

Chapter 1: The Level and Pattern of Corruption in the Transition Countries

In recent years, a consensus has emerged across the globe on the high costs of corruption for economic, political, and social development. There has also been broad agreement on an approach to combating corruption that focuses on limiting the *discretionary* powers of state officials to intervene in the economy.¹ As a result, the fight against corruption in the transition countries has been incorporated into a wider reform agenda combining liberalization and privatization to roll back the state and governance reforms to promote greater transparency and accountability in the state's legal and regulatory framework. However, the experience of the first decade of transition in reducing corruption has been decidedly mixed. Efforts to reform basic state institutions have generally had limited impact. Anticorruption campaigns have been hijacked for narrow political advantage. Governance reforms have frequently been blocked by powerful vested interests. The political will to implement and sustain structural reforms has often been lacking. This experience suggests that, although we may know a great deal about the causes and consequences of corruption, we know much less about the factors underlying the *persistence* of corruption.

Part of the problem comes from unrealistic expectations about the time necessary to address the fundamental roots of corruption, even in the fast-paced environment of the transition. But an important part of the problem also lies in the tendency to focus exclusively on the state and, in so doing, to limit our anticorruption strategy to standardized technical solutions. This has led to an incomplete and overly uniform approach to combating corruption that does not take into account important differences among countries in the capacity of the state, the power and concentration of economic interests, and the channels of accountability between the state and civil society—all of which are crucial determinants of the pattern and persistence of corruption across countries.

This report attempts to develop a more nuanced approach to corruption. It begins by unbundling the problem to recognize that different dimensions of corruption might have unique origins and consequences.² On this basis, a typology of corruption is developed to distinguish among different patterns of the problem across the transition countries. Specific policy recommendations are tailored to these distinct patterns, drawing from a common set of institutional and policy reforms, and with emphasis on how to target anticorruption efforts, how to sequence reforms, and how to calibrate realistic expectations in different contexts.

The typology is based on the distinction between two types of corruption—*state capture* and *administrative corruption*. State capture refers to the actions of individuals, groups, or firms in both the public and private sectors *to influence the formation* of laws, regulations, decrees, and other government policies (i.e., the basic rules of the game) to their own advantage by means of the illicit and non-transparent provision private benefits to public officials (see Box 1.1 for a further discussion of this concept). For example, an influential “oligarch” at the head of a powerful financial-industrial group could buy off legislators to erect barriers to entry in a particular sector. Alternatively, the state can be captured to serve the private interests of a political leader who shapes the framework of reforms to ensure his own private control over key resources.

There are many different forms of state capture. Distinctions can be drawn between the types of institutions that are captured—the legislature, the executive, the judiciary, or regulatory agencies. Further distinctions can be made on the basis of who does the capturing—private firms, political leaders, or narrow interest groups. One could even distinguish between the nature of the benefits provided to public officials in exchange for capture—direct bribes, illicit equity stakes, informal control rights. Yet all forms of state capture are directed toward extracting rents from the state for a narrow range of individuals, firms, or sectors through distorting the basic legal and regulatory framework, with potentially enormous losses for the society at large. They thrive where economic power is highly concentrated, countervailing social interests are weak, and the formal channels of political influence and interest intermediation are underdeveloped.

While state capture encodes advantages for particular individuals or groups in the basic legal or regulatory framework, administrative corruption refers to the intentional imposition of distortions in the prescribed *implementation* of existing laws, rules, and regulations to provide advantages to either state or non-state actors as a result of the illicit and non-transparent provision of private gains to public officials. The classic example of administrative corruption is that of a hapless shop owner forced to pay bribes to a seemingly endless stream of official inspectors to overlook minor (or possibly major) infractions of existing regulations. Beyond such forms of extortion, administrative corruption also includes such familiar examples of “grease payments” as bribes to gain licenses, to smooth customs procedures, to win public procurement contracts, or to be given priority in the provision of a variety of other government services. Finally, state officials can simply misdirect public funds under their control for their own or their family’s direct financial benefit. At the root of this form of corruption is discretion on the part of public officials to grant selective exemptions, to prioritize the delivery of public services, or to discriminate in the application of rules and regulations.

Both state capture and administrative corruption can cut across different levels of government.³ Both can be initiated by state officials, private businessmen, or other non-state actors. The key difference is neither who extracts the rents nor how important is the official who receives the bribe, but rather the nature of the political relationship underlying each form of corruption. In capturing the state, actors prejudice the rules to their own narrow advantage, which subsequently constrains the actions of others in the economy. Through administrative corruption, actors obtain individualized exceptions to or favorable application of those rules. The difference lies in how deep the corrupt transaction reaches into the operations and functions of the state and the extent to which the advantages of the corrupt transaction are institutionalized into the basic rules of the game. Though there will be many specific cases where the borderline dividing these two forms of corruption might be difficult to draw with a high degree of certainty, the distinction nevertheless has important analytical and practical implications for the potential effectiveness of different anticorruption strategies.

Box 1.1: The Concept of State Capture

The definition of state capture used in this report is derived from the concept of regulatory capture, already well established in the economics literature.⁴ State regulatory agencies are said to be “captured” when they regulate businesses in accordance with the private interests of the regulated as opposed to the public interest for which they were established. Though regulatory capture can occur through the provision of private gains, both direct and indirect, by regulated businesses to state officials, it is not limited to influence through corrupt means.⁵

State capture is a broader concept in that it encompasses the formation of laws, rules, and decrees by a wider range of state institutions, including the executive, ministries and state agencies, legislature, and the judiciary. At the same time, state capture has a narrower definition in that it focuses exclusively on illicit, illegitimate and non-transparent forms of influence.

