

## **The Bright and Dark Sides of Trust : Corruption and Entrepreneurship <sup>1</sup>**

### **-A Cross-Cultural Comparison of Emerging vs. Mature Market Economies-**

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#### **Abstract**

In corruption research, it is often argued that in “high-trust” societies, i.e. societies with a high level of trust in anonymous others and institutions, there exist lower corruption rates than in “low-trust” societies. As demonstrated in this study, this holds true only for a generalized trust, i.e. trust which is neither situation nor person specific; the higher the (generalized) trust in anonymous others and institutions, the lower the corruption. On the other hand, this paper also sets out to explore another form of trust, particularized trust, i.e. trust which is person and situation specific, acknowledging that the higher the particularized trust the higher the corruption.

In a cross-cultural comparison of emerging vs. mature market economies, trust in friends and kins, defined as a particularized and a “dark side of trust”, shows the strongest positive impact on corruption. It thus increases the likelihood of self-employed people of becoming involved in corrupt business practices. Also (particularized) trust of an entrepreneur towards a public servant to deliver “services as agreed” seems to foster corruption. Insofar, in environments with a low level of generalized trust, the self-employed develop a high particularized trust (in friends, kins, and public servants) through engaging in (business) networks and which apparently becomes a breeding ground for corruption.

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## 1. Introduction

Up to now, the major part of corruption research in the field of Economics has been done from the viewpoint of a bribe-taker (a national officer). However, for the appropriate analysis of the roots of this phenomenon, one also needs to scrutinize it from the horizon of the bribe-payer at the micro level. Only an investigation of both sides involved in corrupt transactions as well as their motives and laws of behavior will contribute to a better understanding of this phenomenon and thus enable us to combat it efficiently (Bardhan 2003). Considering this, in this paper, I attempt to give insights into the determinants of (perception of) corruption from the viewpoint of *entrepreneurs as potential bribe payers*.

An analysis of (the perception of) corruption from the perspective of self-employed is also crucial for understanding the *causes and consequences of corruption in economic life*. Numerous empirical studies point out that survival, success and growth of enterprises in the post-Soviet block depend on how well they adapt to the corrupt institutional environment (Kaufman et al. 1999). Investments in corrupt, illegal rent-seeking activities and social networks are therefore a crucial component of a successful business strategy in the CIS-countries. At the same time, it is argued that a high level of administrative corruption and excessive bureaucratic burdens hinder start-ups (De Soto 1987).

Being among the highest in the world, corruption rates in the post-Soviet republics continue to rise (Bjornskov and Paldam 2002). Although there is an increase of corruption in advanced western economies too, there still exists a tremendous gap in corruption levels between East and West (Treisman 2000). Many researchers have tried to explain these international discrepancies in corruption rates as being mainly due to the different formal institutional environment. *Informal institutional aspects*, such as culture-bounded attitudes, norms, traditions and habits have been mostly neglected.

Against this background, the primary aim of this paper is a theoretical and empirical contribution to the *relationship between entrepreneurship, corruption and trust* as an informal institution in different national and cultural contexts. It tries to assess the sig-

nificance of trust for the perception of corruption of self-employed in the western, central eastern Europe and post-Soviet countries. Furthermore, it also examines the influence of “civic society” on the perceived level of corruption from the point of view of self-employed.

## 2. Research Issues

### Two Sides of Trust: Generalized vs. Particularized

In corruption research, the category “trust” has been mostly examined from its one side: It has been a “high level of generalized trust” in people and institutions. This form of trust has been postulated as a robust, negative factor on corruption.<sup>3</sup> In this paper, I regard trust as a multi-dimensional theoretical construct (Coleman 1990) which can have both positive and negative implications for corruption. According to Parsons’s theory of Social System (Parsons 1977), I strictly differentiate between two major forms of trust as a cultural value, namely, between *generalized trust* and *particularized trust*. The generalized, universalistic aspect of values by Parsons implies that they are neither situation-specific, nor function-specific but have a collectivistic character while a particularized aspect entails specification to aim, context and time of action.<sup>4</sup> Therefore, I classify the concept “trust” into two major groups:

#### Generalized Trust:

- Generalized trust in people
- Trust in the legal framework (judiciary, police)
- Trust in the state institutions (government, parliament, political parties, civil service)
- Trust in the civil society (Green and Women’s movement, mass media)
- Trust between anonymous economic actors

#### Particularized Trust

- Trust in family, friends and kins
- Trust (of an entrepreneur) towards a national bureaucrat to be an “honest bribee”

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<sup>3</sup> I will return to this issue in subsection 3.1.1.

<sup>4</sup> See similarities to the concept of attitudes by Ajzen and Fishbein 1980.

Moreover, I argue that these various forms of trust have different, i.e., either positive or negative implications on (the perception of) corruption. In sum, I expect that a high level of generalized trust (in the legal system, in the state, in the civic society as well as between economic actors) will lead to a lower level of perceived corruption. And, on the other side, a high level of particularized trust (trust in kinship and networks, trust of an entrepreneur towards a national bureaucrat to be an “honest bribe-taker”) might become a breeding ground for a high level of corruption, especially, when there prevails a lack of generalized trust in institutions and anonymous others.

