This book considers how emerging economies around the world face the challenge of building good institutions and effective governance, since so much of economic development depends on having these in place. The promotion of shared prosperity and the battle against poverty require interventions to reach out to the poor and the disadvantaged. Yet time and again we have seen such effort foiled or diminished by corruption and leakage.

The creation of good governance and institutions and structures to combat corruption require determination and passion but also intricate design rooted in data, analysis, and research. In this book, leading researchers from around the world bring to the table some of the best available ideas to help create better governance structures, design laws for corruption control, and nurture good institutions.

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The promotion of shared prosperity and the battle against poverty require interventions to reach out to the poor and the disadvantaged. Yet time and again we have seen such effort foiled or diminished by corruption and leakage. The creation of good governance and institutions and structures to combat corruption require determination and passion but also intricate design rooted in data, analysis, and research. In this book, leading researchers from around the world bring to the table some of the best available ideas to help create better governance structures, design laws for corruption control, and nurture good institutions.

6

Why is Italy Disproportionally Corrupt?: A Conjecture

Diego Gambetta

Corruptissima republica, plurimae leges
Tacitus, Annals, III, 27

Italy is an anomaly in terms of corruption: various indicators show that her level of corruption is on a par with or worse than that of much less developed countries while being far above the level of similarly developed countries. Some of the evidence, such as the widely used Transparency International Corruption Perception Index, relies on the opinions of experts and various economic agents, and some scholars question its accuracy. Still, other sources too, including citizens' reports of their corruption experiences and behavioral experiments, corroborate these indexes, and their possible inaccuracies, however plausible, are most

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unlikely to subvert the ranking in any drastic way. The basic fact of the Italian anomaly seems solid enough to be taken seriously and to make it worth trying to explain it.

However, where the puzzle lies exactly, whether in corruption or in development, is not clear. It could go in both directions: why is as developed a country as Italy so disproportionally corrupt? But also, how can such a corrupt country have reached a high level of socio-economic development? The latter direction of the puzzle is a challenge to the many who argue that corruption is an obstacle to development. But the former direction of the puzzle too defies those who believe that a developed society, relying to some degree on market competition, a free press and the rule of law, should not foster a "culture of corruption", certainly not to the point of making it as widespread as it appears to be in Italy.

It is not easy to disentangle this chicken and egg dilemma. Ceaseless political altercations aim to make Italian corruption seem like the fruit of the greed and moral bankruptcy of the parties in government at any one time. But, while there have been differences in how loud political parties have turned up the volume of corruption, the evidence suggests that corruption cuts long and deep into Italian society,[1] and has coexisted with many different governments, including the Fascist regime, for a very long time (Ricciuti and Petrarca 2013; Bosworth 2006).

An implication of the puzzle is that either the outcomes of corruption "Italian style" or its underlying mechanisms must be compatible with at least *some* development. But I believe that Italy's social quirkiness—often an uncomfortable thorn on the side of unadventurous social science beliefs—allows us to go further. Here I propose a bolder conjecture, namely that the same micro processes that make corruption thrive in Italy have a sunnier side and also help development to hobble forward.

The paper is organized as follows. I first present the data on Italian corruption. I then review how the explanations that have been proffered do not account for the evidence. Third, I present a micro mechanism—sharing compromising information (SCI)—that could sustain corrupt deals, and some evidence thereof. Fourth, I conjecture on the possible reasons why this mechanism could work so well in Italy, better than

elsewhere, and why it could sustain not just corrupt deals, which by being a crime cannot by definition rely on legal enforcement, but also *any* deal that cannot count on effective state enforcement.

The Italian Anomaly: The Evidence

Relative to what we should expect, in comparative perspective, Italy shows a much higher level of corruption.[2]

Let us first look at the distribution across the world most developed countries of the *Corruption Perception Index* (CPI), compiled yearly by Transparency International (Fig. 6.1): in 2015 Italy had a CPI of 44 points (a CPI of 0 means maximum corruption and a CPI of 100 zero corruption). Out of 167 countries for which the CPI is produced in 2015, this score corresponds to the 61st rank—a rank that Italy shares with Lesotho, Montenegro, Senegal and South Africa. Among EU countries only Bulgaria and Rumania (not shown in the figure) do worse than Italy.

Consider now Fig. 6.2. Out of the 167 countries, I took the subset of developing countries with a CPI that is equal or lower (that is better) than that of Italy. I then plotted the distribution of both the CPI and the

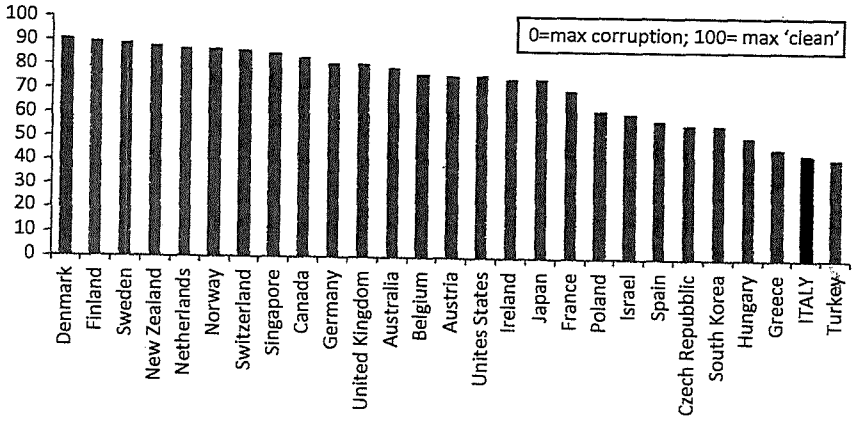


Fig. 6.1 Corruption Perception Index for a selection of developed countries, Transparency International, 2015. Source: http://www.transparency.org/cpi2015

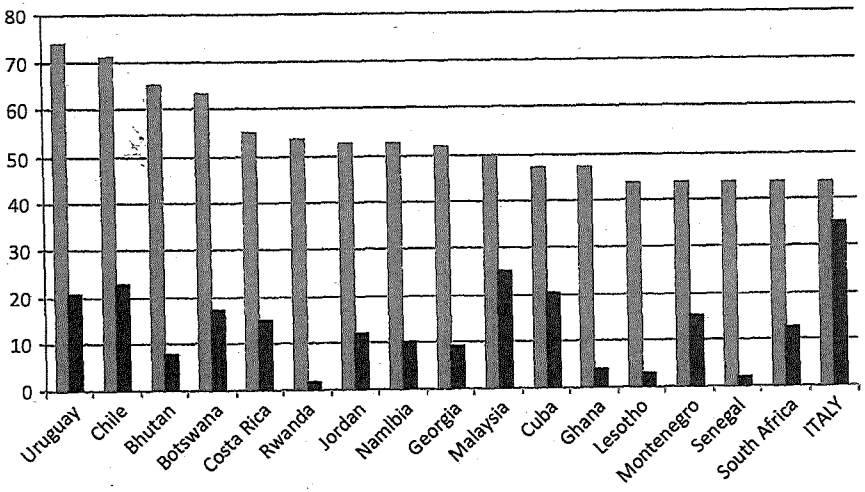


Fig. 6.2 CPI (blue bar) and GDP per capita (red bar, 000 of US $) in a set of developing countries, whose CPI is either equal or worse than that of Italy. Source: CPI: http://www.transparency.org/cpi2015; GDP per capita, World Bank Data (http://data.worldbank.org/indicator/NY.GDP.PCAP.CD) 2011–2015

GDP per capita of these countries. The picture is striking: Italy's GDP is no less than one third *higher* than the GDP of the most developed of these countries (Malaysia), and is much higher than that of all other countries, which however do either as well as or better than Italy in terms of corruption. "Cleaner" cases are found in Asia, Africa, and in Central and Latin America, where Chile and Uruguay distinguish themselves as outliers in the opposite direction to that of Italy.

