

Corruption in Georgia: Survey Evidence

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EXECUTIVE SUMMARY

In 1997, the President of the World Bank offered to support member countries in the battle against corruption. Georgia was among the first countries to accept this offer. This report presents the main findings of three diagnostic surveys on corruption, targeted at households, enterprises, and public officials.

The information provided by the surveys *contribute* to our understanding of corruption in Georgia, but the survey evidence in isolation is not definitive – it should be considered in conjunction with other views provided by analysis of the incentives and opportunities generated by the governance framework, by qualitative assessments and the opinions offered by civil society, and by the practical views of implementing organizations. As this report is based on survey evidence, it focuses primarily on lower-level corruption in the public sector, and outlines the key features and findings which can inform policy actions and reforms to be undertaken by the state in conjunction with civil society.

The preliminary survey findings were released in June 1998 at a Workshop on Improving Public Sector Performance and Combating Corruption, and thereafter consolidated into a brief Briefing Note jointly drafted and published by the Government and the World Bank. This report contains more details from the survey findings.

How bad is corruption in Georgia?

- 57 percent of households, and 44 percent of enterprises, felt that corruption was worse relative to 4 years ago.
- More than half the surveyed officials reported that bribery often or frequently occurs. Bribes enterprises must pay amount to 9 percent of turnover. 3 percent of household income go toward bribes. 87 percent of households report that corruption is an essential or useful part of doing business.

Which organizations get the worst ratings?

- *The traffic police, the customs service, the police, energy companies, and the tax authorities* generally receive the worst ratings from surveyed households, enterprises, and public officials. These five organizations receive the worst scores in terms of honesty and integrity, and are all important recipients of the total bribe flows from both enterprises and households.
- *Tax inspection* was selected as the most corrupt government function by public officials.
- *Health-related services* are also among the largest recipients of bribe flows from households, although they do not rank badly in terms of honesty and integrity.
- *Local courts, the police, and local prosecutors* are all believed by households to be among the five organizations that demand bribes most frequently, over half the time.
- *Bribes are required in 7 out of 10 contacts with the traffic police*, according to households with contact.

What are the causes of corruption?

- *The existence of large rents¹ to be extracted and divided among the parties to corrupt activities:* Corruption is related to the presence of regulations that allow opportunities for it. The high corruption levels reported in customs, tax inspection, and other inspection agencies suggests that the rents from taxes and regulations are important for describing the level of corruption in Georgia.
- *Public officials' discretion in their activities:* This discretion to make decisions, while necessary to a degree for the efficient execution of their duties, affords them the ability to profit from their positions. For Georgia, there is mixed evidence on the contribution of discretion to the problems of corruption.
- *A low degree of accountability,* which limits the probability that a corrupt official's illegal actions will be detected and prosecuted. Public officials reported that low civil service salaries, low security of tenure, a lack of meritocracy in the civil service, and poor examples from leaders were important causes of corruption. Each of these problems suggest that *civil servants may be working in an environment in which the costs – and the probability – of getting caught are small: 64 percent of public officials reported that bribes are usually shared with supervisors or colleagues.*

Corruption: key dimensions relating to enterprises

- The costs of corruption to enterprises are large, and the costs of corruption far exceed the benefits.

¹ “Rent” refers to the net benefit to some activity. These rents are the payoffs to corruption.

- Corruption disproportionately affects small enterprises.
- Firms in the manufacturing sector are less likely to have paid bribes than firms in trade or services.
- Education and gender of the senior manager are highly correlated with the propensity to pay bribes: those with a university education are less likely to bribe, and women are less likely to bribe.
- The cost of hiring security personnel (on average 4 to 10 percent of turnover) can be considered, in part, a measure of the costs imposed on enterprises by the failure of the legal/judicial sector.

Corruption: key dimensions relating to households

- Among the households that bribed, roughly 2.8 percent of household income goes for the payment of bribes.
- Households with higher income are more likely to have paid bribes.
- Poorer households seem to pay a larger fraction of their income in bribes than richer households.
- Rural households are more likely to have paid bribes than urban households – on average 39.8 percent of rural households paid bribes, while only 18.5 percent of urban households paid bribes.
- Men reported paying bribes more frequently than women: overall, 38.4 percent of male respondents admitted paying bribes, while only 19.8 percent of women made such an admission.
- Bribes are required in 7 out of 10 contacts with the road police, according to households with contact.

Corruption: key dimensions relating to the civil service

- *The organizations in which positions are bought most frequently are the organizations which have the largest expected yearly bribe payments.* Estimates of the percentage of officials who pay to acquire their positions run as high as 45 percent for customs inspectors.
- *Sharing bribes is common.* When middle-level bureaucrats extract bribes, 64 percent share the bribes with colleagues or supervisors. This is a worrying signal of entrenchment of corruption within the public sector. It is also a cause for concern about the effectiveness of an anti-corruption campaign.
- *The level of entrenchment of corruption is high.* When a domestic enterprise pays a bribe, 50 percent of the time both sides know in advance what needs to be done, and 18 percent of the time “there is no other way to accomplish what needs to be done.” There is also a high degree of certainty about the amounts of the bribes, and about how closely linked bribes are with outcomes (i.e., once the bribe is paid, how certain can the briber be of getting what is wanted).

This report may serve as a starting point for discussion involving the three branches of the state, civil society, and development partners, on a medium-term institutional reform agenda for Georgia, aimed at combating corruption and improving the performance of the public sector.

1. OVERVIEW

1. In 1997, the President of the World Bank offered to support member countries in the battle against corruption. Georgia was among the first countries to accept this offer. A key element of the World Bank's approach to corruption is to help countries to unbundle "corruption", a vague and menacing-sounding term for abuse of public office, into its constituent parts; to isolate the underlying causes, illuminate the agencies and organizations most affected, and to evaluate corruption in the context of public sector institutional reform. Toward these ends, a system of diagnostic surveys focusing on corruption in the public sector was developed and implemented in mid-1998. Three surveys, targeted at households, enterprises, and public officials, sought to add specificity to the policy dialogue, to provide the hard numbers to confirm or refute popular conceptions about corruption in Georgia, and to provide a baseline against which to measure future progress in the battle against corruption.

2. This report presents the main findings of Georgia's diagnostic corruption surveys. The purpose of the report is not to pass any judgments but to highlight the complexity of the corruption problem and its causes and consequences, as evidenced in the survey responses. Our hope is that the report be taken in the proactive spirit in which it was intended – looking to the future and what needs to be done, rather than dwelling on the past and what cannot be undone.

3. The information provided by the surveys *contribute* to our understanding of corruption in Georgia, but the survey evidence in isolation is not definitive – it should be considered in conjunction with other views provided by analysis of the incentives and opportunities generated by the governance framework, by qualitative assessments and the opinions offered by civil society, and by the practical views of implementing organizations. As this report is based on survey evidence, it focuses primarily on lower-level corruption in the public sector. High-level or grand corruption, including political corruption, is more difficult to detect in surveys (as discussed in Section 2), but is every bit as important as low-level corruption. It is for practical purposes only that we orient this report toward the lower-level corruption faced by households, enterprises and public officials, rather than grand corruption.

4. The survey evidence suggests that corruption in public service delivery is a serious concern. Many respondents feel that the trend is getting worse, while few think things are getting better. Enterprises rated corruption as an important problem in doing business, and the frequency with which some organizations are reported to require bribes can be very large. The surveys also present clear evidence of certain "vicious circles" that point to increasing entrenchment of corruption, expansion of the unofficial economy, and deterioration in the quality of government services. Particularly worrying is the practice of public officials buying jobs, a corrupt activity in itself that serves to further entrench corruption within state institutions.

5. Surveys are very useful for pinpointing corruption "hot spots," agencies and organizations in which corruption is particularly severe. To some degree corruption is pervasive across organizations, but the surveys suggest that it is particularly rife in traffic police, the customs service, the police, energy companies, and the tax authorities. Households further expend considerable resources in bribes related to health.

2. METHODOLOGY

6. The diagnostic surveys on corruption were carried out by the World Bank and GORBI in mid-1998. The survey questionnaires were designed and pre-tested in collaboration with the Government of Georgia. Altogether, 802 households, 350 enterprises, and 206 public officials were surveyed. Each of these populations provide a different perspective on the extent of corruption, its causes, and consequences.

7. Households are particularly knowledgeable about the widespread low-level corruption that affects them in their everyday lives, and the opinions expressed by a representative sample of households provide an indication of how society perceives corruption.

8. Enterprise managers are much more likely to interact with government regulatory bodies, tax and customs authorities, and the courts. They generally have deeper pockets than households, and are therefore

potentially rewarding targets for corrupt public officials. At the same time, they are more likely to be informed about the modalities of corruption, when it is in the enterprise's best interest, when it is not, and how to avoid it when it can be avoided. Enterprises provide a view of how corruption affects the business environment, competition, investment and growth.

9. Public officials can provide an insider's view on the causes and modes of corruption, and can assist in identifying the organizations which have the worst reputation among civil servants. Public officials can also provide insights into a specific form of corruption that only they know about firsthand – corruption within the civil service itself and the manner in which the demand side of corruption is organized².

10. Individually, each of the surveys – households, enterprises, and public officials – provides information on corruption from different perspectives. The three surveys together present an even more powerful tool for understanding the overall dimensions of the problem and the specific micro-structure of corruption.

11. Ultimately, surveys can reflect only the information that respondents are willing to provide. For most types of surveys (e.g., public opinion research) respondents are happy to give their honest views, and simple factual questions (e.g., education) are usually answered honestly. But the subject matter of corruption is particularly sensitive. Even with reassurances of confidentiality, households, enterprises and public officials may be reluctant to provide honest answers to certain direct questions about corruption. This difficulty was addressed in several ways, for example:

(i) For most of the questions, phrasing was used that allowed the respondent to show knowledge about corruption without admitting involvement in corrupt practices. For example, in the evaluation of corruption among various government agencies, enterprises were asked to base their ratings on the corruption faced by "firms like yours." Questions were also asked aimed at gauging how frequently the enterprise interacted with specified organizations, permitting inference of the accuracy of those perceptions.

(ii) For some questions, phrasing was used that cast the guilt for the corrupt activity on the other party. For example, households were asked about instances when they were forced to make unofficial payments, while public officials were asked about situations when corrupt enterprises offered bribes.