Who can capture the state? Often, the “captors” are individuals, groups, or firms from the private sector seeking rents or other advantages from the state. Yet any actors with access to public officials and the capacity to provide private benefits to these officials in order to obtain advantages in the governing process can be seen as potential captors. Indeed, public officials themselves can capture the state if they abuse their authority to shape institutions and laws primarily to further their own private financial interests at the expense of the broader public interest, though identifying and indeed measuring such conflicts of interest are nearly impossible in the context of the transition.

The influence of private interests on the decisions of the state is a normal feature of all political systems. What separates state capture as a form of corruption from conventional forms of political influence, such as lobbying, are the mechanisms by which the private interests interact with the state. State capture occurs through the illicit provision of private gains to public officials via informal, nontransparent, and highly preferential channels of access. It can also occur through unclear boundaries between the political and business interests of state officials, which has been a particularly prominent characteristic of many transition countries. In all its forms, state capture tends to subvert, or even replace, legitimate and transparent channels of political influence and interest intermediation, reducing the access of competing groups and interests to state officials.

Different forms of state capture as distinguished by different types of captors (e.g., private firms, politicians, ethnic groups, the military) and different state institutions involved (e.g., the executive branch, the legislature, the judiciary, or regulatory bodies) will undoubtedly have their own unique dynamics and consequences. Therefore, state capture itself could be unbundled to reveal a wide range of different relationships.

Reducing state capture does not entail eliminating private sector influence on the formation of policies, rules, and laws by the state. Indeed, such influence can be an important factor pushing forward both economic and political reform. Nor will it be resolved by legalizing private payments to public officials. Rather, reducing state capture involves shifting private sector influence from illicit, nontransparent, and highly preferential channels of access toward legitimate, transparent, and competitive forms of interest intermediation. It also involves developing clearer boundaries between the political and business roles of state officials in order to prevent conflicts of interest.

Though the report highlights the problem of state capture in transition countries, it is by no means confined to the transition and continues to be a serious problem in most societies. Yet the problem in many transition countries is exacerbated by the high concentration of economic power, the poorly developed formal channels of political influence and interest intermediation, and the weak organization of countervailing interests both from the economy and civil society.

In analyzing different forms of corruption, this report places primary emphasis on the interaction between the state and the private sector. Of course, this dimension represents only one subset of corruption. Corrupt transactions can occur entirely within the state, for example when politicians bribe bureaucrats. The misuse of public authority for private gain need not require the participation of private sector actors.⁶ At the same time, corruption within the private sector itself can be an important dimension of the problem. Asset-stripping, abuse of minority shareholder rights, and bribery to obtain private services in restricted or distorted markets are all forms of corruption that do not directly involve public officials (though their indirect complicity is often an important factor). While these forms of “public-to-public” and “private-to-private” corruption will be discussed in the report, the focus on the interaction between the state and the private sector is rooted in the particular nature of the process of transition, characterized by the simultaneous building of the state and the market economy.

Faced with the concurrent challenges of defining the basic rules of the game, redistributing the bulk of state assets, forming new political structures, and establishing the key institutions of a market economy, most transition countries have been unable to define clear boundaries and effective forms of intermediation between the state and the private sector. The fusion of the party and the command economy that characterized the previous communist system has been replaced in many countries of the region by a new fusion of the transitional state and the now largely private economy. Political leaders are closely tied to business empires. Political parties are thinly veiled fronts for powerful firms. The media trumpet the rival interests of oligarchs to explain key policy decisions of the state. Though such phenomena are hardly unique to transition, the simultaneity of the political and economic transformations in a highly truncated time frame has exacerbated the opportunities for state capture in the transition countries.

Yet despite its importance, the lack of reliable empirical data on state capture has prevented serious empirical investigation. This report presents and analyses the first systematic data on state capture collected in the transition economies, along with new efforts to quantify the level and impact of administrative corruption. The data come from the 1999 Business Environment and Enterprise Performance Survey (BEEPS), a firm-level survey commissioned jointly by the World Bank and the European Bank for Reconstruction and Development (EBRD) to assess obstacles in the business environment across the transition economies (see Box 1.2 for a description of the survey).⁷ Based on more than 3,000 interviews with the owners and senior managers of firms in 22 countries across the region, the BEEPS data provide an opportunity to investigate state capture and administrative corruption from the point of view of some of those most directly affected. While the BEEPS data spotlight the relations between the state and firms, data from a wealth of audit reports, empirical studies, and detailed diagnostic surveys in selected transition countries are also presented to provide a broader picture of other forms of corruption from the perspectives of households and state officials. These surveys constitute a major step forward in understanding the depth and contours of the problem of corruption within and across countries.

Box 1.2: The Business Environment and Enterprise Performance Survey

The BEEPS survey was conducted on the basis of face-to-face interviews with firm managers or owners in site visits during the period June through August 1999 in the following countries: Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Moldova, Poland, Romania, the Russian Federation, Slovak Republic, Slovenia, Ukraine, and Uzbekistan. With the exception of Albania and Latvia, the survey was conducted in all countries by local staff of an international survey firm to ensure consistency of training and approach across countries.

In each country, between 125 and 150 firms were interviewed, with the exception of three countries where larger samples were used: Poland (250), Russia (550), and Ukraine (250). The sample was structured to be fairly representative of the domestic economies with specific quotas placed on size, sector, location, and export orientation. The sample was heavily weighted toward privately owned firms, though there were quotas for state-owned firms and firms with foreign ownership. However, no attempt was made to construct a representative sample across these ownership strata and the quotas were designed only to ensure representation.

Attempts to compare levels of corruption across different countries are fraught with difficulties. Most existing cross-country surveys of governance and corruption rely on the subjective views of outsiders, namely expert assessments, country analysts, or foreign investors.⁸ The results of such surveys are thus highly subjective and estimated with a large margin of error that inhibits cross-country comparisons.⁹ The BEEPS relies on the direct experience of firms rather than external subjective comparisons across countries. Where possible, numerical cardinal estimates of problems are used (such as share of annual revenue spent on bribes) to measure the extent of the problem, as well as to gauge the specific costs and benefits to the firm associated with corruption. These estimates enable us to measure the margin of error on many questions, which are reported in the form of error bars in the figures below.