### **3. Theoretical Background and Hypotheses**

#### **3.1. Generalized Trust**

##### **3.1.1. Generalized Trust in People**

It is argued that "high trust societies" are usually less corrupt (see Rothstein 2000 for the case of Sweden). If people have confidence in others, they are more likely to endorse strong standards of moral and legal behavior (Uslaner 1999). People who perceive the legal system as fair and impartial are more likely to trust their own fellow citizens (Rothstein and Stolle 2002). Paldam et al. (2002) regard a lack of generalized trust in persons (as a form of social capital) in the post-Soviet republics as a robust explanatory factor for the high level of corruption. And, vice-versa, low corruption rates particularly in the Scandinavian countries are mainly due to the high level of generalized trust (Bjronskov and Paldam 2002).

**H1:** With a high level of generalized trust of self-employed in anonymous others, a lower level of (perceived) corruption should be expected.

##### **3.1.2. Trust in the Legal Framework**

Whether an entrepreneur gets involved in corrupt activities or whether he perceives the level of corruption as high or low is a matter of his subjective *perception of the legal framework*. I distinguish two aspects relating the legal framework and its implication for corruption. The first argument concerns the protection of the property rights and con-

tract enforcement. From an entrepreneurial point of view, a weak legal environment, e.g., in transition economies cannot provide firms with effective methods of business dispute resolution and protection of the property rights (Ryterman 1998). Entrepreneurs in most CIS-countries do not actually believe that resolving such disputes through their country's court system will be impartial and unbiased. In this regard, I assume that distrusting the legal institutions causes the building of social capital embedded in the firm's participation in the range of informal "closed networks" (kinship, friends) aiming at reducing the environmental uncertainty in which the probability of becoming corrupt rises.

On the other side, according to Gary S. Becker (1968), performance of a criminal act depends on the expected value of negative outcomes (costs) as well as on the probability of being caught, prosecuted and sentenced. By planning a corrupt transaction, an entrepreneur takes into consideration the anticipated costs of sanctioning. And if an entrepreneur expects the legal restrictions (the costs of punishment and the likelihood of being punished) to be imposed on him from the court to be very low, he will be more likely to engage in corrupt transactions.

**H2:** High generalized trust of self-employed in the judiciary and the police to be unbiased and impartial should lead to a lower probability of becoming engaged in illegal rent-seeking activities. On the contrary, distrusting the legal framework might lead, first, to the building of "closed networks" susceptible to illegal transactions. Second, it might raise the odds that a corrupt deal will not be punished.

### **3.1.3. Trust in the State Institutions**

Also the influence of the *state institutions* on the perception of corruption of an entrepreneur has yet to be ascertained. The *Executive* is expected to carry out its declared political program, provide principled, high standards of ethical conduct and exercise oversight over the civil service. The Executive must ensure that "it provides clear leadership" and maintains "clean government"; its own actions are lawful, transparent and fully accountable" (TI 2000:59). Moreover, it is essential for the Executive to respect the independence of the Judiciary and to comply with their judgements. In many countries where democratic integrity does not function satisfactorily, "much of the blame lies with

the Executive in its refusal to accept the concept of judicial and prosecutorial independence” (TI 2000:60).

The quality of the *civil service* can be characterized through its ability to allow the state accomplish its objectives as efficiently as possible. Tanzi (2000) argues that the public sector should enable the state to perform its tasks with the minimum degree of distortion of the market, with the lowest burden of taxation on taxpayers, the smallest number of public employees, the lowest absorption of economic resources, and the maximum degree of accountability and transparency in the relevant processes and outcomes. It should implement policies, enforce rules and provide policy advice in a cost effective and accountable manner. Following Clague (1993) and Rose (1993) (quoted in Raiser 1999), “trust in the behavior of government officials may be important in determining citizens’ obedience to rules and hence the effectiveness of third-party enforcement” (Raiser 1999:6).

Hence, I suppose that an assessment of behavior of the state institutions to be dishonest and corrupt from the perspective of economic actors will have strong implications for both, the perceived level of corruption and the probability of becoming involved in a corrupt transaction. The weakness and dis-functionality of the state creates economic incentives for entrepreneurs to become corrupt. If the governmental institutions and the public service do not ensure a proper business environment but rather hinder them, they “force” the entrepreneurs to engage in corrupt transactions. In doing so, the entrepreneurs will try to reduce the transactions and opportunity costs<sup>5</sup> caused from the bad quality of such institutions. And, vice-versa, high generalized trust of self-employed in the “good governance” should actually “keep them away” from becoming involved in corrupt deals.

**H3:** High trust in the fairness and efficiency of government and public sector should have negative implications on (perception of) corruption and should diminish the probability of becoming engaged in illegal deals.

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<sup>5</sup> For instance, the sunk information and transaction costs due to the accelerated operations in the bureaucratic authorities can be considered as expected utilities from a “petty”, administrative corruption.

### 3.1.4. Trust in the Civil Society (Freedom of Associations, Strong Press)

In this paper, *civil society* is referred to organizations and networks which do not belong to the formal state apparatus. These can be non-governmental-organizations, professional or environmental associations, labor or women's unions, chambers of commerce, religions, students groups, cultural societies, sports, recreation clubs and informal community groups. As such, civil society gains its legitimacy from *supporting social interest*<sup>6</sup>, not personal profit.<sup>7</sup> "It is characterised by a strong element of *voluntary participation*: thus, people participate because they believe in what they are doing.." (Transparency International 2000: 132).

Putnam suggests, that the voluntary organizations of civic society are crucial for making democracies work (Putnam 2000). Civic society is regarded as an inevitable part of a participatory democracy. It would play a vital role "in the production of social capital by bridging divisive social cleavages, integrating people from diverse backgrounds and values, promoting "habits of the heart" such as tolerance, co-operation and reciprocity, thereby contributing towards a dense, rich and vibrant social infrastructure" (Norris 2001:2). Civic society would promote interpersonal trust between people involved in such formal networks, fostering the capacity to work together in the future and creating the bonds of social life. Consequently, it would strengthen connections between citizens and the state. Besides, because of its proximity and familiarity to the local, state issues, it is believed to be able to monitor, detect and reverse activities of national officials in their midst and, thus, be able to tame corruption (Transparency International 2000:133).

