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Policies and Corruption Outcomes

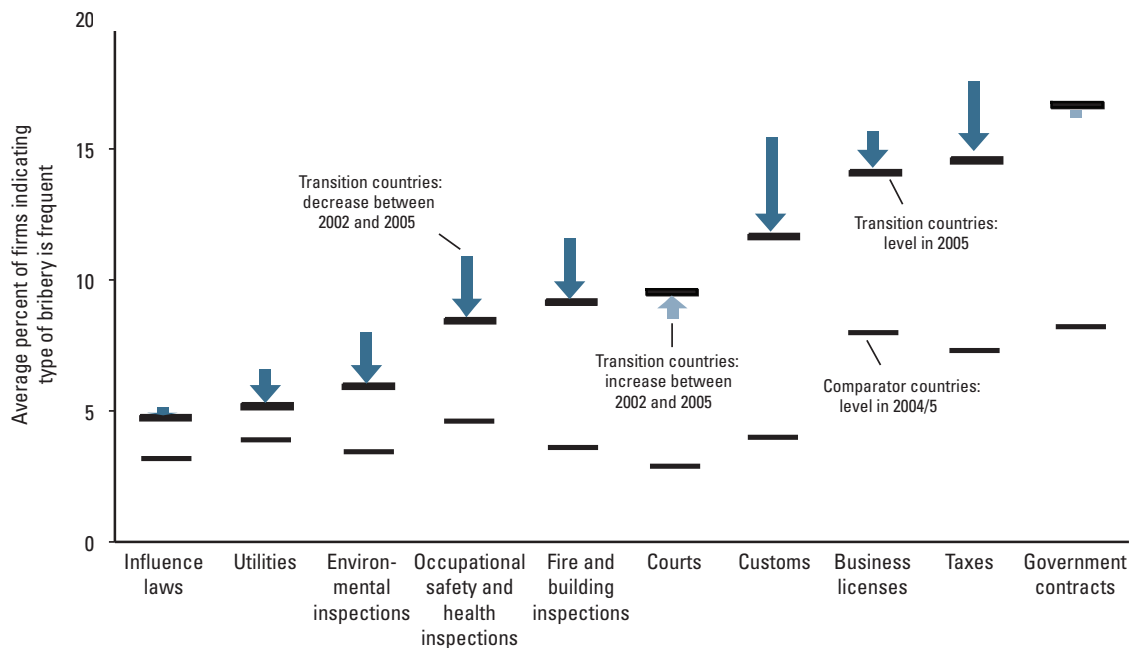
CHAPTER 2 ESTABLISHED THAT BROAD INDICATORS OF CORRUPTION, as reported by the business community, have declined in many transition countries in the 3-year period from 2002 to 2005, continuing the trend of the three earlier years. Chapter 3 analyzed the relationships of these corruption trends to several broad features of the firms surveyed and the institutional and political environment. This chapter looks more closely at specific types of corruption and how they are influenced by public policies and institutions. To be successful in an anticorruption drive, leaders need to understand where corruption occurs and what government actions might influence it. Recent reforms in policies and institutions in some transition countries provide guidance on what steps might help.

Figure 4.1 summarizes the trends in corruption in specific areas from 2002 and 2005 for transition countries and compares the results with nontransition countries.¹ Congruent with the findings in Chapter 2, firms in transition countries reported significant reductions in corruption in the regulatory environment, access to utilities, and tax and customs administration. However, for the region as a whole corruption did not improve for the courts or public procurement. The extent of state capture—that is, payments to influence the design (as opposed to the implementation) of laws and government regulations—appears mostly unchanged.² In every area, however, the average frequency of bribery in transition countries remains significantly higher than the average for nontransition countries.³

Understanding the reasons for progress requires some examination of the policy environment. While there are several choices of indicators on corruption, including surveys such as BEEPS and expert opinions such as

those produced by Freedom House, there are relatively fewer sources of indicators on the policy environment. In this section, we draw on a dataset produced by the World Bank called “Doing Business” to examine how official laws, rules, and procedures affect the frequency of bribery as reported by firms in specific sectors. Box 4.1 clarifies why Doing Business and BEEPS are complementary tools. The analysis covers all of the sectors surveyed by the BEEPS for which there is a direct analogue on the policy side from Doing Business. We also draw on indicators of the institutional and policy environment provided by the World Bank’s CPIA and indicators of specific anticorruption measures collected by other researchers to get a sense of the degree to which cross-cutting reforms influence the levels of corruption. The analysis is supplemented by the World Bank’s experience in helping countries on the ground with policy reforms and institutional strengthening in the various areas discussed.

Figure 4.1 The frequency of bribery by subsectors, 2002–2005



Source: BEEPS 2002, BEEPS 2005.

In reviewing the apparent relationships between policies and corruption outcomes, an important caveat should be stated up front. Much of the analysis relies on cross-country patterns of contemporaneous indicators of both policies and corruption. While the approach is a static one, a dynamic interpretation is projected based on the cross-sectional patterns. In terms of long-run relationships, this is a reasonable approach. Complications may arise, however, when the relationship between policies and outcomes is subject to long lags, or is influenced by reverse causality or by the existence of additional factors that influence both policies and corruption outcomes.⁴

Box 4.1 The relationship between the BEEPS and the Doing Business indicators

The BEEPS and the World Bank Group's "Doing Business" are complementary efforts to examine the environments in which firms do business. They use different methodologies and answer related, but different, questions.

Most of the Doing Business indicators are generated by asking lawyers, accountants, and other professionals in each country about the details of the laws, rules, and procedures that govern various aspects of doing business. In order to ensure cross-country comparability, the Doing Business methodology presents hypothetical cases or situations that are the same for each country, and the cases are assumed to be taking place in the largest city. Doing Business can be thought of as a compilation of indicators about various government policies, rules, and procedures.

The BEEPS, in contrast, asks 200–600 firms throughout each country questions about their business environment and their interactions with the state. The samples are chosen in a uniform way in each country, with sector composition divided according to contribution to GDP. The BEEPS can be thought of as a compilation of indicators about what firms are saying about the ways that government policies, rules, and procedures are implemented in practice.

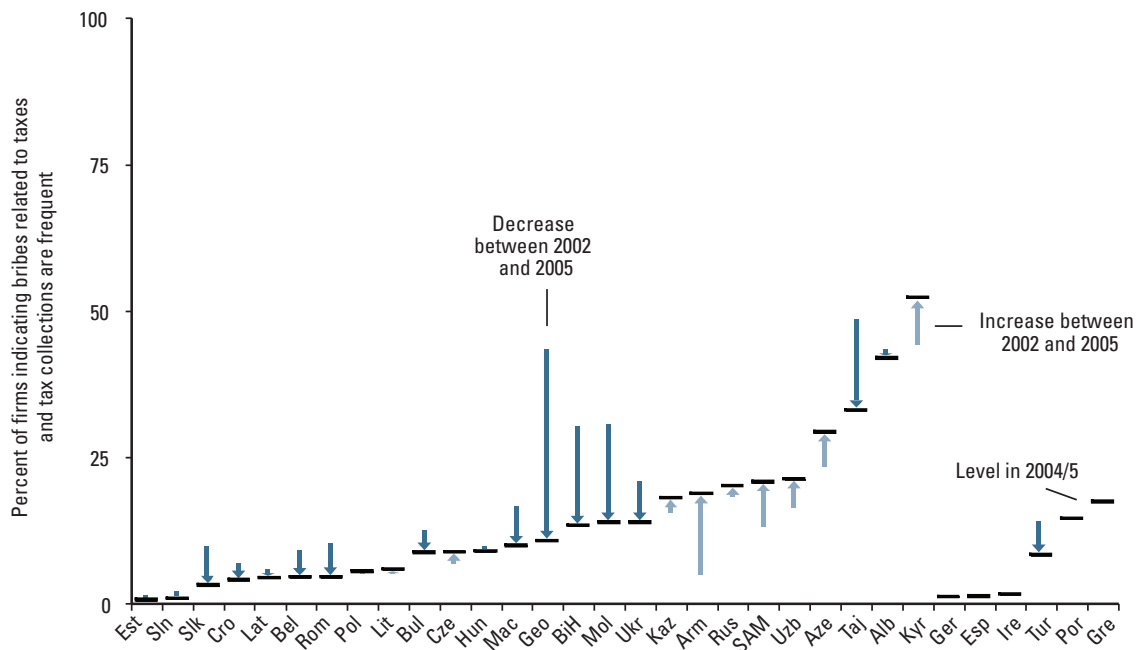
Often, Doing Business and BEEPS suggest the same trends. Doing Business in 2006 highlighted several countries in Europe and Central Asia as leading reformers, and the BEEPS 2005 results also suggest improvement over the past three years in some of the same countries. In countries where the results do not seem congruent, there are many possible explanations. Firms may have found ways to work around problematic regulations so that they are less burdensome; conversely, the formal rules and procedures may appear benign, while nontransparent implementation may cause firms considerable difficulty. In addition, improvements captured in the Doing Business indicators may take time to be recognized by the business community. For example, reductions in minimum capital requirements to start a company will not help the firms that are already in existence.

For further information see World Bank 2006c: www.doingbusiness.org.

Taxation

An important area where it appears that solid progress is being made in the fight against corruption is tax administration. Although still a concern, far fewer firms in transition countries report that bribes are frequent in the tax system (Figure 4.2). Among individual countries the most striking improvements from 2002 to 2005 were in Georgia, where the percentage of firms reporting that bribery of tax officials was frequent fell from 44 percent to 11 percent in these three years. Marked improvements from relatively high levels of corruption are evident Bosnia and Herzegovina, Moldova, Tajikistan, and Ukraine; and more modest improvements are evident from lower starting points in FYR Macedonia, Romania, and the Slovak Republic. Bribery appears to have worsened from already high levels in the Kyrgyz Republic, from more moderate

Figure 4.2 Frequency of bribery in tax administration, 2002–2005



Source: BEEPS 2002, BEEPS 2005.

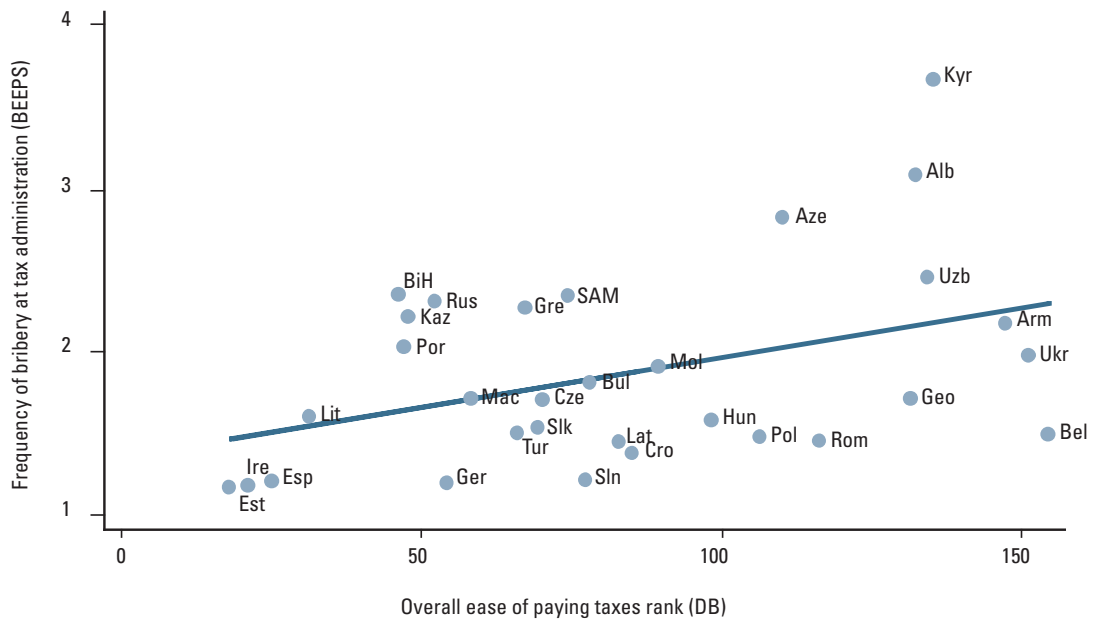
Note: Changes in the following countries are significant: Arm, Bel, BiH, Geo, Mac, Mol, Rom, SAM, Slk, Taj, Tur, Ukr. See Annex for details.

levels in Serbia and Montenegro, and from previously low levels in Armenia. Of the comparator countries, corruption in the tax system appears relatively higher in Greece and Portugal, moderate in Turkey, and very low in Germany, Ireland, and Spain.

