ANNEX. ASSESSMENT METHODOLOGY*

The assessment methodology used to evaluate the corruption situation in the country is based on theoretical developments in two broad areas: administrative corruption and state capture. These are in essence different forms of corruption that are interconnected but have different manifestations, forms and societal implications. State capture has its roots in administrative corruption and would be practically impossible without widespread corruptness of officials at non-executive positions. However, state capture is a form of "superstructure", which directs, amplifies and stabilizes administrative corruption making it even more difficult to identify, investigate and prosecute.

Administrative corruption

Elements of corruption behaviour

The most common way to define corruption behaviour is by defining it as a specific activity occurring inside the interaction between collective actors (public organisations or institutions) and their clients (private individuals or companies). The most frequently used models of this activity is the Principal-Agent-Third party model (PA). in this model the principal is the collective actor which is represented by the director of a public institution (or other type of public organisation). The role of the Agent is "played" by officials working for the public institution, or people hired by the principal. The main obligation of the agent is that he executes the orders of the principal and serves and protects his interest. The agent should not abuse the rights which he has been given by the principal and breach the trust of the principal by serving his own interest or other private interests.

The most common definition of corruption (V. Tanzi) is that it is abuse of public authority (power) for private gain. In terms of the PA model corruption would be abuse of power or trust (given by the principal) by the agent in favour of his private interest (gain).

In view of the PA model, the specific characteristics of public institutions are:

- The power of both the principal and the agent are forms of public power, which is used (utilised) in favour of the common (public) good (the People, who are the supreme principal of all public authority).
- Public authority has complex structure which is differentiated by regions (central and local), sectors (economy, security, educations, etc.) and types of authority (executive, legislative, judiciary). The principals

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* CSD, State Capture Diagnostics Roadmap, Sofia: Center for the Study of Democracy, 2016.

of most public institutions are subordinated to public institutions and official of higher rank within a complex system of distribution of authority, responsibilities and subordination.

From the complex structure of public authority, it follows that many principals can in turn be agents of the superior level of public authority. Respectively abuse of public authority can have complex structure and include several level of public authority. Therefore, the agents are not only officials who communicate directly with citizens (third party) but also official who at the same time are themselves principals at different levels. In view of the hierarchy of public authority the superior principals are those positions of authority which are occupied by elected officials and who represent and serve the interests of the population which has elected them (the public interest).

In view of the structure of public authority, corruption could be subdivided into political and administrative. Administrative corruption would include abuse for gain behaviour of officials at the lowest administrative level – those who directly communicate with clients (citizens or companies). Political corruption would include abuse for gain behaviour of officials at the political level of public authority, i.e. those who occupy the highest levels of the hierarchy and are essentially political appointments (the level directly associated with elections and are appointees of the ruling party).

An important indicator for political corruption is the replacement of larger parts of the administration (including officials who are not political appointees) with the change of the ruling party after elections. The main reason for such reshuffles is the need of the political class to use the administration for corruption transactions and extraction of corruption rent for services to private interests.
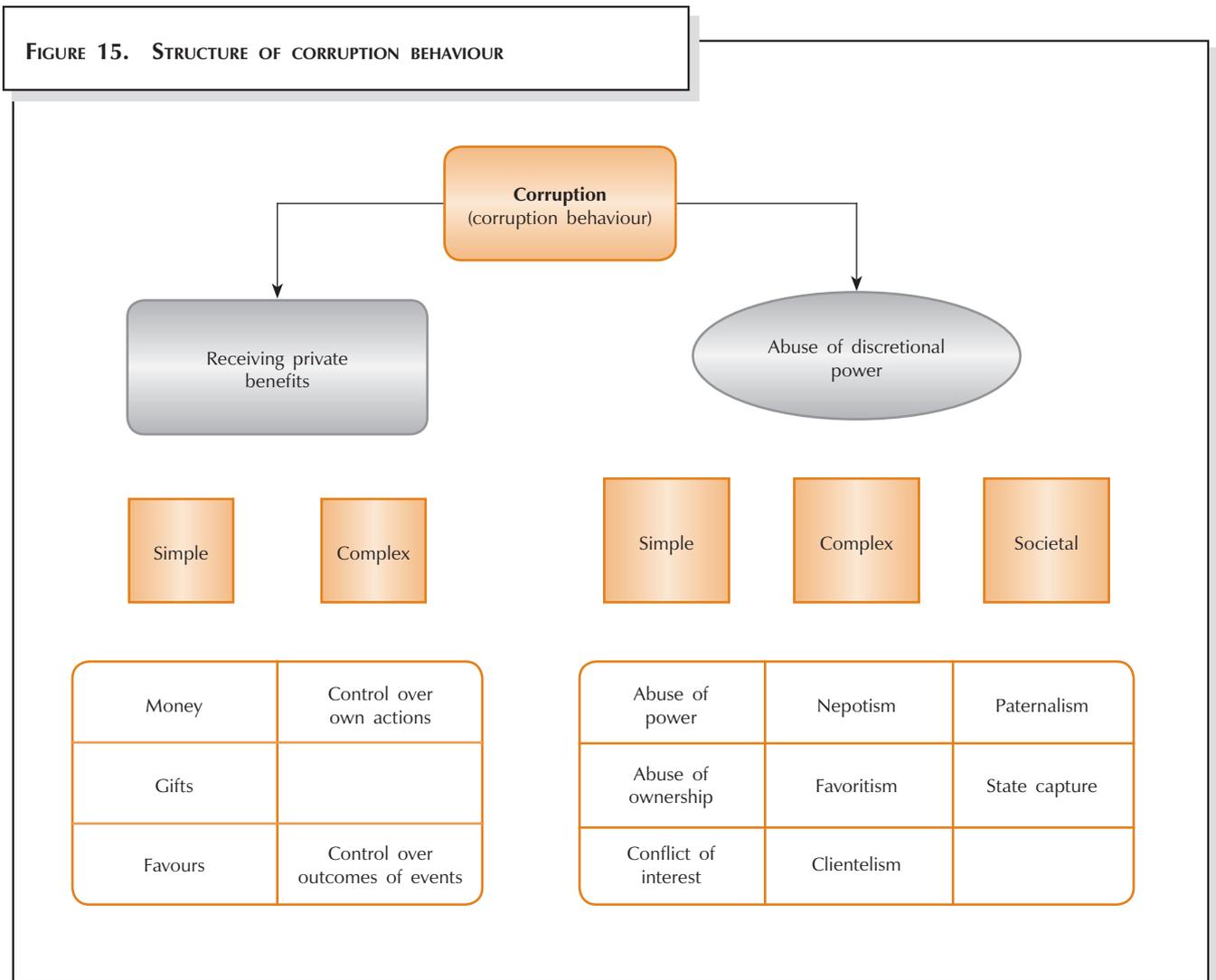
Structure of corruption behaviour

