The Anticorruption Frontline

The Anticorruption Report

Volume 2

Alina Mungiu-Pippidi (editor)

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Executive Summary

From Turkey to Egypt, Bulgaria to Ukraine, and Brazil to India, we witness the rise of an angry urban middle class protesting against what they see as fundamental corruption of their political regimes, perceived as predatory and inefficient. Corruption is near the top of all global protesters' list of grievances – from the Occupy movement to the Arab Spring. Their countries have benefited to varying degrees from globalization, but their regimes have all failed to evolve politically to meet their expectations. Corruption has become the main explanation for failures in government performance, for networks of patrons and clients subverting fair competition, and for billions of Euro in disappearing public funds, national or foreign assistance income. The economic crisis exposed the hypocrisy of rich countries which control corruption at home but use it to advance their economic interests abroad. The rise in the last two decades of an international anti-corruption regime only raised awareness but failed so far to diminish corruption. There is increasing demand for good governance resulting in quality education and health systems, and denunciation of sheer bread and circus populism. Briefly put, governments unable to control corruption cannot get away with organizing football World Cups anymore.

Volume 2 of the ANTICORRP Anticorruption Report tackles these issues across key cases and developments. The report is grouped into three parts:

1. The frontline reports, tracing developments in Ukraine and Bulgaria, where people rebelled against corrupt leaders, plus Rwanda and Qatar, who advanced in good governance charts, but find themselves accused of sponsoring wars across borders or bribing FIFA officials;
2. The methodology to move beyond perception-based corruption indicators, in the form of a three-country study on procurement data which reveals how EU funds increase the risk of corruption in Central Europe;
3. The empirical evidence on why control of corruption works when it does, and does not work for the most part, in the shortened version of ANTICORRP's first milestone report.

Chapter 1

In Chapter 1, Andrew Wilson discusses Ukraine whose February 2014 uprising was both caused by, and helped reveal, the extent of corruption in the country. Estimates are now that President Yanukovych and his circle stole $100 billion in just under four years. Ukraine has always been a badly-governed neo-patrimonial state; corruption has been endemic since independence in 1991. Ukraine's corruption is a post-Soviet legacy and has its roots in a failed transition, which multiplied resources for corruption instead of reducing them. Gas is at the heart of the problem, as most rich people in Ukraine made their money on subsidised Russian gas. Gas is to Ukraine like cocaine was to Colombia. Until the Orange Revolution in 2004, Ukraine received massively subsidised Russian and Central Asian gas at $50 per 1,000 m^3, when its average level of imports was 60 billion m^3 per annum (Ukrainian heavy industry is hugely energy-inefficient). In January 2006 Russia engineered a gas cut-off to punish the leaders of the Orange Revolution, and the price was controversially forced up to $230, though mixed with Central Asian gas it was discounted to $95 in a corrupt scheme. Only in 2009 did Ukraine agree to market prices, after another cut-off in the depth of winter, with the price rapidly topping $400. From 1991 to 2009, therefore, a massive gas subsidy was corruptly divided between Ukrainian and Russian politicians, at the expense of taxpayers in both states. Businesses still divert huge amounts of gas that is nominally supplied to households at a quarter of the import price (Ukrainian households supposedly consume two and a half times more gas than their richer Polish equivalents). Ukrainian companies like Oil and Gas of Ukraine have therefore built up huge debts, also because oligarchs used them for slush funds and covert funding of political projects.

The challenge for Ukraine now is how to put its house in order, as Russia claims it is basically a 'failed state'. How can the country at last enter a virtuous circle to avoid that after pushing down a neo-patrimonial regime a regime of competitive clientelism follows? Ukraine is presently the most problematic case of a corrupt order in Europe, and the EU does not have much experience in changing such regimes. Italy and Greece are living proof of how difficult governance is to change even under beneficial external influence - and Ukraine is subject to conflicting influences and major existential threats.