12. The results in this report demonstrate that many respondents were not shy about discussing corruption. For obvious reasons, however, surveys are relatively better at uncovering evidence of small-scale corruption than of high-level corruption. This difficulty is unavoidable. But since the underlying societal factors that would cause small-scale corruption to grow could be linked to those that influence high-level corruption,³ learning about the former can throw some light on the latter. It remains important to complement the surveys with analysis of the political process and policy-making framework.

13. Surveys are very well suited for analyzing quantifiable interactions. This report attempts to quantify levels of corruption based on information that can be measured, such as flows of bribes. For this reason, much of the report focuses on the direct cost of bribery, rather than the less easily quantifiable deadweight loss to society from corruption. By no means does this imply that the direct cost of bribery is the only issue. Every bit as important are the other damages that society suffers: the productive activity that did not take place, the environmental or health costs when standards are evaded, and the losses stemming from reduced competition and mis-allocated resources, to name a few.

² The Georgia public officials' survey was the first such survey pioneered by the World Bank, and has since been refined and used in different countries in the region and outside.

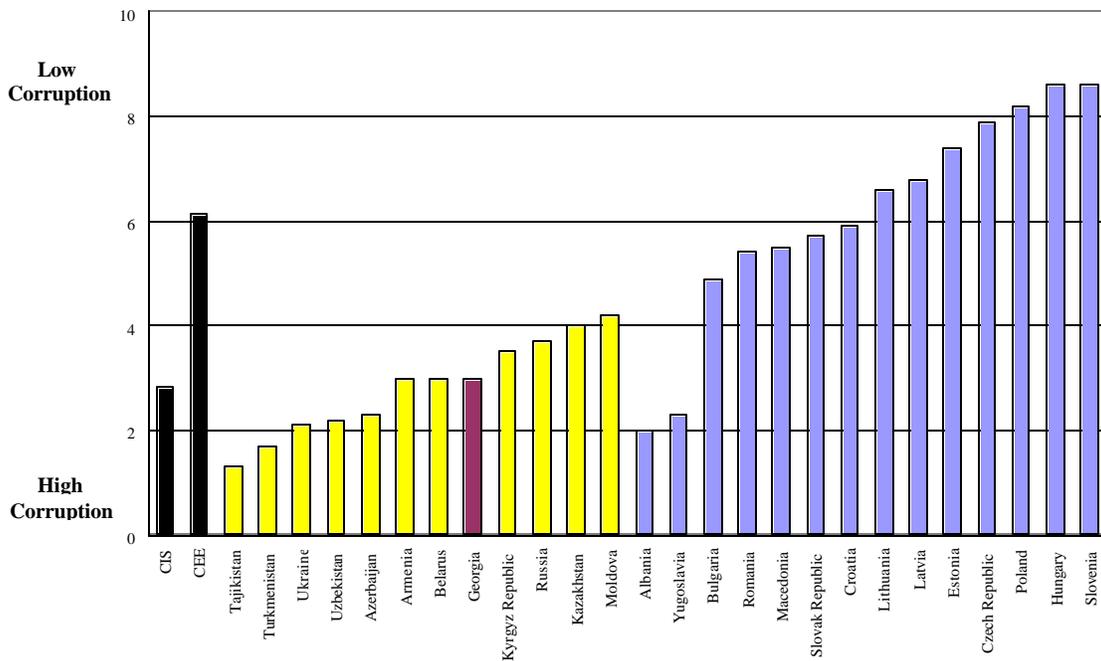
³ Paulo Mauro summarizes: "Country-specific studies and anecdotal evidence suggest that high-level and low-level corruption tend to coexist and reinforce each other." "Corruption: Causes, Consequences, and Agenda for Further Research," *Finance and Development*, March 1998, p. 13.

3. HOW BAD IS CORRUPTION IN GEORGIA?

14. Corruption exists in varying degrees around the world, so the answer to this question depends on the benchmarks against which Georgia is judged. Moreover, “corruption” is an extremely broad term, encompassing such diverse acts as theft of state assets, petty bribery, bid rigging and political payoffs.

15. One useful benchmark could be the overall level of corruption in Georgia relative to other countries. Several organizations generate cross-country indices of corruption. These results, however, must be viewed with caution – many of the indices are not consistent with each other – but they at least provide one perspective on the overall level of corruption. The Central and East European Review (Wall Street Journal) provides a corruption index for transition countries, and the levels from this index appear in Figure 1. Georgia ranks the tenth worst out of the 27 countries that are ranked.

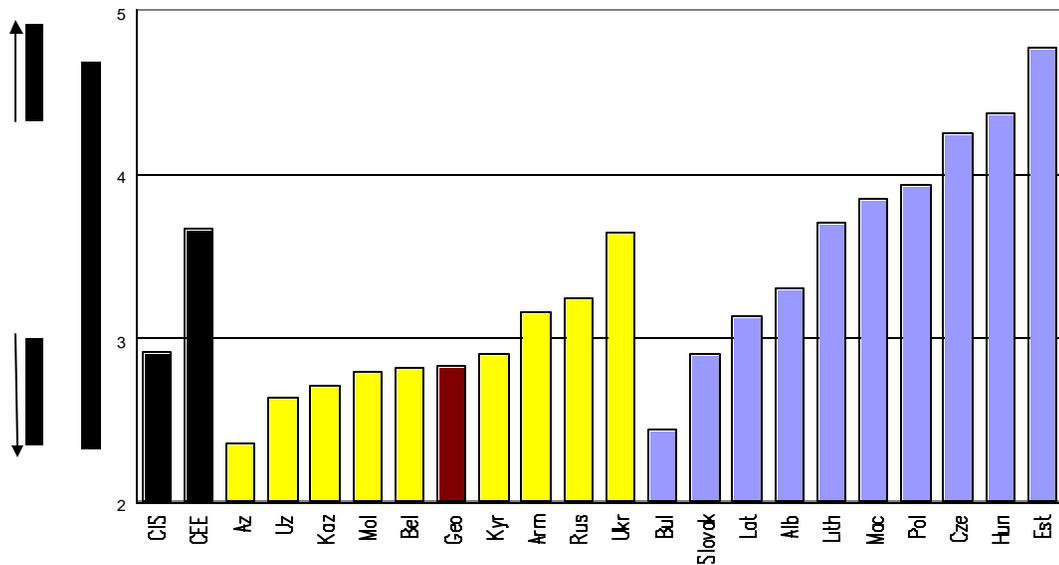
Figure 1. CEER Corruption Index



16. Another cross-country data source tells a similar story. In 1996 the World Bank supported a survey of enterprises in 68 countries to inform the World Development Report (WDR) 1997, *The State in a Changing World*.⁴ The survey included several questions about corruption, including a direct question on how frequently firms must make “additional payments” to get things done. The average response in Georgia falls squarely in the middle of the CIS countries, but it is clear that additional payments are more frequent in Georgia than in most transition countries. (Figure 2.)

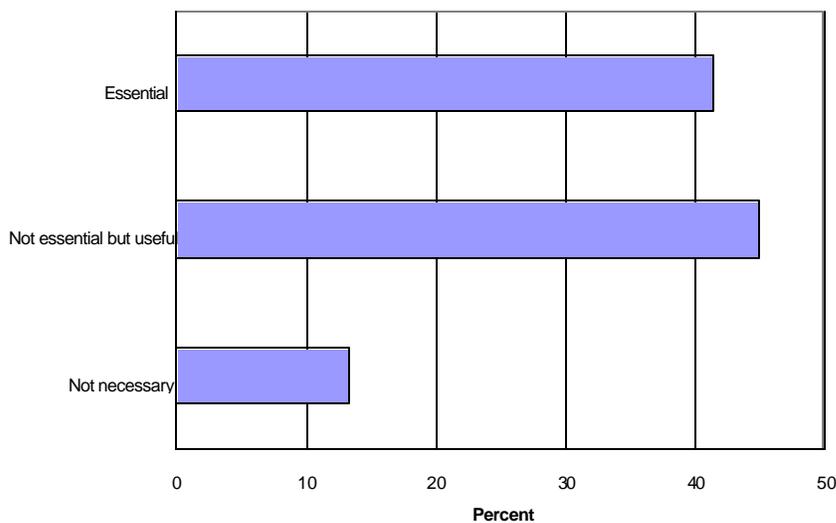
⁴Detailed information about the survey can be found at [Http://www.worldbank.org/html/prdmg/grthweb/growth_t.htm](http://www.worldbank.org/html/prdmg/grthweb/growth_t.htm)

Figure 2.
"It is common for firms in my line of business to have to pay some irregular 'additional payments' to get things done."



17. A second benchmark for evaluating the overall level of corruption is the trend: is the problem getting better, worse, or staying the same? For this sort of question, the surveys are well-suited. Most households (57 percent) feel that corruption has worsened, while only 7 percent said it has gotten better, relative to 4 years ago. Enterprises do not rate things so badly: 44 percent say things have gotten worse, 4 percent say things have gotten better, and 56 percent say the problem has remained the same.

Figure 3. Household Perception of Necessity of Unofficial Payments



corruption is an essential or useful part of doing business, while only 13 percent say it is not necessary (Figure 3).

