As transitions to the market economy have become increasingly focused on “second generation” reforms designed to strengthen the institutional foundation of a well-functioning market economy, the obstacles to improving governance and reducing corruption from a political economy perspective have come to dominate the reform agenda. While numerous studies and policy papers have enunciated, often in great detail, the types of institutional reforms that have proven effective in reducing corruption and improving governance across the globe, it is clear that governments in many transition countries lack both the incentives and the capacity to adopt and implement such reforms. Many transition countries, particularly in the CIS and southeastern Europe, appear to be trapped in a low-level equilibrium in which reforms that threaten the concentration of economic and political power forged in the initial stages of transition by preferential distributions of rent flows and a wide range of anticompetitive barriers are rejected or otherwise undermined in the process of implementation. While most existing studies stress how corruption is a symptom of weak governance, analyses of the political economy dynamics of reform increasingly suggest that corruption should also be seen as a key cause of weak governance, since it alters the incentives of politicians to adopt efficiency-enhancing reforms. Consequently, combating corruption has become a first order condition for advancing the reform process in many transition countries.

To understand better the incentives from a political economy perspective that make standard anti-corruption reforms so difficult to implement, Hellman and Kaufmann elaborated the concept of state capture, a form of corruption in which firms make private payments to public officials to influence the choice and design of laws, rules and
regulations.\footnote{The concept of state capture is clearly based on the more familiar notion of regulatory capture, though it is intended to suggest a range of interactions between the state and firms that go beyond the regulatory structure to affect the overall investment climate. For more background, see Joel Hellman and Daniel Kaufmann, “Confronting the Challenge of State Capture in Transition Countries,”\textit{ Finance and Development} (September 2001) and “Seize the State, Seize the Day: State Capture, Corruption and Influence in Transition Economies,”\textit{ World Bank Policy Research Working Paper} (No. 2444). Data and related papers on state capture are available on the web at http://www.worldbank.org/wbi/governance.} This was distinguished from administrative corruption, or efforts to alter the prescribed implementation of laws, rules and regulations through private payments to public officials. By capturing state institutions, firms are able to encode preferences for themselves in the basic rules of the game for the market economy, creating a wide range of policy and institutional distortions that generate highly concentrated gains to narrow sectors and groups, often at a high social cost. The advantage of the concept is that it differentiates corruption as a form of political influence from the more conventional notion of corruption as a function of the “grabbing hand” of the state.\footnote{On the notion of the grabbing hand, see Andrei Shleifer and Robert Vishny, \textit{The Grabbing Hand} (Harvard University Press, 1999).} Such a distinction has implications for the distribution of rents resulting from different forms of corruption and for the pattern of vested interests supporting the institutional distortions that give rise to these different forms. The concept of state capture thus raises important political economy issues that are relevant for devising a strategy to combat corruption, in particular in countries seemingly trapped in a low-level equilibrium in which reforms that threaten to disrupt established rent flows are rebuffed as a result of the political influence of captor firms and other beneficiaries of corruption.

The concept of state capture recognizes a set of problems associated with the relationship between politics and business in the transition context that are widely discussed but still poorly understood. Increased discussion of this issue has sparked a greater demand for building on our existing knowledge and experience of anti-corruption work to develop operational strategies that can be tailored to address different forms of corruption. Designing strategies to explicitly combat the problem of state capture is perhaps the most difficult frontier of the reform process as it touches upon fundamental aspects of the design of the political system and the interactions between business and political elites. It also tremendous consequences for the redistribution of rents. Multilateral and bilateral donors face particular constraints in directly confronting state capture given the limits of their political mandates and the potential risks associated with external interference into domestic political matters. As result, these frontiers must be approached with great caution and with careful monitoring of implications on ground. But regardless of these caveats, combating state capture is critical for addressing the fundamental constraints that prevent progress in improving governance in many transition countries.

The problem of state capture is rooted in the structure of the one market that has received comparatively little attention in the transition process—the market for influence. In all political systems, whether democratic or authoritarian, groups compete for influence over the state to have an impact on the choice and design of laws, rules and regulations in
order to shape these rules of the game to their own advantage and, by so doing, encode preferences for themselves in the basic institutional framework. Like other markets, the market for influence is subject to a range of distortions that limit competition and entry, reduce transparency, create an unlevel playing field and misalign incentives. Capture is a form of monopolization in an often highly segmented market for influence based on the illicit provision of private benefits to public officials.

