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Author(s): Yan Sun

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# Reform, State, and Corruption

## Is Corruption Less Destructive in China Than in Russia?

*Yan Sun*

Both China and Russia have experienced unprecedented corruption during their transitions to the market, but beneath this similarity lies an important difference. While Russia's economy continues to falter amidst rampant corruption, China's is among the best reformed socialist economies despite a level of corruption that once gave rise to the Tiananmen protests.<sup>1</sup> Does the type of corruption make a difference?

The debate about the relationship between corruption and growth is old. During the heyday of modernization theories revisionists challenged traditional moralistic views of corruption by emphasizing the utilitarian consequences of behavior, arguing that corruption helped overcome structural deficiencies that inhibited economic and political development in modernizing countries.<sup>2</sup> More recent findings, however, show that corruption is never more than a second best alternative to honest public policies and that in the long run it distorts and retards development.<sup>3</sup> These arguments are confirmed by analyses of corruption in contemporary China and Russia.<sup>4</sup> Indeed, recent interest in corruption, arising from the spread of markets, focuses primarily on its negative effects on growth.<sup>5</sup> Yet the paradox of corruption and growth in the Chinese and Russian cases remains perplexing. Within the two countries debates over the benefits and costs of corruption have also become part of elite politics, to the extent of even deciding winners and losers in political battles. In both China and Russia corruption charges have become a favored weapon of conservatives, while corruption's inevitability is a preferred defense of reformers. The most dramatic example was China's Zhao Ziyang, who alienated conservative leaders with his reluctance to fight corruption and lost his position as general secretary after Tiananmen.

This article seeks to explain the paradox of corruption in recent Chinese and Russian reforms. It argues that corruption tends to be somewhat less costly in China than in Russia. Its divergent effects are linked to larger differences in the type of transition and nature of the state. In China, where economic reform has preceded political reform, the survival of old politics has not hindered economic reform in part because corruption has helped to turn political forces otherwise hostile to change into participants, while enabling social forces otherwise excluded from power to buy their way in. Both functions are theoretically unnecessary under

Russia's reversed sequence of reform. China's institutional stability and expansion of a nonstate entrepreneurial sector, in turn, have not left too large a functional vacuum that illegitimate forces could fill, as the mafia has done in Russia. Finally, the stronger Chinese state is better equipped to enforce discipline and limit the nature and impact of corruption, capabilities unmatched in Russia's weakened and divided political system. Such comparative insights, gained from weighing the benefits and costs of corruption against alternative policies and outcomes, make discussions of the effects of corruption more meaningful.

### **The Type of Economic Transition and Corruption**

The extensive literature on corruption in developing countries, Communist regimes, and postcommunist societies suggests that corruption is most likely to occur under two sets of circumstances. One is the presence of opportunity, opened by the extensive role of the government as a regulator, allocator, producer, and employer, the widening of government power by increased economic activities, the weakening of institutional and legal sanctions, and the prevalence of regulatory loopholes and legal ambiguities. The second is the presence of motivation, such as confusion over changing values, erosion of moral conventions and sanctions, relative impoverishment, and lack of alternative access to power. By loosening up the economy, market reforms have drastically increased both the opportunities and motivations for corrupt pursuits. But does the type of reform make a difference in the patterns and impact of corruption?

The Chinese and Russian reform models have two major distinctions. First, China's economic reform is marked by incrementalism or piecemeal change, as opposed to the big bang or shock therapy adopted by Russia. Second, China's economic reform has been carried out through existing party and state structures, as opposed to the comprehensive dismantling of the old political system in Russia. The Chinese model runs counter to the conventional wisdom among policy advisors on reform of Soviet-type regimes that sweeping economic and political reforms are inseparable.<sup>6</sup> This wisdom, from which Russia's big bang approach is derived, is based on two lines of argument. Economically, the interdependence of the different parts of the planned economy requires comprehensive and rapid reforms.<sup>7</sup> Politically, those who stand to lose their power and position present bureaucratic obstacles.<sup>8</sup> Partial reform as in China is dismissed as impossible because the party elite as a class must be removed as a condition of reforming socialism.<sup>9</sup> Thus, economics and politics are fused in Soviet-type systems, and this fusion entails the interdependence of economic and political reforms. Not only economic change but also the politics of reform demand political change.<sup>10</sup> Gorbachev's failed economic reforms seem to have confirmed these arguments. Their implementation was obstructed by ministries

and local cadres. Yet political reform also weakened authority structures to the point of systemic disintegration.<sup>11</sup>

