0.356$ , see Figure 5). As inequality has risen, so has the shadow economy. Perhaps more critical than economic inequality is the perception that political and legal influence was stacked against the ordinary citizen. Changes in the shadow economy are linked more closely to business executives’ perceptions that the courts are not fair (the best surrogate for public attitudes,  $r^2 = 0.580$ , see Figure 6). We saw above that perceptions of courts not being fair are also linked to economic inequality. These views also track increases in economic inequality (data not shown,  $r^2 = 0.500$ , N = 16). Growing inequality clearly threatens both the ability to raise revenue and the perception that justice is tilted toward the rich. It would be nice if we could unpack the dynamics of this pattern, but the sample size is too small.

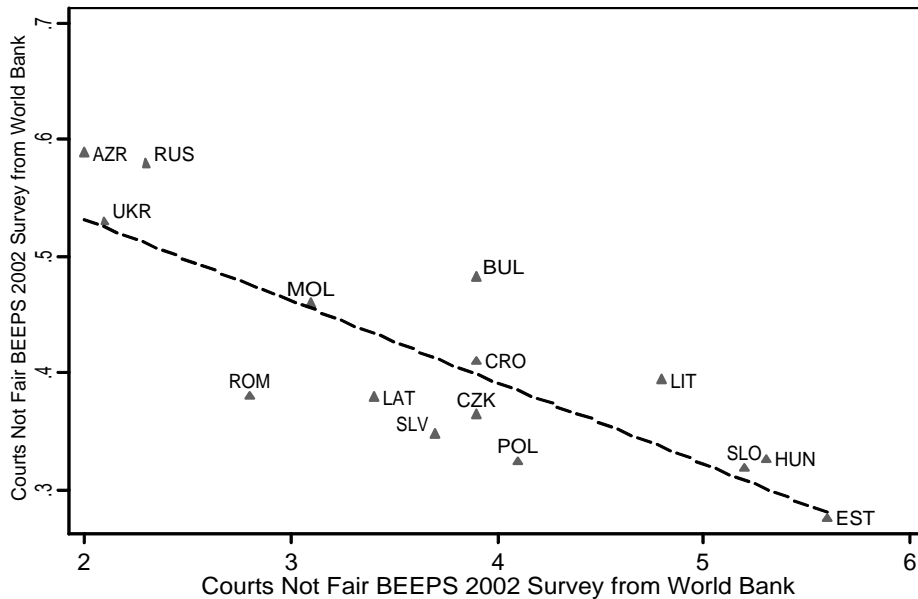
Some of my expectations do not stand up. There is no aggregate connection between inequality and generalized trust ( $r^2 = 0.0006$ ). There is a powerful relationship between generalized trust and economic inequality over time in the USA and across nations without a legacy of communism (Uslaner 2002). I now turn to the survey results and here I find support for the argument that growing inequality threatens social solidarity (generalized trust) as well as for linkages with government performance and limiting the incomes of the rich.

Figure 7: Shadow economy (physical input method) by TI Corruption Index, 2001



Note:  $r^2 = 0.600$  N=14.

Figure 8: Courts not fair BEEPS 2002 survey from World Bank by TI Corruption Index, 2001



Note:  $r^2 = 0.691$  N=15.

The effects of corruption are similar (if less surprising). In societies with large unofficial economies, there is also much corruption. This link might seem trivially true, but the relationship is not as powerful as we might expect ( $r^2 = 0.600$ , see Figure 7). The shadow economy seems to be reflect activity at all levels (especially for lower income people) while corruption points to dishonesty at the top. Corruption flourishes when the courts turn a blind eye to misdeeds, so it is hardly surprising that when corruption is strong, people believe that the courts are not fair ( $r^2 = 0.691$ , see Figure 8).