18. Lastly, the severity of the problem in Georgia can be evaluated in absolute terms based on the surveys of households, enterprises, and public officials. Respondents to all three surveys report that corruption in Georgia is pervasive. More than half of the surveyed officials report that bribery often or frequently occurs, and only 8 percent report that corruption is rare or non-existent. Enterprises likewise report that the bribes they must pay amount to 9 percent of turnover; for households, 3 percent of household income must go toward bribes. Eighty-seven percent of households report that

Figure 5.
Frequency of Unofficial Payments by Enterprises
 95% confidence intervals, as a percent of total number of contact with relevant public official

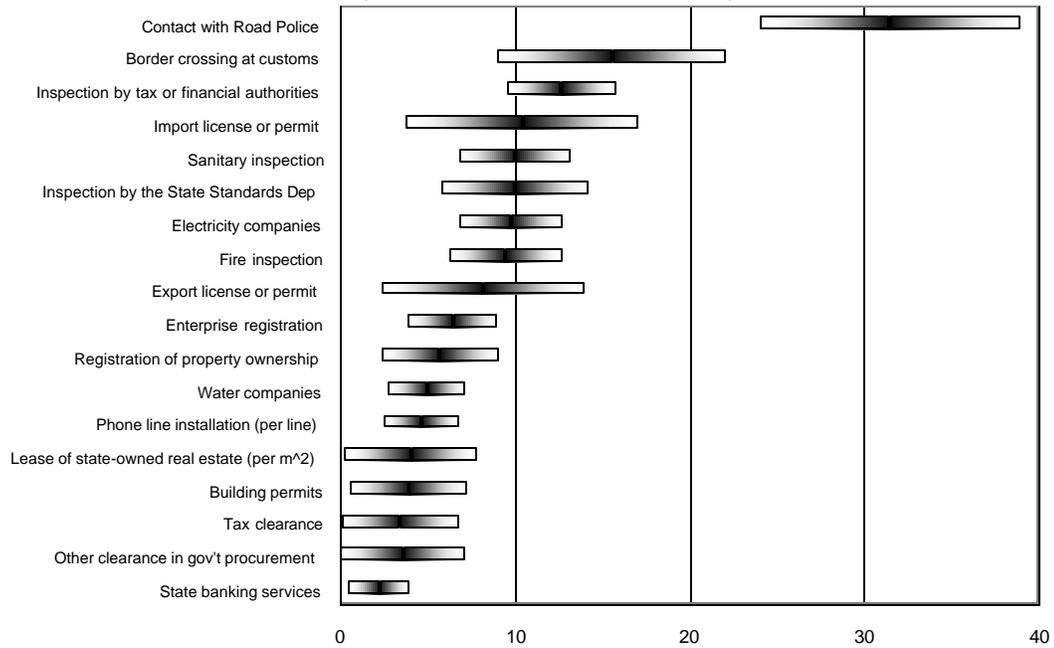
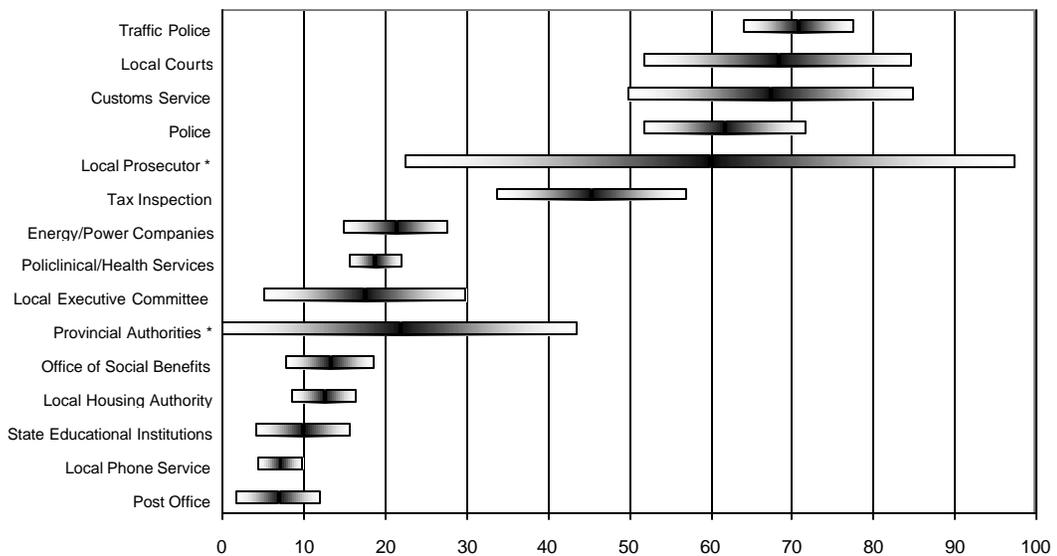


Figure 6.
Frequency of Unofficial Payment by Households for Various Agencies
 95% confidence intervals



Honesty and Integrity

22. Figure 7 shows how various organizations, governmental and non-governmental, are rated by survey respondents in terms of their honesty and integrity. Public officials, enterprises, and households seem to be in broad agreement about the two organizations with the least amount of honesty and integrity: traffic police and customs. Note that households provide lower honesty/integrity scores than enterprises and public officials for every single organization except the media. In a separate, open-ended, question public officials selected tax inspection as the most corrupt government function (Figure 8).

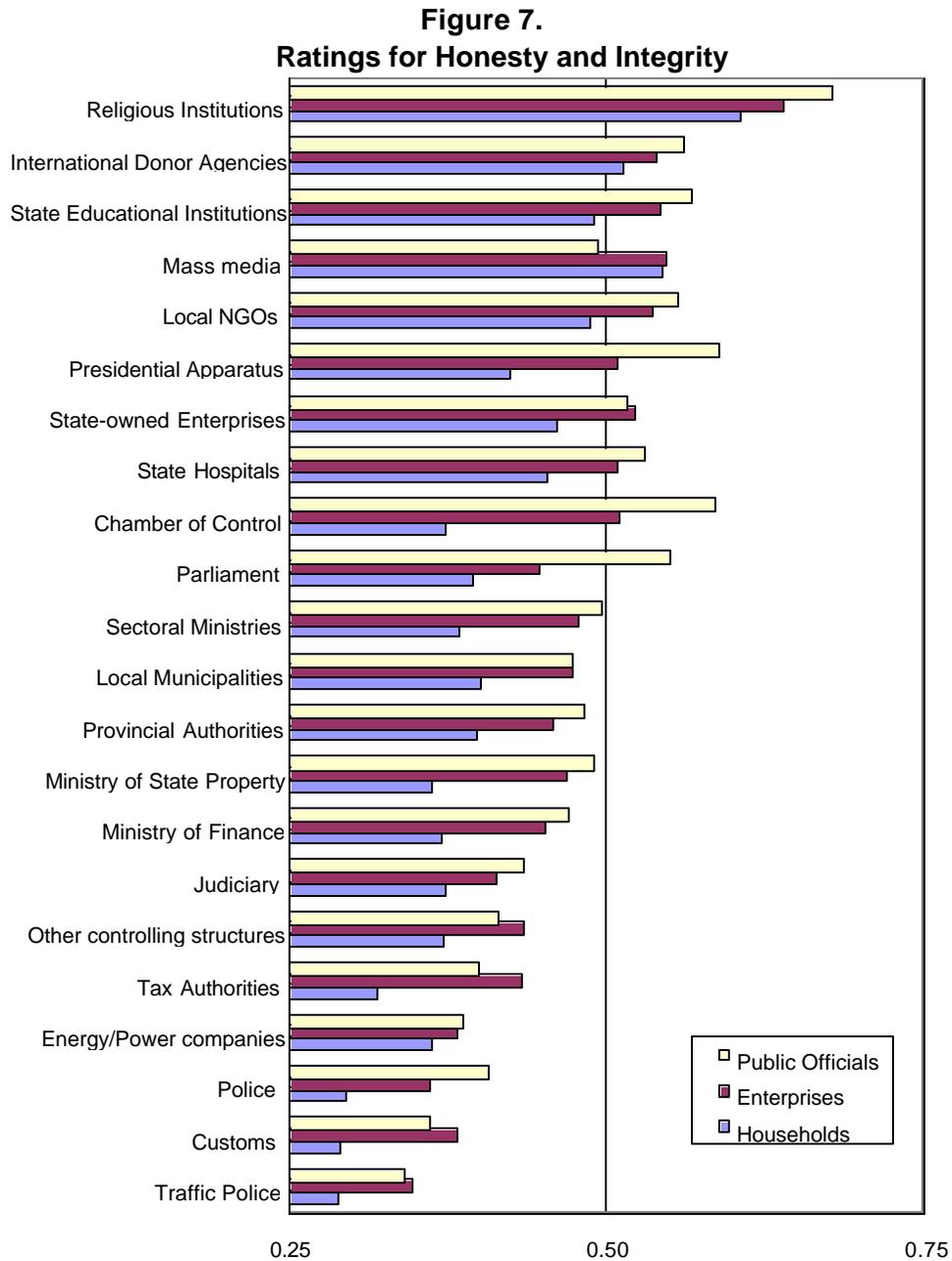
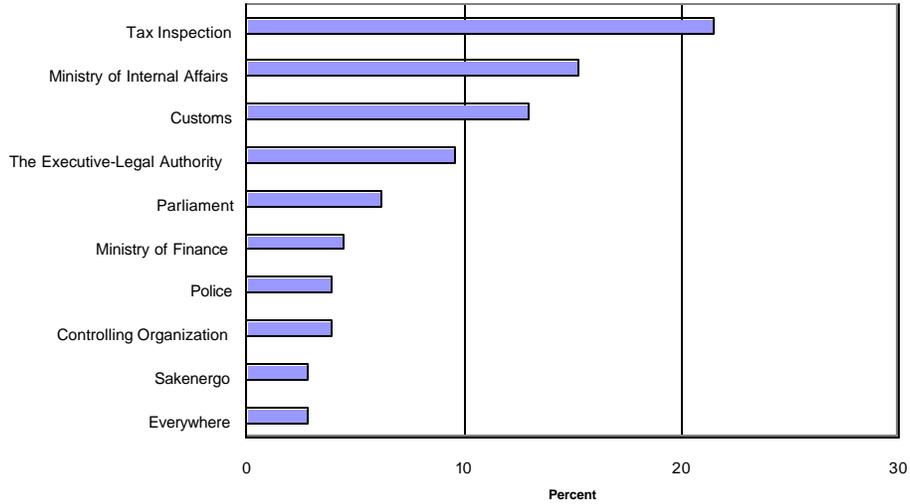


Figure 8. Public Official Perception of the Most Corrupt Agency



Impact on Households and Enterprises

23. The direct impact of corruption on households and enterprises can be measured by the aggregate bribe flows from households and enterprises to various organizations. Figures 9 and 10 illustrate the composition of expected yearly unofficial payments. For households, it is clear that much of the bribes they are forced to pay flow to the traffic police and to state providers of health services. For the average enterprise in Georgia, border crossing at customs and inspections by the tax or financial authorities absorb the greatest flows of bribes, followed by the road police and electricity companies.