How did China escape this big bang logic? China's modestly reformed political system has been able to sustain a successful transition to a mixed economy. Is China exceptional? First, China's most successful economic reforms may have been outside the planned economy. Second, Chinese officials did not seriously resist reform efforts. Indeed, one explanation of China's seeming exceptionalism in defying the logic of the interdependence of economic and political reforms emphasizes the role of a leading sector outside the planned economy that served as the institutional basis of the Chinese sequence of reform.<sup>12</sup> This sector, comprising rural and urban collectives, especially the township and village enterprises, already existed before market reforms, making China's initial institutions different from Russia's. First developed under Mao, this sector was sanctioned as part of local initiative, protected and supervised by local governments. Encouraged to enter the economy once market reforms began, this sector has taken the initiative, expanded, and created a virtual parallel economy alongside the state sector. Advocates of China's gradualism argue that the massive growth of this sector is the most important factor in China's economic reform success.<sup>13</sup>

In Russia, where this nonstate sector was lacking, it has been difficult to introduce new economic institutions.<sup>14</sup> Gorbachev's initial restrictions on private business further exacerbated the problem. The related failure of partial reform contributed crucially to the eventual adoption of the big bang approach. Once the old economy collapsed, the functional void left by the retreat of the state and lack of dynamic new institutions was filled by a ruthless illegitimate force, the mafia.<sup>15</sup> Resurrected from the underworld of Soviet days, the mafia quickly took over the economy and emerged as possibly the only Soviet institution to benefit from the Soviet collapse. In 1993 organized crime controlled as much as 40 percent of the turnover in goods and services and half of the privatized capital.<sup>16</sup> Another estimate put mafia control at 35 percent of all capital and 80 percent of "voting shares" in commercial entities.<sup>17</sup> In the absence of effective state regulation, criminal cartels have infiltrated wholesaling networks, industries, banks, real estate, stock exchanges, and other economic institutions. Gun-toting "protectors" extort money or shares from a majority of private business. In contrast to China's township and village enterprises, the mafia may be seen as Russia's leading sector outside the state.

These dominant social forces form the leading constituencies for corruption in the transitional economies of China and Russia. In China the nonstate sector was never included in state plans and thus had no access to material and financial resources from the state. Under market reforms it was allowed to develop on a much larger scale and to compete directly with the state sector. Yet, unable to receive cheaper and more secure input and financing, transportation, and marketing networks and faced with distrust from bankers, retailers, and consumers, township and

village enterprises often had to resort to corruption to level the playing field.<sup>18</sup> The Chinese reform model of creating a parallel economy outside the state sector thus spurred their primary motivation for corruption: to compensate for their lack of access and to overcome unfair competition.

Russian organized crime did not emerge as a parallel economy that complemented and competed with the state sector. Rather, it overwhelmed and overtook the economy after the Soviet collapse. The mafia's initial rise was inadvertently spawned by Gorbachev's restrictions in the early stage of reform. Only a few groups were permitted to set up private businesses. Benefiting from the enormous disparities between state controls and market pressures, many soon became wealthy. Their wealth inspired groups of thugs and racketeers to take a share. Before long the mafia controlled 70–80 percent of the private sector. By the time Gorbachev and Yeltsin removed restrictions, it had a stranglehold on the private sector and was further aided by the breakdown of the state sector. Except for some substandard manufacturing, the mafia engages in nonproductive and counterproductive extortion and racketeering. Its motivation for corruption is its need for complicity among bureaucrats and law enforcement officials.<sup>19</sup>

The divergent paths of reform in China and Russia have also shaped the suppliers of corruption. China's gradualism has allowed officials to retain some of their old powers and to acquire new powers over the economy. The partial reforms have created several opportunities for cadre corruption. The foremost was the two-track system under which goods and services were produced and distributed on state-regulated and market tracks. The gap between the two tracks amounted to 20–25 percent of the domestic national economy between 1981 and 1988.<sup>20</sup> Such sizable rents presented huge incentives for officials in charge of allocating controlled goods, especially input and output, fuel and transportation, and financing and foreign currency. Second, decentralization gave local officials greater leeway in allocating resources and services. Third, new economic activities provided officials with additional powers, for example, over business licenses, prices, taxes, imports and exports, loans and credits, properties, stock exchanges, contract bidding, and enterprise leasing. Fourth, the contracting and leasing of state enterprises to individual managers, the major forms of state enterprise reform, gave them autonomous powers over production and operation.

One opportunity to cash in these powers in the market has been provided by the growth of the nonstate sector. Indeed, township and village enterprises have been at the forefront in grabbing resources from the state sector with corrupt means.<sup>21</sup> Rather than worry about losing power, officials can put their old and new powers to profitable use, and they have a direct and personal interest in ensuring that public policies do not inhibit their market-related activities. Corruption thus acts as a solvent for the uncompromisable issues of ideology and interests by turning potential opponents of reform into its supporters. Surely, some have supported reform out of

party discipline and genuine conviction. But corruption, along with more legitimate arrangements of profit sharing, also helped to soften cadre resistance to reform. Rent seeking was the price for institutional stability, but it may be a necessary price.