Chapter 2

Chapter 2, on Bulgaria, argues that corruption is a key element to understand the Bulgarian governance regime, i.e. the way political and administrative power are acquired, used, structured, delegated and reproduced. The Worldwide Governance Indicators show that Bulgaria has made significant progress in the area of 'control of corruption' since 1996. This finding contrasts with the general opinion of the Bulgarian population who perceive Bulgarian institutions as corrupt, and contradicts the decision of the European Commission to continue monitoring Bulgaria's progress in fighting corruption and organized crime. Currently the governance regime of Bulgaria can best be described as having moved gradually from patrimonialism towards open access order, but most of its features are still in the competitive particularism stage when various power factions compete for spoils. Bulgarian governance has progressed since 1998 in particular as relates to administrative (petty) corruption, but it is has not yet evolved into an open access order. The indicators in the report are mostly from the area of public procurement. Despite the volume of the available government public procurement budget having declined since the crisis began, thus limiting the opportunities for corruption somewhat (European funds grew in volume as compensation), the two biggest public procurers, the energy and healthcare sectors, have opaque practices and remain vulnerable. Approximately 40% of all procedures for the awarding of public procurement contracts in the energy sector for 2012 were non-competitive, encompassing the various negotiated procedures with or without the publication of a contract notice under the 2004 Act on Public Procurement (APP). If the contracts awarded without any public procurement procedure are added to this number, it becomes apparent that avoiding market competition is the rule rather than the exception in the Bulgarian energy sector.

Chapter 3

Chapter 3 analyses Rwanda, a country which has been praised by a large number of donors and development experts for its recovery from the 1994 genocide, sustained economic growth and improvement of many socioeconomic indicators, partly achieved thanks to massive aid flows. A key feature of Rwanda's progress is often considered to be governance and particularly anti-corruption: the country is generally regarded as one of the least corrupt in Africa and a success story in reducing corruption. This chapter analyses the state of corruption and the wider governance context in Rwanda, attempting to evaluate whether the country's governance regime is an open access order characterized by ethical universalism, a limited access order dominated by particularism, or a hybrid.

The author uncovers an important indicator, namely the presence of private companies who are dominant in the public contracts market and have close ties to rulers. Three holdings, or conglomerates, of 'party-statals', exist in Rwanda, although their connections with their stakeholders are not transparently stated on their websites. The largest one belongs to the government party (Crystal Ventures Limited (CVL), formerly known as Tri-Star Investments), which grew out of the production unit of the then-rebel army RPA during the 1990-94 war, which eventually put an end to the Genocide. Tri-Star got the bulk of its initial funding from wealthy supporters from the Rwandan diaspora. Today, CVL holds a majority stake in 11 companies and a minority stake in several joint ventures, ranging from civil works to real estate, telecommunications and security services, most of which are the leading national company in their sectors. The group's 2009 turnover represented over 3% of Rwanda's GDP. The second conglomerate, Horizon Group Limited, is often referred to in Kigali as 'the army's company.' The third consortium is Rwanda Investment Group (RIG), a holding company created in 2006 at the instigation of the Government, which is now a holding with both public and private shareholders whose purpose is to raise funds to invest primarily in the construction and energy sectors. There is a general perception among many local and foreign entrepreneurs that CVL and Horizon companies enjoy preferential treatment when they compete for public contracts. Given that Rwanda is practically a one-party state, the electoral as well as market domination raises serious doubts about the capacity of impartial distribution of public goods. Rwanda's top achievement remains control of petty bribery, an accomplishment which distinguishes the country in its geographic region.

Chapter 4

Chapter 4 explores the case of Qatar, a country recently showcased by international anti-corruption indices to be among the highest performing countries in the Middle East and North Africa. How can this be when Qatar is a neo-patrimonial absolute monarchy in which the state is not immune from private interests, and where the ruling family can bypass the rule of law? ANTICORRP author **Lina Khatib** looks for indicators to understand Qatar in the areas of public-private separation and allocation of public resources. Here Qatar emerges as a very special case since there is no real separation between the state and the private interests of the ruling family. There are no lobbies, no government watchdogs, no independent civil society, and freedom of the press is restricted when it comes to addressing internal affairs. Instead, citizens air their grievances through a traditional 'majlis' with tribal leaders, where people can submit petitions. However, conflicts of interest and the wealth of individuals are not scrutinised. There is also no transparency in public procurement. There is an official procurement process in place as well as regulations regarding conflicts of interest; but direct contracting is allowed in case of 'urgency' and seems frequent. However, several top down reforms have cut red tape and increased predictability.