Despite the theoretical debates on the dimension of corruption behaviour, several issues are important for corruption assessment and anticorruption efforts:

First, corruption transactions can be subdivided into two elements – form and content. Form is related to the private gain received by officials. Content refers to the type of abuse of discretionary power. Every corruption transaction includes both form and content.

Second, abuse of discretionary power can be identified only in the context of a system of laws, rules and regulations which govern the activity of public institutions. This system defines which transactions constitute abuse. In this respect the content of corruption behaviour is essentially deliberate abuse of existing rules. The problem of identification of corruption behaviour is often that deliberate abused could be masked as incompetence and/or lack of motivation.[44]

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[44] This characteristic of corruption behaviour is referred to as "mimicry" – See Gambetta, D., 2002. Corruption: An Analytical Map. In S. Kotkin & A. Sajo, eds. *Political Corruption in Transition: A Skeptic's Handbook*. Budapest: CEU Press, pp. 33-56.

The assessment of the level of corruption and the elaboration of anticorruption strategies and policies is dependent on the way the forms and dimension of corruption behaviour are interpreted. One way to operationalise such an interpretation is to separately decomposed its multitude of forms (gain) and contents (abuse of discretionary power). Such a decomposition directly impacts the design of anticorruption legislation, anticorruption strategies and policies, and corruption assessment and measurement.[45]

FIGURE 15. STRUCTURE OF CORRUPTION BEHAVIOUR

Third, the multitude of forms and content element of corruption behaviour combine in a multitude of different ways. The need to identify gain in combination with deliberate abuse of rules makes identification and prosecution of corruption behaviour a difficult and often impossible task.

[45] For example, the draft of the Law on Countering Corruption among Officials at High Positions of Public Authority (paragraph 2.1) defines: "Corruption behaviour, according to this law, is when an official, as a result of occupying high positon of public authority, receives gains leading to illegal increase of his, or people related to him, personally possessed assets or when he executes his office responsibilities in conflict of interest."

Levels of analysis

At the macro level, corruption could be interpreted as:

- Model of governance. This is governance which is characterised by paternalism – systematic promotion of private interests at the expense of the public interest as a result of deliberate decisions of the ruling party (government) and not by universalism – governance that threats all private interests as equal.[46]
- Diversion from the model of good governance. Governance that spend public funds in favour of private interests and not in favour of the public interest. As public interests are not defined per se, they should be formulated by parties and competing definitions should receive public support at elections. In this respect the problem in many countries is that public interest definitions that have received the predominant electoral support are, after elections, replaced by policies favouring private interests or by mismanagement of public resources.

The macro aspects of corruption describe above are realised through a multitude of micro-corruption transactions. In most cases they include deliberate abuse of rules combined with personal gain for empowered officials who enforce the transactions.

Measuring and assessing administrative corruption

In the outlined context, the measurement and the assessment of corruption would include the assessment of all components of corruption at all levels of public authority. This would be possible if we could measure/assess:

- The prevalence (magnitude) of all acts of personal gain (form) or,
- The prevalence of different types of corruption practices (content).

As a rule, the measurement and assessment of cases of personal gain is a proxy indicator for the level of administrative corruption because it is based on measuring the incidence of bribes. What remains outside this measurement are, more complex gain patterns as mutual services, linked decisions in different spheres, the revolving doors phenomenon and others. Defined in this way the indicator used (experience with corruption) is the closest possible approximation to the concept of administrative corruption. The CMS of CSD uses this concept to measure the level and the dynamics of administrative corruption.

The Corruption Monitoring System

The corruption monitoring system (CMS) was designed and developed by CSD in 1998[47] (*Clean future*, 1998, pp. 64-91). Introduced at a time

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[46] The typical example of paternalism in Bulgaria are the activities of "agents/subjects, who distribute the "portions" (public resources or the authority to distribute public resources) in favour of parties with their "circles of companies".

[47] Center for the Study of Democracy, *Clean future.*, pp. 64-91.

when corruption measurement was confined to public perceptions, the CMS launched a measure of the corruption victimisation of individuals by officials accounting for their direct experience with various corruption patterns. Based on CMS diagnostics assessments could be made about the dynamics of prevalence of corruption behaviour patterns in a society.

The CMS methodology ensures comparability of data across countries and registers the actual level and trends of direct involvement in administrative corruption, as well as the public attitudes, assessments and expectations in relation to corruption. CMS diagnostics is being implemented in Bulgaria since 1998,[48] at the regional level (Southeast Europe) in 2001, 2002 and 2014,[49] in select years in Georgia and Moldova. Some CMS concepts have also been modified and included in the Eurobarometer surveys on corruption; this makes CMS data comparable to Eurobarometer data.[50]

The CMS is one of the possible measurement approaches to corruption. Its principal objective is to provide statistical estimates of the prevalence of the most common incidents of corruption and has diagnostic and descriptive functions.

In the CMS context, corruption is conceptualized as a specific type of social behaviour, which includes specific forms of interaction between actors, attitudes associated with these interactions and a set of perceptions which relate to the interactions (serving both as reflections of the interaction and prerequisites which define the behaviour strategy of the actors). Corruption refers to a specific group of interactions: citizens receive public services from public organizations (institutions) by contacting officials, who are employed of these organizations. Corruption is described through the Principal-Agent model: citizens (clients) interact with organisations (principal) through officials (agents); agents act on behalf of the principal who defines their rights and obligations and entrust them with certain discretionary power. Corruption is an interaction in which officers in public institutions (agents) abuse the discretionary power they entrusted with by the public organisation (principal) in their interaction with citizens (clients).