Finally, let us look at Fig. 6.3. On the vertical axis I plot Italy's *ranking* on the CPI, and compare it with Italy's rankings among world countries on a host of other measures of socio-economic development. This shows that corruption is an outlier, not just compared both with more and with less developed countries, but also compared with Italy's *own* achievements in other spheres. The only other index in this group on which Italy is performing poorly is freedom of the press. I return to this in the last section for this could play a part in explaining Italy's anomaly.

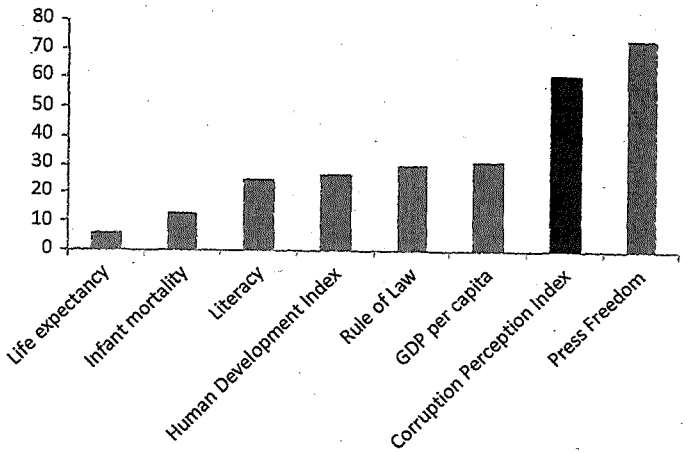


Fig. 6.3 Italy's ranks among world countries on CPI and various development indexes, the higher the rank the worse Italy's position among world countries for which the corresponding measures are available (2015 or nearest year). Sources: Life expectancy, WHO; Infant mortality, CIA; Literacy, UNESCO; Human Development Index, UN; Rule of Law, World Justice Project; GDP per capita, IMF; Corruption Perception Index, TI; Press freedom, Reporters Without Borders

Other corruption indexes show a very similar pattern. The 2010 corruption index produced by the Quality of Government Institute is based on "the combination of national level international expert assessments from the World Bank and the largest QoG survey to date", namely a survey of approximately 34,000 EU citizens. Although the sources are very different from those used by the CPI, the ranking is closely consistent with the CPI distribution (Fig. 6.5a). Also the 2010 Eurobarometer index recording citizens' personal *experience* of corruption in the previous 12 months is highly correlated with the CPI (Vannucci 2012: 85–86) and confirms the Italian anomaly. This is striking since the citizens' experience index is not strongly correlated in general with the CPI (Treisman 2007: 31–32), and is deemed to be a good index, which has been used to identify some errors in the indexes derived from experts' opinions (Razafindrakoto and Roubaud 2010).

Finally, evidence that we are dealing with an anomaly comes from *Progetto Integrità*, carried out by the Scuola Superiore di Amministrazione; they calculated what they dubbed the *Excess Perceived Corruption Index* for EU countries, the US and Japan: this index estimates the deviations of the observed CPI from the CPI that we would expect given various measures of development. Once controlling for the Human Development Index, for instance, Italy shows the second furthermost deviation from the expected value (Vannucci 2012: 89–90).

These indexes rely on the views of various economic agents, or on citizens' reported experience, and one could question their objectivity (Treisman 2007).[3] There is for instance a cultural bias that I have been able to appreciate by living for many years in the UK: when confronted with a case of bribery the British typical interpretation follows "the bad apple" model, while the Italian interpretation follows "the tip of the iceberg" model. The expectation of corruption yet to be discovered is infinitely larger among Italians than among the British—a people who, as Alexis de Tocqueville observed, are peculiarly resistant to generalization. Paradoxically, the more cases of corruption are uncovered by the Italian authorities the more people think not "oh good, we have an effective judiciary catching the scoundrels!", but rather "damn, this country is even more corrupt than I thought!".[4] This bias could influence the replies and inflate the answers for Italy and deflate those for the UK (it could also have a self-fulfilling force and induce further corruption among the Italians, "if they do it why not I?", kind of reasoning).[5]

Despite these doubts, a systematic study by Charron (2016) found that "the consistency between actual reported corruption, as well as citizen and expert perceptions of corruption, is remarkably high and such perceptions are swayed little by 'outside noise'" (p. 147). Furthermore the CPI has been validated *behaviorally* in two experiments. One is a famous natural experiment on UN diplomats' unpaid fines received for parking violations in New York City (Fisman and Miguel 2007). They found that the correlation between unpaid fines and the perception indexes of the diplomats' countries is very high. The other is an experiment carried out by Abigail Barr and Danila Serra (2010) with Oxford undergraduates who played a game in which subjects could choose whether to ask for bribes and, if asked, could choose whether to pay the bribes or refuse.

They found that both paying and asking for bribes in the experiment are highly correlated with the CPI values of the country of origin of the participants. "In 2005, we took a sample of individuals living and studying in Oxford but originating from 34 countries with markedly different levels of corruption, presented them with a corruption decision associated with an exogenously defined set of monetary costs and benefits, and found that, among the undergraduates, we could predict who would and who would not engage in corruption with reference to the level of corruption prevailing in their home country" (Barr and Serra 2010: 869). Both experiments validate the CPI generally, but even looking at their country-level data we find—admittedly relying on only a handful of cases—that Italian diplomats and Italian undergraduates in Oxford conform to the general correlation. The conclusion of these studies is that the disposition to corruption has seeped into the *culture* of the countries of origin and it sticks to its citizens, old and young, wherever they may be.

The Italian Anomaly: Explanations

There is a comprehensive test of the Italian anomaly based on observational data: it does not just show Italy as an anomaly, but that this anomaly is not accounted for by any of the many factors that could plausibly explain corruption. This test can be extracted from Daniel Treisman's (2000) cross-country model of corruption, in which—drawing from a wide range of theories and previous findings—he includes most of the conceivable variables that could affect corruption. Corruption, he argues, should be *lower* in countries in which

- Democracy is stronger
- Economic development is higher
- People are better educated and aware of the public/private distinction
- There is greater freedom of the press, and livelier civic associations
- Public servants wages are higher
- There is more exposure to competition from imports

- There is an efficient legal system—"common law" better than "civil law"
- There is a protestant tradition

By contrast, corruption should be *higher* in countries in which the state is more present in the economy, there are significant natural resources, and there are ethnic divisions. Finally, Treisman included measures of Federalism and Political instability, which, scholars have conjectured, could produce effects *in both directions.*

The outcome of Treisman's model that interests us is reported in Fig. 6.4: Italy comes top in terms of *unexplained corruption* as measured by the residuals obtained by regressing all of the above variables on the CPI index. The Italian puzzle survives the toughest of spins in the statistical mixer, even after all plausible ingredients are thrown in.[6]

