



## THE IMPACT OF CORRUPTION ON ECONOMIC DEVELOPMENT: CASE STUDY ROMANIA

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### Abstract

*In the last decade, Romania implemented a strong legislation and a comprehensive program of public financial management reform in order to improve the national fiscal transparency and to reduce corruption.*

*Corruption is a growing phenomenon all over the world, affecting economic development and aggravated by the legacy of the global economic crisis. The global risks are different from the past due to notably cyber-attacks, new economic realities and geopolitical risks. Most of the time, corruption is associated with financial crime, fraud and bribery. Corruption is a major factor of reducing economic development and the governments must increase of macroeconomic and fiscal forecasts in order to facilitate access to the public funds.*

**Key words:** *financial crime; corruption; government; fraud.*

**JEL Classification:** C61, D73, H11, H26



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### Introduction

This paper seeks to present some aspects of corruption in a changing European environment and how corruption has a significant impact on the economic development. In our opinion, corruption, fraud and crime institutionalize suspicion and create a deep loss of mutual trust and confidence within the public and private organizations all over the world.

Corruption is an international persistent phenomenon and gives some people advantages that others don't have [Uslaner, 2008].

Despite the program of public financial management reform implemented in Romania, there is strong perception on corruption, like many other European countries, with bad consequences over economic development and investment. According to Global Competitiveness Report 2015-2016, WEF Geneva 2016, the most problematic factors for doing business in Romania are: tax rates, inefficient government bureaucracy, access to financing, inadequate supply of infrastructure, corruption, complexity of tax regulations, inadequately educated workforce, restrictive labour regulation, poor work ethic in labour force, policy instability, insufficient capacity to innovate, inflation, poor public health, foreign currency regulations, crime and theft, government instability. In the last years, foreign investors consider corruption one of the problematic factors of doing business in Romania.

### Literature Review

The paper has based its conclusions on the researches from the last few years: Măgureanu, A.L. (2014), "*Few Aspects Regarding Bribery as a Social and Economic Threat*", who presented bribe giving as active corruption and bribe taking as passive corruption. He thinks that corruption affects all segments of society, including businesses, as it affects markets and competition. "Concepts such as ethics, integrity and corruption may apply in different contexts. Individuals and organizations alike have standards and moral principles and their behaviour may or may not comply with ethical principles. It has become clear today that the role that a corporation (or any other form of business) cannot be reduced to obtaining a



profit.” [Măgureanu, 2014]. He is suggesting that any juridical entity (including corporations) must primarily take internal measures of preventing corruption, but it is unlikely that corruption will ever be completely eradicated. Corruption could be reduced, primarily by a proper education, by making peoples realizing the costs and the long term implications of any act of corruption, no matter how small (as none of them are irrelevant).

Frâncu, L.G. and Paicu, C.L. (2008) in “*The Romanian Bureaucratic System of Public Administrations*” explained the connection between bureaucracy and corruption in Romania. They think that the most obvious problem is that bureaucracy encourages corruption especially because of this complicated way of solving simple problems that become complicated when dealing with bureaucrats. In their opinion, the problem is that bureaucrats got used to the idea that they have a certain power, artificially created and for offering free information or services they ask something in return. This is reason to offer some flowers, coffee to the public servants, but of course it depends on the nature of the problem we must solve. They explain how if the problem gets bigger, then the “gift” must be bigger, must have a big value. Finally, it came to the point in which citizens have to give something in order to be taken into consideration or addressed nicely.

*Global Risks Report 2015* (World Economic Forum) presented how cross-cutting challenges can threaten social stability, perceived to be the issue most interconnected with other risks in 2015, and additionally aggravated by the legacy of the global economic crisis in the form of strained public finances and persistent unemployment. According to the Report, the interconnections between geopolitics and economics are intensifying because states are making greater use of economic tools, from regional integration and trade treaties to protectionist policies and cross-border investments, to establish relative geopolitical power. This threatens to undermine the logic of global economic cooperation and potentially the entire international rule-based system. [Global Risks Report 2015] Corruption is still one of the problematic factors of doing business in many European countries.