Figure 9. Composition of Expected Yearly Unofficial Payments by Households
Including those who have not contacted the agency, total unofficial payments=42 lari

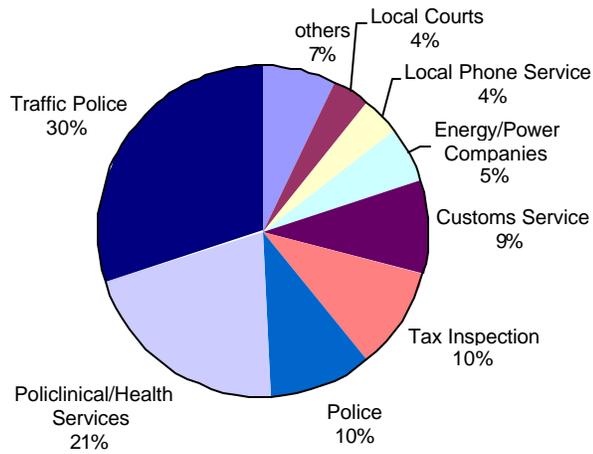
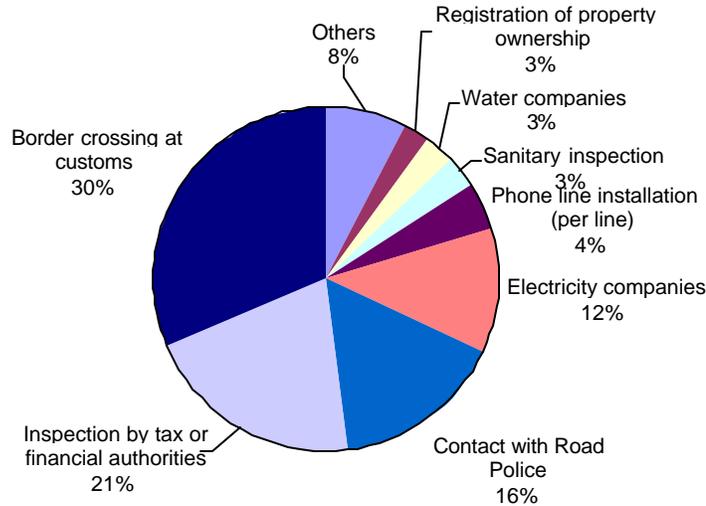


Figure 10. Composition of Expected Monthly Unofficial Payments By Enterprises

for all, the total expected monthly unofficial Payments=55 lari



* In the survey question, no item related to unofficial payments in courts is listed. Therefore, unofficial payments in courts are not included in the calculation.

Summary: Organizations With the Worst Ratings

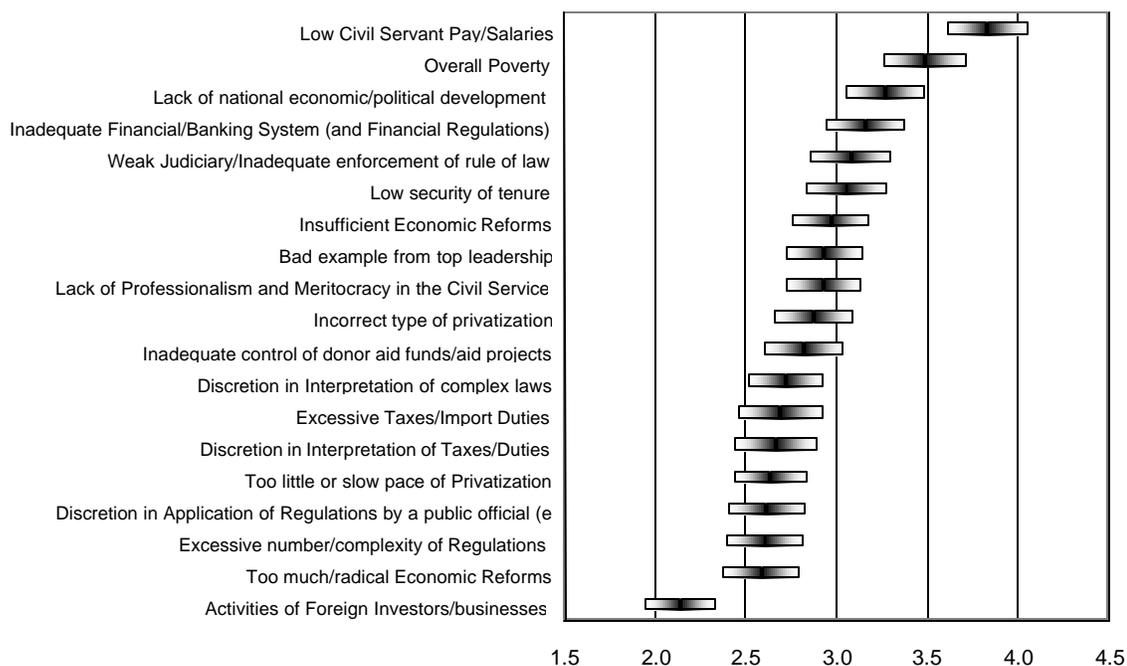
24. The organizations which generally receive the worst ratings from surveyed households, enterprises, and public officials, are the traffic police, the customs service, the police, energy companies, and the tax authorities. These five organizations receive the worst scores in terms of honesty and integrity, and are all important recipients of the total bribe flows from both enterprises and households. Health-related services are also among the largest recipients of bribe flows from households, although they do not rank badly in terms of honesty and integrity. This finding is consistent with the notion that households view payments for health services as necessary given the low budget of health-related organizations. Moreover, the position of health services as a major recipient of bribes probably derives from the fact that many households have to pay the bribes, even though the size of the bribes may be small.

5. WHAT ARE THE CAUSES OF CORRUPTION?

25. Corruption stems from the interaction of several related factors. First, there must exist large *rents* to be extracted and divided among the parties to any corrupt activity. (“Rent” refers to the net benefit to some activity.) These rents are the pay-offs to corruption. Second, the public officials must have *discretion* in their activities. This discretion to make decisions, while necessary to a degree for the efficient execution of their duties, affords them the ability to profit from their positions. Third, the degree of *accountability* must be low. A lack of accountability limits the probability that a corrupt official’s illegal actions will be detected and prosecuted.

26. The survey responses illustrate very clearly that there is no single cause for the problem of corruption in Georgia (Figure 11). Many factors are blamed, in varying degrees. For convenience, we will classify the reasons for corruption (according to survey respondents) into the overlapping categories of rents, discretion, and lack of accountability.

Figure 11. Public Officials' Perception of Causes of Corruption
95% confidence interval, 1=not important, 5=very important



Rents

27. Rents can be generated in many ways. Some are natural, for example the rents emanating from the existence of a very profitable oil field. Others may be manufactured by policies and regulations. For example, high levels of taxes and complex regulatory regimes can be very costly for enterprises – the money that an enterprise could save by not paying the taxes or not complying with the regulations can be thought of as rents.

28. As is clear from the WDR data presented in Figure 4, Georgian firms selected “high taxes and tax regulations” as the most important obstacle to doing business, although in our survey, public officials did not seem to think that taxes were a leading cause of corruption (Figure 11).

29. While there may be mixed evidence about the importance of tax levels as a cause of corruption in Georgia, the story being told by enterprises and public officials about regulations seems to be less controversial. Regulations, *per se*, appear to be less of a constraint on Georgian firms relative to other obstacles; labor, safety and environmental regulations were viewed by enterprises as less severe obstacles than insufficient infrastructure, problems with financing, or even corruption itself. Furthermore, when public officials were asked the causes of corruption, the number and complexity of regulation are ranked relatively low.

30. Care must be exercised when using rankings to evaluate the importance of a factor. While enterprises place several types of regulations low on the list of “problems of doing business”, this may merely reflect the severity of the other obstacles on the list. In fact, on our enterprise survey, managers reported that 27 percent of senior manager and administrative time is spent dealing with regulations. Clearly, the regulatory burden on enterprises is not trivial. Moreover, firms are willing to pay 23 percent of revenues for the elimination of corruption. They are willing to pay a similar amount to get rid of unnecessary regulations but not much more to get rid of both corruption and bad regulations, which suggests that corruption is related to the presence of regulations that allow opportunities for it. Lastly, the high corruption levels reported in the customs, the taxation department, and inspection agencies (see Section 7) suggests that the rents from taxes and regulations are in fact important for describing the level of corruption in Georgia.

Discretion

31. As discussed in the previous section, Georgian enterprises viewed “high taxes and tax regulations” as the most important obstacle to doing business – the money that an enterprise can save by avoiding taxes or regulations can be thought of as rents. But the existence of a rent is not sufficient to generate corrupt behavior. There must also be discretion. For example, an enterprise may choose to save a large amount of taxes by bribing a tax inspector, but this is only possible if the inspector has the power (the discretion) to ensure that the enterprise does in fact save the taxes. (This example works both ways: a tax inspector may initiate the transaction, promising to look the other way, thus saving the enterprise money, or threatening to manufacture charges of tax evasion. But again, the corruption is only credible if the inspector had the discretion to make such decisions.)

32. For Georgia, there is again mixed evidence on the contribution of discretion to the problems of corruption. On the one hand, public officials rank “discretion in interpretation of complex laws” twelfth out of nineteen possible causes of corruption⁵. On the other hand, “uncertainty on the costs of regulations” was an important obstacle to doing business in Georgia, based on the WDR survey, more important than the number of regulations themselves.

33. A certain level of discretion is necessary for the efficient operation of government. An official who is mired down with bureaucracy will not be able to work effectively. Yet, discretion that is excessive and completely unchecked contributes to corruption. The process of reforming public institutions must ensure that the discretion necessary to do a job effectively does not devolve into unchecked power in the hands of public officials with access to rents.

Accountability

34. Systematic corruption feeds on itself. When corruption is widespread there is little accountability for corrupt practices; there is little fear of “whistle-blowers”, public officials may feel that “everybody is doing it”, and they may even be benefiting from corruption by others.

