

ANTI-CORRUPTION HELPDESK

PROVIDING ON-DEMAND RESEARCH TO HELP FIGHT CORRUPTION

STATE CAPTURE: AN OVERVIEW

QUERY

Can you provide information on state capture in a seemingly well-run country? Are there many similar situations? What can be done to better understand the issue and to influence the system in the right direction?

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NOTE

This answer draws on a previous U4 Helpdesk answer on [“Influence of Interest Groups on Policy-Making”](#).

SUMMARY

State capture is one of the most pervasive forms of corruption, where companies, institutions or powerful individuals use corruption such as the buying of laws, amendments, decrees or sentences, as well as illegal contributions to political parties and candidates, to influence and shape a country's policy, legal environment and economy to their own interests.

The literature on state capture focuses to a great extent on former Soviet countries, but this form of corruption can also be found in other countries where politics and business have very close ties and transparency is lacking, such as in Singapore, South Korea, the United States and other European countries. State capture may also be a problem in countries where the military, ethnic groups or organised criminal groups are powerful and use the state to extract rents.

This answer provides an overview of the main issues related to state capture and the reforms necessary to address it.

1. OVERVIEW OF STATE CAPTURE

What is state capture?

State capture refers to “a situation where powerful individuals, institutions, companies or groups within or outside a country use corruption to shape a nation’s policies, legal environment and economy to benefit their own private interests” (Transparency International [Plain Language Guide](#), 2009). It is one of the most pervasive forms of corruption.

Public institutions such as the legislature, the executive, the judiciary and regulatory agencies both at the federal and local levels are subject to capture.

As such, state capture can broadly be understood as the disproportionate and unregulated influence of interest groups or decision-making processes, where special interest groups manage to bend state laws, policies and regulations through practices such as illicit contributions paid by private interests to political parties and for election campaigns, parliamentary vote-buying, buying of presidential decrees or court decisions, as well as through illegitimate lobbying and revolving door appointments.

State capture can also arise from the more subtle close alignment of interests between specific business and political elites through family ties, friendship and the intertwined ownership of economic assets.

The main risk of state capture is that decisions no longer take into consideration the public interest but instead favour a specific group. Laws, policies and regulations are designed to benefit a specific interest group, often times to the detriment of smaller firms and groups and society in general. State capture can seriously affect economic development, regulatory quality, the provision of public services, quality of education and health services, infrastructure decisions, and even the environment and public health.

Measuring state capture

There are several methodological challenges involved in measuring state capture. Hellman, Jones and Kaufmann (2000), for instance, note that one of

the challenges in terms of determining the extent to which a set of state institutions is captured is that it does not necessarily matter how many firms are engaged in state capture. In this context, a powerful monopoly could generate a much higher level of state capture than a larger number of smaller/less influential firms competing to capture public officials.

Against this backdrop, there have been only a few attempts made to measure levels of state capture. The Business Environment and Enterprise Performance survey (BEEPS), which was first conducted in 1999 by the World Bank and the European Bank for Reconstruction and Development (EBRD) to assess obstacles in the business environment across 22 transition economies, included questions regarding state capture. The questions aimed to analyse the extent to which firms make illicit payments to public officials in order to influence the formation of laws, rules, regulations, or decrees by state officials¹.

Where can we find state capture?

A great deal of the literature on state capture focuses on countries in Central and Eastern Europe, where the transition from socialism entailed radical transformations of political and economic institutions, which in turn created opportunities for powerful interest groups to influence the formulation of economic policy to their own advantage. In these countries, state capture was facilitated by: (i) the rewriting of an exceptional volume of laws, regulations and policies; (ii) the unusual redistribution of wealth from the state to the private sector; and (iii) the virtual absence of institutions either within or outside the public sector that could effectively check the abuse of public office (World Bank 2000: 25).

State capture can also be found in other nations where the military, ethnic groups, kleptocratic politicians or organised criminal groups become extremely powerful and manage to shape laws and policies. For instance, this is the case in Colombia,

¹ Companies were asked the extent to which the following six types of activities had a direct impact on their business: (i) sale of parliamentary votes on laws to private interests; (ii) sale of presidential decrees to private interests; (iii) central bank mishandling of funds; (iv) sale of court decisions in criminal cases; (v) sale of court decisions in commercial cases; (vi) illicit contributions paid by private interests to political parties and election campaigns.

Pakistan, conflict states in Sub-Saharan Africa, among others (Kupferschmidt, 2009; Kaufmann, Hellman & Gerain 2000).

While literature on state capture in other countries is scarce, there is evidence suggesting it is also a problem in developed countries where government and businesses have very close ties and where economic interests are often times intertwined.

