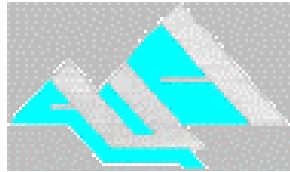


AMERICAN UNIVERSITY OF ARMENIA



**A STUDY OF THE EFFECTS OF CORRUPTION ON ECONOMIC AND
POLITICAL DEVELOPMENT OF ARMENIA**

**A MASTER'S ESSAY SUBMITTED TO THE FACULTY OF THE
GRADUATE SCHOOL OF POLITICAL SCIENCE
AND INTERNATIONAL AFFAIRS FOR PARTIAL FULFILLMENT OF THE
DEGREE OF MASTER OF ARTS**

BY

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YEREVAN, ARMENIA

NOVEMBER 2000

ACKNOWLEDGEMENTS

To write about corruption in a society where it is a widespread phenomenon, it becomes difficult to collect appropriate data. So I would like to thank to all those people who help me in this difficult work.

Special thanks to my faculty advisor Dr. Nicol Shahgaldyan, who advised me to choose this interesting topic for my Master Essay and help me with his valuable advice.

Special thanks to all my faculty staff especially to Dr. Lucig Danielyan whose given knowledge direct me to find out the solution of the problems of corruption in Armenia.

Special thanks to Civil Society Development Union and to The Armenian Center for National and International Studies for providing very valuable information about the corruption in Armenia.

I would like to thank all the interviewed persons who shared with me their experience and gave me advice, which help to realize the situation in Armenia. Thanks to all my friends and colleagues who provided me sources and materials for my Master Essay.

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LIST OF ABBREVIATIONS

CSDU - Civil Society Development Union

CEE - Central European Counties

FDI- Foreign Direct Investment

FSU - Former Soviet Union

GDP- Gross Domestic Product

IMF- International Monetary Fund

NGO - Non Governmental Organization

NA - National Assembly

OECD- Organization for Economic Cooperation and Development

OED - Oxford English Dictionary

USA- United States of America

ABSTRACT

The essay demonstrates that high scale corruption may have very harmful effects on economic and political development. Corruption as one of the oldest phenomenon in human society exist in every country contemporary world. Corruption can be defined in many ways such as general disease of body politics, public exploitation and abuse of public office for private gain. The causes of corruption also are many in number. For example, cultural factor, psychological factor and system related factors may cause corruption in every society. There are some factors such as monopoly power, discretionary power and weak accountability of public officials may give opportunities for corrupt acts. Corruption may decrease the efficiency of public spending, decrease the budget revenues, raise the budget deficit, hinder Foreign Direct Investment, reduce the effectiveness the use of aid, dissipate political legitimacy and hinders the democratic development. The anticorruption campaign should mainly concentrate on the reforms of civil service, judiciary system, tax and custom departments. In Armenia the successful implementation of anticorruption campaign is preconditioned by the free and fair elections, politically educated people and by honest leader.

METHODOLOGY

The research methods used for the completion of the essay were the content analysis and historical/comparative analysis. These methods will include thorough investigation of the international experience in this field through the suggested materials and through the materials from the Internet. The situation in Armenia will be studied through personal interviews with former and present public officials (including those in fiscal sector and local government) and private entrepreneurs and also analyzing articles from the different newspapers.

INTRODUCTION

The purpose of this essay is to reveal what are the causes of corruption and the factors that create the opportunities for corruption, what are effects of corruption on economic and political development in Armenia and in different nations. And according to this findings and the experience of other countries that have succeeded in their fight against corruption suggest the policies for reducing corruption in Armenia.

The first chapter of the essay mainly deals with the terms, definitions, concepts and types of corruption. Corruption as one of the oldest and most perplexing phenomenon in human society exists in every country. The classical conception of corruption, as a general disease of the body politics, was stated by ancient philosophers Plato and Aristotle. They saw corruption as dysfunctional, which is destructive of a particular political order, be it monarchy, aristocracy or democracy. Carl Fredrich defines corruption as a deviant behavior associated with a particular motivation, namely that of private gain at public expense. Van kKlavaren see corruption as the exploitation of the public. There have been a number of different attempts at defining corruption. However no precise definition can be found which applies to all forms, types and degrees of corruption, or which would be acceptable universally. More frequently used definition of corruption is **the abuse of public office for private gain**. Public office can be abused in many ways, for example, when officials accept or extort bribe; or public office can be abused for personal benefits even if no bribery occurs through the theft of state assets or diversion of state revenues.

