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Theme: STATE OF DEMOCRACY IN EUROPE

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Ladies and Gentlemen,

Thank you for giving me this opportunity to address the Parliamentary Assembly and comment on the Monitoring Committee's report regarding the *State of Democracy in Europe*. I believe the Monitoring Committee's and Mr. Holovaty's work is commendable.

The report assessed the improvements and the drawbacks from the past year on seven issues, which all together allow analyzing the state of democracy in Europe. In the following paragraphs I will address two issues that are in the remit of Transparency International's activities: *a) the fight against corruption; b) political parties and their funding*. I will make my short comments based on Transparency International's experience in its 15 years of activity in fighting against corruption around the globe, therefore in many transition countries as well.

It is not contested any more that corruption undermines democracy and the rule of law. One of the hallmarks of the third wave of democratization has been the package of reforms, which the transition countries tried to implement. However, the experience of the past decades has proven that anti-corruption reforms can only be successfully implemented when they are accompanied by macroeconomic, social and political reforms. If we look at the positions of Council of Europe's Member States on the attached TI's *Corruption Perception Index (CPI)*, we will see that most of the transition countries reviewed in the Monitoring Committee's report are at the very bottom of our "ranking". There seems to be a direct correlation between the advancement of general political and economic reforms on the one hand and the level of success in combating corruption on the other. Wherever fundamental reforms are lagging behind, the fight against corruption also remains unsuccessful.

Among many tools, which are at the disposal of the transition countries in their quest to fight corruption, are the creation of Anti-Corruption Commissions or Agencies and drafting of National Anti-Corruption Strategies. While some have been viable and by all means fulfilled their mission, others have served as a mere imitation of the governments' intention to fight corruption in the respective countries. Therefore, another lesson learned by the transition countries was that the experience with the anti-corruption agencies, strategies and action plans has been quite different and just the drafting of a strategy and the creation of a commission or an agency is not enough. Without a strong mandate and real independence the commissions remain ineffective and even counter-productive: they actually contribute to the overall cynicism and hopelessness that prevail in many transition countries when it comes "to fighting against corruption". Deeds have to follow words.

Another aspect which has proven to hold true was the nexus between the business climate of a country and its level of corruption. If one would put TI's *CPI* ranking next to the World Bank's *Doing Business* ranking, this correlation would immediately come to the fore (see the annex of this speech). In other words, the most corrupt countries are those where doing

business is the most risky and difficult. The infrastructure and opportunities which corruption offers are ideal for the shadow economy to flourish in these countries.

Let me briefly touch upon the issue of “shadow” economy, or otherwise known as “black”, “grey” or “extra-legal” economy, by turning to *János Kornai*, the famous Hungarian economist. I think his lucid analysis explains some of our frustrations caused by the slow progress in reducing corruption in the transition economies.

*Kornai (Kornai 2003)* reminds us that any well-functioning market economy rests upon what we call “*trust*”: on an environment in which private contracts – so essential for capitalist economy – are by and large enforced. The enforcement and the “security” it brings with it are fundamental for any business and other transactions. Generally, *Kornai* identifies three types of “enforcing” mechanisms:

1. The legal-judicial-bureaucratic mechanism provided by a well-functioning state.
2. The moral-associative mechanism, which rests on common norms - honesty and mutual trust - the contracting parties share.
3. When the two (1 and 2) mechanisms are weak, a third will emerge: the aggressive mechanism. I call it the extra-legal enforcement, which rests on bribes, corruption, and in its most extreme form, on violence, mafia-type of enforcement outside the law.

Needless to say, the # 1 and # 2 mechanisms reinforce each other: “The more a business can trust in legal enforcement of private contract, the more rarely it will need to resort to judicial proceedings. (...) The greater the mutual trust between business partners, the fewer the court cases. That reduces the pressure on the judiciary and speeds up legal proceedings, which further reinforces the reputation of the legal-judicial-bureaucratic mechanism” –writes *Kornai*.

This is the situation where there is trust: businesses trust each other, citizens trust the state, and the state trusts its citizens. The big problem in most of the transition countries is that businesses don’t trust each other, citizens do not trust the state, and the state doesn’t trust its citizens. The “trust” as such is very low in these societies. The above mentioned two mechanisms – the legal and the moral one - are very weak: neither the state, nor the established norms can provide the necessary “security and enforcement” for business transactions. Here a damaging substitution develops. The third mechanism – the extra-legal – will take over. “The more the business world relies on mechanisms #3 and resorts to illegal means, the lower the prestige of the law falls” – writes *Kornai*. “The result is a vicious circle, in which damaging processes reinforce one another”- *Kornai* continues. The existence of the third mechanisms explains the strength of corruption in many transition economies. As we say, much of what we see in transition countries is not corruption “by choice”, but rather corruption “by default”.