Why did Soviet bureaucrats not find economic reform lucrative enough to embrace? They were certainly not more morally or ideologically committed than Chinese bureaucrats. Three explanations are possible. First, official privileges were greater in the elitist Soviet Union than in Mao's egalitarian China. Second, a constituency for market-related corruption never developed on China's scale under Gorbachev. Finally, the moderate expansion of market activities under Gorbachev failed to broaden significantly cadres' power into new areas. In short, Soviet officials had greater incentives to resist economic reforms than to utilize them to their advantage. Once the Soviet system collapsed and shock therapy was applied, corruption could no longer serve the function of delaying political while permitting economic reform, as in China. Rather, systemic disintegration created irresistible opportunities for self-seeking.

During the "insider" privatization of state enterprises, or "spontaneous privatization," public assets were often transferred or auctioned for pennies to existing managers who raided public treasuries under their control, to mafia representatives who paid bribes, and to others who financed the acquisitions and kickbacks through banks or with funds they later plundered from the purchased enterprises.<sup>22</sup> The plunder involved not just factories, buildings, and banks, but also Russia's vast deposits of natural resources, especially oil, gas, and precious metals. Another area of abuse was the export and import privileges enjoyed by power insiders, including Yeltsin's entourage. The marketability of Russia's natural resources combined with the shortage of consumer goods made foreign trade invaluablely profitable.<sup>23</sup> Still another avenue of abuse lay in the "spontaneously privatized" banks. These banks' new activities included financing the buyout of state assets, converting cheap loans from the central bank into dollars to be stashed abroad and later repaid in heavily depreciated rubles at a fraction of their original value, and providing insider cooperation for cheating banks through fake documents, projects, bankruptcies, and money laundering.<sup>24</sup>

## **The Nature of the State and Corruption**

Divergent opportunities and incentives for corruption in China and Russia are linked to differences not only in the reform model but also in the nature of the state. The structure of government institutions and the political process are important determinants of levels of corruption because weak governments that do not control their agencies experience high levels of corruption.<sup>25</sup> The Chinese state remains relatively strong as gradual economic reform has been carried out through existing state

organs under the leadership of the Communist Party. By contrast, the Russian state has been thoroughly weakened by Gorbachev's political reform and the collapse of the Soviet system.

Mechanisms and reputation for discipline are crucial in maintaining links of hierarchical authority in the transitional period. The Chinese regime has not only preserved old mechanisms but also created new ones to deal with the prevention, discovery, and control of corruption. The party's old discipline inspection committee and the state's new ministry of administrative oversight both have grass-roots offices in most public institutions; the rest are supervised at a higher administrative level. These offices have the power to investigate and discipline offenders and refer them to law enforcement agencies. Public institutions and firms are also subject to inspection by the new public accounts review bureau, which monitors compliance with state budgets and accounting procedures. It has discretionary power to move into any public institution when necessary. A mass monitoring system, the Center for Reporting Economic Crimes, was created in 1988 with local branches nationwide. Several old and new technically oriented agencies oversee the compliance of public and private enterprises with commercial and pricing regulations and technical standards. The office for the inspection of tax revenues, bookkeeping, and consumer prices organizes annual selective and voluntary inspections, known as the "three-inspection campaigns." Finally, law enforcement agencies handle the most serious offenses. Additionally, 80 percent of public institutions above the county bureau level and 95 percent of central state organs have instituted income disclosure mechanisms since early 1995.

While these institutions are not always effective or free of abuse, corruption would be far harder to control without them. In the first five years of their existence centers for reporting corruption received over 14 million tips from citizens and became the leading source for cases for law enforcement agencies. This mechanism increased both the capture of offenders and recovery of losses and the prevention of potential abuse.<sup>26</sup> Accounting reviews and inspection campaigns have served to uncover more obvious violations and deter future ones. The party's disciplinary committees and the state's oversight bureaus each deal with over a hundred thousand cases annually. Tens of thousands of offenders are disciplined, and a few thousand are sent to law enforcement agencies. Complaints about police corruption are common, but even in the worst cases it is concentrated in extortion for routine services, such as the issuance of residential cards, passports, and vehicle registration, rather than protection of criminal activities. Other problems of China's control mechanisms remain numerous but not crippling. Various monitoring agencies lack coordination and, being subordinate to the local party and government, also lack political independence to take on the powerful and well-connected. The negligence of monitoring agents can leave thinly concealed misdeeds undetected. Their integrity can be compromised by generous hosts. Citizens' tips have decreased since 1993 due to increas-



ing retaliation against informants and a perceived lack of prompt action against reported misdeeds.