### **3.2 The economic psychology of transition dynamics**

I use the survey<sup>6</sup> of the Romanian population, carried out in October 2003, to examine a complex set of relationships linking economic inequality and corruption to the success of the democratic transition. I am primarily concerned with the impacts of two of my exogenous concepts, the perceived increase (or decrease) in income inequality in 2003 compared to 1995/96 and measures of corruption on the five endogenous variables in my model. Increasing inequality and corruption are the major threats to political legitimacy, social solidarity, and support for a market economy. I thus posit a causal chain from perceptions of corruption and rising inequality to less optimism for the future (country moving in the wrong direction and a negative evaluation of government performance) to governmental legitimacy (trust in political institutions), social solidarity (trust in people), and less support for a market economy (favouring limitations on incomes of the rich). In each of these models, I presume that what matters most to people is the overall performance of the economy rather than their own personal wellbeing—what political scientists call ‘sociotropic’ as opposed to ‘pocketbook’ evaluations (Kinder and Kiewiet 1979). Personal economic circumstances do have some significant effects. Yet, political legitimacy, social solidarity, and support for the market depend more on overall performance than on personal wellbeing.

Perceptions of greater inequality should lead to greater pessimism for the future and less trust in others. When there is a great deal of inequality, those at the top and those at the bottom do not see the ‘shared fate’ that underlies the solidarity that is generalized trust (Uslaner 2002). The belief that income inequality is increasing is widespread in transition countries (Orkeny 2000: 106; Stephenson and Khakhulina 2000: 85; Vlachova 2000: 63); 91 per cent of Romanians believe that inequality increased from 1995-96 to 2003; 35 per cent believe that it has become much greater.

Corruption undermines both trust in other people and trust in government (Uslaner 2004). I distinguish between high-level corruption among people with power and money (politicians, parliamentarians, ministers, judges, local council members, and

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<sup>6</sup> The survey was carried out by the Center for Urban Sociology (CURS) in October 2003, as part of the Public Opinion Barometer programme, sponsored by the Soros Foundation for an Open Society, Romania.

business people), and low-level corruption among ordinary professionals (journalists, professors, teachers, and doctors). I also differentiate between large-scale corruption (as measured by how corrupt are different groups in the survey) and more petty corruption, as reflected in gift payments that are necessary to get by in life (to doctors, banks, the police, the county, courts, the county, the city). These gift or gratitude payments are common in an economy marked by shortages and arrogant administrators. Many people see these payments as a way to ensure supply and also to establish longer term relations with their doctors and other professionals, or to obtain even routine services from local governments.

Kornai (2000) reports that barely more than a third of Hungarians see a moral problem when doctors demand gratitude payments for medical services. This system of gift giving is so widespread that almost all doctors accept 'gratitude money'; 62 per cent of physicians' total income is off the books. A majority of public officials in the Czech Republic, Slovakia, Bulgaria, and Ukraine in 1997-98 found it acceptable to receive extra payments from clients. Between 11 and 39 per cent of citizens of those countries (in that order) reported offering a 'small present' to officials and between 6 and 24 per cent offered 'money or an expensive present' (Miller et al. 2001: 217, 241).

In the Romanian survey 35 per cent of respondents who had contact with doctors in the past five years admitted making gift payments to them, compared to 22 per cent for the courts (for people with contact) and seven per cent to city or county officials (for contact over the past five years), and nine per cent for the police (again for contact). Even though these figures may be modest, most Romanians believe that professionals and government officials are corrupt. Rothstein (2001: 491-2) presents a rationale for a close connection between strong legal institutions, corruption, and trust in others:

In a civilized society, institutions of law and order have one particularly important task: to detect and punish people who are 'traitors,' that is, those who break contracts, steal, murder, and do other such non-co-operative things and therefore should not be trusted. Thus, if you think that particular institutions do what they are supposed to do in a fair and efficient manner, then you also have reason to believe ... that people will refrain from acting in a treacherous manner and you will therefore believe that 'most people can be trusted.'

I reported elsewhere that low-level corruption had little impact on generalized trust (Uslaner and Badescu 2004; Miller et al. 2001: 7). I extend that argument to trust in government as well. I expect that high-level corruption and to a lesser extent high-level gift payments will lead people to have less trust in each other and in governing institutions. People do not reason that dishonest doctors—or simply doctors who must supplement their income by gift payments—are a sign of a mistrusting society. Gift payments to professionals are not a sign of moral decay; apparently, not even corrupt professionals point to a failure of the social fabric or the state.