Public allocation in Qatar follows a rentier system. State wealth is subject to distribution, with the existence of a welfare state that increases dependence on foreign expatriates to be the real work force, while Qatari nationals take state distributions for granted. While non-citizens pay for health care, electricity, water, and education, those services, in addition to housing, are provided to citizens for free. Fuel is subsidized for businesses as well as citizens, and Qatari businesses and agriculture also receive capital, electricity, and water subsidies. This makes Qatar a very special case.

The complete control by the monarch of state institutions and policies leaves no space for bottom-up calls for reform, or for independent assessment of the performance of the state and the actions of the ruling family by civil society and the media. The permeation of informal networks within state institutions and civil society, the lack of interest in and avenues for political participation among Qatari citizens, and the clientelistic relationship between citizens and the state support the continuation of this status quo. The chapter concludes that the absence of certain types of information on Qatar in the first place casts a shadow of doubt over the performance of the country in anti-corruption indices.

Chapter 5 explores the impact of EU structural funds on institutionalised grand corruption in three countries where corruption is systemic – Czech Republic, Hungary, and Slovakia – between 2009-12. By exploiting a unique pooled database containing contract-level public procurement information for all three countries, ANTICORRP researchers were able to systematically examine corruption risks associated with EU funding at the micro-level.

Developing comparative indicators of institutionalised grand corruption in public procurement for all three countries represents the primary methodological innovation of this article. The approach closely follows the composite indicator building methodology developed by the authors and introduced previously in ANTICORRP reports through the **work of author Mihály Fazekas.** It is based on a **data mining technique** making use of a wide range of public procurement 'red flags'.

The measurement approach exploits the fact that **for institutionalised grand corruption to work, procurement contracts have to be awarded recurrently to companies belonging to the corrupt network**. This can only be achieved if legally prescribed rules of competition and openness are circumvented. By implication, it is possible to identify the input side of the corruption process, that is techniques used for limiting competition (e.g. leaving too little time for bidders to submit their bids), and also the output side of corruption, that is signs of limited competition (e.g. single bid received and recurrent contract award to the same company). By measuring the degree of unfair restriction of competition in public procurement, a proxy indicator of corruption can be obtained. This indicator, called **corruption risk index (CRI) represents the probability of particularistic contract award and delivery in public procurement** falling between 0 and 1.

Regression results indicate that there is considerable market access restriction, hence likely institutionalised grand corruption, going on in all three countries during the 2009-12 period, by and large following the same techniques and 'tricks'. These results on their own demonstrate that corruption is systemic in public procurement in these countries. The reaching of robust regression models with considerable explanatory power by using the same regression set-up and variables point at the feasibility of cross-country measurement.

For instance, in the **Czech Republic**, the modification of the call for tenders is associated with a 0.6% higher probability of receiving a single bid and with a 1.5% higher winner's contract share. Both results point at a likely interpretation that modifying the call for tenders during the bidding phase is systematically used for restricting access and recurrently benefiting the same company. This result warrants making the modification of call for tenders part of the Czech CRI. In **Slovakia**, not publishing the call for tenders in the official journal is associated with 9.0% higher probability of a single bidder contract award and a 1.3% higher winner's contract share. Both results suggest that avoiding the transparent and easily accessible publication of a new tender can typically be used for limiting competition to recurrently benefit a particular company. This means that calls for tenders not published in the official journal becomes part of the Slovak CRI. In **Hungary**, leaving only 5 or fewer days, inclusive the weekend, for bidders to submit their bids is associated with 20% higher probability of a single bidder contract and with a 7.9%

higher winner's contract share compared to periods longer than 20 calendar days. These indicate that extremely short submission periods are often used for limiting competition and awarding contracts recurrently to the same company.