Most of these anticorruption mechanisms do not exist in Russia. The demise of the Communist Party removed its power of promotion and appointment as a control and incentive structure. The new regime's neoliberal belief in the minimal role of the state, coupled with its weakened authority, precludes the use of administrative control methods such as China's monitoring offices, accounting reviews, and inspection campaigns. The division of power among branches of government makes it difficult to adopt, let alone implement, anticorruption laws.<sup>27</sup> State agencies that oversee business activities, such as the tax police department, have little investigative power.<sup>28</sup> General accounting procedures and laws on disclosure have barely been codified, making it hard to uncover abuse and discrepancies. Law enforcement agencies, the last resort in dealing with corruption in China, constitute the only mechanism in Russia. Yet the ministry of internal affairs apparatus, which includes the police and the prosecutor's offices, is notoriously corrupt and ridden with what one internal affairs minister called "treachery, inactivity, and collusion with criminal elements."<sup>29</sup> Individual officers and police chiefs have close ties with ganglords.<sup>30</sup> By the ministry's own account, among bureaucratic violators of the presidential decree on fighting corruption in 1993, 25.8 percent were law enforcement officers.<sup>31</sup>

Chinese leaders also have a greater resolve than their Russian counterparts to preserve the regime's reputation for discipline. Corruption has always been a focal area of contention between China's reformist and conservative leaders. Unlike economic battles, in which reformers usually prevail, reformers who tolerate corruption for fear of disrupting reform often lose the political and moral battle, as Zhao Ziyang's fate testified. Characteristic of this elite battle, every major reform wave—in 1982, 1985, 1988, 1989, and 1992—was followed by a crackdown on the attendant rise of corruption. Although such periodic crackdowns can result in excesses in some regions but be limited to appearances in others, they nevertheless reinforced the regime's reputation for discipline and deterred some potential offenders. On average, two-thirds of offenses at financial institutions are committed by employees under thirty-five years of age, who have fewer memories of government discipline; similarly, a third of economic crimes committed by enterprise managers, who are usually older, involve those thirty to forty years of age.<sup>32</sup>

Although Yeltsin has frequently called for crackdowns on corruption, the lack of leadership resolve and organizational strength has hampered enforcement. Corruption among the top echelons is routinely ignored except in power struggles. Even frequent accusations of abuse in the defense ministry, including the murder of a journalist who investigated military corruption, are not taken seriously.<sup>33</sup> The former prime minister, Chernomyrdin, was an unabashed champion of the "spontaneously privatized" natural gas monopoly, Gazprom, which he headed under the Soviet system. With the tax breaks and equity acquisitions, approved by him,



Gazprom owns a third of the world's identified reserves of natural gas and has become one of the world's largest corporations. One of his close advisors chairs the Association of Russian Oil Exporters. The first deputy minister of finance who deals with Gazprom belongs to its board of directors. The prime minister's son is one of Gazprom's largest shareholders.<sup>34</sup> Such direct ties between top political echelons and private businesses are almost unheard of in China. Moscow's mayor, Yuri Luzhkov, unabashedly transferred state property and assets to companies owned by himself and his cronies and continues to dole out other favors.<sup>35</sup> By contrast, Beijing's deputy mayor, Wang Baoshen, committed suicide after being exposed for less naked deals, while his protégé, Chen Xitong, was deposed as the city's party boss and awaits prosecution. The chief of the MMM company, a pyramid scheme that cheated millions out of ordinary Russians, won election to the national Duma. But the chiefs of two similar companies in China, the Great Wall Group and New Prosperity Group, both received capital sentences, and their promoters received twenty year sentences for bribe taking.

The strength of market-supporting institutions that facilitate free enterprise and ensure unhampered competition also makes a difference. In Russia the lack of attention to the role of the state in the transitional process, coupled with the weakness of the state more generally, has resulted in a dearth of key institutions critical for free enterprise. Despite the introduction of new legal codes, the court system only weakly enforces contracts and defends property rights, investors, and consumers. The state is weaker in regulating banks, commodity exchanges, and stock markets. Antimonopoly commissions have little authority. They provide ample opportunities for profiteering by bankers, managers, bureaucrats, and mafia bosses. Insider trading is already the norm within Russia's nascent stock markets. In short, key market-supporting institutions have not emerged spontaneously, leaving a fertile soil for corruption.<sup>36</sup>

Although China's market-supporting institutions are by no means perfect, the government is not dogmatic or shy about the role of the state in developing the market. The court and banking systems have never disintegrated and do not face problems of enforcement to the same degree as Russia. Bribe taking and extortion exist among court officials and frustrate businesses seeking to settle disputes and cut costs, but these deficiencies have not incapacitated the court system to the extent in Russia, where the mafia is preferred as the more effective alternative in settling disputes and enforcing contracts among businesses. Violations at banks, commodity exchanges, and stock markets, though perceived as widespread, are still aberrations rather than the norm.<sup>37</sup> When citizens reported insider abuse in the issuance of new stock at ninety-five branches of Shenzhen's stock exchange in 1992, anticorruption agencies investigated 303 branches and disciplined 277 violators at 127 branches.<sup>38</sup>

