CORRUPTION AND MONEY LAUNDERING - BASIC COMPONENTS OF ECONOMIC AND FINANCIAL CRIME

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Abstract: *Economic and financial crime is based on three main pillars, namely the underground economy, corruption and money laundering. Corruption seen as a central element of the phenomenon called economic and financial crime is likely to seriously distort the health of the economic environment in a state, altering democratic governance and the rule of law, in fact a real threat to economic development on the principles of market economy. In the following we will refer to theoretical approaches of the literature on the phenomenon of corruption, revealing a possible form of quantification, respectively how it affects the economic environment and the social implications associated with the manifestations of this phenomenon. We aim to perform a theoretical analysis of the corruption term, and then develop the study with the analysis of real implications in society. The research in question is intended to be a basis for understanding the phenomenon in correlation with the complexity of social implications, in order to subsequently propose concrete solutions to combat it, aiming to limit it and its adverse effects on the economy and society. The phenomenon of money laundering can be considered a reaction of the private environment to the fiscal strategy of the state. In this paper we have analyzed this phenomenon to reveal the methods and means used by different people to mask certain amounts of money of dubious origin, in order to reintegrate financial flows into legal economic circuits. The use of the methodology for investigating the specialized literature, followed by the analysis and synthesis of data, allowed us to identify the main implications of corruption in the economic and social ecosystem of the state, respectively the structuring of money laundering techniques and methods.*

Keywords: economic-financial crime, underground economy, corruption, tax evasion, money laundering

JEL classification: H26

1. Introduction

Corruption seen as a central element of the phenomenon called economic and financial crime is likely to seriously distort the health of the economic environment in a state, altering democratic governance and the rule of law, in fact a real threat to economic development on the principles of market economy. In this study we refer to theoretical approaches of the literature on the phenomenon of corruption, revealing a possible form of quantification of it, respectively how it affects the economic environment and the social implications associated with the manifestations of this phenomenon. We aim to perform a theoretical analysis of the term corruption, and in subsequent works we will complete the study with the analysis of real implications in society. The research in question is intended to be a basis for understanding the phenomenon in correlation with the complexity of social implications, with the subsequent goal of proposing concrete solutions to combat it, aiming to limit it and its adverse effects on the economy and society. By investigating the literature, followed by data analysis and synthesis, we were able to identify the main implications of corruption in the economic and social ecosystem of the state.

In Europe there is a more consistent presence of the phenomenon in former communist countries, which seems to have difficulties in building and functioning of democratic institutions, in increasing the education and training of the population, and in determining appropriate behaviors (Donato et al. 2010). The inconsistency of the legal framework in these countries, amid political and social instability, is a favorable condition for the spread of corruption at all levels.

In fact, corruption significantly burdens the democratic government and the rule of law, an impediment with a negative impact on investment and economic growth (Mauro, 1995).

The phenomenon of money laundering - subsumed by economic and financial crime - is associated, as a beginning, with the beginning of the 20th century and can be considered a response of some economic actors to the fiscal policies of the state. In the situation of obtaining consistent profits from criminal activities, those involved must identify solutions to dispose the resulting money without drawing attention to the illegal activity from which they resulted. This is done by concealing the sources, changing their form, or redirecting the funds to a place where they do not raise suspicions to the authorities.

Despite the measures taken by various states to prevent and combat this practice, it has so far not been possible to reduce it, although at European level, has been adopted since 2005 Directive 2005/60 /EC of the European Parliament and of the Council on the prevention of the use of financial system for the purpose of money laundering and terrorist financing.

Analyzing the specialized literature, we found that money laundering is not treated in a unitary way and in connection with the specific activities of economic and financial crime, without revealing clear correlations between the phenomenon of money laundering and corruption. This article proposes an inventory of the means and methods used to launder money, so that we can later try to identify a relationship (from the perspective of favoring factors or common elements) between the phenomenon of corruption and money laundering.

2. Defining and quantifying corruption

According to the World Bank’s definition, also highlighted by Achim and Borlea (2019), “corruption is the illegal use of public resources for personal gain”, while Transparency International (2019) defines corruption ”as the abuse of power entrusted to obtain private benefits ”.