Government corruption and especially gift payments to the courts or other government officials should have greater impacts on people's optimism for the future, their evaluation of government performance, trust in both other people and in government, and on demands for redistribution of income. Different measures of corruption may shape different components of my model, but they all follow a common pattern: Petty corruption (gift payments) does not shape trust; it does shape optimism and evaluations of government performance; larger scale corruption has more pervasive effects on both forms of trust, on government performance, and on demands for redistribution of income. Whenever corruption shapes people's evaluation of their state or their society, it is high level corruption. The misdeeds of ordinary professionals do not matter.

The endogenous variables in my model are: the successful performance of government in improving the quality of life; whether Romania is moving in the right or wrong direction; generalized trust; trust in government; and demands that the state limit the incomes of the rich. The success of government in improving the quality of life and the direction of the country are both measures of optimism for the future. Optimism in turn is the strongest determinant of both forms of trust (Uslaner 2002). My best measure in this survey is the direction of the country. Shorter term expectations, especially government performance on the economy or quality of life, play a larger role in shaping people's support of trust in government (Kluegel and Mason 2000b: 201). There is mixed evidence on the link between generalized trust and trust in state institutions; Uslaner (2002) finds little relationship between the two types of trust, while Zmerli et al. (2003) argue that the two types of trust are strongly linked.

State limitations on the incomes of the rich is my best measure in this survey of the *consequences* of growing inequality. Putting a limit on the incomes of the rich taps suspicion of the market and reflects the belief that ordinary people cannot become wealthy. Almost 70 per cent of Romanians favour limits on income. Mateju (1997: 4-5) argues:

the long-lasting presence of an egalitarian socialist ideology and a functioning 'nomenclature system' associated with various social and economic privileges mean that those countries undergoing the post-communist transformation will show a low tolerance for the growth of inequality ... individuals who feel that life-chances for their group or class are declining in relation to those of other groups or classes may tend to consider such changes as the result of social injustice ...

While most Westerners believe that the path to wealth stems from hard work, 80 per cent of Bulgarians, Hungarians, and Russians say that high incomes reflect dishonesty (Kluegel and Mason 2000a: 167; Orkeny 2000: 109). When Russian entrepreneur Mikhail Khorodovsky confessed his sins of relying on 'beznissmeny' (stealing, lying, and sometimes killing) and promised to become scrupulously honest in early 2003, Russians regarded this pledge as 'startling'. When he was arrested and charged with tax

evasion and extortion under orders from President Vladimir Putin ten months later, the average Russian was unfazed. About the same share of people approved of his arrest as disapproved of it (Schmemmann 2003; Tavernise 2003).

Fifty per cent of Romanians in the survey say that people become rich by breaking the law and another 24 per cent say that wealth comes from having connections; an additional six per cent cite luck, and just eight per cent say that hard work brings wealth. In a companion survey in May 2003, 55 per cent proffered an 'ideal' limit averaging US\$854 on wealth. There is a direct link from growing inequality to demanding limitations on income, but it is not strong (Kluegel and Mason 2000a: 184). Growing inequality threatens the social fabric (generalized trust) directly and indirectly (through its effect on government performance on the quality of life) on faith in political institutions. Corruption endangers social solidarity, but has even greater effects on government performance and (both directly and indirectly through performance) on governmental legitimacy (Kluegel and Mason 2000b: 201).

This more complex dynamic suggests that we would miss much of the story of the problems of transition were we to estimate only the simple model from increasing inequality to greater demands for limitations of income on the rich. Transition countries rank low on both trust in institutions and in generalized trust. In the World Values Surveys (using the most recent year for all countries with data), an average of 42 per cent of people in Western countries agree that 'most people can be trusted,' compared to an average of 24 per cent in the former communist nations; 42 per cent of people in transition countries have confidence in their legal systems, compared to 57 per cent in the West. Both forms of trust are low because Romanians do not have faith that the future will be better than the past and because they most emphatically do not credit the government for making their lives better. Just 41 per cent of Romanians believe that their country is heading in the right direction and only 20 per cent believe that the government is doing a good job in improving the quality of life.

Inequality and corruption are the major 'unmoved movers' of all five of our endogenous variables. These models also show strong support for our thesis that optimism for the future leads to greater generalized trust and to stronger support for government. Our framework posits a causal chain among my endogenous variables as follows:

- Performance of government on the quality of life: positive views lead people to believe that the country is moving in the right direction and to have more confidence in government.
- Direction of the country: believing that the country is moving in the right direction leads to greater social solidarity (generalized trust) as well as to trust in government.
- Generalized trust should lead to greater trust in government.