The Chinese state also has not totally relinquished rights over public property and has retained partial rights over hybrid property. A key cause of Russia's insider privatization was the defection of local and enterprise officials when hierarchical authori-

ty broke down and ministerial superiors could no longer stop them from claiming property already under their control. Why has China's central authority retained control over local officials even as the latter have increasingly gained the resources to defect during economic and fiscal reforms? Steven Solnick emphasizes the incentives that Chinese reforms have created in preserving hierarchical links. The township and village enterprises have partial property ties to local governments and are supervised by them. Local officials profit from these enterprises through higher tax collection and profit sharing. They thus have economic interests tied to property rights that codify local governments' role as shareholder and/or tax authority. Importantly, they rely on their position in the state bureaucracy to preserve their "quasi-ownership rights." Thus, local Chinese officials seeking to profit through the commercial deployment of public assets were not driven to move these assets out of the state sector, as in Russia. Rather, they faced strong incentives to keep their state and party positions and accepted whatever discipline was necessary to retain them.<sup>39</sup>

However, state-owned enterprises remain a major area of abuse in China's public sector, though the government's reluctance to privatize them has slowed down a Russian-type theft. Unlike the township and village enterprises, which are partially privately owned, managers of state-owned enterprises are more likely to be motivated by short-term personal gains than by the long-term well-being of the enterprises. Decision-making autonomy has made it easier for them to divert company resources for personal use or profits. There are also "hidden" factories set up by managers or their children and cronies that become profit centers feeding off the assets, budgets, and supplies of state enterprises. Profitable transactions with outside contractors are channeled through such enterprises, leaving state enterprises underutilized and idle. Managers thus reap profits from state property without bearing the risks or liabilities associated with total ownership.<sup>40</sup> Similar abuse occurred in Russia when Gorbachev allowed nonstate enterprises and cooperatives to coexist with state ones.<sup>41</sup> It is impossible, however, to assess how widespread this form of corruption is across China. The Chinese state, then, is not strong enough to protect public interests and curb individual abuse, but it can prevent corruption from resulting, as in Russia, in outright theft or massive subversion of the state.

### Suppliers of Corruption

Differences in the type of reform and the nature of the state help shape divergent incentives for corruption. These incentives, in turn, help shape the effects of corruption. Such effects are inherently hard to measure but may be analyzed on two major levels: suppliers and buyers. On the first level, one may assess the benefits and costs of corruption by looking at those who supply corruption. How do officials extract corrupt money, and what do they do with it? <sup>42</sup>

**Looting** Looting, such as the embezzlement and theft of public resources, is the most harmful type of corruption with no benefits in itself. Its negative effects range from fiscal deprivation to distorted income distribution.

Looting was the dominant form of corruption in Russia in the days before and after the collapse of the Soviet system. Major manifestations included the insider privatization and shady auctioning of enterprises, banks, natural resources, and industries, the military's sale of army properties, and police protection of the mafia's theft of public properties. Insider privatization is not totally harmful if new enterprises follow market incentives. But Russian managers had the option of receiving government subsidies, thus surviving without making decisions according to market principles.<sup>43</sup> With little or no pressure from outside shareholders for profits and no hard budget constraints enterprises became inefficient at the micro level, and inflation became rampant. Some managers, frustrated that they could no longer automatically receive input and sell output or pay for input and receive payments for sales, found it more profitable to sell enterprise assets and pocket the gains personally. An estimated \$23 billion left Russia this way in 1993 and was deposited in overseas banks. The even bigger grab occurred in the oil and gas industries. In 1994 their exports totaled \$22 billion, 45 percent of Russia's exports. Much of the vast earnings that the Soviet state formerly collected from energy sales, particularly exports, now ends up in the pockets of a few dozen men.

Looting is a major but not dominant form of corruption in China. The key difference lies in opportunities. Short of a Soviet-type collapse, opportunities for open theft, and the amounts involved, are more limited. Looting of public funds therefore occurs on an individual rather than massive basis. The most common form, embezzlement, is committed through frauds in contracts and payment records, inventory theft, misappropriation at financial institutions, and diversion of state resources. Thefts incurring the highest net losses occur at financial institutions and state enterprises but on a much lower scale than in Russia.<sup>44</sup> Misappropriation, or unauthorized personal "borrowing" of public funds with the intention to repay, falls under looting when the original money is not returned. It is hard to assess its impact. Between 50 and 80 percent of the exposed cases involved the diversion of funds for profit making by individuals or nonstate enterprises.<sup>45</sup> Because usually those who failed to return the money get exposed, it is impossible to determine how many actually returned the money or the social effects of their activities.

