

## **Economic Crime in Romania<sup>1</sup>**

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At this point, a Romanian company has far more incentives to activate in the shadow economy than it has to operate legally and legitimately. Economic crime is directly related to the lack of economic reforms, the slow pace of privatization, and the weak legal framework. Economic crime in Romania is characterized by the emergence of organized criminal gangs. There are connections within this community that have important impacts on money laundering, terrorist activities, and counterfeiting

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Economic crime is fostered by and reinforces the shadow economy. During the last decade the shadow economy in Romania has grown to alarming levels fuelled by inflows of illegal capital obtained through a wide variety of schemes and frauds.

Economic crime is directly related to the absence of economic reforms, the slow pace of privatization, and the weak legal framework. The criminals were able to exploit these weaknesses and use the illegal profits obtained in the process to further develop and sustain illegal activities. State corruption has played an important role in such development allowing criminals to often benefit from support and protection from high ranked government or local administration officials.

### **Illegal Capital**

#### **– Capital Obtained Through Illicit Means**

After the fall of Communism in 1989, Romania was confronted with the difficult task of building a market economy on the ruins of a centralized economic system in which the capital was entirely owned by the State. In theory, this task was to be accomplished through economic reform and privatization initiated and supervised by the Government, within a clear and well-defined legal frame.

In the early 1990s, in Romania there were few local investors able to purchase the state owned assets and companies. The local investors

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simply lacked the necessary capital.

However, it did not take long until a number of people identified the lack of legal regulations in certain areas – such as banking, commerce, foreign trade, and so on – and started to exploit this vacuum for their own benefit.

For instance, the coexistence of an official (regulated) currency exchange rate on the inter-bank market with a “free market” currency exchange rate represented a golden goose for the speculators who used their personal connections in the state banking system in order to buy cheap dollars on the inter-bank market and then sell them at a premium price on the “free market”. Although this kind of operation was illegal and specifically prohibited by law, speculators were able to do it by relying on the corruption of certain officials and on weak law enforcement. These illegal transactions took such a boost that they generated a monetary crisis, which couldn’t be solved until the introduction in November 1991 of a single, unified, currency exchange rate whose value was since established by the forces of supply and demand.

The non-existence of a proper legal frame fuelled the explosion of pyramid schemes throughout the country between 1992-1993. Many people attracted by the mirage of earning easy profits took part in such schemes and lost their money while the initiators of these schemes, along with the corrupted officials who supported them, became extremely rich. When the scandal of pyramidal schemes morphed into a socio-economical crisis, the Parliament issued laws and regulations to forbid them. The initiators had to go to court but their trials stretched for years and in many cases they were found not guilty or had to pay little damages and compensations.

During the hot days of the Romanian Revolution millions of people contributed with money deposits to the so-called “Liberty Fund” This fund was hosted in a bank account that was supposed to be administered by the Government and used in order to support the victims of the Revolution. As incredible as it seems, this account has totally vanished and since then none of the officials have offered any relevant information about what happened with the money. A similar situation involved the money in the personal accounts of the former dictator – Nicolae Ceausescu and money in certain accounts of the former secret police – Securitate. Some allege that all this money was embezzled by corrupted officials and former members of the Communist nomenclature.

Using glitches in the institutional and legal frames, personal connections, political influence, bribery or a combination of these,

certain individuals or companies were able to obtain insufficiently secured or unsecured loans from state banks and later to default on them. This money has almost never been recovered and the persons involved have rarely had to face sentences in court.

All these cases were just a small number of relevant economic crimes through which the illegal capital was accumulated in Romania. We will take a closer look to these economic crimes and describe the main mechanisms behind them later, in the article.

For the time being we'll limit ourselves to say that the illegal capital was further used by its owners to acquire state owned assets and companies through the privatization process.

Due to political reasons, between 1991-1996 the social democrat Government of Romania opted for a mild transition to market economy. While most of the Central and Eastern European countries planned their privatization strategies based on selling the state owned property to foreign investors, the Romanian Government chose to primarily use the Management Employees Buy Out<sup>2</sup> (MEBO) method in the privatization of the state owned companies. In most of the cases domestic investors were preferred to foreign investors. Ironically, at the time, the most important domestic investors were those who secured the illegal capital. Soon this illegal capital would become the foundation of a very profitable shadow economy.

### **The Shadow Economy in Romania**

At the end of year 2000, the Romanian shadow economy was characterized by tax evasion, illegal employment, relationship with the organized crime and terrorism, and involvement in almost all areas of economic crime.

A study prepared by the US Department of Treasury and quoted by Oegar Report<sup>3</sup> indicated that by the end of the year 1999 Romanian shadow economy accounted for 49% of country's Gross Domestic Product (GDP). The same study indicates that should the shadow economy had been kept under control, in 1998 Romania would have had a 3.2% economic growth instead of a 7.3% decline. Most of the shadow economy's proliferation can be traced to a sustained increase in the tax levels after 1997. For instance, between 1993 and 1996 the study indicates that the shadow economy accounted for 5-15% of GDP.

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<sup>2</sup> In essence, the method consisted in transferring the ownership of a company from the state to managers and employees by allowing them to buy stock in the company in which they worked.

<sup>3</sup> An Alarming Report: The Underground Economy Represents Half of the Romanian Economy, Oegar Report, <http://www.oegar.com/ralar.html>

Starting with 1997 the Romanian Government imposed additional taxes in an attempt to compensate its annual deficit. However, this led to an increase in illegal activities, as noted above.

The following example is a good example of this concept. By 1999, for a net monthly wage of \$100 (\$130 gross), both the company and the employee had to pay the following taxes:

- the employee:
  - o state tax: 15%
  - o health care: 7%
  - o unemployment fund: 1%
  - o retirement fund: 5%
- the company:
  - o social security: 30%
  - o unemployment fund: 5%
  - o health care: 7%
  - o Labor Chamber commission: 1%

Therefore, for \$100 in wages the combined tax contribution amounted to \$92. (Adevarul economic nr. 38(32)/22-28 September 1999)

**Economic Crime** – An act in violation of the criminal law that is designed to bring financial gain to the offender [*Nelson.com*]

We can conclude by saying that, by its very own nature, the shadow economy is a perfect environment for the development of economic crime. We note, however, that the shadow economy provides the support, much the same way a bacterial culture provides the perfect conditions for a generalized infection. The economic crime could not proliferate without the influence of certain external factors, a number of which we are discussing below.