Variations of this problem are common to all political systems and recent episodes in France, Germany and the United States highlight the need to maintain constant vigilance to prevent illicit forms of influence. However, the problem is particularly serious in the transition countries for a number of reasons:

- **Most transition countries lack a stable system for political financing.** As the transition countries are characterized by newly emerging political systems, political parties remain extremely weak in much of the region with limited membership and minimal fund-raising capacities. Support for public financing of elections is limited given the strong skepticism of political parties inherited from the Soviet era and further eroded during the transition. Politicians and political parties are therefore highly dependent on a limited range of economic actors with the capacity to finance elections or on securing control over key rent flows in the emerging market economy.

- **Levels of collective action and social organization remain weak.** Again as a result of the Soviet legacy, the existing structure of organized collective interests was largely discredited and new interest groups have been slow to re-emerge. Firms have survived as the principal means of social organization and play an important role in mobilizing the electorate and delivering political support. In many transition countries, there are still few organized constituencies to compete with firms or sectoral and regional lobbies in the market for influence.

- **The stakes are particularly high in the market for influence as almost all of the basic rules of the game are being forged in a compressed time period with considerable distributional consequences.** The transition is characterized by a highly concentrated period of redistributing property, drafting laws, establishing institutions, and determining regulatory frameworks. Encoding advantages in these structures at the early stage of transition, when competing constituencies are still poorly organized has the potential to generate substantial gains both in the short term and over time. The rewards to capture can be quite significant.

- **The market for influence is virtually unregulated.** Given the early stage of development of most of these political systems in the transition countries, rules governing such areas as political financing, conflict of interest, freedom of information, lobbying, and income and asset declarations are virtually non-existent. In those transition countries where some regulations have been approved, there is little capacity to implement them.
Given these problems, there are no simple solutions for reducing state capture, nor is there any single model from international experience for regulating the market for influence in transition countries. There are no fine lines determining the border between a competitive, transparent and well-regulated market for influence and one dominated by illicit payments, non-transparent methods, and significant barriers to entry. Nevertheless, given the importance of these issues in shaping the environment for economic reform in transition countries, it is important to address this form of corruption directly in our dialogue with client governments and in the development of programs of structural and institutional reform.

Reforms to deal with the problem of state capture need to target the buyers of influence (mostly firms), the sellers of influence (public officials) and the structure of the market in which they interact (the policymaking process). Reforms can be considered in three broad areas: 1) increasing competition in and access to the market for influence; 2) altering the procedures of the policymaking process to ensure greater openness and wider consultation in the formulation, review and decision of laws and regulations, and; 3) strengthening regulation and monitoring over private financing of public officials.

**Increasing competition in the market for influence.** This is the area that is most closely aligned with the traditional economic reform priorities. The excessive vertical integration inherited from the Soviet period left a small number of powerful incumbents in many sectors. In addition, the privatization process often maintained these incumbents largely in tact, though with a different ownership structure. The process of restructuring the large behemoths has been slow, even under private ownership, and various implicit subsidies have softened budget constraints weakening pressures to restructure. In addition, the transition itself has generated the creation of large financial-industrial holding companies in several transition countries that have come to dominate particular sectors, especially in natural resource sectors. This concentration of capital, either inherited from the Soviet period or forged under the transition, has led to an inevitable concentration of political influence in some transition countries. Powerful incumbents and new financial-industrial groups have used their influence to place entry barriers, anti-competitive obstacles and other restrictions to preserve their dominant role in their respective sectors. This has had a particularly stifling effects on the development of SMEs, given the distorted investment climate that results.