The second chapter investigates the variety of causes of corruption and opportunities that governmental structures create for corruption in Armenia and in different nations. Leslie Holmes

(1993 p.157) the causes of corruption divides into three categories, *cultural, psychological, and system-related*. And Klitgaard, R. (1998) brings three dimensions of institutional structure that he considers most critical in bearing on the opportunities for corruption.

"1.The monopoly power of officials.

2.The degree of discretion that officials are permitted to exercise.

3.The degree to which there are systems of accountability and transparency in an institution."

The third chapter examines the effects of corruption on economic and political development. According some scholars some levels of corruption may encourage the economic growth. But in case of high level of corruption most scholars agree that corruption has very harmful effects on economic and political development. High scale corruption reduces the efficiency of public spending, raise the budget deficit, reduce budget revenues, dissipate political legitimacy and hinder the democratic development.

The last chapter examines the ways and policies for reducing corruption, such as reform of civil service, judiciary system, tax and custom departments etc. and according to those policies and the experiences of other countries suggest the policies for reducing corruption in Armenia. But for proper implementation of those policies in Armenia is preconditioned by the free and fair elections, politically educated people, and honest leader.

WHAT IS THE CORRUPTION

As one of the oldest and most perplexing phenomenon in human society, political corruption exist in every country in the contemporary world and it is not exclusively a problem of developing countries. The classical concept of corruption as a general disease of the body politics was stated by ancient political philosophers Plato and Aristotle. Plato in his theory of the "perverted" constitutions-Democracy, oligarchy, and tyranny-worried that these regimes instead of being guided by the law were serving the interest of the rulers. "These fundamental general notions of corruption all practically define corruption as dysfunctional. For it is seen as destructive of a particular political order, be it monarchy, aristocracy, or polity, the latter a constitutionally limited popular rule, and thus by definition devoid of any function within a political order." This classic conception of corruption continued into modern times, and is central to the political thought of Machiavelli, Montesquieu and Rosseau. For Machiavelli corruption was process by which the virtue of the citizen was undermined and eventually destroyed. "Since most men are weak and lacking in the virtue of the good citizen except when inspired by a great leader, the process of corruption is ever threatening. And when virtue has been corrupted, a heroic leader must appear who in rebuilding the political order infuses this virtue into the entire citizenry." Arnold Heidenheimer (1993 p. 25) Montesquieu saw corruption as the dysfunctional process by which a good political order is perverted into evil one and a monarchy into a despotism. According to Rosseau political corruption is a necessary consequences of the struggle for power. Then he argued "that man had been corrupted by social and political life. It is not the corruption of man which destroyed the political system but the political system which corrupts

and destroys man." Arnold Heidenheimer (1993 p. 25) There is an agreement between the views of Rousseau and Lord Acton that "all powers tends to corrupt and absolute powers corrupts absolutely." Lord Acton is focused on the moral depravity which power is believed to cause in man, "they no longer think about what is right action or manner, but only about which is expedient action or manner." Arnold Heidenheimer (1993 p. 16) According to Carl Fredrich (1972 p.18) "Corruption is a kind of behavior which deviates from the norm actually prevalent or behaved to prevail in a given context, such as the political. It is deviant behavior associated with a particular motivation, namely that of private gain at public expense." So he stated the concept of corruption in a way that constitutes a break of law or of standards of high moral conduct. Jacob Van Klavaren (1954, p.25) defines corruption as the exploitation of the public. And he brought very interesting explanation taking a public official as an economic subject who, as every economic subject, tries to maximise his gain or income. Supposing that the income derived from the free-market agreement with the functional-economic income. In a system of free competition, there can be market equilibrium if both sides of the market, sellers and buyers, are equally strong and two exchange curves intersects. However, if there is a monopolistic condition on one side of the market, the monopolist will try to get the maximum profit from the other side. So the income of public official, who as an economic agent regards his office as a business, "does not depend on his usefulness for the common good but upon the market situation and his talent for finding the point of maximal gain on the public's demand curve." Thus the "corruption is always an exploitation of the public, which can occur only because the civil servants occupy a constitutionally independent position vis-a-vis the public."