While the details of policies and institutional design matter, a simple association exists between corruption levels on the one hand and the degree to which the tax system is a burden on the other (Figure 4.3). Countries where firms make paying taxes simpler and easier tend to have lower levels of corruption related to taxes.⁵

The positive results in many transition countries are correlated with aggressive reforms over the past few years to simplify tax policy and tax administration. On the tax policy side, transition countries have been worldwide leaders in adopting simplified low- or flat-rate income taxes with broad bases and few exemptions. The flat tax took effect first in

Figure 4.3 Corruption in tax administration and ease of paying taxes



Source: BEEPS 2005/4.; Doing Business 2005.

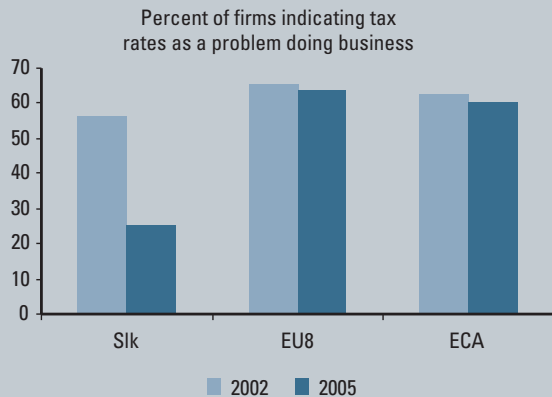
Estonia in 1994, followed by Lithuania (1994), Latvia (1995), Russia (2001), the Slovak Republic (2004), Ukraine (2004), Georgia (2005), and Romania (2005). The Slovak Republic's experience with tax reform is described in Box 4.2. Even where income tax rates are not entirely flat, there tend to be fewer rate brackets with relatively low top rates (typically in the teens or low 20s). Armenia's corporate and top personal income tax rates, for example, are both 20 percent, and Poland's corporate and small business tax rates are both 19 percent. There have also been reforms in indirect taxes. Value-added taxes (typically at a uniform rate) have replaced the turnover taxes inherited from socialist times and generally account for a large and growing share of revenues. While the VAT is a formidable revenue raiser (particularly at rates in the high teens that are typical in the region), VAT refunds have proven to be difficult to implement smoothly in most settings and are one source of significant corruption. Arguably the most pressing current tax policy issue relates to labor taxes (including social contributions), which continue to be very high in most transition settings. These rates create tax "wedges"—the difference between the cost of labor to the employer and the take-home pay of the employee—of up to 50 percent, contributing to the relatively low rates of formal employment in many transition countries.⁶

Reforms in tax policy and improvements in tax administration can be mutually reinforcing, and many of the countries that have undertaken major tax policy reforms are benefiting from improved administration and lower corruption. However, one does not necessarily lead to the other, and thus it is important for governments to focus on both areas simultaneously. Many transition countries are undertaking far-reaching reforms to improve their tax administration services and promote greater transparency and efficiency. Most have moved to a functional organization to consolidate the same processes (assessment, collection, appeals, and so forth) for different taxes under one group. In some cases, such as Bulgaria, the collection of taxes and social contributions have recently been merged to increase compliance and reduce superfluous audits (which themselves create opportunities for corruption). Countries have established "Large Taxpayer Units," which have proven very effective in mobilizing resources from large companies and other major taxpayers in their countries. They have introduced unique taxpayer numbers, taxpayer self-assessment procedures, and information technology (IT) systems for electronic filing and data collection, all of which help to reduce discretion and direct contact between taxpayers and tax officials while enhancing efficiency and transparency

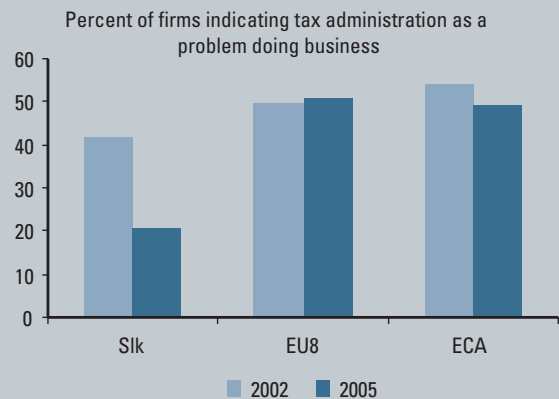
Box 4.2 Tax reform in the Slovak Republic

One of the key reforms undertaken in the Slovak Republic in recent years is the 2004 reform of the tax and benefits system. The reform introduced a relatively low flat-rate tax and reformed the system of social benefits. Although the reform was praised by many for its positive impact on competitiveness, concerns were voiced about its potential negative effect on poverty and income distribution. A detailed evaluation of the reforms found, however, that the move to a flat-rate tax made the tax system more rather than less progressive. Furthermore, overall tax collections were not significantly affected, and the BEEPS data show that firms' perceptions of the tax system have improved markedly, that tax evasion is falling, and that bribes related to taxes are paid less frequently.

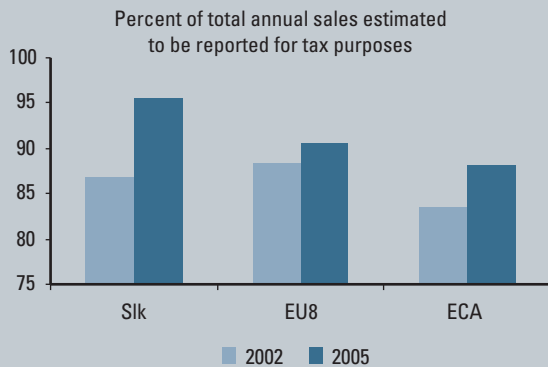
Tax rates as a problem doing business



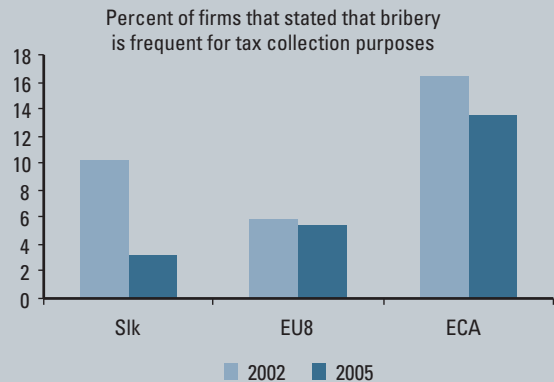
Tax administration as a problem doing business



Annual sales reported for tax purposes



Unofficial payments for tax collection



The tax reforms did not come in isolation. The Slovak Republic has also adopted many other sector-specific and cross-cutting reforms. As with many other countries that have shown improvement, both in specific sectors and across the board, the Slovak Republic led reforms through the implementation of a freedom-of-information law, effectively making civil society and the general public allies in the fight against corruption.

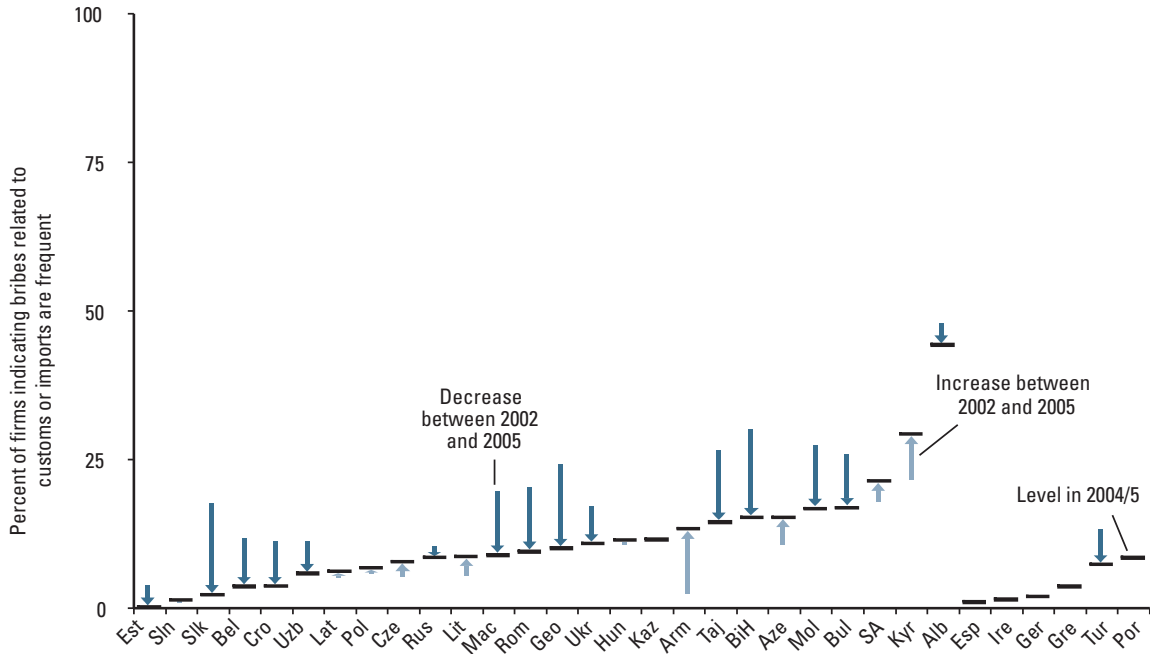
Sources: BEEPS 2002, 2005; World Bank 2005c.

throughout the tax system. Audits and enforcement have also been stepped up or made more efficient, including in some cases (most notably Georgia and Ukraine) large-scale replacement of managers and staff in the tax service and increases in the salaries for tax officials. Tax administration remains weakest in some of the poorer countries in the region, such as the Kyrgyz Republic and Tajikistan, where resources are tight and policy and institutional reforms are not as advanced.

Customs

As with tax, the BEEPS results also point to significant reductions from 2002 to 2005 in customs-related bribery for many transition countries (Figure 4.4). Country-specific patterns of changes in customs-related bribery are similar to those in the tax system, with major improvements in Bosnia and Herzegovina, Bulgaria, Georgia, FYR Macedonia, Moldova, Romania, the Slovak Republic, and Tajikistan, and some deterioration in Armenia. Among the comparator countries, Portugal and Turkey appear to have levels of corruption in customs that are comparable to most of the new EU members, while bribery in customs appears to be very low in Germany, Greece, Ireland, and Spain. By far the highest levels of corruption in customs are reported in Albania, where 44 percent of firms report that bribery is frequent.