As many of the forms of corruption examined in this report are illegal in most countries, firms must be expected to be reluctant to admit that they engage in such activity. In implementing the survey, the problems associated with collecting reliable data were kept constantly in mind, and every effort was made to assure respondents that their answers would be treated confidentially. Questions were phrased indirectly about the corruption faced by “firms in your line of business” and respondents were assured that responses would be aggregated and not attributable to themselves or their firms. The survey questions examine corruption from a number of different angles, providing consistency checks on each firm’s responses. Moreover, tests were conducted to detect any systematic positive or negative bias among the firms in any given country. The ranking of transition countries on the indices of administrative corruption and state capture used in this report remain basically unchanged when individual firm characteristics such as size, sector, and ownership are controlled for statistically.

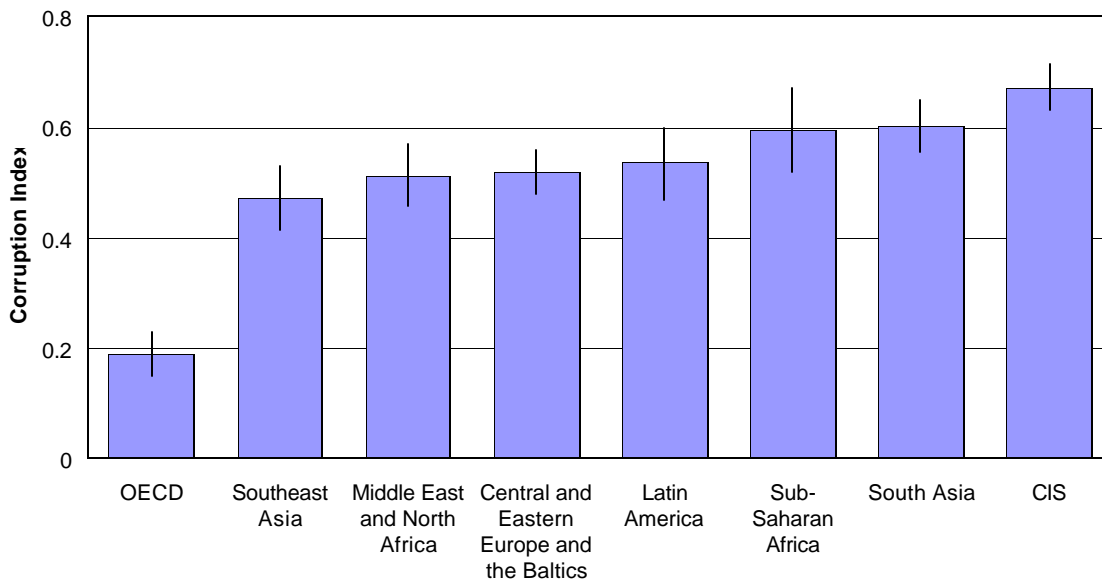
Source: Hellman, Jones, Kaufmann, and Schankermann (2000).

The report is divided into six chapters. This chapter goes on to investigate the incidence and pattern of corruption in the transition countries, developing a country typology of corruption that frames the entire report. Chapter Two examines the consequences and costs of different forms of corruption on economic performance, poverty and inequality, and the credibility of the state. Chapter Three looks into the origins of these different patterns of corruption, tracing alternative paths of transition and how they are shaped by initial conditions, institutional structures, and policy choices. Chapters Four and Five present the policy recommendations for combating corruption that have been derived from the analysis. The former sets out the building blocks to design an anticorruption strategy, while the latter draws lessons for combining, prioritizing, and sequencing these building blocks to address most effectively the particular contours of the challenge of corruption in different countries. Chapter Six draws conclusions on the basis of existing international experience.

The Extent of Corruption in the Transition Countries

According to most existing efforts to compare perceptions of the level of corruption across countries, many of the transition economies—in particular in the CIS—are seen to have among the highest corruption indicators of all the countries surveyed. According to a summary index developed from a weighted average of 12 of the most widely known cross-country corruption indices with data from 1996-1999, the level of corruption in the CIS countries is perceived to be comparable with the levels in South Asia and Sub-Saharan Africa as depicted in Figure 1.1.¹⁰ In contrast, corruption in Central and Eastern Europe and the Baltics is seen to be on par with Latin America and the Middle East, though the level remains considerably higher than it is in the Organisation for Economic Co-operation and Development (OECD) countries.

Figure 1.1 World-wide Perceptions of Corruption



The thin line at the top of each bar represents the statistical margin of error (based on a single standard deviation) calculated on the basis of the aggregated indicators. Source: Kaufmann, Kraay, and Zoido-Lobaton (1999a).

While such comparisons are a useful indicator of international *perceptions* of corruption, they provide little assistance in developing effective anticorruption strategies. They tend to be based on the perceptions of external observers and investors rather than those of nationals having direct experience of corruption in these countries. They collapse many different forms of corruption into a single scale without recognizing the diverse patterns of corruption that can be found in many countries. They hide important variation in the nature and level of corruption within regions in any individual country. Enhancing the measurement and analysis of this variation can provide critical insights both into the nature of corruption and the development of strategies to combat the problem.