There have been a number of different attempts at defining corruption. However no precise definition can be found which applies to all forms, types and degrees of corruption, or which

would be acceptable universally. According to Oxford English Dictionary (OED) the term corruption in political context is defined as “ Perversion or favor, the use or existence of corrupt practices, especially in a state, public corruption, etc.”

One of the most popular definition of corruption was given by Leslie Palmier (1983, p.207). According to this definition corruption is seen as the *use of public office for private advantage*. According to Friedrich (1966, pp.174-5) the use of public office for private advantage is not always widely perceived in a given society to be corrupt. "Particularly if an individual making personal gain is simultaneously making a positive contribution to the society-there is no necessary contradiction between private advantage and contributing to the general good-many citizens will see such actions as at least acceptable and sometimes even just reward." Considering the conflict that can arise between an abstract definition of corruption and its application to a complex real world some writers have distinguished between what can crudely be called good, bad and ambiguous corruption. For example, Katsenelinbogen (1983, p236) identifies two basic types of corruption.

"1.Actions whose harmful effects on society are questionable. According to

Katsenelinbogen, this form of corruption involves redesigning the system and legalizing the appropriate actions of people in it.

2.Actions that unambiguously harm society. Such acts should be treated as corrupt and criminal."

Then Arnold Heindehmer (1970 pp.3-28) goes further and identifies three basic categories of corruption 'black', 'white' and 'gray'. Depending on the level of commonality of perception of a given act by public officials and citizens. 'White' acts are more or less accepted by both groups,

whereas 'Grey' acts are those about which both officials and citizens disagree. 'Black' acts are perceived as wrong by both officials and citizens.

It is evident from the above discussion that there is a wide range of definitions of corruption. For our further discussion about the forms of corruption we take the definition given by Leslie Palmier (1983, p.207) *use of public office for private gain*. This definition is both simple and sufficiently broad to cover most of the corruption that we face, and it is also widely used in literature. Public office offers many opportunities for private gain. **Bribes** are one of the main tools of corruption. The Oxford English Dictionary defines a bribe as “a reward given to pervert the judgment or corrupt the conduct.” A bribe consists of an offer of money by an outside party to secure desired action from the governmental officials. Bribes can influence the choice of private parties to supply public goods and services and the exact terms of those supply contracts. According to Robert Thobabeen (1991, p.62) buying contracts can be called also **Kickbacks** "when government officials may use their bargaining power with contractors and their discretion in awarding contracts to obtain a fee or service charge for arraigning the contract. A percentage, usually 5 percent, of the contracts is returned or kicked back to the public officials by the contractor." According to World Bank report (1997 p.20)

"Bribes can influence the allocation of monetary benefits (for evasion, subsidies, pensions, or unemployment insurance.) Bribes can be used to reduce amount of taxes or other fees collected by government from private parties. In many countries tax bill is negotiable. Bribes may be demanded or offered for the issuance of license that conveys an exclusive right, such as a land development concession or exploitation of a natural resources. Sometimes politicians and bureaucrats deliberately put in place policies that create control rights, which they profit from by selling. Bribes can speed up the government's granting of permission to carry out legal activities. Bribes can alter outcomes of the legal and regulatory process, by inducing the government either to fail to stop illegal activities or to unduly favor party over another in court or other legal proceeding."

The converse of bribery is *extortion*, the abuse or threat of power in such a ways to secure response in payment of money or other valuable things. Extortion according to the Oxford English Dictionary "is the act or practice of extorting (defined as either to wrest or wring from a person, extract by torture or to obtain from a reluctant person by violence, torture, intimidation, or abuse of legal or official authority, or – in a weaker sense by importing, overwhelming arguments or any powerful influence) or wresting especially money, from a person by force on by undue exercise of authority or power."

Another type of corruption is the *misuse of public property and funds*. Control of property provides opportunities for mismanagement and corruption. An extreme form is the large-scale "spontaneous" privatization of state assets by enterprise managers and other officials in some transition economies. According to Leslie Holmes (1999, p.5) the process of privatization which is ultimately implemented by the state provides new opportunities to state officials. They can demand or request bribes and kickbacks from private agents interested in purchasing a formerly state-owned business. At the other end of the scale is petty theft of items such as office equipment and stationary, vehicles and fuel. The perpetrators of petty theft are usually middle and lower-level officials, compensating, in some cases, for inadequate salaries.