Asia

In Asia, for instance, there is evidence of policy and regulatory capture by the elite and powerful business groups in Singapore and South Korea.

In Singapore, research conducted by the Tax Justice Network (2013) shows that the financial services sector in the country exercises strong influence over law-making. According to one of the politicians interviewed, laws are always approved according to the wishes of the offshore financial services sector, and since the 1990s the country has been liberalising financial markets and banking sectors. Former ministers and civil servants are members of the boards of banks and according to one diplomat, “the notion of conflicts of interest does not exist, because everyone is in some form a shareholder of Singapore Inc.” (Tax Justice Network 2013).

In South Korea, businesses have long maintained controversial relationships with politicians (Transparency International 2006). The so-called Chaebol, large conglomerate family-controlled firms, are characterised by their strong ties with government agencies. In addition to the control these conglomerates are said to have over politics, they also benefited from government bail outs on three different occasions (1974, 1987 and 1997), which led to government reforms after labour unions, international investors, small shareholders, as well as other civil society organisations advocated for more regulations (Lee 2008).

An anti-trust law was approved in the 1980s (Petersen 2011) and several reforms were implemented in the late 1990s aimed at making Chaebol leaders more accountable, eliminating loan guarantees among affiliates and enhancing managerial transparency. However, it is still not clear whether the reforms implemented actually reduce the

power and influence of these conglomerates on decision-making.

Americas

In the United States, corporations have become extremely powerful and they have been using lobbying, the revolving door and campaign financing to exercise control over the rules governing their operations, as well as over the allocation of public resources in several sectors (Monks 2012; Kupferschmidt 2009).

The recent events in the financial sector are a good example of how regulators have failed to reform existing rules for ensuring more transparency and accountability, as well as for punishing irresponsible behaviour due to pressure from business groups.

The final report on the financial crisis published by the Financial Crisis Inquiry Commission (2011) concluded that the financial industry itself played a key role in weakening regulatory constraints on institutions, markets and products. For instance, from 1999 to 2008, the financial sector spent US\$2.7 billion in reported federal lobbying expenses, and individuals and political action committees in the sector made campaign contributions of more than US\$1 billion (Financial Crisis Inquiry Commission 2011). Moreover, according to the former chair of the Securities and Exchange Commission (SEC), the agency responsible for overseeing financial institutions in the United States, “lobbyists exerted a huge amount of pressure once word of a proposed regulation got out. Members of Congress would then “harass” SEC with frequent letters demanding answers to complex questions and appearances of officials before Congress”. According to the former chair, these requests consumed much of the agency’s time, impacting its ability to make and enforce regulations (Financial Crisis Inquiry Commission 2011).

Past investigations into the influence of pharmaceutical industries on US law-making show that money spent on lobbying and campaign financing may have helped favourable laws be adopted at the federal level, and led to a more industry-friendly regulatory policy at the Food and Drug Administration, the agency that approves pharmaceutical products for sale and most directly

oversees drug companies (Center for Public Integrity 2011).

Europe

In European countries, the risk of state capture is often debated due to extensive opaque lobbying practices and politicians' dependence on private donations for financing of election campaigns (Transparency International 2012).

Important business groups often have direct access to politicians in many European countries. In addition, as the EU becomes a key policy-maker, businesses have increasingly tried to influence officials both at the commission and the parliament to shape laws and regulations according to their interests ([AlterEU](#)).

The 2011 "[cash for amendments](#)" scandal, where members of the European Parliament (MEP) were caught accepting money in return for tabling pro-industry amendments, has helped shine a light on the issue. Since then, several other cases of amendments that are favourable to powerful interest groups, sometimes drafted by industry lobbyists themselves, have been disclosed by non-governmental organisations advocating for more transparency in lobbying. In 2013, a Belgian MEP tabled 229 amendments against the European data protection directive. After the issue became public, the MEP declared that his assistant had met with several lobbyists and had tabled the industry amendments without his knowledge (Corporate Europe Observatory 2013).

At the domestic level, for example, the close ties between the German government and the car industry became more evident in 2013 (Spiegel 2013). After the elections, Chancellor Angela Merkel's party the Christian Democratic Union (CDU) received a donation of €690,000 (almost US\$900,000) from major shareholders of the BMW automotive company. Following the donation, Germany took a stronger stance in favour of postponing the implementation of an EU agreement limiting CO₂ emissions. If implemented, the new EU rules on emissions would have had an impact on the German car industry (Project for Democratic Union 2013).