Unbundling Corruption in Transition

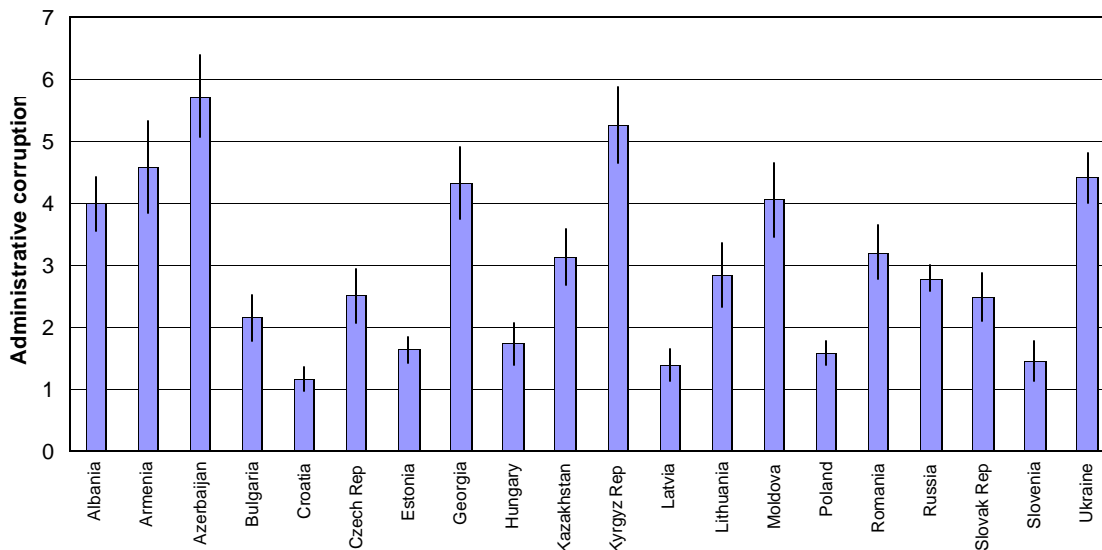
The BEEPS survey unbundles corruption to examine state capture and administrative corruption separately to provide an empirical foundation for a more complex analysis of the pattern of corruption in each country. However, the BEEPS data do not provide a comprehensive measure of corruption in the transition countries. The survey focuses on the forms of corruption in the enterprise sector that are subject to reliable measurement. As a result, the questions tend to be biased toward those corrupt transactions in which direct payments are made to public officials by enterprises. This leaves out a very wide range of corrupt transactions in which other forms of benefits that are much more difficult to identify and measure are transferred to public officials, for example, equity stakes in firms, gifts and services, or promises of future benefits. In particular, the critical issue of conflicts of interest among public officials is not addressed in the survey, as the boundaries between politics and business are inherently difficult to identify, much less to measure across countries. It is likely that these different manifestations of corrupt transactions are all highly correlated, though this remains an issue for further study.¹¹

In addition, the BEEPS survey provides a measure of corruption only from the perspective of the firm in relation to its interactions with the state. Consequently, the data do not capture a wide range of corrupt transactions that occur between public officials, between private sector actors, or between individuals and the state. In some transition countries, pure public finance corruption (i.e., theft or misappropriation of funds without the participation of firms) is likely to be even more important than the public-private nexus. To supplement the BEEPS data, we rely on surveys of households and public officials that were conducted in the context of “diagnostic exercises” on corruption in selected countries of the region. Country examples are also used to highlight forms of corruption that are particularly difficult to measure and compare across countries.

Measuring Administrative Corruption

On the basis of the BEEPS data, indicators of the level of administrative corruption can be constructed and compared across countries. As a proxy for a wide range of manifestations of administrative corruption, firms were asked to estimate the share of their revenues that they typically pay per annum in unofficial payments to public officials in order to influence the implementation of state policies, regulations, and laws in each country.¹² Figure 1.2 presents the results aggregated by country.

Figure 1.2. Administrative Corruption
(bribes as a share of annual revenues)



The thin line at the top of each bar represents the statistical margin of error (based on a single standard deviation) calculated for each country within the sample. Source: BEEPS.

Across the countries of the CIS, average payments for administrative corruption are estimated by firms to be 3.7 percent of their annual revenues; the share falls to 2.2 percent of revenues in Central and Eastern Europe.¹³ Yet measuring administrative corruption as a share of firm revenues does not convey the full weight of the burden of this form of corruption. Though data on profit margins for firms in transition economies are notoriously unreliable, given the strong incentives to conceal profits and operate in the unofficial economy, the BEEPS survey does provide a rough estimate of profit margins for firms that can be used to give a very crude estimate of administrative corruption as a share of profits. Using the average reported profit margin of 22 percent in the CIS countries and 13 percent in Central and Eastern Europe (CEE), administrative corruption constitutes approximately 17 percent of profits across the region. Though such estimates should be treated with considerable caution, they provide an indication of the heavy burden of administrative corruption on firms in transition countries.

Beyond the clear differences between the CIS and CEE, the variation in administrative corruption across countries within these regions is substantial. Some countries within CEE, such as Albania and Romania, have reported levels of administrative corruption on par with the CIS countries. Within the CIS, the highest levels of administrative corruption are reported in the Caucasus, Kyrgyz Republic, and Ukraine. Other CIS countries fall within ranges more comparable to countries in CEE.

The most commonly reported form of administrative corruption is unofficial payments to obtain licenses and permits from the state. Other common forms of administrative corruption include payments to deal with taxes and tax collection and to gain government contracts. A more comprehensive picture of the extent of administrative corruption in transition countries can be gained from household surveys, since individuals can also make unofficial payments to alter the

implementation of government policies. Household surveys in selected transition countries show that corruption within the police force, particularly the traffic police, and the health services accounts for approximately half of all bribe payments by households.¹⁴ Bribe payments associated with the educational system, especially at higher levels of the system, are also relatively common.

Measuring State Capture

Measuring the extent of state capture across countries presents a number of challenges. First, relying on the BEEPS firm level data, we can only attempt to measure the extent to which *firms* have managed to influence various state institutions in any given country. Other forms of state capture that do not include private sector participation, such as capture by politicians for their own private interests or by other non-state individuals and groups cannot be examined through a firm level survey. As a result, measures based on the BEEPS data understate the overall level of state capture in any country, while providing a more accurate measure of state capture by private and public firms. This underestimation of overall state capture may be particularly high in countries with kleptocratic political regimes, where institutions of the state have been used to serve the interests of a particular leader and his broader circle (for further discussion of the important issue of “who captures whom” see Box 1.3).

