

Republic of Moldova: economic consequences of corruption

Lilia Carasciuc

The large scale of corruption and shadow economy's spread are phenomena characteristic to a country in transition. In the Republic of Moldova since the beginning of the 1990^s an intensification of this phenomena has taken place. As preconditions for this could be mentioned the weakness of the newly formed state and its structures, contradictions and lack of transparency of the legislation system, dismemberment of the state, insufficiency of custom service, and low wages for state employees. The large spread of this phenomenon represents a threat to the security of the state.

If, by the beginning of the 90^s, one of the biggest problems for the country in transition was the shadow economy, and as the main objective of the state policy in this domain supposed the creation of conditions for the incorporation of shadow economy in the formal one, than in the last years the problem modified and grew into a national tragedy in a set of countries – corruption. Corruption in many cases undertook the mechanisms, structures, and functions of the state.

If at the beginning of the decade the phenomenon of corruption in transition countries served in big part as a brake for the economic development, creating obstacles for local producers and pushing out the potential foreign investors, then actually it simply blocks the reforms in the country. Any perfection of the acting legislation does not have any positive expected effects due to the corruption impact, the economy does not develop according to the market rules, there are not competition and progress in utilisation of disposable resources, state debts grow spontaneously, a pauperisation of the society, a decrease of population's credibility in the state, and a creation of a conflict situation take place.

A simple *definition of corruption* can be formulated in the following way: abuse of power for private gain by the state employees.

Main forms of corruption are: acceptance, soliciting or extortion of bribes, patronage, nepotism, theft of public goods, causing losses to the state, political corruption, etc.

Bribes – in order to obtain state contracts (choice of firms, terms and conditions for contracts), assure state guarantees for credits, obtain facilities, material and financial benefits, preferential support of patronage enterprises, hiding detected violations, non- application or diminishing penalties, obtaining licenses, exclusive rights for economic activities, for speeding-up delivering documents, obtaining political positions, employment in state structures and prestigious positions.

Thefts – spontaneous privatisation of public enterprises, equipment, financial sources, uncontrolled utilisation of the funds of enterprises, obtaining credits without payments, payment of wages to non-existing employees, etc.

Political corruption – violation of the election legislation, financing the electoral campaigns, solving parliamentary conflicts in illegal modalities, lobbying;

Causes of corruption can be economic, institutional, politic, social and moral:

- The *economic* ones include: unrealistic budget, low wages for state employees, delays in payment of wages;
- The *institutional* ones are: lack of real desire to fight corruption, lack of strategy in this field, high level of discretion in the work of legal bodies, an inadequate accounting system, lack of transparency in the system of legislation, weak state policy generating rent-seeking, career promotion without real performance.
- *Political* causes include: fighting corruption in fighting political opponents, interest in the economic and financial collapse of the state of some political groups willing the return of the old social system, import of corruption.

- *Social and moral* causes: demoralisation of the society, erosion of ethical values caused by the corruption amongst the top level employees, insufficient information of population, insufficient work of mass-media, public tolerance.

Corruption can have a strong impact on the economic, politic, social and ecological security of the state.

Economic consequences of corruption are:

- Growth of transactional costs, especially for economic activities in small business, diminishing competitiveness for goods and services;
- Discouraging investments and innovative ideas;
- Growth costs and diminishing of quality of public projects;
- Sliding of economy towards the underground sector;
- Unfair competition by using state institutions as repressing organs, falsification of information regarding competitors, technical and industrial espionage, racketing, signing monopolistic agreements, etc.
- Fund embezzlement, diminishing economic efficacy;
- Macroeconomic instability, susceptibility of the country to economic crises.

Social consequences:

- Creation of an additional tax burden;
- Strong negative impact on the vulnerable starts of the society, having no political influence vulnerable starts often have to face a heavier social pressure;
- Reduction of quality of goods and services;

Consequences on the political security of the state:

- Formation of an economic and politic clan, which impose to the society its wish, not taking into the account societies needs, and contributing to the huge growth of state debts;
- Diminishing payments to the budget resulting in the failure of the policy supporting small business, social, educational, health, and environment policies, and unfair work retribution in the budget system;
- Paralysis of state institutions, affection of rights and constitutional guarantees of citizens, discredit of the state system, lack of respect towards the state from the side of population;
- Deterioration of economic and politic security of the state;

Environment consequences:

Deterioration of the environment due to the fact that the society is imputed interests of separate groups - immediate profits without depreciating losses of the environment.