2. ADDRESSING STATE CAPTURE

Addressing state capture requires reforms and improvements across a whole range of institutions and in relation to the internal organisation of the political system, as well as a complete overhaul of the relationship between state and business. Consequently, anti-corruption strategies addressing state capture usually aim at enhancing state capacity and public sector management, strengthening the accountability of political leaders, enabling civil society and increasing economic competition (Kaufmann, Hellman & Gerain 2000).

Enhancing the accountability of political leaders

Within this framework, countries should encourage civic participation, facilitate (or enforce) open hearings on policies and consultative decision-making processes (Transparency International 2009).

Other measures that may enhance transparency and accountability in policy-making and help to identify suspicious/illegal relationships between private groups and politicians include for example: freedom of information legislation to allow access to government documents related to the policy-making process; E-government mechanisms to encourage consultation and public feedback on draft laws and regulations; and public disclosure of parliamentary votes (Hellman 2011)². Political competition should also be enhanced by strengthening civil liberties.

Beyond that, special attention should be given to the following issues:

Transparency in political financing

Illicit political finance is one of the mechanisms often used by large corporations to influence policies, laws and regulations. While international evidence shows there is no universal blueprint for ensuring the effectiveness of political finance regimes, transparency is essential to curb opportunities for corruption and undue influence. In this context, in order to enhance transparency and accountability

² For more information on civic participation in policy-making, please refer to a previous Anti-Corruption Helpdesk answer available upon request.

and avoid state capture, countries should seek to (Transparency International 2009; Council of Europe 2003):

- **Reduce the costs of election campaigns:** High campaign costs increase politicians' reliance on private funds, providing companies and wealthy individuals with a great tool for manipulating policy-making or buying political favours. Countries should establish spending ceilings regulating both the type and amount of expenditures (for example limits/bans on advertisements, public events, amount of money spent on staff, public opinion surveys, etc.).
- **Limit/restrict private donations:** Restrictions on donations aim to reduce the excessive or inappropriate influence of private money in politics. These restrictions may involve limits on private contributions (regulating the maximum permissible contribution amount) or restrictions on the source of funding, including prohibition/limits on anonymous contributions, foreign contributions, donations from legal entities and state enterprises, or firms which provide goods or services to the public administration (Council of Europe 2003). Attention should also be given to illegal donations coming through loans or entities related to political parties.
- **Guarantee public funding:** Public funding also plays a key role in preventing the dependence of political parties (and candidates) on private donors. The success of a public funding scheme depends on whether political parties and candidates report on how funds are used as well as their other sources of income.
- **Establish efficient disclosure and reporting mechanisms:** Political parties and candidates must be required to disclose information on all the donations received (including name and address of donors and amounts). Political parties, in addition to reposting donations, should also be required to carry out proper bookkeeping and publish audited annual accounts of all income and expenditure. Such requirements are a prerequisite for the enforcement of spending ceilings, contribution limits and the allocation of public funding. The effectiveness of a disclosure mechanism also depends on the existence of an

independent oversight agency. It is also essential that such information is presented in a timely manner and is accessible to the public.

For more information on political party financing, please see the previous Anti-Corruption Helpdesk answer [Political Party Accountability: Intra-Party Democracy, Funding, and Minimal Standards for Candidates](#).

Conflict of interest rules

Conflict of interest is defined by Transparency International as a "situation where an individual or the entity for which they work, whether a government, business, media outlet or civil society organisation, is confronted with choosing between the duties and demands of their position and their own private interests" (Transparency International 2009). In particular, lawmakers and policy-makers in countries liable to state capture are uniquely vulnerable to conflicts of interest.

Regulation may take a number of forms, including laws, codes of conduct and internal rules or management guidelines, and cover a wide range of issues, including:

- **Asset and interest declaration requirements:** Public officials and politicians should be required to regularly (at least once a year) declare their assets, liabilities, income from all sources, gifts, advantages and other benefits, as well as unpaid contracts and employment, unpaid board memberships and directorships, participation in organisations, trade-unions, NGOs, and post-tenure positions and employment.

It is also important to request the disclosure of precise amounts of all income and the identification of concrete sources, as well as to make such information available to the public in an easily searchable database. Finally, an independent and capable oversight agency is instrumental to safeguarding the correct implementation and enforcement of the law.

For more information on asset declaration rules and examples please see the previous Anti-Corruption Helpdesk answers: [Asset Declaration Rules for Politicians](#) and [Declaration of Interests](#).

[Assets and Liabilities: Oversight Mechanisms and Sanctions.](#)

- **Post-public employment:** Regulation regarding conflict of interest should also cover post-public employment and establish mandatory “cooling-off” periods to avoid the revolving door, as enterprises and their consultants often use former public officials for lobbying purposes, or promise lucrative follow-on employment in the private sector to public officials that promote their interests while holding public office.