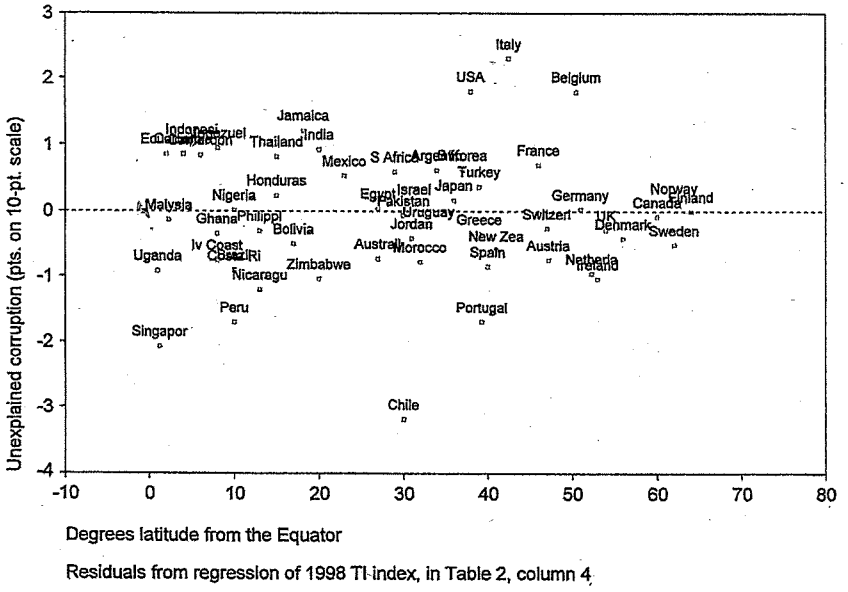


Fig. 6.4 "Residual unexplained corruption, Transparency International 1998 rating." Source: Treisman 2000, p. 438

There is however one ingredient, itself *the* most deep-rooted of Italian peculiarities, which Treisman's model omits: regional disparities. The Quality of Government Index, which has been calculated for 181 European regions (Quality of Government Institute 2010: 39), reveals that regional variations are astonishingly high in Italy, much higher than in *any* other EU country (Fig. 6.5a and b)—Italy contains massive disparities, and virtuous regions coexist with vicious ones, especially in the south. If we treat the two sets of regions, the south and the rest, as if they were separate countries the puzzle would lessen in the south since there both corruption is higher and economic performance is lower, and the two variables thus become more aligned. So partly the Italian corruption puzzle can be explained away as the result of a composition effect.

However, as the map in Fig. 6.6 shows, the QoG corruption index remains high in the rest of the country relative to western and northern EU countries, and is on a par with that of the less developed EU countries in the east. Consider also that socio-economic development is much *higher* in the north, which implies that the tension between corruption and development is not relaxed. The anomaly may lessen somewhat when we take the southern regions out of the picture, but if anything it could become even stronger in the rest of Italy.

Having established with reasonable confidence that Italy is a corruption anomaly, in the next section I will leave the macro picture and delve into the micro mechanisms that preside over corruption.

Sharing Compromising Information

Corrupters and corruptees may be white-collared and meeker than others, but they are criminals nonetheless. Like villains of many stripes they too face two perils. One is of course being caught and to suffer the consequences. The other is being cheated by their partners in crime. The two perils combine when partners inform on one, but each can materialize independently of the other.

The problem with the latter peril is that criminals cannot easily trust one another. This is because they *are* criminals, people who by their very

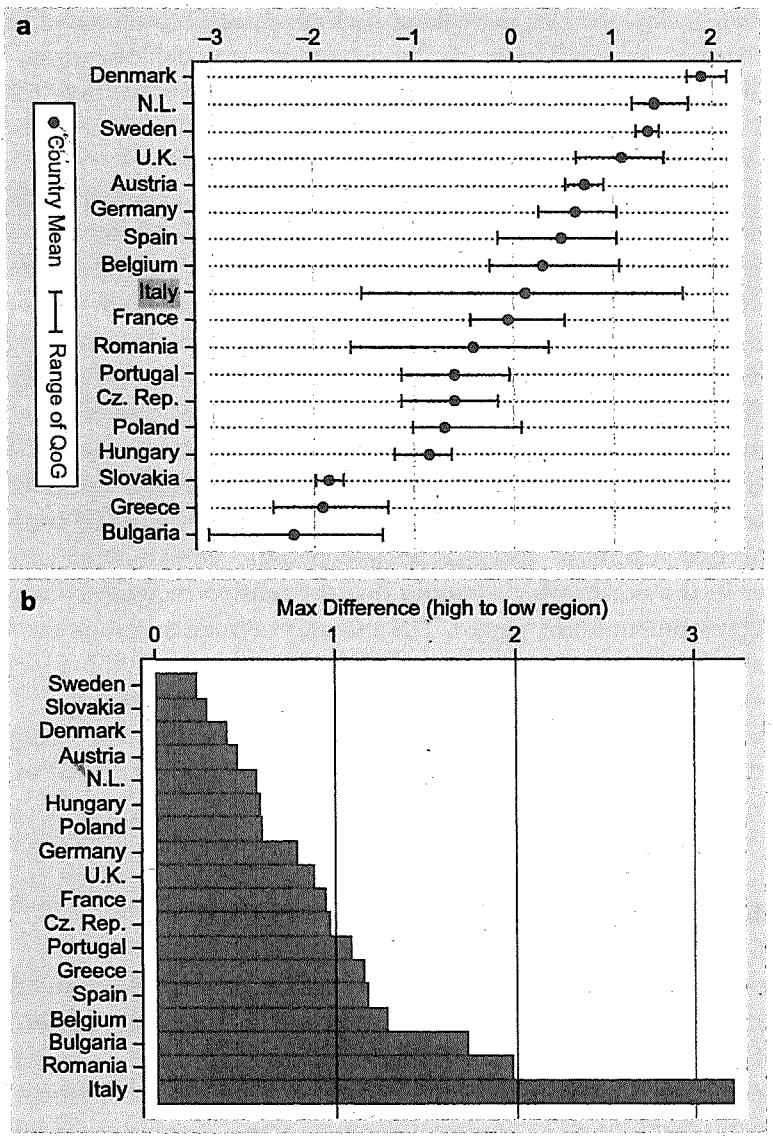


Fig. 6.5 (a) and (b) Quality of Government Index, within country regional variations. Source: Quality of Governance Institute 2010, p. 137