### **Factors that Contributed to the Proliferation of Economic Crime**

#### *The Weak Legal Frame*

The weak legal frame characterized by incoherent, contradictory or incomplete laws, glitches and inconsistencies was the most important factor that contributed to the proliferation of economic crime. For instance, the Bankruptcy Law was issued by the Parliament in 1995. Between 1990-1995 the creditors of a company had very little legal protection if that company ran out of business.

*The Weak Enforcement of the Law*

The state institutions and agencies in charge with the economic crime prevention lacked the material resources, the experience, and the motivation to fight this phenomenon. Faced themselves with corruption, these institutions were very ineffective in enforcing the law. As a consequence, the number of economic crimes increased, as the offenders grew bolder. For instance, the largest warehouse complex in Bucharest was illegally built on public property during the mid 90s. Not only that the owner, Mr. Puzdrea, had no building authorizations whatsoever but also he erected the construction on a major water pipe, fact which was specifically prohibited by law. The Bucharest City Town Hall sued the owner and won in court. Based on the sentence, the Police and other law enforcement agencies made at least three attempts to evacuate the perimeter and level the construction. All of them failed. The owner's connections in the high level circles were too strong for the enforcement agencies.

*The Corruption of the Government and Justice*

Between 1990-2001 the Romanian press revealed countless cases in which state officials provided favors and services to selected individuals and companies in exchange for bribe or illegal commissions. As far as the government was concerned, bribe was particularly important in the cases related to privatization, assignment of government contracts and issuing export/import licenses. Corrupted judges and magistrates took bribe for not pursuing economic crime charges or for switching sentences for serious offenders into milder ones. Two notorious cases refer to attorneys elected senators and represented famous offenders in court as "simple" barristers.

*The Unstructured Bureaucracy*

Most of the Romanian bureaucracy is unstructured, a lot of times the standard operating procedures are inexistent or are not applied. This leaves room for discretionary, subjective interpretations by the official employees. In return, this situation creates optimal conditions for corruption. For instance, "Ziarul Financiar" newspaper<sup>4</sup> mentions the case of a local entrepreneur who, in order to get the license for using the water from a nearby river to supply his hotel, had to submit the written consent of the owner of the dam he was using. When he told the authorities that he was the owner of the dam and let them understand

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<sup>4</sup> Marinescu, Oana, Interview with Cornel Gaina, President of SIMPATURISM Travel Agency, Ziarul Financiar, September 6, 1999

that he was unwilling to pay bribe, he was made to write down a paper that he was consenting to allow himself to use the dam.

### *The Formation of a Political Clientele*

Political parties spent huge amounts of money for advertising during their campaigns. The bulk of this money comes from “sponsors” who hope to be rewarded upon the winning of the elections. The reward usually comes in different forms from appointments to jobs in the high hierarchy of the administration to “favors” such as preferential tax treatments for sponsor’s company, allocation of government contracts and so on. It is important to note that most cash transactions cannot be traced while the modern instruments of payment provide at least some background checking and transaction tracing opportunities.

### *Key Government Organizations*

In order to correctly understand the economic crime we need to describe a number of government organizations that have played important roles in relationship with this phenomenon.

### *State Ownership Fund<sup>5</sup>*

The State Ownership Fund was created in 1991 as a government agency in charge with the administration and the privatization the state owned companies. A major criticism brought to this agency was that its generously paid employees didn’t have any interest to attain its purpose (entirely privatizing the state capital) because the law stipulated that the agency was to be dissolved immediately after the accomplishment of its goal. In fact, between 1991-2001, the State Ownership Fund has privatized only 30%-35% of the total state capital that it administers. This institution had gained a tremendous political and financial power over the years. It soon became a “state in state”, an institution that was practically under no control. (see Supreme Court Accounting Court) The State Ownership Fund is “*de facto*” responsible for most of the illegal privatizations in Romania.

### *Department of Customs*

The Department of Customs has been reorganized several times after 1989, but the Romanian press still echoes every now and then various illegalities that happen in the Customs Office, varying from small crooks (i.e. custom officers accepting bribes to allow private persons not to pay custom taxes on personal goods brought from abroad) to larger scale operations.

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<sup>5</sup> In December, 2000 the Government dissolved the State Ownership Fund and replaced it with the Romanian Privatization Authority who took over its responsibilities.

*Financial Guard*

The Financial Guard was established in 1991 in order to act as a certified auditor and controller for private companies. It is organized based on the same principles as several other similar foreign agencies (most notably the Italian Financial Guard). In time its powers grew and some of the incidents in which the Financial Guard was involved, included:

- a) Financial Guard officers who abused their positions in order to benefit themselves or to harass certain companies. For instance, a Financial Guard officer who owns or is a major shareholder in a company can convince his inspection team colleagues to audit his company's competitors, with the sole purpose of finding something wrong in their accounting papers and fine them a huge amount of money. (One must note that the controlling team knows beforehand that they must find something wrong).
- b) Financial Guard officers who abused the unclear and contradictory regulations and standard operating procedures. For instance, the regulations that state how the penalties for not paying taxes in due time should be calculated are vague. That allows a Financial Guard officer auditing a firm to use several methods (depending on his own personal interest) to calculate the penalty. Suppose that a company owes \$10,000 in taxes to the Government and pays only \$9,999, delaying the payment of the last dollar for 3 months. The norms don't explicitly say that the penalty should be calculated only for the remaining unpaid dollar or for the whole amount. Therefore, an Financial Guard officer can compute the penalty owed to the State based on the \$10,000 amount. The effect is, of course, a raise in the level of tax evasion. A company in the situation described above has no incentive to pay its taxes entirely, unless it can do it in a single payment of \$10,000, because it is going to be penalized on the full amount anyway, rather than the remaining balance. Typically, the company would pay only \$1 instead of the \$9,999 that they could have spared initially, and use \$1,000 to bribe the auditing officer to compute the penalty in a more favorable way.
- c) Corrupted high ranked Financial Guard officers working with/for the organized crime. The newspaper "Ziua" has recently published an article<sup>6</sup> about a person from Suceava city who refused to become part of the local mafia. In retaliation, the organized crime using its

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<sup>6</sup> "Ziua" newspaper, "Alone against the Mob" by Marius Batca, June 20, 2001.

connections in the Police and the Financial Guard set him up and had him arrested charged under inexistent offenses.

