Controlling Corruption in Europe

The Anticorruption Report

Volume 1

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Lessons learned. The Good, the Bad and the Ugly

ALINA MUNGIU-PIPPIDI

This policy report reviews the lessons learned from the three European political regions researched by ANTICORRP in the first year of the project: the EU, the South-Eastern Europe and the Former Soviet Union (FSU). Given the large differences among countries, recommendations are different for the three European regions, and are based on the corruption model presented in these regional reports, as well as on the more specific policy data presented in the Romanian, Estonian and Hungarian case studies.

The Anticorruption Report 1 offers these five contributions to the objectives of the project:

I. On defining corruption

One main finding arising from this report is the important presence of 'legal corruption', including favouritism of businesses by government, preferential allocation of public funds and more generally favouritism in public services and law enforcement. According to the ANTICORRP pan-European survey reported in this volume by Nicholas Charron, favouritism is more widespread than previously thought and accounts for most of what European citizens call corruption. Favouritism plays an important role in deterring economic performance, and it subverts political legitimacy and trust. This report shows that this type of corruption is present in a large number of countries and is not limited to those that are usually considered corrupt or suffer from visible corruption scandals. While the countries where the survey shows favouritism of public services as most problematic are not EU members (e.g. Serbia, Ukraine), the case studies from Hungary and Romania show that favouritism and discretionary allocation of public resources are also major issues in some EU member countries. This is particularly evident in the realm of public fiscal management, which is usually the one citizens know the least about.

II. On producing new, change sensitive corruption indicators which are not perception based.

This report offers two types of new indicators. The first are pure policy indicators and come from the Romanian and Hungarian examples (presented in the comparative report, as well as in the two case studies). The methodology for computing these indicators is similar for all the examples provided in this report and consists of a survey of public resources allocation (funds or contracts of public procurement) followed by an analysis of the result's distribution or a comparison with a benchmark category. When the results show a distribution that is far from random or is statistically implausible, they hint at a hidden organizing factor, i.e. corruption. In Romania, for instance, mayors who belong to the government parties are disproportionately benefitting from funds for natural emergencies, and this disparity has been growing from one electoral cycle to another. Romanian companies with political ties also win more public contracts than internationally reputed firms and make huge profits even in times of crisis. In the case of Hungary, the turnover and profit of politically connected companies is simply reversed when the winner of elections changes. These examples come from countries where

ANTICORRP researchers were more advanced in collecting data and should not be seen as exceptional. Similar studies should be undertaken in Italy, Slovakia, Greece and a score of other countries to check on such indicators since this type of government favouritism causes important market distortions.

The second category of indicators developed by the project is made of determinants of corruption. Due to an explanatory model based only on policy and not on structural factors, we are able to significantly attribute corruption to human agency as manifested in policies or different institutional arrangements. We know, for example, that red tape is bad for corruption because it has a statistically significant association with the aggregated corruption rankings computed by the World Bank and Transparency International. As shown in this report, these corruption indicators show a remarkable consistency between them, which suggests that, despite being based on perceptions, they point to a similar reality. We therefore believe that monitoring a country on determinants of corruption, once the statistical model is proven robust, can bring great policy benefit, as most of them can be changed by human action. Testing other indicators and policies remains a main goal of ANTICORRP as this opens the door to a permanent assessment of anticorruption policies' impact.

III. On identifying corruption and anticorruption risks

Using the methodology described above, this report establishes policy based risk categories where countries are ranked according to their performance on various objective policy indicators (i.e. not perception-based indicators). The indicators used to construct the ranking were identified as significant determinants of corruption. A further method to categorize countries according to their corruption risks was developed in the comparative report on South-Eastern Europe (Chapter 3). In that section, corruption and anticorruption risks were combined for the first time to create an indicator of implementation gap. We argue that policies designed to improve governance and policies not directly related to corruption, have the potential of increasing corruption as an unintended consequence since they risk widening the gap between law and practice. Therefore, enforcement will and implementation capacity are major factors to account for when selecting an anticorruption policy. We further argue that whenever a country deals with some degree of group or party capture of the state, grounding anticorruption policies in the government alone is counter-productive and will increase the risks of corruption instead of decreasing them.