From these arguments, I derive the following hypothesis:

**H4:** Corruption will be lower in countries with a participatory democracy, with a vigorous free press, and thus with a high level of trust in the principles of a strong civic society.

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<sup>6</sup> For instance, to promote the human rights, the environmental, educational aspects, or to struggle the corruption.

<sup>7</sup> Of course, it is possible that such associations try to maximize their own profits. For example, business communities have paid bribes to public officials to gain business (Transparency International 2000:134). However, these possible aspects are behind the scope of this paper.

### 3.1.5. Trust between Economic Actors

Trust is an important category embedded in the institutional infrastructure of market economies.

In the face of uncertainty and information asymmetry, *reciprocal trust between economic actors* turns into a crucial mechanism constraining opportunistic behavior and thus allowing efficient and smooth transactions (Raiser 1999).

The other way around, distrusting economic actors in their business ethics to be fair and ethical, may lead the entrepreneurs to a higher likelihood of becoming engaged in corruption. In other words, the perception of entrepreneurs of “codes of conduct” of their own competitors to be corrupt to “get things done” (e.g. to receive governmental projects or tax cuts) would increase the probability of becoming involved in corrupt deals: For, “*If they can do it (behave illegally), so can I*” (Baraulja and Müller 2001).

**H5:** Distrusting business partners and competitors in their business ethics to be fair and moral increases corruption.

## 3.2. Particularized Trust

### 3.2.1. Trust in Kins and Bonding Networks

However, as Putnam (2000) confirms, the functions of social networks can be quite different, not only in a positive but also in a negative sense. Networks can also bind certain groups together in ways that are undesirable for society as a whole, e.g. by reinforcing the practices of nepotism or ethnic hatred. He acknowledges this in differentiating between “*bridging*” networks that are porous and socially inclusive, promoting interactions between heterogeneous social groups with different backgrounds, and “*bonding*” networks which tend to exclude outsiders. Indeed, the idea about such types of “closed networks” can also be met in Coleman’s theory of social capital (Coleman 1990). After all, the blood-brotherhood in the ex-Yugoslavia, or Mafia structures in the south of Italy or in Russia exemplify such close-knit, mutually dependent communities.

Since such “bonding networks” like kinship and “strong ties” represent the opportunity to reduce the transaction costs, namely costs associated with searching and finding of business counterparts, defining contract conditions and enforcing the agreement, they create an atmosphere of mutual trust and co-operation between business partners embedded in these social structures. Transactions between members of a kinship group or friendship are based on what Martin Raiser calls “ascribed trust” attributed to family, ethnic or other specific characteristics (Raiser 1999:4).

Raiser (1999:4) also points out another form of trust, namely, “process-based” trust which would be typical for repeated relationships between individuals, e.g. between business partners, “who have known each other for a long time, without sharing the loyalty to a specific group”. In this context, Lambsdorff (2002 a) also provides us with some examples of how (particularized) trust can develop, emphasizing repetition of transactions and reputation of individuals as important determinants of becoming engaged in corruption. Furthermore, he also mentions that kinship and networks may facilitate corrupt deals. In saying so, he first refers to Schramm and Taube (2002) which described the “Chinese guanxi networks” as embedding individuals in social structures which provide safeguards against opportunism and simultaneously facilitate corrupt transactions (Lambsdorff 2002 b). The second example by Lambsdorff draws on “secret societies and criminal organizations” by Anderson (Anderson 1995:42-47) characterized as “guarantors” of corrupt transactions (Lambsdorff 2002 b).

**H6:** Acknowledging this, I hypothesize that the inclination to behave illegally increases the closer the surrounding network. Networks become closer when trust is shared only with the people belonging to the same social structure (kinship, ethnic group, business associations) but not with the anonymous others.

### **3.2.2. Reciprocal Trust between an Entrepreneur and a National Officer**

Moreover, I consider a “*reciprocal trust*” between an entrepreneur and a national officer to be a crucial determinant of the likelihood of becoming engaged in corruption. Corrupt behavior of an entrepreneur is affected by his/her expectations about the trustworthiness of the national officer to be an “honest bribee”. This trustworthiness can be based on mutual calculations of the interests of the counterpart involved in corruption (Cole-

man 1990, Gambetta 1988 and Hardin 2001). Expected benefits from a corrupt transaction for the client (entrepreneur) and the agent (national bureaucrat), as well as the anticipated costs of legal punishment (Becker 1968) create a need for mutual protection and trust for both an entrepreneur and a national bureaucrat. Moreover, if this interest-based trust (Rose-Ackerman 2001, Graeff 2002) between an entrepreneur and a national bureaucrat has paid off over time, then such activities will be continued with a high likelihood in the future. And so, corruption takes place due to trust based, firstly, on the consideration of mutual interests (each actor is not interested in revealing the counterpart) and, secondly, on the actors' knowledge of each other (Zucker 1986, Sheppard and Tuchinsky 1996). The better the knowledge and the higher the interdependence between the counterparts, the more reliable the evaluations from a planned corrupt transaction. Therefore, a crucial point for an entrepreneur of becoming engaged in corrupt arrangements in the future is his successful experience made in the past.<sup>8</sup>

**H7:** Considering this, I suppose that a high expectation of a self-employed person to meet corrupt officers in national institutions (e.g. governmental or financial) would lead to a higher level of corruption.