Attempting to quantify corruption, as well as the underground economy, is an approach with an extremely high degree of relativity, practice showing that both the phenomenon of corruption and the concept of underground economy cannot be inscribed in any strict pattern from the point of mathematical view, in the absence of relevant statistical bases. Corruption is not representative for the entire underground economy because the concept of underground economy in a broad sense also includes segments such as self-consumption or criminal type (drug trafficking, arms trafficking etc).

Because it is a difficult phenomenon to quantify, the literature has tried several ways to approach / classify corruption. As indicated by Achim and Borlea (2019), in terms of the severity of corruption, it can be classified as small, large or medium.

Data from Transparency International (2019), in the report "Global Barometer on Corruption", shows that about 25% of the world's population said they were in a position to pay bribes to access public services.

The calculation of the corruption level has been in the attention of Transparency International since 1995, when the Corruption Perceptions Index (CPI) was launched, which is based on corruption data from specialized surveys conducted by several independent institutions. Surveys used to draw up the CPI raise questions about the misuse of the civil service for personal gain, focusing, for example, on bribery by public procurement officials and embezzlement of public funds, thus leading to administrative corruption.

The literature has tried various forms of defining corruption in order to create a framework as realistic as possible for a quantification closer to the perception of the phenomenon in reality. In this sense, we highlight the approaches of Klitgaard (2015), who proposes the following formula:

$$C = M + Dp - R,$$

where C is corruption, M is the monopoly position, Dp is discretionary power, and R is responsibility. Corruption can occur where there is a cumulative monopoly situation, a discretionary power is exercised regarding the distribution or provision of the monopoly, respectively there is no regulated liability regarding the distribution made.

The presented formula unequivocally indicates the factors favoring corruption, practically highlighting the predisposition of the public governance area in the development of this phenomenon. The monopoly situation in the allocation of (budgetary) resources in conjunction with the discretionary allocation of financial funds (depending on certain subjective interests), without any constraints or rigors (both institutional and legislative or law enforcement) is likely to contribute to the emergence and development of the corruption phenomenon.

3. Implications of corruption on the economic and social axis

Corruption manifests itself both in individual forms and in intercalated form, affecting differently the democratic governance, respectively the market economy, with implications of the most diverse felt in the economic, social and political spheres.

As Bîznă (1999) also captures, a common form of corruption manifestation at the national level refers to the misappropriation of budgetary funds in personal interest. In the first stage, the main authorizing officer allocates to the legal entities subordinated to the public administration the amounts necessary for carrying out the activity, paying salaries, making investments, etc. Subsequently, in order to achieve their own objectives, these institutions enter into contractual relations with economic agents specialized in carrying out certain works which, in turn, conclude subcontracting contracts with natural / legal persons, on certain fields of activity.

However, these subcontractors include, directly as shareholders or indirectly, through their relatives, those main authorizing officers who have the size and destination of the allocated funds. In fact, the described procedure of this form of corruption reveals the standard scheme by which the funds destined to achieve the objectives of public interest are “directed” for the benefit of some private interests.

A comparative study of the World Economic Forum (2018), entitled “Global Competitiveness Report”, highlights risks associated with corruption. The values were centralized on the basis of business surveys for EU Member States. Higher values indicate a relatively better situation (chart 1 and 2). The situation of Eastern European countries, which are constantly lower, is relevant. However, in the situation of Romania there is a slight upward trend in the analyzed period (2015-2018).

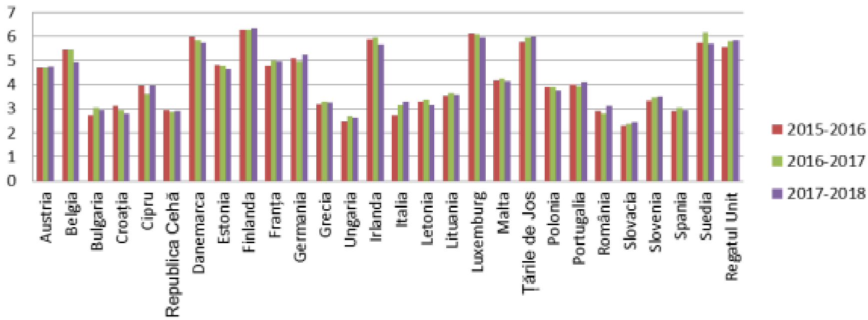

Figure 1: Misappropriation of budgetary funds in personal interest
Source: World Economic Forum, Global Competitiveness Report, 2018

