

CORRUPTION IN RUSSIA

by

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A. Introduction

Corruption is often cited as a key factor behind Russia's economic problems. However, while it is generally agreed that Russia does suffer from a particularly high incidence of corruption, economists are far from clear as to the actual economic implications of the problem. This note discusses Russia's experience of corruption from the perspective of the substantial literature that has developed on the links between corruption and economic development, and suggests some strategies for tackling corruption in Russia. Finally the note briefly discusses the issue of transparency, which may be seen as a key means of combating corruption, and promoting good governance in general.¹

B. Scale of corruption

Russia consistently ranks poorly in international comparisons of corruption. For example, probably the most widely quoted source, the Transparency International (TI) survey, placed Russia 82nd out of 99 countries in 1999, with a score of 2.4 on a scale of 0 (highly corrupt) to 10 (highly clean). An aggregate indicator of graft compiled from numerous sources by Kaufmann et al. (1999a) places Russia 113th out of 155 countries. In a 1997 survey conducted by the Economist Intelligence Unit, the CIS emerged as markedly more corrupt than any other region of the world, with Russia (along with the other four CIS countries included in the survey) receiving the maximum rating for corruption among public officials. These surveys suffer from a number of serious technical problems – in particular, they tend to rely heavily on the subjective impressions of businessmen, especially foreign investors – and therefore should not be regarded as hard evidence of the extent of corruption within a country. Nevertheless, the general impression that corruption is very widespread in Russia is widely accepted both inside and outside the country.

The survey evidence tells us little about the type of corruption encountered. Two broad categories may be identified: “petty” corruption, whereby low-ranking officials supplement

* The views expressed in this paper are those of the author(s) and do not necessarily represent those of the IMF or IMF policy.

¹ This paper follows the conventional definition of corruption: “the exercise of public power for private gain” – although it can be argued that the concept of corruption applies also to many purely private-sector situations.

inadequate salaries with bribes, and “high-level” corruption, involving large-scale appropriation of state resources by the political and business elite. For what it is worth, anecdotal evidence of both types is common, ranging from reports of bribes required for many small-scale interactions with the state, to rumors of large kickbacks associated with privatizations and other deals with “big business.”

As to the scale of corruption in absolute monetary terms, this is very difficult to gauge. The 1999 EBRD/World Bank survey reported that Russian firms paid an average of 4.1 percent of annual revenues in bribes, somewhat less than the CIS average of 5.7 percent. In addition there are sums associated with high-level corruption which are essentially impossible to estimate. Of course, any estimates of the “transaction volume” of corruption do not translate directly to economic losses associated with corruption, since their primary effect is the redistribution of resources.

C. Causes of corruption

The prevalence of corruption in Russia is often blamed on behavioral norms inherited from the Soviet period. It is easy to find reasons why this might be so: as far as we can tell corruption was widespread – certainly the broad reach of the state provided myriad opportunities – and cynical attitudes to the government and the law were fostered by inconsistencies and arbitrariness in the law, and the failure of the government to abide by legal norms itself. However, the fact that corruption in Russia appears to have got worse since the fall of communism, while it has improved in the more advanced Central European countries, suggests that this legacy may not be decisive.² Another view looks even further back, asserting that corruption is an inherent element of Russia’s cultural heritage. These claims are challenged by Shleifer and Treisman (2000), who report cross-country regressions of the TI data showing that the level of corruption in Russia can be fully explained by four variables (per capita income, federal structure, exposure to democracy, and free trade) without requiring any special cultural ingredient. The fact that Russia suffers from a “normal” level of corruption in this sense is of only limited comfort, since the fact remains that the confluence of these factors leads to a very severe problem – but at least this result confronts a defeatist view that Russia’s corruption is somehow inherently more intractable than that of other countries.

A more practical assumption is that corruption in Russia, as in other countries, results from a combination of opportunities and incentives, however these may have arisen over time. Opportunities for abuse of power abound in areas such as Russia’s complex tax and customs systems, in capital controls and financial market regulation, in wide-ranging regulations on businesses, and in the management of state-owned assets, including their privatization. Incentives to engage in corrupt behavior include low government salaries, excessive tax rates and overly intrusive and time-consuming bureaucracy, weak legal enforcement, and the poor

² Using Business International data, TI reports corruption indices in 1980-85 of 3.6, 5.1 and 1.6 for Poland, Czechoslovakia, and Hungary respectively, compared to 5.1 for the USSR, on the same 0 to 10 scale as quoted earlier. Comparable data provided for 1996 shows improvements to 5.6, 5.4 and 4.9 for Poland, the Czech Republic and Hungary, while Russia’s score fell to 2.6.

example for standards of public conduct set by the political and business elite. Other facilitating factors include overlapping or confused mandates of the different levels of government, the prevalence of opaque noncash transactions, poor systems of accounting and auditing, a general lack of transparency in government operations, a lack of “civil society” institutions monitoring the actions of the state, and a media that may hold back from exposing corruption because it is beholden to vested interests. These factors are dealt with in more detail in the section on measures to combat corruption below.

