

# 1

## Introduction

**T**HIS REPORT IS THE THIRD IN A SERIES OF DETAILED STUDIES PREPARED by the World Bank on patterns and trends in corruption in the transition countries of Europe and Central Asia (ECA). The first study, *Anticorruption in Transition: A Contribution to the Policy Debate (ACT 1)*, was published in 2000 for the World Bank-IMF Annual Meetings in Prague, and the second, *Anticorruption in Transition 2: Corruption in Enterprise-State Interactions in Europe and Central Asia 1999–2002 (ACT 2)*, was published in early 2004. All three reports are based on the findings of cross-country surveys of enterprises, the EBRD-World Bank Business Environment and Enterprise Performance Surveys (BEEPS), as described in Box 1.1. Taken together, this work provides an in-depth look at how corruption in business-government interactions is changing in the transition countries and what factors might be influencing those trends.

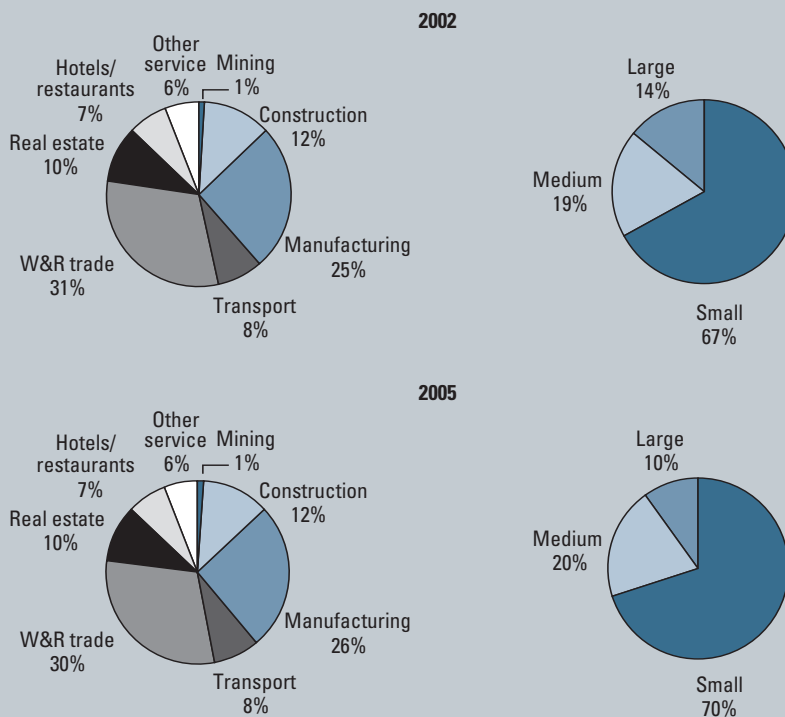
Corruption has received ever-expanding attention in the past decade, although this was not the case in the early stages of the transition process. For the first few years of transition in the early 1990s, the twin challenges of dismantling communism and installing the basic building blocks of democratic free-market systems occupied reformers. But it was not long until a sense of injustice and disillusionment with the transition process began to emerge among a large segment of the population. The process of designing wholly new legal and regulatory frameworks, as needed for a market economy, provided wide-ranging opportunities for newly emerging elites to gain personal advantages. The privatization process in some transition countries was seen by many as unfair and corrupt, but countries that did not privatize as quickly did not escape the problem, as managers of state-owned firms were often seen as illegally siphoning off state-owned assets for personal uses. With the controls of the communist

**Box I.1 The Business Environment and Enterprise Performance Survey**

The EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS), a joint initiative of EBRD and the World Bank, has been carried out in three rounds in 1999, 2002, and 2005. The survey covers 27 countries, including Turkey and all transition countries of Central and Eastern Europe and the former Soviet Union (except Turkmenistan). More than 20,000 firms have been interviewed—about 4,500 in 1999, 6,000 in 2002, and almost 10,000 in 2005. Based on face-to-face interviews with firm managers and owners, BEEPS is designed to generate comparative measurements on many aspects of the business environment, which can then be related to specific firm characteristics and firm performance. BEEPS3 in 2005 added several new features, including a panel subsample of 1,462 firms (interviewed both in 2002 and 2005), and a “manufacturing overlay” of 1,715 firms in seven countries to allow in-depth analysis of particular subsectors. (To maintain comparability across countries, the manufacturing overlay was not included in the analysis for this report.) An extension of BEEPS to several nontransition countries in Europe and Asia provides a broader set of comparators. The non-transition comparator countries used in this study include Germany, Greece, Ireland, Portugal, Spain, and Turkey.

The BEEPS used an identical sampling approach in all three years, with the sectoral breakdown of firms in each country determined by their relative contribution to GDP. Farms and regulated firms (such as banking, power, rail, and water) were excluded. The breakdown of the BEEPS samples for transition countries by sector and size in 2002 and 2005 is shown below.

**Figure I.1 BEEPS Sample, 2002 and 2005**



For more information and for access to the BEEPS data, see World Bank 2006a: [www.worldbank.org/eca/econ](http://www.worldbank.org/eca/econ) or [www.worldbank.org/eca/governance](http://www.worldbank.org/eca/governance).

system gone and economic rules and social norms changing quickly, corruption also began to grow in the delivery of public services, such as health care and utilities, and in other public functions, such as licensing, inspections, and tax and customs administration.<sup>1</sup> As the role and importance of judicial systems changed with the emergence of the private economy, corruption also increased in the courts.<sup>2</sup> By the close of the first decade of transition, corruption was perceived throughout the region to be widespread and pernicious.

The growing citizen disenchantment motivated an increasing number of prominent political and civic leaders across the region. As Milos Zeman assumed his post as the Czech Republic's Prime Minister in 1998, he declared that "privatization as it was conducted in the Czech Republic over the last five years was corruption, nothing more. It created an environment in which the idea that you got something for nothing became the norm."<sup>3</sup> Slovak Deputy Prime Minister Ivan Miklos spearheaded a strong anticorruption program immediately upon taking office at the end of the Meciar regime in 1998, highlighting the abuses of the Meciar years and noting that "corruption is a problem in every country, but it is a bigger issue in transition countries like ours."<sup>4</sup> In Bulgaria a number of nongovernmental organizations (NGOs) came together in 1998 to launch *Coalition 2000*, an initiative designed to monitor and promote public awareness about what they saw as a growing problem of corruption in that country.<sup>5</sup>

More recently, two of the most notable political transitions in the region in 2003 and 2004—the "Rose Revolution" in Georgia that removed Eduard Shevardnadze from power and the "Orange Revolution" in Ukraine that ousted Leonid Kuchma—were both powered by citizen anger about corruption and bad government. Mikhail Saakashvili, who was elected to the Presidency in Georgia, declared immediately that rooting out rampant corruption would be his highest priority. Shortly after his election, Ukrainian President Yuschenko declared that "I know what responsibility these words carry, but I have the honor of telling you — my government will not steal."<sup>6</sup> The new Prime Minister of Albania, Sali Berisha, who took office in September 2005, similarly campaigned on a strong anticorruption platform and pledged that "uprooting corruption will be the first challenge for our new government. In Albania corruption has developed into a sophisticated system, with state capture, fiscal evasion and bribing at dramatic levels."<sup>7</sup> While not every leader who campaigns on an anticorruption platform necessarily follows

through effectively if elected, strong and committed leadership can make a difference, as will be illustrated further in this report.