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### **Fraud and Corruption Risk Assessment**

Major fraud or corruption can set off a chain reaction resulting in serious corporate harm or failure. Managing the risk of fraud and corruption requires an on-going commitment to acquiring fresh knowledge. Managing fraud and corruption risks requires a level of commitment from partners and allies. Fraud often accompanies corruption. The true victims of fraud and corruption are usually innocent people. There are accelerating factors involved in the prevalence of fraud and corruption. Fraud and corruption have a corrosive and damaging effect on the competitive spirit. The elements of fraud and corruption risk management are *assessment*, *prevention*, *detection*, and *response*. Measuring the extent of fraud and corruption is inherently difficult. On-going fraud and corruption schemes are a continuing drain on a company's profitability. There is a trend toward more aggressive enforcement of anti-corporate fraud and anti-corruption laws. Fraud and corruption risks are virtually impossible to avoid completely. Companies that implement detailed fraud and corruption risk management processes can experience related benefits. Companies now face as great a risk of fraud and corruption as ever before. Fraud and corruption risk assessment considers the ways that fraud and corruption can occur by and against the company. A fraud and corruption risk assessment is tailored to the company's size, complexity, industry, and goals. Globalization has increased the likelihood of encountering bribery and corruption risks. Fraud risk factors often are present in circumstances where fraud or corruption exists. [Bishop & Hydoski, 2009]

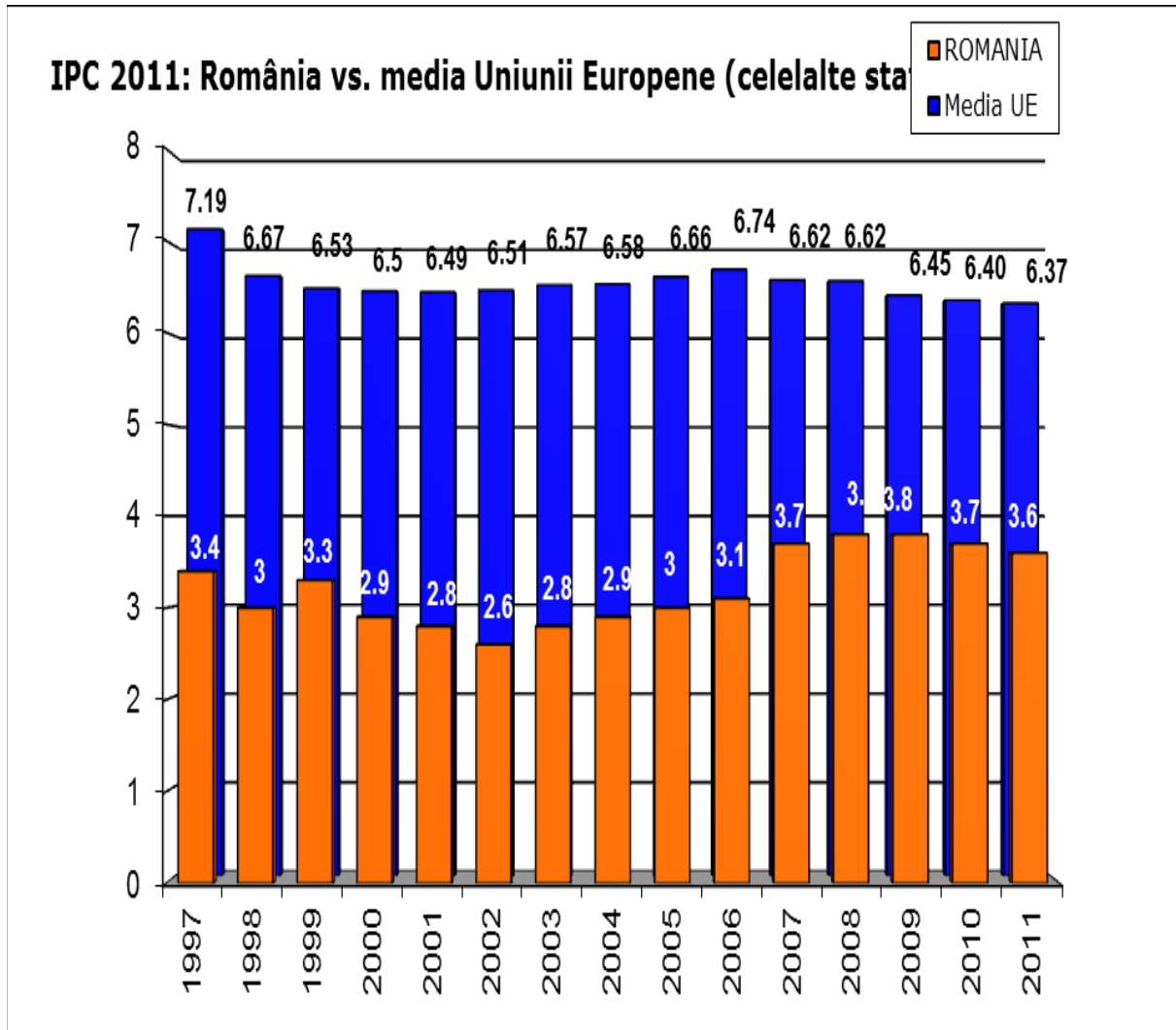
Corruption and money laundering have a devastating impact on national economies, international security, and human development. Corruption produces enormous profits to be laundered. Following the money trail should help to detect and deter corrupt exchanges. Corruption and money laundering are closely interrelated: they are serious problems for most countries all over the world. Grand corruption and money laundering are international phenomena. Corruption is the greatest obstacle to economic development. Offering and soliciting bribes count as corruption, even if the advances are rejected. International grand corruption is the most damaging