- Greater trust in government should lead to more optimism for the future, more generalized trust, and to opposing demands to limit the income of the rich.

I picture an economic psychology where people who are satisfied with government performance will be optimistic for the country's future; greater optimism leads to more social solidarity and in turn to more support for the government. A stronger government in turn will create more social solidarity and make people sufficiently secure to oppose limits on incomes.

### **3.3 The economic psychology of transition in Romania**

What do the data tell us about the impacts of perceived inequality change and corruption, and about the determinants of positive perceptions of governmental performance in improving the quality of life, the direction of the county (right or wrong), generalized trust, trust in government, and beliefs that the government should limit the incomes of the rich?<sup>7</sup>

I have a lot to summarize, so I shall focus on the results that are critical to my analysis and leave other discussions to footnotes. My models include variables not of direct relevance to my theoretical concerns here since I wanted to ensure that any specification error is minimized. Table 1 presents the model; Figure 9 presents a more parsimonious summary diagram of my findings, eliminating variables not of immediate interest and aggregating variables by larger concepts (all corruption and gift giving variables listed under corruption). I first focus on the two key exogenous variables, perceptions of rising inequality and of corruption. The most important results for my two key exogenous variables are simply stated: Perceptions of rising inequality lead to the perception that government is doing a poor job in improving the quality of life and to lower levels of interpersonal trust (both significant at  $p < 0.0001$  or greater). There is a lesser and barely significant effect ( $p < 0.10$ ) of rising inequality on demands for limiting the income of the rich.

The belief that business people are corrupt ( $p < 0.0001$ ) and whether the respondent has made a gift payment to the city ( $p < 0.05$ ) drive demands for limiting incomes. Perceptions of high-level, especially large-scale, corruption are powerfully related to government performance, generalized trust, and trust in government as well. Government success in controlling corruption is the strongest determinant of how people evaluate the state's performance in improving the quality of life ( $p < 0.0001$ ).

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<sup>7</sup> The measure of trust in government is a factor score from trust in the following institutions: government (generally), president, parliament, justice, the army, police, city hall, and political parties. I use the overall measure because the relationships I investigate do not vary much by specific institution and, indeed, the findings are more crisp for the factor score.

Table 1: Simultaneous equation estimation of inequality and trust models for Romanian Survey 2003