**Rent Seeking** Rent seeking, by distorting public policy to scrape off rents (additional resources) from the economy, is generally harmful. It creates monopoly in the hands of those in power and increases the price of goods and services.<sup>46</sup>

Rent seeking has been the dominant form of corruption in China. The two-track system was the primary source of rent seeking in the second half of the 1980s, though its impact diminished as the range of regulated goods gradually shrank, espe-

cially after 1992. Other sources—law enforcement, business regulation, and the awarding of loans, land, and contracts—remain entrenched. The most common misconduct is to take bribes in exchange for government goods and services. Between 1987 and 1989 over 70 percent of cadre economic crimes in a southern province were linked to the two-track system, while 66.3 percent of those in a northern province involved the exchange of power for money.<sup>47</sup> A related practice was to trade controlled resources through quasi-official companies affiliated with official entities. Known as *guandao*, or official profiteering, it was the most widespread and resented form of corruption in the 1980s. Not surprisingly, *guandao* was a leading target of Tiananmen protesters, especially among the nonstudent participants

During Russia's wave of "dividing the riches," control over public assets was a primary source of rent seeking. Other than outright plundering, bribe taking was the next best way to grab a share of privatization. Regulatory power has also assumed increasing prominence as a source of rents, as Russia's new elite moves from dividing the riches to protecting them. Managers of privatized state enterprises depend on corrupt exchanges with officials for soft budgets. Gangsters purchase insider information and nonintervention, if not outright protection, from law enforcement officers and local officials. License seekers see public officials as worse than mafia extortionists, since the former demand prior payments while the latter are more willing to wait until their businesses take off before taking a share of the profits. Bribes are needed in every other step of running a business, for credits, commercial space, cash conversion, customs, and taxes.<sup>48</sup> Foreign investors often see corruption as a greater concern than organized crime.

Two considerations affect the degree of harm in rent-seeking activities. First, the harm is greater when a service is not performed after a bribe is paid. Second, independent monopoly structures are more harmful than joint monopoly structures. Thus, rent seeking may have more adverse effects in Russia. An American businessman attested that doing business was far easier in China than in Russia because in China greasing palms got results whereas the Russian practice was more akin to extortion, with no guarantee of favors in return.<sup>49</sup> Further, though both countries have experienced decentralization, independent monopoly in corruption—where government goods are sold by independent monopolists—is more dominant in Russia. Thus, organizing a joint venture may require as many as ninety signatures and a like number of bribes.<sup>50</sup> In China a handwritten note or a phone call from one well-placed official is often sufficient to get through the hurdles for one service. The difference can be attributed to Russia's more divided government and to China's culture of "giving face," which makes it hard for others to decline an approval already given by another official.

In addition, the level of bribery makes a difference. The larger the bribe required is, the more costly it will be to society. Yet the level of bribery is inherently difficult to know. According to Anders Aslund, crime and corruption add 15–20 percent to

turnover costs of Russian businesses.<sup>51</sup> The mafia pays much more because the stakes are high. Russian sociologists and police contend that half of the income earned by illegal activities is spent on bribing government and law enforcement officials. The ministry of internal affairs reported that the minimum bribe usually offered by gangsters to organized crime investigators is \$100,000.<sup>52</sup> In China some may spend a third to a half of their profits on bribing, while others give special gifts as routine practices. Hong Kong investors are reported to have spent 3–5 percent of revenues on bribing Chinese officials.<sup>53</sup> Without profit margins, it is impossible to compare the levels of bribery. But it is plausible to conclude that, if fewer bribes are needed for a service, then bribery costs may be generally lower in China.

**Profit Sharing** In profit sharing nonstate actors pay government officials to induce favorable policies concerning, for example, capital for investment, land for expansion, and export quotas. The rents accrue to the nonstate sector rather than to the state. They amount to a share of the profits from private hands or a reallocation of private goods. This type of corruption may be the least harmful and could even lead to good social results.

In China the profit sharing model was widespread during the early phases of development of township and village enterprises. In exchange for commercial privileges (access to favorable credits, supplies, marketing networks, tax rates), township and village enterprises illicitly offered local officials profit shares. To the extent that such privileges helped them to take off and grow, the exchanges were not negative. But they resented officials who “forced” their way in and continuously found pretexts to extract shares. Indeed, government bans on official participation in businesses in the late 1980s were applied to cadres who shared profits from township and village enterprises. A rising form of profit sharing in the 1990s occurs among financial/property allocators and commercial investors. Another form, popular among enterprises unable to offer payoffs easily, such as state-owned enterprises restrained by state accounting procedures, is to shower regulatory officials with lesser tributes such as gifts, banquets, and trips, with the expenses counted as “public relations spending.” Yet the benefits of exchanges based on profit sharing are not always clear because officials can skew policies to benefit themselves. Chinese analysts complain that opponents of the liberalization of interest rates (around 10 percent for state loans compared to the market rate of over 20 percent) are motivated largely by the desire to maintain their power and chances for graft.<sup>54</sup> Reported cases show that the profit sharing incentive can lead to lax scrutiny of potential investors, bad investments, and financial losses. Of the 74.69 percent of its net worth that a provincial bank loaned in 1991, 31.6 percent was loaned on unconventional terms, and 16.9 percent became unperforming loans.<sup>55</sup> Thus, nearly half of the loans were made without following regular procedures, and half of these loans became ineffective.