#### *National Securities Commission*

The National Securities Commission (the Romanian acronym is CNVM from Comisia Nationala a Valorilor Mobiliare) was formed at the same time with the Romanian Stock Exchange. Its primary duty has been to watch over any transaction involving securities, as well as to develop some rules for trading. However, due to various reasons including vested interests, lack of adequate training, etc. CNVM has been involved in various scandals (see Securities Fraud).

#### *Prime Minister's Department of Control*

The Prime Minister's Department of Control (or DCG, from Departamentul de Control al Guvernului) was formed to act as a prevention and control body in charge with the investigation of illegal activities in which members of the Government or local administration members (mayors and such) might be involved. Since its inception it has uncovered a number of illegalities that have compromised some public figures, even though some of the charges have been (allegedly without strong reasons) dropped.

#### *Supreme Accounting Court*

The Supreme Accounting Court is similar to Financial Guard, only that its primary duty is to act as auditor/controller for state owned companies and state institutions (it can audit the Financial Guard, for instance). The main criticism brought to this institution was less related to corruption and more related to its ineffectiveness. Confronted with a tremendous number of economic crime cases, some involving criminals with strong political connections, lacking the expertise and the adequate personnel resources, the audits performed by the Supreme Accounting Court rarely translated into practical consequences for the offenders.

The institution lost a lot of its power and effectiveness when the Romanian Parliament took away its ability to audit the privatizations done by the State Property Fund, an area that was traditionally prone to economic crime.

### **Main Types of Economic Crime:**

#### **Commercial Crime**

This type of scheme was mostly used between 1990-1995. The typical mechanism involved at least 3 persons: an "insider" - a loan manager from one of the state-owned banks, a "beneficiary" - a person



that owned a limited liability corporation and “a sponsor” -politician or high-ranked official that acted as a intermediary between the two. The “beneficiary” was typically a friend or a campaign donor for the “sponsor”. In return for his support, or in the name of their friendship, the beneficiary would require the “sponsor” to facilitate a loan between the “insider’s” bank and the “beneficiary”. Often, both the “sponsor” and the “insider” were promised and then given cuts from the loan. Then, the sponsor would use his influence, political power, connections or official authority to determine the “insider” to grant the loan to the beneficiary under very favorable terms (i.e. long grace periods, without due diligence, without business plans, without or with little collaterals, at a very low and discriminatory interest rate, etc). The insider would use the bank money to grand a loan to beneficiary’s limited partnership corporation for financing the purchase of an asset.

In a lot of cases, the loan money was then split among the three parties. In some other cases, part of the loan money was invested in an asset by the beneficiary. This asset was then used as a collateral for a further loan, at a different bank, using pretty much the same scheme. There were cases when the spiral continued for a few more iterations. Most of the loans obtained through such schemes were never returned to the banks that issued the loans. This was possible due to a number of causes:

- As an owner of a limited liability corporation, the beneficiary was only liable to he extent of the equity he owned in the corporation.
- The beneficiary (as a manager and only owner of the company) could cover the misuse of the loan by recording inexistent or grossly over-evaluated purchases of assets.
- The representatives of state authorities in charge with controlling and supervising the banks (i.e. National Bank of Romania, the Supreme Accounting Court, etc) as well as the representatives of the authorities in charge with controlling and supervising the activity of corporations (Economic Crime Police and the Financial Guard) were in many cases corruptible by either bribe or through political pressure from the “sponsor”.
- Between 1990-1995 the ruling party had the absolute control of the most state institutions and the illegalities committed by certain members of the party were usually covered up for different reasons (e.g. to avoid public scandal and a decrease in popularity/number of votes)

This type of scheme lasted for some years and what blew it apart was that by 1995 a number of big banks, such as Dacia Felix and Credit

Bank, went bankrupt. Only then, under the pressure of public opinion (deponents), the investigations revealed the truth. It was the first time the public learned about the truth. In all cases only the insider and the beneficiary had to face trials and most of the times they were given mild sentences. By the end of year 1998, Bancorex – the largest state-owned commercial bank, Banca and Bankcoop, – went bankrupt while Banca Agricola faced serious difficulties. This generated a serious crisis in the Romanian banking system.

As for those who benefited from these schemes, probably the most known case is that of Ilie Alexandru, CEO of “Hermes” a company that produced TV sets among other goods. During 1992-1995 Mr. Alexandru secured funds using the above-mentioned scheme and started using them to his own interest, rather than to benefit his company. He used some of these loans in order to build a huge but unfeasible theme-park ranch, named “Southfork Slobozia” (after the “Dallas” soap opera) in which he also erected small replicas of the Eiffel Tower and Statue of Liberty. The Romanian press coined the term “cardboard billionaires” for these types of persons, the hidden irony being the fact that should the loaned money be asked back, those persons should collapse, together with their small empires, like castles made of playing cards. Mr. Alexandru was placed on trial today for fraud, and all of his possessions auctioned in order to recover part of the loaned money.

The scandals that ensued showed that the main bankruptcy reason was an enormous amount of granted loans that had little chances of recovery. Since then, the National Bank of Romania issued new regulations and the banks have adopted tighter credit policies.

### *Pyramid Schemes*

“...promise consumers or investors large profits based primarily on recruiting others to join their program, not based on profits from any real investment or real sale of goods to the public. Some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure<sup>7</sup>.”

### *Caritas*

In 1992, leveraging on the legal “vacuum”, Ioan Stoica established a new limited liability company named “Caritas” that promised whoever deposited his money at Caritas a return eight times his money, in three

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<sup>7</sup> Prepared statement of Debra A. Valentine, General Counsel for the U.S. Federal Trade Commission on “Pyramid Schemes” presented at the International Monetary Fund’s Seminar on Current Legal Issues Affecting Central Banks, Washington, D.C., May 13, 1998 <http://www.ftc.gov/speeches/other/dvimmf16.htm>

months. This whole affair was structured as a typical pyramid scheme. What made this phenomenon distinct was its amplitude. Between 1992-1994, 4 million people deposited at Caritas the equivalent of about \$820.5 million<sup>8</sup>. This scheme could not have existed without the tacit support of high ranked officials, including names in the Parliament, Government, Police and local administration who “invested” in Caritas and were paid preferentially and substantially, over the line. The same people were the first to recover their money when Caritas crashed in 1994.

The crash threw Romania into a serious social and financial crisis and it turned into a huge political scandal. The trial took 6 years during which, the court had to go through over a ton of complaints from the 256,000 of plaintiffs.

Since 1994 the pyramid schemes were have been banned by law.

#### *Chain of Phantom Companies Schemes*

A phantom company is a fictitious company that cannot be hold accountable in a court because it doesn't exist as a “*de jure*” entity.