The relation between corruption and economic development is dual: on one side, low economic development, small incomes stimulates growth of corruption. On the other side, corruption breaks the development in the official economy, and stimulates the development of shadow economy.

The macroeconomic impact of corruption is essential in any country. Data of numerous studies in this field prove it. Vito Tanzi¹ says that corruption serves as an impediment to the three main functions of the state – macroeconomic situation, resource allocation, redistribution of incomes and welfare.

¹ Tanzi, Vito, and Hamid Davoodi, 1995, "Government Role and the Efficiency of Policy Instruments", IMF Working Paper N97/139 (Washington, D.C.: International Monetary Fund)

Paolo Mauro² made an attempt to find the impact of corruption on investment and growth. He shows that the decline of corruption index (Transparency International) by a medium square deviation (2.4 points) is connected with a 4 percentage points growth of the share of investments in the economy and a 0.5% growth of pace (rhythms) of economic growth.

Shang-Jin Wei³ analysed the impact of corruption on direct foreign investments. He found that increase of corruption index by a unite (on the ten level scale) is equivalent to growth of the marginal tax rate by 4.7 percentage points, and is accompanied by a decline of direct foreign investments by 0.9 percentage points.

A study of the World Bank(1996) ⁴ shows, that countries with high but “predictable” levels of corruption had a gross investment-to-GDP ration of 19.5%. For countries with low predictability but a still high level of corruption, the ration was just 12.3%. Unsurprisingly, countries with the highest ration were those with low corruption and high predictability (28.5%).

An inverse link between corruption index and Government investment ⁵ is investigated by Vito Tanzi and Hamid Voodi.

The investigation of Gupta, Davoodi, and Alonso-Terme ⁶ found that there is a strong correlation between corruption and degree of inequity in the country. But the main affecting the economy impact of corruption is, certainly, growth of shadow economy.

The results of numerous cross-countries comparative studies of shadow economy indexes and economic performance (Heritage Foundation, Transparency International, Freedom House Rankings) can be used in order to show a quantitative relation between the growth of the degree of corruption of the country, the volume of illicit transactions, and economic decline.

Corruption index (Transparency International) in the countries of the European Union fluctuates from 0.54 in Denmark (meaning a practical lack of corruption) to 5.5 in Italy, total corruption index corresponding to the value of 10. The average for EU oscillating around the value of 2.5. For the country in transition which hope to join the EU this index is at least 2.5 times bigger, reaching from 4.5 in Estonia till 7.6 in Russia. On this scale Moldova is placed together with Bulgaria after Romania and is followed by the Ukraine. However, it should be mentioned that the evaluation of the corruption index is based on the evaluation of the level of perception of corruption by the population, than on the evaluation of its real dimensions.

² Mauro, Paolo (1996), “The Effects of Corruption on Growth, Investments”, IMF Working Paper N96/98

³ Wei, Shang-Jin, “How Taxing is Corruption on International Investors”, NBER Working Paper Series, Working Paper 6030