The marked reduction in customs-related bribery in many transition countries is not particularly surprising given the concerted efforts that are being made to improve customs administrations. Virtually all countries have revised their customs legislation, often in line with EU standards and with EU assistance. Most countries have invested in new information technology to increase efficiency and transparency. Not only does this allow greater information sharing among relevant government agencies and customs sites, but it also allows customs administration to become increasingly paperless, giving both traders and customs officials the ability to handle documents and track progress on-line. Customs administrations in the region are also moving to risk-based assessment and more selective auditing, which reduces discretion in the selection of items for physical inspection. Croatia, for example, has fully rolled out selectivity and risk management techniques and has reduced the number of physical exams extensively, and the results on the corruption front appear very promising. Albania and Moldova have introduced IT and the

Figure 4.4 Frequency of bribery at customs, 2002–2005

Source: BEEPS 2002, BEEPS 2005.

Note: Changes in the following countries are significant: Arm, Bel, BiH, Bul, Cro, Est, Geo, Mac, Mol, Rom, Slk, Tai, Tur, Ukr, Uzb. See Annex for details.

well-known ASYCUDA clearance system, but both need to move toward greater selectivity and risk assessment. Although firms in Serbia and Montenegro reported no significant change in the frequency of bribery at customs between 2002 and 2005, reforms focusing on transparency, simplified procedures, and monitoring have accelerated in the past year.

Where systemic corruption is widespread, strong sanctions may also be needed to change staffing and expectations. For example, the new Georgian government that took office after the Rose Revolution moved quickly to replace many managers and staff in the customs and tax administrations, and the Slovak Republic has set up a criminal office in the customs service to strengthen the detection and investigation of fraud and corruption. The strong and concerted efforts to address corruption in both countries appear to be paying off. In addition, some countries (such as FYR Macedonia) have introduced internal audit or ethics departments

in their customs services to focus more directly on broad strategies for combating corruption.

Given the cross-national nature of customs work, international cooperation can help improve the efficacy of reforms. One example is the project on Trade and Transport Facilitation in southeast Europe (TTFSE), which aims to streamline customs procedures and improve efficiency at border crossings in eight southeast European countries (see Box 4.3). A key element of the program is the system of detailed monitoring of customs clearance times at the pilot borders, and nearly every border crossing shows a trend of dramatic improvement. This finding is also borne out in the BEEPS—the southeast Europe region showed more improvement in levels of bribery at customs than any other region.

As with taxation, reforms in policy and administration can be mutually reinforcing in the area of customs. Not only do low and uniform tariffs reduce uncertainty and room for bargaining over tariff rates with customs officials, but they also induce a higher volume of trade and thus more pressure for efficiency in customs administration. Although the findings of academic research are not unanimous, there is some evidence that more open and liberal trade regimes are correlated with lower levels of corruption.⁷ Most transition countries (other than Belarus, Turkmenistan, and Uzbekistan) have reduced tariffs and now have quite liberal trade policy regimes, with low average tariffs and few nontariff barriers.⁸ Of course the level of tariffs and nontariff barriers at the border is only part of the story, as “behind the border” administrative regulations and other restrictive domestic policies can also stifle international trade. Reducing the often-large number of required precustoms permits, registrations, and licenses, and clarifying and simplifying technical regulations are critical steps in removing opportunities and incentives for corruption.

Figure 4.5 shows the relationship between the frequency of bribery in customs and the Doing Business indicator for the ease of trading across borders, which is based mostly on the administrative burden for firms in dealing with customs. The relationship between policies, institutions, and the level of bribery is again evident.

Judicial systems

In contrast to tax and customs, the BEEPS results do not point to an overall decline in corruption in the judicial systems in transition

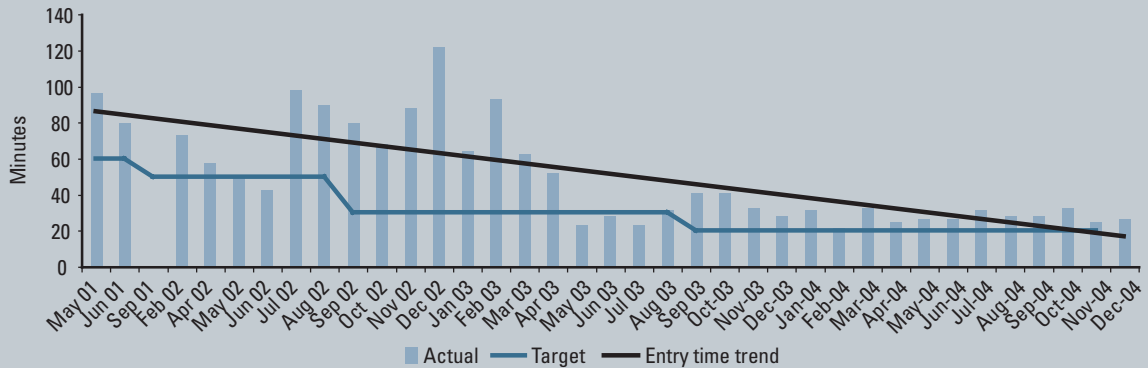
Box 4.3 International cooperation in customs reform—trade and transport facilitation in Southeast Europe

The southeast Europe subregion stands out as the one where bribes to customs officials are most frequent, yet also where bribes have declined the most. As every border crossing involves two countries, international cooperation may be necessary for effective reforms. The project on Trade and Transport Facilitation in Southeast Europe (TTFSE), a collaborative effort between eight national governments, the World Bank, the United States, and the European Union, seeks to reduce nontariff costs of transport, reduce corruption at borders, combine modernization of customs administration with institutional reform, and bring transparency to border crossing procedures.

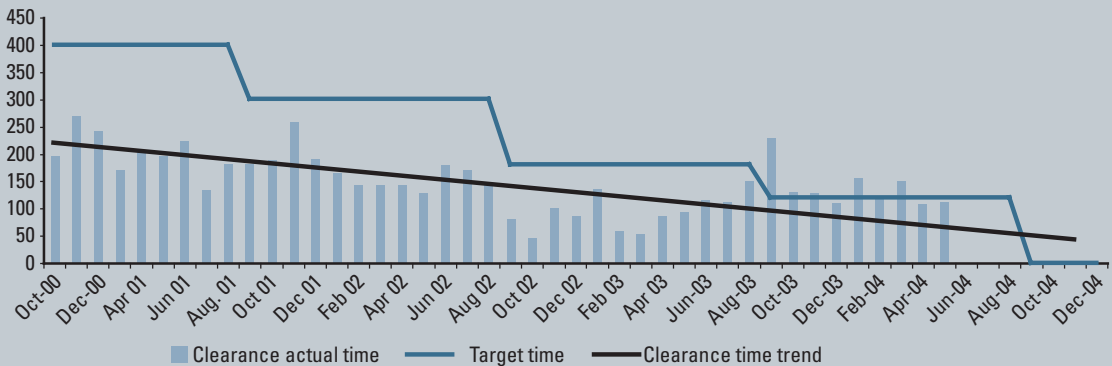
Surveys of truck drivers in 2001 and 2002 asked about typical bribe payments when crossing borders. In Albania, 96 percent of trucks said they paid bribes to customs officials, while in Bulgaria 24 percent said likewise—the other countries fell in between. The bribe amounts ranged from a high of 342 Euros reported by Albanian drivers to a low of 23 reported by Romanian drivers. Payments were made most frequently in Moldova, where 82 percent of border crossings involved a bribe. Thus the challenge faced by the project was formidable.

There has been considerable success to date. The project places a premium on monitoring, tracking clearance times for each of the border crossings. For nearly every crossing the average trend has been favorable, and clearance times have declined sharply at many of the border crossings. Trends for two of them are depicted below.

Bosnia and Herzegovina, Federation, Izacic. Entry times

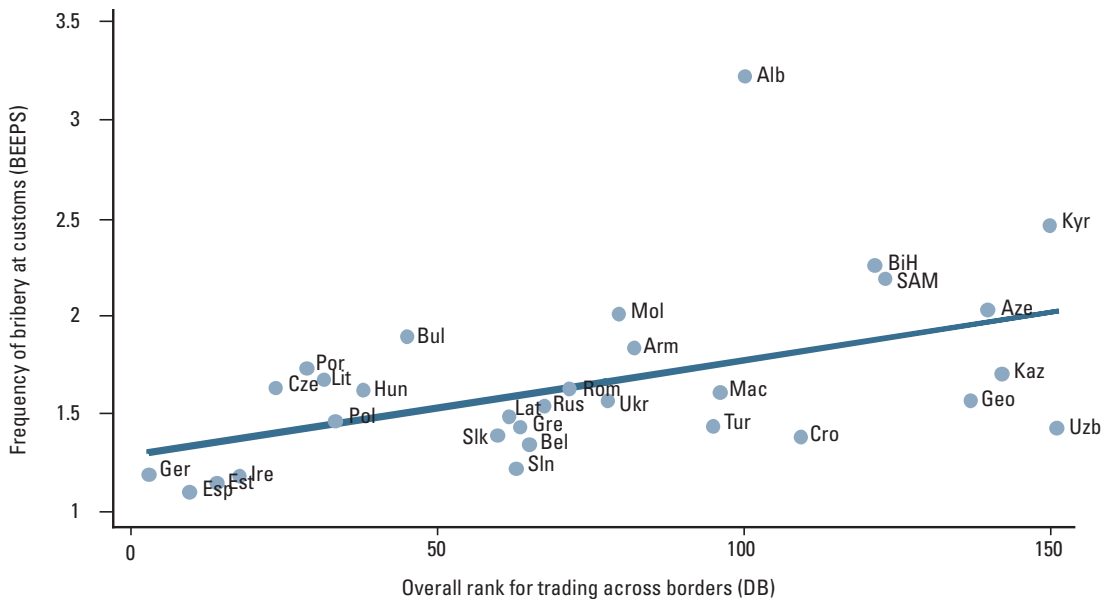


Romania, Constanta. Clearance times



Source: The Website of TTFSE (<http://www.seerecon.org/ttfse/>), and PlanConsult (2003).

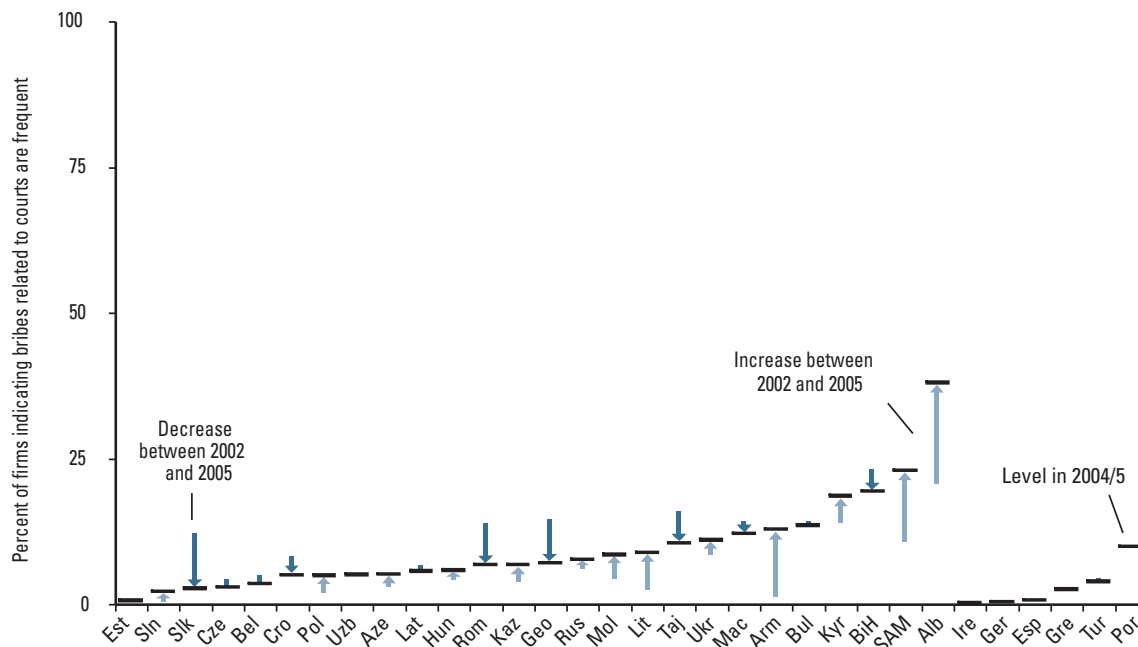
Figure 4.5 Corruption in customs and ease of trading across borders



Source: BEEPS 2005/4; *Doing Business 2005*.

countries, although there is progress in some countries. Figure 4.6 shows the percent of firms reporting in 2002 and 2005 that bribery in courts is frequent. The firms in the survey report less frequent bribery in the courts than three years ago in a few countries, including Georgia, Romania, and the Slovak Republic, but more frequent bribes in others, most notably Albania and Serbia and Montenegro (and, from a low base, Armenia). One does not see the improvements in Bulgaria, Moldova, FYR Macedonia, or Ukraine that were evident in tax and customs.