The international community also dramatically increased its attention to the issue of corruption during the 1990s. The political developments in transition economies gave this increased attention a strong push, as the breakup of the Soviet Union and resulting softening of superpower competition created conditions in which international organizations, donor agencies, and NGOs could be more forthright in challenging corrupt regimes in developing countries. The increasing attention grew in part out of a change in thinking in the economics profession, as a rapidly growing body of economic research in the early 1990s highlighted the importance of well-functioning institutions for economic growth and the harmful effects of corruption on development.<sup>8</sup> The World Bank adopted a formal anticorruption strategy in 1997,<sup>9</sup> and the amount of lending and analytic work devoted to understanding and tackling problems of corruption increased dramatically in the late 1990s, including in the ECA region.<sup>10</sup>

A wide variety of other international organizations and NGOs have also devoted extensive resources to the fight against corruption in transition countries. The European Union (EU), for example, has focused on anticorruption efforts in setting timetables for EU accession for new and prospective members.<sup>11</sup> The Organisation for Economic Co-operation and Development (OECD) has established an Anticorruption Network for Transition Economies.<sup>12</sup> The Stability Pact for southeastern Europe has established an Anticorruption Initiative (SPAI) to help coordinate anticorruption activities in the Balkans.<sup>13</sup> The Council of Europe has set up the Group of States Against Corruption (GRECO) to support peer monitoring of anticorruption initiatives among member countries.<sup>14</sup> Transparency International and other NGOs support research and monitoring and have a strong set of country-level affiliates who often spearhead discussions on governance and corruption issues.<sup>15</sup> In-depth analytic work also increased substantially in the 1990s and early 2000s, with academic and donor institutions supporting a variety of in-country and cross-country surveys to throw light on political and institutional realities in transition countries (see Box 1.2).

In sum, plenty of attention has been paid to the issue of corruption in transition economies—its causes, its costs to society, and how to reduce it. Is this attention making a difference? Is widespread corruption an endemic and long-term feature of these newly capitalist economies, or is

### Box 1.2 How do the BEEPS results compare to other corruption indicators?

Indicators of corruption outcomes abound, although they vary by definition (firm-level bribery versus probability of losing investments), methodology (expert assessments by foreigners versus surveys of people in the country), and transparency of methodology. Aggregates of other indicators, such as the Transparency International Corruption Perceptions Index (TI-CPI), are popular among researchers because they cover hundreds of countries, and they have been useful for raising the profile of corruption and governance issues. They are not, however, designed for making comparisons over time, as they are rescaled each year and the implicit definition of what is being measured also changes over time. Nevertheless, the overall trends for the Europe and Central Asia region evident in some of the underlying indicators—including the firm-level surveys done by the World Economic Forum and the expert-opinion measures produced by Freedom House *Nations in Transit*—are consistent with the main conclusion emerging from the BEEPS: Firm-level corruption fell significantly between 2002 and 2005. For a fuller discussion of various governance indicators and their application in transition countries, see Knack (2006).

it a more transitory feature that will decline over time once market and institutional reforms take hold? Are transition countries really more corrupt than European countries further west? This report provides the latest evidence on these questions.

## Notes

1. Between 1998 and 2002, the World Bank, often in cooperation with the United States Agency for International Development (USAID), carried out corruption diagnostic surveys of firms, citizens, and public officials in Albania, Bosnia and Herzegovina, Georgia, Latvia, the Kyrgyz Republic, Kazakhstan, Romania, and the Slovak Republic. Households commonly reported unofficial payments for health and educational services and to traffic police, while firms commonly reported bribing customs and tax officials, the courts, and police. Several of these countries are now leading reformers in the region and have made major strides in tackling corruption, as will be shown in this report. The country survey results can be found at World Bank 2006a: [www.worldbank.org/eca/econ](http://www.worldbank.org/eca/econ) or [www.worldbank.org/eca/governance](http://www.worldbank.org/eca/governance).
2. Anderson, Bernstein, and Gray (2005) and Anderson and Gray (forthcoming).

3. Quoted in Hessel and Murphy (2004).
4. *The Times* (United Kingdom), February 21, 2001.
5. Coalition 2000 (2006).
6. Radio Free Europe/Radio Liberty Belarus and Ukraine Report. Vol. 7, No. 6, 11 February 2005
7. Speech to the diplomatic corps in Tirana, Oct. 17, 2005. <http://www.keshilliministrave.al/english/lajm.asp?id=5481>
8. See, for example, Bardhan (1997), North (1990), and World Bank (2002). For reviews of recent literature on corruption and development, see Lambsdorff (2005) and Svensson (2005).
9. World Bank (1997).
10. See World Bank 2006a: <http://www.worldbank.org/eca/econ> or <http://www.worldbank.org/eca/governance> for details of the Bank's anticorruption work in the ECA region.
11. EUMAP 2006: <http://www.eumap.org>.
12. OECD 2006: <http://www.oecd.org>.
13. Stability Pact Anticorruption Initiative 2006: <http://www.spai-rslo.org>.
14. Council of Europe Group of Countries Against Corruption 2006: <http://www.greco.coe.int>.
15. Transparency International 2006: <http://www.transparency.org>. Other prominent groups promoting good governance in ECA countries include the Open Society Institute (OSI), the National Democratic Institute (NDI), the Organization for Security and Co-operation in Europe (OSCE), the International Crisis Group, and Freedom House.

## 2

# Patterns of Corruption, 2002–2005

AS NOTED IN CHAPTER 1, RHETORIC ABOUT CORRUPTION INCREASINGLY permeated political speech in the 1990s and early 2000s, although reforms were often delivered with less vigor. But some countries did take corruption seriously, and many transition leaders undertook reforms to combat it. These reforms varied in their policy and institutional arrangements, reflecting differing degrees of emphasis on prevention and punishment. Have they been successful? This chapter examines recent patterns and trends in broad indicators of corruption. Chapter 3 explores factors that influenced the trends, including growth, institutions, and politics, while Chapter 4 looks in more depth at sector-specific policies and corruption outcomes.

The analysis in this chapter focuses on the period from 2002 through 2005, complementing the analysis of changes from 1999 to 2002 described in detail in ACT2. In both cases the analysis focuses on four summary measures of corruption: (i) the extent to which firms see corruption as a problem for business; (ii) the frequency of bribery; (iii) the amount of money paid in bribes (that is, the “bribe tax”); and (iv) the impact of state capture on firms. The first summary measure is meant as a composite, while the second and third focus on *administrative corruption* and the fourth on *state capture*. Administrative corruption refers to bribery by individuals, groups, or firms in the private sector to influence the *implementation* of laws and regulations, while state capture refers to bribery to influence the *formulation* or *content* of laws and regulations.<sup>1</sup> While somewhat different conceptually, both types of corruption can have major impacts on the business environment. Administrative corrup-

