

Corruption “La Punct”. How Corruption Generates Poverty?

Analytical Commentary

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The purpose of this commentary is to explain about the impact of corruption on the welfare of the state and its citizens, as well as the measures required to eliminate this issues, in a simple and clear language.

The Concept of Corruption

What does the phenomenon of corruption really represent? Corruption is the abuse of professional duties for personal or group interest. It may occur both in the private sector (e.g. offering a loan on preferential terms contrary to the prudential policy of the financial institution), but more commonly in the public sector (e.g. offering a bribe for obtaining a license, ‘arranging’ public tenders or promulgating laws for obscure interests).

The most dangerous form of corruption is the Big Corruption. It consists of major embezzlement/thefts from the State Budget, money laundering or capturing the state institutions by obscure interests. For example, the bank frauds discovered in 2014, which resulted in decapitalisation of the banking sector by about 12% of GDP, depreciation of the national currency, and increase in the state debt by about MDL 14 billion, were caused by Big Corruption in the banking and public sectors.

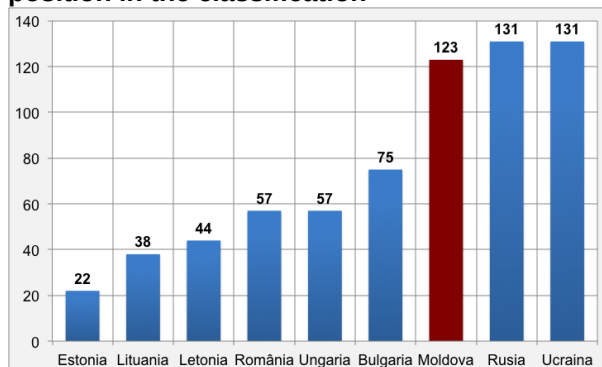
The Situation in Moldova

Although corruption is one of the most debated topics in the Republic of Moldova, the society still fails to realize all the risks it involves. Corruption has always been the leitmotif of electoral platforms of the political parties, governance programs and country strategies of Moldovan development partners, with a broad consensus that it is a fundamental challenge for country development. However, strange as it may seem, opinion polls reveal a different situation. The latest edition of the Barometer of Public Opinion (April 2017) has proved that poverty is the top people's concern (40.3% of respondents said they were primarily worried namely about poverty), followed by prices (17.3%), unemployment (11.1%), children's future (9.9%), while corruption was only the fifth (8.6%). There are at least two explanations for this paradox. The first one is that people are primarily concerned with the issues that affect their material situation in a direct and tangible way, and fail to realize that it is the systemic corruption that causes them. Secondly, the society traditionally tolerates corruption to some extent (for example, a representative survey conducted at the request of Expert-Grup in 2014 reveals that Moldova has one of the lowest tax morale in the

region¹). In both cases we can observe that the population fails to understand the danger and severity of corruption.

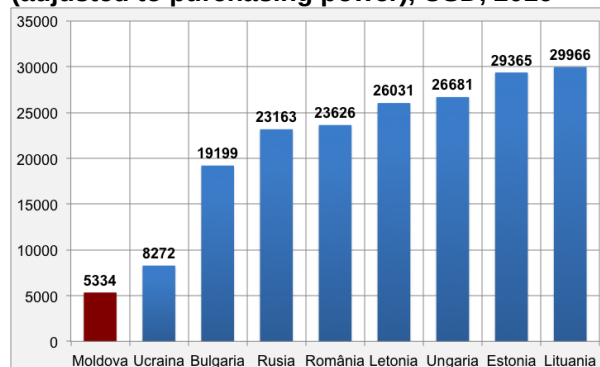
Moldova is one of the most corrupt and, at the same time, poor countries in the region. Moldova ranks 123rd out of 176 countries in terms of the Transparency International's Corruption Perceptions Index 2016. Thus, Moldova has accumulated only 30 points, being in the same group of countries with Sierra Leone, Paraguay, Mexico, Laos, Honduras, Djibouti and Azerbaijan. Moreover, during the past years, the country has consistently regressed in this respect: 105th place in 2010, 112th in 2011, 94th in 2012, 102nd in 2013, 103rd in 2013 and 2014. Figures 1 and 2 show that while Moldova occupies one of the lowest international positions in terms of corruption, it also has the lowest GDP per capita in the region.