What would it take to establish true accountability in the judiciary? A myriad of individual steps are needed, including (i) ensuring merit-based systems for judicial appointment, promotion, and disciplinary proceedings, as well as adequate judicial salaries and training; (ii) promoting transparency in all judicial proceedings through open access to court hearings by the public the media and through publication of judicial decisions; and (iii) prosecution of some high-profile corruption cases, whether in the judiciary or in government more broadly. Only through

Figure 4.6 Frequency of bribery in the courts, 2002–2005

Source: BEEPS 2002, BEEPS 2005.

Note: Changes in the following countries are significant: Alb, Arm, Geo, Lit, Pol, Rom, SAM, Slk. See Annex for details.

the “carrot” of professional stature and remuneration and the “stick” of potential punishment for wrongdoing—together with the incentives and self-enforcement mechanisms that arise from transparency—can corruption be successfully tackled.

Judiciaries and governments are aware of the dismal stigma of corruption, and significant steps are being taken to address it in many countries.⁹ In Romania and Russia, for example, judicial salaries have been raised substantially to a level that compares reasonably to average private-sector salaries. This move has raised the status of the profession, its “value” to incumbents, and its attractiveness to potential candidates. The process of judicial selection is also being tightened, and training opportunities for judges are being expanded. Georgia, for example, was one of the first countries to introduce examinations for judges, and other

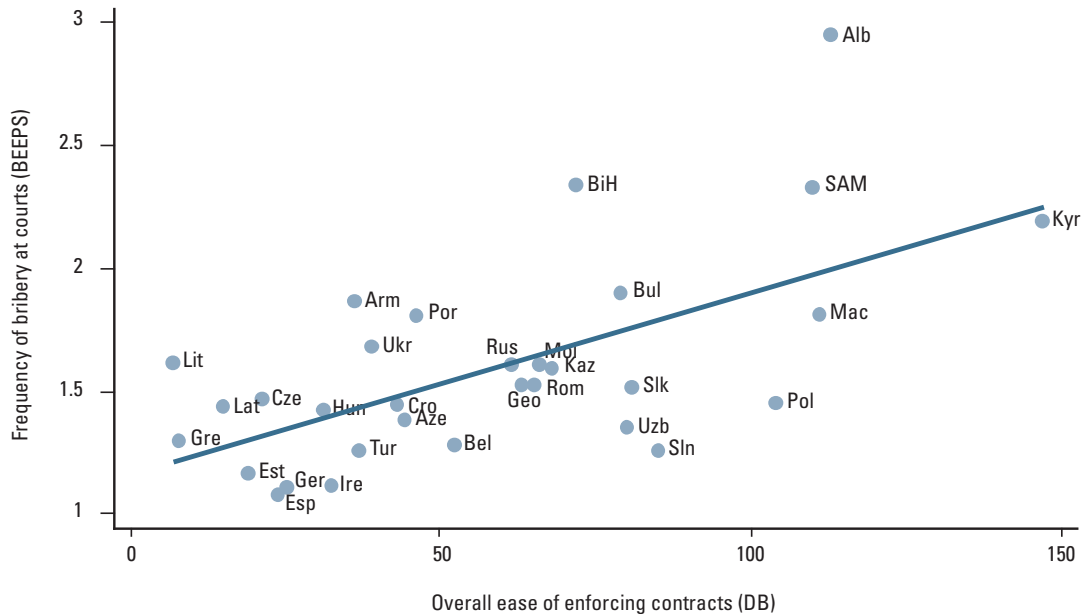
transition countries have followed suit. Georgia and Armenia have also adopted nationwide merit-based exams for entrance to law schools in an effort to reduce corruption at this entry point into the profession. While these examination processes are themselves not without difficulties, they are a step in the right direction compared to selection processes of old. As a complement to merit-based selection of judges, the Slovak Republic has put major efforts into strengthening government's capacity to prosecute cases of judicial corruption, including setting up a special court and prosecution office to deal with cases of corruption and organized crime.

Transition countries are also taking important steps to teach citizens¹⁰ about their rights and to increase the transparency of the legal system. In Armenia, a television show called "My Rights," in which a government official plays the role of a judge hearing cases, has become popular and is now in its second year of production. In Russia, the government set up a network of "Legal Information Centers" in public libraries and other locations in the late 1990s, where the public can access information on laws and the justice system. In Croatia (and many other transition countries), the courts are adopting an automated case-management system that will not only improve efficiency but also produce better statistical data to monitor performance. Countries' judiciaries and ministries of justice throughout the region are establishing wide-area networks to connect courts and websites to publicize laws, judicial calendars, and decisions in individual cases.

Finally, corruption in the judiciary can be reduced through deregulation and other legal reforms that reduce the number of encounters that firms and private citizens must have with judges and other court personnel. Figure 4.7 points to the significant correlation between the number of procedures required to enforce a contract and the extent of bribery in the judiciary. Overall, the findings with respect to the judiciary support those of earlier research underscoring that judicial reform deserves focused attention.¹¹

Government procurement

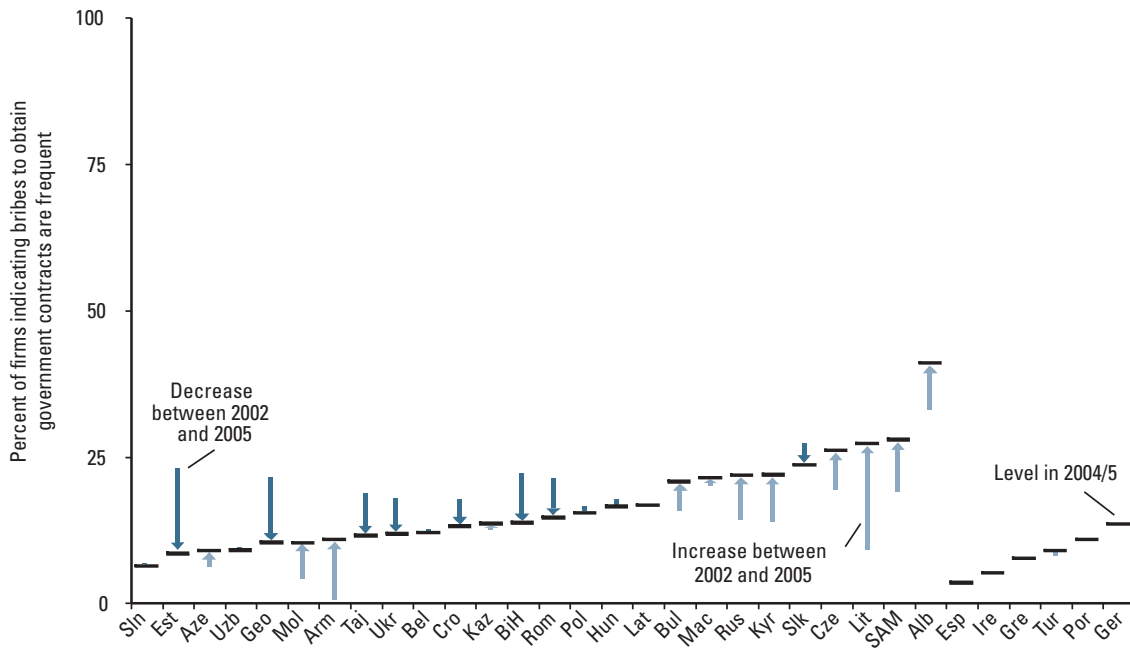
As in the courts, government procurement is another area where levels of bribery are relatively high and do not appear to be improving in many countries (Figure 4.8). While the average "kickback tax"—the percent-

Figure 4.7 Corruption at courts and ease of enforcing contracts

Source: BEEPS 2005/4; *Doing Business 2005*.

age of contract value that firms say they must pay to secure government contracts—has declined for the region as a whole, the frequency with which firms say they bribe for government contracts has not. In some countries with low or improving levels of corruption in other areas—most notably Estonia and Georgia and also Bosnia and Herzegovina, Romania, Tajikistan, and Ukraine—firms also report declining frequency of bribery in public procurement between 2002 and 2005. However, firms in some of the richer and otherwise less corrupt countries in the sample—including the Czech Republic and Lithuania—report growing levels of bribery in government procurement and among the highest levels of such bribery in the region. Firms in the wealthier comparator countries (most notably Germany) also report significant levels of corruption in public procurement, indicating that this is a particularly difficult problem for governments to address.¹² For larger procurements, the potential bribes may well be large enough to have political implications, and thus corruption in public procurement may shade into state capture.

Figure 4.8 Frequency of bribery for government contracting, 2002–2005



Source: BEEPS 2002, BEEPS 2005.

Note: Changes in the following countries are significant: Arm, BiH, Cze, Est, Geo, Kyr, Lit, Mol, Rom, Rus, SAM, Taj, Ukr. See Annex for details.

Many governments are trying to improve the efficiency and transparency of their public procurement processes. Many have passed new procurement laws and established state procurement agencies with clearer and more transparent operating rules. Centralizing procurement has been helpful in some settings, but a decentralized model can also work (and may even be preferable) if backed by a solid legislative framework and a comprehensive capacity-building program. Following the lead of OECD and more advanced developing countries (such as Mexico and Chile), a number of transition countries (such as Armenia) are moving to e-procurement, using public websites to disseminate tenders, accept bids, and announce results.

