Why Corruption Decreases the Efficiency of Public Spending?

Analytical commentary
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What is the relationship between corruption and public spending?

In the Republic of Moldova, the efficiency of public spending is low, compared to other states in the region. In 2017, according to the World Economic Forum's Global Competitiveness Report, the efficiency of public spending in the Republic of Moldova was marked with 2.7 points\(^1\), which reveals an improvement compared to 2016 when the score was 2.6 points. Despite this progress, the Republic of Moldova ranks the 14\(^{th}\) of the 20 countries in Eastern Europe and Caucasus in terms of public spending efficiency\(^2\) (see Error! Reference source not found.).

![Figure 1. Efficiency of public spending, 2017](Source: World Economic Forum)

Corruption affects negatively the efficiency of public spending. In general, corruption is detrimental to state efficiency. Corruption affects the efficiency of spending made from the Government sources. Thus, for Eastern Europe and Caucasus countries, reducing the corruption\(^3\) by one unit increases the efficiency of public spending by 0.65 points (see Annex 1). Public spending can be affected via several channels:

- Allocation of budget funds to non-priority sectors. Because of corruption, budget sources are not oriented towards implementing the most necessary programs for the society, but are offered to areas that bring

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1. The efficiency of public spending is assessed according to a scale from 1 (extremely inefficient) to 7 (extremely efficient).
2. The following countries were included in the Eastern Europe and Caucasus region: Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Czech Republic, Croatia, Estonia, Georgia, Latvia, Lithuania, Mongolia, Poland, Republic of Moldova, Romania, Serbia, Slovakia, Slovenia, Ukraine, Hungary.
3. Indicator 'Ethics and corruption' (historical dataset for the Global Competitiveness Index) was taken from the World Economic Forum website and applied in order to reflect the level of corruption. The indicator 'Ethics and corruption' ranges from 1 (poor ethics and high corruption) to 7 (high ethics and low corruption). In its turn, 'Ethics and corruption' includes 3 indicators that reflect: the diversion of public funds, the ethical standards of politicians, and the spread of informal payments.
personal benefits to politicians or favor the parties they belong to. In order to increase their popularity, politicians prefer to finance big infrastructure projects from public sources. Very often, the construction of a new infrastructure is not necessary, but is imperative to repair the existing ones. In this context, public money is wasted;

- **Vitiation of the public procurement process.** To recover the costs associated with corrupting decision makers, private companies can raise prices or can provide amounts of goods and services below the levels set in public procurement contracts. Also, less competitive companies are favored in the procurement process, and the more qualified firms are neglected, which undermines the quality of implemented projects;

- **Embezzlement of public funds.** In some instances public funds are simply diverted from their intended use, embezzled and exploited for private enrichment. During public procurement process, decision makers, in a dishonest way, can select a company they have connection with. Subsequently, the company donates to the politician money received from the Government, but cannot deliver the total amount of goods and services stated in the public procurement contract;

- **Reducing the quality of public administration.** Because of nepotism, unskilled people are employed in public institutions. This contributes to developing and implementing wrong public policies, which implies the inefficient use of budget money.

Compared to other countries in the region, the Republic of Moldova has a high level of corruption, which greatly affects the efficiency of public spending. In 2017, the level of ethics and corruption in the Republic of Moldova was estimated at 2.5 points. The result achieved in 2017 is better than the one achieved in 2016, when the level of ethics and corruption was estimated at 2.3 points. However, in 2017 the Republic of Moldova obtained the lowest score compared to other states in Eastern Europe and the Caucasus (see Figure 2).

![Figure 2. Ethics and corruption, 2017](source: World Economic Forum)

**What Needs to Be Done?**

Reducing corruption can play a decisive role in increasing the efficiency of public spending. Combating corruption involves a wide range of reforms, but in the context of optimizing the use of public money, several lines of action can be highlighted:

- **Diminishing the chances of politicians with poor moral values to accede to power.** In order to strengthen the institutions in the fight against corruption, one major condition is a credible intent of political actors to
attack this scourge at a systemic level. To a certain extent, such a commitment is revealed by the extent to which reform initiatives are embedded in the messages of political stakeholders. In addition in order to reduce the chances of people with poor moral values to accede to power the funding of political parties must be regulated, and corruption practices must be removed from the electoral process.

✓ Improving the public sector. In fact, it is hard to separate measures aimed at improving institutions from those aimed at fighting corruption. Strengthening public institutions reduces the possibilities to corrupt the state representatives. It should also be mentioned that ensuring the integrity of public employees boosts the promotion of other measures related to the reform of the Government sector. At the same time, the optimization of the budget process must include the following elements: setting clear rules for the use of public money by public institutions, establishing performance-oriented budgets and consultation about use of public spending should be organized for citizens.

✓ Transparency of the budget process. In general, the increased transparency of public administration has an important role in reducing corruption in Government institutions. One measure in this regard is ensuring a wide availability of data on public spending. Thus, the information on public procurement (amounts paid, final beneficiaries) should be published in open data formats.
ANNEX 1.

Determinants of the efficiency of public spending, Tobit regression output estimation

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>Coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.8223128</td>
</tr>
<tr>
<td>Ethics and corruption</td>
<td>0.6470104*</td>
</tr>
<tr>
<td>Sigma</td>
<td>0.4866988</td>
</tr>
<tr>
<td>Pseudo $R^2$</td>
<td>0.2530</td>
</tr>
</tbody>
</table>

Source: EG calculations

Note: * – the variable is significant for a confidence level of 1%