Corruption In The Baltic State Region

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ABSTRACT

The corruption studied here includes illegal, immoral, or dishonest acts that undermine economic and government activities. This gray area of economic activity is often referred to as the "underground economy," and the number of individuals and the amounts of money involved can only be ascertained by educated guesses. Corruption is used to mean a state of progressive putrefaction; on a large scale corruption curtails a country's ability to grow efficiently and effectively. The European Bank for Reconstruction and Development (EBRD) and the World Bank have developed a methodology to study transition economies. Through one-on-one interviews the Business Environment and Enterprise Performance Survey (BEEPS II 2002) gathered information from business owners and managers on a variety of topics in 23 transition economies. This paper uses the BEEPS data to examine the perceptions of corruption in Estonia, Latvia, Lithuania, and Poland.

INTRODUCTION

Political corruption is the use of official powers by elected or appointed government officials for unlawful private gain. In some nations, political corruption is so common that unofficial payments are expected when ordinary businesses or citizens interact with government officials for services such as telephone, electricity and water. In some cultures the salaries of public officials are meager and political corruption is considered the normal way to supplement government salaries. Supporting corruption around the world are inconsistent norms; certain practices that are legal in one country may be illegal in another country. In some countries, government officials have broad or poorly defined powers, and distinguishing between activities that are legal and not legal can be difficult. Prior to 1996 the World Bank considered bribery to be an important component in the functioning of business and government. In 1996, James Wolfensohn, the president of the World Bank, declared that bribery was sand in the wheels of commerce and not the grease that made the wheels turn (Wolfensohn, 1996).

In 2006, one single political corruption activity, bribery for government contracts, was estimated to cost about $400 billion (Transparency International, 2006). According to Nichols (2000), the payment of bribes hurts businesses in four ways: risk of reputation in the country where it pays bribes, reputation among bureaucrats as a bribe payer, risk of reputation in the company's home country, and the degradation of markets. When a business pays a bribe, it siphons off profits that could have gone to the business and shareholders, and gives company profits to government official(s) instead of shareholders. In turn, the payment of the bribe lowers the profit margin for the company in that country, and therefore lessens the incentive of the company to invest in the "bribed" country.

The World Bank believes corruption is a large barrier to economic and social development because it undermines rule of law and weakens institutional foundations that support economic development (World Bank, 2009). Corruption exists in every country of the world; however, the emergence of new democracies in the former communist countries of the Soviet Union and Eastern Europe have provided an interesting opportunity to study the extent of political corruption in the former communist countries. The relatively rapid change from centrally planned economies to market-based economies during the 1990's created marked changes. A grey-market expanded to fill the ill-defined relationships in the new market-based economies.

The Baltic States have made more progress toward democracy and a market economy than many of the other former communist countries (Fuxman, 1997, Moses 2000, Dabla-Norris 2006). Many former communist enterprises have stayed afloat by not paying taxes, debts, or employees, through bartering, or paying off debt with obligation notes (Moses, 2000). Kaser (2000) has estimated the loss to corruption (particularly underreported revenue and uncollected tax liability) to be half of the economic activity in the CIS states.

If one is concerned with the capture of the state by business then one only need to look at the findings by Libman (2006) that found a negative relationship between the relative bargaining power of business and the progress of economic reforms. Bunce (1998), Goble (1999), and Moses (2000) conclude that economic reform in the former communist countries has only worked when economic reform has been simultaneously introduced with democratic reform aimed at creating a sense of community, a sense of trust, and is based on a real rule of law. Karatnycky (2002) found civic empowerment to be more significant in determining the successful outcome of the new CIS democracies than whether or not a society suffered a violent revolution.

The purpose of this study is to examine World Bank data about corruption and the "grey" economy in the Baltic States and Poland. The study results can be used by non-governmental organizations (NGO), government, and regulatory officials as a basis for making policy decisions.

THE BEEPS DATA BASE

The European Bank for Reconstruction and Development (EBRD) and the World Bank (WB) have developed a methodology for studying the performance of transition economies such as the new EU entrants. The Business Environment and Enterprise Performance Survey (BEEPS II 2002) was developed to capture a wide variety of data from firms in countries undergoing political and economic transition. Data was collected on numerous aspects of business performance including sources of financing, corruption and business relationships with government. This paper focuses on a subset of the BEEPS II data which includes: material from the major category Corruption and State Capture. Subcategories chosen from the data set were Public Procurement Kickbacks, State Capture, Tax Compliance, and Unofficial Payments.