35. Public officials in Georgia believe low civil servant salaries to be the main causes of corruption. A low salary, indeed, may help an otherwise honest civil servant justify abuse of public office. Yet, there is tremendous variation in levels of corruption across government agencies and organizations, and it is unlikely that customs officials and traffic police, for example, are paid less than other government officials. So, while low civil servant salaries may be contributing to the problem of corruption, raising salaries alone cannot be expected to have much effect on the level of corruption. Moreover, public officials reported that state employees actually pay money for their jobs with alarming frequency (see Section 7 and Figure 19). This suggests that among corrupt civil servants, many actually bought the jobs with the intention of earning a positive return on their investment, an image very different from that of otherwise honest civil servants turning to corruption only because their official salaries are too small to make ends meet. Certainly there will be cases where otherwise honest people turn to corrupt practices to feed their families, but it is hard to accept this explanation as the dominant cause of the problem of corruption in Georgia. Nevertheless, the perception that corruption stems from low civil service salaries hinders accountability – if there is sympathy for bribe-takers, a bribe-taker will be less likely to be held accountable for his actions.

36. Salary is but one civil service policy variable related to corruption. Public officials also reported that the low security of tenure, a lack of meritocracy in the civil service, and poor examples from leaders were important causes of corruption (Figure 11). Each of these problems suggest that civil servants may be carrying out their duties in an environment in which the costs – and the probability – of getting caught are small. Indeed, 64 percent of public officials reported that bribes are usually shared with supervisors or colleagues.

37. As will be discussed in Section 7, corruption in the judiciary appears to be an important problem in Georgia. Local courts, the police, and local prosecutors are all believed by households to be among the five organizations that demand bribes most frequently, over half the time. Corruption in the legal sector has ramifications for the overall level of corruption, as it may erode the effectiveness and honesty of other branches of government. Indeed, public officials place “weak judiciary” as the fifth most important cause of corruption

⁵ This is in contrast to Latvia, where both the third and fourth selections of public officials had to do with discretion.

(Figure 11). The focus group also stated that corruption in law enforcement agencies themselves is one reason corruption continues in Georgia.

6. WHAT ARE THE EFFECTS OF CORRUPTION?

38. Corruption disrupts society in numerous ways. Efficiency suffers when resources are mis-allocated, when regulations are not enforced or improperly enforced, and when scarce human talents are wasted on corruption. Equity suffers when corruption allows for uneven tax incidence and regulatory compliance, and when corruption deprives poor households of government services. Corruption further causes the decay of certain institutions that hold society together, namely the system of law enforcement and jurisprudence. Corruption, the unofficial economy, and the deterioration of the quality of government services degenerate in vicious circles, each feeding on the others. It is not possible to discuss (or even imagine) all of the ways that corruption harms society because they are too numerous. Yet, a brief discussion of the impact of corruption on society helps to illustrate the importance of the task currently facing reformers.

Who bears the brunt?

39. The surveys of enterprises and households provide detailed information about characteristics of the respondents. This section examines the enterprise and household characteristics correlated with the propensity to fall victim⁶ to, or engage in, corrupt practices, and with the impact on those enterprises and households (Section 7 discusses how individual institutions, such as the judiciary, are affected).

Enterprises

40. *The enterprise survey shows that the costs of corruption to enterprises in general are large, and the costs of corruption far exceed the benefits.* The average firm pays 9 percent of turnover in bribes.⁷ Of course, firms that pay bribes generally receive some sort of benefit from the transaction, as well. Yet the survey responses make clear that the net effect of corruption on firms is negative. Firms were asked how much additional taxes, as a share of revenues, they would be willing to pay to eliminate corruption. Enterprises in Georgia reported that, on average, they would be willing to pay 22.5 percent of official revenues to eliminate corruption.

41. *The presence of majority state ownership is a firm characteristic that is important for explaining whether a firm has bribed*⁸. Specifically, majority-owned firms are less likely to have bribed, and this effect remains strong even after accounting for numerous other factors such as size and sector. This could be because majority state-owned firms have historical contacts that make bribes less necessary, or perhaps it is the case that many majority state firms found themselves to be self-regulating after the demise of communism left almost no distinction between production and oversight.

42. *Corruption disproportionately affects small enterprises.* While only 14 percent of large enterprises reported making bribes, 34.5 percent of medium and 45.7 percent of large enterprises reported paying bribes (Figure 12). This effect is very strong and persists even after controlling for many enterprise characteristics, and even for the fact that large and small firms are likely to contact different agencies.

43. *Firms in the manufacturing sector were less likely to have paid bribes than firms in trade or services.* This seems to be due in part to the fact that manufacturing firms tend to be larger, although size does not explain all of the effect.

44. *Certain characteristics of the senior manager are highly correlated with the propensity to pay bribes.* The two important characteristics are education and gender. Those with a university education are less likely to

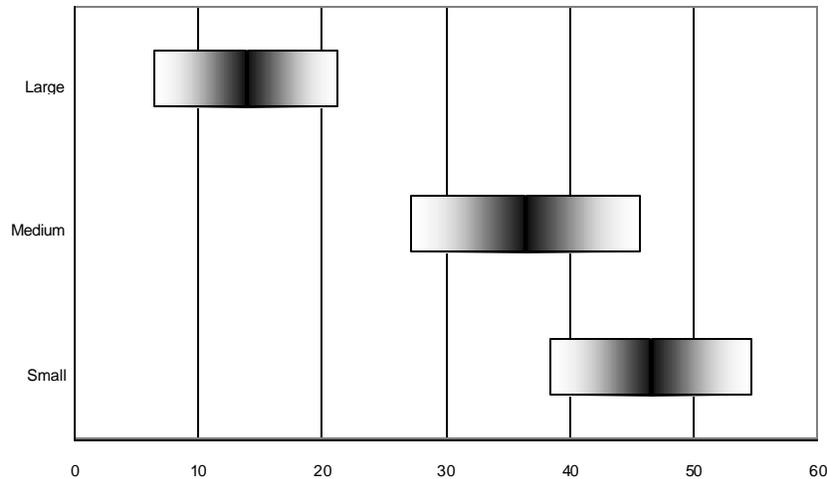
⁶ Most corrupt acts have at least two participants; some enterprises and households may not be victims so much as beneficiaries of corrupt activities. Our goal is not to make the distinction between victims and beneficiaries, but to sift through the data on corruption incidence for clues on key issues of reform.

⁷ The average payment per month was 233 Laris, although this will depend on firm size.

⁸ The presence or absence of foreign ownership appears unrelated to the propensity to be involved in corrupt behavior.

bribe, and women are less likely to bribe, as well. These are consistent with results on respondent characteristics for the household survey (see below).

Figure 12. Propensity to Pay Bribes by Size of Enterprise
95% confidence intervals, percent that have made unofficial payments



Households

45. The impact of corruption on households is large, as well. Among the households that bribed, roughly 2.8 percent of household income goes for the payment of bribes⁹.

46. **Households with higher income are more likely to have paid bribes.** Among households with monthly income greater than 200 Laris, 32 percent had paid bribes, while only 28 percent of households with income between 50 and 200 had paid bribes, and 18 percent of households with less than 50 Laris had paid bribes. These findings are not surprising since richer households probably have more interactions with state officials (for example, perhaps richer households are more likely to own automobiles and are therefore more likely to come into contact with the traffic police). Even after controlling for contact agencies and other household characteristics, the income effect is still present.

47. **There is some evidence that poorer households pay a larger fraction of their income in bribes than richer households.**

48. **Rural households more likely to have paid bribes than urban households** – on average 39.8 percent of rural households paid bribes, while only 18.5 percent of urban households paid bribes. There may be several reasons for this finding: rural households may be more likely to earn their income from their own agricultural production and marketing, while urban households may be more likely to earn their income from wage employment. Rural enterprises therefore would have more interactions with state officials in the course of operating their household business, or perhaps interactions with different state agencies. Indeed, after controlling for urban-rural differences in contact agencies, location in urban or rural areas ceases to be statistically related to the propensity to pay bribes.

49. **Men reported paying bribes more frequently than women:** overall, 38.4 percent of male respondents admitted paying bribes, while only 19.8 percent of women made such an admission. This seems to be partially due to the fact that men are more likely to be the main income earners, and men and women interact with different agencies. But even after accounting for such factors, men are roughly 10 percent more likely to bribe than women.

⁹ On average, households spend 49 Laris per year on bribes.

50. **Respondents with lower levels of education are more likely to have paid bribes.** Among those with at least a college education, 20 percent reported having paid bribes, while among the group with technical or lower education, about 31-32 percent reported having paid bribes. This appears to be due to other characteristics that are related to age. After controlling for such things as urban/rural location, gender, income, and contact organization, education becomes insignificant for explaining whether or not someone has bribed.

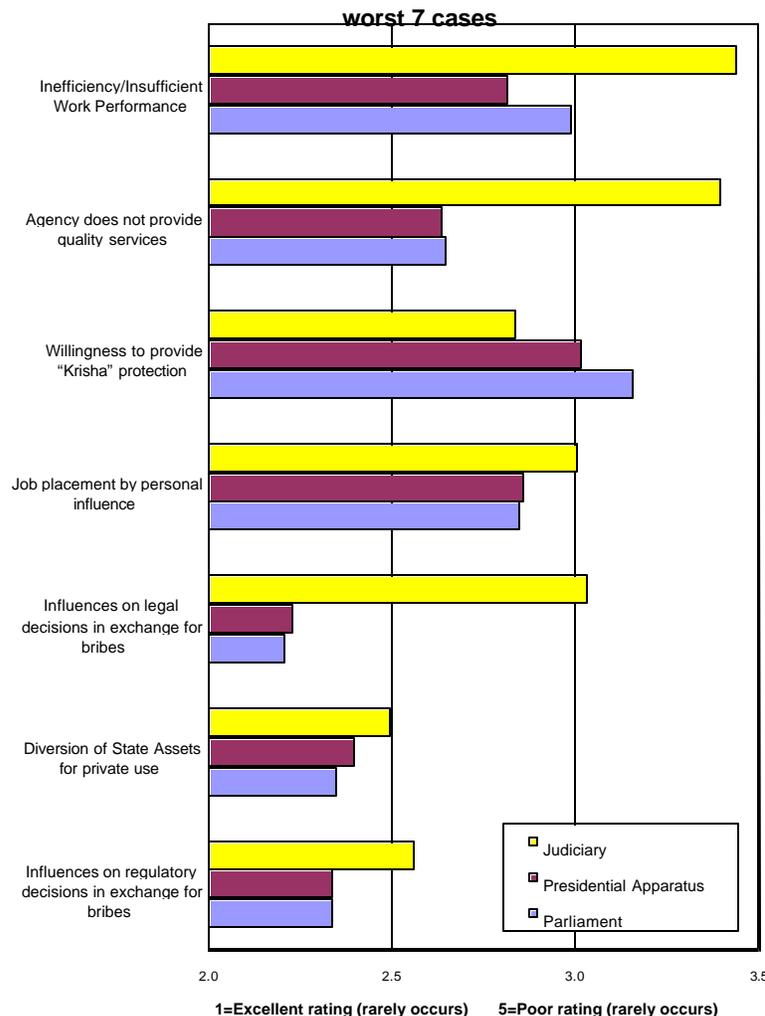
7. SPECIAL ISSUES

52. This section explores in greater detail the level and characteristics of corruption in selected sectors: the judiciary and police, electricity and power, and in education and health. Certain issues of particular importance for public sector reform are also explored, such as the interaction between corruption and the quality of government services, corruption within the civil service itself, and corruption in procurement and revenue generation. Lastly, this section examines how survey respondents view the credibility of anti-corruption efforts.