While increasing efficiency and transparency can no doubt make a difference, tackling the full range of corruption in public procurement is likely to entail deeper political reforms in many instances. Moreover, this area of reform is prone to backsliding, because it depends on consistent

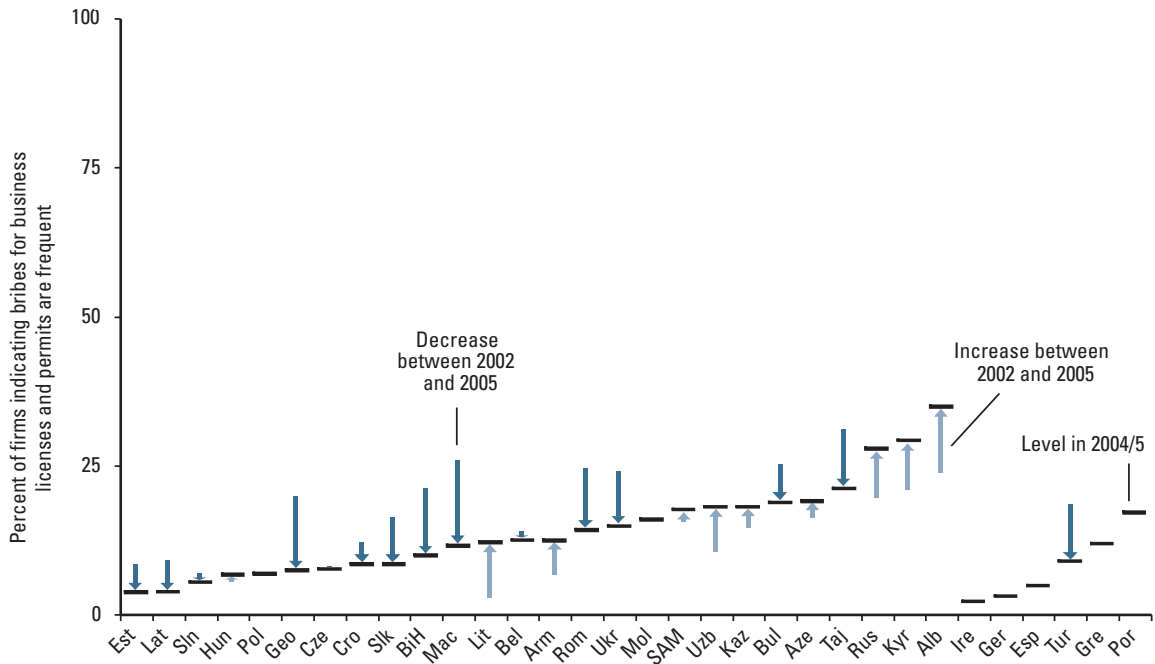
application of transparent and standardized rules for competitive procurement. Countries may adopt world-class procurement laws but apply them in an inconsistent manner, or may adopt subsequent laws exempting some procurement from the standards and thereby weakening their effectiveness.

As a whole, progress in reducing corruption related to government procurement has been disappointing.¹³ While there were large improvements in a few countries, the number of countries where corruption got worse in this area is also large. The decline in the magnitude of the kickback tax reflects large improvements in a small number of countries, and the frequency with which firms say they bribe for government contracts remains worrisome. As the region continues to develop and larger investment projects become more feasible, the potential rents in government procurement will keep pace. Even in the most advanced countries with sophisticated procurement systems, corruption scandals often surround procurement transactions. Indeed, some of the European comparators have higher levels of unofficial payments related to procurement than several of the transition countries. Improving procurement systems—focusing on transparency, competition, and standardization—must be a key priority for governance reforms in the coming years.

Regulatory environment

Firms in Europe and Central Asia have been calling for reductions in red tape and bureaucracy for years, and many countries have begun to address these pleas. *Doing Business in 2006* (World Bank 2006c) highlighted the region as the leader in adopting reforms that make it easier for firms to do business. The average “time tax,” a rudimentary indicator from the BEEPS of the amount of time senior managers spend dealing with public officials, has declined significantly across the region.¹⁴ So, too, has the propensity to encounter bribery when dealing with business licensing or inspections, as is clear from Figure 4.9. Across countries, however, business licensing continues to be one of the areas most beset by unofficial payments. One example is Russia (see Box 3.1), where laws were adopted in 2002 to reduce the number of activities requiring licenses and to cut the cost of obtaining such licenses. However, various recent surveys conclude that these legislative changes, while having some positive impact in the first year, have not resulted in lasting

Figure 4.9 Frequency of bribery for business licensing and permits, 2002–2005

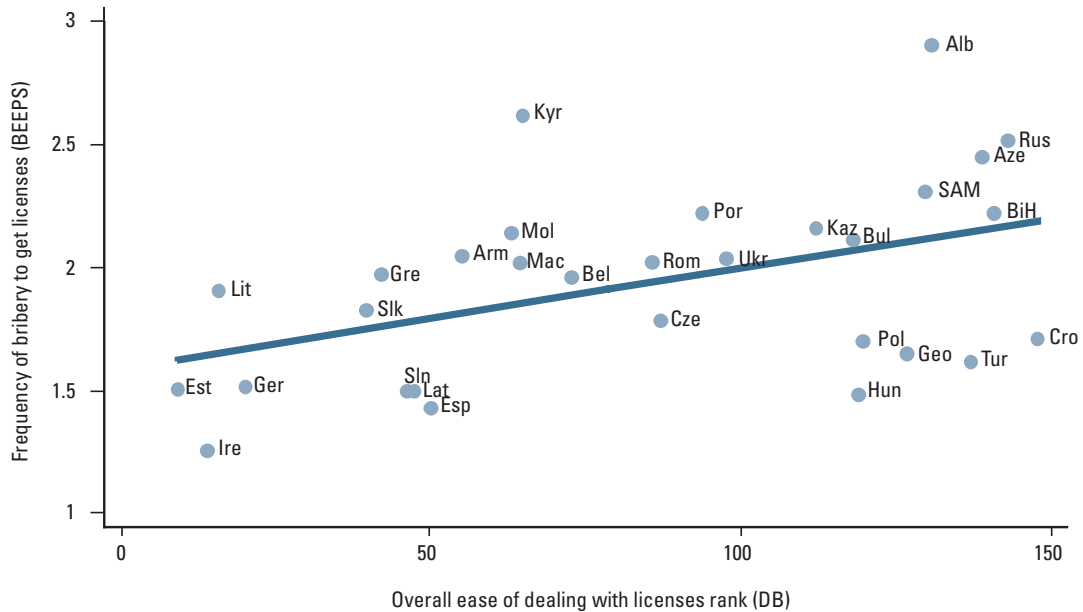


Source: BEEPS 2002, BEEPS 2005.

Note: Changes in the following countries are significant: Alb, Arm, BiH, Bul, Est, Geo, Kyr, Lat, Lit, Mac, Rom, Rus, Slk, Taj, Tur, Ukr, Uzb. See Annex for details.

reductions in the burdens of licensing and associated bribery on businesses.

Doing Business provides support for the importance of including reforms in business licensing in an anticorruption strategy. Unofficial payments are lower in countries that make it easier for firms to deal with licenses (Figure 4.10). Similarly, Figure 4.11 shows that, on average, countries with less frequent inspections (using occupational health and safety inspections as an example) have fewer unofficial payments. Of course, most types of inspections serve a public purpose, so the goal should not be merely to reduce numbers but to rationalize the system of inspections so that they achieve their purpose without unduly burdening firms and opening greater opportunities for corruption. Moreover, reducing the number of regulations without simultaneously establishing

Figure 4.10 Bribery to obtain licenses and ease of dealing with licenses

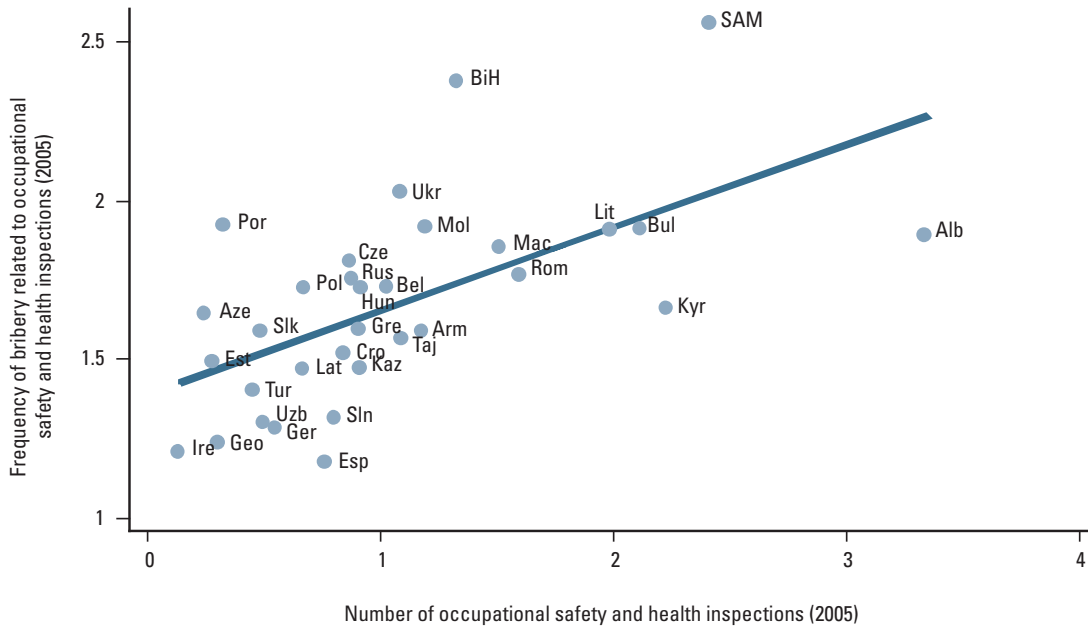
Source: BEEPS 2005/4; *Doing Business 2005*.

a mechanism to vet upcoming draft regulations may lead to only short-lived successes. In the Kyrgyz Republic, for example, many regulations were eliminated in the past five years, only to be reintroduced later. While removing regulations might be relatively easy, reforming the process through which regulations are drafted, evaluated, and publicly discussed is a much deeper—and more challenging—institutional reform.

Cross-cutting reforms

Apart from the specific areas of reforms described above, countries can adopt a wide variety of cross-cutting policy and institutional reforms to strengthen public-sector performance. Improving bureaucratic efficiency through public administration reforms has been a staple of such efforts. Although targeted at improving performance generally rather than

Figure 4.11 Occupational inspections and unofficial payments



Source: BEEPS 2005.

reducing corruption per se, efforts to improve the meritocratic orientation of the civil service are increasing viewed as important steps in the long-run process of reducing corruption.¹⁵ Similarly, fiscal transparency is correlated with lower levels of corruption.¹⁶ Many reformers have also sought to reduce corruption through broader efforts to promote transparency and mechanisms for citizen redress. These include, among other measures, conflict of interest laws and asset declaration rules for public officials, freedom of information laws, and the establishment of supreme audit institutions, ombudsman offices, and anticorruption commissions. Some countries have instituted hotlines and other confidential avenues for citizen complaints. Often these laws are elements of national anticorruption strategies.

The paucity of systematic information on anticorruption institutions has, until recently, made it hard to analyze (except anecdotally) the effectiveness of many cross-cutting anticorruption reforms.¹⁷ Two recent

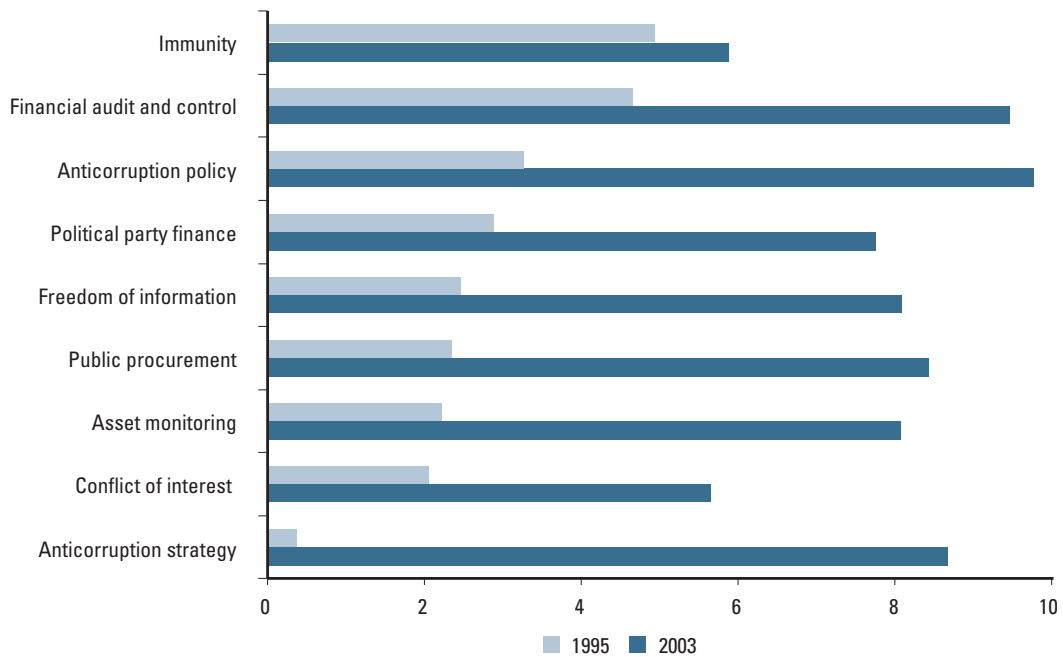
studies have begun to change that by systematically collecting information on anticorruption measures in transition countries. Steves and Rousso (2003), focusing on the period from 1999 to 2002, collected information on the adoption of laws in transition countries addressing freedom of information, civil service, political party finance, anti-money laundering, and so forth, as well as details on anticorruption strategies and status with regard to international conventions. They found that the adoption of laws was associated with declines in many forms of corruption, although adoption of an anticorruption strategy (without targeted legislative components) was not significantly associated with changes in corruption between 1999 and 2002. A more recent update (Rousso and Steves 2005) examined changes between 2002 and 2005 and found no links between the anticorruption policies that were adopted between 1999 and 2002 and the subsequent changes in corruption.¹⁸