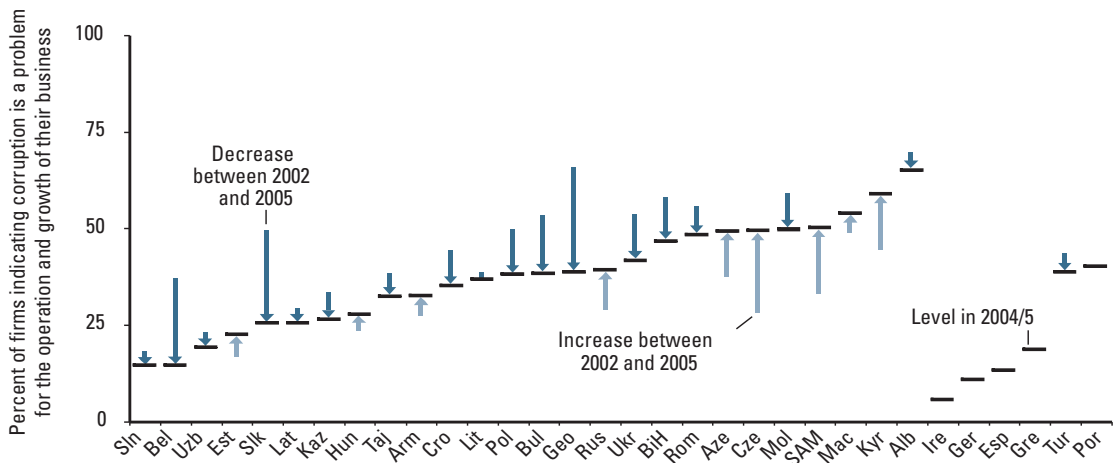
tion tends to weaken the rule of law by undermining a government’s ability to implement laws and regulations, while both administrative corruption and state capture can have pernicious effects on economic competition by restricting market entry and distributing economic preferences to influential elites.

### Corruption as a problem for business

The first indicator of corruption measured by the BEEPS focuses on the bottom line for firms: How much of a problem is corruption for the operation and growth of firms, both in and of itself and compared with the many other problems firms face? Figure 2.1 shows the average percentage of firms that viewed corruption as a problem for the operation and growth of their business in 2002 and 2005, by country.<sup>2</sup> The arrows illustrate the direction and extent of change. The figure also shows analogous levels in 2005 for the six nontransition comparator countries—Ireland, Germany, Spain, Greece, Turkey and Portugal.<sup>3</sup>

Although there was generalized improvement across transition countries, some had remarkable improvement while others showed a

**Figure 2.1 Corruption as a problem for business, by country, 2002 and 2005**



Source: BEEPS 2002, BEEPS 2005.

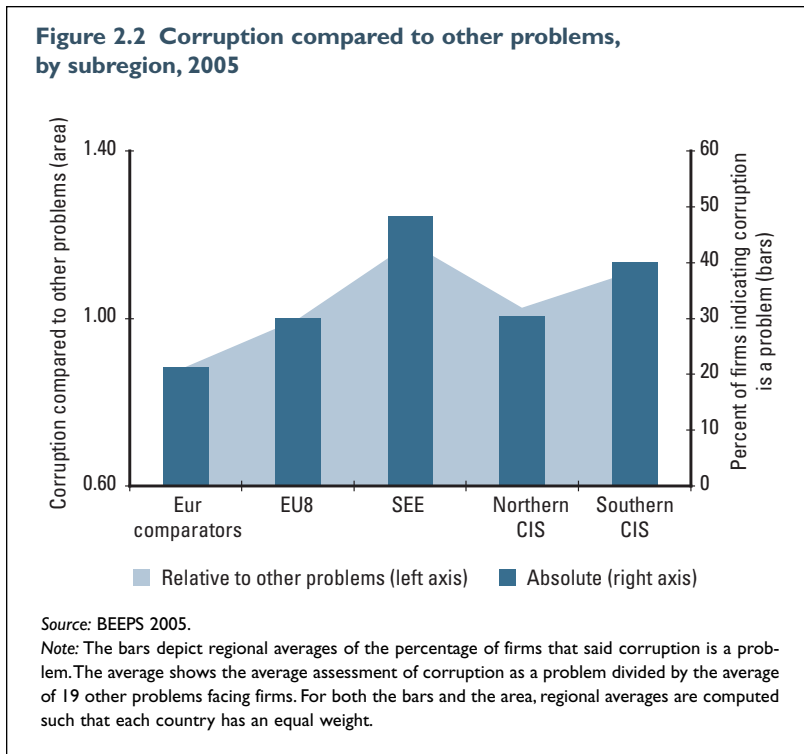
Note: Changes in the following countries are significant: Aze, Bel, BiH, Bul, Cro, Cze, Geo, Kaz, Kyr, Mol, Pol, Rom, Rus, SAM, Slk, Tur, Ukr. See Annex for details.

worsening trend. Among the eight new EU members,<sup>4</sup> firms in the Slovak Republic reported the largest improvement and firms in Poland the second largest, while the Czech Republic was the only country in the group where significantly more firms reported corruption to be a problem in 2005 than three years earlier. Indeed, the Czech Republic is among the half-dozen transition countries where businesses perceive the most significant corruption problem. Changes in the other five new EU members between 2002 and 2005 were minor or insignificant.

In southeast Europe the findings are mixed. The good news is that the two countries that will soon join the EU, Bulgaria and Romania, both showed significant improvement, although levels are still high—in Romania about half of the firms in the survey indicated that corruption is a problem for the operation and growth of their business. Croatia's results were also better in 2005 than in 2002. However, the survey showed a worsening situation in Serbia and Montenegro, and the slight improvement in Bosnia and Herzegovina still leaves it at a high level (with nearly 50 percent of firms saying corruption is a problem), similar to Romania and Serbia and Montenegro. Albania remains the worst performer among all transition countries, that is, the country where the most firms (about two thirds) reported corruption to be a problem.

Findings are also mixed in the southern Commonwealth of Independent States (CIS). Firms in Georgia, and to a lesser extent Moldova, reported corruption to be much less of a problem, albeit from very high levels three years earlier, while firms in Azerbaijan and the Kyrgyz Republic reported a worsening of the problem. The findings for Armenia, Tajikistan, and Uzbekistan, which did not differ much between 2002 and 2005, indicate that firms in those countries do not view corruption as a problem to the same extent as elsewhere in the CIS. Among the northern CIS countries, all showed improvement except for Russia, which is now more or less on a par with Ukraine.<sup>5</sup>

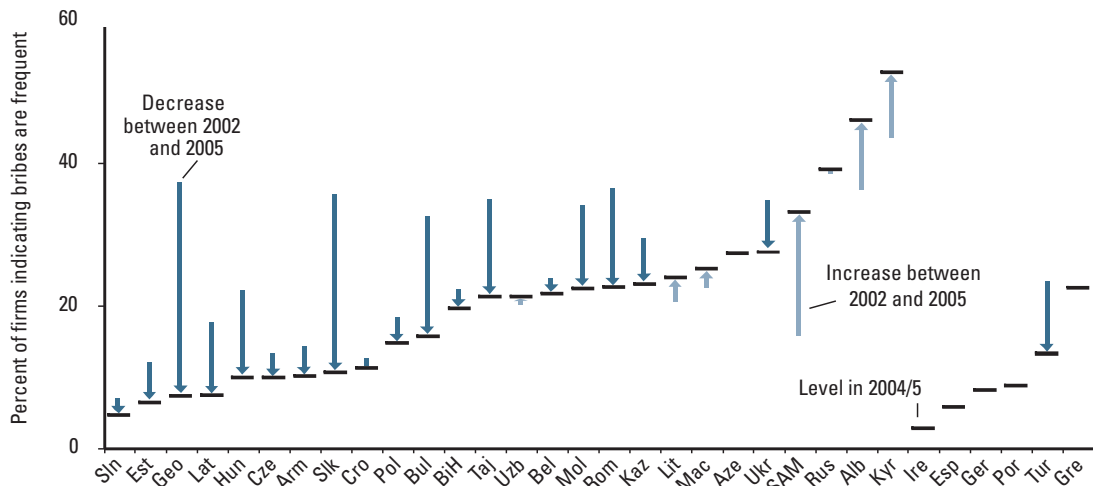
Figure 2.2 shows the average values for 2005 by subregion and adds a measure of the relative value of firms' ratings on corruption compared to their ratings on the many other problems they face in the business environment. The relative assessments mirror the absolute assessments, with firms in southeast Europe and the southern CIS reporting corruption to be a worse problem on average than the many other problems they face, and firms in northern CIS and the EU-8 placing corruption on a par with other problems. Firms in the European comparator countries see corruption as a less serious problem than others they face.