For a more detailed explanation of the BEEPS data base please visit the World Bank Institute at www.wbi.org.

RESULTS

One-Way Analysis of Variance (ANOVA) was used to test for differences between countries on questions from the BEEPS database related to corruption and the business environment. Post-hoc tests used the Student-Newman-Keuls method for determining statistical differences between country averages. All of the reported results are statistically significant at the five percent or lower level of significance.

To correctly interpret the results in the tables below, when a statistical difference does not exist between two or more countries, the countries are found in the same column. When a statistical difference exists between two or more countries, the countries are found in a different column(s).

Corruption And State Capture - Public Procurement Kickbacks

No significant differences exist between the countries on the percent of a government contract that is paid to secure the contract (Table 1). Sixty-nine percent of respondents said no (zero percent) part of the contract was paid in unofficial payments/gifts to secure a contract. On average, one to two percent of the contract is typically paid in additional or unofficial payments/gifts to secure the contract.

Estonian firms are less likely than firms in Poland to know in advance about how much the "additional payment/gift" is to officials. Estonian firms responded on average "Seldom" while responses from firms in Poland were between "Seldom" and "Sometimes."

Firms in Estonia on average pay less (under .4%) of their total annual sales in unofficial payments/gifts to public officials. Firms in Latvia (.9%) and Poland (1.2%) pay more on average than firms in Estonia.

Table 1: Public Procurement Kickbacks

When firms in your industry do business with the government, what percent of the contract value would typically be paid in additional or unofficial payments/gifts to secure the contract?	Estonia (1.0), Lithuania (1.0), Latvia (1.3), Poland (2.2)	
Firms in my line of business usually know in advance about how much this "additional payment/gift" is to officials (2 = Seldom, 3 = Sometimes)	Estonia (2.0)	Poland (2.5)
On average, what percent of total annual sales do firm's like yours typically pay in unofficial payments/gifts to public officials?	Estonia (.4%)	Latvia (.9%), Poland (1.2%)

Corruption And State Capture - Frequency Of Unofficial Payments

Firms in Lithuania make payments/gifts to obtain business licenses and permits less often than firms in Latvia and Estonia (Table 2). Firms in Lithuania on average make these payments less than halfway between "Never" and "Seldom" while firms in Latvia and Estonia make these payments on average closer to "Seldom."

When asked about how often they make payments/gifts to obtain government contracts, firms in Lithuania, Poland, and Latvia make these payments less often than firms in Estonia. Lithuanian firms make these payments halfway between "Never" and "Seldom" while firms in Poland and Latvia are much closer to "Seldom." Firms in Estonia make these payments between "Seldom" and "Sometimes."

Firms in Lithuania, Poland, and Estonia make payments/gifts to deal with fire and building inspections less often than firms in Latvia. Latvian firms make these payments "Seldom" while firms in Lithuania, Poland, and Estonia make these payments between "Never" and "Seldom."

Estonian firms make payments/gifts to deal with taxes and tax collection less frequently than firms in Latvia. Estonian firms on average make these payments closer to "Never" than "Seldom," while Latvian firms on average make payments halfway between "Never" and "Seldom."

Estonian, Lithuanian, and Polish firms make payments/gifts to deal with courts less frequently than Latvian firms. Estonian, Lithuanian, and Polish firms make payments closer to "Never" than "Seldom," while firms in Latvia make payments halfway between "Never" and "Seldom."

Firms in Lithuania on average make payments/gifts to influence the content of new legislation, rules, decrees, etc. less often than firms in Estonia. Lithuanian firms make payments closer to "Never" than "Seldom," while firms in Estonia make payments halfway between "Never" and "Seldom."