Theft of government financial resources is another form of corruption, officials may pocket tax revenues or fees (often with the collusion of the payer, in effect combining theft with bribery) steal cash from treasures, extend advances to themselves that are never repaid, or draw pay for fictitious "ghost" workers, a pattern well documented in the reports of audit authorities. For example former Philippines president Ferdinand Marcos was accused of stealing millions of dollars, much of it in American foreign aid. In another example in Iran-Contra affair in which

profits from the sale of US government property (antitank and antiaircraft missiles) were diverted to private arms dealers and to counterrevolutionaries in Latin America.

Robert Thobabeen (1991, p.63) brings another form of corruption ***Influence Peddling*** when individuals with access to people in high places are sometimes tempted to trade on the influence of high ranking government officials. "There is money to be made through sale of access, the arrangement of contracts and timely intervention to secure favorable disposition of regulatory decisions and government contract. The use of these kinds of connections for personal gain is usually described as influence peddling."

Patronage is another form of corruption. The assignment of government positions to political supporters has long been a practice in politics. While civil service regulations at the national and state level may effectively curtail the number of patronage jobs, political appointments remain at the top levels of government and provide a legitimate way for elected politicians to influence bureaucracy through the appointment of legal executive officials. The process becomes corrupt when appointees are expected to pay for their jobs. The custom of rewarding wealthy campaign contributors with appointments as ambassadors has been traditional in presidential politics. Leslie Holmes (1993, p.205) brings three major forms of patronage. These are the following.

Nepotism In this context "is the granting of public office on the bases of family ties." This is a good example of a point where different cultures have very different attitudes towards some forms of corruption.

Shared experience "there the patron and client have usually worked together in the past and are on good terms and the patron promotes or has promoted the client on the basis of these past experience and warm relationship."

Shared Interest In this case, "the patron does not have common experience with someone he she wishes to promote, but rather a common interest" (for example, they both come from the same republic and/or are of same ethnic group; they both favor a large increase in defense expenditure in contrast to what others want, they are of the same gender.)

Corruption in a society can be rare or widespread. If it is rare, consisting of a few individual acts, it is straightforward to detect and punish. In such cases noncorrupt behavior is the norm, and institutions in both the public and private sector support integrity in public life such institutions, both formal and informal, are sufficiently strong to return to a noncorrupt, equilibrium In contrast, corruption is systemic where bribery, or a large or small scale, is routine in leading between the public sector and firms or individuals. Where systemic corruption exists, formal and informal rules are at odds with one another bribery may be illegal but is understood by everyone to be routine in transactions with the government. There are many countries in which bribery characterizes the rules of the game in private public interactions.

So it should be now clear that there are a number of ways of defining corruption. The term corruption can not be defined satisfactorily, similarly it is not possible to provide a classification that is suitable for all. In this chapter I tried to focus the types, concepts, and definitions of corruption existing in the world.

CAUSES OF CORRUPTION

If we take the human nature as a base we may explore why all political systems have experienced corruption. But it does not explain why some officials engage in corruption while others do not. These differences we can understand by making apparent the causes and opportunities for corruption. As we have seen in the first chapter there are many different

definitions of corruption and, consequently, the causes and opportunities for corruption are also expected to be many in number. So In this chapter I will focus on the factors which may be causes of corruption and which may create appropriate conditions or opportunities for corruption as in the world as well as in Armenia.

Leslie Holmes (1993 p.157) the causes of corruption divides into three categories, *cultural, psychological, and system-related*.

Cultural factor: "In many countries certain types of corruption are more or less acceptable often depending on the scale in the traditional political culture." Some countries have more of a reputation for corruption particularly because of traditional attitudes towards family, kinship, etc.

For example Leiken Robert (1997) writes of the Africa that

"In postcolonial Africa, neopatrimonial regimes become the rule, and the state emerged as an extension of the ruler's household, patronage, ethnic and kinship ties, and bribes became major modes of governance. Corruption funded patronage to Kinsman and crimes have exacerbated regional, tribal, religious, and ethnic divisions. The International Forum for Democratic Studies estimates that in oil-rich Nigeria some \$12.2 billion in government revenue was divested to "Extra-Budgetary accounts" between 1988 and 1994, and there are no record of how these funds were used. Nigerians themselves wait in mile-long lines for gas, and Nigeria now import nearly 70 per cent of its petroleum. Unfinished pipelines, financed by loans from multilateral development banks that have been pocketed by government officials, tell a large part of the story. Oil earnings do less to feed Nigerians than to enrich their corrupt rulers who instantly transfer their pickings to foreign banks."