Judiciary and Law Enforcement Bodies

53. **Corruption in the judicial and law enforcement bodies** has the potential to do far more damage to society than corruption elsewhere. An independent, impartial, process of law enforcement and law adjudication are often cited as fundamental institutions supporting a law-based market economy. When law enforcement becomes moot or judicial decisions become suspect due to corruption, businesses reduce productive activities, particularly those with greater potential for disputes, such as long-term investment or the production of complex goods. More importantly, the overall level of compliance with law (criminal and civil) will be diminished,¹⁰ and when disputes do arise they will more likely be addressed outside of the overall framework of laws. Although some forms of informal dispute resolution may be very effective, others (e.g., violence) are quite troubling. Lastly, since the final word in a law-based anti-corruption program resides with judicial bodies, a tainted judiciary may also limit the success of anti-corruption programs.

Figure 13. Public Official Perception of Problems in the Public Sector

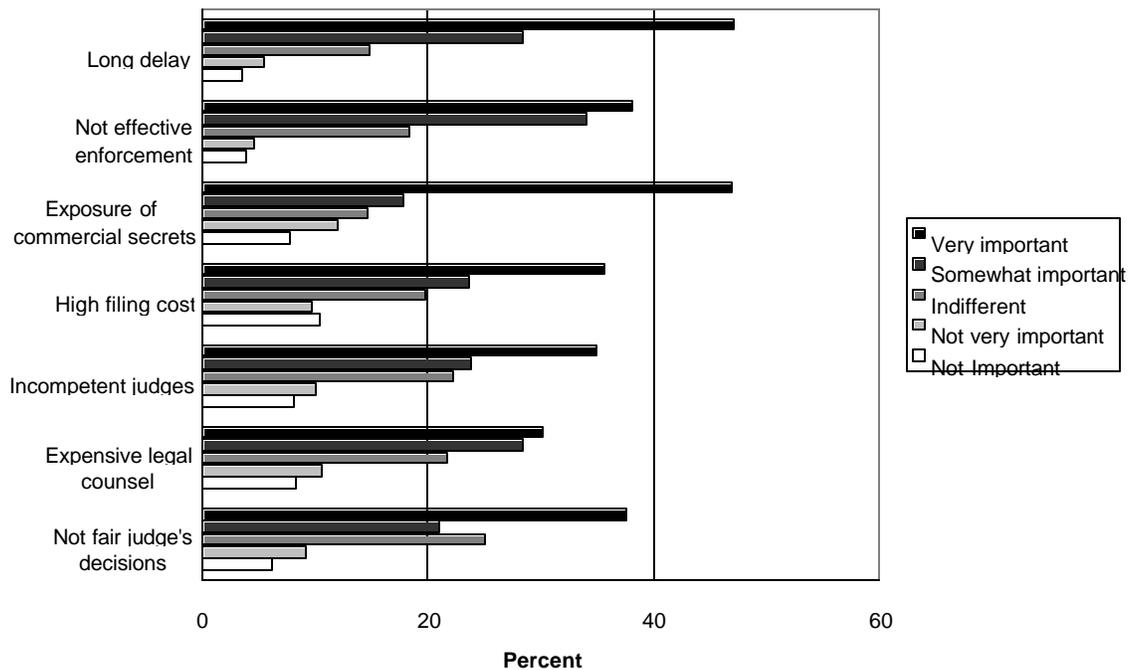


¹⁰ Recent research suggests that fear of punishment is less important for explaining whether or not people obey the law than a belief in the fairness of the judicial and law enforcement process. Tom R. Tyler, *Why People Obey the Law*, New Haven: Yale. 1990.

54. **Judiciary.** Among the three branches of the state, public officials generally gave the judiciary the lowest overall ratings (Figure 13), worse than either parliament or the presidential administration. Service quality, in particular, was rated much worse than for other branches of government. This sentiment was echoed in the household survey (Figure 16): *the two organizations given the lowest average quality rating were local courts and local prosecutors.* The negative perception of the judiciary is also reflected in opinions about the honesty and integrity of various institutions. Although several organizations received worse ratings for honesty and integrity, the judiciary is still among the bottom third (Figure 7).

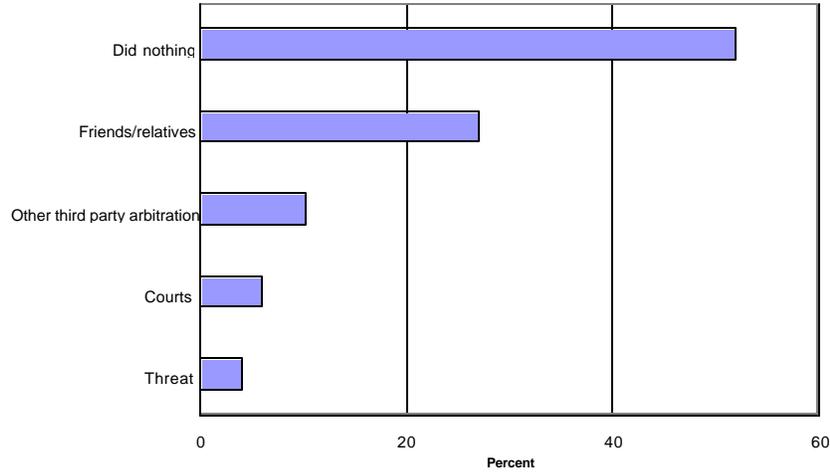
55. Corruption often goes hand-in-hand with problems of bureaucracy. Bribes may be offered to encourage speedier or more efficient service, for example. Conversely, some officials may use bureaucratic excuses as leverage to extract bribes. The survey asked enterprises about the problems they face when using the court system; the results are presented in Figure 14. The first observation is that for every problem with using courts that was presented, the plurality of the respondents marked “very important.” Second, while many enterprises clearly feel that judges are either incompetent or unfair, enterprises feel even more strongly that long delays and ineffective enforcement are the most important problems with using courts. (Households are more likely to blame the costs - both official filing costs and the cost of legal counsel - and judges’ fairness and competence.)

Figure 14. Enterprise Perception of Obstacles to Using Courts



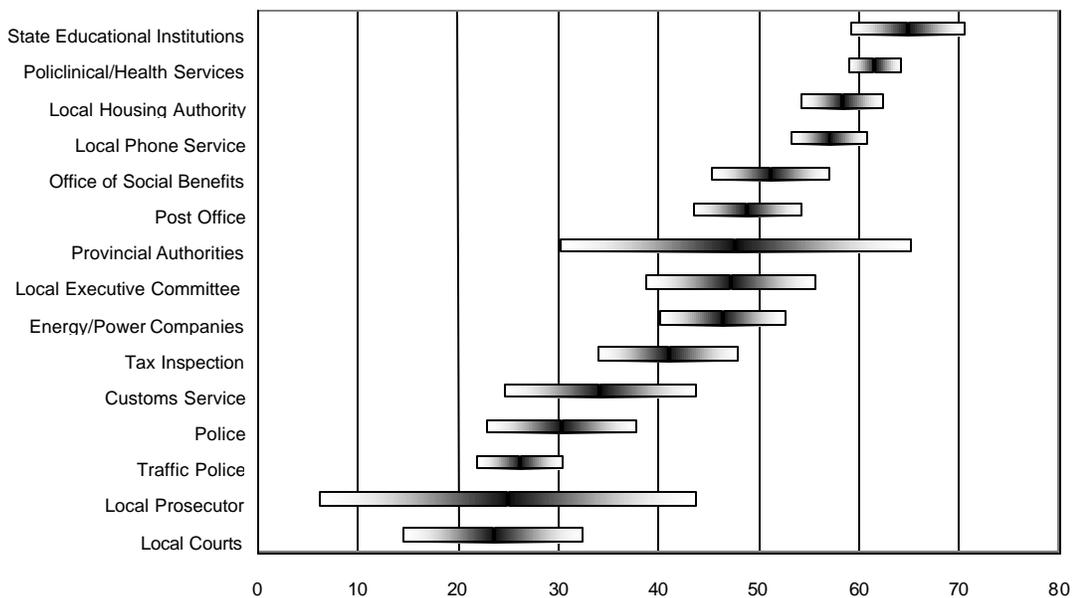
56. Perhaps in response to the inefficiency and dishonesty of the judiciary, households seek other means of dispute resolution. Of those households that had been cheated or defrauded in the two years before the survey, over half reported doing nothing in response, and only 6 percent appealed to courts for adjudication. One interpretation of these findings is that the lost confidence in the judicial system is driving people to find informal alternatives (Figure 15).

Figure 15. Conflict resolution method used by households that had been defrauded



57. The diminished faith that Georgians have in the legal sector applies not just to the judicial system, but to the police, as well. While households give the lowest quality ratings to local courts and local prosecutors, the next two worst ratings are given to the traffic police and the police. (Figure 16.) The police and the traffic police are both reported to demand bribes very frequently – the traffic police were the worst according to both households and enterprises – and the levels reported are staggering. According to households with contact, bribes are required 7 out of 10 times they come into contact with the road police.

