

The Connection between Corruption and the Underground Economy- An Obstacle on Innovation and Development of the Business Environment

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Abstract

This article presents the two phenomena of economic financial crime: corruption and the underground economy, which have managed to expand internationally. The current context has allowed the emergence and the development of this phenomena into the society, the public sector and the business environment that generates a decrease of investments, innovation and research at national, European level. In this article we have presented some elements of the literature review on corruption and on the underground economy, as well as the direct and strong connection between the two and the impact of corruption and the underground economy in the innovation and development of the business environment at the level of the European Union. The research methodology used in the elaboration of this article was the qualitative method.

Keywords: Corruption, Underground economy, European Union, OECD, Transparency International Index

JEL Classification: D7, D 73, E2, E 26

Introduction

Corruption and the underground economy produce negative effects and major gaps in the economy that affect social life, the state and the business environment. These two phenomena, due to the complexity and speed of adaptation and self-feeding, have become a real challenge for the authorities and the academic

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environment. The relationship between corruption and the underground economy manages to overcome national barriers and regulations imposed by the authorities, both at European and international level, but also locally.

The phenomenon of corruption appears, in most cases, with the objective of paying for certain activities within the underground economy, for which entrepreneurs or citizens are certain that they will not be discovered by the authorities. This corrupt behavior is branching out and spreading rapidly from small businesses to multinationals, authorities, taking over states and the business and public environment.

In these conditions, the creation of a legal, solid, efficient framework with appropriate measures to prevent and combat both corruption and the underground economy, together with the training of the future entrepreneurs are the basis of the fight against corruption, the underground economy and the connection between them that allows mutual maintenance.

Review of the scientific literature: corruption and underground economy

The phenomenon of economic-financial crime is a difficult concept to define, due to the complexity of operations and forms of manifestation, being associated with the following crimes: corruption, fraud, money laundering, tax evasion, terrorist financing, leading to tax havens and of an underground or illicit economy.

This article focuses on the study of corruption, the underground economy and the connection between these phenomena. Therefore, corruption, considered one of the most serious and widespread forms of crime that degrades the administration of public affairs (Conseil de l'Europe, 1996) dates back to antiquity. The 1999 European Council adopted a convention designating corruption as the act of soliciting, granting, accepting in an indirect or direct form undue benefits or financial incentives, which result in changing the behavior or actions of the person receiving the incentive to the advantage of the one who can offers it (Iamandi and Dorobantu, 2007). The World Bank in 2005 defined corruption as "the abuse of public or corporate office for private gain"(World Bank Global, 2005). In 2008, the OECD issued definitions in the Glossary of International Standards in Criminal Law so that each state could take on the definition of the situation: abuse of funds that could be both public and private for personal use (OECD, 2008). According to Transparency International, corruption is the abusive use of influence entrusted or held in order to pursue the personal interests or interests of a category of persons (T.I., 2006). The most well-known and representative forms of corruption are: Extortion, Fraud, influence peddling, bribery, etc. Also, in the literature we have identified various types of corruption: private corruption which can have 4 courses of action: grand or petty (Elliot, 1997) or unorganized or

organized (Shleifer & Vishny, 1993) public corruption, arbitrary and pervasive corruption (Bahoo, Alon, Paltrieri, 2019).

The second phenomenon we have analyzed, the underground economy, is considered much more complex than corruption. The specialized literature, from the conceptual perspective, presents a variety of conceptions regarding the definition of this concept according to the range of its elements. Thus, the underground economy designates the production of services or goods, both legal and illegal, which bypass official estimates of Gross Domestic Product (Smith, 1994). In addition to illegal economic activities, the underground economy also includes revenues from these activities that avoid taxation, regulation, or government observation (Achim, Borlea, 2019). Therefore, this phenomenon includes all unregistered economic activities, and if a record were kept, they would be included in the observed or calculated GDP (Achim, Borlea, 2019).