According to the Law of Commercial Companies, in order to establish a company, the initial investors have to register at the Trade Registrar by presenting a notarized company statute, a notarized copy of investor's IDs, a notarize proof that the company functions at a real address (proof of residency), and a notarized proof that the minimum capital stated by law has been deposited by the investors in the company's account. Based on these documents, the Trade Registrar issues the company a unique Registration Number written on a registration certificate, along with the name of the company and its address. Simultaneously, the company is required by law to obtain a “fiscal code” from the Minister of Finance. Based on this number, the company pays its taxes. A company cannot function without a registration certificate and a fiscal code.

Using various means including false IDs and false proofs of residency, somebody can establish a company that doesn't exist, in order to obtain a certificate of registration and a fiscal code. A “clean” phantom company is an invaluable asset for a group of economic criminals because it can be used in all types of economic crimes without fearing the consequences of the law. When the investigators come to check the books or the activities of a phantom company, they usually

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<sup>8</sup> Amount based on the average Romanian leu/US dollar exchange rate between 1992-1994, calculated from values published by the National Bank of Romania (<http://www.bnro.ro/>), and the total value of the fraud as given by Evenimentul Zilei , February 11, 1999 (<http://www.expres.ro/arhive/1999/februarie/11/cotidian/9-1.html>).

find an empty apartment, or an inexistent address, the “owners” prove to be persons that left the country or people that lost or had their IDs stolen, and so on.

A simple scheme involving a phantom company works as follows. A person representing the phantom company would contact another company making arrangements to buy goods from the latter by check. The supplier will issue a fiscal bill for the goods to the phantom company. The representative of the phantom company will pay by corporate check and leave with the goods. By the time supplier is notified about the fact that the check is invalid and the phantom company does not have any money in its account, the goods are long sold on the through other phantom or legitimate companies.

More complicated schemes, involving chains of phantom companies are used in gas, cigarette and alcohol smuggling when the owners of illegally obtained merchandise want to cover its origin.

For example, let's say a group of criminals is specializing in stealing gas from the national gas pipe system. They manage to puncture the pipe, install a pump and fill up a cistern with gas. They cannot sell the gas directly to a gas station, because by law, the gas stations cannot buy from individuals. They can't sell the gas directly to a legitimate company because, again, the companies cannot buy gas from individuals. Therefore they need a phantom company, either that they own it or that they steal for it. This first phantom company will pay them a fraction of the value of the gas and then it will sell the gas to a second phantom company. This can be repeated a number of times until the origin of the gas is totally covered. The stolen gas can even be traded among a few legitimate companies before it's finally sold to a gas station.

### *Money Laundering*

This scheme was in fact very simple and involved two partners: the “loser” and the “winner”. While in practice there was no losing or winning, in order for the scheme to work somebody had to appear as losing money and somebody – as winning money. The two partners had to work together and split the laundered money. The loser had money coming from illicit activities (drug dealing, prostitution, smuggling, etc). He couldn't justify their origin. Lets say that Mr. L had \$100 of illicit money. He will be the loser. Let's also say Mr. W owns a limited partnership corporation that sells shoes. He will be de winner. Let's further assume that a pair of shoes is normally sold on the market for \$5. Mr. W's company would sell a pair of shoes to Mr. L for \$100. Mr. L will further sell the shoes on the market for \$5 recording a loss of \$95. In the same time, Mr.W's company will record revenues of \$100. After

deducting the cost of shoes and paying taxes, he gets to keep, say \$70 as net profit. This money is now clean money that can be taken out from Mr. W's company through dividends that he can pay to himself as the owner and single unique shareholder. Finally, as a private person, Mr. W will return the laundered money to Mr. L minus a commission for the laundering.

The same scheme can be employed in casinos, where all the gains are taxable. The loser will lose the dirty money, and then, after a period of time, he will "win" back the same amount, minus the state taxes and the commission for the winner.

### **Main Types of Economic Crime:**

#### **State Statutes and Programs**

##### *Tax Evasion: Illegal VAT Recovery from False Exports*

This scheme involves an "exporter" and a customs officer. According to the Romanian law, all the goods that are sold on the Romanian territory are subject to a Value Added Tax (VAT) of 19%. This tax is applied the same way the sales tax is applied in the US.

The same law states that goods that are exported from Romania to other countries are exempt from VAT. For example, a Romanian company produces TV sets and prices them at \$100. If the company is going to sell a TV in Romania it will have to sell the TV for \$119 to accommodate the VAT. However, if they export the TV, they can sell it abroad for \$100. The trick is to convince the Romanian authorities the company exports the TV while in fact the TV remains on Romanian territory and is sold at \$119. Out of this amount, \$100 are declared in the company's ledgers as an export-generated revenue while \$19 remain undeclared and represent illicit money.

This scheme cannot work without two essential ingredients: a false "Export Declaration Form" (see forged official documents) and the cooperation of a custom officer that can be obtained through personal relations and/or bribe.

##### *Tax Evasion through False and Misleading Statements in Company's Ledgers (recording inexistent expenses in company's ledgers)*

In Romania, the taxable profit of a company is computed by subtracting all the company's expenses from all the company's revenues. If a company wants to decrease its taxable profit, it can increase its expenses keeping in the same time all other things constant. Many companies evade paying taxes by recording inexistent or inflated expenses in their ledgers.

A simple tax evasion scheme works as follows. The company buys on the black market a false, blank “fiscal bill” (see official documents forgery). Then it fills in this fiscal bill, as if a supplier issued it. Afterwards, the company records in the ledger an expense equal with the amount it previously put in the bill. At the end of the fiscal period, the revenue is diminished by that expense, leading to a decrease in taxable profit. In such a way, the owners of the company not only that can evade paying profit taxes but they can also cash the expense money out of the company’s bank accounts without paying income and social security taxes.

Another form of evasion was the scheme of false “collaboration contracts”<sup>9</sup>. Until 1999, the law stated that part-time workers and consultants had to pay lower income taxes than full-time employees. The same law stated that a company does not have to pay social security taxes for these categories of employees. Therefore not only that most of the companies tried to avoid having full time employees and offered employment only under the a “contract of collaboration”, but also falsified such contracts to record inexistent “collaborations” in order to decrease their taxable profits.

