International state capture

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State capture

Is defined as *"the actions of individuals, groups, or firms both in the public and private sectors to influence the formation of laws, regulations, decrees, and other government policies to their own advantage as a result of the illicit and non-transparent provision of private benefits to public officials."* While state capture encodes advantages for particular individuals or groups in the basic legal or regulatory framework, **administrative corruption** refers to the intentional imposition of distortions in the prescribed implementation of existing laws, rules and regulations to provide advantages to either state or non-state participants as a result of the illicit and non-transparent provision of private gains to public officials. The introduction of the concept of state capture, its analysis and measurement was based on a collaborative research project between the EBRD and The World Bank, which generated a dataset based on the Business Environment and Enterprise Performance Survey (BEEPS) - a firm level survey of more than 3,000 enterprise owners and senior managers in 22 transition countries in the Europe and Central Asia Region.

The session discussed the various forms which state capture can take and the extension of the concept to the international arena, focusing on the region of Central Europe and the former Soviet Union where the notion of state capture was originally developed. Examples were given of international state capture within the region as well as from the West. Main themes and conclusions follow.

In discussing state capture, the state and the market cannot necessarily be conceived of as separate entities. Economic and political power may be fused. In many countries, the situation is characterized by complex networks and interpenetration of business, politics, administration, police and security forces, and sometimes NGOs, which colonize the interface between ostensibly different spheres, between public and private. They can compromise or prevent the emergence of autonomous spheres of operation: the state, economy, civil society, and can also compromise autonomy and separation between different entities of the state. In some countries, criminal organizations seek to control the state or the market or both, and the same individuals revolve through all three dimensions depending on the advantage to be gained. It is important to stress also that different patterns of state capture emerge in different countries, depending on the form of political organisation, the path of transition, and the systems for the distribution of access and accountability. Taking a historical perspective, the tendency towards fusion of economic, political and social power during Soviet times has been transferred to business and political elites. These elites then stall reforms that are not in their interests and seek further to entrench their advantage.

State capture takes many forms. At one end of the range, a single individual or family may exert control over both state and economy. Other forms include the development of oligarchies with a quasi-feudal structure of dependants, or a complex range of networks with more equal and reciprocal relations. The BEEPS data focuses primarily on measurable forms of state capture in relation to firms in transitional economies. The discussion suggested the relevance of the concept to other types of relationship while also recognizing some of the difficulties in drawing precise distinctions between capture activities and apparently legitimate forms of lobbying and other types of influence.

State capture does not necessarily remain stable over time. Many instances were given of efforts to construct well-functioning states early in the transition period which were then swamped in the second half of the decade. For some countries, it is a question of whether they will progress or regress in the transition to democracy and a market economy. In Russia, capture in the first half of the transition decade was characterized by state capture of the economy, while business capture of the state became more prevalent later on. When the state intervened in the oil sector, the oligarchs moved many of their activities to Ukraine, where they exemplify international state capture. Russian firms in Ukraine are now paying vast sums in political party financing, in contravention of weakly enforced electoral laws, in order to have laws changed to their advantage.

One feature of the definition of state capture is that laws or institutions become the product of corrupt transactions, so that what counts as legality is itself a function of corruption. Thus definitions of corruption that appeal to legal standards will miss this dimension of state capture. In this situation, what counts as "illicit" influence has to be settled by an appeal to shared norms, international standards, or a model of good governance.

Into this complex mix come foreign investors from outside the region. There is considerable empirical evidence (from the BEEPS survey) that foreign investors do not necessarily bring higher standards of corporate governance, and in some cases - most often FDI with local headquarters - they may be more likely to engage in state capture than domestic firms or FDI with foreign headquarters. Evidence also indicates that foreign firms select their mode of approach and operation according to the environment, with firms that are more prepared to use dubious techniques choosing higher corruption environments. They may then seek to encode anti-competitive advantages into the legal and regulatory system with which they are dealing.

In the paths towards transition, initial stages can themselves generate forms of capture with long-lasting implications. One example suggested was the distribution of oil rights in Azerbaijan where oil concessions were awarded in the absence of an oil law and the State Oil Company operated in a situation of conflict of interests. The process went forward without transparency or open tenders. Paradoxically, the regime of Production Sharing Agreements that emerged has a clearer legal framework than the regime operating in the rest of the economy, probably generating better governance in this sector than in others.

Another example was cited of corrupt links between the government and corporate sector relating to corruptly granted government guarantees for enterprise debt, undermining the development of economic competition, which is one of the defences against state capture.

Controls

Foreign Corrupt Practices Act (FCPA), 1997: The United States' FCPA has not appeared to result in many prosecutions, but this is not necessarily the best measure of the effectiveness of a law. There is evidence that some U.S. companies take it very seriously, to the point where some refuse to do business in corrupt environments. However, the BEEPS data indicate that, overall, U.S. companies do not do better than other Western states.

OECD Convention: A representative from the OECD explained the nature of the 1999 Convention Combating Bribery of Foreign Public Officials in International Business Transactions and the monitoring mechanisms deployed by the OECD Working Group on Bribery, which essentially uses a peer review process. She stressed that many leading western countries have not yet complied fully with the legislative requirements, and none has pursued a prosecution under the law. The implementation of the Convention is still at an early stage and appears to have potential as a useful mechanism but is likely to take a long time to be effective. However, if the "supply-side" countries do not restrict corruption, they cannot credibly ask others to do so. It would be useful to update the BEEPS survey, collected in 1999, to assess the impact of the Convention.

The World Bank blacklist: The World Bank refuses to do business with or allow funds supplied by The World Bank to finance certain companies. Once corrupt or fraudulent behaviour has been established by the Bank's investigators, the company is blacklisted. Since 1999, the names of these companies have been published on a blacklist on The World Bank website.

These international initiatives cannot substitute, however, a domestic environment of good governance. Different countries will need different governance strategies depending on the features of capture. Some countries may have a weak state but a strong market, a strong state but a weak market, or both state and market may be weak. An early priority will be to start to unravel the interpenetration of state and market, protecting each from the other and developing autonomy in both. One speaker recommended starting with the weakest entity and attempting to strengthen its autonomy. Some more general points can also be made. Care needs to be taken with rules to ensure that they don't create perverse incentives, or a compliance culture that does not value integrity. Integrity can exist without rules, but not vice versa. Accountability systems must aim to support integrity, rather than an excess of rules which foster observance in the letter rather than the spirit, and demand heavy monitoring and surveillance. Highly politicised forms of accountability for public officials are also to be avoided, as they encourage patronage and clientelism.

Some reforms produce more leverage than others. A number of participants pointed to the value of Freedom of Information Acts. In Latvia, for instance, the fusion of political and economic power was said to take the form of off-shore shell companies. Publicity about ownership made possible through freedom of information could be a more powerful instrument than any other available.

Where capture has reached the point where the law and policy-making system is locked up by capture, and seems not to be amenable to legal, political or institutional reforms, one entry point may come through increasing economic competition. One speaker advocated support for the small and medium enterprise sector. Another speaker evoked the case of the roving versus stationary bandit. Roving bandits take their profit and move on, stationary bandits maximize profit by investing within their own borders. The international economy allows oligarchs and other captors to become roving bandits, exporting their gains. Relevant controls that the international community can impose include closing channels for the export of capital and money laundering, and use of financial sector and banking standards so as to lock the elite's financial resources within the country, essentially forcing it to invest in its own future.