Table 2[1:] Frequency of Unofficial Payments

Thinking now of unofficial payments/gifts that a firm like yours would make in a given year, how often would they make payments/gifts to obtain business licenses and permits?	Lithuania (1.4)	Latvia (1.8), Estonia (1.9)
Thinking now of unofficial payments/gifts that a firm like yours would make in a given year, how often would they make payments/gifts to obtain government contracts?	Lithuania (1.6), Poland (1.9), Latvia (1.9)	Estonia (2.3)
Thinking now of unofficial payments/gifts that a firm like yours would make in a given year, how often would they make payments/gifts to deal with fire and building inspections?	Lithuania (1.6), Poland (1.7), Estonia (1.7)	Latvia (2.0)
Thinking now of unofficial payments/gifts that a firm like yours would make in a given year, how often would they make payments/gifts to deal with taxes and tax collection?	Estonia (1.3)	Latvia (1.6)
Thinking now of unofficial payments/gifts that a firm like yours would make in a given year, how often would they make payments/gifts to deal with courts?	Estonia (1.3), Lithuania (1.3), Poland (1.3)	Latvia (1.5)
Thinking now of unofficial payments/gifts that a firm like yours would make in a given year, how often would they make payments/gifts to influence the content of new legislation, rules, decrees, etc.?	Lithuania (1.2)	Estonia (1.5)

[1]1=Never, 2=Seldom, 3=Sometimes

Corruption And State Capture - Tax Compliance

Firms in Lithuania on average report a lower percentage of their total annual sales for tax purposes, than firms in Poland and Estonia (Table 3). Lithuanian firms on average report 85% of their total annual sales, while firms in Poland (90%) and Estonia (93%) report a larger percentage of their total annual sales.

Table 3: Tax Compliance

Recognizing the difficulties that many firms face in fully complying with taxes and regulations, what percentage of total annual sales would you estimate the typical firm in your area of business reports for tax purposes?	Lithuania (85%)	Poland (90%), Estonia (93%)

Corruption And State Capture—State Capture

Polish, Estonian, and Lithuanian firms perceive that private payments/gifts or other benefits to Parliamentarians to affect their votes has less impact on their business than firms in Latvia (Table 4). On average, Latvian firms were closer to a minor impact on their business while firms in the other countries were, on average, about halfway between no impact and minor impact.

Polish, Estonian, and Lithuanian firms perceive that private payments/gifts or other benefits to Government officials to affect the content of government decrees has less impact on their business than firms in Latvia. On average, firms in Poland, Estonia, and Lithuania feel the impact is halfway between no impact and minor impact, while firms in Latvia are closer to feeling the impact is minor.

Estonian and Polish firms on average, felt the impact of private payments/gifts or other benefits to judges to affect the content of criminal court cases was just less than halfway between no impact and minor impact. Lithuanian firms felt more impact than Estonian and Polish firms. Latvian firms felt the most impact on their business, closer to a minor impact than no impact.

Estonian firms feel the least impact on their business from private payments/gifts or other benefits to judges to affect the content of commercial cases. Lithuanian firms feel more impact than Estonian firms on their business, and Latvian firms felt the most impact on their business from payments to affect commercial cases, closer to minor impact than no impact.

Lithuanian, Polish, and Estonian firms perceive the least impact from private payments/gifts or other benefits to central bank officials to affect the content of central bank policies and decisions at about halfway between no impact and a minor impact. Latvian firms perceive a larger impact on their business from payment to affect the content of government decrees.

Estonian, Polish, and Lithuanian firms on average felt the impact of private payments/gifts or other benefits to political parties to affect the decisions of elected officials was halfway between no impact and minor impact. Latvian firms felt more impact than Lithuanian, Estonian, and Polish firms. Latvian firms felt the most impact on their business, closer to a minor impact than no impact.