The chapter ultimately concludes that EU funding impacts institutionalised grand corruption in the three countries in two ways: first, by providing additional public resources available for corrupt rent extraction; second, by increasing the controls of corruption for the additionally allocated funding. Their preliminary calculations indicate that the first effect increases the value of particularistic resource allocation in the three countries up to 1.21% of their GDPs, while the second effect decreases the value of particularistic resource allocation by up to 0.03% of GDP.

Chapter 6

Chapter 6 is based on the largest and most substantial report of ANTICORRP so far. It explores why some societies manage to establish control of corruption and others not. Control of corruption is defined by **author Alina Mungiu-Pippidi** as the **capacity of a society to constrain individual corrupt behaviour (defined as particular distribution of public goods leading to undue private profit) in order to enforce the norm of individual integrity in public service and politics as well as to uphold a state that is free from capture by particular interests and able to promote social welfare**. This shortened version of the ANTICORRP milestone report explains the causes of the global fight and stagnation against corruption. It uses 2013 data to explain why societies around the world that feel their governments act for their self-interest alone call this corruption.

The main research question is addressed from an interdisciplinary perspective and by a large-N comparison method. For the dependent variables, the report uses: the aggregated Control of Corruption Index (CoC) from the World Bank, the Corruption Risk Index from the International Country Risk Guide (ICRG), the experience with bribe and perception of official's corruption from the Global Corruption Barometer 2013, the experience with bribe and perception of favouritism from ANTICORRP's own QOG 2013 European survey, the expert perception of diversion of public funds from the World Economic Forum Global Competitiveness Survey and the tolerance towards corrupt practices from the World Values Survey 2008. The full version can be read at http://anticorrp.eu/publications/quantitative-report-on-causes/. The report finds that individual behaviour is predicted by context (most people simply follow the 'rules of the game' in their own societies) and individual status (individuals who believe in competition more due to their individual skills tend to be less tolerant towards corruption). Societal control of corruption is reached as a state of equilibrium between opportunities or resources (power discretion and potential spoils such as natural resources) and legal and normative constraints (checks and balances, collective action capacity of enlightened citizens). A parsimonious model based on this concept proves robust to testing and opens the possibility to calculate country risk and areas of vulnerability on more objective grounds than was possible until now. Institutional 'silver bullets' prove, on the contrary, disappointing and only the interaction between civil society and various tools of transparency seems to work. By and large the report fulfilled these objectives:

First

To propose and bring solid evidence in favour of a holistic approach to control of corruption as a governance order. The report brings evidence that control of corruption is an equilibrium involving both state and society, widely perceived by respondents in highly salient opinions and attitudes which inform their behaviour. The various forms and types of corruption should be seen only as symptoms of a systemic vicious equilibrium, which can vary from one context to another according to individual resistance but which do not change the definition and mechanism of the equilibrium as a whole. It is highly unlikely that a radical change can work other than by a systemic approach.

Second

To show that determinants of control of corruption are similar across measurements from very different sources, businesspeople, ordinary citizens and experts therefore validating the measurements of corruption. For the first time in anti-corruption research a similar model explaining control of corruption is tested across three different sources of data and proves similar and robust.

Third

To propose a policy-relevant model able to explain most variance without resorting, like many models of 'institutional quality', to legacies such as age of democracy, colonial past, legal tradition and religion. All elements of the model can be influenced by human agency – if not by the agency of governments uninterested in changing the status quo then by the agency of civil society and international donors.