Figure 16. Household Perception of Quality
 95% confidence intervals
 (0=Poor, 100=Excellent)

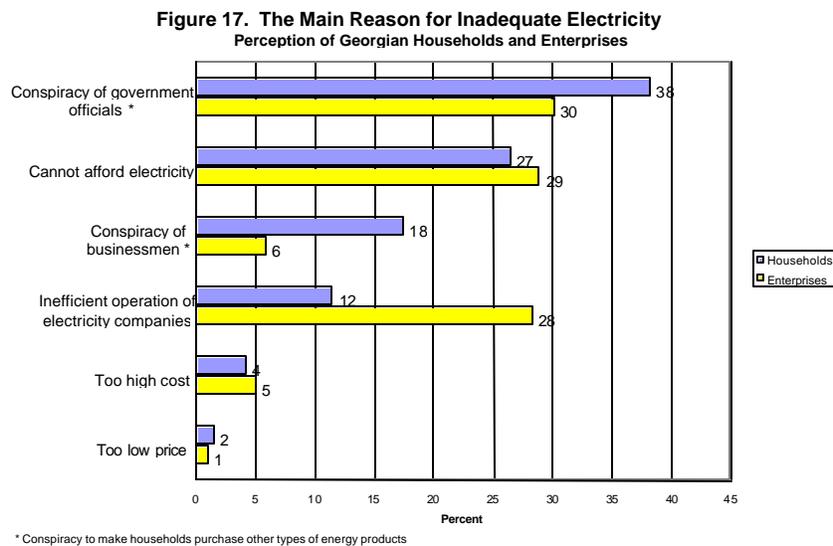


58. In response to poor law and order, many firms reported hiring security personnel which cost on average between 4 and 10 percent of turnover for large and small firms, respectively. This added cost to enterprises can be considered, in part, a measure of the costs imposed on enterprises by the failure of the legal/judicial sector.

Electricity and Power

59. According to the surveys, each household has only 5 hours of electricity supply per day, on average. As a response to this inadequate supply, around half of households have some kind of independent source of electricity. Six and a half percent of households produce their own electricity using generators. (The generators reportedly cost \$300 to purchase, and roughly \$23 annually to operate.) An additional 5 percent of households address the problems with electricity supply by obtaining multiple hookups.

60. Households and enterprises both perceive that the main reason for the inadequate supply of electricity is that there is a conspiracy among corrupt government officials to induce households and firms to purchase other types of energy products. Unlike households, enterprises also blame the inefficient operation of electricity companies for inadequate electricity supply. While monthly expenditure on electricity is a little more than \$5, monthly expenditure on other types of energy products averages \$24. If the perceptions are correct, and corruption is the reason for the problems with electricity supply, these figures illustrate the magnitude of costs that corruption are imposing on Georgian households. (And even if the perceptions are not correct, the importance of an erosion of confidence in government institutions should not be underestimated.)



61. For enterprises, some 12 percent of the total bribes they pay goes to the electricity and power companies, the fourth largest single component. (Figure 10.) But if the perception that the energy companies are in a conspiracy to boost sales of independent energy providers, the flow of bribes would greatly understate the true cost of this form of corruption. Perhaps it is for this reason that the electricity and power companies receive the fourth poorest overall ratings for honesty and integrity. (Figure 7.)

Education and Health

62. *State educational institutions received relatively “good” marks in the household survey.* The percentage of the time that bribes are required is among the lowest (Figure 6), and the total flow of bribes to state educational institutions is not large (Figure 9). Lastly, state educational institutions receive fairly high ratings for honesty and integrity (Figure 7).

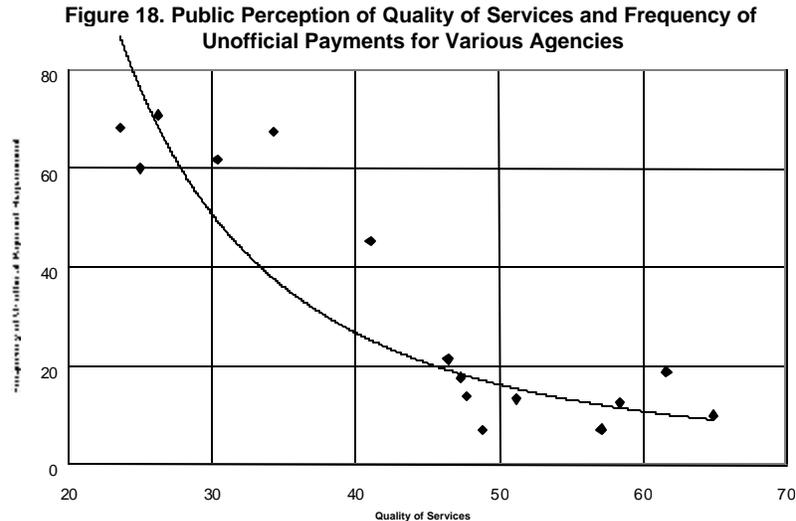
63. *The health sector, by contrast, appears to have a much greater problem with corruption.* In the aggregate, some 21 percent of the total bribes paid by households go towards polyclinic and health services

(Figure 9), second only to the traffic police. The percentage of time that a bribe is required is estimated to be about 20 percent, among neither the best nor the worst (Figure 6). But since a large proportion of household must occasionally seek health services, the aggregate impact is large. State hospitals receive mediocre marks for honesty and integrity (Figure 7).

Quality of Government Services

64. Among the more subtle costs of corruption is the deterioration in the quality of government service delivery. At its worst, the quality of services may be intentionally reduced in order to generate rents for corrupt public officials. But even in the absence of such a specter, the quality of government services degenerates due to the interaction between corruption and the unofficial economy. A decline in the quality of government services reduces the benefits to enterprises of operating officially¹¹, driving more and more enterprises into the unofficial economy. Expansion of the underground economy in turn reduces tax revenues leading to a further deterioration in the quality of government services.

65. The survey data provide some good examples of this vicious circle in action. Enterprises and households evaluated the quality of service delivery and the frequency with which bribes are demanded for 18 and 15 different government agencies or organizations, respectively. Agencies that were rated as less corrupt were



generally the agencies providing the higher quality services (Figure 18). The public officials survey also showed that the various positions and organizations in which people are more likely to pay money to get their jobs, are also organizations which more frequently demand bribes (discussed below, please see Figure 19).

Civil Service

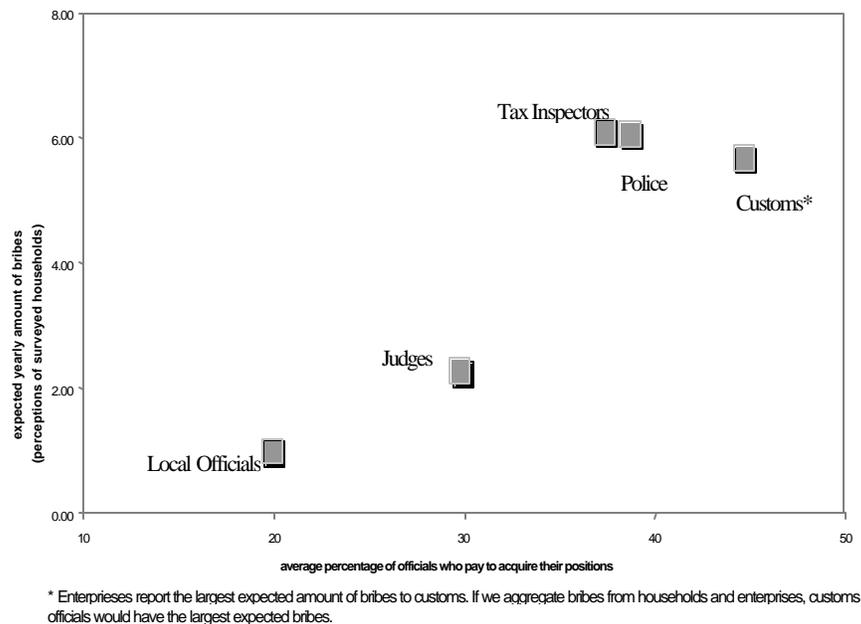
66. **Buying jobs.** The practice of awarding civil service positions in exchange for bribes has direct implications for civil service reform – an efficient bureaucracy cannot stand for such practices – but it also has important implications for understanding how entrenched the system of corruption is. Some important research on corruption¹² suggests that the practice of awarding jobs in exchange for money ensures that maximal bribes will continue to be collected. Officials that have paid for jobs must extract bribes to earn a return on their investment; the ability to extract bribes in turn increases the benefits of the position and applicants willing to pay for the positions will win out over those not willing to pay. Paying for positions also may have the effect of legitimizing corruption in the minds of the civil servants that paid for their positions. Government agencies in which corruption is particularly profitable (i.e., those with access to large rents and the discretion to extract

¹¹ Simon Johnson, Daniel Kaufmann, and Andrei Shleifer “The Unofficial Economy in Transition”. Brookings Papers on Economic Activity 2:1997.

¹² Andrei Shleifer and Robert W. Vishny “Corruption” Quarterly Journal of Economics 1993, p. 604.

them) will attract people who are willing to pay for their jobs rather than those who are most capable to deliver quality services.¹³

Figure 19. The Vicious Circle: Buying Jobs and Extracting Bribes



67. Figure 19 shows that this vicious circle is alive in the Georgian civil service.¹⁴ *The organizations in which positions are bought most frequently are the organizations which have the largest expected yearly bribe payments.* Estimates of the percentage of officials who pay to acquire their positions run as high as 45 percent for customs inspectors¹⁵.

68. **Sharing bribes.** Georgian public officials reported that when middle-level bureaucrats extract bribes, 64 percent share the bribes with colleagues or supervisors. This is a worrying signal of entrenchment of corruption within the public sector. It is also a cause for concern about the effectiveness of an anti-corruption campaign. Superiors can not be counted on to discipline corrupt officials when the superiors themselves are benefiting, and colleagues can not be counted on to “blow the whistle” when they are benefiting. This practice hinders the ability of organizations to self-police for corruption.

69. **Modalities.** The level of entrenchment of corruption can be gauged by the attitudes that enterprises and public officials take toward corruption. Public officials in Georgia estimate that when a domestic enterprise pays a bribe, for example, 50 percent of the time both sides know in advance what needs to be done, and 18 percent of the time “there is no other way to accomplish what needs to be done.” Less than one third of the time does the bribe begin with a unilateral suggestion by one side or the other. (When a foreign enterprise pays a bribe, the likelihood is higher that one side or the other initiate the bribe, and the likelihood is smaller that both sides know in advance what needs to be done.)