The connection between the underground economy and corruption

As a result of researching the literature on the phenomena of corruption and the emergence of the underground economy, we found that there are various studies that have a direct connection, but also an indirect one between them. According to another study, corruption is often used as a tax directed at the activity of an organization within the real, official economy, directing it to illegal, underground activities (Johnson et al., 1997). Other authors have found a positive link between the underground economy and corruption (Schneider and Buehn, 2010). One study demonstrates, in an empirical way, that states that have a high degree of corruption also have a high degree of underground economy (Friedman et al., 2000).

These studies provide empirical evidence that demonstrates the destructive role of the phenomenon of corruption and forms of manifestation (bribery of officials) with the aim of giving the underground economy fuel to function and develop. Author O.H. Fjeldstad, in his works approaches the phrase "fiscal corruption" highlighting the fiscal purpose of corruption (M.V. Achim, S.N. Borlea, 2019). Therefore, the expansion of corruption will fuel the underground economy, which has a positive relationship between the two phenomena.

At the same time, another model approaches these two phenomena as complementary, so that work can be done in the official economy, as well as in the underground one, and an increase in the underground economy will generate a decrease in the official market (Johnson, Kaufmann, Zoido-Lobaton, 1998). On the same idea, it is present the fact that the inspector fills in with the taxpayer, so that, in exchange for the bribe, the inspector does not report the obligations of the taxpayer citizen (Hindriks, Muthoo, Keen, 1998). Another model shows the

choice of entrepreneurs to be part of the underground economy, causing the corrupt official to ask for a bribe (Choi, Thum, 2004).

Another relevant analysis between 2005-2014, carried out on a sample of European Union member states, the empirical results demonstrating a strong connection between corruption and the underground economy, respectively, a high value of corruption implies a high degree of underground economy (Miron, Borlea and Achim, 2017).

Regarding the indirect relationship, there are a number of studies conducted in this direction, including the investigation conducted in different geographical areas of the world to discover the relationship between the underground economy and corruption, starting from the fact that various forms of bribery can have different repercussions in the underground economy (Virta, 2007). Also, corrupt practices can take various forms depending on certain regions, with a higher frequency in some geographical areas, depending on several factors. At the same time, it is specified that bribery in order to reduce taxes, has different consequences compared to bribery in order to obtain public contracts (Virta, 2007). The negative relationship between these 2 phenomena has been identified especially in the case of states in the tropical region, as a result of a common situation of bribing public employees in order to function in the official sector (M.V. Achim, S.N. Borlea, 2019).

The research question was to discover the connection between the 2 illegal activities, how strong it is and what implications it can have for society, the public sector and the business community. Thus, we presented the two phenomena: corruption and the underground economy, and later, we detailed about the direct connection between them and the effects they had to highlight the direct connection between these two. At the same time, in this article we presented the impact of corruption and the underground economy on innovation and the development of the business environment and the public sector at EU level.

Research methodology

The research methodology used in the elaboration of this article was the qualitative method, through which we presented each phenomenon, as well as the link between corruption and the underground economy.

At the same time, we presented the impact of corruption and of the underground economy at the level of the business environment, which generates a decrease of investments, innovation and research at national, European level. Thus, through the synthesis we transmitted the research results in a concise and clear manner, the connection between the 2 illegal activities, how strong it is and what implications it can have for society, the public sector and the business community.

Results and discussions

As mentioned above, there is a direct, strong link between these two phenomena, which allows mutual influence to develop and find new methods of action. They have become more widespread in Europe and worldwide, with visible effects on society, the business and innovation environment, the political environment.

Both phenomena affect the harmonious development of states, with a major impact on the public sector, implicitly of citizens and the business environment, by impeding or slowing down innovation and development.

On the one hand, from the perspective of Corruption Perception Index 2019, although the Western Europe & European Union region registers the best "score 66 out of 100" (Corruption perception Index, 2019) it is not protected from the appearance and development of this phenomenon. The countries that have registered a strong evolution of corruption are: "Bulgaria (43), Romania (44) and Hungary (44)" (Corruption perception Index, 2019), as opposed to "Denmark, Finland, Sweden and Switzerland", but it is worth noting that although these countries have a high score symbolizing a low degree of corruption, they are not bypassed by the phenomenon of corruption.