IV. On the highest risk and greatest achievement

The report identifies Bulgaria, Czech Republic, Greece, Latvia, Poland and Romania as facing the highest corruption risks in the European Union, with a more problematic situation than previously thought also for Slovakia, Slovenia, Italy, Portugal and Spain. The process of EU integration does not improve governance by itself. Greece and Italy, for example, have regressed instead of progressed since their accession to the EU. Moreover, the new member countries only showed some progress before accession, but they have regressed since. The shining exception is Estonia but, as the case study shows, progress in this country is due to a political dynamic of its own reforms and not due to EU conditionality. Estonian continuity in government of parties which have drastically curtailed discretionary spending and increased administrative transparency has worked: The country presents the greatest global progress in controlling corruption by reducing opportunities for corrupt behaviour. The Estonian lessons are applicable elsewhere and should be replicated whenever possible. The downside is, of course, that such political elites enjoying this kind of support are not easy to find, but their policies could and should be transferred whoever international donors and EU have a say.

V. On the economic crisis and effect on the free market

The primary and secondary data analysed by ANTICORRP shows that the dramatic consequences of corruption are a major impediment to economic recovery in the EU. Corruption bolsters deficits on behalf of discretionary spending (and hurts investment in public health and education), reduces tax collection, detriments the absorption rate of EU funds, and further generates vulnerable employment and brain drain. Fundamentally, as data from the less developed part of Europe (but also Hungary) shows, corruption affects free market competition. Both, domestic markets and global competition are affected by government favouritism and vested interests in certain companies. As a result, bribery needs to be seen as a part of this larger picture of market distortion and as a way to open an otherwise preferential market. Therefore, criminalizing only bribery and not all forms of market favouritism does not have much potential to correct the distortion.

It is not the aim of this report to make recommendations for individual countries beyond the general analytical framework laid out here, but that framework is essential. Since those factors differ greatly, however, recommendations are grouped into ten generic categories:

1. Effective anticorruption policies are broad good governance policies not based solely on repression.

Even when we manage to document anticorruption policies at the European and global level, control of corruption as equilibrium is influenced by so many powerful factors that even effective policies do not manage to account for much difference across countries. Only countries which are more transparent fare significantly better in controlling corruption. Countries which have a specialized anticorruption agency or have adopted more legislation do not perform better. Repressive policies alone do not seem to work where corruption is a major problem. Anticorruption has to be understood in a broader governance context and policies to reduce or at least not increase opportunities and resources for corruption (as is the case with EU funds) need to be promoted.

2. There are serious limitations of international approaches to national anticorruption which should be considered at all times.

Recently, the European Union has been very active and plans to be even more so in pursuing cross-border anticorruption activities and promoting global legislation against tax havens, money laundering and assets' recovery. These policies are extremely valid, but some limitations apply which should be considered at all times. First, expectations tied to such policies should be moderate. Evidence shows that control of corruption is a national equilibrium. Unless it is seriously affected at its origin, tax evasion and other behaviours of this type will reproduce themselves. In other words, we should not expect policies which cut the dragon's head to be sustainable if dragons are known to grow three heads for each one cut off. Such policies do not touch the underlying causes of corruption. Asset recovery, for example, is extraordinarily costly and will not be cost effective if applied in isolation from a serious attempt to shake the vicious equilibrium in the country where the assets were originally stolen. These policies also risk increasing red tape in countries which fall below the 65 percentile in the World Bank control of corruption rankings (which is closely correlated with rule of law) thus generating more corruption instead of reducing it. Therefore, unintended consequences should be very carefully weighted, bearing in mind that whenever rule of law is still problematic, tighter laws will create a larger implementation gap and not solve problems. Only a combination of policies addressing causes and result-tracing can hope to produce some lasting and sustainable success.

3. Policies which do not pass a cost-effective examination, either due to very high costs (including political), or proven lack of impact should be discarded.