This definition has two key elements which need to be further operationalized: "abuse" and "benefit". Both should be present for certain behaviour to be categorized as corruption. The relation between these concepts could be defined as a "form-content" relationship. The "benefit" is the form of the transaction, while the "abuse" refers to the content of the transaction – the type of resource that is being offered in exchange for a benefit. Varieties of corruption behaviour arise because

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[48] All corruption assessment reports published since 1998 can be found at the web page of CSD at: http://www.csd.bg/artShow.php?id=1339

[49] A. Stoyanov et al., eds., *Anticorruption in Southeast Europe: First steps and policies* (Sofia: Center for the Study of Democracy, 2002). Additional information is also available at the SELDI web page: www.seldi.net

[50] TNS Opinion & Social, *Corrruption. Special Eurobarometer 374* (Brussels: Directorate-General Home Affairs, European Commission, 2012); TNS Opinion&Social, *Corruption. Special Eurobarometer 397* (Brussels: Directorate-General for Home Affairs, European Commission, 2014).

of the variation in both form and content: of the benefits that are being extended from clients to agents and of the types of abuse of public power are the content of the exchange. The most common word used to label the forms of corruption is bribe. Regarding content variations in corruption behaviour could be numerous, but they depend on what is being done, how it is done and who is the perpetrator. In more concrete terms the above variation in corruption behaviour could be summarized in four sub concepts (Figure 16):

- Form. Bribe is the common label of the private benefit that is being exchanged. The most common forms of bribes include money, gifts or favours. The latter could be linked to types of corruption behaviour. It is important to note that bribes are the empirical manifestation of corrupt behaviour but receive their corruption load only in conjunction with the other aspects of corruption.
- Type. Entrusted discretionary power can be abused in many different ways (trading in influence, nepotism, clientelism, etc.).
- Level. Agents at different levels could abuse discretionary power and this might not always be directly linked to specific clients (level).
- Violation model refers to the model of abuse of discretionary power and could be split into two broad categories: 1) violation of existing laws and/or institutional norms; 2) provision of a better service. In some societies and cultures, additional benefits extended to agents could be regarded (by custom, law, tradition, etc.) as normal behaviour when/ if provided services are normal or better; in such cases additional benefits take the form of a tip and not the form of a bribe.

While the above abstract summary model of corruption behaviour could further be specified in order to list most possible variations of form and content, it is important to note that form and content could easily be used as proxies to each other. If there is a bribe, there is most probably some kind of abuse; on the other hand, if there is an abuse, there probably is some material gain. Therefore, in order to measure the prevalence of corruption behaviour, attempt should be made to either measure the number of bribe incidents, or the number of abuses of different types. In empirical terms, the easier way to "access" to corrupt behaviour is through identification of instances of bribery. Types, violation models and levels are more difficult to observe and account for as they always tend to be hidden and/or deliberately obscured. Even when the latter is the case, there is always a possibility that a violation has occurred without any personal benefit for the offender (the official).

The specific objective of the CMS is to address the most common forms of abuse. In terms of the above classification this would be **low level (administrative) corruption of all types and violation models**. The reason for choosing such a criterion is expected prevalence that could be registered with random sample techniques: low level (administrative) corruption of all types and violation models. The proxy to these abuses is the occurrence of bribery which is defined as benefit received informally by the agent (the public official) in the form of money, gift or favour. It is an addition to public services clients are entitled to, given the organization of the public service system of a country.

FIGURE 16.   CORRUPTION BEHAVIOUR ELEMENTS
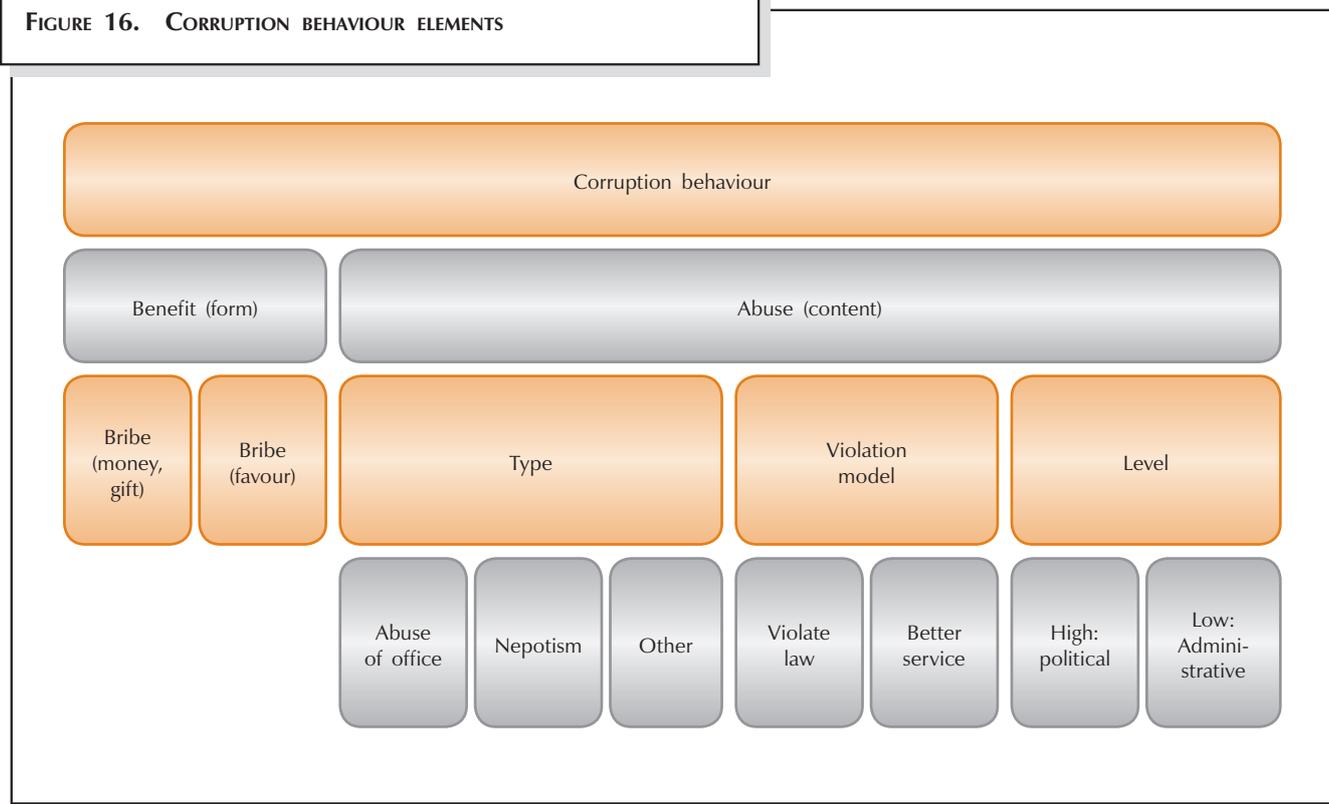
CMS indicators and indexes

The main indicators of the CMS describe corruption (as a social phenomenon) using three groups of concepts: experience, attitudes, and perceptions (Figure 17).