We may also look to opportunities and incentives to try to understand why corruption appears to have worsened during the transition period. Enormous opportunity for high-level corruption arose particularly in the early years of transition, as vast sections of state property came up for grabs. On the other hand the discretionary power of the state has been reduced, particularly by the elimination of many price controls and subsidies and by the unification of the exchange rate. In terms of incentives, the picture is of a clear deterioration: the real value of official salaries has fallen, there is probably less likelihood of being caught, legal punishment is less draconian, and, importantly, it is now much easier to flaunt wealth without raising suspicions, thus making the fruits of corrupt behavior easier to enjoy.

Shleifer and Vishny (1993) discuss a further reason why corruption may have worsened during the transition. Under communism, corruption was institutionalized under the Communist Party, and strictly controlled by the party machinery. Under such a monopoly, bribes will be set at a relatively low, revenue-maximizing level, since the bribetakers want to ensure that the activity being “taxed” is not driven out of existence. However, since the collapse of communism, corruption has become a free-for-all. Without a coordinating monopoly, various officials may attempt to maximize their own take, without taking into account the effects of their actions on other bribetakers. This can lead to a “tragedy of the commons” situation, with, for any given activity, a multitude of officials each attempting to extract high bribes – such that in the extreme the activity may no longer be worth carrying out at all. Similar processes are thought to have taken place when stable, coordinated systems of corruption broke down after the ending of colonial rule in Africa.

D. Costs of corruption

There is a growing consensus among economists that corruption is detrimental to growth and development, but there is little agreement as to how serious a problem it is. Some early writings suggested corruption might actually have a positive impact on growth, mainly by allowing businesses to get around excessive government red tape and bureaucratic delay. This view fails to take endogeneities into account, however, since corruption may be both a consequence and a cause of excessive bureaucracy. One of the strongest lobbies for regulation is formed by those benefiting from the rents arising from it, and the opportunity to profit by expediting bureaucratic processes provides a powerful incentive to make sure those processes normally take as long as possible. Also, corruption does not discriminate in the regulations that it circumvents: while some may be considered excessive, avoidance of others may be highly detrimental. For example, it may increase growth (as conventionally measured) if a factory bribes inspectors to ignore its pollution, but this should not be regarded as a positive economic effect.

More recent writings have increasingly stressed the negative consequences of corruption. These may be grouped into two main classes: primary financial consequences, and secondary behavioral effects. For the former, the immediate financial impact of corruption is to redistribute resources from businesses, persons and the state to officials and the politically connected. For some forms of petty corruption, this may be relatively inconsequential, if small bribes are essentially an element of officials' remuneration, offset by lower salaries.³ In other cases, and particularly for high-level corruption, the transactions can carry very strong negative consequences for equity.

A particular area of concern regarding the distributional impact of corruption is its effect on the public finances. Here Shleifer and Vishny (1993) make a useful distinction between corruption involving theft from the government and corruption without such theft. In the latter case, a corrupt official charges a bribe for carrying out his public duty as normal; for example a customs official who demands a bribe before he will stamp the required import papers. The principal effect is a transfer from the importer to the official, although the state suffers second-round effects because the volume of imports, and therefore import duty, will drop in response to the rise in their effective price. The case of corruption with theft is more damaging, however. Here, in our example, the customs official takes a bribe in exchange for allowing the importer to bring his goods in under a more lightly-taxed category, or for no customs charge at all. Typically the bribe will be less than the saving in tax, so that the corrupt behavior is in the interest of both parties. The effect of the corruption is then a transfer from the state to both the official and the importer, at heavy fiscal cost. Because of the coincidence of interest between bribe-payer and bribe-taker, and in the absence of effective financial controls and monitoring mechanisms on the part of the state, corruption with theft seems likely to be the dominant form of corruption in Russia (and, because the bribe-payer has no interest in exposing the corruption, the hardest to tackle). While there is no way to estimate the overall effect on the budget deficit, this may be assumed to be one of the major factors undermining revenue collections and expenditure management.