type (in the sums of money stolen and in the broader societal consequences). The incidence and scale of corruption is difficult to measure. Corruption can facilitate the laundering of the proceeds of crime. [Chaikin & Sharman, 2009]

Corruption is a relatively new challenge for social sciences: we may fail to understand corruption without considering its intrinsic dynamics and logic. Corruption is harmful even to those who have the chance of striking illegal deals. Downsizing the public sector does not help in reducing corruption. Certain cultural determinants drive both decentralization and the absence of corruption. Encouraging competition and reducing corruption can be two sides of the same coin. The causality runs from culture to corruption and not the other way round. Culture explains only a fraction of the variance of levels of corruption. Unpredictability acts as a deterrent to a further spread of corruption. A hierarchical relationship within a firm may help in arranging a corrupt exchange. Corruption is often restricted to well-acquainted business partners, and adversely affects economic development. Corruption constrains the contractual space available to agents and principals. Countries riddled by corruption exhibit poor government institutions. Corruption acts as an inducement to public servants to create artificial bureaucratic bottlenecks. Excessive regulation provides opportunities for future corrupt transactions. The creation of a distortionary decision becomes the actual intention of the corrupt inducement. Corruption can enlarge the set of possible actions to be taken by the parties involved. The possibility to behave in a corrupt manner does not enlarge the contractual possibilities. Corrupt bureaucrats base their decisions on expected corrupt income. Corrupt opportunities constrain the contractual space available to public servants and the government. [Lambsdorff, 2007]

### **GDP Model and Corruption Perception Index: Case Study Romania**

In this section, we present a GDP model for Romania and the correlation with corruption perception index (CPI) for Romania for the period 1997-2011 [Ionescu, 2012].



**Figure no. 1. Corruption Perception Index (CPI) for Romania for the Period 1997-2011**

Source: Own calculations based on Eurostat data

There are differences in GDP per capita convergence in EE countries, but selected data for Romania [Albu, 2012]. Thus, we started from the equation:



$$PIBL = C(1) + C(2)*ISD + C(3)*EXPN + C(4)*STOCK$$

where:

- PIBL represents GDP per inhabitant (mil. RON – 2005 current prices);
- ISD represents Foreign Direct Investments (mil. RON – 2005 current prices);
- EXPN represents Net Export (mil. RON – 2005 current prices);
- STOCK represents Capital (mil. RON – 2005 current prices);

For our model, we used data collected from National Institute of Statistics from Romania, and National Bank of Romania, for the following period: 2003-2011. We realize that the period is short, but more data are not available, for the moment [Nica, 2012a]. Despite this shortcoming, the parameters managed to explain quite well the evolution of GDP per inhabitant [Albu *et al.*, 2010].