### **The Discriminatory System of Tax Exemptions, Holidays, and Rescheduling (Eurodrinks)**

#### *“Tick” Companies*

A “tick” company is a parasite company that sucks up the resources of a state own company. Usually the “tick” company is owned by the manager or a member (person A) of the board of a state owned company. Person A uses her position to give preferential facilities to the “tick” company in its commercial relationships with the state company.

In a typical scheme, using his influence on the board, person A manages to bring the “tick” company to be a preferred supplier and/or client of the state company. Being in a preferred position, the “tick” company sells raw materials at a *higher* price than the market price, thus bringing prejudices to the target company. After the processing is completed, the finished goods will be sold to the same or other “tick” company at a *lower* price than market price of the final product, thus bringing another prejudice to the target company. These schemes contributed to a large number of state-owned companies’ bankruptcies. The beauty of this scheme is that many managers brought afterwards – either themselves or through intermediaries – the bankrupted

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<sup>9</sup> In Romania, a “contract of collaboration” is a temporary work contract between an employer and a part time employee or consultant.

companies that they had formerly mismanaged at a bargain price, liquidated their assets and pocketed the cash.

*Fraudulent Privatization (Contracts)*

From the very beginning, one must note this type of economic crime would not be possible without the support of corrupted State Ownership Fund employees and officials responsible for privatizing the state owned companies.

The Law of Privatization states that the privatizations can be done by the State Ownership Fund through one of two methods: public tenders and direct negotiations with selected investors and it clearly states the situations in which the each method can be applied.

While a complete taxonomy of economic crimes related to privatization is beyond the scope of this paper, one can observe that most of these crimes are related to:

1. Illegal tenders (bribery, lack or disregard of due diligences) and
2. "Gray" privatizations through Joint Ventures or Direct Negotiations

*Illegal Tenders (bribery, lack or disregard of due diligences)*

This scheme involves an investor A and number of corrupted State Ownership Fund officials. The State Ownership Fund organizes a tender in order to sell a company. The bids are submitted by the interested investors in a written form. An insider from the State Ownership Fund committee that organizes the bid, informs investor A about the offers of the other companies. Investor A modifies his offer at the last moment so it match and exceed the other offers. Investor A wins and becomes the owner of the company. He immediately starts selling its assets, borrowing money from banks (see Obtaining credits secured with collaterals subject to previous commitments) and using "tick" company schemes. He never abides to the contractual terms that he specified in his offer. After a period of time (usually years) the State Ownership Fund formally takes note of the fact that investor A has not completed his obligations and revokes the privatization contract. Meanwhile, most of the assets of the company no longer exist, and the company is in a worse financial condition that it was before its privatization. The amount of money that the investor loses from his initial deposit/investment and from the foreclosure of the guarantees is far exceeded by the illegal profits that he makes using this scheme.

As far as the State Ownership Fund employees are concerned, their offences relate to accepting bribe, failing to pursue the due diligences, and the background and solvability checks on the potential investors,



breaking the laws, and regulations and procedures concerning the privatization tenders and so on.

*“Gray” privatizations through Joint Ventures or Direct Negotiations*

The parties involved in joint venture privatization scheme are the same that above. The difference consists in the fact that the investor forms a joint venture with the State Ownership Fund (or, in certain cases, with the local administration) in which the former brings an insignificant amount of equity capital and the later brings a company or major assets. The key of this scheme is a clause in the joint venture contract stating that a partner has preemption rights in the event the other partner decides to sell its shares. Usually the contract stipulates that the preemption rights can be exerted at a price far below the actual market price of the shares. After the joint venture is established all the investor needs to do is to “convince” the State Ownership Fund to sell its shares.

While this scheme is not illegal *per se*, considering that it is used to preferentially privatize a company that otherwise should have been sold through a public tender, it constitutes a “gray” privatization.

As we mentioned before, the law permits the privatization through direct negotiations with a pre-selected investor. However, the law specifically states the circumstances in which this form of privatization can be employed. Despite of that, there were cases in which state company were discretionary and preferentially privatized through this method in complete disregard of the legal prescriptions, therefore breaking not only the Privatization Law but also the spirit of the Romanian Commercial Code.

*Smuggling*

The three most important products that are subject to smuggling and illegal traffic are cigarettes, alcohol and illicit drugs. These products are brought into the country by smugglers that leverage on the ineffectiveness and lack of experience of the custom officers, from their propensity to corruption and lack of modern technological resources. Romanian press often related that smugglers use automatic weapons, the latest generation of radio and wireless communication, state-of-the-art tracking devices, expensive and powerful cars and boats, while the police and the custom officers often relay on scarce or rudimentary resources.

Over the last decade there were many important cases of smuggling. The most interesting were those that involved state officials. Here are two examples:



Operation “Jimbolia” is a case in which a Romanian company violated the embargo imposed against Yugoslavia by exporting oil and oil products to Yugoslavia allegedly with the full knowledge and support from the Romanian Government and Romanian Information Service (SRI). The case is still in the court.

Operation “Cigarette” was in fact a series of operations in which cigarettes were smuggled in Romania. In one of using military facilities with the support of high hierarchy officials, including police, customs, and secret service (Serviciul de Paza si Protectie - SPP) officers, local administration officials, Financial Guard officers and so on. In one of these operations, an airplane secretly landed on the Air Force section of the Bucharest-Otopeni Airport in order to avoid the customs. The landing was approved by the commander of the air base, and the whole operation was coordinated by a SPP officer.

### **Voluntary Mismanagement**

#### *Illegal/Preferential/Discriminatory Bank Loans and Credits*

These schemes are connected to the collateral schemes explained above (see Illegal loans and “tick” companies). They usually involve power abuses and/or political pressures. Under these schemes a person that works in a bank and has deciding power (VP or chief position) strikes a deal with somebody that does not have the financial power to secure a loan though the normal procedures, and promises a “cut” to the loan officer. The business is made and the money is paid in cash after the loan is secured. The most known cases are probably those of Gabriel Bivolaru – a senator of the ruling party and his wife Mona de Freitas. In the mid-nineties they obtained several loans using these schemes. Mr. Bivolaru never stood trial because he benefited from the parliamentary immunity. His wife left Romania and got her residence in the UK. At the present time, all of their British possessions (properties and bank accounts) have been seized and the authorities are waiting for their Romanian counterparts to start the investigations.

#### *Embezzlement*

During the last decade there was an uncountable number of embezzlement cases involving managers of state companies and banks, members of the local administration, members of the Government, and other state employees. All these people used a tremendous variety of methods. Unfortunately, only a few of these criminals were brought in court and even fewer were found guilty due to the traffic of influence between the politicians, the interference of politicians in the justice, corruption and so on.