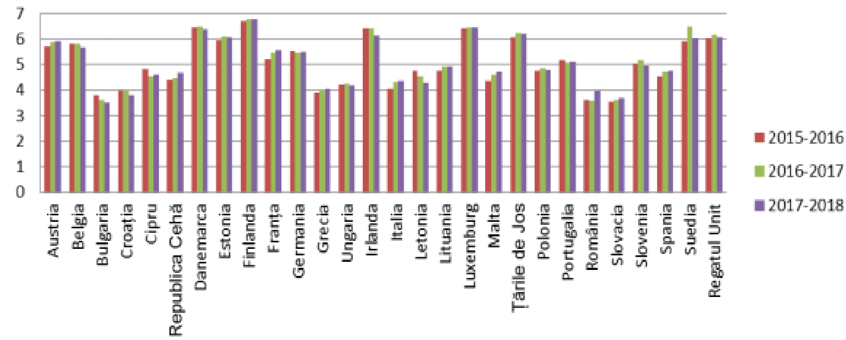

Figure 2: Undue payments and bribes
Source: World Economic Forum, Global Competitiveness Report, 2018

The complex forms of corruption manifestation affect differently the democratic governance, respectively the market economy, with implications of the most diverse felt by both the economic and the social sphere.

Various studies mentioned by Achim and Borlea (2019) highlight the negative impact of corruption on fiscal policies. Relevant is the analysis of Kaufman (2010) who established a direct relationship between corruption and fiscal deficits, highlighting that this phenomenon reduces tax revenues, increases public spending, affects competitiveness and economic growth.

On the other hand, the literature Gupta et al (2002) and the European Parliament (2015) highlight a direct relationship between corruption level and social inequality, respectively poverty. Countries with a high level of corruption have lower literacy rates and higher mortality rates due to poor health services with privileged access for different sections of the population.

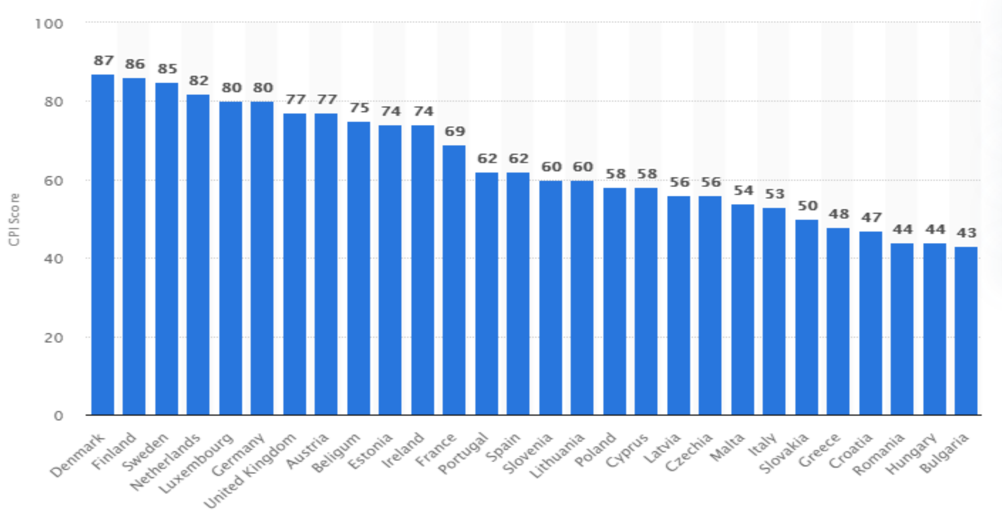

Figure 3: Corruption perception index score in European Union countries, 2019
Source: Clark, 2020, Statista, 2020

The statistical study (Clark, 2020) on the corruption perception index is a composite indicator that includes various data on corruption precepts in areas such as: bribery by civil servants, refunds in public procurement, embezzlement of state funds and effectiveness government efforts to combat corruption. The highest possible score in the perception of corruption is 0, while a score of 100 indicates that no corruption is perceived in that country. It can be seen (chart no. 3) that developed countries in the EU have the highest score of perception of corruption, while Romania, with a score of 44, has almost the lowest value, along with other Eastern European countries.