The most important profit sharing scheme in Russia is between the top government echelon and the natural resource industries. The combination of export privileges and low domestic prices for the oil and gas sector could only come at a price. Unlike China's export sector, where tax credits benefit manufacturing firms, the virtual absence of taxes on Russia's energy sector until early 1996 was extremely harmful because of its nonmanufacturing nature and the size of the export. If this sector were treated as other industries and paid normal taxes, it could contribute up to 10 percent of Russia's GDP, or \$30 billion in tax revenues. At industry executives' insistence, domestic oil and gas prices are kept artificially low; they buy oil at home for a quarter of the world price and export it for personal profit. Moreover, the low domestic price reduces domestic profits and thus share prices, benefiting the executives who accumulate shares.<sup>56</sup> Though taxes were imposed on this sector in early 1996 under IMF pressure, they have not been effectively collected. Likewise, special import privileges, which gave a few individuals and companies the right to import consumer goods without paying duties, have cost state coffers dearly. A single company has imported 98 percent of all liquor legally sold in Russia and 90 percent of all tobacco. The value of total goods imported without import tariff or value-added tax was 6 trillion rubles (\$1.3 billion) in 1994. On vodka alone the government lost \$220 million a month in revenues, a huge sum in a financially starved country.<sup>57</sup>

**Where Does the Money Go?** The other factor in determining the effects of corruption is the destination of the corrupt money. If it is reinvested in the economy, capital losses will not be total. The likelihood of reinvestment in turn depends on the nature of extraction and the business environment. Thus, money from looting and rent seeking are more likely to leave the country or be consumed than gains from profit sharing.

In China the empirical picture is mixed. As predicted, embezzled money tends to be consumed, but mainly younger offenders have such a short-term orientation. Older offenders tend to hide the black money privately, out of apprehension and caution. Indeed, many offenders are still hiding the money intact when they are exposed. Law enforcement agencies recover 60 percent of the black money from offenders who voluntarily confess or surrender. The biggest looters are more likely to flee, by either purchasing a passport or hiding locally. Although the former group is small and the latter is often caught, publicized flights harm the regime politically by shaking public confidence and aggravating public cynicism. In cases of misappropriation, where the money is often "temporarily loaned" to other parties for investment, most or all of the sum is retrieved in exposed cases.<sup>58</sup>

Among rent-seeking activities, bribe takers are more likely to hide their proceeds than those who speculate in controlled goods. The latter's activity is legally ambiguous and makes discretion about earnings less necessary. These earnings, especially profits from *guandao*, are the largest source of black money and are the



most likely to be reinvested. The primary examples are members of the “prince party” (high-ranking central and local officials’ children), the largest quasi-official corporations known as the big five, which engage in privileged profiteering and large-scale investment in commercial and sectoral development, and local quasi-official corporations that buy property and invest in Hong Kong. Bribe taking, in contrast, is not only illegal but vulnerable to exposure by bribers. Hence cash bribes tend to be hidden or transferred privately. Noncash bribes—special gifts, loans, product trials, stock shares, and sponsorships—allow takers to consume more easily. The same dualities characterize money from profit sharing. When directly dispensed to individual officials, it can be less secure or insufficiently large for significant reinvestment. Stock shares are more likely to remain invested. Overall, the Chinese case suggests that the crucial incentive for reinvestment lies not in the type of corruption scheme alone, but also in the amount, type, and security of black payment.

During much of postcommunist Russia capital losses from all three types of corruption were high, if not total, for primary destinations of corrupt money were overseas banks and real estate possessions. The absence of a favorable domestic environment and of confidence in the regime’s survival contributed to massive capital flight. The lack of foreign investment should also be considered as a major capital loss caused by the corrosive domestic environment. As the Russian economy stabilized, however, money began to be plowed back from overseas into privatization schemes. Privileged exporters and importers also had more incentives to invest profits domestically. Mayor Luzhkov’s unabashed nepotism, for example, seemed to serve Moscow’s development well and did little harm to his popularity.

### **Buyers of Corruption**

Arguments about the effects of corruption on buyers are economic and concern the market. Corruption can bring out better economic policies because government policies are less perfect than the market. The private sector can use corruption to get around cumbersome government regulations. Those who can afford bribes may also be more able and competitive entrepreneurs. Critics question whether corruption rewards the unsuccessful but well connected rather than the enterprising and the innovative, whether it creates nefarious incentives, and whether it twists officials and citizens toward socially unproductive but personally lucrative activities.

Evidence points to the more positive direction in the case of the Chinese township and village enterprises, which are generally enterprising but disadvantaged. But even here corruption is harmful. It allows the nonstate sector to compete unfairly with the state. Township and village enterprises are free to use company resources to buy their way. Their high bidding increases prices for input and output. Because they can get away with inadequate technical standards, nonstate industries also create many

public “bads,” such as cutting corners, making inferior and contraband products, and shutting out competitors. Finally, squeezing state-owned enterprises out of input and markets can idle large and often better equipped factories. Beyond the nonstate sector, corruption’s effects are as diverse as its buyers. Professional speculators are usually well-connected but unenterprising. Many farmers are overburdened with multiple exactions from local officials. The general public sees every government agency as trying to extract payment for routine services. Nevertheless, a few still commend the flexibility that corruption makes possible and that helps people to obtain services that are otherwise difficult to secure.