### *Debt Collection Schemes*

After the financial crisis generated by “Bancorex” and “Agricola” banks in 1998, the Government decided to create the Asset Recovery Agency (Agentia de Valorificare a Activelor Bancare -AVAB). The role of this agency was to recover the money these banks lend to private companies before going out of business. One method employed by AVAB in order to recover these assets was to sell them at a discount to companies that would foreclose them and cash the money from the actual debtors.

One big scandal related to the activity of AVAB was revealed by the Romanian mass media when a debtor of Bancorex bought from AVAB the recover his debt to Bankorex (from himself), at a very big discount.

### **Main Types of Economic Crime:**

#### **Technological Crime**

##### *Internet Related Crimes: “Carding”*

“Carding” is a term used to designate credit card fraud associated to purchases on the Internet. These criminals call themselves “carders” and take pride in the number and the quality of merchandise they can acquire fraudulently. There are literally thousands of websites on the Internet that provide ample documentation, software and even online assistance on “carding”. The idea behind carding is to find:

1. A functional credit card and
2. An e-commerce website with a vulnerable credit card authentication system that can deliver merchandise to Romania.

A functional credit card can be obtained in a various number of ways:

- **Hacking into an online database with credit cards.** Typically, the hacker will try to find and attack an adult website with a vulnerable online transaction database. Once accessing the database, he will download it on his own computer. That will give him the credit card numbers, names and billing addresses of all the website customers. Afterwards, he can use this information both for carding and (less typically) for black mail.
- **Using a credit card number generator.** A credit card number generator (“CC generator”) is a program that uses mathematical algorithms to “guess” a credit card number. CC generators are free and easily available for download on the Internet. Some of these programs are very versatile being capable of generating up to 20-25% valid credit card numbers. Because of its ease of use,

this way of carding was very popular until 1998 when most of the e-commerce companies included supplementary authentication measures such as the automated billing address/credit card number match check.

- **Buying a credit number and information from somebody else.** In Romania there were cases in which some dishonest cashiers or waiters allegedly sold credit card information to carders. Carders also trade credit card numbers online, through email, chat channels, and in many other ways.
- **False or bogus e-shops.** A carder can design a website if it belongs to a legitimate e-commerce company, or can copy the website of such an existing company and put it on his server. The purpose of this scheme is to trick people into ordering goods from the false online shop and thus to obtain their credit card information.

Although finding a suitable e-commerce website has become more and more challenging because of the increased security measures the e-companies have introduced during the last 5 years, carding has flourished. An explanation is that, in the same time, the methods employed by the carders became more and more sophisticated. The lack of legislation concerning the online transactions has nurtured the Romanian Internet related crime to the point where most of the big e-commerce companies ceased to make any deliveries to Romania. However, with the boom of the online commerce at the end of the last decade, a growing number of small companies went online and many of them lacked the computer security experience and training to protect themselves against carders.

The typical Romanian carder is between 15 and 32 years old, has a personal computers and strong knowledge of IT. The experienced carders do not use their personal computers directly because they claim that the dial-up connections on the digital lines are easy to track. Many carders operate from Internet cafés or from home but using stolen dial-up accounts and pirated phone lines. They prefer to place many small sized orders in different places rather than one big order with a single company, in order to increase their chances. Sometimes carders pay other people (usually very old senior citizens) to use their addresses as drop off addresses for the goods they order on the Internet. These persons are usually naïve and have no idea that the merchandise they receive is stolen.

After they get the goods, carders keep for themselves only what they need and sell the rest through classifieds or through stolen goods retailers.

The authors believe that between 1997 and 1999, on the average, a Romanian carder made between 8 and 7 thousand dollars a year from proceedings on Internet stolen merchandise.

### *Phreaking*

“Phreaking” is a general term used to designate the telephone related crime. This kind of crime has two aspects: a virtual, intangible aspect that derives from the usage of the Internet pc-to-phone and calling card services, and a physical aspect related to phone line piracy.

It is very important to mention that while the physical aspect of phreaking affects primarily the Romanian telephone company – Romtelecom, the virtual aspect affects almost exclusively the foreign long distance carriers and Internet phone companies because the phreaked calling cards are used to make international pc-to-phone calls.

As in the case of carding, there are huge numbers of websites with resources for phreakers. Their *modus operandi* is very similar to those of carders. As in the first case, there are calling card authentication number generators available for download, online forums and chat channels available for support and information, a market (although quite small) for phreaked calling cards.

As far as the physical aspect of phreaking is concerned, before the implementation of digital telephony servers in Romania, a number of people (especially carders) used devices called “boxes” in order to pirate the phone lines. The most popular “boxes” used to derive phone line connections from other people’s apartments, boxes used to alter the phone signals or lines in order to avoid the charges for outgoing calls, and boxes used to prevent an incoming call to be charged by the phone company.

### *Warez*

“Warez” is a term used in conjunction with software piracy over the Internet. “Cracking” is a term that designates the procedure through which the protection code of commercial software is removed thus, making it usable to anyone for free. A great number of websites have well diversified cracked programs and cracking software available for download along with lists of serial numbers, serial number generators.

Since 77 to 80%<sup>10</sup> of the Romanian software market represents pirated software, the importance of “warez” appears in a greater perspective.

Based on the usage of warez, the pirates can be divided into two categories:

- Private pirates are computer users that go on the Internet from home, usually on dial-up connections and use warez for their own needs. They download cracked programs, especially games that they use on their personal computers.
- Commercial pirates are people that have fast connections and download a huge number of cracked programs from the Internet, compile software collections, burn hundreds of CD-s and sell them on the market. (see also copyright infringements)

### **Main Types of Economic Crime:**

#### **Document Fraud Crimes**

##### *Official Documents Forgery*

One of the most widely available forged official documents in Romania is the so-called “fiscal bill”. In Romania, the companies cannot print their own bills. According to the law each company buys registered blank bill-books from office supply stores licensed by the Minister of Finance. Each bill-book has a unique identification number, and each bill in the bill-books has a unique number as well. These are called “fiscal bills”. When a company sells goods to other company, it has to take such a fiscal bill, print on it the quantity, the description of the merchandise, the price of goods and the VAT paid by the buyer. The bill needs to be sealed with the company’s seal before it’s sent or given to the customer.