Figure 1. Corruption Perception Index 2016, position in the classification



Source: Transparency International

Figure 2. Gross Domestic Product per capita (adjusted to purchasing power), USD, 2016



Source: World Bank

Corruption weakens the economy and generates poverty. The causal link between corruption and the level of country's economic development, and respectively the poverty, is obvious. Thus, a 2016 IMF report² points out that there is an international consensus on the negative implications of corruption for the economic growth. This conclusion is also supported by other reputable international organizations, among which the World Bank³ and OECD⁴. Indeed, the most corrupt countries are, as a rule, the poorest, which is confirmed by the positive correlation between the Corruption Perception Index and Gross Domestic Product (GDP) per capita for 2016: the countries with a higher index (less corruption) are better off from the economic point of view. Figure 3 shows that an additional point to the corruption perception index increases the GDP per capita by an average of USD 800-820. For example, if Moldova advanced to the level of Romania's index, the GDP per capita would increase by more than 3.5 times.⁵

Figure 3. Link between corruption and economic development in 2016

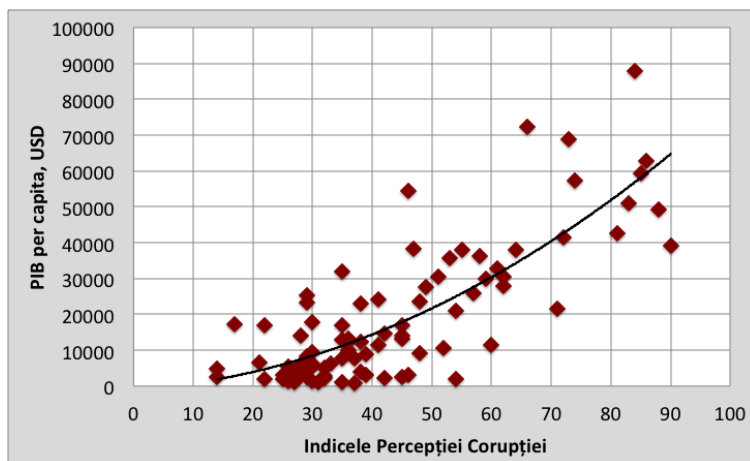
¹ 'Tax Gap - An Invisible Reality', Expert-Grup, 2014

² 'Corruption: Costs and Mitigation Strategies', SDN/16/05, FMI Staff Discussion Note, 2016

³ The 2017 World Bank Commitment on Combating Corruption

⁴ The 1997 OECD Convention on Combating Bribery

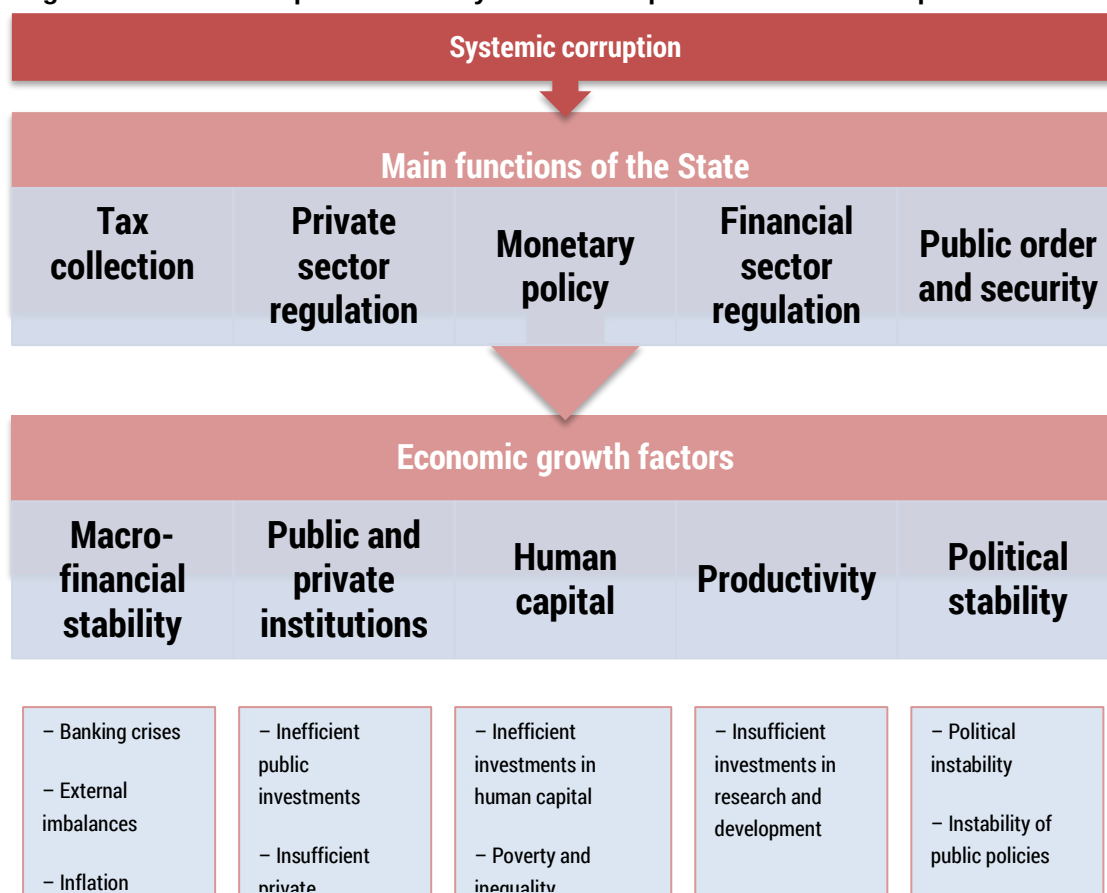
⁵ Obviously, GDP is also influenced by a multitude of other factors that were not included in the model. The author simplified the model to illustrate the economic benefits of the fight against corruption as clearly as possible.