### 3.3. Financial Situation

In the macroeconomic studies of corruption, economic development of a given country is regarded to be a robust explanatory factor having a negative impact on corruption. According to Daniel Treisman, "economic development increases the spread of education, literacy, and depersonalized relationships – each of which should raise the odds that an abuse will be noticed and challenged" (Treisman 2000:404).

**H8:** For this reason, I draw a hypothesis that corruption will be lower, the stronger financial situation of the self-employed. Financially stronger self-employed would be more able to notice and challenge misuse of the public officials.

## 4. Data and Methods

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<sup>8</sup> See "shadow of the past" by Snijders 1996, and also about impact of "the past behavior" on the future actions explained theoretically by Bentler and Speckart 1976.

The data used to support inquiries documented in this paper were drawn from the third wave of the World Value Survey (1995-1996) and from the World Business Environment Survey (2000). *The World Value Survey* is an investigation of basic socio-cultural, political values and beliefs of people throughout the world. It has been conducted in more than 65 societies, containing almost 80 per cent of the world population. *The World Business Environment Survey* includes 10,000 enterprises in 80 states and examines the impact of the state institutions on the economic performance of the firms.

#### 4.1. World Value Survey

To analyze the first source of data, the World Value Survey (WVS) 1995-1996, I chose 20 emerging and mature market economies and classified them into 8 regional groups. The following regional groups have been selected: Western European (Britain, West Germany, Spain, Switzerland), Scandinavian (Norway, Sweden and Finland), Central East-European (Poland, Slovenia, Bulgaria), Baltic (Lithuania, Latvia and Estonia), Trans-Caucasian countries (Armenia, Azerbaijan and Georgia) as well as other post-Soviet republics (Russia, Ukraine, Belarus and Moldova). The Scandinavian countries served as a reference category in the analysis.

**Table 1: Classification of country groups**

Countries	Regions/Country Groups (Number of Observations)
Britain, West Germany, Spain, Switzerland	Western European Countries (N=4533)
Norway, Sweden, Finland	Scandinavian Countries (N=3123)
Poland, Slovenia, Bulgaria	Central East-European Countries (N=3232)
Lithuania, Latvia, Estonia	Baltic Countries (N=3230)
Tambov (Russia), Russia, Belarus, Ukraine, Moldova	Other Post-Soviet Republics (N=8427)
Armenia, Georgia, Azerbaijan	Trans-Caucasian Republics (N=6595)
USA	USA (N=1542)
East Germany	East Germany (N=1009)
Total	(N= 31 691)

Source: World Value Survey 1998; Classification by ifm Mannheim

In the World Value Survey, "employers/managers of establishment with 10 or more employees", "employers/managers of establishment with less than 10 employees" and "farmers running own business" have been analyzed as "self-employed".

With respect to the theoretical framework, I have examined the impact of various forms of trust, both generalized and particularized, as well as the implications of civic society on the (perception of) corruption in different parts of the world. The dependent variable is an ordinal, 4-scaled, and measures the perception of prevalence of "bribe-taking and corruption" in a given country (see table 2).

**Table 2: Dependent Variable: Perception of Corruption**

Dependent Variable	Measurement Scale
How widespread do you think bribe taking and corruption is in this country?	Almost no public officials are engaged in it (Low level) A few public officials are engaged in it Most public officials are engaged in it Almost all public officials are engaged in it (High level)

### Constructing Indices

Most indices have been built by employing "*principal component analysis*" (*factor analysis*) as a multivariate technique for reducing matrices of data to their lowest dimensionality by use of orthogonal factor space (Schnell et al.1999). For this purpose, I firstly identified the number of significant factors (principal components) and tested them with regard to their one-dimensionality. Table 3 displays information about the technique with which the indices have been constructed, as well as the description of variables used to build them.<sup>9</sup> Finally, I conducted an analysis of reliability and demonstrated the accuracy of measurement of each index with Cronbach's alpha.<sup>10</sup>

Three groups of indices and variables used in the empirical analysis have been summarized in table 3. The first group embraces variables and indices measuring the impact of trust on the (perception of) corruption. Overall, these have been generalized trust in people, trust in the legal system, trust in the state institutions, trust in the civil service, trust in Green movement and Women's movement, trust in the major companies, and trust in the mass media. The variable depicting the behavior of entrepreneurs

<sup>9</sup> For example, the index for the "*trust in the state institutions*" has been created by means of three variables depicting the level of generalized trust of the self-employed in government, political parties and parliament. According to results from the principal component analysis, the eigenvalue of the first component of this index is 2,135, its explained sum of square is 71,17%.

<sup>10</sup> For instance, the Cronbach's alpha for index measuring "trust in state institutions" is 0,7963%.

supposed to live up to the expectations of their friends served as a proxy for measuring trust of self-employed in friends. The logic behind this is that the high efforts of entrepreneurs to live up to the expectations of their friends certainly entail a trust-component. So far, would the entrepreneurs not have trust in their friends, they would not make any efforts to live up to the expectations of the friends. Doubtless, this behavior also reflects the importance of social norms for self-employed, that is, the relevance of norms exposed from the friends.