The complexity of corruption is highlighted in some studies that propose an approach from another perspective, namely its ability to contribute to economic development through the possibility of shortening bureaucratic flows. As the study developed by Hoinaru et al (2020) shows, corruption can also have the role of "lubricant" of economic mechanisms, in addition to the obvious "defeat" of them, with an indirect contribution to economic growth.

According to the aforementioned study, which analyzed a large database over the period 2005 - 2015, it is found that corruption and the underground economy are predominantly present in underdeveloped countries, their higher levels being correlated with low levels of economic development. and durable.

Based on this fact, which unequivocally reveals the harmful role of corruption and the underground economy on the models of healthy and sustainable development of states, evidence has been found that the phenomenon of corruption can also be seen as a way to circumvent the law in order to obtain greater economic benefits and, as a result, to contribute to economic development.

Of course, this side of the complexity of the corruption phenomenon has different economic and social effects depending on the development degree of an economy. For an economy with a high degree of development, corruption itself can have a strictly negative effect, seizing economic mechanisms and affecting the state's insistence, by altering decision-making levers. On the other hand, for states with poorly developed economies, in the short term, corruption can have a "positive" role in the economy, having the function of mechanisms "lubrication", caught short-circuiting excessive bureaucratic effects, with a direct effect on economic growth. However, the deprivation of national budgets of available funds for the implementation of development state policies is a negative long-term issue. As a result, reducing corruption is the long-term solution to ensure healthy growth and sustainable development in the economy.

Due to the complexity of the phenomenon, the study of corruption cannot be limited only from the perspective of the present analysis. Certain favorable factors contribute decisively to the development of corruption diversity forms: the high degree of political and administrative power concentration in the state; the fragile democratic system; strong bureaucratic system; low standard of living etc.

The inventory of the phenomenon consequences is an exhaustive process, also surprised by the studies carried out by Mauro (1997) and Gray and Kaufmann (1998), among the most relevant consequences being mentioned: the decrease of the production factors efficiency; the competitive environment depreciation, the depreciation of public services quality and the decrease of level investment.

4. The relationship corruption - money laundering. Techniques and methods of money laundering

In a broad sense, money laundering consists in the money transfer from an illegal activity to a legal business, with the aim of inducing the idea of legality money origin (OECD, 2017). In fact, the multitude of literature definitions converge towards the model synthesized by Achim and Borlea (2019), respectively “the process of disguising illegally procured sources through criminal procedures in order to give them a legal appearance”. The authors summarize the common central element of the corruption - money laundering relationship: the tendency to evade the regulations regarding the calculation and payment of tax debts owed by economic actors. Both phenomena produce the same type of effects, without a clear delimitation: the decrease of the state budget revenues in parallel with the supply of the underground economy, artificially increased public expenditures, respectively the slowdown of economic growth.

The literature captures a multitude of methods used by economic actors in the money laundering process, but the mechanism underlying the process itself can be summarized in three major stages, according to the document "Training Manual on Combating Money Laundering and Terrorist Financing” (2002) published by the National Office for Preventing and Combating Money Laundering.

The first stage - placement - is the "escape" of cash resulting from illegal activity, aimed at breaking down funds from illicit sources, those obtained legally, the former may be subject to law enforcement. Basically, at this stage, the subject of the money laundering crime introduces the illegally obtained profit into the financial circuit. After the "injection" of illegally obtained funds into the financial system, the second stage takes place - stratification. The operation involves the process of money "movement" between different accounts, the obvious purpose being to hide their origin. At this stage, a series of funds transfers take place to remove them from their source. These may be aimed at buying and selling investment instruments, or the person carrying out the money laundering operation may transfer the funds, electronically, to a number of accounts in various international banks. After successfully completing the two mentioned stages, the people involved move on to the third stage - integration. This represents the funds "reinsertion" in the legal economic circuit. Offenders can then choose to invest funds in the real estate, luxury goods or business markets.