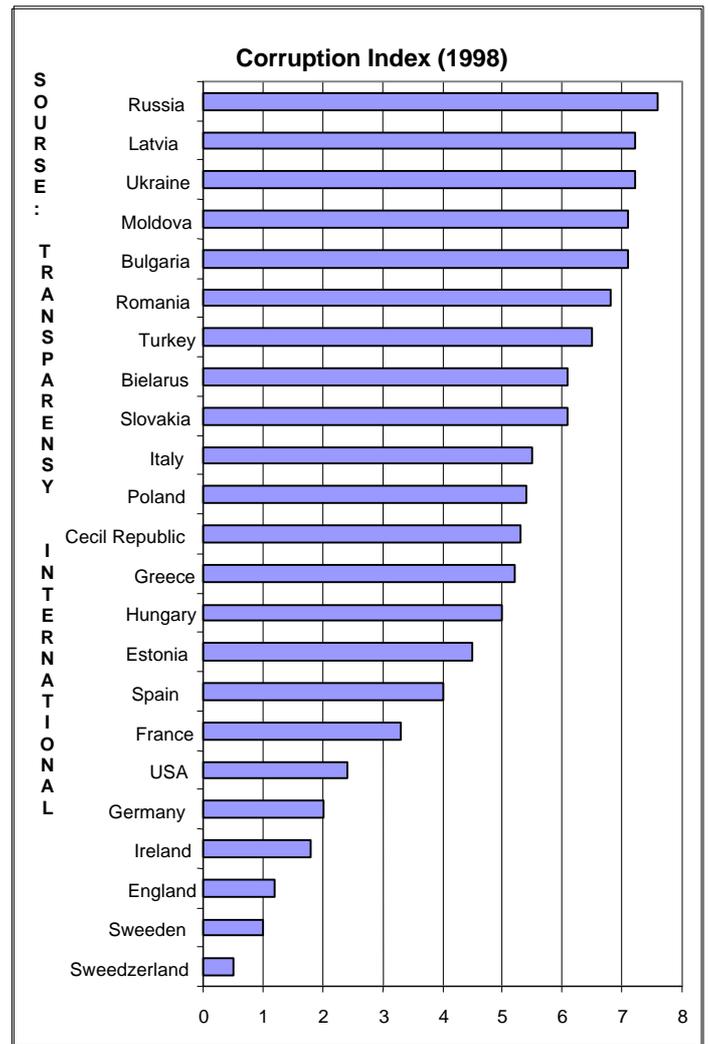
⁴ Segal, Philip, The Hell of Corruption, *The IFC Review of private Investment in Developing Countries*, Spring, 1999, Vol.3,Nr.2

⁵ Tanzi, Vito, and Hamid Davoodi, 1997, ‘Corruption, Public Investment and Growth’, IMF Working Paper N 97/139 (Washington, D.C.: International Monetary Fund)

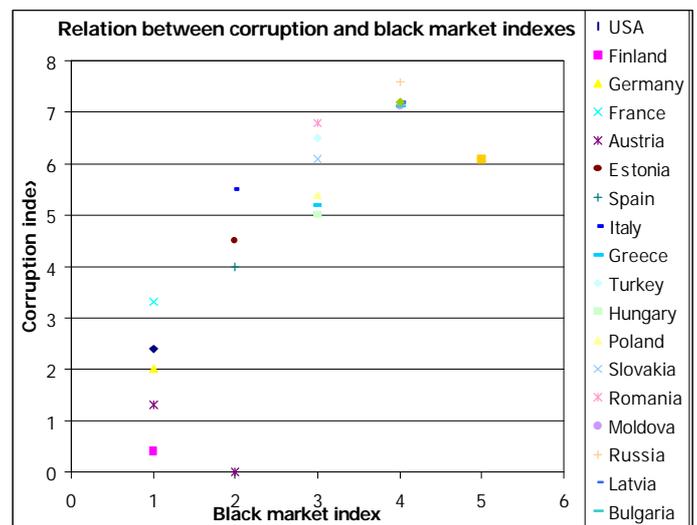
⁶ Gupta, Sanjeev, Hamid Davoodi, and Rosa Alonso-Terme, 1998, ‘Does Corruption Affect Income Inequity and Poverty?’, IMF Working Paper

Therefore, in a traditionally more democratic country this index can be overestimated. At present, there are attempts to develop the Bribery Propensity Index.

High level of corruption in transition countries implies growth of black market (Herritage Foundation), the index of black market varying from its minimum -1 in Austria, France, Germany, Finland, 2 - in Italy, Spain, Estonia, 3 - in Greece, Turkey, Hungary, Poland, Romania, 4 - in Latvia, Bulgaria, Lithuania, Moldova, Ukraine, Russia, and reaching its maximum of -5 in Georgia and Belarus. Calculations also show a strong inverse link between the degree of corruption and GDP per capita. An inverse relation between corruption index and the index of economic performance in transition countries persists, the last one having as basic components the politic system, the degree of freedom for mass-media, the rule of law, the degree of public administration, the development of private sector. On the picture the relation between these two indexes can be clearly seen.



Corruption is a *self-generating process*. If the state employees did not receive their wages during 4-5 months, bribes become their only stable source of income. The following evolution in a vicious circle takes place: corruption → economic decline → insufficiency of sources for the budget → delays in paying wages for state workers → growth of corruption. More than this, it is easier to blackmail and force to repeat corruptive actions a person disclosed in corruption. Not willing, this person starts to belong to a strong enforcing system.