To examine the *implications of civic society* for corruption in the second group, I utilize the following 3 indices. The first index describes participation of self-employed in a range of voluntary organizations exemplified in my paper through religious, recreational organizations, professional, charitable and other types of associations. By developing the second index called political commitment in the past, I summarized those self-employed who have been politically active in the past by having signed a petition, having joined in boycotts and having attended lawful demonstrations. The third index referring to the civic society measures "attitudes toward democracy". Following the argumentation given in the theoretical part of this paper which has related a high level and good quality of democracy to lower level of corruption, I employ a hypothesis that the more negative the attitudes towards democracy, the higher the (perceived) level of corruption. Against the background of Putnam's thesis about erosion of social capital through television, I also examined the impact of a variable describing "people watching TV very often" on corruption. In this context, I took an assumption that "people watching TV very often" can be characterized by less social contacts and by more civic disengagement and thus by less generalized trust and therefore as more likely to corrupt.

In the third group, there is a single variable depicting the degree to which the self-employed are satisfied with the *financial situation* of their own household.

**Table 3: Indices and Variables Measuring Trust and Civic Society**

Index/ Variable	Name	Variables	Index Analysis 1. Eigenvalue (EV) 2. Explained Variance (%) 3. Reliability: Cronbach's Alpha / Variable Descrip- tion	Predicted Influence on Corrup- tion
<b>I. Indices and Variables Measuring Trust</b>				
Variable	1. Generalized Trust in People	Generally speaking, would you say that the most people can be trusted?	Dummy variable: 0 "Have to be careful" 1 "Most people can be trusted"	negative
Index	2. Trust in Legal Framework	How much confidence do you have 1. In the legal system 2. In police (4 point scale: 1 "None"... ...4 "Great Deal")	1.EV: 1,505 2. % Variance: 75,375% 3. Cronbach's $\alpha = 0,6721$	negative
Index	3. Trust in State Institutions	How much confidence do you have 1. In the Government 2. In the Political Parties 3. In the Parliament (4 point scale: 1 "None"... ...4 "Great Deal")	1. EV: 2,135 2. % Variance=71,177% 3. Cronbach's $\alpha = 0,7963$	negative
Variable	4. Trust in Civil Service	How much confidence do you have in the Civil Service? (4 point scale: 1 "None"... ...4 "Great Deal")	1- none 2- not very 3- quite 4- great deal	negative
Index	5. Trust in Green/Ecology Movement and Women's Movement	How much confidence do you have 1. In the Green/Ecology movement 2. In the Women's movement (4 point scale: 1 "None"... ...4 "Great Deal")	1. EV: 1,571 2. % Variance=78,567 3. Cronbach's $\alpha = 0,7272$	negative
Variable	6. Trust in Major Companies	How much confidence do you have in the Major Companies? (4 point scale: 1 "None"... ...4 "Great Deal")	1- none 2- not very 3- quite 4- great deal	negative
Index	7. Trust in Mass Media	How much confidence do you have 1. In the press 2. In the mass media (4 point scale: 1 "None"... ...4 "Great Deal")	1. EV: 1,643 2. % Variance=82,168 3. Cronbach's $\alpha = 0,7826$	negative
Variable	8. Importance of Friends	I make a lot of effort to live up to what my friends expect	4 point scale: 1 "Strongly disagree" ..... 4 "Strongly agree"	positive
<b>II. Indices and Variables Measuring Civic Society</b>				
Index	1. Participation in Voluntary Organizations	Active member in the following voluntary organizations: 1. Church or religious organization 2. Sport or recreation organization 3. Professional association 4. Charitable organization 5. Any other voluntary organization	Additive Index (Values from 0 to 5)	negative
Index	2. Political Commitment in the Past	In the past, I have ... 1. signed a petition 2. joining in boycotts 3. attended lawful demonstrations	Additive Index (Values from 0 to 3)	negative
Index	3. Attitudes toward Democracy	1. Attitudes toward having a democratic political system 2. Democracies are indecisive and have too much squabbling 3. Democracy may have problems but it's better than any other form of government 4. Using violence to pursue political goals is never vs. always justified	Additive Index (Values from 0 to 4)	negative
Variable	4. Watch TV	How much time do you usually spend watching television on an average weekday?	Dummy: 0 "less than 3 hours" 1 "more than 3 hours"	positive
<b>III. Control Variable</b>				
Variable	Financial Situation (subjectiv)	How satisfied are you with the financial situation of your household?	10 point scale: 1 "completely dissatisfied"	negative

			..... 10 "completely satisfied"	
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Source: World Value Survey 1995-1996; Calculations by ifm Mannheim

## 4.2. World Business Environment Survey

After having examined the World Value Survey 1995-1996 (the first source of data), I will be employing the second source of data, the World Business Environment Survey (WBES 2000) to test once again the implications of the particularized trust of entrepreneurs in friends/kins on the likelihood of becoming engaged corruptly. Therefore, in subsection 5.2., I will be going to interpret the effects of only two variables tested by means of the WBES 2000. These reflect the *particularized trust of self-employed*, first, *towards friends and kins* and, second, *particularized trust towards a national bureaucrat to deliver services "as agreed"* after having taken the bribe.<sup>11</sup> The trustworthy relationship between an entrepreneur and his friends/kins has been measured by means of a proxy depicting "the share of firms finance over the last year coming from family and friends". The trust of the self-employed towards the national officer to be an "honest bribee" has been examined by means of the question "If a firm pays the required "additional payment" the service is usually delivered as agreed.

## 5. Empirical Findings

### 5.1. World Value Survey: Results from Ordered Probit Regressions

Table 4 displays results from two ordered probit models of parallel assessments of implication of all indices and variables on (the perception of) corruption from the perspective of entrepreneurs.