The current generation of anticorruption policies has been promoted with little or no cost-effectiveness analysis, despite evidence that impact is quite impossible to prove. We have meanwhile developed new indicators allowing the tracking of progress by sectors or over time. In the future, policies should be more evidence based. The Romanian example on competition in the infrastructure sector is telling: such indicators are needed to understand and prevent government favouritism, the most harmful form of corruption for the common market.

4. Reducing administrative opportunities for corruption is essential.

Such reforms are indispensable for nearly all Mediterranean and East European countries. Rather than presuming with no evidence that those countries need special anticorruption units or new legislation, there is evidence that they can easily obtain more effective results if they focus on administrative reforms, cut red tape, liberalize trade, streamline regulation to reduce informality, increase transparency (in particular fiscal transparency to allow monitoring of government expenses in real time through online tracking systems, but also transparency allowing monitoring of politicians and policymaking) and develop e-government. These measures would work especially well for countries such as Italy, Greece, Cyprus, Slovakia, the Czech Republic, Poland, Lithuania, Malta, Spain and Romania. Countries like Latvia, Estonia and even Bulgaria have already undertaken reform to become more 'Scandinavian' and it is the right way for them to go, although great challenges remain. East European countries have the shining examples of Estonia and Georgia to follow.

5. Reducing fiscal opportunities for corruption plays a very large role and austerity can help anticorruption if it is exercised on behalf of discretionary (government investment) and not universalistic spending (education).

This report brings ample evidence that government investment is feeding corruption far more than economic recovery. Discretionary spending is a major source of legal corruption and subverts sound public finances, competiveness and growth. Good spending is universalistic spending with a clear destination, for instance education and health. Bad public spending is any spending where discretion is high. Spending on new infrastructure projects, for example, allows to channel government resources to favourite companies either directly or through local or regional governments, producing unnecessary outputs with high costs. Apart from fiscal transparency, which is indispensable for good governance, it is recommended that the structure of public expenses channels resources to education, skill development, research, innovation and public health in countries where our survey shows that gifts from patients are a major source of public health financing. Governments should instead manifest austerity in all other forms of public investment.

6. The auditing mechanisms of EU funds should be refined and connected to an impact evaluation of funds

The report also argues that EU funds for countries with poor control of corruption only manage to further feed local client-driven spending in the absence of an early warning mechanism based on social accountability. It also brings evidence that corruption subverts absorption of EU funds and thus economic recovery of countries which are already the poorest in EU. The solution recommended is the development of a link between the EU evaluation of the opportunity and impact of such funds, in cooperation with regional civil society and business, on the one hand, and the oversight and audit mechanisms on the other. Presently the control mechanism of EU funds is purely bureaucratic (it is not checked if building of a soccer stadium is indeed the proper investment for tourism infrastructure in a city where tourists come only during the soccer league break) and top down. It has also developed in the last years, when confronted with unprecedented corruption, a repressive approach, suspending all funds at the warning of irregularities. The report argues that this further diminishes the chances of economic recovery of poor countries and that a more specific mechanism can be created to protect funds better without hurting absorption.

7. Public audit capacity should be increased in unconventional forms, for instance by cooperation with the private and third sector.

This applies especially to Italy, Bulgaria, Latvia, Spain and Greece, but also to a lesser extent to all post-communist countries and should be seen as part of administrative reform. It can also be treated more creatively, by introducing audits by private sector, civil society, stakeholders, or combinations of the above. Such creative state-society approaches to audit are especially needed in countries of Eastern Europe and the Balkans, where evidence exists that control agencies sometimes engage in extortion and discretional enforcement.

8. *Judicial autonomy and accountability should be permanently and publicly monitored.*

The judicial autonomy from power and its accountability when corruption is concerned remain serious problems in some East European countries and in South Eastern Europe. But more work needs being done also in Romania, Italy, Greece, Bulgaria, the Slovak Republic, and, to a lesser extent, in Latvia, Lithuania, Spain and the Czech Republic. This is obviously more of a goal than an action itself, so it should not be itself the centrepiece of any anticorruption strategy. Italy has relied on this strategy alone in the last twenty years with some notorious successful prosecutions, but an overall small progress. Countries should self-organize their judiciaries as they see fit, as no design is ideal, but their performance should be the object of permanent monitoring and public debate.