Increasing competition in the sectors now dominated by monopolies or powerful incumbents is key to increasing competition in the market for influence. Though this has always been an important issue in the reform dialogue with transition countries, its priority should be particularly high in countries with high state capture. Measures to promote competition are already well known including:

- restructuring key monopolies;
- promoting entry through liberalization;
- removing anti-competitive advantages;
- enhancing the provision of public goods to improve the investment climate.
While much work in this area has tended to focus on increasing the number of competitors, less emphasis has been placed on promoting different forms of interest representation among existing firms. Evidence suggests that state capture was considerably less prevalent in countries where business associations played the major role in representing the interests of individual firms to government. Business associations tend to channel influence activities away from individualized relationships between firms and public officials (which are more likely to be non-transparent and fueled by private payments) to the representation of collective interests at the sectoral or regional level. By widening the scope of actors whose interests are represented, such associations broaden access to influence in the policymaking process to a wider range of firms. Business associations also create the opportunity to bring in the collective voice of less powerful individual actors, such as SMEs. Business associations, therefore, are an important tool for maximizing the potential of existing firms to promote greater competition in the market for influence.

Reform programs could place greater emphasis on efforts to promote the development of business associations and mechanisms for their inclusion and consultation in the policymaking process. There are strong coordination problems that hold back effective collective action by firms, in particular SMEs. External assistance, often in partnership with international business and trade associations, could help in promoting their development. More efforts could be made to incorporate new and existing business associations into permanent consultative councils, oversight mechanisms, monitoring arrangements and other forums to promote collective representation of business interests in interactions with the government. This is particularly important in promoting the collective interests of SMEs to counterbalance the influence of powerful incumbent firms.

Assistance is also required for anti-monopoly agencies in a number of transition countries. With privatization near completion in most transition countries, these agencies may begin to play a larger role in regulating the activities of existing monopolies and promoting entry and competition.

**Reforming the policymaking process.** State capture is not only a function of the monopolization of channels of influence, but of the lack of transparency and access to the policymaking process. It thrives in an environment where draft laws and regulations are prepared without consultation, narrowly circulated for comments, not subject to open hearings, and approved without clear designations of responsible officials. In more serious cases, much policymaking is based on executive decrees with minimal procedures for review and consultation even within government. Such environments create opportunities for all forms of illicit influence and limits competition in the policymaking process. Combating state capture thus requires reforms in the formal procedures of policymaking, which in many transition countries are still strongly influenced by bureaucratic procedures of the Soviet period.

It is necessary to have a detailed understanding of the specific procedures governing the policymaking process in each country in order to make meaningful reform.
recommendations. Once properly assessed, there are a number of reform proposals to enhance transparency and access to policymaking that can be recommended to reduce the risks of capture, including:

- the introduction of mandatory public hearings to discuss draft laws and regulations;
- the development of corruption impact assessment procedures for draft regulations similar to the regulatory impact reviews that are required for draft regulations in certain countries;
- the introduction of “sunshine” provisions that require open access to a wide range of government hearings or the publication of minutes at specified stages of the policymaking process;
- the passage and implementation of freedom of information legislation to allow ex post access to government documents related to the policymaking process;
- the use of e-government mechanisms to encourage consultation and public comment on draft laws and regulations;
- the use of oversight bodies or consultative committees in key sectors to solicit broader participation of relevant constituencies in specific areas;
- strengthening the system of individual accountability of public officials for specific regulations and associated instructions;
- mandatory public disclosure of parliamentary votes;
- mandatory publication of judicial decisions and case schedules.

With a comprehensive assessment of vulnerabilities in the broader policymaking process, a more coherent reform package could be designed to target the procedures that facilitate state capture.

**Strengthening regulation and monitoring of political financing.** As there are buyers in the market for influence, so are there sellers. Of course, in most transition countries, there are legal restrictions against private payments to public officials to influence the choice and design of laws, rules and regulations. Enforcement of the law in this, as in so many other areas has been weak across the region. Yet raising the risks to public officials of engaging in state capture is more than just an issue of enforcement in three important respects.

First, several of the key concepts defining boundaries between political financing and the policymaking process, such as conflict of interest, are still largely unfamiliar in much of the region. Second, while bribe-taking may be illegal across the region, there is a vast gray area around the financing of politics that is largely unregulated. Only a handful of transition countries have laws regulating political contributions, financial disclosure, lobbying limits, conflict of interest, and asset declarations. Third, the instruments and capacity for public monitoring and oversight in these areas, which generally play a much greater role in enforcing such restrictions than legal action, are still lacking in most transition countries.