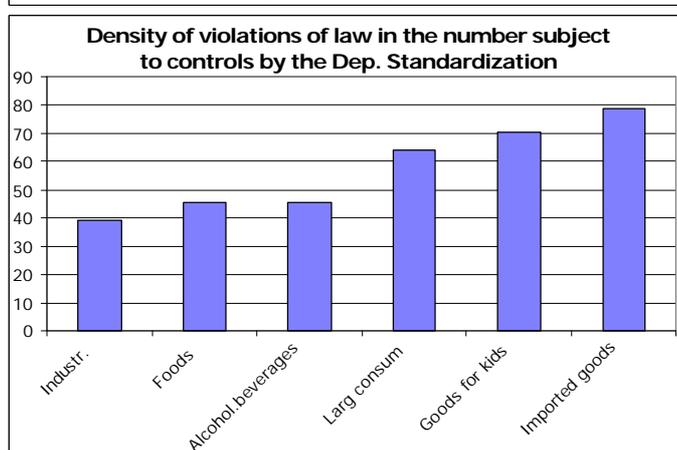
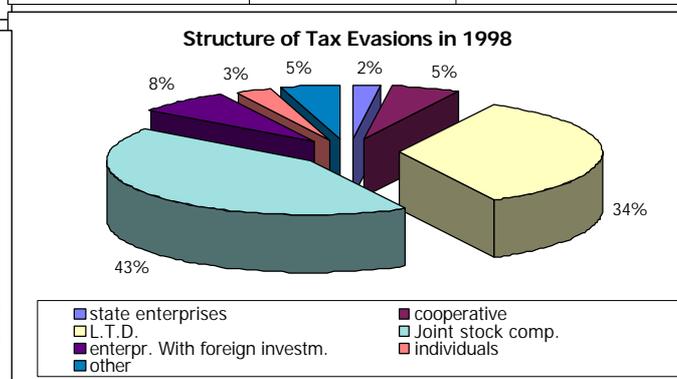
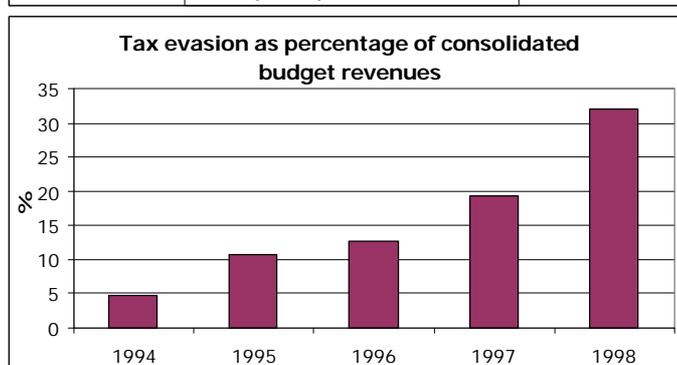
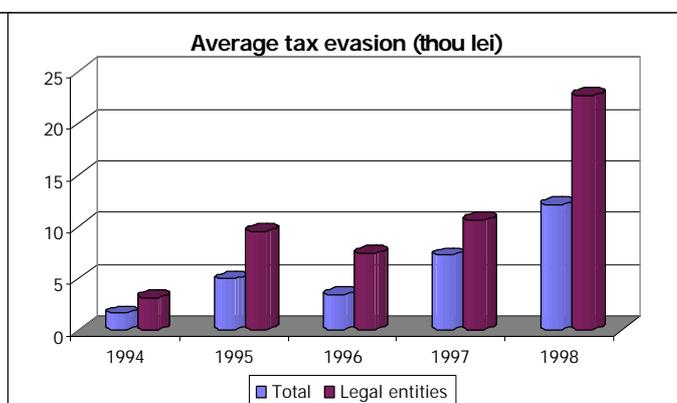
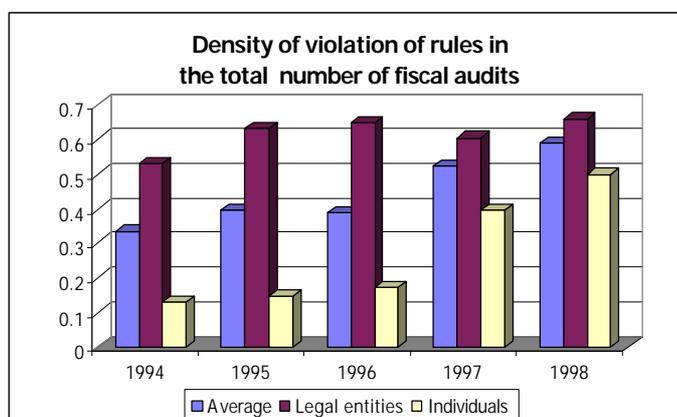