Information on CMS indicators is collected through a survey questionnaire. Indicators are first decomposed into survey questions and, at the analysis stage, the information is aggregated to form the CMS indexes. This allows for a more robust interpretation of findings and has been a way to keep findings aligned to the theoretical background of the study.

Over the years two methods of aggregation have been used: 1) quazi normalization procedure which calculates individual respondent scores for each respondent and "places" scores on a scale ranging from 0 ("best value" in terms of corruption) to 10 ("worst value" in terms of corruption); 2) direct allocation of respondents into specific (for each indicator) categories. Essentially both procedures render similar results, but have some important differences. The advantages of the first method (normalization), used till 2011, are that all indexes use the same scale and are in this way comparable in terms of values. The disadvantage of the index calculated in this way is that it is not directly interpretable. The conclusions that can be made would be based on time series and evaluation of dynamics over time. However, an index of 0.5 or 5.6 does not directly relate to the content of questions and the specific aspects of the concept it represents. Another disadvantage is that possibilities for statistical analysis of data are largely limited.

FIGURE 17. STRUCTURE OF THE CORRUPTION MONITORING SYSTEM INDEXES
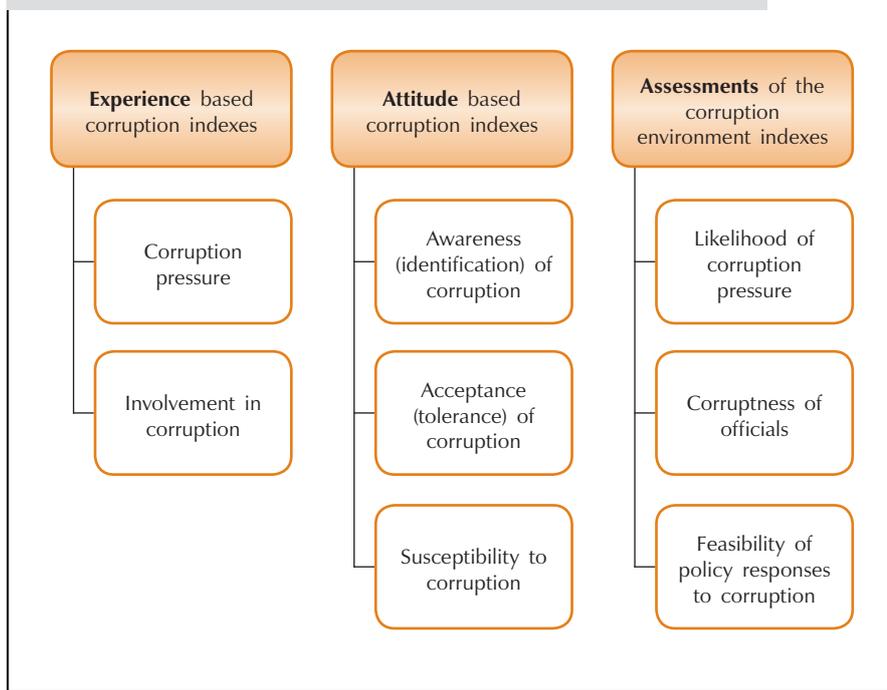
The main advantages of the direct allocation method (conditional recoding of variables that compose each indicator) are two. First, results are directly interpretable in terms of content. In this way the index is more or less "self-explanatory" and needs little input explanations as to what is measured and presented. Second, the index variables provide all possibilities for statistical analyses and tests. A limitation in this respect is that index variables are measured on weak scales (nominal).

A comparison of results between quazi-normalization and conditional recoding calculation methodologies is presented below for one of the most important and widely commented indexes: involvement in corruption transactions.

Experience based corruption indexes	
Involvement in corruption	Involvement in corruption captures the instances when citizens make informal payments to public officials. The concrete questions used to gather information about this indicator are victimization questions and reflect experience during the last year. The indicator summarizes citizens' reports and divides them into two categories: people without corruption experience (have not given bribes) and people with corruption experience (have given bribes at least once during the last year).
Corruption pressure	Corruption pressure reflects instances of initiation of bribe seeking by public officials: directly by asking for an informal payment or indirectly by "hinting" that informal payment would lead to a positive (for the citizen) outcome. CMS results have shown that pressure has been a decisive factor for involvement. Most corruption transactions occur after the active solicitation of payments by officials.
Attitude based corruption indexes	Direct involvement in corruption transactions is accompanied by the prevalence of specific attitudes towards corruption and corruption behaviour and by perception of the spread of corruption in society. Ideally low levels of involvement in corruption would be paired with negative attitudes towards corrupt behaviour and perceptions that corruption is rare and unlikely. This does not mean that perceptions and attitudes directly determine corruption behaviour of citizens. Rather they could influence behaviour to a certain degree but essentially express the general social and political atmosphere in society related to corruption.