A second data collection effort provides a needed time series. Dorhoi (2005) collected information on many anticorruption institutions in nine policy areas for 15 transition countries¹⁹ for three specific points in time: 1999, 2002, and 2003. Using a detailed scoring system, qualitative assessments of the virtues of the laws resulted in indexes of quality with a ten representing the best possible score.²⁰ Figure 4.12 shows the average score across all 15 countries for both 1995 and 2003. Clearly, this was a period of much activity in many countries, with the exception of the area of immunities.

Such measures cannot be very effective without strong leadership and other mutually-supporting reforms.²¹ Albania, for example, has instituted many cross-cutting anticorruption reforms, and has among the highest scores for the indexes created by Rousso and Steves and by Dorhoi. The BEEPS results did not point to progress on anticorruption through the spring of 2005, when the survey was conducted, although the new government has committed to address the problem with renewed intensity. In contrast, Romania has undertaken many of these reforms under strong pressure from the EU, apparently with significant success (see Box 4.4).²²

The success of anticorruption strategies also varies, a key theme of the Rousso and Steves (2005) analysis. Armenia developed an Anticorruption Strategy and Action Plan in 2003 and created a high-level Anticorruption Council chaired by the Prime Minister in 2004, but the 2005 BEEPS results were significantly worse along many dimensions of corruption than the 2002 results. In contrast, Georgia also adopted a

Figure 4.12 Progress in cross-cutting anticorruption reforms, 1995–2003



Source: Dorhoi (2005).

Note: Countries covered included: Albania, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, FYR Macedonia, Moldova, Poland, Romania, the Slovak Republic, Slovenia, and Ukraine.

National Anticorruption Strategy and Action Plan, but it was accompanied by (or in some cases followed by) a large array of policy and institutional reforms and aggressive enforcement actions that together appear to be reducing the extent of bribery and changing society’s overall expectations and tolerance for corruption. Turkey also appears to be tackling corruption successfully through a wide variety of policy and institutional reforms, including a strengthened supreme audit institution and a law on “Freedom of Information for Citizens” enacted in 2003 that has led to a major expansion in the distribution of information to the public through government websites.

More recently, a small number of the more advanced transition countries have begun to address a more complex set of cross-cutting institutional issues related to lobby reform. Hungary has passed a law regulating the lobbying activities of the parliament, the national govern-

ment, local governments, and the lobbyists and their clients. Latvia, Lithuania, and Estonia are similarly addressing this difficult issue. A glance at recent newspaper headlines in the United States demonstrates the challenges of finding the right balance between the need for a productive dialogue between lawmakers and firms and the unproductive opportunities for corruption that can accompany such dialogue.

The time-series nature of the data collected by Dorhoi (2005) makes it possible to examine how cross-cutting institutions affect the patterns of corruption in subsequent years, and how long it takes for changes in institutions to be reflected in changes in corruption outcomes. Noting that some reform measures more directly control one branch of government than others, Dorhoi groups them into indexes for the executive, the legislature, and the judiciary. Interestingly, the levels of corruption in 2005, as reported by firms, are in some cases more closely correlated with the institutions that existed in 1995 than with those adopted more

Box 4.4 Evolution of asset monitoring in Romania

Romania's experience with asset monitoring can best be described as evolutionary. A great stride forward came in 2003 when the government adopted a comprehensive package of laws that included provisions for the public declarations of assets and income. The forms themselves were abysmal: They lacked detail and consisted of simple boxes to check indicating whether or not the official has any assets in the category; the thresholds for many categories were very high (€10,000); and many types of assets did not need to be declared. But they did have the single most important feature of asset declarations—they were public information, posted on the web for high-level officials. The other shortcomings have been redressed in a series of amendments to the law, most recently in January 2005, and the declaration form is now among the most detailed and comprehensive in Europe.

Despite the lack of a formal institution for auditing the declarations, their public nature has made them effective. Prior to the elections in 2004, a group of NGOs, think tanks, and journalists formed a Coalition for a Clean Parliament and created lists of candidates that they viewed as unfit for office. Many criteria were used, including involvement with the Securitate and tax arrears to the budget. Among the key sources of information used to compile the list were the public declarations of assets and income. The Coalition ultimately had an effect on the elections in the fall of 2004, as many candidates were dropped from party lists and there was ultimately a change in the ruling party.

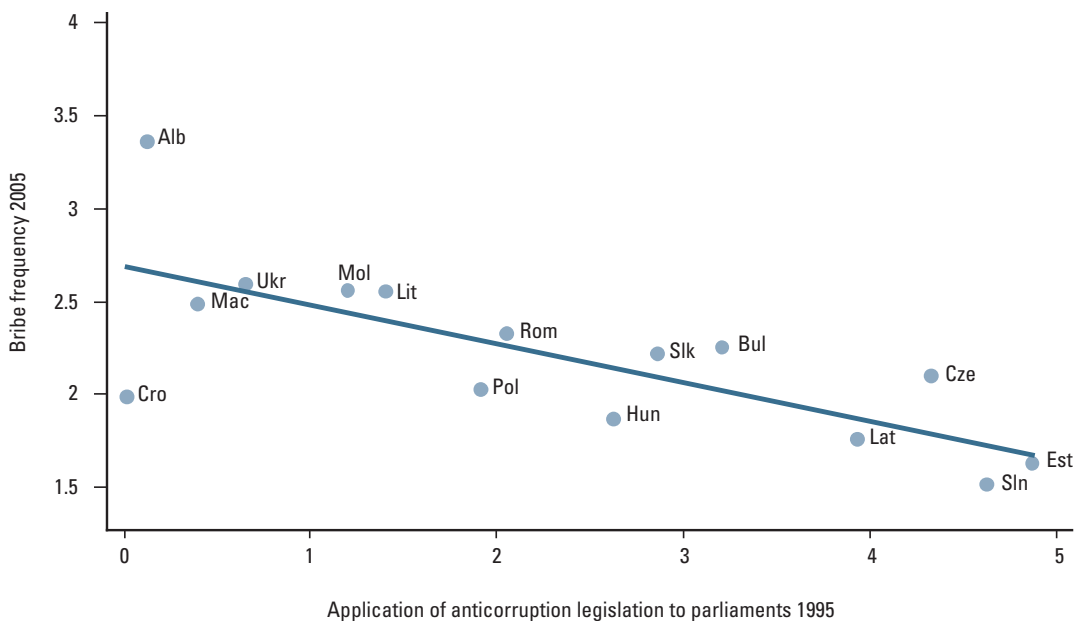
A second stride forward came in early 2005 when the new government, as one of their first major reforms, mandated declarations according to even stricter forms. Now among the toughest in Europe, the new forms call for considerably more detail than the previous version, making it easier for observers (including the general public) to identify discrepancies. The declarations have taken on even greater significance more recently, with several former high-level officials (including a former prime minister) being accused of corruption because of information included in their declarations.

Many challenges remain. While the public nature of the declarations has helped to bring some accountability through the political system, the lack of a workable formal enforcement mechanism means that official sanctions are weak or nonexistent. Plans are currently underway to strengthen enforcement through the creation of a new governmental body whose purpose is to receive and audit the declarations.

See: Romanian Coalition for a Clean Parliament (2005).

recently, indicating that it may take significant time for institutions to change. While recent controls over the executive (that is, those in existence as of 2003) are associated with less frequent bribery, controls related to the other two branches of government that were in existence a decade ago are surprisingly strong predictors of bribe frequency in 2005. A glance at Figure 4.13, which shows the index of controls over legislators in 1995 against the level of bribe frequency in 2005, may give the impression that this is merely a result of the relatively higher levels of income in countries such as Slovenia and Estonia.²³ Indeed, income levels contribute to this pattern, but they do not explain it entirely: Even after controlling for level of income, the pattern apparent in Figure 4.13 remains very strong. Most remarkable is the fact that these two simple variables from a decade ago—controls over legislators and average income—explain 71 percent of the variation in bribe frequency for these 15 countries.

Figure 4.13 Anticorruption institutions in 1995 and bribe frequency in 2005



Source: BEEPS 2005, Dorhoi (2005).

The relationship depicted in Figure 4.13 may well be spurious in the sense that controls over legislators in 1995 can hardly be expected to have a direct link on the propensity of a line inspector to take bribes in 2005. The point is rather that countries that had stronger controls over legislators in 1995, a time when corruption was not as prominent an issue, may have had stronger institutional structures for constraining corruption, and perhaps less cultural acceptance as well, and these long-term factors continue to influence levels of bribery years later.²⁴

While this chapter has discussed sector-specific and cross-cutting reforms separately, the two complement each other to varying degrees.²⁵ In the case of tax administration, for example, sector-specific policies do not explain levels of corruption (in a statistical sense) as well as an index of cross-cutting measures—and both are dominated by the level of income in the country. This stands in contrast to the judiciary, for which sector-specific policies explain much and cross-cutting policies (and income) explain little. Customs and business licensing seem to be influenced in equal measures by cross-cutting and sector-specific policies.

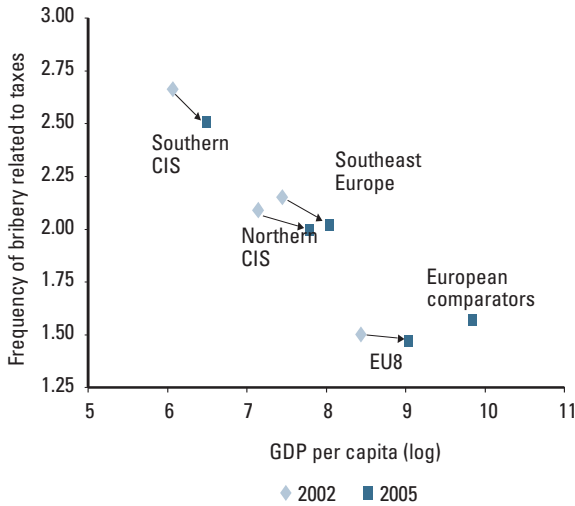
Grouping countries by patterns of corruption

The BEEPS data provide interesting insights into how per capita income levels and other broad legacies of history shape today's patterns of corruption. As noted in Chapter 3, wealthier countries tend to have better institutions and lower levels of firm-level bribery, although there is not clear evidence that rapid economic growth reduces corruption in the short run. Figure 4.14 shows the relationship between (i) levels and changes in per capita income and (ii) levels and changes in corruption by plotting subregional averages of six sector-specific corruption measures against the log of GDP per capita for both 2002 and 2005.²⁶ While the patterns with regard to taxes, customs, and fire and building inspections are all in the right direction, and the pattern for business licensing is in the right direction for some subregions, those with regard to courts and government procurement are not. With regard to these areas, which face perhaps the most complicated and challenging sets of institutional reforms, there is no “virtuous circle” of higher income leading to lower corruption.