Therefore, starting with 1998, official data regarding the results of audits and inspections became more “optimistic”. Thus, in 1998 there were registered 2910 violations of economic and financial legislation, by 244 less than in 1997, losses being estimated at 103 million lei. Police of Chisinau city marked a decline by 13% in the number of registered crimes, although 298 cases of shading crimes were discovered. There were collected 11% less taxes in Chisinau (853 million lei). The 10% decline of industrial production and 18% inflation can not explain this phenomena. Two parallel process take place: a) hiding or closing criminal files, b) decrease of small crimes and growth of the big ones.

Unfortunately, the actual situation in the Republic of Moldova, as well as in many other countries in transition, does not contribute to the growth of credibility of Moldova as an economic and political partner. The share of underground economy got outstanding proportions, tax evasion rises continuously. The lack of control of state employees' activity and low enforcement, as well as delays in payments of wages for the state workers contributed to the extension of corruption and the level of economic crime in the Republic of Moldova.

According to our estimations, the tax evasion grew up from 4% of the consolidated budget revenues in 1994 to 20% in 1997, and 32% in 1998. The average evaded tax rose from 7 thousand lei in 1997 (10 thousand lei per legal entity) to 12 thousand lei in 1998 (23 thou lei for legal entity). The density of rules breakers in the total number subjected to audits grew from 51% in 1997 to 57% in 1998.

In 1998 the collaborators of the Department of Financial Control and Revision accomplished 9506 controls, 2353 less than in 1997. Though, the total sum of losses for the economic agents and state, caused by illegal expenditures, lacks and thefts amounted to 87.4 million lei, in comparison to 36.3 million lei in 1997 (a 2.4 time growth).



Data of the National Center for Standardization, Metrology and Certification show that the density of violations of law detected during the controls of consumer goods varied from 40% for foods to 70% for the goods for children. Maximum is achieved for the imported goods –79%. The quality of goods varies on the territory of the country.

Data of the scientific-practical conference “Organized crime and shadow economy in the Republic of Moldova” held under the aegis of the Ministry of Internal Affairs of the Republic of Moldova, Academy of Police and the Independent Association of Criminology, shows that corruption in Moldova achieved outstanding proportions. Lack of state power creates conditions for the appearance of mechanisms and structures which quickly can substitute the state structures.

Ordered murders: the existing practice of repeating (2-3 times) temporary break out of prison convicted persons with a view to commit an ordered murder is recognised. There are about 300 criminal groups, 35 criminal clans, which control the economic, political, and social performance of the country. Thus, the problem of non-payments can be easily solved if applying to criminal structures, playing the role of informal court, for 50% of the sum.

On the territory of Moldova there are four channels of *drug trafficking*. Only the monthly traffic of heroin is estimated up to 150-200 kg (for information: the wholesale price of 1 kg of heroin amounts 1.5 thou \$ in Pakistan, 10 thou \$ in Turkey, 40 thou \$ in England, the retail price reaching 120 thou \$). On the territory of Moldova there exist clandestine laboratories producing drugs by local, much cheaper technologies, and this presents an essential threat for the local evidently poorer population. During the last five years the estimated number of addicted persons rose from 3 thou to 60 thou people. Only in 1998 their number grew 5 times in comparison to 1997. Drug industry is highly concentrated, about 60% of transaction with drugs are made by local Gypsies (for information: Gypsies make up to 0.3% of the total population of Moldova).