If the whole process is successfully completed, the integration circuits will send again the results of the laundering in the economic circuit (chart no. 4), the money re-entering the financial system in the form of "clean" funds, the result of honest business activities.

Figure 4: Money laundering circuit
Source: National Office for the Prevention and Combating Money Laundering - “Manual for the Prevention of Money Laundering and Terrorist Financing”, 2002

The manual for the Prevention of Money Laundering and Terrorist Financing (2002) has classified various techniques for simulating the legal origin and / or concealing the illicit origin of money, as follows:

Money laundering in the context of legal business activities controlled by organized crime is done by: overestimating the price of a good; false business transactions; unregistered purchases and processing of raw materials.

The purpose of using these techniques is to give a source of legality to illegal funds: either by an invoice higher than the real value of the goods paid or by a completely false invoice that could be used to justify illicit trafficking (of drugs). The "illegally" purchase of raw materials with illegally obtained money allows the offender to launder money at the next sale.

International practice allows the classification and exemplification of several categories of methods used for money laundering, among the most used being:

a. Money laundering through cash transactions: the exchange of large sums from one currency to another, without any obvious economic purpose; the exchange of large quantities of low value banknotes into high value banknotes; unusually large cash deposits and withdrawals made by a customer whose activities normally involve the use of non-cash payment instruments; unusually large cash deposits and withdrawals made by a customer who normally uses a current account; a customer who makes several deposits on the same day at different cashiers or bank branches; cash withdrawals immediately after replenishing the account; crediting of the company's accounts by their associates / administrators, followed by repeated withdrawals justified as "loan repayment", etc.

b. Money laundering through bank accounts: the use of accounts that do not reflect normal banking or commercial activities, but are used only for deposits or withdrawals; large cash withdrawals from an account, previously inactive, or from an account to which a significant amount has just been unexpectedly transferred from another account opened in the country or abroad; making frequent and substantial transfers of funds that cannot be clearly identified as having an economic justification; large amount transfers, withdrawn on the same day in the form of a "loan repayment", etc.

c. Money laundering by electronic bank transfers: frequent transfers from the account of a legal entity to the account of a natural person without any reference to the transfers nature; the frequent transmission or reception of large volumes of electronic transfers to and from offshore companies; regular deposit or withdrawal of large sums by electronic transfers to / from or through countries that are known as sources of narcotics or whose banking secrecy laws facilitate money laundering, etc.

d. Money laundering through external operations: use of credit lines and other financing methods to make external transfers when the transaction does not justify the normal activity of the client; the establishment of large balances, inconsistent with the economic activity performed by the client, followed by subsequent transfers to foreign accounts; making external payments in advance for imports for which the goods were not delivered, not followed by a refund of the advance paid, respectively justification of advance payments, etc.

e. Money laundering through credit operations: customers who repay loans unexpectedly quickly with funds from unknown sources; the purpose stated by the client for the loan is not justified and proposes a cash guarantee or mentions it when specifying the purpose of the loan, etc.

5. Conclusions, limits and research directions

The three main pillars of economic and financial crime, namely the underground economy, corruption and money laundering converge on the same goal: avoiding the tax obligations payment resulting from economic activity, reducing tax revenues having a direct impact on limiting the levers available to the state to ensure durable economic development.

The corruption and money laundering study cannot be limited only from the perspective of this analysis. Certain favorable factors contribute decisively to the diversity development forms of corruption: the high degree of political and administrative power concentration; the fragile democratic system; strong bureaucratic system, low standard of living, etc., which may be the subject of future research.

The phenomenon consequences inventory is an exhaustive process, also surprised by the studies carried out by Mauro (1997) and Gray and Kaufmann (1998), among the most relevant consequences being mentioned: the efficiency decrease of production factors use; the depreciation of the competitive environment, the depreciation of public services quality and the decrease of the investment level. Of course, further studies in this segment may lead to further conclusions.

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