Box 1.3: Who Captures Whom?

State capture can clearly take many forms beyond the purchase of laws and decrees by private and public enterprises. State officials may use their positions to capture enterprises, or may channel state funds for their personal use in ways that do not involve other players at all. Yet the salient feature of these forms of capture is the same as that of enterprise-state capture: the perversion of the rules of the game, through corruption, to the benefit of the captors, rather than for society as a whole.

State capture can also be undertaken by actors within state institutions—the parliament, the executive, or the judiciary. Ministers may shape laws, regulations, or tax policy to benefit themselves or their own financial interests. In a number of countries ruling groups have disposed of assets for privatization through closed mechanisms designed to preclude competition and to benefit themselves or their associates, enabling them to gain control of substantial parts of the economy. In state-initiated capture, an explicit transaction need not take place, though there may be an implicit contract or expectation of future rewards through *quid pro quo* asset transfers or employment in advantageous posts. The defining characteristic is that representatives of state power, whether in the legislature, executive, or judiciary, manipulate state powers for their own private gain.

The terrain for this kind of capture is larger when a substantial part of the economy remains in state hands. Appointments to boards of state-owned enterprises can be a license to make money out of diversion of products, or closed procurement, including setting up contracts with companies owned by the board members. In these cases, the gains may be shared beyond the individuals who engineer them, with some part of the bribes and other advantages being channeled back to the political party that ensured the appointment to the lucrative post.

One key source of the problem is that the concept of a conflict between public duties and private interests is either poorly understood or inadequately respected. Safeguards against conflict of interest are key, and it is noteworthy that many countries of the region have adopted legislation designed to prevent parliamentarians and other officials from acting in a situation of conflict of interest. While few countries have implemented this legislation effectively, its existence is a signal of aspirations to restrict state capture emanating from within the state.

Second, the dynamics of state capture may be very different depending on the extent and nature of the private sector in any given country. Where the economy is still largely dominated by state ownership and key elements of the command system continue to function, the capacity of the nascent private sector to capture the state will be minimal. Indeed, the very dynamics of state capture might be expected to differ in countries where some minimal threshold of private sector development has not been crossed. As a result, though the BEEPS survey was implemented in some countries where such a threshold has yet to be reached—namely, Belarus and Uzbekistan—the results are discussed separately in order to recognize the unique nature of the problem in these cases (see Box 1.4).¹⁵

Box 1.4: Corruption When Transition is Stalled

A number of former Soviet republics (including Belarus, Uzbekistan, and Turkmenistan) have made very limited progress towards either a market economy or a multiparty political system. These countries retain substantial similarities with key elements of the previous command administrative system.

In these countries the private sector has a small share in GDP and employment (20 percent in Belarus, 25 percent in Turkmenistan, and 45 percent in Uzbekistan, where in agriculture it may be grossly over-estimated) and is subject to strict bureaucratic controls, state orders and lack of credit. There are still large scale price controls with widespread subsidies and occasional shortages. Industrial policy is product- and enterprise-oriented; central commands still abound. Multiple exchange rates, with overvalued official rates and undervalued parallel rates, are distortionary and lead to low trade flows and high current account deficits. FDI levels have remained extremely low. The EBRD's transition indicators rank Belarus, Turkmenistan, and Uzbekistan lowest among all the transition economies.*

According to international perceptions, the level of corruption in these countries is quite high. Belarus is ranked 58th of 99 countries surveyed in the Corruption Perceptions Index by Transparency International, while Uzbekistan is ranked 94th (Turkmenistan is not assessed). Yet according to the BEEPS survey, the percentage of firms impacted by state capture in these countries is reported to be among the lowest in the region, as reported below. Though there is much greater variation in the extent of administrative corruption, one of the slowest reformers – Belarus – also records one of the lowest levels of this form of corruption. Does this suggest that highly authoritarian regimes are more effective at preventing administrative corruption and state capture than democratic systems?

	Administrative Corruption (bribes as a share of revenues)	State Capture (percent of firms affected by state capture)
Belarus	1.3	8.0
Uzbekistan	4.4	5.8

Source: BEEPS. See Figures 1.2 and 1.3 to put these numbers in perspective.

The answer lies in the nature of the BEEPS survey. The BEEPS data measure corruption by firms, primarily in the private sector. Thus, state capture, as measured in this report, assumes the development of some degree of autonomy between the state and the private sector. Where the private sector is barely developed and the state continues to own and control most of the economy through administrative methods, this autonomy does not exist. In such an environment, the BEEPS questions on state capture may not provide an adequate depiction of the relationship between the state and firms.

When an authoritarian regime continues to exercise considerable control over both the executive and the judiciary, administrative corruption may be kept in check. Although such scenarios could lead to relatively low levels of capture and administrative corruption as empirically measured by the survey, this implies that the transition is still in its infancy. Hence the lower incidence of corruption in Belarus is likely to reflect lack of reform in the guise of a small private sector and lack of perceived market incentives – which also explains lower incidence of state capture – and the maintenance of a stronger state administration. Uzbekistan's combination of more advanced marketization with widespread controls is a more favorable environment for administrative corruption, as well as some forms of state capture. But in both cases, the continued existence of authoritarian controls may tend to constrain the measurable components of state capture and administrative corruption. As a result, the empirical results would not be comparable with countries that are more advanced in transition.

*These same three countries received the lowest scores in the region for political process, civil society, independent media, and democracy, from Freedom House. Karatnycky, Motyl, and Graybow (1998, p16).