## Bribe frequency

The finding that many firms see corruption to be less of a problem for business in 2005 than three years earlier, both in absolute terms and relative to other problems, is welcome news. Yet corruption as a problem for business is the most subjective of the assessments covered by the BEEPS. It is possible, for example, that corruption is viewed as less of a problem simply because it has become commonplace and firms are now used to it.

In this section, we examine what firms are saying about the extent of firm-level bribery. Managers were asked to assess how frequently firms like theirs made unofficial payments to get things done.<sup>6</sup> The percent of firms responding in 2002 and 2005 that such payments were frequent is depicted in Figure 2.3. Transition countries as a whole showed a decline in the frequency of unofficial payments, with the strongest improvements in the new members of the European Union and the southern CIS. Among the new EU members, the Slovak Republic had the most notable

**Figure 2.3 Bribe frequency, by country, 2002 and 2005**

Source: BEEPS 2002, BEEPS 2005.

Note: Changes in the following countries are significant: Alb, Bul, Est, Geo, Hun, Kaz, Kyr, Lat, Mol, Rom, SAM, Slk, Taj, Tur, Ukr. See Annex for details.

improvement, while firms in Latvia and Estonia also reported that unofficial payments were less frequent than in 2002. The southern CIS saw improvements in Moldova, Tajikistan, and especially Georgia, all from relatively high figures in 2002. The country with the worst deterioration, and from an already high level, was the Kyrgyz Republic (see Box 2.1). In southeast Europe, more firms in both Albania and Serbia and Montenegro said unofficial payments were frequent in 2005 compared to three years earlier, while the reverse occurred—that is, the reported frequency of bribery fell markedly—in Bulgaria and Romania. In the northern CIS, Kazakhstan and Ukraine had modest but significant improvements, whereas no change was reported in Belarus or Russia.

Notwithstanding the trends, firms in many transition countries continue to report high frequency of unofficial payments. About one half of firms in the Kyrgyz Republic and Albania, and more than one quarter of firms in Russia, Serbia and Montenegro, Ukraine, and Azerbaijan, said that bribery was frequent. The least frequent bribery is reported in some of the western European comparators (Ireland and Spain, but not Greece, where bribe frequency appears quite high) as well as in Slovenia, Estonia, and Latvia. And the marked improvements in Georgia and the Slovak

### Box 2.1 The Kyrgyz Republic—still a long way to go

The Kyrgyz Republic faces a big challenge in addressing the problem of administrative corruption. In 2005 it rated first among all countries surveyed by the BEEPS in the frequency of bribes, second (to Azerbaijan) in the level of the bribe tax, and second (to Albania) in the extent to which corruption is a problem for business. Moreover, two of the three indicators—the frequency of bribes and the extent to which firms see corruption as a problem for business—increased from 2002 to 2005, in contrast to the trends in most of the countries in the region. And these trends are occurring despite efforts at economic and institutional reforms since the early 1990s.

Numerous initiatives, focusing largely on legal frameworks, have been undertaken in recent years to deal with governance and corruption issues, included adoption of an anticorruption law, establishment of Councils on Good Governance (in 2003 and 2004) to advise on anticorruption policy, legal reform to improve the business environment, establishment of an anticorruption commission in 2005, a new civil service law to promote a professional civil service with merit-based appointments, a law on the declaration of income and assets of high state officials, and reforms to make public finances more transparent. However, there has been relatively little attention paid to implementation, capacity building, and upgrading of managerial skills.

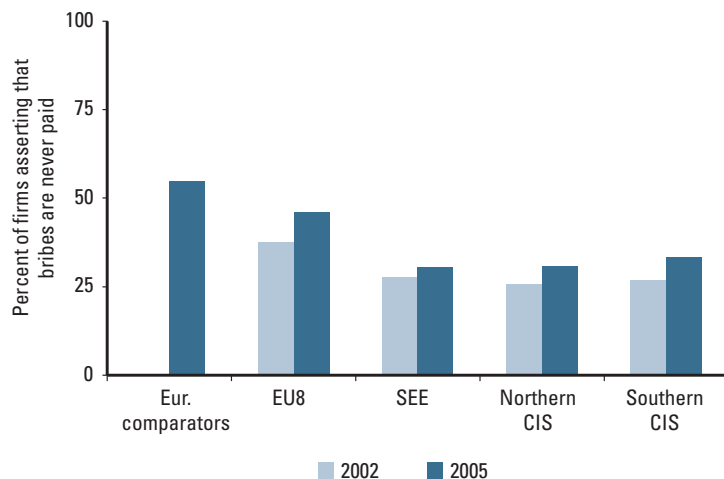
Practical enforcement and implementation have been slow, and in practice, these actions have not yet had significant impact. For example, there have been no prosecutions under the anticorruption law, and the councils on good governance have had unclear and overlapping mandates. Action plans and anticorruption strategies have consisted mainly of lists of proposals to change the legal framework and carry out public information campaigns. The laws to improve the business environment have not been implemented, and the regime of multiple inspections of business activity remains essentially unchanged. On the positive side, the key provisions on competitive appointments in the Civil Service Law are beginning to be implemented in practice, and it is likely that the impact of these will be felt in coming years if the authorities fully commit to effective and consistent implementation. One small but important step forward has been the publication of income and asset declarations for high state officials, but even this will only improve governance to the extent that the authorities provide an environment to allow the media and civil society to hold officials accountable for the origins of their wealth.

These limited outcomes are the result of an unbalanced governance reform and anticorruption strategy. Reforms, many of them supported by the World Bank and other donors, have focused on introducing legislative changes with inadequate attention paid to implementation and enforcement. The Kyrgyz Republic had a revolution at the time of the survey, and so the results largely reflect developments under the previous administration. The next survey will shed light on the new government's ability and willingness to start to deal with corruption by reducing opportunities for rent seeking and changing public perceptions about what is tolerated in society. The former requires regulatory reform to improve the business environment and promote competition in the economy, stronger emphasis on transparency in government, a movement from patronage to meritocracy in the public service, and a wider distribution of both power and accountability through decentralization and other means. The latter requires strong and consistent leadership, outreach, and results.

Republic have brought them to levels similar to the best performers in the region in 2005.

Figure 2.4 shows the converse of Figure 2.3—the percentage of all firms that asserted that unofficial payments are *never* paid by firms like theirs to get things done. Results are grouped by subregion. The same improvements emerge, but only in the European comparators do more than half the firms assert that unofficial payments are never required to get things done.