There are complex networks of criminals that design, print, and distribute the forged “fiscal bills”. These networks are very well organized and consist of specialized persons with well-defined roles. There are people that establish companies (see phantom companies schemes) for the sole purpose of obtaining a company seal that can be used in forging a fiscal bill. Another category of people copy or emulate the identification numbers on actual fiscal bills in order to make the forged documents more credible; they can also have attributions related to the design and printing of such documents. A third category (especially old women and children) takes care of the distribution. Usually one can buy forged documents on the highway exits at the suburbs of big towns, from women and children that flash the false bill-

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<sup>10</sup> Sixth Annual BSA Global Software Piracy Study, Business Software Alliance, <http://www.bsa.org/resources/2001-05-21.55.pdf>

books to drivers. A fourth category of people involved in such networks is “the security people”. They are stay in cars parked on the side of the road and supervise the distributors, alerting them immediately when the police shows up.

Another category of forged official documents includes state registration numbers<sup>11</sup>, fiscal codes<sup>12</sup>, fiscal stamps for tobacco and beverages (see smuggling), company check-books, export declaration forms, sanitary and health compliance certificates, company seals, etc. The third category is made of forged IDs such as: ID cards, passports, work ID-s, bachelors’ diplomas, etc.

### *Counterfeiting*

Most of the counterfeiting cases uncovered by police and reported by media involved “primitive” counterfeiting methods such as color-scanning a bill and printing the image on regular paper. A typical network involved in counterfeiting includes the designers that scan and print the bills and the distributors that buy the counterfeited bills usually at half or a third of their face value and try to place it on the market in exchange for real goods or money.

### *Copyright Infringements*

While there are a lot of copyright infringements in the publishing industry, most of these offences come from the software and music industry. According to Business Software Alliance<sup>13</sup>, between 1995-2000, the software piracy rates in Romania decreased from 93% to 77%. The effect of this decrease can be attributable to the introduction of the Copyright Law in 1996, the activity of some Romanian anti-piracy organizations and businesses such as, Business Software Alliance, Romanian (ORDA), Microsoft Romania, etc. However, in spite of this decrease, the Romanian piracy rate is still very high, placing Romania among the top four countries in Eastern Europe from this point of view, next to Bulgaria, Russia and Ukraine.

The market for pirated software is concentrated on two main categories:

- Operating systems and professional software;
- Games

The most pirated programs include: Microsoft Windows 95, 98, Me, NT and 2000, Microsoft Office, and Adobe Photoshop. However,

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<sup>11</sup> See phantom companies

<sup>12</sup> See phantom companies

<sup>13</sup>Sixth Annual BSA Global Software Piracy Study, Business Software Alliance, <http://www.bsa.org/resources/2001-05-21.55.pdf>

virtually all the software titles are available on the black market. There are merchants that sell pirated software on the streets. Some of them give their customers their telephone numbers so they can order custom compilations of software programs. A typical compilation CD entitled, say, "Graphic Software" can contain for instance Adobe Photoshop, Adobe Go Live, Bryce, 3D StudioMax, Corel Draw, Macromedia Fireworks, and many, many other programs. The price of such a compilation CD is between 80-100.000 Romanian lei (about \$2.50 - \$3.00). To get a true dimension of this phenomenon, one should think that Adobe Photoshop 6.0 alone has a listed price of \$609.00<sup>14</sup>.

There are three main ways through which the commercial pirates obtain the pirated software:

- Imports (mostly from Ukraine, Bulgaria and Russia) 60%<sup>15</sup>
- Internet 15-20%<sup>16</sup>
- Local cracking (also see Warez).

These commercial pirates have modern multiplication capacities (multiple computers with CD-burners, or professional CD-burning installations) in their apartments, but the size of these capacities is still less than a plant. Software pirates also have large distribution networks and connections within the police. Usually, police patrols close their eyes to pirated software merchants in exchange for bribe. Every now and then, police raids these merchants and fines them, but this is extremely ineffective, especially when you think about the huge profits made by commercial pirates.

Music and video piracy in Romania is usually done using the same scenario as in the case of software piracy, and many times, the same merchants that sell pirated software sell pirated music and videos as well.

Another type of copyright infringement relates to cable television and cable piracy. This is done either by consumers of such services using home-made decoders for pay-per-view channels such as HBO, or by cable-operators that retransmit satellite programs and broadcasts intended for other countries in Western Europe without paying royalties.

According to International Intellectual Property Alliance, "The MPA<sup>17</sup> reports that annual losses to the U.S. motion picture industry

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<sup>14</sup> <http://www.adobe.com>

<sup>15</sup> International Intellectual Property Alliance: 2000 Special 301 Report – Romania:  
[http://www.iipa.com/rbc/2000/ROMANIA\\_2000.PDF](http://www.iipa.com/rbc/2000/ROMANIA_2000.PDF)

<sup>16</sup> *idem*.

<sup>17</sup> Motion Picture Association

due to audiovisual piracy in Romania are estimated to be US\$6 million in 1999.”

### **Main Types of Economic Crime:**

#### **Securities Fraud**

##### *Insider Trading and Other Security Related Offenses*

SAFI-FMOA 1996 (Mutual Fund for Business People administered by SAFI Invest) was a major scandal in 1996 because it employed several illegal business policies, such as including in the present value of the fund uncertain future cash flows from other activities. The result was a disproportionate increase in the market value of the fund and the attraction of thousands of investors. When CNVM (the Romanian equivalent of SEC) recalculated the real present value of SAFI, the fund crashed and a large number of investors lost their money. Some of the blame can be traced to CNVM due to its ineffective supervising policy, as well as to the fund manager for its shady methods of management. Presently, the fund is reorganized as an open fund; however its present market value is a tiny fraction of what it was in 1996. There were almost 200.000 people affected by this crash, people that invested more than 170 million dollars in the fund.

FNI/FNA 2000 (National Investment Fund/National Accumulation Fund) – The funds, just like SAFI, reported fictive asset increases; the difference however was that the money attracted from investors were pulled out and pocketed by the fund managers and certain third parties associated with them. When the scheme was uncovered, there weren't any money left in the fund's bank account and the database containing the list of all the investors was missing. Again, the blame is to be divided between CNVM who did not supervise strictly the fund's activity, and the managers who organized the con scheme. In this case there were over 300.000 affected by the crash.

“Albina” Bank, 1999 – biased management policies as well as disregard for any bank prudence rule. The bank used the deposits to give risky credits to a number of companies whose managers had ties with the bank's Board. Obviously, the bank filed for bankruptcy, since the credits were never recovered. The investors received small compensatory amounts. Beside the management, some of the blame can also be traced to the National Bank of Romania for ineffective supervising.