I begin my analysis by testing the impact of trust and civic society in the first model. So far, model 1 lists estimation results from the first ordered probit regression of all determinants supposed to affect the perception of corruption of entrepreneurs designed to test H1 to H7. In the second model, I add "financial situation" of respondents to examine H8 and H8', as well as country-specific dummies as control variables.

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<sup>11</sup> For some detailed information about other variables examined with the help of the WBES 2000 see Tonoyan (2003).

The estimation results provide here considerable support for the importance of factors already discussed in the theoretical part.

### *Implications of Trust for (Perceived) Corruption*

One can notice clear evidence of trust implications on (the perceived level of) corruption from the viewpoint of entrepreneurs. These are, first, *generalized trust in people*, and second, *trust in the effectiveness of the judiciary and police*, and, third, *trust in the quality of government, political parties and parliament*. Thus, the higher the generalized trust of self-employed in other people, the lower (their perception of) corruption.<sup>12</sup> The higher their trust in the effectiveness of the legal system and police, the lower (the perception of) corruption. Also a high confidence of self-employed in a good quality of government, political parties and parliament leads to a low (perception of) corruption. Even after controlling for regional groups, these factors still remain statistically significant. With these results, I have replicated findings of Lambsdorff (2002 b) and Tonoyan (2003) of implications of trust in the legal system and the state institutions (government, political parties and parliament) for (perceived level of) corruption. Also findings by Bjornskov and Paldam 2002 about a "high level of generalized trust" being a robust explanatory factor for a low level of corruption could have been verified in both models, with and without controlling for country-group dummies. Another form of trust, namely, *trust in the civil service* becomes slightly significant in the second model. Thus, the higher the trust of self-employed in the good quality of the civil service, the lower corruption.

On the other side, a high *trust in friends* demonstrates a highly significant and positive impact on corruption. Insofar, we observe here a "dark side of trust", namely, a form of particularized trust which gives rise to corruption. Besides, this effect does not disappear even when controlling for the financial situation and country-dummies in the sec-

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<sup>12</sup> This statement certainly bears an endogeneity problem. In other words, some further research is needed to examine which of these factors has to be considered as a cause or a consequence of the other one. Is that a low level of generalized trust (in other people) which causes a high level of corruption or rather a high level of corruption that generates a low level of trust in anonymous others? Nonetheless, first examination by means of instrumental variables regression reveals that despite an interdependence and a feedback effect between trust (in people) and corruption, a low level of generalized trust in people remains a robust explanatory factor for a high level of corruption.

ond model. Moreover, it shows an even greater significance to corruption than the generalized trust in people.

Against this background, I conclude that the entrepreneurial perception of the performance of judges and police to be unbiased would support a low level of corruption in economic life. Furthermore, the effectiveness of governmental institutions, of parliament and the trustworthiness of political parties and public service from the perspective of self-employed can be regarded as a further crucial mechanism which might keep the self-employed away from becoming involved in illegal activities.

Also a high confidence of entrepreneurs in anonymous others has to be associated with a lower level of corruption.

On the other side, particularized trust in the importance of friends and kins and a behavior aimed at living up to the expectations of friends and kins should be considered as mechanisms generating corruption.

#### *Civic Society*

Two indicators of civic society appear to be relevant for (perceived) corruption. The first index measures an active behavior of the self-employed in the past in terms of their *political commitment* and demonstrates in the first model a negative effect on corruption. Thus, those self-employed seem to be less susceptible to corruption who have been active in the past in the range of political matters by having signed a petition, having joined in boycotts and having attended lawful demonstrations. However, this index seems to be important for some of the controlled regions since it shows no longer a significant effect in the second model. There seem to exist another robust explanatory factor for corruption linked to the civic society, namely, the *attitudes towards democracy*. So far, self-employed considering a democratic system to be bad, indecisive and causing too much squabbling as well as those justifying violence to pursue political goals have to be considered as more susceptible to corruption.

**Table 4: Ordered Probit Regressions on Perception of Corruption of Self-employed**

Ordered Probit Model	Model 1				Model 2			
	Coef	Std. Err.	z	P> z	Coef	Std. Err.	Z	P> z
<b>Indices and Variables Measuring Trust</b>								
1 Generalized Trust in People	-0,40	0,09	-4,23	0,000	-0,23	0,10	-2,28	0,023
2 Trust in Legal Framework	-0,24	0,06	-4,08	0,000	-0,10	0,06	-1,63	0,103
3 Trust in Policy	-0,24	0,06	-4,22	0,000	-0,19	0,06	-3,30	0,001
4 Trust in Civil Service	0,02	0,07	0,22	0,825	-0,14	0,07	-1,94	0,052
5 Trust in Green and Women's Movement	0,05	0,05	1,08	0,282	-0,00	0,05	0,05	0,963
6 Trust in Major Companies	0,01	0,07	0,09	0,926	-0,13	0,07	-1,74	0,083
7 Trust in Mass Media	-0,03	0,05	-0,67	0,503	-0,08	0,05	-1,54	0,125
8 Importance of Friends	0,32	0,05	6,79	0,000	0,16	0,05	2,96	0,003
<b>Indices and Variables Measuring Civic Society</b>								
1 Participation in Voluntary Organisation	-0,06	0,05	-1,23	0,219	0,00	0,06	-0,03	0,977
2 Political Commitment in the Past	-0,09	0,05	-1,92	0,055	-0,04	0,05	-0,88	0,380
3 Attitudes toward Democracy	0,13	0,06	2,32	0,021	-0,16	0,06	-2,51	0,012
4 Watching TV	0,17	0,12	1,40	0,161	0,02	0,12	0,13	0,895
<b>Control Variable</b>								
Financial Situation (subjectiv)					-0,05	0,02	-2,33	0,020
Baltic Countries					1,28	0,56	2,30	0,022
Central East-European Countries					0,10	0,22	0,44	0,657
East Germany					0,49	0,21	2,33	0,020
Other Post-Soviet Republics					1,45	0,19	7,46	0,000
Trans-Caucasia					1,10	0,16	6,80	0,000
USA					0,72	0,23	3,12	0,002
Western Europe					0,75	0,17	4,48	0,000
$\alpha_1$	-2,47	0,27			-1,88	0,33		
$\alpha_2$	-0,84	0,26			-0,12	0,32		
$\alpha_3$	0,51	0,26			1,41	0,33		
N=645	McKelvey <sup>13</sup> and Zavoina's R <sup>2</sup> :0,327 McFadden's R <sup>2</sup> :0,138				McKelvey and Zavoina's R <sup>2</sup> :0,444 McFadden's R <sup>2</sup> :0,204			