For more information on the revolving door, please see Transparency International’s 2010 [Working Paper](#).

Lobbying regulations

Regulation on lobbying is a relatively new global practice and some countries are still lagging behind in ensuring the relationship between lobbyists and public officials, particularly decision-makers, is transparent and ethical. Rules regulating lobbying should establish integrity safeguards for both lobbyists and decisions-makers. In order to enhance transparency, regulations on lobbying should seek to (Transparency International 2009):

- **Adopt a broad definition of lobbyists:** Lobbying activities can be carried out by different individuals, companies or organisations, such as lawyers, consultants, public affairs staff, and non-governmental organisations in different forms (meetings, phone calls, written text, e-mails). It is important that there are clear definitions of the activities exercised by lobbyists as well as their role.
- **Establish mandatory lobbying registers:** Mandatory lobbying registers are fundamental to ensure that the interactions between private interests and public officials are more transparent and accountable. Ideally, registration systems should allow for public disclosure of lobbyists’ names, their clients, the specific issues in which they have engaged, targets, techniques, as well as

financial information (how much is being spent to influence decisions). Effective implementation also requires robust mechanisms of oversight and enforcement (Zinnbauer 2009).

- **Establish “legislative footprints”:** while lobby registers are instrumental for keeping track of lobbyists’ interactions with decision-makers, in many cases the information provided is not enough to precisely identify how lobbyists are seeking to influence decisions/laws. This is exactly what the legislative footprint aims to do; it is a document annexed to draft laws and decisions detailing the interest group representatives who were consulted and provided input during the preparation of the bill/report.
- **Establish robust oversight and enforcement mechanisms:** Effective implementation of lobbying rules requires robust mechanisms of oversight and enforcement, including an independent and well-resourced oversight agency, a strong verification mechanism and proportionate and dissuasive sanctions.
- **Mobilise civic groups and the media to track and oversee the information disclosed about lobbying activities:** Citizens and the media can play an important role in questioning their political representatives regarding excessive contact with interest groups.

For more information please see the previous Anti-Corruption Helpdesk answer on [Best Practice in Regulation of Lobbying](#) and on [Legislative Footprints](#).

Ensuring a competitive private sector

Fostering competition in the economy and in the marketplace for political influence is one of the main challenges in preventing and combating state capture.

Therefore, it is possible to constrain the ability of powerful economic interests to capture the state by restructuring monopolies to increase competition,

encouraging trade, fostering a more favourable business environment, simplifying tax procedures and facilitating market entry (World Bank 2000).

Economic policy liberalisation

Deregulation of prices or other aspects of production or trade are important steps toward reducing opportunities for state capture. Price subsidies, tax exemptions and other benefits provide politicians and public officials discretionary power that is highly subject to abuse. Reforms towards greater liberalisation can help to reduce this discretionary power, if conducted in a transparent and non-discriminatory manner; otherwise, there is a risk that the reform process itself will be captured by powerful and influential groups (World Bank 2000).

Enhancing greater competition

Enhancing competition by lowering barriers to entry, requiring competitive restructuring (in particular of monopolies and prior to privatisations) and clarifying ownership structures are important elements for reducing the concentration of power in the hands of large vested groups (World Bank 2000). These measures will in turn reduce the likelihood of small group of influential conglomerates capturing institutions and the benefits of market reforms.

Transparency in formulating and implementing such policies is essential to ensure a fair process (World Bank 2000). Competition can also be enhanced through anti-trust laws and the establishment of independent competition agencies.

Regulatory reform

Routine aspects of business operations should also be simplified where possible. This includes registration and licensing procedures (for example establishing one-stop registration) or workplace safety (for example simple and clear rules for site inspections), in order to promote new market entry, growth, and to limit companies' contact with bureaucrats. This thereby reduces the opportunities/reasons for firms to capture the state. Firms should also be provided with low-cost methods for challenging administrative decisions (World Bank

2000).

For more information, please see the previous Anti-Corruption Helpdesk answer on [Best Practices in Reducing Bureaucracy and Corruption](#).

Corporate governance

Weak corporate governance institutions may also facilitate corruption and state capture. According to the World Bank, a wide range of corporate governance reforms have proven effective in curbing both incentives and opportunities for corruption. Among other things, such reforms include: public disclosure of share ownership and cross-holdings; strong penalties for insider trading and pyramid schemes; the appointment of outsiders to boards of directors; the introduction of regular, published independent audits of financial accounts based on standardised rules; the establishment of an effective legal framework for the exercise of creditors' rights; and the strong enforcement of ethical standards (World Bank website).

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