9. National civil society capability for monitoring governance and controlling corruption at both national and local levels should be increased and applied to EU cohesion and assistance funds in particular.

The existence of watchful and demanding citizens is an essential deterrent for the rent seeking behaviour of governments. Evidence shows an insufficient level of societal constraints to corrupt behaviour across nearly all Eastern Europe (Ukraine struggles, with wide internal differences) and the Balkans. In the EU alone, this applies to Romania, Portugal, Greece, Slovakia, Poland, Cyprus, Bulgaria, Latvia, Spain and Slovenia. Policies to increase civil society oversight capacity include:

- systems of social accountability designed for the auditing of public expenses or budget planning (with civil society and business groups being permanently involved in the monitoring of EU funds and other government expenses, for instance);
- support from government to develop broad internet access and use, especially at local community level. Even the smallest village becomes capable to improve its governance if it has one Internet café where locals can gather to monitor town hall expenses, fill online petitions or read the statements of assets of the judge presiding their land trial;
- development of civil society, on the model of assistance programmes to developing countries, especially in less developed contexts where the number of people involved in civil society groups is very small.

Unfortunately, this policy has serious limitations. Some countries like Russia do not encourage anticorruption grassroots activity and even repress funding of such organizations. Anticorruption is seen as politically subversive by authoritarian governments and anticorruption NGOs are at risk in many East European countries. In Georgia, Ukraine, Moldova and Armenia the situation is somewhat better, but civil society still faces considerable challenges even there. In the Balkans, EU accession offers more incentives and resources to civil society anticorruption activities, but they remain seriously insufficient in Albania, Bosnia, Macedonia and Montenegro.

The situation is particularly poor in some new EU member countries. With the exception of Estonia, no new EU member country has an operational program dedicated to civil society and the EU funds for building oversight capacity of civil society are practically zero. In countries like Czech Republic, Slovakia, Romania and Bulgaria the grassroots fight against corruption exists based on only a handful of activists. If only a tiny fraction of the EU funds intended for projects in Sicily or Bulgaria went to citizens' associations that could take part in the planning, evaluation and auditing of such projects, and if all the expenses could be published in real time on the Internet, an immediate improvement would be felt. Thirty years of EU evaluations have not managed to uncover what any Sicilian villager could have told evaluators from the onset: what is the money really for (or whom) and how it was really spent, because such evaluations never consult the villagers. The empowerment of those who lose from corruption is the most neglected from all the potentially effective and sustainable anticorruption strategies.

10. An economically depressed media faces high risk of capture and needs support to be able to enforce its role as good governance watchdog.

All across Europe mass media suffers from various degrees of vested interests capture in this difficult economic environment and thus becomes less and less able to play the main role they could in building control of corruption. A media outlet in the hands of a corrupt politician or an oligarch whose private fortune is built on capturing public funds will not do its civic job to report and investigate corruption and protect public interest through accurate reporting. Governments who want to help, and not control media, and the international community should promote increased transparency of media ownership and advertising revenues to protect media from capture by vested interests in difficult economic environments. EU funds should also support new media and civil society organizations acting as watchdogs and contributing to an increase in the public awareness of government and officials' expenses in member states, associated states and neighbourhood countries.

Acknowledgments

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ANTICORRP is a large-scale research project funded by the European Commission's Seventh Framework Programme. The full name of the project is "Anti-corruption Policies Revisited: Global Trends and European Responses to the Challenge of Corruption". The project started in March 2012 and will last for five years. The research is conducted by 21 research groups in sixteen countries.

The fundamental purpose of ANTICORRP is to investigate and explain the factors that promote or hinder the development of effective anti-corruption policies and impartial government institutions. A central issue is how policy responses can be tailored to deal effectively with various forms of corruption. Through this approach ANTICORRP seeks to advance the knowledge on how corruption can be curbed in Europe and elsewhere. Special emphasis is laid on the agency of different state and non-state actors to contribute to building good governance.

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