Therefore, a strategy to increase the risks to public officials of engaging in state capture would require concerted efforts in public education and awareness raising, the development of a legal framework to regulate political financing, and capacity-building
to create adequate systems for monitoring the boundaries between money and politics. Public education and awareness-raising issues to establish standards in such areas as conflict of interest and political financing could be incorporated into WBI training programs. There are a number of non-partisan research and monitoring organizations in this area in Europe and the United States that could provide assistance in such training.

The development of a legal framework to regulate conflict of interest, political financing and asset declarations is critical. The adoption of laws in these areas has now become increasingly common across the region with much assistance from international donors. The development of effective monitoring systems, though, has been quite rare in these areas. This is, to some extent, a technical issue. While some transition countries have laws requiring public declaration of assets for elected officials and senior civil servants, they lack a system for auditing these declarations. While some countries require public disclosure of political party financing or contributions to individual candidates, they lack the technology to make such disclosures widely available to the public. While some countries have freedom of information provisions, they have no system in place to process and handle such requests. IT systems to record and disseminate judicial decisions, parliamentary votes, transcripts or minutes of legislative sessions and committee hearings are also lacking. The development of such systems can be integrated into assistance in knowledge management and e-governance. Such capacity-building would have to be based on the identification of clients with the commitment to use this capacity effectively.

**Administrative corruption.** Addressing the underlying incentives that give rise to administrative corruption – i.e. private payments to public officials to alter the prescribed implementation of policies – has been at the core of public sector management reforms for many years. Most economic reforms in transition countries are targeted towards reducing bureaucratic discretion in the implementation of core public services encouraged by over-regulation, unclear rules and service delivery standards, weak public expenditure management systems, insufficient auditing capacity, patronage and the legacy of the Soviet command system. In the public sector, there is broad agreement on the need to strengthen budget management (with particular emphasis on treasury systems, procurement reforms, audit mechanisms and fuller budget coverage), promote a meritocratic and adequately compensated civil service, strengthen procedures and IT systems in tax and customs administrations and promote decentralization of service delivery with increased accountability. In the private sector, efforts to improve the investment climate with particular attention to removing the administrative barriers that restrict entry and inhibit investment are critical. These are the key measures that address the underlying causes of administrative corruption and they have been a core component of the public sectors reforms for a long time.

Given the full complement of activities in this area, the question arises as to the value-added of additional anti-corruption efforts focused on administrative corruption. Anti-corruption diagnostic surveys and national anti-corruption strategies play an important role in raising awareness of the problem. In particular, surveys have give detailed breakdowns of the extent of the problem of administrative corruption across a wide range
of agencies and core public services. Such data can be used to set priorities among the set of reforms outlined above. The surveys are now a common feature of the landscape in many transition countries with the initiative coming mostly from the robust growth of domestic anti-corruption groups in civil society. The anti-corruption strategies, now common across the region, tend to emphasize the importance of reforms to reduce discretion in public service delivery.

Given the high profile and raised expectations on administrative corruption that have come from surveys, national strategies, and government programs to reduce corruption in service delivery, the main challenge is to create mechanisms that will ensure accountability for results in this area. Here is the potential value-added of anti-corruption activities. The World Bank has been developing a new set of governance monitoring tools. In contrast to large-scale, one-off surveys of households, firms and public officials, governance monitoring tools constitute a range of different instruments and procedures (including surveys, scorecards, feedback and evaluation forms, hotlines) that are easy to implement on a repeat basis and are designed to evaluate performance and enhance accountability over time in specific problem areas.

**Point-of-service evaluation surveys (POSEs):** One particularly promising monitoring tool to measure the impact of efforts to reduce administrative corruption is point-of-service evaluations. These are short surveys based on the model of customer feedback and evaluation techniques from private sector consumer research in contrast to the more costly, large-scale opinion surveys that have become more common in recent years. POSEs have the following characteristics:

- they are based on short survey instruments focused on evaluating a specific service;
- they are distributed to users of the service at the point of service, for anonymous return by post, at designated collection boxes or through internet-based mechanisms (where appropriate);
- they provide a continuous stream of feedback over time that can be monitored on an ongoing basis or at periodic intervals;
- they provide additional contact information to the customer regarding complaints procedures or hotlines to report problems or irregularities.