The other cultural factor is a weak tradition of the rule of law and low level of respect for the law. According to Holmes (1993 p. 159) "several of the Asian states were formerly colonies and "the law" has been seen by some citizens as theirs' and therefore not respected in the same way that it might be in a long-established independent country, such as many western states." Conversely according to West German specialists in 1986 in GDR corruption was in very low levels, which can be explained by the German tradition of respect for law and order. In Armenia also there is evidence that people do not trust in or do not respect the law. During the interviews

many tax collectors ensure that, although they are inclined to take bribes, in most cases taxpayers themselves offer bribes. People in Armenia mainly are inclined to solve their problems with the help of bribes and not with the help of law. Bribing tax collectors, traffic police, judges publicly perceived as a way of life. Holmes (1993) explains this political culture by the experience under communism. According to Lampert (1984 pp.371-2) "In the Soviet republics especially in the Transcaucasian republics a number of influences such as strong family ties, have led to a systematic disregard of the law." During the Soviet times in Armenia, especially from the 1980s, the bribery was widespread phenomenon and during some period of time it becomes a norm that bribes can solve the problems more efficiently than law. So citizens over time come to see some types of corruption as normal and beneficial. This also affirms the survey results made by the Civil Society Development Union (CSDU).¹ Where, if the definition of corruption includes serious cases of corruption, for example, "taking money for "closing a case" in the Prosecutor's office" (See Chart I) 89 percent of the respondents answer positively to those questions. But when to the definition is added the "nurse taking money from the patient" the positive answers reduces becoming 52 percent. (See Chart II) So this can be explained that in Armenia people are more tolerant towards some types of corruption and it is accepted by people as a normal phenomenon.

According to Banfield (1958) historical tradition might also affect the perceived costs of corrupt action through the influence of religion. This might work in at least two ways. Religious traditions have often been thought to condition cultural attitudes towards social hierarchy. Where more "hierarchical religious" – Catholic, Eastern Orthodoxy, Islam – dominate, challenges to office holders might be rarer than in cultures shaped by more egalitarian or individualistic

¹ the survey was conducted in Yerevan in December 1999, by Civil Society Development Union. The survey was aimed to reflect the perception of corruption in the Armenian Society.

religious, such as Protestantism. Religious may also influence how individuals view their loyalties to family as opposed to other citizens- what Edward Banfield has called “familism” – which, in turn, may affect the level of *nepotism*. Tanzi Vito (1994) suggests that, in many developing countries where family ties routine a greater importance than they do in Europe or North America, officials in public office will be less able to escape demands that they extend special favors to family and friends.

The other factor of causing corruption is *psychological* factor. There are number of psychological factors that help to explain some types of corruption. Taking into account the internal factors of individuals some individuals are "naturally evil" and will commit criminal acts, including corrupt ones in any type of system. The external factors, individual's relationship to the group is also important. According to Holmes (1993, p. 165) “the power of both peer-pressure and peer-comparison can be great, for instance in the words of one artist “when the best of people take bribes, isn't it the fool who doesn't?” In other words if individuals see others around them benefiting from corruption, they may well choose to indulge too.” The psychological factor may have some role of causing corruption in Armenia. People who work in a position that can take bribes and don't use their chance they will be considered by their coworkers as stupid men. So under the pressure of this factor many public officials during some period of time become corrupted. But in many cases because people choose their new job depending on the scale of opportunity for taking bribes and they know they should take bribe because this is the way of life. According to Holmes (1993, p.170)

“The other psychological factor that is *fear* also can encourage people to act corruptly. For example in a hierarchical situation a subordinate may fear the consequences of not acting in a similar way to his/her corrupt superior. Another type of fear, which was more widespread during soviet times, is the *fear of underfulfilment of the plan* that may encourage public officials to act corruptly. This fear may lead individuals to engage in

corrupt practices, either in order actually to fulfil the plan or else to appear to have done so (the false reporting syndrome).”