**Figure 2.4 Percent of firms that pay no bribes, by subregion, 2002 and 2005**



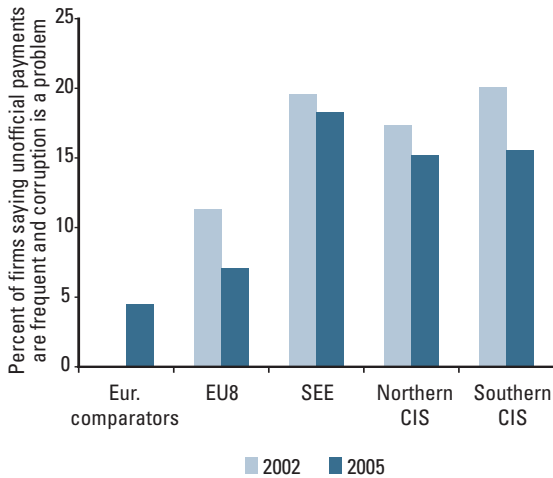
Source: BEEPS 2002, BEEPS 2005.

Note: The bars depict regional averages of the percent of all firms that stated that the bribes were never paid (i.e., 1 on a scale of 1 to 6). Regional averages are computed such that each country has an equal weight.

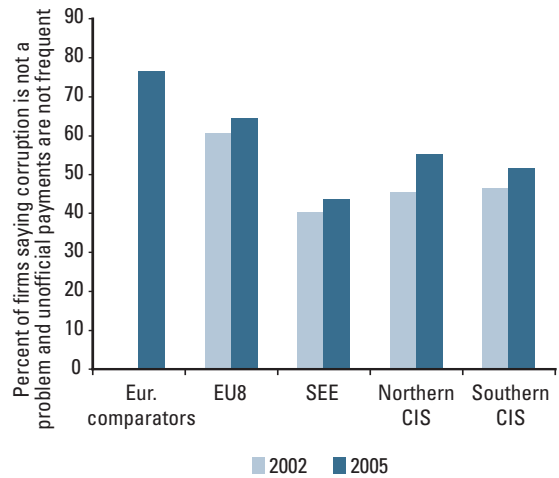
The overall trends in both the frequency of firm-level bribery and the assessments of corruption as a problem for doing business both point generally in the same promising direction. Concerns that corruption has become so commonplace that firms now accept it therefore might not be warranted. However, digging deeper into the firm-level responses to these two survey questions reveals some interesting patterns. The two combinations of answers that show nontolerance of corruption by society are (i) a no on both questions—bribes are not frequent and corruption is not a problem for business—and (ii) a yes on both questions—bribes are frequent and corruption is a problem.<sup>7</sup> As seen in Figure 2.5 and Figure 2.6, over 80 percent of firms in the European comparator countries answered one of these two ways in 2005, compared to about 60–70 percent in the transition countries.

The other two combinations of answers are more problematic. For example, a relatively high percentage of firms in southeast Europe—about one third—viewed corruption as a problem for business even though they reported that bribery was not frequent (Figure 2.7). This could reflect a concern with types of corruption that do not necessarily

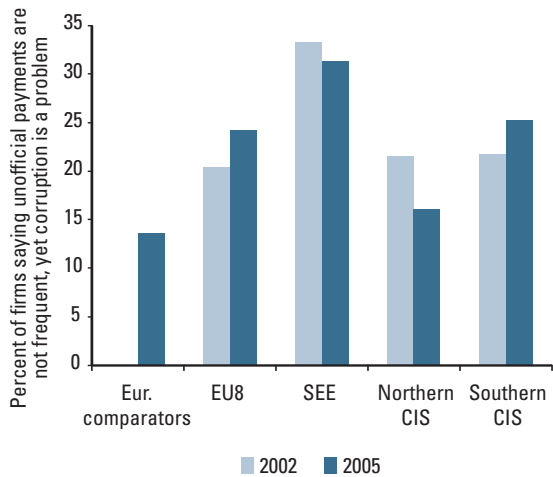
**Figure 2.5 Frequent and a problem, by subregion, 2002 and 2005**



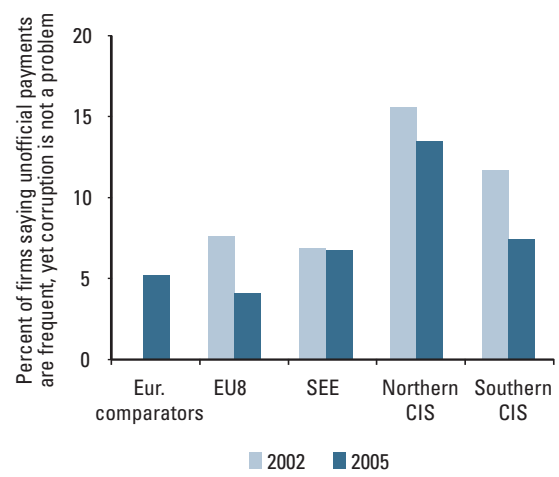
**Figure 2.6 Not a problem and not frequent, by subregion, 2002 and 2005**



**Figure 2.7 Problem but not frequent, by subregion, 2002 and 2005**



**Figure 2.8 Frequent but not a problem, by subregion, 2002 and 2005**



Source: BEEPS 2002, BEEPS 2005.

Note: Regional averages are computed such that each country has an equal weight.

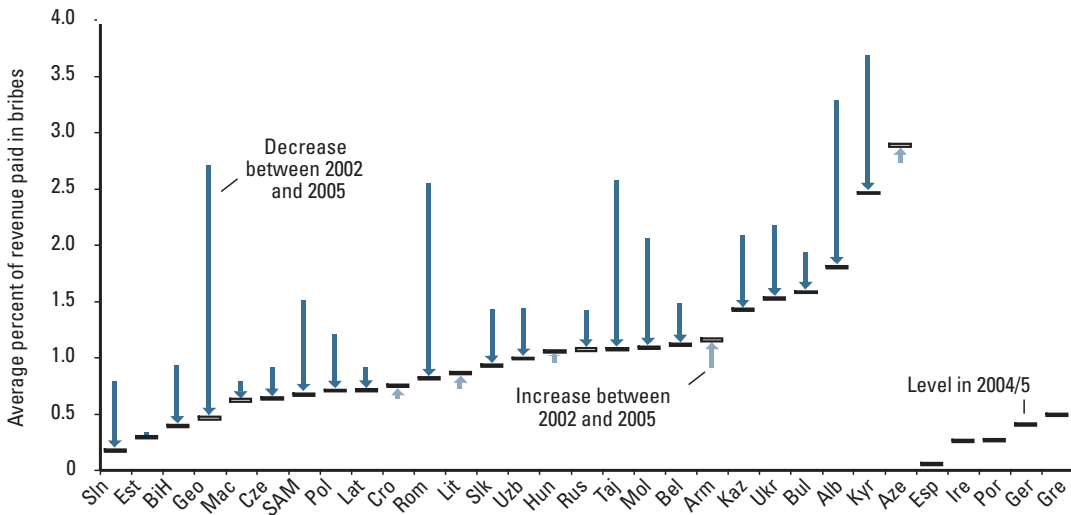
involve bribes, such as theft of state resources or state capture by narrow economic interests. In contrast, a relatively high percentage of northern CIS firms—about one out of eight (and one out of five in Russia)—reported that firms frequently make unofficial payments to get things done, yet corruption is not an obstacle to their business (Figure 2.8). These firms, arguably, find bribery acceptable. A positive finding from the 2005 BEEPS is that such “acceptance” is not only very low in absolute terms (less than 5 percent of firms in the new EU members and European comparators and less than 10 percent in southeast Europe and the southern CIS) but also appears to be falling in every subregion, with the exception of southeast Europe.