The annual volume of narco-business in Moldova is estimated at 200 – 250 million \$, this figure exceeds 3.5-4 times the annual direct foreign investments in Moldova. It is clear that the “efficacy” of functioning of this branch is definitely “higher”. Possibilities to corrupt the state officials are extremely big. That is why the list of narcotic and psychotropic substances proposed by the specialists of the Committee of Drug Control undergone essential “modifications” by the moment of its adoption and publication in the “Official Monitor”. A number of substances which can be easily produced on the territory of Moldova vanished. That is why the custom service does not have an elementary cinologic service (dogs detecting drugs). That is why there does not exist any data-base regarding drug traffic, or an unique informational system of the ministries of force. That is why criminal files do not “reach” the court (their total number diminished from 15 in 1996, to 10 in 1997, and 9 files in 1998). That is why extremely expensive cars with four degree of protection are used for the transportation of drugs.

Smuggling: According to the data of custom service, the detected volume of smuggled goods grew from 2,7% the total export-import in 1997 to 10,6% in 1998. During the same time, the number of criminal files reaching the court diminishes continually, criminal files are closed (from 28 open criminal files no one was investigated in 1998).

Data regarding the *volume of illegal export-import transactions* are more relevant. An accomplishment of a cross-checking of Moldovan and Ukrainian information regarding Moldovan exports to Ukraine shows that the Ukrainian figure is almost double. This can not be explained only by the contribution of Transnistria. The same situation takes place in the

case of Russia. It is few probable that workers of the Ukrainian and Russian custom services are likely to be more honest than those from Moldova, therefore the real distortions could be even more grave.

This result could be not so surprising, if to take into consideration the current situations when the custom service detains full trains with illegal transported goods, and after a call from the “top officials” it is constrained to let the train pass.

The list of corrupted actions characteristic for the *management of public property, accumulation and utilisation of financial resources, execution of state control* is quite wide. Amongst the most characteristic for Moldova the following can be mentioned:

- Improper formation and utilisation of the state budget funds, lack of methodological norms of their formation and utilisation, illegal financing of structures and activities not envisioned in current legislation;
- Inefficient and irrational utilisation of budget resources by the state-owned institutions due to improper organisation of state-owned budget institutions, financing that leads to wasting of enormous amounts of state funds, improper utilisation of investments and donations, including in foreign exchange, as well as their transfer to certain commercial structures that use them for a long or for a symbolic fee;
- Irrational and inefficient utilisation of investments and credits as a result of a bad allocation of state resources, improper utilisation of investments and credits given to economic agents;
- Evasion from taxes. Fees and other compulsory payments to the state budget;
- Violation of price discipline, especially ungrounded increase of prices;
- Wasting of public property as a result of intentional non-accounting of certain objects of state property, illegal rent of premises and equipment, ungrounded or illegal privatisation of state property, violations while purchasing of 20% of shares by the staff of the enterprise without holding a tender, diminishing the value of property, and excluding the former staff, and including outsiders in privatisation process, unreal evaluation of the property;
- Irrational and inefficient contracts with certain economic agents, especially with non-government structures;
- Unsatisfactory accounting of financial and economic activity which enables government officers to freely dispose of the state property, including budget resources in their personal interests.

In short time Moldova transformed in a corrupt and kleptocratic state, with amoral nepotism. How, if not through corruption and lobbyism, could be explained that fact, that the legislation of Moldova even does not include the term “racket”, there are not foreseen special measures towards prostitution, it is not adopted a special system of taxing gambling? Moldova, being over-indebted for energy resources, imports natural gas at prices much higher than international ones, and even does not ask payments for the transit of natural gas throughout its territory (for information: the payments for the transit of gas throughout the territory of Ukraine exceed the GDP of Moldova). More than this: Moldova does not have gas counters at the entrance and exit from its territory. The only explication is the group interest, which is completely opposed to the interests of the whole society.

This situation is characteristic for the autocrat states, in which there is a lack of practice of auto-organisation, based on horizontal links, reciprocal credibility and solidarity, in which for a long time a bureaucratic hierarchy, a preponderance of vertical relations of domain -subordination, tutelary-dependence were maintained.

Fighting corruption brings *immediate profits*. Revenues from combating corruption exceed many times the costs. According to some Western estimations, the expenditures of £1

bring in average £23, in fighting corruption at the local level, and for about £250 on the international level⁷.