| Variable  | Coefficient | Std. Error | t-Ratio |
|---|-------------|------------|---------|
| <b>Performance of government on quality of life</b>   |             |            |         |
| <i>Inequality change</i>                              | -0.106***   | 0.036      | -2.94   |
| Government success in controlling corruption          | 0.215****   | 0.031      | 6.85    |
| Make gift payments to courts                          | -0.347***   | 0.131      | -2.65   |
| Satisfied with democracy in Romania                   | 0.118***    | 0.030      | 3.91    |
| Satisfied with market economy in Romania              | 0.161****   | 0.031      | 5.25    |
| Wealth (can afford consumer goods)                    | 0.020***    | 0.008      | 2.67    |
| Constant  | 0.297**     | 0.105      | 2.83    |
| <b>Direction of country: right or wrong</b>           |             |            |         |
| <b>Generalized trust</b>                              | 0.294**     | 0.143      | 2.06    |
| <b>Trust in government scale</b>                      | 0.073*      | 0.051      | 1.45    |
| <b>Performance of government on quality of life</b>   | 0.160***    | 0.063      | 2.54    |
| Level of social protection increased or decreased     | 0.061**     | 0.028      | 2.20    |
| State of national economy in three years              | 0.078***    | 0.024      | 3.24    |
| Quality of life next year                             | 0.041**     | 0.024      | 1.71    |
| Number of connections you can rely upon               | 0.042***    | 0.016      | 2.58    |
| Make gift payments to city                            | -0.088      | 0.101      | -0.86   |
| Hungarian ethnicity                                   | -0.114*     | 0.078      | -1.47   |
| Constant  | 0.455       | 0.190      | 2.40    |
| <b>Generalized trust</b>                              |             |            |         |
| <b>Direction of country: right or wrong</b>           | 0.331***    | 0.117      | 2.82    |
| <b>Trust in government scale</b>                      | 0.024       | 0.050      | 0.47    |
| <i>Inequality change</i>                              | -0.089***   | 0.031      | 2.86    |
| Level of social protection increased or decreased     | -0.050      | 0.029      | 1.70    |
| Most politicians are corrupt                          | -0.075***   | 0.030      | -2.47   |
| Most teachers are corrupt                             | -0.032      | 0.026      | -1.26   |
| Constant  | 0.276*      | 10.39      | 1.99    |
| <b>Trust in government scale</b>                      |             |            |         |
| <b>Generalized trust</b>                              | -0.064      | 0.317      | -0.20   |
| <b>Direction of country: right or wrong</b>           | 0.427**     | 0.244      | 1.75    |
| <b>Performance of government on quality of life</b>   | 0.221*      | 0.139      | 1.59    |
| Performance of government on public safety            | 0.252****   | 0.060      | 4.23    |
| Government success in controlling corruption          | 0.101**     | 0.046      | 2.18    |
| Most politicians are corrupt                          | -0.136***   | 0.050      | -2.71   |
| <i>Inequality change</i>                              | -0.105**    | 0.058      | -1.82   |
| Number of contacts to public and private institutions | 0.049**     | 0.022      | 2.25    |
| State should control media and political parties      | -0.049**    | 0.025      | -1.94   |
| Church attendance                                     | 0.035*      | 0.023      | 1.47    |
| Support PSD   | 0.212****   | 0.027      | 7.89    |
| Live in Bucharest                                     | -0.214***   | 0.086      | -2.48   |
| Constant  | -1.308****  | 0.253      | -5.16   |

table continues...

**State limit incomes of rich (agree)**

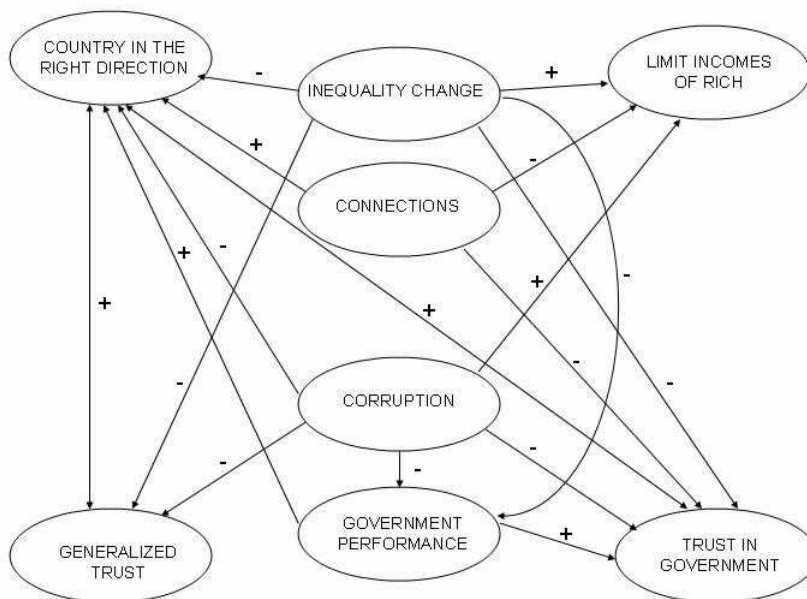
|  |            |       |       |
|--|------------|-------|-------|
| Trust in government scale              | 0.121      | 0.078 | 1.56  |
| Inequality change                      | 0.091*     | 0.069 | 1.34  |
| Satisfied with democracy in Romania    | -0.138***  | 0.052 | -2.63 |
| Most business people are corrupt       | 0.155***   | 0.048 | 3.21  |
| Make gift payments to city             | 0.400**    | 0.234 | 1.71  |
| Rely on connections in court           | -0.282**   | 0.125 | -2.26 |
| Rely on connections in foreign country | -0.246**   | 0.124 | -1.98 |
| Constant                               | -1.878**** | 0.253 | 7.41  |