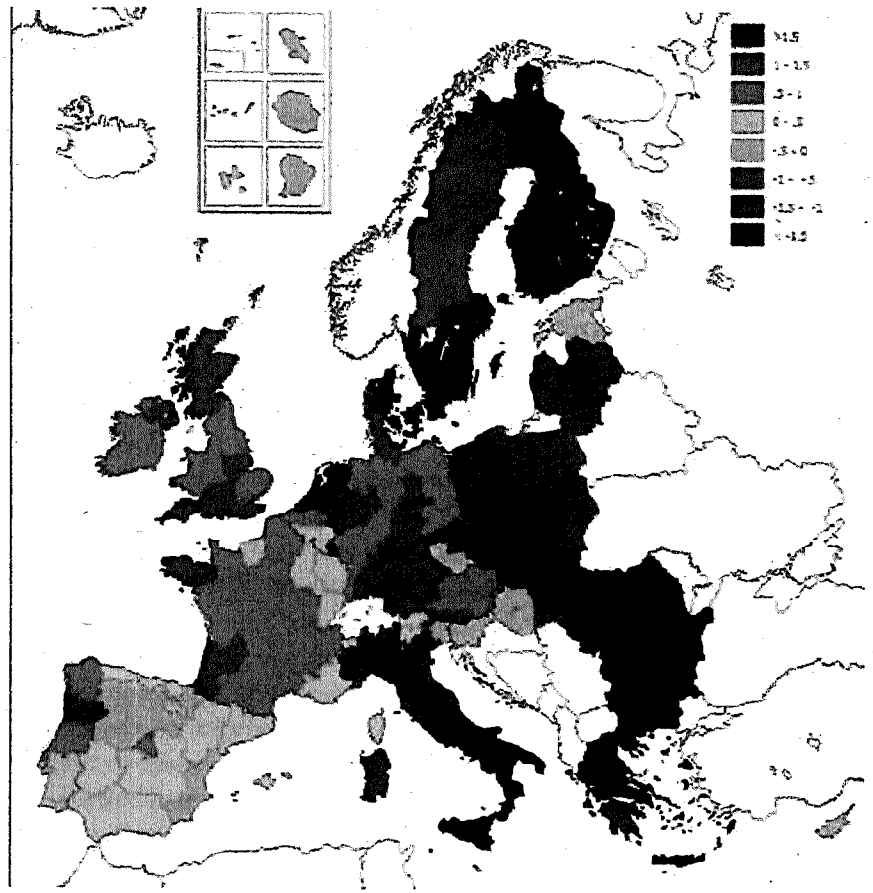


Fig. 6.6 "Combined corruption pillar with regional data." Source: Quality of Governance Institute 2010, p. 147

behavior reveal to have, more than average, the character dispositions—for example, selfish preferences, risk-taking attitudes, lack of morals and lack of respect of social norms—to rip other people off. Unlike law-abiding citizens, criminals cannot trust their partners' good character or socialization into pro-social norms: they are the first to expect little honor among thieves. It stands to reason that in order to thrive in business, the agents of corruption, who renounce by their very nature the option

to resort to the law for redress, have to find some strategy to buttress their cooperation (Gambetta 2009: Chap. 2). Trust that their partners will neither cheat them nor turn them in. My general conjecture is that a solution of the puzzle could lie in some comparative advantage that Italians must have in this regard. What could this be?

The criminal quandary of whether or not to trust one's partners is far from having a perfect solution, and this deters many would-be criminals. Those who persist in engaging in crime make do in various ways (not mutually exclusive). Some criminals restrict their dealings to *family* circles, a reassuring choice that however imposes severe limitations on business expansion. Or they arm themselves and rely on the threat of *violence*—but, as I have argued in *Codes of the Underworld*, this solution while good for movies can be bad for business as it deters those potential partners who are too intelligent or too squeamish to get mixed up with a violent lot. Some other villains enjoy indefinitely *repeated interactions* that sustain their honest dealings—as the illegal lotto in Naples or the peculiar travel insurance that pay the fines of commuters caught traveling without a ticket which is found in Mumbai (Gambetta 2011: 153). Repeated interactions, however, sustain self-enforcing cooperation only if the law does not disrupt business continuity—to function it requires ineffective or corrupt law enforcement. The luckiest criminals of all are perhaps those who can count on stable and independent enforcing agencies, entrenched monopolies of violence with an incentive to provide even-handed protection to illegal transactions—aka *mafias* (Gambetta 1993). The lively fauna of mafias that has plagued Italy's southern regions for at least a century and a half provide a pseudo-government of the underworld: they enforce illegal deals, including corrupt deals, thus increasing the incentive to engage in them. They make corrupters and corruptees stick to their promises and refrain from cheating one another, while ensuring *omertà* and decreasing the chances of detection. These institutions give Italy a comparative advantage in terms of corruption.

Are mafias then the solution to our puzzle? There are two reasons to doubt it. First, while helping criminals, mafias impose a "tax" on legal transactions too; they stifle competition in the economy and in politics, worsen the quality of public services and public works, and encourage the exodus of creative and civic individuals. In other words, mafias may

well explain the higher corruption levels in the south of Italy, but as their modus operandi is incompatible with economic development they do not explain the other horn of our puzzle. Next, mafia enforcement is not a necessary condition of corruption in Italy. Many cases that have come to the surface, even in recent times, have occurred in Milan and in Venice.[7] These cases involve vast networks of complicity and seem to have functioned well—till they were discovered of course—without third-party enforcement. How did the people involved manage to sustain their cooperation?

In earlier work I have identified another mechanism that solves the problem of criminal cooperation, and which does not require recourse to in-house violence or mafia protection; it benefits from but does not require repeated interactions either. It is the modern version of hostage exchange: instead of exchanging people what is exchanged is *compromising information* (Gambetta 2009: Chap. 3). This idea originates from an intuition of Thomas Schelling: consider the case, he wrote, in which "both the kidnapper who would like to release his prisoner, and the prisoner, may search desperately for a way to commit the latter against informing on his captor once released, without finding one". This is an instance in which two agents would like to agree on an action that leads to an outcome that they both prefer to all other outcomes, but one of them cannot trust the other's promises. The kidnapper in this case fears that once freed the victim will inform on him. Schelling proposed a solution: "If the victim has committed an act whose disclosure could lead to blackmail, he may confess it [to the kidnapper]; if not, he might commit one in the presence of his captor, to create the bond that will ensure his silence" (Schelling 1960: 43–44).

The example of the kidnapper is somewhat extreme and asymmetric for the victim already has compromising information on the kidnapper—that is the inevitable by-product of the kidnapper's crime. Only the victim needs to show evidence of her misdeeds to rebalance the situation thereby gaining the trust of the kidnapper. While inspiring, it is not the form typically taken by the exchange of compromising information. In criminal circles it is rather symmetric: all participants worry about each other's loyalty, and all disclose compromising information about themselves to one another. Just witnessing each other commit a joint

crime, for instance, seals their bond. Mark Hiaasen, the thriller writer, summed up the strategy tersely: "The best part about this deal" [Eddie Marsh] said, "is that nobody's in a position to screw anyone else. You've got shit on me, I've got shit on you, and we've both plenty of shit on Snapper. That's why it's going down so clean" (1995: 234).

Schelling's solution identifies a counterintuitive case in which there is an advantage to opening up one's cupboard for others to see our skeletons. Worse still, the agents may have an interest in filling their cupboards with some skeletons, which may come in handy. The same reason that makes incriminating information best kept secret is also that which gives it its persuasive force. Sharing credible evidence of having done bad deeds makes us vulnerable and, because of that, makes our promises credible.

As an example let me quote the spiel that a researcher recruited by a public Italian institution received from the head of his unit: "You are deluding yourself if you think that your brilliant academic achievements in foreign universities matter for your career. You see, in order to be promoted and have career prospects I had to collect a thick dossier full of not so praiseworthy facts which make me blackmailable. This is my real asset, what guarantees to those who appoint me my loyalty, my pass for my career" (Anonymous, personal communication, my translation).

The advantages of SCI are considerable: as a means of enforcement it is cheap, for someone else once informed bears the cost of administering the punishment for you—it grows perversely in the shadow of the law or indeed of any normative system that punishes infractions. Unlike the very few people one cares about who could be sacrificed as hostages, there is plenty of raw material of potential infractions that one can use as compromising information. Evidence is easier to carry, to hide even just in one's head as a potential witness, and does not need to be fed. And it is more effective as the vulnerable person is not a relative as in the case of hostage exchange but the very agent of the transaction.

SCI has drawbacks to be sure. It can be difficult to initiate SCI "cold turkey" in ways that do not leave only one partner vulnerable to the other—"you go first", "no you go first!" kind of impasse. SCI is naturally exposed to sudden shocks that modify payoffs, for example, accidental disclosure, arrest, changes in the law de-penalizing previously prosecuted crimes—homosexuality, for instance, was likely the source of

strong bonds of loyalty among politicians, but now in many countries this can no longer be the case. No criminal venture is deprived of risk. But on balance the advantages of this solution outweigh the disadvantages.