The materials of the United Nations Commission for crime preventing show that the nominated phenomenon wide-spread in the Central and East Europe during the last decade. These kind of problems are included into the programs of seminars and congresses of many international bodies. (*INTOSAI, EUROSAL, SIGMA, Accounting Court of the EU, World Bank, Working Group on briberies OECD, International Monetary Fund, etc.*).

The Defend Supreme Council of Romania adopted the proposal of establishing the National Institute for the studies of corruption and organised crime under the Academy of Romania.

The goals of fighting corruption can be different:

- short run efficacy in the private sector;
- long run dynamic efficacy, economic growth;
- social equity, political legacy.

The durable strategic directions of fighting corruption in the Republic of Moldova should include deregulation, privatisation, transparency, institutional reform, improving of the enforcement system, reduction of the monopoly force in all spheres, clarifying the degree of discretion in the work of decision makers.

Implementation of a ***policy fighting corruption*** needs the reform in legislation, the institutional reform, improvement of the system of regulation of fiscal audits, reduction of the public tolerance:

Reform in legislation:

- Appealing to the aid of international institutions for fighting corruption and economic crimes, applying to an external system of monitoring;
- Addressing to projects financed from foreign technical assistance to perform a juridical expertise of laws and amendments proposed for adoption, improving the legal system, removing of contradictions, double meanings, etc.;
- Perfecting of preventive measures for crimes;
- A clear definition of a penalty system for law breakers;

Amelioration of fiscal control procedures:

- Simplification of regulations of state controls and audits;
- Systematisation and unification of the work different audit agencies;
- Publishing a clear information regarding controls, rights and obligations of control agencies;
- Establishing of a unite, which registers and regulates the number of controls of the same enterprise;
- Reform of fiscal and accounting systems, simplification, ensuring its transparency;
- Perfecting the qualification level of control and audit personnel;
- Publishing fiscal information, transparency of preparation and execution of state budget;
- Introduction of an obligatory tender system for public procurements.

Institutional reform:

⁷ I.Bogdan, Corruption and economic crime, "Curierul Economic", 45(347)

- Reduction of the number of state institutions, reduction of the staff;
- Substitution of the procedure of personal visits for solving problems by using mail, including e-mail system;
- De-politisation of Government, introduction of an obligatory system of professional promotion on the base of performance and concurs;
- Introduction of a clear and definite system of ethic standards for the state employees;
- Creation of independent institutions authorised for investigations the accusations in corruption.

Reduction of public tolerance:

- Co-ordination of efforts of educational, religious organisations and mass- media in the anti-corruption campaign;
- Assuring transparency of financing politic parties;
- Employment in promotion of a balanced of reporting, introduction of a ethic code for journalists;
- In order to improve the credibility of population in state structures – creation of a unique body for complaining about inadequate behaviour of policemen, workers of custom service, fiscal auditors, etc.

As *immediate measures of fighting corruption* there are proposed:

- Elaboration of a strategy for fighting corruption in division of ministries and main directions: public procurements, public campaigns' management, urban planning, fiscal administration, custom reform, legislation;
- Formation at a national level of a co-ordinating body responsible for the implementation of the strategy for combating corruption;
- Identification of a number of key-agencies in domains, in which a concentration of efforts to combat corruption could be done during the first year;
- Applying of income declaration procedure to the state employees, starting with the top level;
- In countries with a high level of corruption, where any attempt to fight corruption is treated as discrediting political opponents, a strategy of “detecting” corrupted persons at the top level in proportion represented by parties in the Parliament (formula 2+2+1) could be applied. In order to gain the credibility of population, the cases should be proceeded publicly, announcing the punishment of the law breakers, and the directions where obtained money were spent (pensions, wages, repayment of debts, etc.).
- An immediate installing of gas counters at the entrance and exit from the territory of Republic of Moldova.

Conclusion. *By no way the author of this paper wishes to say that Moldova is an exception between the NIS countries regarding the spread of corruption and shadow economy. In the area of NIS any attempt to modify the legislation directed to the stimulation of private sector's development, encouragement of investments and innovative activities, export promotion, solving the problem of budget deficit, external debt, problems of the social and educational sectors, – no one will achieve successes, until drastic measures to combat corruption, the moving force of the shadow economy, will be undertaken. In order to achieve this, an elaboration of a clear strategy of fighting the nominated phenomenon, and appealing to the experience of international organisations are needed.*