Note: \*p < 0.10, \*\*p < 0.05, \*\*\*p < 0.01, \*\*\*\*p < 0.0001, N = 610. RMSE (R<sup>2</sup>) by equation: performance 0.560 (0.361); direction 0.426 (0.277); generalized trust 0.452 (0.129); trust in government scale 0.708 (0.471). state limits incomes of rich 1.001 (0.054). Endogenous variables in bold; endogenous dependent variables in bold italics. Inequality change in italics. Exogenous variables: Gender, age, education, make gift payments to doctors, make gift payments to county, Romania needs strong leader, tolerance of gays, government performance on jobs, government performance on agriculture, government performance on privatization, maximum salary that should be allowed, economic situation of country, life satisfaction.

Source: see text.

People who have to make gift payments to courts are less likely to say that the government is performing well (p < 0.01). The belief that most politicians are corrupt makes someone 23 per cent less likely to trust fellow citizens compared to the (rare) expectation that no politicians are corrupt, and 15 per cent less likely compared to the more common belief that only a few politicians are corrupt (p < 0.01). So dishonest behaviour by leaders makes people less trusting; but when I include a measure of whether most *teachers* and are corrupt (low-level corruption), the coefficient is insignificant: I get similar results for doctors, professors, journalists, police officers, or higher level officials (ministers, judges, local councilors, or even business people).

Figure 9: Linkages from Romanian survey models



Corrupt politicians also lead people to distrust government ( $p < 0.01$ ); government success in controlling corruption makes people *more* trusting in the state ( $p < 0.05$ ). There are both direct and indirect (through the performance of government on the quality of life) effects for controlling corruption. But more important than how well the government improves the quality of life seems to be how well the state does in improving public safety, with a regression coefficient two and a half times the size of the endogenous quality of life measure (both measured on the same scale). With the close ties of organized crime and corruption, this measure of government success is also tapping a measure of public venality. The indicators of official dishonesty are the major determinants of trust in government.

Support for limiting incomes of the rich depend almost exclusively on perceptions of corruption and ties that most ordinary citizens would regard as less than upright—having connections in court and abroad. If you believe that most business people are corrupt or have to make gift payments to the city government ( $p < 0.0001$  and  $< 0.05$ ), you are likely to favour limiting the incomes of the rich. Generalized trust is *not* a significant predictor of limiting incomes of the rich (including it yielded an insignificant t-ratio and a loss of many cases from this equation, therefore it was dropped). Trust in government has the wrong sign and a modest t-ratio. This does *not* mean that neither government legitimacy nor social solidarity shape the transition to a market economy. Support for the market, social solidarity, and trust in government all depend upon the fairness of economic and political institutions (corruption and economic inequality).

If a person is well connected, using connections in dealings with the courts or having connections in a foreign country, that person will oppose limiting incomes. Relying on connections to get by in daily life—to stand in line for food, to help run errands, or to use a friend or relative to cut through the bureaucracy—was common practice under communism (Flap and Voelker 2003; Ledeneva 1998). These networks continued after the fall of communism. The only other significant predictor of support for limiting incomes is satisfaction with democracy in Romania: The happier you are, the less likely you will be to demand restrictions on income.<sup>8</sup> The effects of rising income inequality and corruption on satisfaction, trust, and demands for redistribution are large. It is corruption at the top that matters, not from below, and even at the top it seems concentrated in politicians, business people, local officials, and courts—precisely the officials most commonly cited when people discuss dishonesty in the transition countries. Lower level professionals are not held blameworthy.

I turn now to a summary of the models for my endogenous variables. When people are satisfied with governmental performance, they are more likely to believe that the country is headed in the right direction ( $p < 0.0001$ ). Government performance on the

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<sup>8</sup> Trust in government has the incorrect sign and, hence, is not significant even at  $p < 0.10$ .

quality of life and especially government performance on public safety lead to greater legitimacy for government ( $p < 0.10$  and  $p < 0.0001$ , respectively). So does the belief that the country is heading in the right direction ( $p < 0.05$ ). The direction of the country is the most powerful predictor of generalized trust: Someone believing that Romania is on the right track is 33 per cent more to trust fellow citizens than a person who holds the country to be heading in the wrong direction. There are *no* links between generalized trust and trust in government. Performance measures (including the success of government in controlling corruption) as well as contacts with public (and private) institutions ( $p < 0.05$ ) and especially supporters of the PSD, the governing party ( $p < 0.0001$ ), shape trust in government but *not* faith in other people.<sup>9</sup>