Over the years I have gathered diverse pieces of evidence of SCI at work, which I now summarize. A typical case concerns recruitment into illegal or extra-legal organizations that require loyalty: novices are required to commit bonding crimes that give recruiters evidence against them. This is a well-documented case in organized crime and in insurgents groups, but as the quotation above suggests, it may also permeate the dark side of otherwise legal organizations and political circles. A stark digital case can be gauged from the way in which pedophiles were admitted to join online networks of like-minded individuals—they had to supply a certain amount of *new* indecent pictures, which increased the asset of the group but also compromised the new members. Close to the topic of this paper, there is abundant evidence flowing from corruption trials and defendants' confessions that agents in corrupt networks ensure their loyalty through the potential damage they can inflict on one another by revealing their crimes (for details see Gambetta 2009: Chap. 3; many examples of how *kompramat* is used in Russian politics are in Ledeneva 2006: Chap. 3).

In another study Jennifer Flashman and I show that the SCI theory has a reach outside of career criminals' circles. We apply it to explain the patterns of homophily among deviant adolescents. Individuals who engage in deviant behaviors are more likely to be friends with other deviants compared to non-deviants—this pattern has been observed across different types of deviant activities and among different age groups. We test whether SCI theory can explain homophily among deviants. Deviance makes one vulnerable to the risk of being caught and sanctioned. This vulnerability imposes a stringent constraint on deviants, who must pick their friends from among people on whom they can solidly rely. We conjecture that a way to establish trust consists of making oneself "blackmailable" by disclosing compromising information of one's misdeeds. If two individuals share their illicit behaviors with one another, both are made vulnerable and a friendship can be established. Using data from the National Longitudinal Study of Adolescent Health in the US we estimate adolescents' preferences for deviant and non-deviant friends, within and across types of activities, and across different social contexts.

We find that (a) the more secretive an illicit activity, and thus the stronger the need to trust one's friends, the higher is the homophily, and that (b) the tougher the sanctions incurred for a certain infraction, and thus again the stronger the need to trust one's friends, the higher is the homophily. Taken together these tests allow us to distinguish the effect of SCI from that of alternative explanations of homophily (Flashman and Gambetta 2014).

The evidence above relies either on case studies or on observational data, which do not provide causal validity. This is why Wojtek Przepiorka and I tried to recreate the complicity of SCI in the lab to see if even in simplified artificial conditions naïve subjects grasp the strategic potential of it (Gambetta and Przepiorka 2016). Here is a summary of what we did. In a computerized laboratory experiment we ask subjects go through a series of dyadic interactions involving trust, without at first disclosing the details of the whole experiment; then we assign the label "dove" to subjects who prove cooperative in those interactions and the label "hawk" to the uncooperative subjects. In the remainder of the experiment subjects go through the same interactions again, and we vary whether

- subjects' labels are revealed to their interaction partners automatically or by their choosing (within-subject).
- hawks, who are revealed or make themselves known as such, can be inflicted a monetary penalty by their interaction partner (between-subject).

When labels are automatically revealed and without the possibility to inflict a penalty on hawks, we find that doves cooperate with doves but avoid hawks, whereas hawks seek to interact with both doves and hawks but, unlike doves, mostly defect. The cooperation rates among doves and among hawks are 63% and 23%, respectively.[8] Both these rates differ significantly from the cooperation rate in the control condition, in which all subjects interact not knowing the label of their partner.[9] This pattern hardly changes after subjects are given the choice to reveal their label before each interaction.

Once the option to penalize hawks is introduced, subjects' behavior changes dramatically. First, doves become less reluctant to interact and

cooperate with hawks, but hawks, fearing the "stick", prefer to avoid doves. Second, if labels are automatically revealed the proportion of hawks, who cooperate with each other increases from 23% to 39%.[10] Finally, among hawks who choose to reveal their label, when revealing is an option, the cooperation rate increases further, from 39% to 67%.[11] The majority of hawks follow a rather blunt strategy: hide their label and defect. But a minority of hawks understand the strategic advantage of SCI and do so to cooperate with each other. These hawks know to use their sticks conditionally, that is only if the other does. Our results corroborate SCI.

Why Do Italians Do It better?

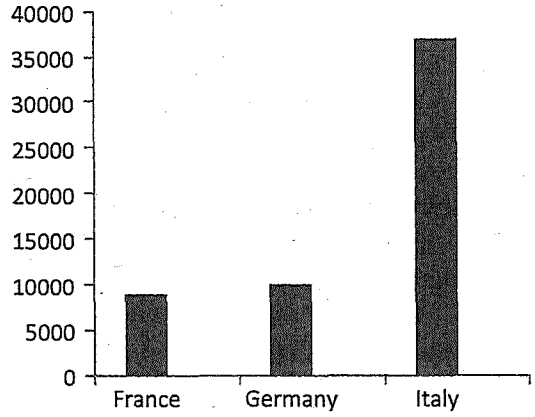
Although SCI seems to be employed far and wide, this says nothing about how it could solve our corruption puzzle. To argue that SCI is part of the solution, we need to argue that Italians somehow "do it better" than people in other countries: what are the conditions that could make it *easier* for Italians to rely on it?

Let us imagine that we want to build a mechanical device mimicking SCI optimal properties. (This amounts to building a homemade equivalent of the *Doomsday Machine*). Each party to a deal should have:

- a sword hanging over each party's head, which follows them around wherever they go;
- unique and private access to a button controlling the sword menacing the other party. By pressing the button each party can cause the sword to drop on the head of the other party;
- neither party can dodge the strike of the sword once released;
- no other force can cause the sword to be released—release is activated only by the buttons controlled by the parties;
- the buttons should have a short delay, short enough for a party not to avoid the strike but long enough to give time to the target party to realize the sword is falling and reach for his own button to retaliate.

There are two equilibria: indefinite truce or mutual destruction. The requirement to sustain the truce is the belief that neither party would refrain from retaliation if attacked. The case is similar, Schelling again, to "mutually assured destruction"—a theory applied to international relations especially after 1945 with the advent of nuclear weapons, and yet arguably so ubiquitous in an unarmed venial form in ordinary life to have remained invisible.

The ensemble of these five properties of our SCI device is not easy to come by in the real world, but my surmise is that the Italian situation approximates them. First of all, Italy is a country of myriad laws (Fig. 6.7). The legal landscape is inordinately large and bewilderingly complex, written in a convoluted obscure jargon that spreads uncertainty and allows manipulation. The surfeit of laws has two important consequences for our purposes. First, it is hard for Italians to go through a day without violating at least one law or even just *fearing* that they violated one unbeknownst to them. This causes an "overproduction" of compromising information, the raw material of SCI. Italians are, as it were, followed everywhere by lots of variedly sized swords that could fall on their head at any moment. As the majority of Hawks in our experiment, most Italians do not go



Sources: Servizio Studi Camera Deputati; Luigi Tivelli 2006

Fig. 6.7 Number of laws in three European countries

around advertising their infractions—they are nervous rather, fearful of the legal quagmire that may envelop them. Yet, most people have some "dirt" on some other people without even looking for it—they know of their landlords' tax evasion, of their neighbors' illegal building extensions, of their colleagues' shirking and of friends' cheating in exams, drink-driving, dope-smoking or patronizing prostitutes. The pervasiveness of relatively small infractions fosters a folk culture of *tacit complicity*. No one dares to turn anyone else in. (Two commonly heard injunctions up and down the peninsula are "mind your own business" and "don't cast the first stone"—we are all sinners and a bigger stone could come back and hit you). Most importantly for our puzzle, this broth gives people who can appreciate the strategic advantage of making good use of compromising information for criminal purposes, plenty of opportunities. This state of affairs satisfies condition (a) of our SCI device.