Finally, in contrast to administrative corruption, the degree to which a state is captured is not necessarily related to the number of firms that engage in such forms of influence or the amount they spend in doing so. Given that state capture is a function of the concentration of economic power, only a small share of firms can be expected to have the capacity to capture the state. In an extreme case, a single powerful monopoly could generate a much higher level of state capture than a larger number of less powerful firms competing for influence. A measure of state capture, therefore, should be based on the extent to which the state's decisionmaking is distorted by the illicit influence of powerful firms and not necessarily on the number of firms actively exerting such influence.

Despite these caveats, the BEEPS data provide the first opportunity to measure key components of state capture across countries. The survey identified a number of specific activities that fall within the definition of state capture, including: the “sale” of parliamentary votes and presidential decrees to private interests; the sale of civil and criminal court decisions to private interests; corrupt mishandling of central bank funds; and illegal contributions by private actors to political parties.¹⁶ Firms were asked to assess the *direct impact* on their business, either positive or negative, from each of these activities, regardless of whether they engaged in such activities themselves. Thus, capture is measured not by how many firms engage in it, but by the share of firms whose business is directly affected by it.

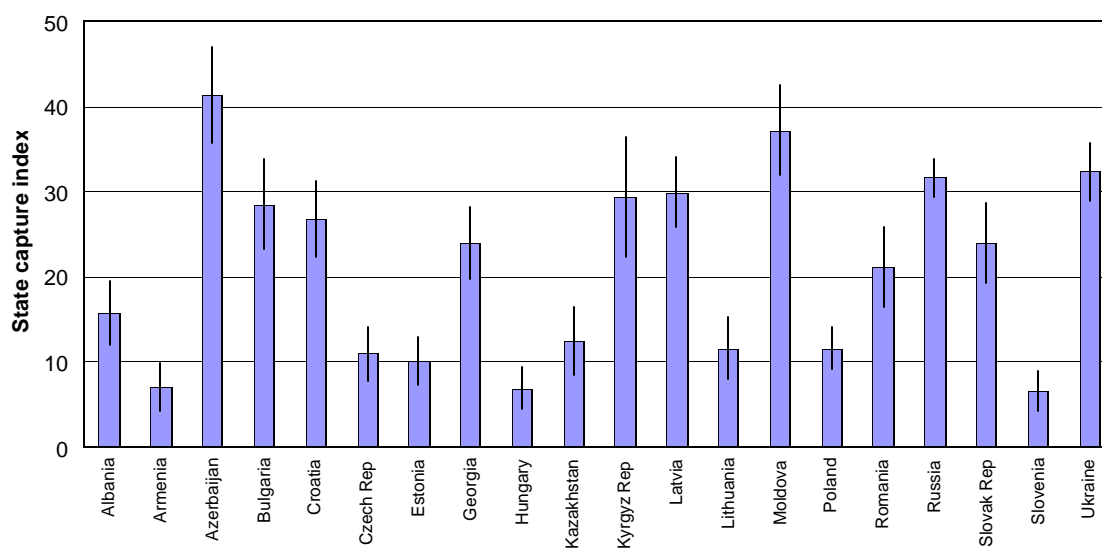
Table 1.1 presents measures of the share of firms in each country that report a *significant impact* on their business from each one of the indicators of state capture. Clearly, state capture is a significant problem throughout the region across a range of state institutions. Yet the variation across the transition economies is striking. Across the different types of state capture, the sale of parliamentary votes and mishandling of central bank funds are seen as having the most significant and direct impact on firms. Box 1.5 provides a discussion of corruption in the judiciary.

By taking the average of different components of state capture in each country listed in Table 1.1, a general index of state capture can be developed. Though the index aggregates several different forms of state capture affecting different state institutions, it is a useful measure of the perceived extent of the problem across the institutions of the state. It should be recognized, nevertheless, that in developing strategies to combat state capture, it may be necessary to further unbundle the concept itself to identify which institutions within the state are most affected and how the nature of capture differs across these institutions. Figure 1.3 compares this index across the transition countries.

Country	Parliamentary Legislation	Presidential Decrees	Central Bank	Criminal Courts	Commercial Courts	Political Party Finance	State Capture Index
Albania	12	7	8	22	20	25	16
Armenia	10	7	14	5	6	1	7
Azerbaijan	41	48	39	44	40	35	41
Bulgaria	28	26	28	28	19	42	28
Croatia	18	24	30	29	29	30	27
Czech Rep.	18	11	12	9	9	6	11
Estonia	14	7	8	8	8	17	10
Georgia	29	24	32	18	20	21	24
Hungary	12	7	8	5	5	4	7
Kazakhstan	13	10	19	14	14	6	12
Kyrgyz Rep.	18	16	59	26	30	27	29
Latvia	40	49	8	21	26	35	30
Lithuania	15	7	9	11	14	13	11
Moldova	43	30	40	33	34	42	37
Poland	13	10	6	12	18	10	12
Romania	22	20	26	14	17	27	21
Russia	35	32	47	24	27	24	32
Slovak Rep.	20	12	37	29	25	20	24
Slovenia	8	5	4	6	6	11	7
Ukraine	44	37	37	21	26	29	32
Overall	24	21	25	18	20	20	21

Source: Hellman, Jones and Kaufmann (2000a). See the Annex 1 for details.

Figure 1.3. State Capture Index
(share of firms affected by state capture)



The thin line at the top of each bar represents the statistical margin of error (based on a single standard deviation) calculated for each country within the sample. Source: Hellman, Jones, and Kaufmann (2000a).

Box 1.5: Corruption in the Judiciary

Corruption in any institution impedes its operation and distorts its objectives. However, corruption in the judiciary is particularly damaging for several reasons. The legal system is one of the fundamental pillars of a market economy whose role as arbiter of the law encompasses both the formulation and implementation of public policy. In addition to deciding criminal cases, the courts are responsible for upholding property rights, enforcing contracts, and settling disputes. As a result, corruption in the judiciary can display aspects of both state capture and administrative corruption as the terms are used in this report.