Awareness (identification) of corruption	Awareness (identification) of corruption is an index accounting for the level of understanding of citizens as to what constitutes corruption behaviour. The index differentiates between three categories of awareness: high (citizens who identify all or most of the common corruption behaviour patterns as corruption), moderate (many of the common corruption practices are identified but some forms of corruption are classified as "normal behaviour"), low (few corruption patterns are identified as corruption).
Acceptance (tolerance) of corruption behaviour	Acceptance (tolerance) of corruption behaviour. While awareness captures the knowledge component, acceptability of corruption captures tolerance (or lack of tolerance) towards corruption. It summarizes citizens' assessments of the acceptability for members of the parliament or the government as well as officials at ministries, municipalities and mayoralties to take gifts, money, favours or receive a free lunch (get "a treat") in return to solving someone's personal problems.
Susceptibility to corruption	Susceptibility to corruption reflects the tendency of the respondents to react in two hypothetical situations – one involves being in the role of an underpaid public official and accepting or denying a bribe that was offered, the other situation asks about giving a bribe to a corrupt public official, if one had a major problem to solve and was asked explicitly for a bribe (cash). Declaring the denying of a bribe in both situations is interpreted as the respondent being not susceptible to corruption, accepting/giving a bribe in both is interpreted as susceptibility, while giving/taking a bribe in one of the situations and not in the other is defined as "mixed behaviour".
Assessments of the corruption environment indexes	The experience with corruption and the attitudes towards corruption, as well as the general current sentiment and level of trust towards public institutions in society determine the public's assessment of the corruptness of the environment
Likelihood of corruption pressure	Likelihood of corruption pressure is an index measuring expectations of citizens for the likelihood to face corruption pressure in interaction with public officials. Overall this is an index gauging perceptions of the corruptness of the environment. In principle corruption theory considers that people would be more likely to "use" corruption patterns if they assess the environment is intrinsically corrupt.
Corruptness of officials	Corruptness of officials is an index reflecting perceptions of the integrity reputation of different groups of public officials; it thus constitutes an estimate by the public of the corruptness of the various public services. The interpretation of this index is specific, as it is an assessment of attitudes of citizens towards public officials rather than a measure of the prevalence of corruption in the respective offices. The added value of this index is that it helps identify top ranking sectors affected by corruption or being least trusted by the public.
Feasibility of policy responses	Feasibility of policy responses to corruption is an indicator capturing the "public thinking" about policy responses to corruption. More specifically it evaluates potential public trust in the government's willingness and/or capacity to tackle corruption, as well as the potential support for anti-corruption policies.

State capture

Definitions

Hellman, Jones and Kaufman distinguish three types of corruption relationship between the state and the private firms including: **influence**, administrative corruption and state capture.[51] Each of them has specific characteristics which are very important for the understanding of the mechanisms of principal-agent interaction. Influence or lobbying, as is commonly known, represents a firm/state relationship, in which a private interest becomes an agent of influence relying mainly on the firm's owner's ties, size, history of repeated interaction with state officials to persuade the authorities (the principal) to act on their behalf. Hence, relations are determined more by power status, rather than by illicit transactions. **Administrative corruption**, on the other hand, is the act of making private payments to officials to deliberately distort the execution of the (externally) prescribed rules. In this case certain officials act as a tool of the private interests without directly influencing the rule-making procedures.

Administrative corruption thrives when the capacity of the state to provide public goods is insufficient. In other words, this is the form of corruption that occurs in weak democracy where the existing mechanisms of accountability and control do not work. The state institutions function in a perverse manner by the laws of free market competition – the one, who is able to pay the most, receives a good-quality public service. Institutional exploitation is visible also in the judiciary, where in essence prosecutors and judges are not appointed based on objective merit-based criteria but after lobbying from outside private actors. Hence, the judiciary is unable to fulfil one of its main functions to check the power of the executive and interpret the fairness of legislative decisions.

Finally, when **systematic corruption** can lead to a permanent symbiosis between the ruling authorities and private interests, which transforms of state/national interests into private ones and consequently to the state capture. The phenomenon refers to the situation when private interests use corruption to mould institutions in such a way as to preserve a monopoly on resources in key economic sectors. Vested interests are able to influence policy-makers in introducing loopholes built in institutional arrangements. They often use the system of public funds allocation to sustain otherwise largely uncompetitive businesses in strategic economic sectors, where clientelistic networks can exploit enormous rents from the corporate governance of SOEs, the management of large-scale projects, and the allocation of public procurement.

The companies engaging in influencing decision-makers via illicit payments are called **captors**. Their ability to transform laws and change the regulatory framework in their own interest is provoked by their inability to succeed in a competitive environment where innovation and efficiency determine profit margins. Instead they take advantage of the state's preferential treatment, secured through personal connections to politicians. **Victims of state capture** are all kinds of different institutions including the

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[51]   Hellman, J., Jones, G., & Kaufmann, D. (2000). Seize the state, seize the day: State capture, corruption and influence in transition. Washington: World Bank Research Working Paper.

judiciary, the regulatory agencies, the state-owned companies but also the parliament and the executive bodies. Policy-makers that act as agents of such captive oligarchs or themselves being the captors might not at all want to reform the system, which threatens the status-quo.

Most analyses define state capture as illegal or illegitimate influence on the business environments by actors, which have sufficient power to realise such an influence. The most common objective is acquiring economic advantage. The latter is pursued systematically and most often through illegitimate methods. Therefore, the achieved outcomes/results are in most cases also illegitimate. Several problems need to be addressed in this respect. State capture most commonly refers to **basic public functions of modern states** as:

- Providing social services
- Assistance to vulnerable groups
- Maintenance of social, market and political order
- Protection of a given territory

In view of the fact that modern states concentrate about 30-50 % of produced GDP, illegitimate access to this public resource could ensure substantial advantages for certain actors. The immediate benefit of public officials would be private gain, while the benefit for captor actors would be undue illegitimate advantage. The latter includes the violation or bypassing of existing legitimate mechanisms of access to and distribution of public resources. This becomes especially evident when corruption is systemic and coverts into an additional tax for access to public goods. At the macro level such access differentiation mechanism could be summarised as particularism in the access to public resources (precondition) or as violation of good governance principles (result).

In state capture situations social and market order violations have several specific characteristics:

- It is enforced by actors with **considerable market or social power** and are most often based in the business sector (i.e. actors are single companies or groups of companies);
- Violations are practiced **systematically** (on a permanent basis);
- Violations result is the **distortion of market order** in favour of certain companies;
- **The means** of achieving market order distortion could vary. Different forms of corruption are often used but are often complemented by other strategies.