What about the other conditions? The second consequence of this congested legal setting is that law enforcement agencies and the judiciary are overburdened, which implies that they seldom can afford to pursue violations suo motu, with the exception of serious and violent crimes. This raises the probability of impunity, which may go somewhere toward explaining the Italian anomaly. But we should not forget that those who consider embarking on corrupt deals face two perils, being caught by the law is one of them, the other is being cheated by their partners. Impunity directly guards against the former. But to understand how impunity indirectly can guard against the latter we need to take the matter to a greater depth.

One could suppose that if law enforcement is made inefficient by being overburdened and impunity is high, then the potential blackmailing effect attached to violations evaporates. Information about violations would be compromising in theory only. I can shout as much as I like that I can prove that you are a crook, but if nobody takes any notice what is the point of SCI? But this is not so. For the probability of being caught and convicted for any one violation in an overburdened system comes to depend almost entirely on whether someone will inform the authorities and induce them to act rather than on the latter's independently initiated investigations. *The fear of sanctions becomes ancillary to the fear of someone informing on one.*

Even so, one might further suppose, an inefficient law enforcement is itself open to corruption, and this too could make the button malfunction as people could buy their way out of troubles. But this is not the case in Italy. Paradoxically, precisely because Italy has a largely independent and incorruptible law and order system, this system becomes a crucial cog that makes the SCI wheel turn smoothly. Italy has the worst judiciary that money cannot buy. It is the combination of being both overburdened *and* independent that makes the law liable to be exploited by SCI. It means that one can press the button—that is alert the law of a transgression—and get results. By informing on people one can trigger the response of the law and its unpleasant consequences. This satisfies conditions (b) and (c) of our SCI device.

This near-automaticity of the investigative process rests on the fact that the judiciary in Italy has a duty to open an investigation whenever it receives information of a crime (*notitia criminis*). This can occur not only when the police or a hospital personnel alert the prosecuting judges of a crime, but also when citizens report a crime of which they or a third party are the victim, or a media source uncover evidence of criminal activities. Even evidence received anonymously or from an undisclosed police informant, while not admissible in court, can nonetheless trigger an investigation.[12] Whenever one wants to reveal compromising evidence, effective disclosure still requires some ingenuity and care. An entrepreneur who typed an anonymous letter denouncing the members of the cartel to retaliate against his exclusion was identified through his typewriter by the *Carabinieri* and indicted with the rest. But disclosure can be awfully safe and simple too: an anonymous graffiti scribbled on the walls of a nursery in Lastre a Signa near Florence, Italy, sufficed to induce police to launch an investigation, which led to corruption charges against three civil servants.[13] The ease with which one can land someone else in trouble makes the threat derived from SCI credible, and discourages people from taking advantage of each other. So much so that the parties to corrupt deals seldom need to carry the threat out and release the compromising information.

Condition (d) is satisfied first and foremost by the dearth of suo motu investigations, but also by that of investigative journalism and the muffled freedom of the press (see Fig. 6.3): these conditions jointly decrease the

chance that a sword will fall on someone's head independently of a SCI deals. Lastly, condition (e) is easily satisfied as at some point, often quite early on, one is informed by prosecutors that one is under investigation, and has ample opportunity to retaliate—he may even be encouraged to do so by the prosecutors eager to secure more convictions and ready to negotiate a sentence discounts for those who turn state witness.

When all these conditions are fulfilled it becomes not so risky for corrupters and corruptees to seek each other out—either of them can propose a deal with little fear the recipient will rush to turn him in lest he too gets turned in. And the consequence of pushing the "mutual destruction" buttons are so severe that by and large corrupt people will stick to their promises, or at least never deviate enough to motivate the other party to trigger the compromising information.

Conclusions

The five conditions that I described could support the lively corruption scene that makes Italy such an anomaly. But what about the other half of the puzzle, namely that the country is far more developed than its level of corruption would predict—why should SCI-driven corruption not be crippling, but just holding the country back, arguably keeping it on a slower growth path than it could otherwise enjoy?

By supporting anti-meritocratic practices antithetical to development—if for example public servants operate as in the case I reported above—I have little doubt that SCI is a major force in keeping institutions in a lamentable state. But here is the twist: by promoting corruption SCI works against economic development, yet SCI in itself is not applicable only to enforce criminal deals: this web of secret-sharing can sustain *any* contract. Why would that matter? Italians who wish to pursue perfectly normal businesses too need to trust their partners, and although unlike their criminal counterparts they can have recourse to the law when disputes arise, they are discouraged from doing so lightly by the slow Italian legal process (starkly illustrated in Fig. 6.8a and b). Ending up in court is not a prospect anyone cherishes, and makes settling business disputes extremely costly for entrepreneurs. The slowness of the legal

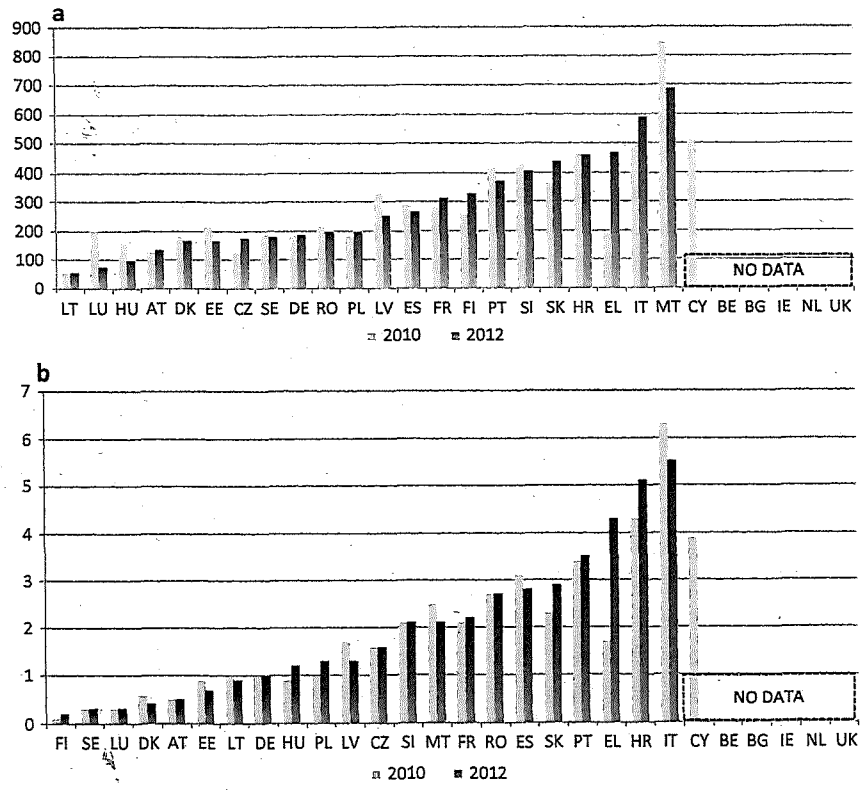


Fig. 6.8 (a) and (b) Pending cases in civil courts (in millions) and time to reach a verdict (in days). Source: graphs: http://www.eunews.it/2014/03/17/giustizia-italiana-penultima-in-ue-per-la-lentezza-e-ultima-per-il-numero-di-processi-pendenti/13462; the data of the graphs are from CEPEJ 2014

process should discourage people from going into business, and it most certainly does. So it seems something of a miracle that in spite of this institutional bottleneck Italy has had any economic growth at all.