Let’s look at the “enforcement of contracts and security in doing business” as commodities or “services”. In a healthy situation, it is the state - through a professional, competent and efficient public administration and an independent and accountable judiciary – that provides these “services”. In disfunctioning and inefficient states these services are provided by alternative “service providers”: informal networks, extra-legal systems of allegiances, corrupt officials, and in extreme cases by Mafiosi.

Therefore, the key element of any successful anti-corruption strategy is the “legalization” of the economy by reducing the size and scope of the grey or shadow economy. As soon as the state starts operating as an accepted and reliable service provider with capacity to ensure the rule of law, it will “push out” the alternative non-state actors from what I call the “rule enforcement market”. As long as we ignore this negative correlation between the level of trust, generated mostly by well-functioning public institutions, and the level of corruption, much of the anti-corruption efforts will remain misguided.

The best link between democracy and corruption is depicted in the issue of political corruption. The evidence clearly shows that parliamentary systems are less corrupt than presidential ones. In the nexus *corruption and political system* the key elements are the checks and balances present and the way how power is being exercised. In addressing this issue, one of the major anti-corruption reforms has been the one for transparent party and campaign financing.

Modern democracies require strong party organizations that compete for political power in fair elections. On the one hand, parties and their candidates need resources (material and non-material) to run their electoral campaigns. On the other hand this strife for resources could perversely lead to the abuse of the entrusted power and means. Therefore, political finance can undermine the same democratic values that it also supports. Throughout its intensive work in this domain, TI identified two main risks – resources can distort electoral processes, but also may improperly influence the decisions taken by a country’s elected representatives.

The main problems identified by TI’s global experience in observing the political financing include a lack of oversight for private donations, scarce accountability by candidates, unreliable data delivered by parties along with the fact that information about political financing is not made public in most of the countries studied.

What has been done in addressing the political funding problems identified up until now? Many countries have taken measures in controlling private donations. Others provide public funding for parties in the election campaigns and regulate the role mass-media plays during these campaigns. Still others have successfully established independent state monitoring agencies.

Based on TI’s experience in tackling political corruption, we can affirm that contrary to other areas of public interest, regulating political finance means that elected officials are making the laws that will affect their own behavior. This intrinsic conflict of interest makes the role and the voice of the civil society even more needed.

There are three interconnected levels across which increased transparency can be promoted to reduce corruption risks related to political finance:

- Accountability within parties – the requirement to use proper internal bookkeeping and accounting systems and keep party members properly informed
- Accountability to the states – the requirement of parties and candidates, donors and service providers to report on political finance transactions to state agencies

- Accountability to the public – the requirement to disclose publicly all information on campaign finance

In light of the above mentioned aspects, TI has identified five aspects at the heart of political financing and advocates for their consideration for any sound reform in this domain:

1. More attention needs to be paid to the abuse of public resources to influence electoral results (such as political use of government access to the media or pressure on the public servants to make financial or in-kind campaign contribution)
2. Private donations have to be scrutinized more intensively
3. Disclosure of politicians' side incomes needs to be strengthened
4. By disclosing the information about funds used to finance the activities, both during electoral campaigns and generally, parties and candidates can facilitate scrutiny of illegal funds and influence peddling in politics.
5. It is vitally important that substantive information about reform in political finance – including obstacles – enter into the public domain. Therefore awareness needs to be increased to create a better informed electorate who can register concern at the voting booth.
6. Transparency International, and civil society with the media more generally, are important partners to help these conditions be met, so that political systems can evolve in healthy ways, be accountable and transparent.

All this being said, I would like to conclude that TI aligns to the call of the Monitoring Commission to make use of the report's findings and recommendations. The Council of Europe should hold up its role to promote values and norms so fundamental for democracies and human rights. After all, corruption is the violation of fairness and justice, two key elements for any society to sustain itself.

Thank you for your attention and for inviting me to speak on behalf of TI today.

Miklos Marschall

#### REFERENCES.

Kornai, János(2003) *Honesty and Trust in the Light of the Post-Socialist Transition*. Collegium Budapest. ([www.Colbud.hu/honesty-trust](http://www.Colbud.hu/honesty-trust))