For a given actor (captor) capturing the state would practically mean that he is **no longer pressed to conform with market rules and is able to extract undue advantages and/or rents**. He could in this way:

- Acquire monopoly status in a given sector;
- Effectively counter attempts to limit his market power;
- Have privileged access to public resources and effectively block attempts to be deprived of this privilege;

- Be able to ensure legal advantages by modification of rules and legislation;
- Be able to control media and influence public opinion;
- Block investigations or court proceeding against his actions or business.

An institution would be captured, if a certain part of its transactions or services is provided through corruption based transactions (clientelist or other). The real (effective) functions of the public institution are in this way substantially diverted from the formally prescribed. For example, if an institution as the competition regulatory body is captured, it would (though deliberate action or lack of action) fail to counter monopolies or cartel agreements in certain sectors or markets. This is possible in sectors with high minimum capital requirements and few big actors (energy, transport, trade with fuels, construction, garbage collection, etc.), which capture the state to ensure monopoly or cartels. A second possible scenario would be in cases of public institutions where corruption is rampant (e.g. traffic control or customs administration) institutions privatised though mass prevalence of corruption transactions would be a convenient capture target for the first capture scenario (control by big market actors) or an object of exchange in the system of political corruption (high level public officials sell services to captors).

One of the most prevalent practices for capturing the state is through political party financing, which contributes to the symbiosis between political and economic interests. An apt example is the creation of strong clientelistic ties between the major political parties and their regional bases of support.[52] Political parties are often the main tool for capturing institutions via wide-spread nepotism guaranteeing loyalty, on the one hand, and promoting the personal interests of a large group of people, on the other.[53] What differentiates corruption and clientelism is that the former is individual strategic behaviour, while the second is a social structure. Clientelism can occur on its own, but usually they go together, especially in the environment of post-communist countries.[54]

The power that the ruling political parties receive is so great that its structure overlaps with the state structure. Hence, the state structure reflects the operation of the party, whose primary goal is to preserve its electoral position. This leads to the replacement of experts in high positions in state companies or in institutions with party members, whereas appointments are driven by party loyalty and not merit.[55] Moreover, rent-seeking behaviour by politically linked private interests affects the independence of funding bodies, which distort the business environment and skew the process of market liberalization and privatization to benefit third parties. The fusion of corporate and party interests provides opportunities for the captors to extract goods and to consolidate their ruling position and to abuse their power. Along with the power that the

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[52] Gërxhani, K., & Schram, A. (2009). Clientelism and Polarized Voting: Empirical Evidence. Public Choice, 305-317.

[53] Pesic, V. (2007). State Capture and Widespread Corruption in Serbia. Center for European Policy Studies (CEPS) Working Document.

[54] Stephen Kotkin and András Sajó, Political Corruption in Transition: A Sceptic's Handbook.

[55] Ibid.

politicians obtain through their posts, their position is also supported by the influence they have over state companies.

Previous research has shown that state capture is prevalent in countries emerging from dictatorial regimes, where democratic institutions are weak and could be easily manipulated.[56] In countries of transition, collusive ties between private businesses and the newly-created public institutions, still governed by the old elite, becomes the basis for the concentration of public resources in private interests.[57] The dismantling of old repressive institutions or practices creates opportunities for skilful actors to use networks and capabilities honed during authoritarian rule to gain control of state resources. This is possible when the regulatory framework of the economy is weak and easily manipulated by and for the private interest. There is a vicious circle between weak governmental structures and state capture, in which the former reinforces the latter in transition countries. The result of state capture of strategic economic sectors combined with weak governance is that legitimate businesses get pushed out of the market leading to a rise of the unofficial economy.[58]

The most commonly used definitions of state capture include the degree of unjustified restriction on competition and unfair concentration of market power. The state can be captured by private or foreign interests; however, in some cases the state can also capture the private sector. Another way of defining the issue is by differentiating between corruption, viewed as overstepping the rules, and state capture, which manifests itself in changing or benefitting from the rules.

Some of the critical indicators of state capture include:

- Legislative amendments to allow public procurement concentration via in-built loopholes
- Judicial dependence
- Clientelism and/or particularism in public procurement
- Regulatory capture for control
- Non transparent party financing

Outcomes of state capture

Countries in transition usually go through an initial boom that then often gives away stagnation as vested interests prevent a wide-scale economic reform.[59] For example, in the SEE and parts of CEE regions, governance

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[56] Hellman, J., Jones, G., & Kaufmann, D. (2000). Seize the state, seize the day: State capture, corruption and influence in transition. Washington: World Bank Research Working Paper.

[57] Hellman, J. Kaufman, D. (2000) A). Confronting the Challenge of State Capture in Transition Economies. International Monetary Fund Publishing.

[58] Ouzounov, A. Nikolay. Facing the Challenge: Corruption, State Capture and the Role of Multinational Business.

Morck, R., Wolfenzon, D., & Yeung, B. (2005). Corporate Governance, Economic Entrenchment, and Growth. Journal of Economic Literature, 655-720.

[59] Murgasova, Z., Ilahi, N., Miniane, J., Scott, A., & Vladkova-Hollar, I. (2015). The Western Balkans: 15 Years of Economic Transition. Washington D.C.: IMF.

deficits and the still pervasive influence of the state in all economic sectors remain a deep-seated obstacle to economic convergence with the EU. State capture impedes high economic growth, motivating rent-seeking economic behaviour based on public funds allocation rather than value-added creation. Deficits in the public funds mismanagement creates prerequisites for systemic corruption in public procurement, which in less-developed economies leads to unhealthy market concentration and detrimental fiscal effects. The capture of public procurement could ultimately result in "misguided selection of projects", "spending structure distortion" and "distorted political competition".[60] The latter is directly related to rent extraction, which is facilitated by high-level government officials, while rents-receivers reinvest the corruption proceeds into election campaigns tilting the scales in favour of a particular party, usually the ruling one.[61]

The capture of public funds allocation goes beyond the public procurement sector. The target of well-organized corruption schemes are also state subsidies in key government-regulated sectors such as energy production and distribution, health services, agriculture and even banking.[62] Using relatively little resources, captors are able to reap enormous benefits by shifting the policy of a government towards preferential treatment of one industry.[63] Easing of licensing regimes, the allocation of quotas, the conclusion of long-term agreements with private actors or direct subsidies could be inscribed into law making capture practices legal and often unobjectionable. By creating a legal construct surrounding an economic transaction, captured government officials are able to defend the status-quo and fend any potential allegations against their integrity.