My surmise is that the same web of complicity that sustains corruption might have a sunnier side and be a substitute to the slow justice system. While mafias exact a heavy cost on development, SCI is cheap, non-violent, manageable without third-party interference, and requires minimal organization. Nothing prevents people from exploiting SCI as a

mutual insurance to cooperate in legal ventures (or play on both the legal and illegal table at the same time). People who would otherwise stay out of business may still embark on it thanks to SCI. It has often been noticed that Italians prefer to do business with people they know rather than with strangers, even if strangers might provide better quality. This is ascribed to the fact that people one knows are more trustworthy, but they are also people about whom one *knows* about their misdeeds and can ensure that they behave trustworthily. SCI does not need to operate upfront, it is not, except in extreme conditions, vented out crassly by nasty utterances, evoking threats, blackmail, complicity—it is often implicit, a reassuring backdrop of complicity. It is plausible that SCI might paradoxically help cooperation and entrepreneurship, and thus square the puzzling circle of corruption *cum* development.

I do not have an empirical test of this conjecture to propose. Broadly speaking, any law, whether introduced or abolished that affects behavior should have an impact on SCI by respectively increasing or restricting the raw material of it. Suppose for instance that alcohol prohibition was introduced in a country in which people are fond of drinking so that not many would be deterred. Drinkers would be pushed underground, but at the same time would acquire barrels of compromising information on each other that would strengthen their bonds. These bonds may remain within the confines of saloon banter and private friendship, but can also spill over into illegal business life. It is not easy to construct a test that exploits changes in the law, but perhaps not inconceivable either. There is however one question the answer to which may afford us easier progress: are there other countries which fulfill the same five conditions, and if so do they too have the same pattern of both high corruption and economic development? Treisman suggests a list of candidates that may be worth some collective examination: "Some countries have grown extremely rapidly in recent decades despite a perception that their states were highly corrupt. Among the fastest were China, South Korea, Thailand, India, and Indonesia" (2007: 19).

Finally, if SCI were the right explanation of the Italian anomaly would there be any policy implication? Reforming and simplifying the Italian legal system is a daunting task, even if politicians were of unshakeable

determination and enjoyed solid majorities in parliament it could take generations. More modestly, with a logic akin to that suggested by "the broken window theory", one could invest more vigorously on combating the myriad smaller and easily observable infractions to dry up the swamps in which every day anti-legal complicity feeds and festers, rather than to persist in thinking that the task of an overburdened law and order system is to focus only on serious crimes. By reducing the expectation of impunity and the belief that suo motu one can be duly punished even for small violations, one would make citizens more wary of bigger violations, and weaken both the direct incentive to corruption offered by impunity and the perverse exploitation of the law on which SCI thrives.[14]

Comments by Juan Dubra, Universidad de Montevideo

Gambetta's interesting and well-written paper documents that Italy is both very corrupt, and very developed. This poses a puzzle "regardless" of our view of the relationship between corruption and development. If one thinks that corruption hinders development the puzzle is "how could such a corrupt country become so developed?" If one thinks that the fight against corruption is a normal good, so that rich countries tend to fight corruption because it does not look good, then the puzzle is "how can such a developed country tolerate so much corruption?" This form of the puzzle is also relevant to the view that a developed country would not foster corruption because of its reliance on the rule of law, competitive markets, a meritocracy in its bureaucracy and a free press.

Gambetta's conjecture is that the Italian environment is particularly good for producing "something" that produces both corruption and development. This something is the SCI. When two people know compromising things about each other it is possible to sustain transactions which on the one hand improve both parties' welfare, and on the other would not be possible in the absence of the mutual knowledge. To illustrate how revealing compromising information about oneself could be beneficial, imagine for example that one person wants to buy a car from

another, but has no money now, and there are no good credit markets, and it is hard to recover the car in good condition if the buyer refuses to pay. If the current owner of the vehicle could implicitly or explicitly threaten the buyer with sending him to jail for something he did in the past, if the car is not paid in the future, the transaction could take place. Even though it seems like it would be bad for the buyer to have compromising information about him being known by others, in this case it would help him obtain the car. This example shows that making compromising information about oneself known can help in transactions; it does not illustrate the mutual SCI (more about this below). Still, in Gambetta's theory, SCI can improve welfare, or development and SCI also fosters corruption.

The article's hypothesis is that Italy is "unique" in its capacity for SCI to play an important role in both generating development and corruption. The reason is that a lot of compromising information is generated, and this promotes transactions, both corrupt and development-augmenting. Moreover, this information has no costs. I will focus on three aspects that according to Gambetta explain Italy's uniqueness in this regard.

- Lots of dirt being generated on everybody.
  - Lots of laws (and lawyers), with no enforcement because judiciary is overburdened, so "everybody" breaks laws all the time.
- It is easy to use it in a damaging way.
  - Clean judiciary responds when a bad deed is reported.
- If nobody "pulls the trigger" on you, dirt is harmless.
  - No good press, so bad deeds do not get aired.
  - Overburdened judiciary, so no investigation without finger-pointing.

Gambetta's theory is intriguing, and certainly has a truthiness to it. Still, as the paper's title makes clear, it is only a conjecture, and more empirical analysis is needed in order to establish whether SCI is in fact a cause of both high development and corruption. In order to guide my

discussion, and where more empirical research might be needed, I will focus on three main points:

- I will argue that Uruguay has those "same" conditions that promote SCI according to Gambetta, but no corruption or development.
- In Gambetta's theory the link between conditions 1–3 above and corruption is not analysed in the paper. This points to the need of sharpening the conjecture, which might bring in new variables that would "kill" Uruguay as a counterexample to Gambetta's theory.
- As a general point, Gambetta's argument highlights the fact that some variables that might affect the level of corruption in a country have "complementarities": a high level of one variable generates corruption only if another variable is also high. For example, lots of laws are bad, only if the judiciary is overburdened (or there is no free press). In the empirical analysis of corruption such complementarities are often not central. This complementarity is not central in most analysis of the determinants of corruption, and in that sense Gambetta's paper is another illustration that theory should inform empirical exercises in this topic.

One way to stress test Gambetta's theory is to produce a country that has the same values in the explanatory variables ("right hand variables") as Italy, but the opposite outcome. Uruguay is one such case. Fig. 6.2 shows that Uruguay is both poorer and less corrupt than Italy.

In addition, in terms of explanatory variables, Uruguay is similar to Italy. One of the main drivers of SCI (or corruption, according to Tacitus) is the proliferation of laws, and lawyers. However, Uruguay has more lawyers per capita than Italy (see Fig. 6.9), and that is despite the fact that in Uruguay only about a third of kids finish high school, while in Italy that same number is 81%.

Also, while still lower than Italy (see Fig. 6.7), the number of laws in Uruguay is very high, about 20,000, that is even despite its young age. Although counting laws is admittedly a hard problem.