We estimated the parameters of the model, through Least Square method, as follows:

$$PIBL = 7014.64930435 + 0.0267615722512*ISD - 0.0406810277116*EXPN + 0.00817997857659*STOCK,$$

where:

- C(1) = 7014.64930435;
- C(2) = 0.0267615722512
- C(3) = 0.0406810277116
- C(4) = 0.00817997857659

Here we present the output from Eviews 7, for the estimators and the specific tests (in order to verify the efficiency of the model):



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Dependent Variable: PIBL

Method: Least Squares

Sample: 2003 2011

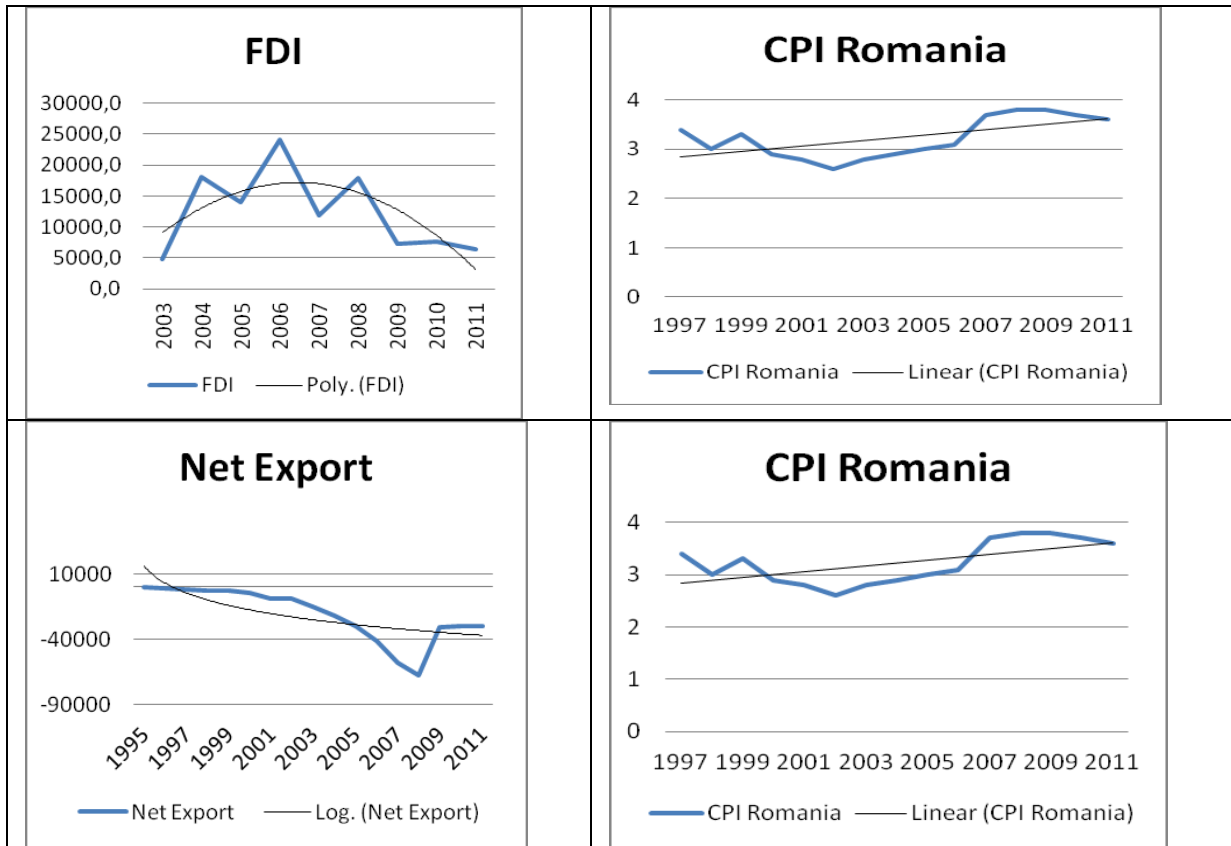
Included observations: 9

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	7014.649	421.3130	16.64950	0.0000
ISD	0.026762	0.013361	2.002954	0.1016
EXPN	-0.040681	0.005174	-7.863059	0.0005
STOCK	0.008180	0.000567	14.41853	0.0000
R-squared	0.991364	Mean dependent var		14521.33
Adjusted R-squared	0.986182	S.D. dependent var		1560.475
S.E. of regression	183.4343	Akaike info criterion		13.56269
Sum squared resid	168240.7	Schwarz criterion		13.65035
Log likelihood	-57.03212	Hannan-Quinn criter.		13.37353
F-statistic	191.3174	Durbin-Watson stat		2.784741
Prob(F-statistic)	0.000014			

We established a connection between the corruption perception index and the following indicators: GDP/inhabitant, Net exports, Foreign Direct Investments and the Capital, as shown in Figure no. 2.

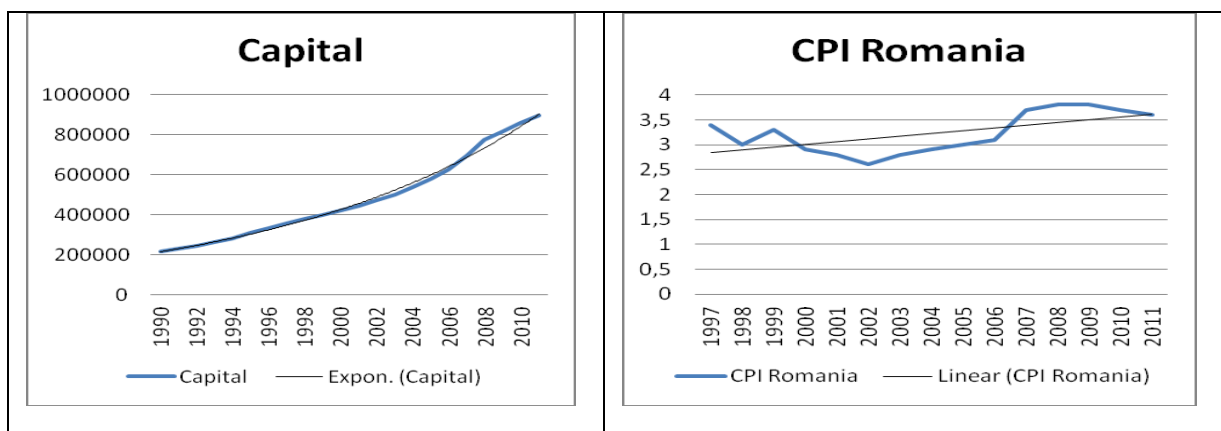
Thus, the evolution of GDP per inhabitant is determined by the evolution of the FDIs, Net Export and Capital [Nica, 2012b]. We managed to show that the connection between CPI and our indicators is as follows: with FDI – negative correlation, with Net Export – negative correlation (but on the short term we expect that the trend of Net Export will change) and with Capital – positive correlation [Popescu, 2012].





**Figure no. 2. Correlation between CPI Romania, FDI and Net Export (mil. RON – current prices, 2005)**

Source: Own calculations based on Eurostat data



**Figure no. 3. Correlation between CPI Romania and Capital (mil. RON – current prices, 2005)**

Source: Own calculations based on Eurostat data



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So, if we want to explain the evolution of GDP per inhabitant in connection with CPI (Romania), we must take into consideration the correlation between CPI and the components of GDP, namely FDI, Net Export and Capital [Albu & Dinu, 2009]. If we take into consideration the following scenario: CPI will continue to decrease (since 2007), we expect to see a change in trend also for GDP per inhabitant (this will be a subject for further research).

### Conclusion

Corruption became an important problem in European countries in the last decades due to global challenges and the legacy of the global economic crisis. We were explaining in our research the influence of corruption on the economic development, we presented the corruption perception index (CPI) for Romania for the period 1997-2011 and the GDP model for Romania with CPI. We observed how corruption determined the suspicion in public administration and create a deep loss of mutual trust and confidence within the public organizations. The interconnections between corruption and economics are intensifying due to fraud, bribery, money laundering and recently to the terrorist attack.

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