Fourth

To test anti-corruption devices and prove which ones seem to work, and in what circumstances. Institutional weapons such as freedom of information acts work if institutional warriors exist and pick them up. Many interventions would gain in effectiveness if the stakeholders (taxpayers, consumers, businesses, NGOs) were to be involved, because **what works to deliver change is the interaction between civil society and the tool itself (for instance, fiscal transparency).** Anti-corruption policies should by default involve stakeholders and be reviewed by them, not formally and marginally, as in many pseudo social accountability designs, but substantively, in the whole policy cycle - the planning, implementation and evaluation of policies. None of the anti-corruption tools - existence of an anti-corruption agency or of an ombudsman, for instance - predict if a country has superior control of corruption or has progressed since its adoption compared with other countries which do not enjoy such tools.

A forecast based on this statistical model would imply that change in governance order can occur only gradually and by a succession of radical actions and disequilibria until a new equilibrium is achieved with better control of corruption. That explains why so few success stories have existed over the past twenty years and why they seem to result more from domestic agency and broad reforms (Estonia, Georgia, Uruguay) than from typical anti-corruption strategies focused on repressive agencies promoted by external donors.

Methodological recommendations

Second generation indicators, unrelated to perception indicators and sensitive to change and policy intervention are a main objective of ANTICORRP so most reports on the first two years of the project design and test some indicator or another (full reports for many countries more can be read at http://anticorrp.eu/anticorrp-publications/). This selection offers a wide variety, such as indicators based on data collection (e.g. the Bulgarian report has an excellent example in the ratio of the total volume of the concluded public procurement contracts/ volume of the nationally audited public procurement contracts/ volume of the public procurement contracts with discovered violations, which shows beyond doubt that irregularities are the norm and not the exception in Bulgarian procurement). Reports on Rwanda, Botswana and Qatar draw on more qualitative indicators, while the report on Central European procurement is based on big data and advanced inferential statistics. By and large, indicators advanced by ANTICORRP manage to answer the main diagnosis questions, if corrupt transactions are occasional or rather the rule of the game - also the essential question in choosing an appropriate policy response.

On the basis of our work on indicators we have developed the following recommendations:

On corruption indicators' reliability and validity

The 'success stories' according to governance charts (World Bank and Corruption Perception Index) are largely not confirmed by the ANTICORRP reports on Rwanda and Qatar. These case studies suggest that the methodology used in the corruption indices is likely to have a biased impact on scores. Transparency International's Corruption Perception Index (CPI), World Governance Indicators (WGI), and the Global Competitiveness Index (GCI-which have rated Qatar highly in terms of anti-corruption measures-all partially rely on surveys or interviews with respondents from the resident business community who are asked about their perceptions rather than about in-country practices. The WGI also includes subjective assessments from non-governmental organizations and public sector bodies. However, in the case of Qatar, the former are not independent from government influence and the latter are controlled by the ruling family. The case in point is revealed by looking at measures of independence of the judiciary as revealed by those indicators, compared with results from the Human Rights Dataset, which relies on Amnesty International reports and the State Department's Country Reports on Human Practices - i.e., indicators of practice rather than perception as sources.

The ANTICORRP analysis reveals that the specific indicators conventionally used to measure anti-corruption are incomplete, due to nuances not covered by those indicators. In their approach to what constitutes corruption, anti-corruption indices focus on bribery but miss measuring if social allocation is based on ethical universalism (people treated similarly) or not. Therefore, particular questions need to be asked to get a fuller picture of corruption and anti-corruption in a given country. Those questions would try to establish:

- Is there public information about public expenditure? How transparent is public procurement?
- Where do sources of information on corruption come from? Is there a freedom of information act? If information mostly comes from the government and the media are not free to report on corruption, a positive governance ranking should be questioned.
- Where do anti-corruption initiatives come from? Are there any non-governmental anti-corruption initiatives?
- Is there a monitoring and accountability framework so that people know what is going on in their government? If there is no watchdog to measure government performance and hold it accountable it is very unlikely governance can be so good.
- How is corruption defined? In Qatar and Rwanda, corruption seems to be narrowly defined as being solely about bribes, while social connections linked with privileged allocation are widely accepted. The paradox then emerges of patrimonial states being rated 'clean' by corruption ratings.