The two measures of optimism also have different roots. The performance of government on the quality of life reflects high level corruption and satisfaction with institutional performance (democracy and the market economy, both at  $p < 0.01$ ). People with greater wealth also give higher marks to government performance. The direction of the country does depend to some extent on institutional performance. Government skill in improving the quality of life does shape the direction of the country ( $p < 0.01$ ); there is a weak link ( $p < 0.10$ ) with trust in government. There is *no* effect for any corruption measure. Making gift payments to the city is insignificant (many other forms of gift payments and corruption were tested for). The longer term fate of the economy (three years out) is the most powerful predictor of whether the country is moving in the right direction ( $p < 0.01$ ); there is a significant, but weaker effect, for the quality of life people expect next year ( $p < 0.05$ ). People who believe that the level of social protection has increased are also more upbeat about the direction of the country ( $p < 0.05$ ).<sup>10</sup>

The individual-level analysis also receives support from an analysis of 17 aggregated surveys conducted by the same firm from October 1996 through to October 2003.<sup>11</sup> Table 2 presents a two-stage least squares analysis of whether the country is moving in the right direction and trust in government. The aggregate models show that: (1) expectations for an improved life next year strongly shaped people's views that the country was headed in the right direction; and (2) so did perceptions that the government was handling corruption well. No impact for corruption was found in the individual-

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<sup>9</sup> Where one lives also plays a role. Living in Bucharest makes one less trusting of government ( $p < 0.0001$ ); people who attend church regularly also develop a deeper faith in governmental institutions, but the effect is weak ( $p < 0.10$ ). Support for a more authoritarian state (giving government the power to control media and political parties) leads to less support for government.

<sup>10</sup> Hungarians, a minority that has faced discrimination, are also less optimistic, but the relationship is weak ( $p < 0.10$ ).

<sup>11</sup> The surveys were conducted once in 1996, three times each in 1996 and 1997, and twice annually thereafter, generally in March and October (the third surveys were conducted in June). The generalized trust question was asked in only ten surveys and government performance was asked in just 15. Government performance was not significant as a predictor of trust in government when direction of the country was endogenous, and it added little as an exogenous variable.

level modelling. However, only a handful of variables are available over time and the impact of corruption may be a surrogate for the trust measures or even the social safety net question. My model also shows that (3) the endogenous measure of the direction of the country strongly shapes trust in government. So does (4) the electoral cycle, a variable measuring the number of months until the next parliamentary elections. In transition countries, as in the West, governments lose popularity as their time in office increases; Downs (1957: 55-60) called this the ‘coalition of minorities’ effect. And I see clear evidence of this here with confirmatory evidence over time that expectations for the economy as well as perceptions of corruption shape evaluations of the country’s overall democratic performance, and that strong government performance leads to greater legitimacy for political institutions. This analysis is based upon a small number of cases so it should be taken with caution, but the results are consistent with the thesis I have advanced.

Table 2: Simultaneous equation model of trust in government and country moving in the right direction from aggregated surveys

| Variable  | Coefficient | Std. Error | t-Ratio |
|---|-------------|------------|---------|
| <b><i>Direction of country right or wrong</i></b> |             |            |         |
| Government success in controlling corruption      | 0.346**     | 0.172      | 2.01    |
| Quality of life improving next year               | 0.836***    | 0.316      | 2.65    |
| Constant  | 1.655       | 9.289      | 0.18    |
| RMSE = 8.294 R <sup>2</sup> = 0.683 N = 17        |             |            |         |
| <b><i>Trust in government scale</i></b>           |             |            |         |
| <b>Direction of country right or wrong</b>        | 0.567****   | 0.150      | 3.78    |
| Electoral cycle                                   | 0.351***    | 0.137      | 2.56    |
| Constant  | 2.547       | 3.924      | 0.65    |
| RMSE = 5.296 R <sup>2</sup> = 0.832 N= 17         |             |            |         |

Note and source: \*p < 0.10, \*\*p < 0.05, \*\*\*p < 0.01, \*\*\*\*p < 0.0001. Endogenous variables in bold; endogenous dependent variables in bold italics. Exogenous variables: trust in justice, growth rate in gross domestic product for the year. Sourced from Penn World Tables from 1996-2000, and from [www.dfat.gov.au/geo/fs/roum.pdf](http://www.dfat.gov.au/geo/fs/roum.pdf) for 2001-2003.