## The bribe tax

The third summary measure of corruption tracked by BEEPS is the “bribe tax,” which is the percentage of annual firm revenue paid in bribes, as reported by the firms themselves. The bribe tax is complementary to bribe frequency as an indicator, and the two do not necessarily move together. In some countries with high levels of “petty” corruption, bribe frequency may be high while the overall bribe tax is not particularly onerous. In contrast, where avenues for corruption are tightly controlled within a government bureaucracy, firms may face high bribe taxes on selected transactions but relatively infrequent requests for bribes on a day-to-day basis.

Across all of the transition countries, the average percent of revenues paid in bribes (weighing each country’s result equally) declined from 1.6 percent in 2002 to 1.1 percent in 2005. Many firms in every country said zero, and these responses are included in these averages. Among firms with nonzero responses—that is, firms that admit to making unofficial payments—the bribe tax declined from 3.6 percent to 2.9 percent of revenues. Major improvement is evident in most countries, but the levels remain substantially higher than in the European comparators (Figure 2.9). Large declines in the bribe tax occurred in Georgia and Tajikistan, as well as five of the six countries in southeast Europe. Two of these six (Albania and Serbia and Montenegro, as well as the Kyrgyz Republic in the CIS) had improvements in the bribe tax even while bribe frequency was increasing, an indication that petty corruption was expanding but the overall cost to firms (as a share of revenues) was not. Romania showed a

Figure 2.9 Bribe tax by country, 2002 and 2005



Source: BEEPS 2002, BEEPS 2005.

Note: Changes in the following countries are significant: Alb, BiH, Cze, Geo, Kaz, Kyr, Mol, Pol, Rom, Rus, SAM, Slk, Taj, Ukr, Uzb. See Annex for details.

huge decline in the bribe tax, matching its improvement on the other two corruption indicators discussed earlier. Half of the EU-8 showed reductions in the bribe tax, most notably in Slovenia. The bribe tax fell even in the Czech Republic, where firms reported no change in bribe frequency and an increase in corruption as a problem doing business. Among European comparators, the bribe tax is the highest in Greece and the eastern part of Germany.

While the results regarding the bribe tax are encouraging, with 16 out of 26 transition countries showing significant reductions and none showing a significant increase, two important facts should be kept in mind. First, the levels of the bribe tax remain quite high, with only Estonia and Slovenia matching the average for the European comparators. Average firm-level net profits were 12 percent of gross revenues, meaning that a 1 percent bribe tax would be equivalent to about 8 percent of net profits. Second, declines in the average bribe tax do not necessarily mean that the absolute amount paid in bribes has fallen, since the bribe tax is measured as a share of firm-level revenues. The size of the economy in every transition country has grown rapidly over the past three years, by an average of

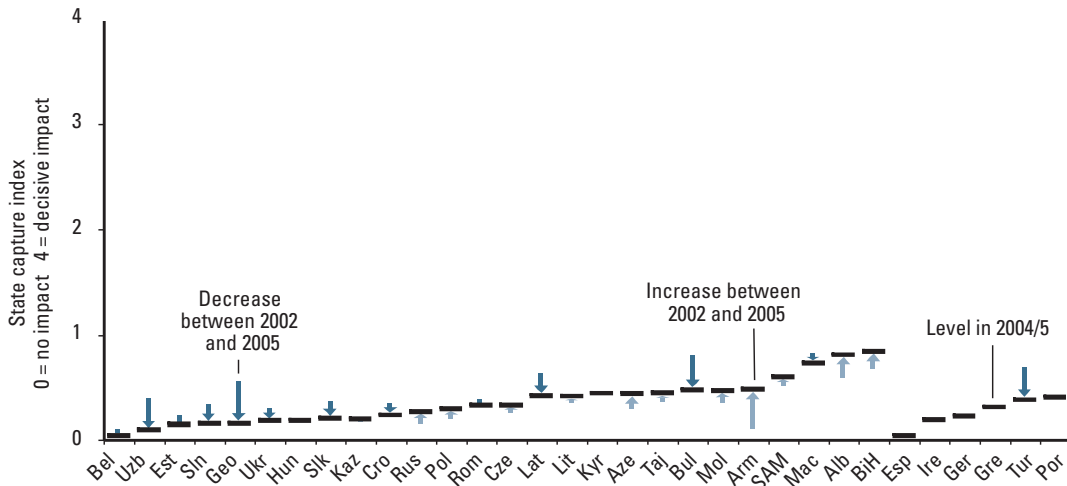
63 percent in nominal terms, and the amount of money changing hands in unofficial payments could well have increased even as the share of bribes in total revenues fell. Indeed, if firms' revenues grew at the same rate as GDP, the average responses to the bribe tax question imply that the total amount of money paid in bribes increased in most countries. In Croatia, Lithuania, Armenia, and Hungary, for example, despite the fact that there was no significant change in the level of the bribe tax as a share of revenues, the rapid growth in these economies implies that the total volume of bribery increased substantially from 2002 to 2005.

## State capture

The fourth summary measure of corruption tracked by BEEPS is the impact of state capture on individual firms. As noted earlier, state capture refers to corruption in the law-making process. State capture can be extremely pernicious to an economy and society, because it can fundamentally and permanently distort the “rules of the game” in favor of a few privileged insiders. Although the concept is easy to grasp, it is very difficult to measure. BEEPS makes an attempt by asking respondents to what extent the provision of unofficial payments, gifts, or other benefits to parliamentarians to affect their votes or to government officials to affect the content of government decrees had a *direct* impact on the respondent's business.<sup>8</sup> Note that the question does not ask whether the firm *made* such payments, but whether such payments by others affected the firm directly.

Figure 2.10 shows the change in perceptions of the impact of state capture from 2002 to 2005, measured as the average of the scores on the two dimensions (payments to parliamentarians and to government officials). The highest levels of state capture are perceived by firms in southeast Europe—Bosnia and Herzegovina, Albania, FYR Macedonia, and Serbia and Montenegro. Major improvements from 2002 and 2005 were reported in Bulgaria, Latvia, the Slovak Republic, Ukraine, Georgia, and Slovenia, and the 2005 results were significantly worse than in 2002 in Albania, Armenia, Russia, and Azerbaijan. The reasons for Georgia's notable improvement on this and other measures of corruption<sup>9</sup> are addressed further in Box 2.2. As discussed in the next chapter, the results for Uzbekistan and Belarus have a somewhat different interpretation given these countries' slow progress in transition.

**Figure 2.10 Changes in the impact of state capture, 2002–2005**



Source: BEEPS 2002, BEEPS 2005.

Note: Changes in the following countries are significant: Alb, Arm, Aze, Bel, Bul, Geo, Lat, Pol, Rus, Slk, Sln, Tur, Ukr, Uzb. See Annex for details.