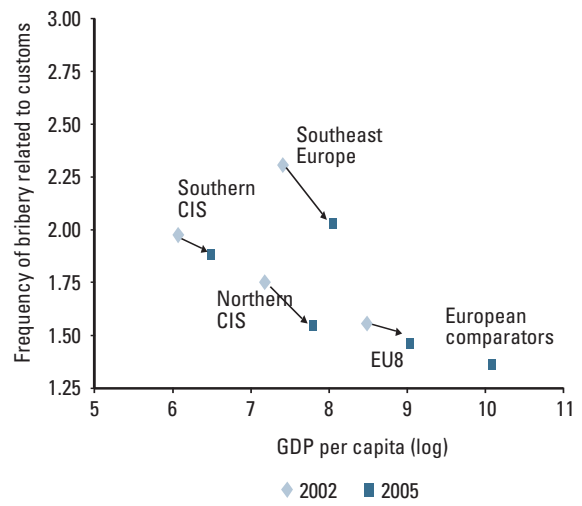
A notable feature of the charts in Figure 4.14 is that subregions do not fit neatly in the sector specific patterns.²⁷ Southeast Europe stands out for

Figure 4.14 Patterns of corruption and levels of income

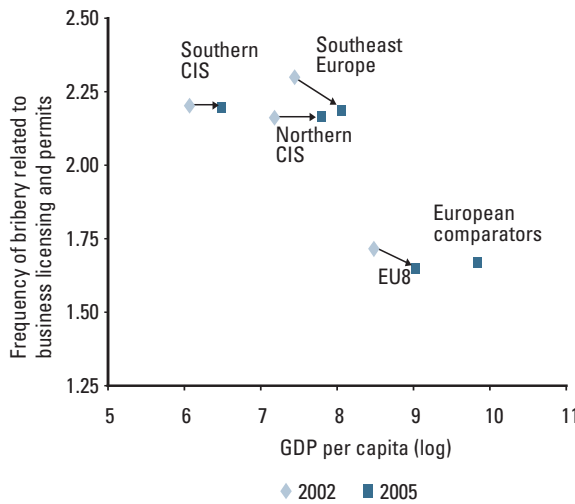
Taxes and tax administration



Customs



Business licensing and permits



Fire and building inspections

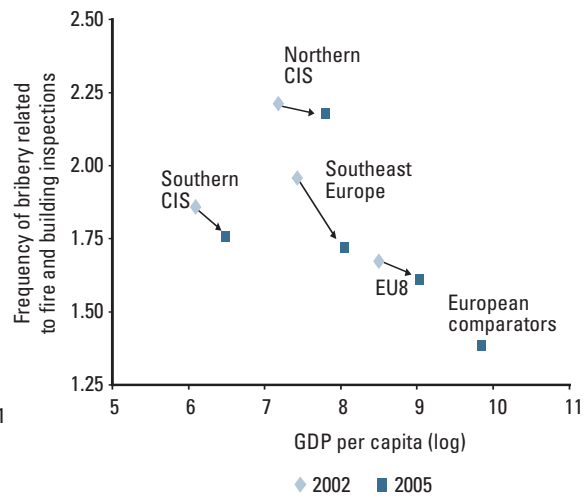
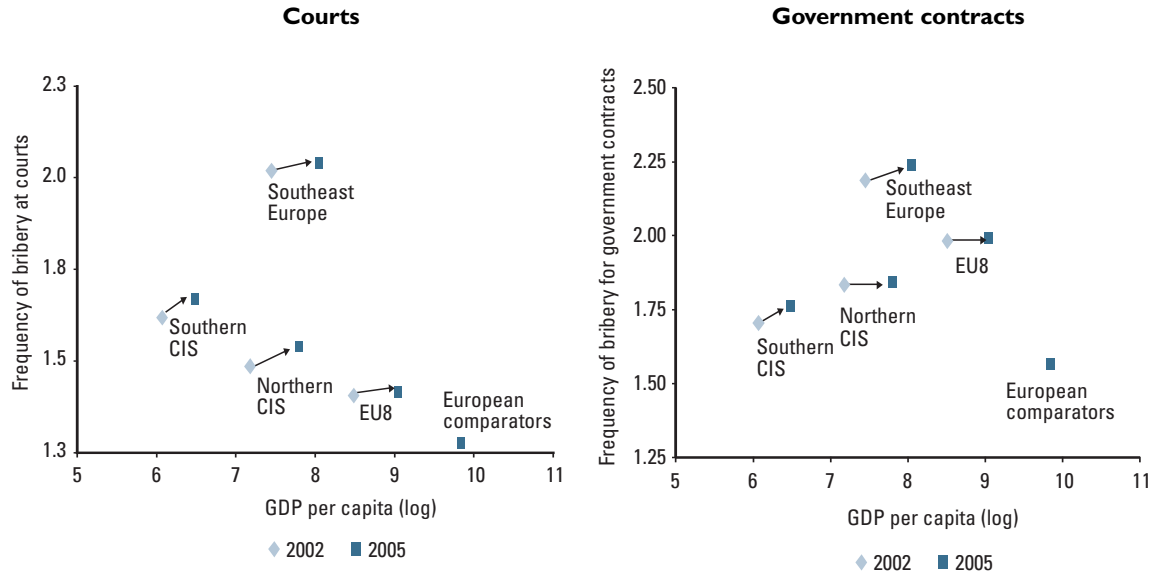


Figure 4.14 Patterns of corruption and levels of income (continued)

Source: BEEPS 2002, 2005.

Note: Southern CIS includes Arm, Aze, Geo, Kyr, Mol, Taj, Uzb; Northern CIS includes Bel, Kaz, Rus, Ukr; Southeast Europe includes Alb, BiH, Bul, Mac, Rom, SAM; EU8 includes Cze, Est, Hun, Lat, Lit, Pol, Slk, Slv; European Comparators include Ger, Gre, Ire, Por, Esp, and Tur. Income levels based on previous full year (2001 and 2004).

customs and the courts; the northern CIS countries are the highest for fire and building inspections; the southern CIS group fares the worst on taxes and tax administration; and firms in the EU-8 report relatively high frequency of bribes with regard to government contracts. Although it is certainly true that subregional groupings do not necessarily reflect the experience of every country in the group, such groupings are typically used to help draw out lessons that may be obscured by the abundance of data. In studies such as this one, it is common to present data according to subgroups such as those in Figure 4.14, and then examine how patterns compare across groups.

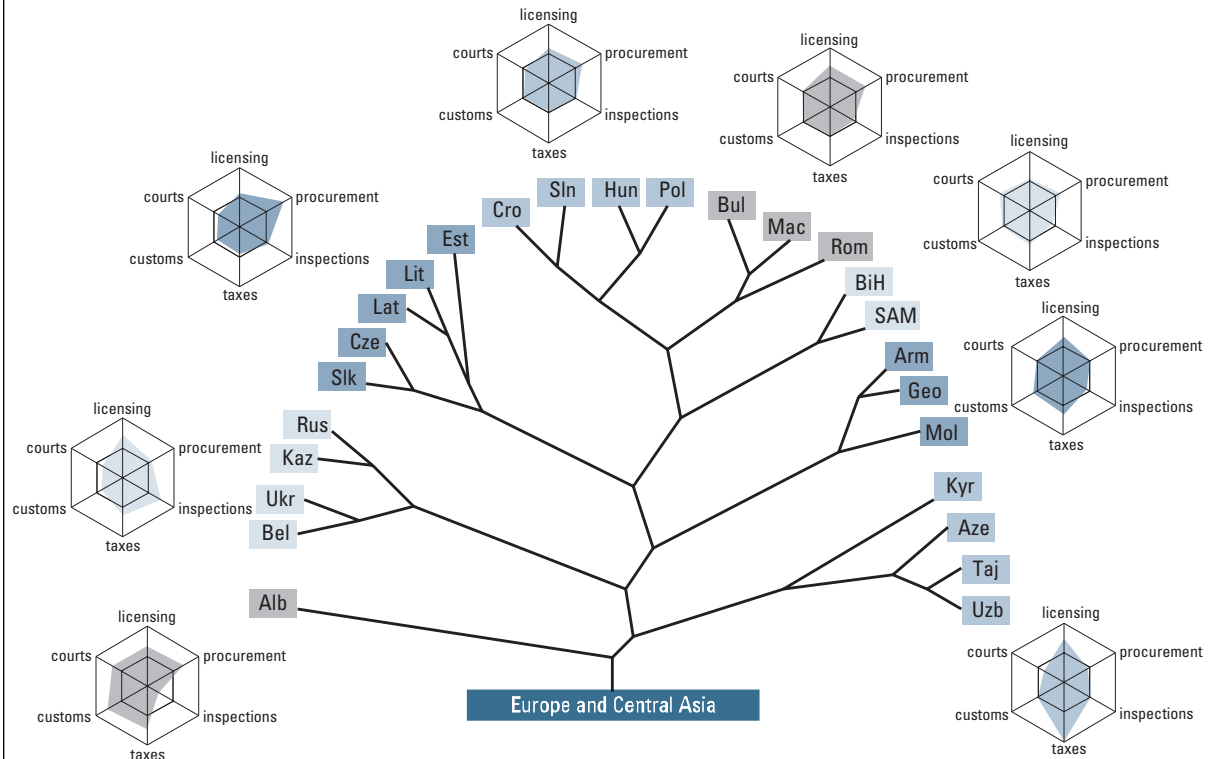
Indeed, when it comes to the pattern of corruption, as opposed to the levels, traditional subregional groupings such as those used in Figure 4.14 make sense. Using several variations of cluster analysis, we examined how countries naturally group together, notwithstanding their proximity, history, or other traditional criteria for grouping countries. A

full explanation is provided in the Annex, but the essence of cluster analysis as applied here is to see which countries are most similar to each other in terms of the *relative* severity of each of 10 different types of corruption. The resulting clusters are presented in a hierarchy in Figure 4.15. These clusters, based entirely on relative prevalence of types of corruption, map very closely to traditional groupings. One group maps perfectly to the northern CIS, while another covers the Baltics and the Czech and Slovak Republics. Another group is made up entirely of countries of the southern CIS, although Azerbaijan is grouped together with three central Asian countries. Croatia is grouped with Slovenia, and Poland with Hungary. Three of the countries closest to EU accession (Bulgaria, Romania, and FYR Macedonia) are grouped together, and Bosnia and Herzegovina and Serbia and Montenegro form a group. Albania, the country that was perhaps the most isolated for nearly 40 years, has patterns of corruption distinct enough from other countries that it forms its own group.