Thus, corruption can be caused by bribers or bribes (Heimann & Boswell, 1998) which means that this phenomenon, both from a private or public perspective, can be correlated with the supply or demand side. In the international business environment, a distinction is made between incentives from the supply side of managers and incentives from the demand side of governments (Cuervo Cazorra, 2016). Regarding the corruption from the demand, it appears that it can take place at the level of the organization due to the insufficiency of resources redirected to the staff, which leads them to adopt a corrupt behavior or if the procedures of supervision and organization are not properly done with various shortcomings. Therefore, regardless of the sector in which it occurs, public, private, corruption is the result, mainly of lack of education (Caiden, Dwivedi, Jabbra, 2001) and ethics, as well as insufficient income to contribute to the smooth running of social, family life, etc.

On the other hand, the underground economy can generate major imbalances in the economy, business environment and social life, leading to unequal and insufficient distribution of resources, as well as stopping or slowing growth, development and innovation in areas such as (IMF Working Paper, 2019, p. 9): *Financial access, Public revenue and services*: the activity generated by the underground economy leads to a decrease of public revenues, effects that will be felt in weaker public services: innovation of the public system, education, *Innovation and productivity*: as a result of informal activation, enterprises will have obstacles in terms of development, will invest less in development and innovation and will

reduce the number of jobs and implicitly, the reduction of capital and resources human resources will decrease, and in the case of organizations that operate equally, they will be constrained by the payment of taxes and duties putting pressure on the departments of innovation, research, etc. Labor markets: a large underground economy will involve an increase in the unemployment rate leading to a reorientation of the workforce to the informal sector, which will be paid less without training.

Therefore, these 2 phenomena, which are closely related, affect the economic environment, business, society, governments that may be overwhelmed by the effects of corruption and the underground economy. At the level of the European Union, the fight against these phenomena is in full swing, as demonstrated by initiatives to improve and adapt legislation to current realities and the implementation of new programs through the Europe 2020 Strategy. For example, in the case of Romania combating economic-financial crime through: the National Research-Development-Innovation Plan III 2015-2020 or National Strategy for Competitiveness 2015-2020, all with the aim of combating, but also preventing these phenomena, especially through awareness and education/training the academic environment and future entrepreneurs and employees to understand the mechanism of action and evolution as well as the discovery of levers that allow development at national, European and global level.

Through the elements of measuring corruption, respectively the underground economy, the authorities can evaluate the results of these illegalities at the economic and social level, as well as finding the best solutions to reduce and counteract these phenomena and concentrate human and financial resources on areas that are essential: education, innovation, etc.

Conclusions

Corruption and the underground economy are illegal activities that together with money laundering, terrorist financing, bribery, fraud, tax evasion, etc. composes economic and financial crime, with major effects on the business environment, the public sector and society. These two phenomena are in a direct connection, they reinforce each other, by the fact that corruption is necessary in the process of developing the underground economy and implicitly, within the underground economy there are activities that involve corruption and bribery. Thus, in order to obtain additional incomes from certain economic agents within the gray economy, individuals, organizations or civil servants have obtained some definite benefits that make the activity easier, thus benefiting from the market formed within the underground economy. Both corruption, whether we refer to poorly developed,

developing or developed countries (the example in Denmark and Switzerland), and the underground economy manage to take root and produce negative effects. At the same time, in order to counteract or prevent the occurrence and effects of these 2 illegal activities, it is necessary to achieve an efficient legal framework, which provides the necessary levers to fight against them, but especially the devastating effects at social, educational and business level.

In these conditions, it is necessary to intervene specialists in these two fields, who have the necessary studies to find the best solutions to prevent and reduce these phenomena. For them, the training of future employees and entrepreneurs, respectively students, is essential in the fight against corruption and the underground economy. Understanding these phenomena, correlating the needs of the labor market with training in universities will generate positive effects in the business environment, because future entrepreneurs and employees will have the necessary knowledge and skills, as well as elements that bring innovation and added value in this domain.

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