As another example of how laws and regulations make life "complicated", leading to the potential generation of compromising information,

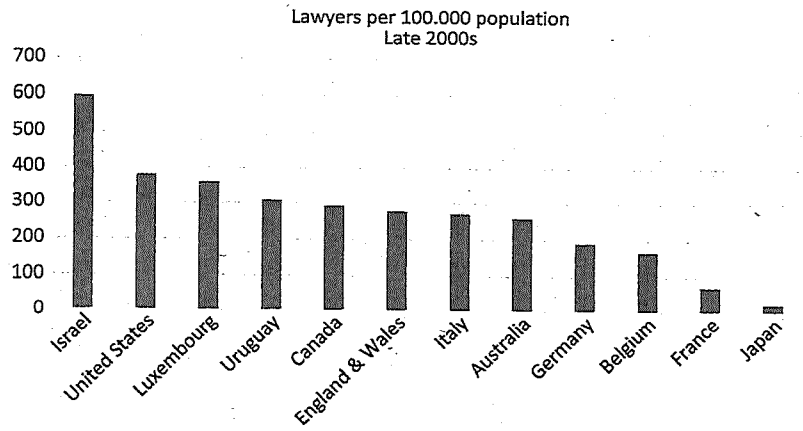


Fig. 6.9 Lawyers per 100,000 population during late 2000s. Source: Author's elaboration with data from Ramseyer and Rasmusen (2010), the Council of Bars and Law Societies of Europe, and Caja de profesionales del Uruguay

Table 6.1 Procedures, time and cost of opening a business

	Procedures	Time (in days)	Cost (% GDP p/c)
Italy	5	5.5	13.8
Uruguay	5	6.5	22

Source: Author's elaboration with data from World Bank's doing Business database

Table 6.1 illustrates the time, number of procedures and cost of opening a business in Italy and Uruguay.

I conclude with three comments that might help sharpen the theory, and validate it empirically.

I mentioned above the need to sharpen the theory in order to exclude a "counterexample" like Uruguay, and that might come from the exploration of how SCI also helps corruption: there may be features which make SCI good for corruption, which are not present in Uruguay. Another point that I would like to see studied further is how can (mutual) SCI foster legal transactions that would not happen otherwise. To be concrete, suppose two parties want to engage in a transaction in which either party can cheat the other and steal a sum of money $x (above

what would be the normal profits of the activity). If SCI will support this transaction, parties have to share information which is more damaging to them than $x. In that case, it seems that the threat is "don't cheat on me, or I'll disclose what I know about you, and you will lose more than the $x you will have stolen from me". But if one of the partners cheats the other, he might say, "Now I have cheated on you. Don't reveal what you know about me, or I'll reveal what I know about you." Since for the cheated party there is no benefit ex post of revealing the information, it seems that SCI would not accomplish its ex ante objective.

In terms of validating Gambetta's theory, two avenues might be worth exploring. First, one can estimate again whether Italy is still an outlier in Treisman's 2000 estimates in terms of corruption (Fig. 6.4) if one includes in the analysis the variables that make for a good environment for SCI. Moreover, as pointed out earlier, one would have to include those variables in a way which is consistent with the theory, in terms of the complementarities that Gambetta points out.

Finally, an important aspect of Gambetta's theory is that an individual will not be prosecuted unless a finger is pointed in his or her direction. If Italy is characterized by a lot of SCI, and some contracts are breached, the number of trials started by finger-pointing should be higher than elsewhere. This would be an "observable" consequence of a lot of SCI going on. The general point I am trying to make is that one should look at observable consequences of SCI, and see whether these are more prevalent in Italy than elsewhere.

Concluding Remarks

The paper is very interesting, and the hypothesis put forward is quite intriguing. The data presented to support the conjecture is rich, and seems to point in the right direction. Of course, as the paper admittedly presents "only" a conjecture, some aspects of the theory need to be refined or clarified (what is the connection between SCI and corruption?), and a deeper understanding of the data is necessary.

Acknowledgements I would like to thank Valeria Pizzini Gambetta and Alberto Vannucci—as well as Avinash Dixit, Juan Dubra, Frank Fukuyama, Francesca Recanatini and the other participants in the IEA Roundtable—for their comments and suggestions.

Notes

1. Daniel Treisman points out that: "Italy's corruption rating fell sharply—by more than one and a half points on the Transparency International Index—between the early and mid-1990s, possibly because of the public outrage and judicial campaign against political corruption. But, for its level of economic development, democracy and openness to trade, Italy before these changes *had an abnormally high corruption rating*" (2000: 441–442, my italics). In that short period of time the judiciary came down the hardest on political corruption in an operation known as "Mani Pulite", causing a positive blip in the index; but since then matters have gone back to ... abnormal.
2. For a comprehensive account see Vannucci 2012, esp. Chap. 3.
3. A new index, based on corruption cases prosecuted in one country but which occurred in a different country, proposed by Saarni Escresa and Lucio Picci, gives some evidence that the CPI may make Italian corruption seem worse than it is (2017).
4. An interesting bias in corruption beliefs is revealed by Olken (2009: 951): "Villagers in more ethnically heterogeneous villages are less likely to report trusting their fellow villagers, and more likely to attend project monitoring meetings, than those in homogeneous villages, which may explain why there is greater perceived corruption in heterogeneous villages but lower missing expenditures."
5. A different bias is mentioned by Treisman: "It is possible that the ratings we have been analysing measure not corruption itself but guesses about its extent in particular countries that experts or survey respondents have derived by applying conventional theories about corruption's causes, the same conventional theories that inform the hypotheses of researchers, which turn out—surprise!—to fit the data well. Believing democracy reduces corruption, the experts give high grades to democracies; researchers then discover that democracy predicts a low corruption rating" (2007: 32). Paradoxically, if this were the reason why we cannot rely on these indexes,

then the Italian case should be reassuring for these variables that explain corruption levels elsewhere, do not explain the Italian case well.

6. The results also confirm Chile as a positive anomaly, but not Uruguay, which is on the expected line.
7. See, for example, http://espresso.repubblica.it/inchieste/2014/06/09/news/confessate-a-milano-tangenti-per-tre-milioni-1.168631; http://corrieredelveneto.corriere.it/veneto/notizie/cronaca/2016/13-aprile-2016/tangenti-mose-via-processo-gli-imputati-matteoli-orsoni-240299413428.shtml; www.ilfattoquotidiano.it/2015/12/21/mose-a-giudizio-il-sistema-delle-tangenti-processo-per-lex-ministro-fi-matteoli-e-lex-sindaco-orsoni/2324332/.
8. $\chi^2(1) = 29.07, p < 0.001$.
9. 39% vs 63%: $\chi^2(1) = 18.75, p < 0.001$; 39% vs 23%: $\chi^2(1) = 8.52, p = 0.004$.
10. $\chi^2(1) = 4.58, p = 0.032$.
11. $\chi^2(1) = 4.13, p = 0.042$.
12. www.diritto.it/articoli/penale/chiaia.html.
13. http://firenze.repubblica.it/cronaca/2016/09/22/news/lastra_a_signa_il_pm_azzera_l_ufficio_tecnico_del_comune-148260467/.
14. The value of concentrating on preventing small acts of deviancy rests on different and deeper reasons, illustrated by evidence coming from neuroscience: "Behaviorally, we show that the extent to which participants engage in self-serving dishonesty increases with repetition. Using functional MRI, we show that signal reduction in the amygdala is sensitive to the history of dishonest behavior, consistent with adaptation. Critically, the extent of reduced amygdala sensitivity to dishonesty on a present decision relative to the previous one predicts the magnitude of escalation of self-serving dishonesty on the next decision. The findings uncover a biological mechanism that supports a 'slippery slope': what begins as small acts of dishonesty can escalate into larger transgressions" (Garrett et al. 2016: 1727).

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7

Cohesive Institutions and the Distribution of Political Rents: Theory and Evidence

Timothy Besley and Hannes Mueller

Introduction

The past twenty years have seen a transformation in the way economists think about economic development routinely bringing in insights from political economy. Moreover, the idea that effective institutions lie behind

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