POSEs not only provide useful feedback to evaluate performance, but can also be designed to include questions regarding unofficial payments or other irregularities in the provision of the specified service. This would not only provide continuous, anonymous feedback on the demand for unofficial payments in specified service areas, but would also alter the incentives for those who request bribes by increasing the risk of disclosure or detection provided these monitoring tools can be successfully integrated in performance evaluations.

POSEs can be used anywhere there is interface between public officials and citizens or firms and can be linked to specific procedures where problems have been recognized through diagnostic surveys, such as customs clearance, business registration, licenses and
permits, inspections, receipt of social benefits, routine police actions (e.g. traffic violations) and many others. Forms would be provided with the actual delivery of the service (e.g. registration document, license, inspection, etc.) with questions designed to measure performance against specified benchmarks and to solicit complaints about irregularities. Additional contact information would be provided to report serious problems, which would be linked to the development of hotlines, ombudsman offices or other complaints mechanisms. The results could be monitored by appropriate audit or inspection agencies, specially designated units within relevant agencies or by oversight committees that could be created in parallel with such monitoring efforts.

There are a number of potential advantages of POSEs. They provide “just-in-time” tracking of public sector performance at a reasonable cost that can be used to monitor the impact of government reform efforts in specified areas. They lower the costs to clients of reporting instances of corruption and other problems by providing important contact information at the point of service. They alter the incentives of service providers in the public sector by measuring performance and increasing the risk of detection for irregularities. They could potentially empower the users of public services to demand fair and efficient treatment in their interactions with public officials.

**Deregulation monitoring surveys:** Reforms to improve the investment climate have focused on reducing administrative barriers to firms through broad programs of deregulation in such areas as licensing, customs, registration, inspections, and permits. Many governments in transition countries have reformed legislation in several of these areas and are experimenting with one-stop shops to consolidate official procedures. Yet central governments have little capacity to monitor the impact of legislative and procedural changes on actual practices. Generalized investment climate surveys are not flexible enough to be specifically tailored to test for the implementation of country-specific deregulation guidelines, nor will they be implemented with the necessary frequency and under the time constraints essential to directly track performance against specific benchmarks. Deregulation monitoring surveys are shorter instruments designed to test actual performance against legislated standards on a more frequent basis. Such monitoring surveys provide rapid feedback to the government on the implementation of legislation across regions and agencies that will allow for a more effective response to variation in the effectiveness of reform measures. Deregulation monitoring surveys are currently being piloted in Russia to track performance on the implementation of reforms in the areas of licenses, certifications, registration and inspections.

**Scorecards:** The techniques pioneered in Bangalore, India to encourage citizens to rate the quality of public services have been widely admired, but rarely implemented in the transition countries. Scorecards do not necessarily require sophisticated methodologies or technologies. They are designed to empower citizens and provide periodic feedback on performance of public service delivery. Scorecards may be useful to rate the extent of administrative corruption in key public services, especially in environments where more complex monitoring instruments are not feasible. Scorecard ratings have also been used to compare government performance across a variety of dimensions based on readily available indicators.
Corruption impact assessments: Some transition countries have already requested assistance in developing monitoring techniques to assess the flow of new draft regulatory acts to determine their potential impact on corruption, in particular administrative corruption. Such techniques would be modeled on regulatory impact assessments that are required of all new draft laws and acts in several advanced industrial countries. The assessments would identify the risks of proposed legislation for increasing the incentives and opportunities for administrative corruption along with ratings that could be a guide to government decision makers and parliamentarians. Responsibility for such monitoring could be vested in a specially selected inter-agency commission, a permanent parliamentary board, a panel of civil society experts or some combination thereof. Guidelines for such impact assessment procedure would have to be country-specific, but a generalizable model for implementation of such a practice should be developed and disseminated.

Of course, these monitoring tools are intended to complement the broad range of existing economic reforms to tackle administration corruption in the areas of public administration, public expenditure management, investment climate, and public service delivery. Such monitoring mechanisms are only meaningful if they are accompanied by policy and structural reforms intended to have an impact on reducing administrative corruption in specific areas. They enable governments and other constituencies to measure that impact over time in order to increase feedback on what works and what doesn’t work, to identify where the obstacles to implementation are and to increase government accountability for results to match the rhetoric in the area of reducing corruption.