What about behavioral effects? Recent studies have highlighted the links between corruption and growth. Using the Business International dataset on corruption in the early 1980s, Mauro (1995) finds a statistically significant relationship whereby a one-point improvement in corruption levels, on a 0 to 10 scale, is associated with a 0.2 percent improvement in per capita growth levels. In other words, if Russia were to reduce corruption to the levels of Poland, Hungary and the Czech Republic, annual growth might rise by about 1/4 percentage point. His regressions suggest that the effect is due to lower investment, which shows a powerful relationship to corruption, with a one-point improvement in corruption leading to a 2 percentage point increase in the ratio of investment to GDP. Very different results arise from testing a different specification: regressing the *level*, rather than growth, of income against corruption, Kaufmann et

³ Such tacit arrangements may be common. Tanzi (1998) notes that in many countries governments have no problem filling vacancies at very low salary levels in areas such as tax administration and customs, suggesting that bribes are understood to be an important element of the remuneration package.

al. (1999b) find that small improvements in corruption are associated with many-fold increases in income levels.⁴ However, it is hard to be sure of the direction of causality in these regressions and whether it is corruption, other governance indicators, or yet other variables that are responsible for the relationship. It does not seem impossible that governance, in its broadest sense, may be the ultimate determinant of economic success, but the implication that corruption alone could have such powerful an effect does appear implausible.

Corruption may reduce investment by adding to its cost and by acting as a tax on its returns, and by adding to uncertainty. High levels of corruption are likely to have been an especially important factor behind Russia's extremely low level of foreign direct investment, for several reasons: (i) the relatively large size of foreign investments, and the special regulations applying to them, are particularly conducive to rent-seeking; (ii) local companies may use corruption to shut foreign competitors out; and (iii) foreigners lack specific knowledge of how to operate in a particular corrupt environment.

As well as decreasing the volume of activity, corruption can affect its quality. Public spending may be misdirected towards activities on which it is easier to earn bribes. Big defense or public investment contracts, for example, are potentially much more lucrative than spending on pensions, education or health. Consistent with this, Tanzi and Davoodi (1997) find evidence that corruption both increases the volume of public investment and reduces its productivity. Mauro (1996) finds evidence that corruption lowers the share of government expenditure on education. It is hard to know how relevant these factors are to Russia, because of the poor quality of statistics on government expenditure. Such data as there are suggest that public investment and defense spending have both fallen sharply during the transition period, although both sectors still seem likely to represent a very significant source of opportunity for corruption. Education spending appears to have remained fairly constant as a share of total expenditure through the transition period. Private sector activity will also be distorted by corruption, since resources will be misdirected to rent-seeking instead of productive activity. Business surveys in Russia reveal that company managers spend an inordinate amount of time dealing with bureaucrats.

One particularly damaging aspect of corruption in a transition economy setting is that it is one of the factors standing in the way of much-needed industrial restructuring. As well as being able to bribe officials to protect them directly from competition, incumbent firms appear to receive privileged rates in graft: the 1999 EBRD/World Bank survey found that significantly higher bribes (as a percentage of revenues) were demanded of new entrants than of existing firms.⁵ There are also a number of links between corruption and Russia's nonpayments problem, particularly because conducting transactions between firms and the government in money substitutes adds to officials' discretionary power, and because the lack of transparency associated with noncash transactions provides cover for bribery. Another potential cost of corruption is

⁴ Specifically, a one-standard deviation improvement in corruption is reported to cause a increase in income per capita of over 2½ times.

⁵ EBRD (1999)

waning external support for Russia as the scale of the problem becomes clear to foreign governments and electorates.

Different types of corruption can have different economic effects. The kind of coordinated corruption prevalent in Russia under communism may have been comparatively innocuous in its economic impact (indeed, with the rents accruing to the Communist Party, there may have been little difference between bribes and taxes). Such corruption does not engender uncertainty, and may even reduce it: once the appropriate bribe is paid, the briber can confidently go about his business. This may help explain why some countries have managed to grow strongly despite apparently high levels of corruption. On the other hand, uncoordinated corruption, as may be more prevalent in Russia now, introduces massive uncertainty: even after a bribe is paid to one official it is not clear that another bribe will not be required by another official (or even to the same one), or that the proceeds from the activity in question will not be appropriated in turn. This will obviously have serious effects on decisions such as business start-ups and investment.