As with other measures of corruption, the impact of state capture is perceived by firms to be somewhat lower in several European comparators—Germany, Ireland, and Spain—but relatively high in Portugal and Turkey and at about the average for transition countries in Greece. Of all of the measures of corruption presented in this chapter, this one shows the least difference between transition and comparator countries. The recent lobbying scandals in many OECD countries underscore the fact that state capture is a persistent problem even in the most advanced economies.

## Summary

This chapter has summarized the BEEPS results for the transition countries and European comparators along four broad measures of corruption: the extent to which firms consider corruption a problem for business, the frequency of bribery, the amount of bribes paid (as a share of revenues), and the extent to which state capture affects firms. Considering all of the results from both the full BEEPS sample and a smaller

### Box 2.2 Georgia—strong leadership yields results

Prior rounds of the BEEPS highlighted that firms in Georgia perceived very high levels of corruption. This changed dramatically with the 2005 round of the survey. The largest reductions in corruption among all transition countries from 2002 and 2005 occurred in Georgia. Firms report that both administrative corruption and state capture have fallen markedly and that corruption is far less of a problem to business. These results are not surprising to those who know the country well, as the pace of economic and institutional reform in Georgia since the “Rose Revolution” in November 2003 has been impressive. For the past two years policy making has been led by a cadre of leaders who gained power on an anticorruption platform and placed governance at the top of the reform agenda.

The leadership has taken bold actions to fight corruption, reduce the burden of the state in the economy, and develop a fiscally sustainable social safety net. As a result they have, in a very short period of time, reformed corrupt institutions and changed public perceptions along many fronts. The executive branch has been reorganized and streamlined and has introduced a cabinet style of government. The government has greatly simplified the regulatory framework for the business sector, implemented a major tax reform, improved management of public finances through adoption of a medium-term expenditure framework (MTEF) and single treasury account for central government, and strengthened oversight institutions. The Chamber of Control of Georgia reopened and resumed its auditing functions in 2005, and in 2006 the government submitted a law to parliament to empower the Chamber of Control as supreme auditing institution. In addition to these institutional reforms, a substantial share of the police force (including the entire traffic police) and a large number of tax and customs officials have been dismissed. Furthermore, higher salaries and stricter rules for hiring and firing in these agencies have created an incentive system that reinforces professional behavior and discourages corruption. These and many other actions of the new government have reduced opportunities for bribery and are changing the public's expectations about the extent to which corruption will be tolerated.

Many of these changes have been accomplished by a relatively small group of young and very determined reformers. Over the next few years, the government needs to translate these impressive gains into lasting institutional change. This will require decisive reforms to strengthen the rule of law. Restructuring the legal and judicial system, ensuring and safeguarding its professional competency, and strengthening its independence are at the core of these reforms. Similarly, to institutionalize the reforms of the state, Georgia will need to build a more efficient and accountable public administration by modernizing the rules for hiring, firing, monitoring, and evaluating public employees and for determining the salaries they receive. Equally important is supporting the development of robust mechanisms for feedback from civil society. In the long term an informed public and civil society, an independent media, and tolerance of constructive criticism of the leadership are essential to sustaining the gains from reform. Committed leadership is important, but transparent, accountable, and well-functioning institutions are the key to good governance over the long term.

“panel” of selected firms interviewed in both 2002 and 2005 (see Box 2.3), there appears to be a broad consensus that corruption has declined markedly dramatically over the past three years in Georgia and the Slovak Republic, and to a somewhat lesser extent in Poland and Latvia. The results also point to improvements in Bulgaria and Romania, which bodes well for their entry into the European Union, and to significant improvements along some dimensions (albeit from relatively high levels) in Ukraine, Moldova, Kazakhstan, and Tajikistan.

Results are more mixed for other transition countries. Rapid economic growth has helped to dampen the burden of the bribe tax almost everywhere, but the frequency of bribery and the perceived problems

**Box 2.3 Do panel data show the same results as the full BEEPS sample?**

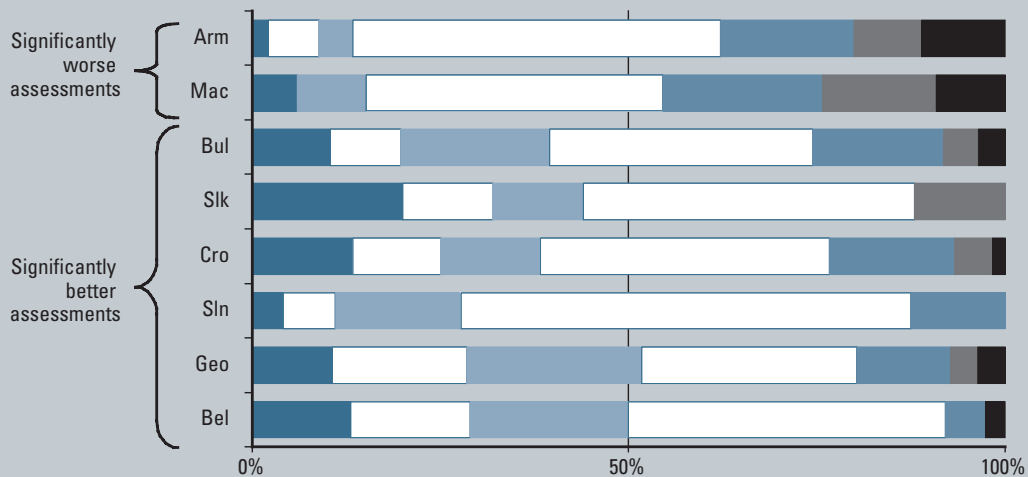
Some of the firms interviewed for the BEEPS in 2002 were interviewed again in 2005, and the BEEPS data from this “panel” of firms expands the range of analysis that can be done with the survey data. Because the same firms were interviewed each year, the differences in their responses from 2002 to 2005 are less likely to reflect idiosyncrasies of the firms and more likely to reflect the changes in the business environment during that period. There are also limitations to this panel data, however; most notably the relatively small size of the sample in each country.

It is interesting nonetheless to compare the results from the broad firm sample (as discussed throughout this report) and the panel on three broad corruption indicators—corruption as a problem for business, bribe frequency, and bribe tax.