Source: World Value Survey 1995-1996; Calculations by ifm Mannheim

Dependent Variable: How widespread do you think bribe taking and corruption is in this country? Low value: "almost no public officials are engaged in corruption"; high value "almost all public officials are engaged in corruption".

<sup>13</sup> Using simulations, Hagle and Mitchell (1992) as well as Windmeijer (1995) found that for ordinal outcomes McKelvey and Zavoina's R<sup>2</sup> most closely had approximated the R<sup>2</sup> obtained by estimating the linear regression model based on the underlying latent variable (see Long and Freese 2001).

### *Controlling for Financial Situation and Country/Regional Dummies*

While researchers in the macroeconomic studies of corruption used to test the influence of the GDP rates of countries as indicators of their economic wealth, I controlled the "financial satisfaction" of respondents as such similar indicator at the micro level. As suggested in H8, a stronger "financial situation" turns out to be negatively associated with the (perceived level of) corruption. Accordingly, similar to the results obtained from the macroeconomic studies<sup>14</sup>, it can be acknowledged that "wealthier" self-employed tend to perceive lower level of corruption or tend to be less inclined to corruption.

By taking a look at the regional dummies which remain statistically significant for almost all country groups in the second model, one can conclude that the discrepancies between regional groups in terms of the level of corruption could not have been explained thoroughly by means of trust, civic society and financial satisfaction.<sup>15</sup>

### **5.2. World Business Environment Survey: Further Evidence of the Particularized Trust**

With the second source of data, the World Business Environment Survey, I first validate the significance of perception of the legal system from the perspective of entrepreneurs for becoming engaged in corrupt deals (see table 5). Thus, a bad performance of the judiciary might support corrupt environments.

Second, and most important, I corroborated the importance of *two further forms of particularized trust* for (perceived) corruption. The first variable depicts the "share of firm's finances over the last year, coming from family and friends", and reflects a trustworthy relationship between a self-employed whose firm has been financed and his/her friends

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<sup>14</sup> which provided an evidence that a high economic development does itself reduce corruption

<sup>15</sup> However, the differences in the perceived level of corruption between central East European and Scandinavian countries could have been explained by generalized and particularized trust, behavior and attitudes of self-employed based on the principles of participatory democracy and civic society, as well as the financial situation. With these variables, also the discrepancies between the level of corruption in Baltic countries and East Germany, on the one side, and Scandinavian countries, on the other side, could have been partly explained.

and kins who have financed this firm. In the probit model, it demonstrates highly significant and positive impact on corruption. So far, a “dark side of trust” becomes evident in this case, as well: the entrepreneurs with investment sources from family and friends are more likely to engage in illegal transactions.

**Table 5: Ordered Probit Model on Perception of Corruption**

	Model 3		
	B-Coeff.	T-Value	Sign.
Index 1: Perception of Bank Officials	0,23	4,97	0,000
Index 2: Perception of Legal System	0,23	4,15	0,000
Business Ethics: Competitor's Fair Play	0,02	0,40	0,686
Transaction Costs: Time for Red Tape	0,03	1,06	0,288
Legal Alternatives to Bribe	0,06	1,87	0,062
Investments from Family and Friends	-0,01	3,72	0,000
Trust towards a National Officer to be an “Honest Bribee”	-0,20	4,97	0,000
$\alpha_1$	-1,66		
$\alpha_2$	0,65		
$\alpha_3$	1,51		
$\alpha_4$	2,10		
$\alpha_5$	2,89		
N=620	McKelvey and Zavoina's $R^2$ : 0,20 McFadden's $R^2$ : 0,06		

Source: World Business Environment Survey 2000; Calculations by ifm Mannheim

\* Dependent variable: Perception of corruption: “It is common for firms in my line of business to have to pay some irregular “additional payments” to get things done” (Question 14, WBES 2000). Low level: always; high value: never.

The second variable describes trust of an entrepreneur towards a national officer to be an “honest bribee” in a planned corrupt transaction. What can be concluded is that the probability for a self-employed of becoming involved in a corrupt transaction rises, if he expects or trusts a national bureaucrat to deliver services “as agreed” after having paid the required amount of bribe.<sup>16</sup>

<sup>16</sup> However, a further analysis is needed here, since in the questionnaire, this variable was linked to the dependent one (perceived level of corruption) as a „filter question“. This means, by analyzing the impact

## 6. Concluding Remarks

In this paper, I demonstrate dark and shining sides of trust important for investigation of corruption. Up to now, most researchers of corruption have emphasized the positive side of trust. Overall, it has been postulated that the higher the generalized trust in people and/or the formal institutions (e.g. judiciary or government), the lower the level of corruption (Rothstein 2000, Bjornskov and Paldam 2002). However, the exact opposite can also be hypothesized, namely, that also *another side of trust might exist, a "dark side"*, which would rather foster corruption. Considering this, this paper sets out to explore both sides of trust examining its impact on corruption from the perspective of entrepreneurs as potential bribe-payers.