70. Entrenchment can also be gauged by how well known the amounts of bribes are, and by how closely linked bribes are related with outcomes (i.e., once the bribe is paid, how certain can the briber be of getting what is wanted). As is clear from Figures 20 and 21, households feel a high degree of certainty on both counts.

¹³ Andrei Shleifer and Robert W. Vishny “Corruption”. *Quarterly Journal of Economics* August, 1993.

¹⁴ The charts are based on surveys of public officials (expressing perceptions about all organizations, not just their own) and households.

¹⁵ Surveyed public officials gave lower estimates for officials in their own positions, saying that only 2.5 percent pay to acquire their jobs. This could imply that their perceptions of corruption within other organizations is exaggerated or it could reflect their own fear of revealing the level of corruption within their own organization.

Figure 20. Household Perception of the Amount of Unofficial Payments

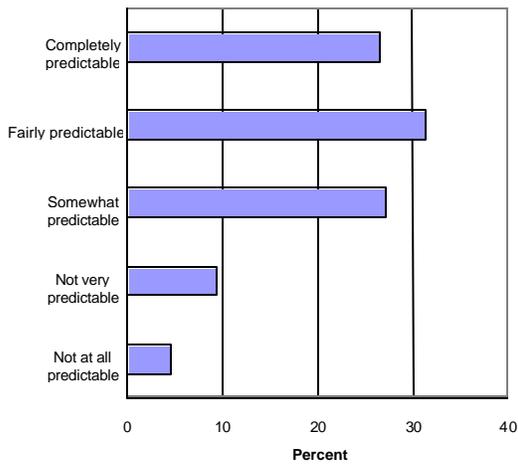
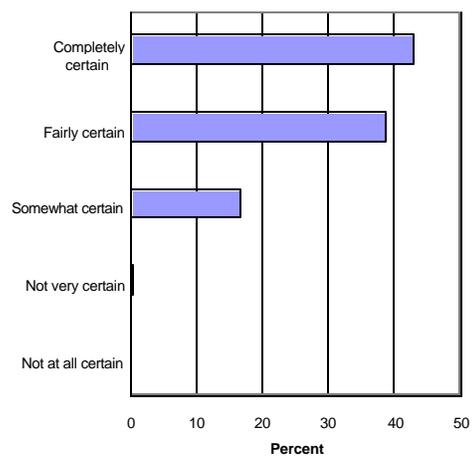


Figure 21. Household Perception of Service Delivery after Unofficial Payments

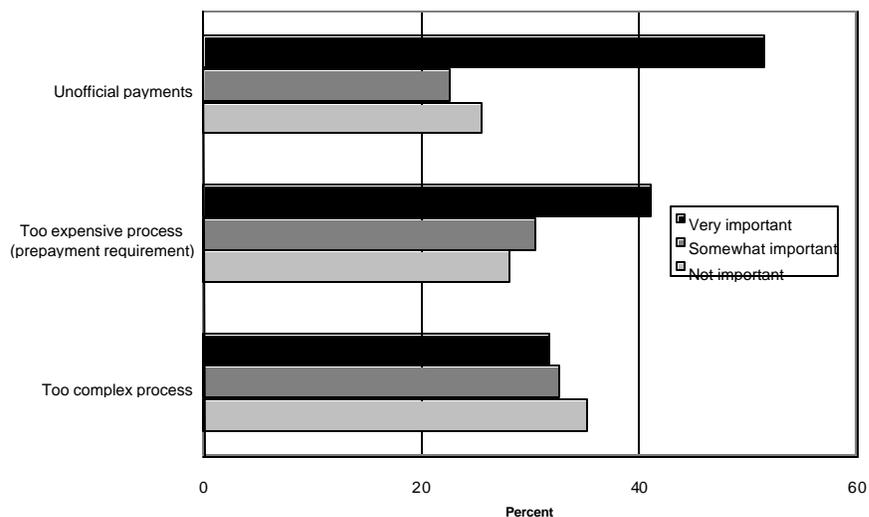


Procurement

71. Sound public sector procurement and asset disposal practices are key to ensuring the efficient use of fiscal resources. Because of the large amounts of money that are frequently involved, public sector procurement provides great potential for corruption. Not only does corruption waste budgetary resources directly, it also reduces the quality of the assets or materials purchased with public money. In the longer run, a reputation for corruption in tenders and auctions reduces the pool of bidding companies to those that are willing to pay unofficially to secure the contracts or win auctions.

72. Over half of the enterprises surveyed said that the necessity of unofficial payments was a very important reason for not participating in procurement. It appears that unofficial payments are perceived by enterprises as a larger problem even than the official costs and the complexity of the system (Figure 22).

Figure 22. Reasons for Not Participating in Procurement
For the Enterprises for which Procurement is Relevant to Business



Revenue Generation

73. By its nature, revenue generation involves rents. The large sums of money that an enterprise can save by not paying taxes, duties, or fine are rents that can be shared with complicit public officials or inspectors. Indeed,

in aggregate terms, tax inspections and border crossings at customs occupy over half of the total bribes paid by enterprises (Figure 10). Accordingly, customs and the tax service receive low ratings for honesty and integrity, outdone only by the police (traffic and ordinary) and the legal system (courts and prosecutors) (Figure 7).

Tax Service

74. Enterprises everywhere dislike taxes. They dislike taxes even more when the quality of government services is poor, and dislike them the most when they feel their competitors are not paying. In Georgia, enterprises cited high taxes and tax regulations as the most important obstacle to doing business in the 1996 WDR survey (Figure 4).

75. The complaints that enterprises have about taxes raise concerns about the potential for corruption within the tax administration. When taxes are high or bureaucratic, there is a large incentive for an enterprise to operate illegally. Honest enterprises suffer twice: once when they pay their taxes, get their licenses, etc., and again in the marketplace as illegal competitors can easily undercut margins. As operating illegally usually involves a degree of complicity with corrupt government officials, the gains to illegality may be closely tied to the levels of corruption. And even for enterprises that are operating officially within the tax system, there is great potential for mutually-beneficial arrangements between tax inspectors and enterprises (bribes to reduce the level of taxes).

76. According to survey respondents, the tax service has one of the worst reputations for corruption in Georgia. According to enterprises, thirteen percent of the time that they are visited by tax or financial authorities, they must pay a bribe (Figure 5). (Households estimate this frequency to be much higher, around 43 percent of the time – see Figure 6.) The aggregate impact is also large: twenty-one percent of the bribes that enterprises pay go for inspections by the tax or financial police (ten percent of bribes by households.) (Figures 9 and 10.) Perhaps it is the frequency with which the tax authorities require unofficial payments that is responsible for their low ratings for honesty and integrity. The tax service received the fifth worst rating out of twenty-two government agencies and organizations (Figure 7). Moreover, 22 percent of public officials reported that the tax inspection was the most corrupt organization on an open-ended question (Figure 8).

Customs Service

77. The customs service, by nature of its work, is a governmental organization with great scope for corruption and in many countries the customs service is among the worst rated agencies for corruption. This is true in Georgia, as well.

78. According to enterprises and households, border crossings at customs require unofficial payments very frequently, second most frequently according to enterprises and third according to households. Enterprises report that more than 15 percent of the time, a border crossing at customs requires an unofficial payment, while households report that unofficial payments are required over 60 percent of the time¹⁶ (Figures 5 and 6). In aggregate terms, customs is the single largest recipient of enterprise bribes (Figure 10).

79. The poor ratings that customs received for frequency of corrupt practices carried over into the survey respondents' perception of honesty and integrity. Customs received the second lowest rating for honesty and integrity by households and public officials and the third lowest rating by enterprises (Figure 7).

80. As described in an earlier section, a measure of the profitability of being a corrupt public official, and a measure of the pervasiveness of corruption within an organization, is the frequency that officials in that organization actually pay money for their positions. Public officials were surveyed about how pervasive the practice of paying money for jobs was, and customs topped the list – public officials estimated that 45 percent of customs officials buy their jobs (Figure 19).

¹⁶ Households generally reported bribes of all sorts to be more frequent than reported by enterprises.

Credibility of the Desire to Fight Corruption

81. Explicit high level leadership and commitment to fight corruption are essential. Without true commitment from leadership, policy reforms will not be effectively implemented and the public's confidence in the anti-corruption effort will erode.

82. Public officials in Georgia were asked whether they thought there was a genuine sentiment among public officials or the government to combat the problem of corruption. About 59 percent said yes. Although it is comforting that most public officials see the desire to eliminate corruption as genuine, the fact that over 40 percent do not is worrying.¹⁷ If the program is not credible it will not be successful. Public officials did indicate, however, that while credibility may be lacking, the potential for a successful anti-corruption program was evident. A larger majority (78 percent) of public officials in Georgia indicated that an anti-corruption program is politically and administratively feasible.

7. TAKING STOCK

83. Between mid-1998 and mid-2000, the Government has moved ahead on some fronts in its effort to improve the functioning of the public sector. For example, a new Law on State Procurement (1998) heralded the beginning of a modern procurement regime – still in its infancy. Simplification of the licensing system was also initiated from 1999. A system for declaration of incomes and assets of public officials has been introduced, though it still needs major improvement and strengthening. A Civil Service Bureau has been initiating some steps in civil service reform. The Government has been endeavoring to develop and articulate a comprehensive anti-corruption strategy and the institutional arrangements to implement such a strategy. These institutional reform efforts, however, are still fragile and require careful nurturing and sustenance.

84. On other fronts, however, much remains to be done. Key areas requiring sustained attention remain the tax and customs authorities (united at present under a Ministry of State Revenues), the police, the procuracy, the judiciary, the core civil service and audit/control/supervision entities.

85. A new Government is now in place. It can begin taking some essential steps to improve the functioning of the public sector. Some of these steps have been suggested by Georgian participants in the 1999 Workshop on Improving Public Sector Performance and detailed in a Briefing Note. These steps, and other measures, can in turn generate higher revenues, more effectively fund basic public services, and create market-friendly conditions essential for private sector growth. To this end, this report may serve to facilitate discussion and decisions on a medium-term institutional reform agenda for Georgia – a process which needs to involve all branches of the state, civil society, and Georgia's development partners.

¹⁷ In Latvia, a similar question was posed to enterprises, households, and public officials, and the results made it very clear that in that country, at least, the general public was much less optimistic than public officials about the sincerity of the desire to fight corruption.

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