Figure 4.15 also shows the relative patterns of bribery for each of the groups depicted in the chart. The group that maps exactly to the four countries of the northern CIS has relatively high values for fire and building inspections and business licensing, and relatively lower values for customs and the courts. This does not mean that the levels of corruption in these sectors are low for these countries, just that these forms of corruption were reported to be less prevalent than other forms of corruption. In contrast, all of the fully European groups have relatively greater severity of corruption in procurement, with slight variations in other areas. The groups covering southeast European countries tend to have relatively more trouble with business licensing than the rest of Europe. The group covering Armenia, Georgia, and Moldova has relatively more frequent bribes for business licensing and taxes, while the importance of bribery in tax administration is relatively most acute in the group consisting of Azerbaijan, Tajikistan, Uzbekistan, and the Kyrgyz Republic. Finally, the relative patterns in Albania are notable for both prevalence of bribes at customs and the (relative) lack of bribes for key inspections.²⁸

Expanding the analysis to include the six nontransition European countries provides additional insights. Four of the six comparators—Ireland, Turkey, Spain, and Portugal—are most similar to Croatia and Slovenia. Germany, with the relatively high reports of corruption in procurement, is grouped together with the remainder of the EU-8—perhaps not surprising considering that half of the German sample came

Figure 4.15 Clusters based on relative frequency of bribes in specific areas



Source: BEEPS 2005.

from the former German Democratic Republic. Greece, somewhat surprisingly, is grouped together with Azerbaijan and three central Asian republics, the group where corruption is highest in tax administration.

It is notable that with regard to overall levels of corruption—as measured by overall bribe frequency, bribe tax, and assessments of corruption as a problem doing business—the groupings derived from the data (that is, those that emerge from cluster analysis) bear little resemblance to traditional groupings. This is the main reason that Chapter 2 focuses primarily on individual country measures rather than subregional averages. With regard to specific types of corruption, in

contrast, the data suggest groupings that have tremendous overlap with the groups traditionally used, as discussed above.

Several implications derive from these results. First, the long arm of history is clearly present in the data. Countries with similar histories tend to have similar institutions, and the structure of these institutions continues to influence the patterns of corruption. Second, the fact that the comparator countries formed a nearly distinct group suggests that there remain, after all, important differences between even advanced transition countries and elsewhere in Europe. Indeed, it is telling that the two transition countries most closely grouped with the comparator countries are Croatia and Slovenia, as Yugoslavia had perhaps the longest experience with market forces. Finally, it is noteworthy that the richer transition and comparator countries tend to have relatively fewer problems with day-to-day administrative corruption (for example, in tax and customs administration) but relatively higher frequency of bribery in government procurement. This may suggest a typical sequencing over time, whereby countries first gain the capacity to control lower-level administrative corruption as their economies and institutional capacities grow, but continue to have difficulty addressing areas (such as public procurement) that span the boundaries between administrative corruption and state capture. Indeed, corruption scandals in OECD countries often involve bribes paid to politicians to influence large government contracts.

Summary

This chapter looked at specific policy reforms and their impact on corruption in particular areas in transition countries. The extensive policy and administrative reforms that have been undertaken in some areas—most notably taxation, customs, and business licensing and inspections—appear to be having a positive impact in reducing corruption in those areas in many countries. In contrast, less progress is evident in addressing corruption in the judiciary and public procurement, and the impact of cross-cutting measures (such as asset declarations, conflict of interest rules, and anticorruption strategies) is mixed and depends on the extent and seriousness of implementation.

The importance of implementation is also evident throughout this chapter. While the simple relationships depicted in the diagrams are statistically significant, there is considerable deviation for many

countries, reflecting, in part, differences in the details of implementation.²⁹ Indeed, a key difference in terms of both policy and corruption outcomes among three countries that had revolutions during the 2003–2005 period was that Georgia exhibited stronger and more dedicated follow-through and implementation than either Ukraine or the Kyrgyz Republic.

Finally, evidence shows that fundamental change takes time. Despite divergent experiences among countries over the past few years, the long arm of history continues to influence patterns of corruption across the region. Countries with similar histories continue to display similar patterns of corruption, and patterns in transition countries continue to be distinct from those in most comparator European countries further west. Moreover, progress in addressing corruption may proceed in a predictable sequence as countries grow in income and institutional capacity. Richer countries appear to be better able to control low-level administrative corruption but still struggle with forms of corruption—such as bribery in public procurement—that are more likely to be linked to politics and state capture.

Notes

1. Each country received an equal weight in calculating these averages.
2. This section focuses on the prevalence of practices. Thus, “state capture” refers to the prevalence of the practice, not to the impact.
3. In every case, the difference between transition and comparator countries in Figure 4.1 is highly significant. The differences between 2002 and 2005 are all highly significant with the exception of: government contracts ($p = 0.18$), courts ($p = 0.24$), and influence laws ($p = 0.81$).
4. If countries adopt policy reforms in response to pressing problems, and if those reforms take time to work, then the true effectiveness of the policies would be understated by the cross-sectional patterns. As will be seen later in the chapter, some of the cross-cutting policies do seem to take time to work. In contrast, if policy reforms are undertaken in places where they are most likely to be easily implemented, and if these places also have less corruption, then the apparent relationship between policies and corruption outcomes might be overstated. Although it is beyond the scope of this report to fully sort out these complexities, the Annex includes information on a series of simple regressions reflecting the information in the chart, including regressions controlling for level of income. To the extent that income captures many confounding influ-

ences, the patterns that remain after controlling for level of income are more robust than simple correlations. The Annex also explores the use of instrumental variables to limit the impact of endogeneity. Nevertheless, alternative interpretations of the patterns evident in the scatter plots exist—indeed, future explorations of alternative explanations for these observed patterns will add to our understanding of the links between policies and corruption outcomes.

5. Indeed, of the three Doing Business indicators related to taxes, the one that is most closely correlated with levels of corruption is the number of payments per year. As each payment has the potential for both a firm and an inspector to benefit by trading lower taxes for bribes, limiting the number of such interactions reduces the opportunities for corruption.
6. World Bank 2006b.
7. Ades and Di Tella (1999); Treisman (2000).
8. World Bank (2005b).
9. Anderson and Gray (forthcoming).
10. Grodeland (2005) conducted 360 in-depth interviews of elites, including judges and prosecutors, in Bulgaria, the Czech Republic, Romania, and Slovenia and found that expectations of the general public that they would be able to influence judicial proceedings hampered efforts to reform the judiciaries. Grodeland argues that efforts to improve judiciaries should be accompanied by efforts to educate the public in the rule of law.
11. Anderson, Bernstein, and Gray (2005).
12. The World Bank engages in a considerable amount of public procurement, but this is not the focus of the current study. For more information on the World Bank's procurement practices, as well as a list of debarred firms and individuals, see the World Bank's website (<http://www.worldbank.org/>).
13. The lack of systematic indicators related to public procurement makes it difficult to analyze the relationship between procurement policies and corruption outcomes (Evenett and Hoekman 2005).
14. The average time tax (with each country receiving an equal weight) was 7.5 percent of senior manager's time in 2002 and 5.5 percent in 2005.
15. The focus on civil service is bolstered by research showing that corruption is lower where civil service systems are more meritocratic. Papers by Rauch (2001) and Rauch and Evans (2000) look at meritocracy in a cross-section of countries, and World Bank (2003) also finds meritocracy important for explaining variations in corruption within countries.
16. Hameed (2005) generates an index of fiscal transparency and shows it to be correlated with Transparency International's Corruption Percep-

tions Index. Hameed's measure is also correlated with each of the four main measures of corruption provided by the BEEPS. Countries with higher indexes of fiscal transparency—medium-term budgeting, disclosure of fiscal risks, data quality control, and so forth—tend to have lower levels of corruption.

17. Most studies of the causes of corruption have not examined anticorruption policies or institutions, preferring instead to look at broad measures of institutional quality, usually as assessed by foreign experts. For example, Daniel Treisman's (2000) comprehensive study of the causes of corruption includes measures for openness to trade, resources endowments, and colonial heritage, among others, all very broadly defined. His conclusion that "the distant past appears as important as—or more important than—current policy" may well be true, but the effect of current policy remains an issue.
18. One limitation of this form of research is that there are far more explanatory variables than there are observations. In each of these studies the basic regressions have a large number of correlated right-hand-side variables: 12 explanatory variables for only 24 countries for the original study, and 7 for 26 countries for the update. With regard to the lack of importance of anticorruption strategies, there is an alternative interpretation: Often legislative reforms are enacted only because there was an organizing framework in which the government promised to pass those laws. Isolating the effects of one from the other is not easily achieved by putting both on the right-hand side of a regression.
19. The countries include: Albania, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, FYR Macedonia, Moldova, Poland, Romania, the Slovak Republic, Slovenia, and Ukraine. The nine policy areas include anticorruption strategy (such as general oversight, coordination, and monitoring of progress of anticorruption efforts), anticorruption policy (that is, the main anticorruption agency), political party financing, conflict of interests, asset disclosure, financial control and audit, freedom of information, public procurement, and immunity. The legislation was evaluated qualitatively, and quantitative measurements were then derived.
20. No system will ever be perfect, so a score of "10" does not imply the lack of imperfections. Rather it implies that the law includes all of a certain number of discrete features associated with a quality system.
21. Dorhoi (2005) found that many reform efforts were strong in one area yet weak in another. For example, in countries where assets declarations were fairly comprehensive in terms of disclosure, they may not refer to spouses; if they did refer to spouses, they tended not be comprehensive. In countries where the assets declarations were comprehensive and did cover spouses, the mechanism of enforcement was weak or missing.

22. Like Romania, Albania has also had declarations of assets for several years, and they were publicly released for cabinet members in 2003. Following a strong negative reaction from many officials, however, the manner of publication changed—interested parties had to request the declarations. Many declarations continued to be published by the media, and there are still reports of citizen complaints that certain officials' declarations are false or that certain officials appear to have amassed wealth very quickly. During the elections in June-July 2005, some ministerial-level officials were defeated because of questions surrounding their declarations. Yet the fact that the declarations must be formally requested constrains the ability of the general public to identify discrepancies. See the website of the High Inspectorate for the Declaration and Audit of Assets (<http://www.hidaa.gov.al/en/declaration.htm> [3/9/2006]).
23. The pattern depicted in Figure 4.13 is the most dramatic ($p = 0.0001$), but there are also significant relationships for other sets of 1995 institutions and 2005 corruption. Controls over legislators in 1995 are significant for explaining state capture in 2005 ($p = 0.07$). Controls over the executive in 1995 are weakly significant for explaining bribe frequency in 2005 ($p = 0.13$). Controls over the judiciary in 1995 are weakly significant for explaining the frequency of bribery in the judiciary in 2005 ($p = 0.09$).
24. Indeed, the application of anticorruption legislation to parliaments in 1995 has no discernible relationship with firms' assessments of bribe-taking by parliamentarians in the 1999 round of the BEEPS. As described in the text, the point of Figure 4.13 is not that the specific policies in existence in 1995 are controlling corruption in 2005, but that the policies in existence in 1995 reflect other factors.
25. Spector, Johnston, and Dininio (2005) argue that sector-specific interventions are more likely to take hold in the long run.
26. As a cardinal measure, GDP per capita is included in log form, while the corruption measures are based on the simple mean from the ordinal scale.
27. If both corruption levels and institutions are determined by level of income, it may be that income is driving the results that are apparent in some of the scatter plots in this chapter. The results vary: In the case of tax administration (Figure 4.3), the effect completely disappears when controlling for level of income. This is due to the very high degree of correlation between the Doing Business measure of ease of paying taxes and the level of income, reinforcing the observation that some elements of tax reform, especially IT-intensive aspects, are expensive. The patterns with regard to business licensing (Figure 4.10) and customs (Figure 4.5) weaken when controlling for level of income, but some rela-

tionship is still evident, and the pattern for courts (Figure 4.7) remains very strong when controlling for level of income. See the Annex for details.

28. As described in the Annex, hierarchical clustering is an iterative process where countries are linked to other countries, and subsequently to other groups of countries, based on how similar they are with respect to the relative frequency of 10 different types of bribes. The small figures show the relative severity of six different types of bribes. “Inspections” in this case refers to fire and building inspections.
29. In addition to variation in strength of implementation, the deviations can also be explained by measurement error and other factors.