Failure of any of these roles is costly, reducing incentives to invest or forcing firms to resort to more costly private means of contract enforcement and protection. In addition to these direct economic costs, a corrupt legal system has a wider impact, undermining the credibility of the state and making the implementation of public policy more difficult. In particular, since the legal system will be the ultimate arbiter of any anticorruption program, a corrupt judiciary will fundamentally undermine anticorruption efforts themselves.

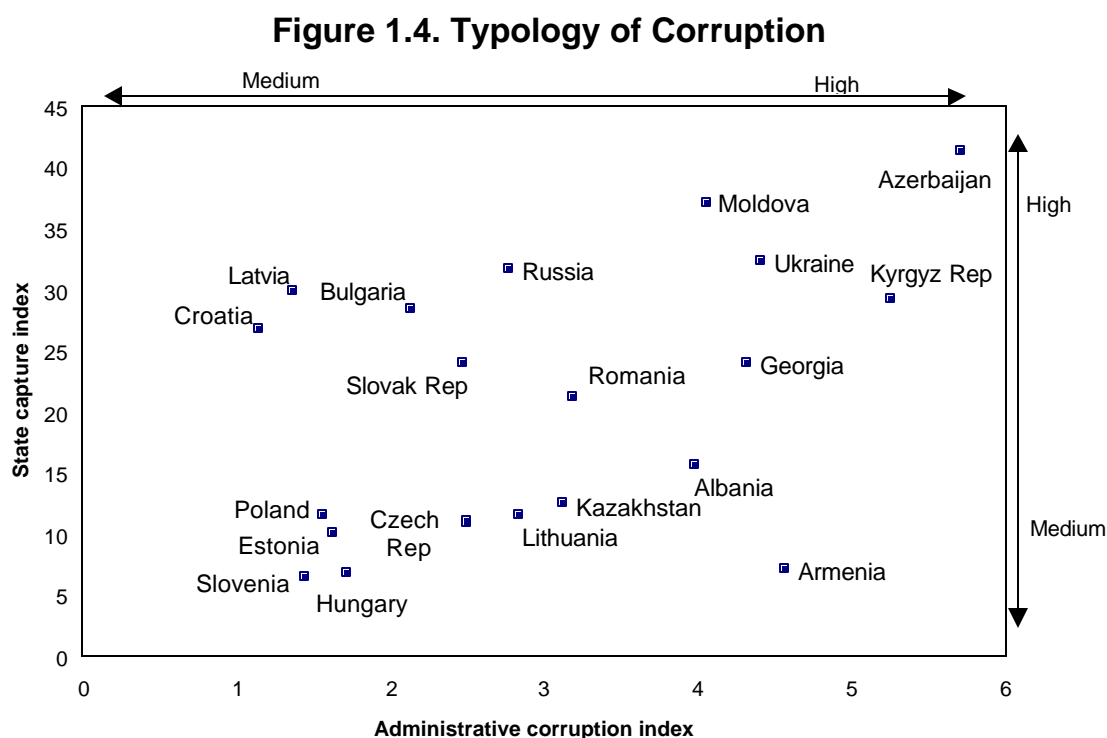
The index shows a rather wide gap between those countries with a high level of state capture and those with a lower level. Beyond a certain threshold level, it would appear that state capture generates a self-reinforcing dynamic pushing toward ever higher levels. According to the index, the following states could be characterized as “high-capture”—Azerbaijan, Bulgaria, Croatia, Georgia, Kyrgyz Republic, Latvia, Moldova, Romania, Russia, Slovak Republic, and Ukraine.

Unlike the measure of administrative corruption, the index of state capture presented above is not based on the behavior of firms, but on the perceptions of firms that such activity affects their business. The BEEPS survey also includes a more direct measure of state capture identifying which firms make unofficial payments to public officials to influence the formation of laws, regulations, or decrees. Only a small share of firms report actively engaging in state capture, ranging from a low of just under 5 percent of firms in Hungary to nearly 15 percent in Latvia. Across all the transition countries, there is a reasonably high correlation ($R=0.69$) between the number of firms that are actively engaged in capturing the state and the share of firms whose business is affected by state capture.¹⁷

Developing a Typology of Corruption in Transition

With measures of state capture and administrative corruption, we can identify variation in the *pattern* of corruption across countries. A typology can be developed on the basis of the interaction of both measures of corruption. For each index, countries can be plotted along an axis ranging from “high” to “medium” in order to suggest the extent of the problem of each type of corruption relative to the other transition countries. There is a clear threshold dividing countries into high capture and medium capture groups. On administrative corruption, there is a more continuous distribution of levels across the countries.

Figure 1.4 plots the transition countries according to the indices of administrative corruption and state capture.¹⁸ The scatterplot reveals a considerable degree of dispersion across both indices generating a two-by-two matrix that groups countries by similarities in both the level and pattern of these different dimensions of corruption. Though some countries clearly lie within a particular sphere of the matrix, others have a more ambiguous position, potentially straddling different spheres.



The typology is not intended to define absolute and unambiguous divisions among countries. Rather, it is presented as a heuristic device to highlight analytically and empirically the differences in patterns of corruption across countries. Like all aggregate indices, the measures of administrative corruption and state capture mask important variation across institutions within the state and across actors engaged in these activities. As a result, the typology cannot replace the critical role that individual country studies should play in identifying the extent and nature of the corruption problem and in further unbundling of the forms of corruption identified in the report. Indeed, the typology should be seen more as a guide for self-assessment by countries as to the nature of the corruption problems they face than a definitive categorization of countries on these complex dimensions of corruption.