The Russian mafia contributes far more negatively to society. Its negative impact—violence, coercion, plunder, price increases, monopoly, and suppression of vibrant economic activities—is well-known. If the effects of gangsters’ corrupt activities are weighed, not just in terms of the protection and commercial privileges gained from corruption, but by their net impact, some benefits may be claimed. Proponents of this view argue that the mafia provides emerging businesses with services they need but the government as yet can not perform: protection against other types of “disorganized” crime, resolution of disputes, and enforcement of contracts. The last service is particularly crucial because, in an economy where private contracts have little force and public enforcement is wanting, mafia enforcement may be the only alternative to halting business activity for some entrepreneurs.<sup>59</sup> Others even see productive benefits in organized crime. Through black-marketeering, predatory buying, substandard manufacturing, and efficient stealing, corrupt entrepreneurs can accumulate the capital to become honest and eventually productive. Moreover, organized crime is the only counterweight to the many firms backed by corrupt officials that now engage in ruthless monopolistic practices.<sup>60</sup> However, these effects must be balanced against their harm to business activity. By pushing underground small entrepreneurs unable to afford private security and by discouraging individuals from choosing business, the mafia disables a vital sector of Russia’s nascent market economy.

### **Corruption and Political Effects**

The political argument about the effects of corruption emphasizes its functions in the political process. Corruption can allow social groups otherwise marginalized from the political system to buy their way in. By giving them a chance to participate in and influence policy decisions, with a humanizing means familiar to them, corruption helps to prevent political alienation.

The buyers of corruption in China indeed involve larger proportions of underprivileged groups. Unlike the Russian gangs, moreover, they tend to be legitimate groups whose integration does not alienate or threaten other social groups. In both China

and Russia the commercial and business sectors tend to be coopted by the status quo and apathetic about protest movements, though not all are happy about corrupt arrangements. The group most coopted by corruption in both countries, contrary to the integration argument, is the officials themselves. However, corruption fosters political alienation and social discontent by contributing to a distorted market, increased costs, retarded efficiency, and aggravated social inequalities. Even its benefits are relative. Not surprisingly, the two top income groups in China are bureaucratic and private merchants, while in Russia they are the new *nomenclatura* (regulatory officials, resource exporters, and managers of privatized firms) and the mafia. In both countries employees and retirees of former or existing state firms are major losers from corruption, as are those of other institutions (education, noneconomic government organs) who do not benefit from corruption. These groups were the primary supporters of the Tiananmen protests in China and the skeptics about capitalism and democracy in Russia.

Corruption also creates powerful economic groups that prefer the status quo to political change or a more perfect market. Foremost among these groups in China is the "prince party," children of top-ranking officials who head large national or local corporations. They were a strong voice calling for the Tiananmen crackdown. Russia's new rich, who are inevitably beneficiaries of official corruption, helped to finance the reelection campaigns of such allies as President Yeltsin and Mayor Luzhkov. The victims of corruption in both countries, then, are twice victimized by failing to be served by the political process.

## **Conclusion**

Reform strategies and institutional arrangements affect the impact of corruption differently in postcommunist societies. Corruption helps political reform lag behind economic reform in China, a sequence that allows market reforms without dismantling authority structures. The survival of a relatively strong state, in turn, can help to prevent the worst types of corruption from dominating society and market activities. A reversed sequence and model of reform, by applying economic shock therapy after old authority and legal institutions are destroyed and before new ones are built, as in Russia, can unleash worse corruption on an uncontrollable scale. Corruption is therefore less destructive in China on balance. In either case, however, corruption creates economic and social problems that entail serious crises of political legitimacy and pressures for political change, as testified by the Tiananmen protests and the resurgence of the Russian Communist Party. Those forces that have benefited most from the transitional economy may also be the most formidable opponents of political change. Thus, the Chinese political system continues to exhibit tensions, testifying to the weakness of the Chinese model of reform. Although such tensions are mit-

igated by a more open political process in Russia, unchecked corruption continues to hamper economic growth and a genuine transition to the market.

Has China resolved the central problem of the relationship between political and economic reform in post-Soviet societies? Has China defied the logic of interdependent reform in post-Soviet societies? From the perspective of this study, the Chinese experience has simply recast the question. There has been political change in China, but not in the ways typical of other post-Soviet regimes. Rather than dismantling the party-state, Chinese reform has helped to lure officials away from public office into private commerce, to engage superfluous cadres elsewhere, to foster rule of law in a wild world where even the powerful can not control everything, to whittle away state power by shifting wealth into private hands, and to replace office with wealth as the most important indicator of individual social status. These changes amount to gradualist political reform.

## NOTES

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