I treat trust as a multi-dimensional theoretical construct which might have both positive and negative implications for corruption. Strictly speaking, I differentiate *between two types of trust*, namely, generalized trust and particularized trust, drawing a basic assumption that a high level of generalized trust would undermine corruption while a high particularized trust would, on the contrary, support it.

*As generalized trust*, I sum up various forms of trust, namely, trust in people, in the legal framework, in the state institutions and in the civic society. This form of trust is regarded as having a "collectivistic" character, that is, being neither person-specific, nor situation-specific. On the other side, to test the positive influence of a *high particularized trust*, defined here as a trust in kins and friends, on corruption, I examine three further explanatory factors. Firstly, I analyse behavior of the self-employed aimed at living up to the expectations of their own friends and, thus, reflecting a high trust towards them. Secondly, I analyze trusted relationships between an entrepreneur and his/her family and friends financing his/her firm over the last years. And, finally, I look at the trust of an entrepreneur, as a bribe-payer, towards a national officer to be an "honest bribee" in the planned corrupt transaction.

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of this variable on corruption, I was able to include into regression only those respondents recognized having paid a bribe in the past. Those, who have denied having ever taken part in a corrupt deal, were excluded in the questionnaire. In this case, estimation of this variable would generate the „selectivity bias“ which could be solved with the „Heckman's selection model“, for example (Verbeek 2000:208).

The empirical findings, drawn from the analysis of two sources of data, from the World Value Survey (1995-1996) and the World Business Environment Survey (2000), reveal that it is worth differing between generalized trust and particularized trust in researching corruption.

On the one hand, it becomes evident that a *high level of generalized trust* has hampering effects on the (perceived level of) corruption. My findings support the hypothesis that a high level of extended, generalized trust in others has a negative impact on the (perceived level of) corruption. Moreover, two other forms of generalized trust, firstly, trust in the legal system and police and, secondly, trust in the state institutions (government, political parties, parliament, civil service) demonstrate a strong reference to (the perception of) corruption. The higher the trust of the self-employed in the judiciary, police and governmental institutions to be unbiased and fair, the lower the level of corruption. Insofar, a key challenge to diminish the level of corruption is to rebuild and/or to strengthen the confidence in the legal framework and institutional infrastructure of the state, such as government, political parties, parliament and public sector.

Also the hypothesis could have been replicated that corruption would be lower in countries with a participatory democracy, with a high level of trust in the principles of a strong civic society. Especially, two indicators of civic society appear to be relevant for (perceived level of) corruption. The first describes an *active political commitment of entrepreneurs in the past* in the range of political matters by having signed a petition, having joined in boycotts and having attended lawful demonstrations. As supposed, this index provides negative effects on corruption. There also seems to exist another robust explanatory factor for corruption linked to the civic society, namely, *attitudes towards democracy*. The more negative the attitudes towards democracy, the higher (inclination to) corruption. Those self-employed who consider democratic systems to be bad, indecisive and causing too much squabbling as well as those who would justify using violence to pursue political goals have to be considered as more susceptible to corruption.

On the other hand, as another central result of this paper, we can regard the positive influence of a high *trust in friends and kins* on the probability of becoming engaged in corrupt business practices. A high *trust in friends*, measured by the behavior of self-employed aimed at living up to the expectations of their friends, shows highly signifi-

cant, positive and the strongest impact on corruption. Insofar, we observe here a “dark side of trust”, namely a form of particularized trust which, as a matter of fact, gives rise to corrupt deals. Thus, those self-employed might be most inclined to corruption who behave in a way to living up to the expectations of the friendship. To ensure the thesis about a high level of trust towards friends and/or kins being positively correlated to corruption, I examine the impact of another variable. This variable defined as “*investments source from family and friends*” characterizes the share (percentage) of enterprises financed over the last year by family and friends. With that, it surely reflects a *trustworthy relationship* between an entrepreneur whose firm has been financed and his friends and/or kins who have financed it. Also in this case, we observe a positive and strongly significant effect on corruption. In so far, entrepreneurs with investment sources from family and friends are more likely to perform illegal transactions. In this regard, I conclude that in “milieus of low generalized trust” where both a low level of generalized trust in persons and institutions are prevalent, the entrepreneurs tend to substitute this deficit of trust by particularized forms of trust through becoming involved in (business) networks with friends and kins which, in turn, becomes a breeding ground for corruption.

Another form of particularized trust seems to ensure corrupt deals. It is *trust of an entrepreneur towards a public servant to be “an honest bribee”* in a planned corrupt transaction. Thus, if a self-employed trusts a national bureaucrat to deliver services “as agreed” after having paid the required “additional payment” (bribe), then he will be more likely to become involved in a corrupt transaction. With that, I replicated the last findings of Lambsdorff (2002).

A positive interdependence between a particularized trust of self-employed (embedded in networks like friendship and kinship) and corruption found in this paper reminds us of close-knit, mutually dependent Mafia structures in the South Italy or in Russia. However, why exactly do such networks facilitate corruption has to be regarded as a future research issue helpful to explore why corruption is more widespread in some countries than in others.

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