The typology suggests a classification of four different patterns of corruption:

- In the **high-high** category, a serious problem of administrative corruption—and hence, weak state capacity—is nested in a state highly subject to capture.

- In the **high-medium** category are countries that have been able to contain the level of administrative corruption relative to other transition countries, but nevertheless have done so in a context of high state capture.
- The **medium-high** category includes countries where the problem of administrative corruption remains the central problem, while the state has been less subject to capture by the private sector than have other transition countries.
- Countries in the **medium-medium** category have lower levels of both state capture and administrative corruption than other transition countries, though serious challenges remain.

The typology is a static snapshot taken at the time of the BEEPS survey (mid-1999) of countries engaged in a dynamic process of evolution in both the development of state capture and administrative corruption. How countries evolve into different patterns of corruption and how they might progress (or regress) into different spheres of the typology will be examined in subsequent chapters of this report. Recognizing these different patterns and analyzing alternative evolutionary paths across these patterns could provide a stronger foundation for devising more appropriate and finely tuned anticorruption strategies in different contexts.

¹ For the most widely known exposition of this approach, see Klitgaard (1988).

² For an early and interesting effort to unbundle analytically the concept of corruption, see Scott (1972). The approach to defining and measuring different dimensions of corruption across countries derives from the following background papers: Hellman, Jones, Kaufmann, and Schankermann (2000); Hellman, Jones, and Kaufmann (2000a).

³ As a result, the distinction between state capture and administrative corruption does not map directly into the more familiar distinction between “grand corruption” and “petty corruption,” which generally refers to the level of state officials engaged in the corrupt transactions. Administrative corruption is most likely to cut across different levels of government, as special discretionary exemptions in the implementation of laws and public procurement decisions are a feature of both the higher and lower levels of government. State capture, by definition, only encompasses levels of government empowered to make legislation, laws, rules, and decrees, though in some systems this could also extend to different levels of government.

⁴ For an excellent review of the extensive literature on regulatory capture, see Laffont and Tirole (1993). For a broader discussion of the roots of the concept of state capture, see EBRD *Transition Report 1999*, and Hellman, Jones, and Kaufmann (2000a).

⁵ Indeed, the literature on regulatory capture tends to focus much less on corruption than on the inherent information asymmetries in the nature of the relationship between the regulator and the regulated.

⁶ The area of public finance corruption is an especially important dimension that could warrant a separate categorization of corruption. Politicians and public officials can alter the mobilization and allocation of public resources and assets for their own private gain. Though this misappropriation of public resources could be classified as a form of administrative corruption, it could be seen to have its own dynamics, especially when such corruption is concentrated at the highest levels of the political system. This would cover instances of kleptocratic political regimes, whose dynamics could be analyzed separately, though many of the normative implications of combating state capture and administrative corruption would still be still relevant to this problem.

⁷ For a comprehensive description of the methodology and contents of the survey, as well as a descriptive analysis of the key findings, see Hellman, Jones, Kaufmann, and Schankerman (2000a).

⁸ The most frequently used index of corruption is Transparency International's Corruption Perceptions Index, which is a survey of surveys based on outside assessments of corruption and on a particular methodology subject to changes over time (as well as its country coverage, which even though it has grown over the years, currently covers only about one-half of all countries for which there is data). Any such aggregate comparative index will have serious limitations in diagnosing in-depth governance and corruption challenges within a country. For that purpose, a new set of diagnostic survey tools (for public officials, enterprises, and citizens) has been developed under a separate project to help countries in addressing governance challenges, see Kaufmann, Pradhan, and Ryterman (1998).

⁹ For an analysis of existing governance and corruption indicators, see Kaufmann, Kraay, and Zoido-Lobaton (1999a and b).

¹⁰ See Annex 1 for a description of the summary indicator.

¹¹ It is possible that the manifestations of corrupt transactions across countries vary systematically with the level of economic or political development, shifting from explicit bribe payments to more subtle types of benefits such as equity stakes or commitments to future employment. If so, then measurements of corruption that rely exclusively on explicit payments might understate the level of corruption in more developed countries.

¹² See Annex 1.

¹³ The rankings of countries on this index of administrative corruption do not change significantly when statistically controlling for the size and sector of firms.

¹⁴ For more detailed information on these household surveys, see Box 5.8: Diagnosing the Problem.

¹⁵ Other transition countries that might be considered in a similar category, including Tajikistan and Turkmenistan, were not included in the BEEPS survey sample.

¹⁶ The decision to include the sale of court decisions to private interests and the mishandling of central bank funds as elements of state capture requires some explanation. Courts are generally seen as institutions that implement existing laws as opposed to making them, though the precedent-setting function of courts can blur these boundaries. In the transition countries, where legal systems are still in the nascent stages of development, courts can be seen as playing a more formative role in the development of the legal framework. As regards the central bank, the institution's role in setting monetary policy and creating the regulatory framework for the developing financial system also blurs the distinction between the formation and implementation of rules. While recognizing the difficulty of drawing concrete boundaries within any particular institution, we have chosen to incorporate these institutions within the category of state capture as a result of the unique nature of the transition period. Yet it is important to note that removing these components from the index of state capture does not change substantially the ranking of countries on state capture presented in Figure 1.3. Moreover, this does not have any effect on the positions of countries in the typology presented in Figure 1.4, which guides much of the empirical work in subsequent chapters. See Annex 1.

¹⁷ By identifying "captor" firms, we can investigate the direct benefits and costs to such firms from engaging in capture. A summary of these results is presented in Chapter Two.

¹⁸ Only countries included in the BEEPS survey are plotted in the typology, which thus excludes: Bosnia and Herzegovina, FYR Macedonia, Tajikistan and Turkmenistan. Though Belarus and Uzbekistan were included in the BEEPS survey, their results are discussed separately in Box 1.4 in recognition of the very different dynamics of state capture in countries that have made minimal progress in transition.