State capture practices could be further legitimized by foreign economic initiatives such as direct loans from international financial institutions for politically-driven projects. This has been one of the critiques of development aid, part of which has in many cases been deviated by government officials to closely-linked firms or most blatantly in their personal bank accounts.[64] State capture also influences negatively the reputation of the country as a safe destination for foreign direct investment. Foreign investors could be potentially deterred from opening businesses in a country driven by wide-ranging corrupt practices.[65] Using

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[60] Fazekas, Mihaly and Péter András Lukács. (2015). The political economy of grand corruption in public procurement in the construction sector of Hungary. Report Deliverable from the FP7-funded Anti-Corruption Policies Revisited (ANTICORRP) project.

[61] Piga, G. (2011). A fighting chance against corruption in public procurement? In S. Rose-Ackerman & T. Soreide (Eds.), International Handbook on the Economics of Corruption, Volume Two (pp. 141-181). Cheltenham, UK: Edward Elgar.

[62] CSD. (2014). Energy Sector Governance and Energy (In)Security in Bulgaria, Sofia, p. 114, p. 34.
Kenny, Charles. (2008). Grand Corruption in Utilities. World Bank Policy Research Working Paper No. 4805.

[63] Shentov, O., Stefanov, R., & Todorov, B. (2014). Anti-Corruption Reloaded: Assessment of Southeast Europe. Sofia: Southeastern Europe Leadership for Development Initiative.

[64] Bamuamba, Clement B. (2002). Political corruption in Congo Zaire: Its impact on development. Saint Mary's University.

[65] Foo, J., Sung, J. (2002). The Impact of Governance Obstacles and State Capture of Transition Countries on Foreign Direct Investment. The Journal of Business in Developing Nations.

data from the BEEP survey, the EBRD, IMF, and the World Bank, a 2002 study found an inverse correlation between the level of state capture in a country and the amount of FDI.[66] The influence of infrastructure development and business governance indicators has been isolated to make the results statistically significant. A later paper by Jensen confirmed the results of other research by using the OLS and Tobit models to show that the lack of economic reform and the capture of state institutions by private interests lead to lower FDI flows.[67] In a captured economy, overall economic growth also lags behind as only the captors are able to effectively expand their business, while other market participants stagnate. Even though a capture-free economy that is operating under a liberalized, transparent regulatory framework is likely to benefit all of the population by increasing business opportunities and raising living standards, it would disproportionately affect captor-firms, who do not have an incentive of fostering a competitive system.[68]

Hence, state capture could also be linked with the persistence of poverty and inequality in less-developed countries or countries in transitions. Poverty seems to be closely correlated with administrative corruption as the misallocation of public funds drains the institutional capacity of a country pushing people to seek an alternative way of "getting things done". In addition, funds earmarked for the improvement of general welfare could often end up in the pockets of captors creating a vicious cycle reinforcing the spread of corruption. The concentration of large amounts of funds in the hands of few well-connected firms consequently breeds inequality.

Finally, state capture fuels the deterioration of transparency standards. Transparency refers to the degree of state's decision-making openness and degree of disclosure of interactions that could easily influence decisions. Moreover, transparency is a key tool for promoting democratic accountability and the efficient functioning of institutions.[69] The lack of transparency of public transactions allows captors to draft new laws or change existing legislation without public scrutiny. Similarly, the deficit in publicly-available and easily-accessible data about public procurement contracts aids the allocation of enormous amounts of public funds to previously-determined companies. Another apt example is the non-transparent corporate governance of state-owned enterprises, which often do not publish timely financial reports or justifications for key management decisions.[70] More transparency means that trading influence becomes more difficult and carries consequences for the reputation of the captor-firms.[71] The lack of transparency and well-articulated

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[66] Ibid.

[67] Jensen, Nathan. (2006). Economic reform, state capture, and international investment in transition economies. 30 Fordham Int'l L.J. 45, December.

[68] Rose-Ackerman, Susan, "Political Corruption and Democracy" (1999). Faculty Scholarship Series. Paper 592.

[69] Hellman, J. Kaufman, D. (2000) A). Confronting the Challenge of State Capture in Transition Economies. In: Finance and Development, September 2001, Vol. 38, Number 3.

[70] OECD (2015), OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition, OECD Publishing, Paris.

[71] Pradhan, S., Anderson, J., Hellman, J., Jones, G., Moore, B., Muller, H., Ryterman, R., Sutch, H. (2000). Anticorruption in Transition-A Contribution to the Policy Debate. Washington: World Bank.

democratic representation is not only a consequence of state capture but also a cause for the phenomenon. In a predation model of state-capture, powerful interest groups would tend to take advantage of the transparency deficits and disconnect between the civil society and governing institutions to transform the regulatory environment in their favor. However, by doing this, they are also managing to reinforce bad practices as a way of maintaining the status-quo.

Initial steps to identify the key state capture risk areas (such as public procurement, subsidies, distribution of EU funds, media, civil society, regulatory and judiciary capture), as well as the availability of public data, and form a concept for state capture measuring. Possible ideas for potential measurement tools include:

- Concentration of market power – differentiation between the naturally-produced market concentration and state-capture-driven market concentration.
- Information on contracts, licenses and public resource allocation transparency
- Voters' analysis and election results through the calculation of the capture of voters.
- Embrace a sectorial or area approach to state capture – some possible indicators are public procurement particularism and judicial dependence.
- Checklists on integrity to evaluate governance standards.
- Exploring the content of wiretapped recordings, whistleblowing information to reveal hidden procedures of designing legislation, of judicial dependence, political control over regulatory bodies and public procurement allocation.

At the societal level, state capture characterises a situation where a company has acquired a long term dominant position in a given market or economic sector. Most often this is within the boundaries of the national state. Such dominance is regarded as undue advantage and should (as a rule) be countered by relevant legislation and enforcement institutions. Preconditions for considering the existence state capture would be:

- Absence of natural monopolies;
- Existence of legislation countering all forms of market concentration;
- Existence of institution designed to enforce the legislation.