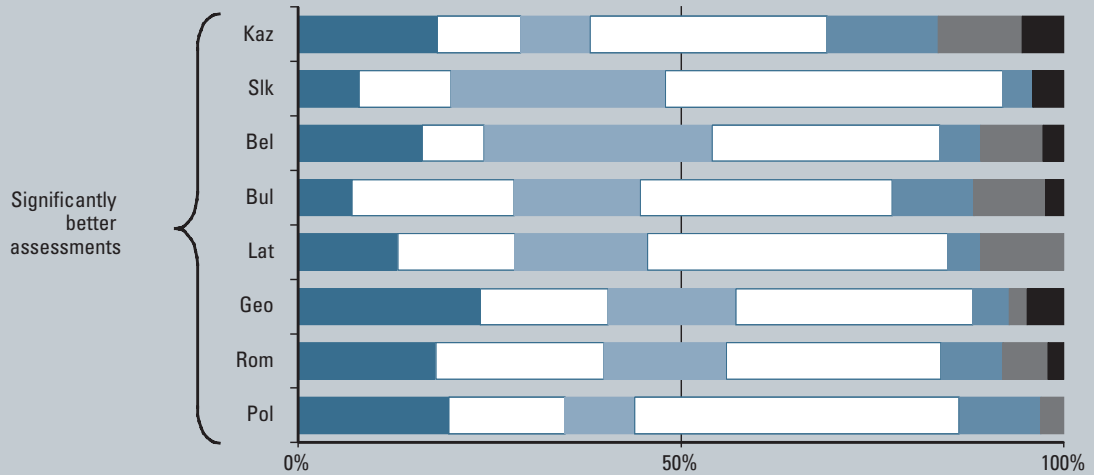
Figure 2.11 shows the percentage of firms in the panel for each country that reported corruption either improving, staying the same, or worsening between 2002 and 2005. (Only countries with significant changes are included.) In most cases the results are similar to those coming out of the full BEEPS survey. With regard to corruption as a problem doing business, large improvements were reported by both the panel and the larger BEEPS sample in Belarus, Bulgaria, Croatia, Georgia, and the Slovak Republic. In contrast, both the panel and the larger sample reported corruption to be a worse problem in 2005 than in 2002 in Armenia and FYR Macedonia. With regard to bribe frequency, improvements were reported by both the panel and the larger sample in Bulgaria, Georgia, Kazakhstan, Latvia, Romania, and the Slovak Republic. Finally, the findings on bribe tax were consistent in finding improvements in a large number of countries. Across all three measures, there was not a single case where a statistically significant trend apparent from the overall sample was contradicted by a significant trend in the other direction in the panel sample.

**Figure 2.11 Changes in corruption according to panel data**

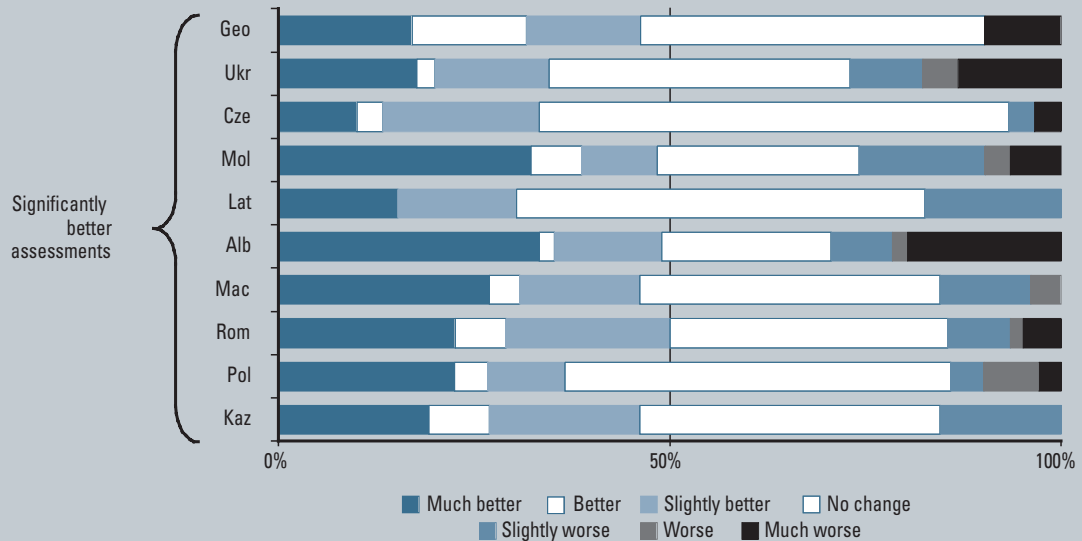
**Corruption as a problem doing business 2002 and 2005**



**Bribe frequency 2002 and 2005**



**Bribe tax 2002 and 2005**



Source: BEEPS 2002, BEEPS 2005.

Note: For the chart on corruption as a problem, “slightly better” means that corruption as a problem doing business improved by 1 point on a 4-point scale; “better” means a 2-point improvement; “much better” means an improvement of 3 points. For the chart on bribe frequency, “slightly better” means that reported bribe frequency improved by 1 point on a 6-point scale; “better” means a 2-point improvement; “much better” means an improvement of 3, 4, or 5 points. For the chart on the bribe tax, “slightly better” means that reported bribe tax was between 0 and 1% smaller in 2005 than in 2002; “better” 1 to 2%; “much better” 2 or more percent. For all three charts the “worse” measures are constructed in an analogous way. Countries with fewer than 20 panel observations were not included in these charts. Statistical significance refers to the 10% level for a t-test of whether the mean equals zero.

caused by corruption for businesses have not changed markedly in most countries and have increased in a few. According to firms, Albania and the Kyrgyz Republic continue, as in 2002, to have the worst corruption indicators of all 33 countries surveyed, and some indicators in Azerbaijan, Russia, and Serbia and Montenegro appear to have worsened from 2002 to 2005. Furthermore, firms in most transition countries—other than perhaps Estonia and Slovenia—still report significantly higher levels of corruption than Western European comparators—most notably Ireland, Spain, and Germany, as some indicators in Greece, Portugal, and Turkey are not too different than those in the transition countries.

## Notes

1. These concepts were introduced in ACT1 and discussed further in ACT2.
2. Figure 2.1 shows the percentage of firms responding that corruption is a moderate or major obstacle (see methodological annex).
3. Two other comparator countries, the Republic of Korea and Vietnam, were also surveyed. As most of the transition countries look westward for models, this report focuses on the European comparators. Responses of Korean firms were generally in step with those of the European comparators, while those of Vietnam resembled those of transition countries. Tables including these two countries were presented in EBRD (2005).
4. For ease of presentation, this report will use the following subregional groupings: The southern Commonwealth of Independent States (CIS) includes Armenia, Azerbaijan, Georgia, the Kyrgyz Republic, Moldova, Tajikistan, and Uzbekistan; The northern CIS includes Belarus, Kazakhstan, Russia, and Ukraine; Southeast Europe includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro; The EU-8 includes the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia; The European Comparators include Germany, Greece, Ireland, Portugal, Spain, and Turkey. Chapter 4 will discuss how homogeneous these groups are with respect to survey responses on corruption.
5. The 2005 BEEPS findings for Belarus are in general very positive compared to the 2002 findings. Given the tight controls imposed by the Belarus government and the very limited scope for private activity in the economy, it is not clear to what extent these findings are comparable to those elsewhere in the region. The same is true for Uzbekistan. Chapter 3 discusses this issue in greater detail.

6. Figure 2.1 shows the percentage of firms responding that bribes were paid frequently, usually, or always (see Methodological Annex).
7. We are using the terms yes and no for ease of exposition. The questions were not yes/no questions; rather they were scaled response questions for which dummy variables were created by dividing the scales down the middle.
8. More dimensions of state capture, including payments to courts, central banks, and political parties, were included in the question in the 2002 BEEPS. Payment to parliamentarians and government officials were considered the essence of state capture, however, and thus the 2005 question was limited to these two. The differences between the average 2002 answers on the two dimensions versus all six dimensions, as reported in *Anticorruption in Transition 2* (World Bank 2004), were small—the two had a correlation of 0.93.
9. The general population also seems to note progress in Georgia. Transparency International’s “Global Corruption Barometer” showed a marked reduction in perceptions of the prevalence of corruption in police, health, and education between 2004 and 2005, and in the 2005 survey of 500 urban respondents, 46 percent said corruption had declined compared to 20 percent that said corruption had increased (Transparency International 2004, 2005).