Table 4[2]: Extent to Which the Unofficial Payments/Gifts Had a Direct Impact on Your Business

Private payments/gifts to Parliamentarians to affect their votes	Poland (14), Estonia (14), Lithuania (17)	Latvia (22)	
To Government officials to affect the content of government decrees	Poland (15), Estonia (16), Lithuania (17)	Latvia (24)	
To judges to affect the decisions of criminal court cases	Estonia (13), Poland (13)	Lithuania (17)	Latvia (21)
To judges to affect the decisions in commercial cases	Estonia (14)	Lithuania (18)	Latvia (22)
To central bank officials to affect central bank policies and decisions	Lithuania (13), Poland (13), Estonia (13)	Latvia (17)	
Illegal contributions to political parties and/or election campaigns to affect the decision of elected officials	Estonia (17), Poland (17), Lithuania (13)	Latvia (24)	

[2] 0 = No impact, 30 = Minor impact, 50 = Moderate impact, 70 = Major impact, 90 = Decisive impact

Perceptions Of The Business Environment

Polish firms are more likely to pay for protection payments (e.g., to organized crime to prevent violence or property damage) than firms in Latvia, Lithuania, and Estonia (Table 5). About half of Polish firms report making protection payments, while very few firms in Latvia, Lithuania, and Estonia make protection payments. Losses due to theft, robbery, vandalism, or arson are significantly lower in Estonia than in Latvia, Lithuania, and Poland.

Table 5: Estimated Cost of Protection and Estimated Losses

Do firms in your line of business pay for protection payments (e.g., to organized crime to prevent violence or property damage)? (1 = Yes, 2 = No)	Poland (1.6)	Latvia (2.0), Lithuania (2.0), Estonia (2.0)
What were your estimated losses as a percent of your total sales over the last 12 months as a result of theft, robbery, vandalism, or arson against your firm over the last over the last 12 months?	Estonia (.5)	Latvia (2.7), Lithuania (2.8), Poland (3.0)

Lithuanian firms believe they have fewer obstacles in accessing financing than Latvian or Estonian firms who consider the access to financing to be a minor obstacle (Table 6). Polish firms have the most difficult time with access to financing, labeling their difficulty as a moderate obstacle. The cost of financing is a minor obstacle to firms in Lithuania, Latvia, and Estonia. However, Polish firms find the cost of financing to be a moderate obstacle.

Acquiring electricity to run a business is not much of an obstacle in Latvia but is about halfway between no obstacle and a minor obstacle for Polish firms. Obtaining transportation for business is not much of problem in Lithuania, while firms in Poland and Estonia find transportation a bit more of an obstacle for their businesses.

Access to land is less of an obstacle in Estonia, Latvia, and Poland, than in Lithuania, where businesses feel that there is a minor obstacle in assess to land. The titling of land in Latvia and Estonia is midway between being no obstacle and a minor obstacle. Polish firms find it almost a minor obstacle to title land.

Tax rates in Estonia are a minor obstacle to conducting and growing a business. Latvian firms find tax rates to be almost a minor obstacle. Lithuanian firms find tax rates to be a moderate obstacle and Polish businesses find tax rates to be about midway between a moderate and a major obstacle for the operation and growth of a business. The administration of taxes is a minor obstacle in Estonia. Lithuanian businesses find tax administration to be halfway between a minor and moderate obstacle to running and growing a business. Latvian and Polish businesses find tax administration to be moderate obstacle to their firms.

Customs and trade regulations are midway between no obstacle and a minor obstacle in Estonia and Lithuania. Latvian businesses find customs and trade regulations to be a minor obstacle to running and growing their businesses. Polish businesses find customs and trade regulation to be almost halfway between a minor and moderate business obstacle.

Labor regulations are a minor obstacle to firms in Estonia, Lithuania, and Latvia. Polish firms find trade regulations to me more of an obstacle than the Baltic state firms.

The skills and education of workers are a moderate obstacle in Estonia. Latvian and Lithuanian firms find the skills and education of workers to be a minor obstacle. Lithuanian firms have the least difficulty with the skills and education of available workers.

Inflation and the exchange rates are a minor obstacle to Estonian firms. Lithuanian firms face a greater obstacle than Estonian firms with regards to macroeconomic instability. Polish firms face the greatest difficulty with inflation and exchanges rates than the other countries.

Polish businesses face the greatest difficulty with the functioning of the judiciary at midway between a minor and a moderate obstacle. Lithuanian firms face less difficulty than the Polish firms. Latvian firms face the lowest obstacle with their judiciary and Estonian firms are between Latvian and Lithuanian firms.

Estonian businesses feel corruption is better than halfway between being no obstacle and a minor obstacle. Latvian and Lithuanian firms feel corruption is a minor obstacle to operating and growing their businesses. Polish firms believe that corruption is midway between being a minor to a moderate obstacle to their business.