As such legislation and relevant public institutions exist in all EU countries, the existence of market concentration would imply either poor institutional capacity or deliberate inaction due to corruption or other motivating interests (e.g. political pressure, which also could be motivated by corruption; in such a case the public institution would be agent of corrupt political will).

Some important state capture characteristics include:

- State capture is not a mass phenomenon, as monopoly status could by definition not include many actors. Also by definition captor

companies are a limited number; usually these are companies with substantial market power.

- State capture is systematic and long term. Its objective is to obtain a privileged status (monopoly) and then exploit the acquired undue advantage. In this respect procurement success of companies depending on the political cycle is rather not and indicator of state capture but of mass political corruption and clientelism (short term system of transactions and gain). Politically dependent procurement success would therefore rather be temporary privatisation of the state by the political class than long term privatisation (capture) of the state by big business. In captured states business favourites usually do not change with the change of government.

Analytically state capture could be decomposed into the following elements:

Outcome: market concentration. Illegitimate market concentration is the main indicator for the existence of state capture.

Results: these are processes and effects which are consequences of market concentration and show how market concentration is used. Respectively, what damages (losses) certain market concentrations impose on the public interest or other private interests.

Means: the methods used to achieve the market concentration status (except completion and excellence). The basic channels (methods) to achieve undue market advantage could be:

- Laws or regulations which ensure market advantage or exempt from prosecution (lobbyist legislation);
- Political corruption aimed at influencing the executive or the legislative. In certain situations, access to the judiciary could also be ensured.
- Judiciary corruption to ensure exempt from prosecution or favourable decisions of courts;
- Institutional corruption: buying officials in public institutions to ensure inaction on cases of market concentration and its consequences. The latter could be numerous, ranging from quality of goods and services and ending with violation of tax, customs and other regulations in order to increase profits.
- Corruption in the access to public resources – procurement contracts and subsidies. Important in this respect is that irrespective of the government in power, captors have privileged access;
- Influence on the design of public policies. This includes captors influence on sector policies, economic policy, government budget execution and even foreign policy decisions (lobbying for contacts with specific countries, modification of international agreements to ensure national sovereignty and partial closure of domestic markets).

The combination of corruption forms used to achieve state capture varies depending on the specific situation and governance models in a given country. Therefore, the main (starting) indicator for identifying the existence of state capture is market concentration (by sectors, markets,

etc.). The prevalence of different forms of corruption used to achieve state capture is a secondary group of indicators because they describe the specific mechanisms through which a state capture situation has been achieved or how it operates.[72] State capture is characterised with the concentration of means (forms of corruption) around a limited group of actors. In this respect research on state capture should necessarily start with the outcome indicators (market concentration). State capture is privatization of the state, or rather privatisation of certain state functions. In some countries (e.g. Russia) a reverse process has also been observed – when government agencies or institutions are used by politicians to extract undue advantages from businesses.

State capture diagnostics areas

State capture is to a large degree hidden phenomenon and is closely connected to governance mechanisms. At present it reaches top level officials in the executive, judiciary and the legislative. It is therefore difficult to directly address state capture phenomena. Rather the **initial focus should be on major outcomes of state capture in critical sectors and zones.**

The approach outlined below is incremental. Its first target would be the **mapping of the most common state capture critical zones** (procurement and market concentration). Depending on the results further research would sequentially focus on captured institutions and prevalence of state capture mechanisms/practices. An important characteristic of **initial state capture diagnostics** is that it should be **based on sectors or institutions**.

State capture risk zones

The principal risk zones for state capture that would be relatively easy to assess (based on big data analysis instruments) are procurement and market concentration.

State capture in **procurement** could be analysed by sectors and would characterise a situation when companies or group of companies:

- Concentrate (attract) predominant volume of procurement in a given market on a systematic basis;
- Companies have exceptionally high success rates in procurement tenders on a long term basis;
- Changes of government lead to substantial changes in the successful bidders in a given procurement market.

Once some elements of the above situation are identified, further research would be necessary to explore what mechanisms (means) of state capture have been deployed: political corruption, legislative corruption (favourable amendments in legislation), blocking of the activities of

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[72] Furthermore, prevalence of capture related form of corruption could show a mass phenomenon which could be randomly distributed among actors (pointing to different forms of corruption) and not concentrated at specific actors (capture).

control institutions (oversight bodies, tax and customs administration, etc.), judiciary corruption (blocking investigation, prosecution and court efforts to identify and sanction violation of laws).

State capture resulting **in illegitimate market** concentration should also be explored by sectors. State capture in this respect would include:

- Existence of sectors with monopolies and/or cartels in the long term
- Failure of government control bodies to identify and sanction illegitimate market concentration
- Deliberate government or legislative activity facilitating establishment or continuing existence of market concentration
- Failure of law enforcement to sanction/counter market concentration or use of law enforcement to undermine competition

State capture resulting in continuing **"smooth operation" of big black and grey markets** (drugs, smuggling, trafficking of people, VAT and other types of tax fraud, substantial volume of organised crime operations).

Captured public institutions or institutional areas

A captured pubic institution could exist in two principal situations:

1) **Institutions which are critical in countering different types of fraud or other types of violation of rules** that enhance various forms of state capture. In this respect critical institutions that could be targeted are related to procurement, competition, enforcement of industry and trade standards, tax administration and judiciary.

2) **Institutions with important controls or other social functions but have been "privatised" by their respective officials**. This situation is tolerated by the government as these institutions are also part of the state capture mechanism. The main indicator in this respect in the level of institutional corruption and respectively of corruption pressure associated with captured institutions. Common problematic institutions in post-communist countries are traffic police and other police departments, customs, some parts of the health care system.

Instrument that could be used in the diagnostics of this type is **MACPI**.[73] The instrument focuses on corruption pressure and corruption mechanisms at the **institutional level**. It evaluates the level of corruption risk, the prevalence of corruption risk related interactions inside the public institution and the existence of anticorruption policies. In this respect high corruption risk in combination with intensive corruption related internal transactions of officials and lack of effective anticorruption measures is the **indicator of a captured institution** (either privatised by insiders and offering corruption services or captured by outsiders to protect their interest).

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