Mass Privatization Process 1995-present – Legally, the only way to sell the coupons (shares) given to everybody is through a brokerage institution. However there were numerous cases in which certain persons acquired those coupons directly from the population at a price



below the market value and then sold them to the brokerage institutions at a higher price, thus pocketing the difference. The operation existed on a large scale and it is still practiced.

Insider information based trading – It is worth mentioning that virtually all the transactions on Rasdaq<sup>18</sup> are based on inside information, since the amount of the information publicly available is close to zero. The information held privately, such as knowing that the equity can be positively re-evaluated and as such some equity will be offered for free, can be speculated by buying stock at low prices, prior to the public announcement (which will lead to an increase in the stock price).

#### *Money Laundering*

There are several ways to accomplish this: for instance, a person buys penny stocks as an individual and then sells them at a ridiculously higher price to his own company. Thus, the funds are transferred from the company to the person. Similarly, the same game can be played on the futures market, when a party wins and the other party deliberately loses the contract so that the funds are again transferred. (see Money Laundering as a commercial crime)

#### *Connections with the Government*

The role of corrupted state officials and employees in the accumulation of illegal capital is tremendous, especially in relationship with the crimes against state statuses and programs. A significant number of government employees are directly involved in crimes related to illegal privatizations, mismanagement, “tick” company schemes, illegal bank loans or indirectly involved in the economic crime by failing to accomplish their mission and duties, by abusing their functions and facilitating the crime.

#### *Connections with the Organized Crime*

Over the last decade, the local mobs have flourished over the Romanian territory. They are organized around local barons – rich and powerful people that accumulated their wealth through illegal means. These barons use their resources increase their illegal capital by obtaining the support of key government and local administration employees, fighting the competition and protecting themselves from the enforcement of the law.

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<sup>18</sup> The Romanian Securities Exchange

The organized crime conducts business by its own rules. If a competitor or a debtor does not comply or payback his debt, he faces threats, enforcers, set-ups, and even gun or bomb attacks.

### *Connections with Terrorism*

There are no reports of terrorist activities on the Romanian territory. However, the “Ziua” newspaper uncovered a case<sup>19</sup> in which a Romanian drug company – Sintofarm SA purchases an illegal quantity of a substance (acetic anhydride) that can be used both in the production of aspirin and the production of heroin. The company illegally sold the substance on the black market, through a number of “tick” companies and allegedly benefited from the protection of high ranked police officers. The same newspaper related in a previous and related article<sup>20</sup> that in 1998, 20 tons of acetic anhydride were illegally exported to Albania by two companies involved in the “Sintofarm” scandal.

According to the CIA World Fact Book<sup>21</sup>, Albania is an “increasingly active transshipment point” for drugs heading to Western Europe

There are speculations that the Kosovo Liberation Army and the Albanian guerillas fighting in Macedonia are financed with drug money.

### **Conclusion**

In Romania, the total of major thefts during the last decade amounted to seven billion dollars<sup>22</sup>, a figure as big as the total public debt of the country. At this point, a Romanian company has far more incentives to activate in the shadow economy than it has to operate legally and legitimately

Economic crime is directly related to the lack of economic reforms, the slow pace of privatization, and the weak legal framework. The legal framework needs to be improved and updated in order to cover the whole spectrum of economic crimes while the shadow economy should be discouraged. This can be achieved by building an efficient and

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<sup>19</sup> “The SINTOFARM Algorithm” by Adina Anghelescu and Petre Niteanu, “Ziua”, March 24, 2001:

<http://www.ziua.ro/search.php3?class=2001&id=17136&keyword=Sintofarm&style=3>

<sup>20</sup> “Yet Other 20 tons of Acetic Anhydride Illegally Exported” by Mariana Gavrilă, “Ziua”, March 17, 2001:

<http://www.ziua.ro/search.php3?class=2001&id=15552&keyword=Albania&style=3>

<sup>21</sup> <http://www.cia.gov/cia/publications/factbook/geos/al.html>

<sup>22</sup> “Over \$7 Billion Worth Of Scams” by Carmen Rudni\_chi, Adriana Halpert, “Capital”, May 31, 2001:

<http://www.capital.ro/arhiva.php?IdOfMagazine=112&IdOfSection=8&MagazineID=95&ViewMagazine=detail&IdOfArticle=3209&ViewArticle=detail>

healthy economy based on the implementation of the economic reforms, a better enforcement of the law, better fiscal and regulatory conditions for the legitimate business, etc. The Government should continue to fight against corruption using more effective means.

The lack or the delay of serious efforts to confine and reduce the economic crime and the size of the shadow economy can seriously jeopardize Romania's plans to join NATO and the European Union.

# **How Good is Your Country? What You Should Know**

*Raymond B. Cattell, Ph.D., D.Sc.*

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## **Business as Usual: Corruption and Business Activity**

Elia Kacapyr\*

*Ithaca College, New York*

A regression analysis is used to verify the determinants of corruption. Using a cross-sectional data set of 48 countries, a significant relationship between GDP per capita and the level of corruption is confirmed. However, it is likely that GDP per capita is a determinant of corruption and affected by corruption. An instrumental variable technique is used to help determine the true impact of GDP per capita on corruption.

Key Words: GDP per Capita, Transparency International, corruption, freedom, government interference, bureaucracy,

### **I. Introduction**

Corruption - what causes it, its costs, and remedies - is a major concern in international business today. Corruption has been blamed for underdevelopment in some countries and a lack of foreign investment in others. Corruption is the result of too much government interference in the economy, or not enough government oversight. Corruption stems from a lack of competition according to some analysts, while others highlight cultural factors, and still others focus on low wages among bureaucrats.

Remedies to fight corruption run the gamut from promoting development and competition to invoking stiffer penalties for the individuals involved (Klitgaard, 2000).

All of this points to a multi-faceted problem with entangled causes. A better understanding of the causes of corruption would help in the design of policies to overcome it. For instance, if corruption is found to be primarily the result of badly functioning large bureaucracies, then attention could be devoted to improving the functionality of national and business institutions.

On the other hand, if corruption is rampant primarily in economies where governmental restrictions are prevalent, then an opening up of the economy to competition and a reduction in regulation will help.

The reasons why corruption is prevalent in some countries are not well understood. Consider the theory that governments that are heavily involved in their economies, whether it is redistributing income or granting licenses for foreign trade, promote corruption. The idea certainly has intuitive appeal and some anecdotal evidence stands

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