But while we can catalogue the possible channels by which corruption could wreak economic damage, it is almost impossible to judge how detrimental it really is to the economy. There is very considerable uncertainty surrounding econometric estimates of the consequences of Russian corruption. Anecdotal evidence from Western businessmen scarred by Russian corruption might lead one to think it has been one of the main reasons for continued output decline in Russia. On the other hand many observers dismiss concern about Russian corruption as an overblown fad. Perhaps the situation is best summarized as follows: corruption is one element of Russia's general problems of poor governance and weak legal enforcement, which together make up a major factor in the country's economic malaise. Within this, corruption clearly has a particular relevance to Russia's fiscal difficulties, because of the associated leakage of public resources. But identifying the exact contribution of corruption may be of secondary importance, since the strategy for tackling corruption, to which we now turn, largely involves measures that are part of the broader governance agenda.

E. Tackling corruption

Any meaningful attempt to curb corruption has to start from the opportunities and incentives that give rise to corrupt behavior. Here we discuss briefly a range of measures in this regard; however it is important to note that none will have much effect in isolation – a coordinated effort across a broad front is required.

A class of measures center around reducing opportunities for corruption by eliminating discretionary elements of government policy. Corruption is one of many reasons why tax reform is an urgent priority. The complexity of the tax system, with many taxes applying to any activity, multiple tax rates and many exemptions, provides extremely fertile ground for corruption. High effective rates of tax also give companies and individuals every incentive to seek side deals with tax officials. Probably more important than the statutory system is the failure to enforce taxes: the discretion of tax inspectors to negotiate individual deals with taxpayers needs to be removed by insisting on full cash payment of taxes at all levels of government. This requires political will to take effective sanctions such as bankruptcy and asset seizure against tax delinquents.

There are some areas where official discretion has been reduced, including unifying the exchange rate, removing price controls, eliminating subsidies and directed credits, and liberalizing the trade regime. Nevertheless there is still much to do in these areas. Russia's system of capital controls invites abuse – and as well as anecdotal evidence of corruption, the fact that the capital controls are highly ineffective in preventing the exodus of capital suggests they are administered corruptly. The customs administration also remains particularly susceptible to corruption. As well as eliminating exemptions, differentials in tariff rates should be eliminated in order to prevent such blatant opportunities for profit as, for example, arise at present from classifying frozen chicken imports as turkey.⁶ The process of replacing quantitative restrictions, which make large rents available to particular traders, by tariffs, should be accelerated.

Another important area of discretion is in government regulation and licensing of economic activity. The average new business applicant must deal with 20-30 registration and licensing agencies.⁷ Simply cataloguing all the regulations applying to business would be useful in helping expose which regulations are economically justifiable and which exist mainly to extort rents. It should be noted in this regard that any theoretical economic justification for state intervention in an activity needs to be weighed up against the practical difficulty in implementing it; all too often the corruption associated with a particular regulation not only damages the business environment directly but renders the regulation ineffective in achieving its objective anyway. The regulation of the financial sector and the infrastructure monopolies is particularly vulnerable to high-level corruption because of the large sums of money available in these sectors. Better bank supervision is doubly important because a corrupt banking sector also provides a channel for the proceeds of corruption elsewhere. Competition is a powerful deterrent to corruption, and strong measures are needed to encourage new entry of firms and to impose hard budget constraints on incumbent enterprises.⁸

Improving control and monitoring of the public finances is a crucial element of an anti-corruption strategy. Russia has made strides in this direction in the expansion of Treasury control, but much more needs to be done, including extending Treasury control to the entire defense ministry and to subnational government. Most extrabudgetary and earmarked funds should be abolished or brought onto the budget, or at the very least subjected to Treasury control. The Road Funds in particular, which receive around 8 percent of total consolidated government

⁶ Gatti (1999) finds a statistically significant relationship between tariff diversification and corruption, and suggests that in the presence of corruption a uniform tariff can result in higher revenues and social welfare than a differentiated tariff menu.

⁷ Broadman (1999). Russia ranks 117th out of 166 countries in the aggregate indicator of the severity of the regulatory burden constructed by Kaufmann et al. (1999a).

⁸ Using data for the set of transition countries, Broadman and Recanatini (2000) find strong correlation between corruption and lack of competition, and point to a range of measures to strengthen competitive forces in the economy. Similar correlations are found for other areas of institutional development, including economic liberalization, regulatory reform, corporate governance, and trade reform.

revenues under conditions of extremely weak financial control, are an open invitation to gross abuse, particularly at the regional level. Use of off-budget accounts should be strictly controlled. Another area of potential misuse of public resources is the Presidential administration, which controls vast assets both in Russia and abroad, again apparently with little financial oversight. A very important weapon against corruption is improved accounting and auditing standards and practices, based on international standards. Improved public procurement legislation and procedures is another priority.