Source: Author's calculations based on World Bank data

Corruption undermines the basic state functions and inhibits economic growth. In particular, it undermines the ability to collect taxes, leading to budget imbalances and public investment shortages; undermines the private sector regulation with adverse effects on private investments and productivity; undermines the monetary policy with effects on inflation; undermines financial regulation, leading to banking crises and restricting the access to capital; undermines political stability and public order. As a result, the macro-financial stability, public and private investment, quality of human capital, productivity, political stability and public policies – which are key prerequisites for sustainable economic growth (Figure 4) – are affected.

Figure 4. Profound implications of systemic corruption for state development



Based on 'Corruption: Costs and Mitigation Strategies' survey, SDN/16/05, FMI Staff Discussion Note, 2016

Source:

Hypothetical case study related to public procurement that clearly shows the repercussions of corruption for welfare: The Government has *MDL 1 million* to build an important road.

<u>When there is corruption</u>	<u>When there is no corruption</u>
- The tender for contracting the executing company is <u>'arranged'</u>: - About 20% of the amount goes into the pocket of the official who arranged the tender; - About 30% goes to the company as super profit. - Out of the original amount of MDL 1 million, only MDL <u>500,000</u> remain for the planned road. <u>Immediate outcome</u>: Road of poor quality and high maintenance costs. <u>Long-term outcome</u>: - The country loses investors (meaning decent jobs and income) that prefer countries with good roads; - The country loses money: high maintenance costs at the expense of construction of other roads or modernization of hospitals or schools. <u>Final outcome</u>: <i>Poverty.</i>	- The tender for contracting the executing company is <u>transparent and competitive</u>: - Functional justice and decent salaries do not allow officials to 'arrange' tenders; - The company's profit is about 15% due to competition. - Out of the original amount of MDL 1 million, about MDL <u>850,000</u> remains for the planned road. <u>Immediate outcome</u>: High-quality road and low maintenance costs. <u>Long-term outcome</u>: - The country attracts more investors (meaning decent jobs and income) that prefer countries with good roads; - The country has more resources for new roads, for modernisation of hospitals or schools. <u>Final outcome</u>: <i>Welfare.</i>

The phenomenon of corruption is a very complex one, while its elimination requires considerable efforts from both the state and the population. The public authorities need to focus on prevention by creating a demotivating environment for corruption. To this end, it is necessary to reform the public sector, because the fight against corruption will be successful only when institutions are strong and civil servants are remunerated well. Another prevention measure is to increase the transparency of funding of political parties and public institutions (people must know in detail how public parties and institutions manage their budgets, assets, as well as their performance). Last but not least, corruption can also be prevented by optimizing the regulations and the role of the state in the economy – the underlying factors fuelling corruption. Finally, a functioning justice system is crucial for detecting and penalizing corruption. To that effect, the anti-corruption institutions (Prosecutor's Office, National Anticorruption Centre, National Integrity Agency) and the judiciary must operate in complete independence and immunity from possible interference and pressure from obscure interests. These measures need to be complemented by citizens' pro-active behavior. In particular, the population must show zero tolerance for corruption, and engage, as far as possible, in monitoring activities, including by adhering to relevant non-governmental organizations, as well as vote for honest politicians.