Corruption should always be defined in broad terms as encompassing all its forms, including non-monetary ones, as a country might have low incidence of some forms and high incidence of others. Moreover, the case of Rwanda suggests that petty or administrative corruption can in some cases be a very different issue from grand or political corruption, as curbing the former does not necessarily mean reducing the latter.

In addition, and perhaps most importantly, Qatar and Rwanda shows that relative success in fighting bribery is not necessarily associated, as many would assume, with high levels of accountability, transparency and citizen participation. This confirms the need, when investigating corruption, to analyse the broader governance context of a country.

On alternatives to corruption indicators

The ANTICORRP work on social allocation indicators provides a country specific, non-perception based data collection method which can add to or replace perception based governance indicators. In the particular case of EU funds this can be achieved by the introduction of an EU-wide, real-time monitoring mechanism of EU funds spending designed to detect systematic fraud and corruption in public procurement using data mining techniques, elements of which can be derived from ANTICORRP research. Such a system should not be deterred by the absence of procurement data, as the availability or transparency of procurement data can be built into the indicator itself and become an important weapon for both advancing transparency and grounding research.

Policy recommendations

According to ANTICORRP'S model, control of corruption in a society has thus to be understood as a complex balancing act rather than as a few separate factors determining corruption. Therefore anti-corruption (AC) cannot be effective unless it manages to assemble these features:

1. AC is adjusted to the real equilibrium level (particular transactions are either the exception or the norm) as very two different sets of policies apply (contextual);
2. if particular (corrupt) transactions are widespread AC needs to affect more than one element of the equilibrium (comprehensive);
3. if particular transactions are widespread, AC needs to be radical and strong enough to affect the balance and so trigger a disequilibrium (deep);
4. if particular transactions are widespread AC needs to involve both state (e.g. fiscal transparency) and society (watchdog NGOs) in order to influence both sides of the formula (balanced);
5. if particular transactions are widespread AC needs to result from action by those groups on all sides (state and society) who oppose the institutional status quo (genuine 'principals') and cannot be simply conceived as top-down 'reforms'.

The Bulgarian case study provides the illustration for these seemingly abstract recommendations. The lessons learnt from the Bulgarian country case study substantiate the findings that corruption is a multi-dimensional phenomenon, which is difficult to target through simple policy instruments. It demonstrates that there are many factors at play, which influence the governance regime and corrupt behaviour, and that changes are unlikely to occur in a top down fashion even under the harshest conditionality in the world, that of the European Union's Cooperation and Verification Mechanism. The case study suggests that improving governance further might be more difficult, requiring more time and more intensive efforts over a broad range of policies.

The report argues that after not even marginal progress was reached in areas such as effectiveness and impartiality of judiciary or e-government reforms the equilibrium can be affected by broader policy reforms which will indirectly impact corruption.

For instance, ***health and pension systems*** are currently heavily dependent on administrative and political decisions. The interests of services are not matched with contributions; as a result revenues are far behind expenses and only budget transfers keep the systems functioning and elementary subsistence level. This gives the political class leverage in times of elections and does not permit a sustainable development based on endogenous factors. Both systems (in view of people who do not contribute in full or on a regular basis) tend to generate substantial amounts of 'grey' behaviour. In this respect, in addition to other aspects, reforms should aim at matching contributions and benefits and limit discretionary power of officials and the political class. By reducing the underfunding of these systems in a transparent way corruption will be reduced. To challenge the equilibrium the authors suggest the removal of monopolistic legislation, a part of which is currently under attack at the European Court of Justice.

Similarly, the chapter on EU funds does not recommend that more procedures be introduced. Those do exist in abundance, complicating the access to these funds but not controlling corruption, as in corrupt environments they are simply not implemented. Where country specific research confirms the higher corruption risks associated with EU funds, the EU will have to consider advancing a radical change of policy for protecting its financial interests and promoting good governance, such as **the reallocation of EU funding going into discretionary investment projects, which typically constitute high corruption risks, towards non-discretionary spending such as unemployment benefit or another form of universalistic distribution which excludes or minimizes discretionary allocation.**

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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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