Tackling high-level corruption is particularly problematic, because of the political and financial power of the interests involved. Ultimately the government will only win back the trust of the population by demonstrating that corrupt behavior will not be tolerated in senior levels of government – a slow process. But there are a number of measures to be taken in the short term. Decisions on privatizations and major public works contracts should be made on the basis of open competitive bidding, including foreign bidders. Measures to strengthen the judiciary and make it more independent are needed to provide a proper check on abuse of executive power. Similarly for the development of a free press that is not beholden to, or intimidated by, political and financial interests. Transparency needs to be improved both in terms of publishing and justifying government decisions, and by introducing stronger checks on the finances of senior members of the government and legislature. The current disclosure rules appear to be effortless to circumvent, and the extent of criminal immunity granted to members of parliament is a particularly troubling aspect of Russian governance.

Measures to strengthen the rule of law in general will play an important role in tackling corruption at all levels. One measure of particular relevance in this regard is for legislation to specify adequately the details of how it is to be implemented; at present much legislation is of a very general nature, allowing implementing agencies very considerable discretion in the application of the law.

Raising civil servants' wages is one element of the strategy to reduce incentives to engage in corrupt behavior. Increases in pay should make government employees more worried about losing their jobs and would also reduce the social acceptability of taking bribes (currently petty corruption is often viewed as fair enough, given inadequate wages). However, there is a tradeoff between the reduction in corruption and the fiscal costs of higher salaries, and indeed it does not seem likely that salary increases would translate one to one to the reduction in leakage of public funds.⁹ This measure should be considered as part of a general civil service reform effort, which, crucially, involves cuts in staff numbers at the same time as rises in salaries. As well as ensuring that officials enjoy adequate salary levels, it is important to clarify who their paymaster is. All too often federal employees located in the regions (for example, tax and anti-monopoly ministry

⁹ In cross-country regressions, Van Rijckenghem and Weder (1997) find that increased relative civil service pay, from parity with manufacturing pay to twice the level of manufacturing pay, is associated with one point lower corruption on a 6 point scale.

employees, or the judiciary) receive important elements of their remuneration from the regional authorities, creating potential conflicts of interest.¹⁰

Finally, there are measures to address corruption that involve other countries as well as Russia itself. These include trading partner countries making it illegal for their companies to pay bribes abroad, and full cooperation on the part of the Russian authorities in any cases of corruption involving Russian companies or individuals that are brought in foreign courts.

F. Transparency in Government

Improving transparency has become increasingly recognized as a vital element of the governance agenda. This has been especially the case since the Asian crisis, to which a lack of transparency in financial policies was widely believed to have contributed. The rationale for increased transparency is that better information on economic policies and conditions should help private sector agents make the right economic decisions, and that exposing the actions of the state to scrutiny should both reduce opportunities and incentives for abuse of power, and, by improving information flows and expanding dialogue, lead to better policy formulation and implementation. Russia has been widely criticized for lack of transparency in government actions.

The work of the IMF in promoting transparency has focused on its core areas of expertise: fiscal policy, monetary and financial policies, and data dissemination. In this work the Fund recognizes that disclosure is not synonymous with transparency: for the release of information to be helpful, there needs to be confidence in the integrity and underlying quality of the information being released. The Fund has therefore developed codes of best practice for both the preparation and dissemination of information relating to economic policies and outcomes. It assists member countries in producing Reports on Observance of Standards and Codes (ROSCs) which assess performance against these codes of best practice. ROSCs in all three areas are currently under way in Russia. These will provide important information to help identify areas in which transparency falls short, and recommendations for achieving improvements.

Even before information becomes available from the ROSC work, it is clear that there are a number of particular issues of concern regarding transparency in Russia. Perhaps chief among these is the prevalence of offsets and noncash transactions, which severely distort economic and financial signals and statistics. In the fiscal area information is lacking on the activities of subnational governments, off-budgetary financing and extrabudgetary funds. Relations between federal and subnational governments tend to lack transparency, as do relations between all levels of government and the energy sector. The slow progress of bank restructuring since the 1998 financial crisis points to a failure to apply clear rules-based policies in banking supervision and regulation. A number of further transparency measures have been mentioned in earlier sections of this paper, including better disclosure of regulatory policies, clarification of how legislation

¹⁰ This is usually in the form of in-kind benefits such as provision of housing, rather than direct wage payments.

should be implemented, adoption of international accounting and auditing standards, more transparent procedures for public procurement and privatizations, and stronger financial disclosure rules for officials and elected representatives.

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