#### 4 The demands of a successful transition

A successful transition depends upon strong institutions and a supportive civic culture (Almond and Verba 1963). A growing economy can lead people to become more supportive of their political institutions and more tolerant of each other. When the economy is expanding, people will be less likely to see the world in zero-sum terms. Sztompka (1999: 179-90) saw hope for civil society in Poland in the late 1990s as the economy revived, crime fell, and young people became the vanguard of a new social order. But wealth can go only so far in restoring trust. Poland ranks 69th of 82 countries on trust and the wealthiest transition country, Slovenia, ranks 72nd.

The results so far suggests that inequality and corruption are the key factors leading to lower social solidarity and governmental legitimacy in transition countries. Corrupt elites and the failure of government to curb them lead to demands for limiting the incomes of the rich and for controlling markets more generally. Support for limiting incomes seems to reflect a critical view of government and business elites rather than social solidarity more generally. There is no significant effect of generalized trust, of increasing inequality, of the direction of the economy, or even the level of social protection on demands for restraining income. There is an insignificant (and wrongly signed) effect from trust in government, but satisfaction with democratic institutions and several measures of corruption are the major factors in shaping calls for limiting incomes.

Despite minimal correlations between the two, the data do show a more indirect connection. Public concern for corruption seems more than just a demand for honest government. If people *only* objected to official dishonesty, then we would expect that all levels of corruption should affect governmental performance, trust in both people and the state, and demands to limit incomes. However, this is not what I find. Public distress focuses on high-level corruption—in the state, the courts, and in business—but not lower level demands for bribes (the police, doctors, and teachers, among others). People link corruption to larger social and political problems when they see powerful and rich people exploiting average citizens, not when they see minor officials padding their meager salaries.

## 5 The inequality trap

Perceptions of growing inequality, corruption and a lack of confidence in government and fellow citizens lead to an inequality trap. When people believe that they have no fair chance to get a better life—and that the only way to prosper is by being corrupt—it will be difficult to escape an inequality trap. Corruption, mistrust, and inequality are all sticky. They do not change easily because each breeds the other. The  $r^2$  between generalized trust from the 1980 and 1990-95 World Values Surveys is 0.81 for the 22 nations included in both waves. Inequality similarly moves little over time. The  $r^2$  for the most commonly used measures of economic inequality (Deininger and Squire 1996) between 1980 and 1990 is not quite as strong as the connection with trust over time, but it is still substantial at 0.676 for a sample of 42 countries. A new inequality database developed by James Galbraith extends measures of inequality further back in time and across more countries.<sup>12</sup> The  $r^2$  between economic inequality in 1963 and economic inequality in 1996 is 0.706 (for 37 countries). The  $r^2$  between the Transparency International Corruption Perceptions Index for 2003 and the ICRG measure for 1980-85 (even though they are not directly comparable) is 0.785 for 49 countries.

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<sup>12</sup> The Galbraith data can be obtained at <http://utip.gov.utexas.edu/web/>.

There is a causal spiral from inequality to corruption (and back again) and from both inequality and corruption to lower levels of trust (Uslaner 2004) and from low levels of out-group trust and high levels of in-group (or particularized) trust to corruption (Gambetta 1993). Perhaps most critical in this vicious circle is the link between inequality and trust. High levels of inequality lead to low out-group trust and high in-group trust and countries with high levels of trust enact policies that help reduce inequality; they spend more on the poor and more on programmes such as education that help equalize opportunities. The path to a successful transition must find a way to break this vicious cycle. Accomplishing this will not be easy. There are few institutional ‘quick fixes’ to corruption and tackling the issue of economic inequality is difficult politically, especially when there are great social strains in a society (Uslaner 2005). Unless the political and social will is found, the road to a successful transition will continue to be rocky.

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