Street crime, theft, and disorder is less than a minor obstacle to Latvian firms. Lithuanian firms find street crime, theft, and disorder to be a minor obstacle to their business. Polish firms find street crime to be between a minor and a moderate obstacle to their firms. Organized crime is less than a minor obstacle for businesses in Latvia, Estonia, and Lithuania. However, Polish firms believe that organized crime is a minor obstacle to their businesses.

Polish firms find the anti-competitive practices of other competitors to be almost a moderate obstacle to their business. Estonian firms feel that anti-competitive practices of competitors to be halfway between being a minor and moderate obstacle. Lithuanian firms believe the anti-competitive practices of their competitors to be a minor difficulty. Latvian firms find competitors anti-competitive practices to be less than a minor obstacle.

Contract violations by customers and suppliers is a minor obstacle for the operation and growth of Latvian firms. Polish businesses find contract violations to be midway between being a minor and a moderate obstacle to their businesses.

Table 6[3]: How problematic are the following for the operation and growth of your business?

Access to financing (e.g., collateral required or financing not available from banks)	Lithuania (1.6)	Latvia (1.9), Estonia (1.9)	Poland (2.7)	
Cost of financing (e.g., interest rates and charges)	Lithuania (2.0), Latvia (2.0), Estonia (2.0)	Poland (3.2)		
Electricity	Latvia (1.3)	Estonia (1.6)		
Transportation	Lithuania (1.3)	Poland (1.5), Estonia (1.6)		
Access to land	Estonia (1.4), Latvia (1.4), Poland (1.6)	Lithuania (1.8)		
Title or leasing of land	Latvia (1.5), Estonia (1.6)	Poland (1.8)		
Tax rates	Estonia (2.3)	Latvia (2.8)	Lithuania (3.1)	Poland (3.4)
Tax administration	Estonia (1.8)	Lithuania (2.5)	Latvia (2.8), Poland (3.0)	
Customs and trade regulations	Estonia (1.6), Lithuania (1.7)	Latvia (2.1)	Poland (2.4)	
Labour regulations	Estonia (1.8), Lithuania (1.9), Latvia (1.9)	Poland (2.6)		
Skills and education of available workers	Lithuania (1.8)	Latvia (2.1), Poland (2.1)	Estonia (2.8)	
Macroeconomic instability (inflation, exchange rate)	Estonia (2.2)	Lithuania (2.5)	Poland (3.2)	
Functioning of the judiciary	Latvia (1.6)	Estonia (1.9)	Lithuania (2.2)	Poland (2.5)
Corruption	Estonia (1.7)	Latvia (1.9), Lithuania (2.2)	Poland (2.5)	
Street crime, theft, and disorder	Latvia (1.8)	Lithuania (2.1)	Poland (2.4)	
Organized crime/Mafia	Latvia (1.4), Estonia (1.5)	Lithuania (1.7)	Poland (2.1)	
Anti-competitive practices of other competitors	Latvia (1.8)	Lithuania (2.1)	Estonia (2.5)	Poland (2.8)
Contract violations by customers and suppliers	Latvia (2.2)	Poland (2.5)		

[3] 1 = No obstacle, 2 = Minor obstacle, 3 = Moderate obstacle, 4 = Major obstacle

CONCLUSIONS

While corruption exists in every culture, the impact of political corruption in the Baltic State region is relatively minor but uneven. More than two thirds of respondents indicated no unofficial payments were made. Of the remaining one third between three and four percent of business' annual sales are paid to government officials. Latvian businesses pay more frequently and perceive a larger impact on their business from unofficial payments to government officials than businesses in the other countries. Compared to the other countries Lithuanian firms report the lowest percent of actual sales for tax purposes. Latvian, Lithuanian, and Estonian firms are more likely to make "protection" payments. Polish businesses face the toughest business environment. Of the 18 questions that queried the magnitude of impediments for the operation and growth of a business, Polish firms faced greater obstacles in 14 areas than the other countries. The implications for the maintenance and growth of domestic businesses, international trade, and foreign direct investment are not equally as positive in all four of these countries.

AUTHOR INFORMATION

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