This factor may have some role of causing corruption in Armenia. There is some fixed plan for tax collector and for custom workers in Armenia. And there are many cases when tax collectors in order to fulfill the required plan extort some extra bribes from the entrepreneurs. For example, as a businessman told during interviews when tax collector saw that there is nothing wrong with accounting and documents, however, he requires bribe, otherwise, he has wide range of discretionary power to use the law against taxpayers, even under the threat to stop the production or close the shop. And there is also an example where the Minister of State Budget Revenue Gagik Pogosyan secretly ordered to all tax inspectors that “even If during the visiting and monitoring there are no mistakes and violations of law you must collect one billion drams, the budget needs money very much” (04.10.2000, Aravot Note: Aravot is Armenian Daily Newspaper)

Human weakness also may cause corruption. Some people find it difficult to reject offers from a person of a "generous" nature. Some officials will accept gifts because they know they have been particularly helpful to someone and either feels they "deserve" a reward (that is they feel that a reward is not inappropriate), or else genuinely do not want to offend or embarrass a grateful supplicant.

According to Holmes (1993) “**nepotism** also as a form of corruption can be explained in psychological term. "The blood is thicker than water" syndrome wanting to help one's family. Nepotism can be explained in terms of individuals seeking to maximize their own power and the lust for power is a psychological variable.”

System related factors: One of the factors that distinguishes post-communist states from transitional societies elsewhere is that they have been undergoing multiple and simultaneous transitions since the collapse of communist power in 1989-1991. In addition they had to

introduce fundamental economic, legal, ideological and social change. Many also had to redefine their boundaries and identities, and realign themselves in international military and trading block. The sheer scope of attempted change is one significant reason why most post-communist states have suffered a severe legislative lag in the past decade. This lag has meant that laws have often been either in essence non-existence or else vague and contradictory. This situation is ripe for both corruption and organized crime. For Armenia factors such as Karabakh war of 1992-94, sharpened the decline in economic activity and income of the population, which creates favorable conditions for corruption.

Holmes (1993) brings another factor that the birth of post-communist states coincides with the increasing dominance of neoliberal ideology in the West. It advocates minimizing role of the state in the economy and encouraging civil society that had in many West European countries been accepted by the state in recent decades. One way in which this occurs is through the privatization of services and industries that had once been run by the state. There is a move away from state-run monopolies towards competition, marketing, and contractual relationships, the notion of 'user-pays', and the maximization of cost-effectiveness. According to Leiken (1997)

In recent years, academics and commentators in the mass media have argued that in transition economies (particularly in the countries of the former Soviet Union) market liberalization and privatization have significantly increased corruption. They maintain that these reforms respond to the vested interests of corrupt elites even highly respected academics are ambivalent on this particular issue, advising extreme caution in initiating economic reforms when legal institutions are not yet developed.

So the very process of privatization - which is ultimately implemented by the state - provides new opportunities to state officials. They can demand or request bribes and kickbacks from private interested in purchasing a hitherto state-owned business, in a way they cannot when there is no privatization process. The privatization in Armenia is one of the main factors that give

wider scope for corruption. There were many violations of law during the process of privatization and it was a source of wealth for many high ranking public officials. The main part of privatization was implemented secretly and illegally and there is no available official information about it. Many fabrics were privatized in very low prices, which further had been dismantled and sold outside of Armenia. For example, about the privatization of “Narine” holiday house had not been informed even the director of the holiday house and it was privatized five times below of its real price estimated by the government. (Aravot 13. 06. 1998) According to the National Assembly’s (NA) Oversight Chamber's audit results of the privatization of 600 fabrics during the 1996-97 there were many violations of law. Chairman of Oversight Chamber of NA Ashot Tavdyan brings examples of Yerevan Wine, Conserve, and Caramel fabrics which were privatized in very low price, for example there were bought only 41 percent of stocks of Yerevan Wine fabric and about the last 59 percent, which should be returned to State, there is no information. And there is no information about the reserves of brandy's spirit and wine's collections. (25.06. 2000, Azg Not: Azg is a Armenian Daily Newspaper.)

As I have mentioned at the beginning of this chapter besides the causes of corruption there can be also opportunities for corruption because of the institutional structure. These opportunities are more important for accelerating widespread and high level corruption. So it is instructive to draw a distinction between those elements, which may be seen to provide opportunities for corrupt acts and those, which causes corruption. For example Klitgaard, R. (1998) brings three dimensions of institutional structure that he considers most critical in bearing on the opportunities for corruption.

"1.The monopoly power of officials.

2.The degree of discretion that officials are permitted to exercise.

3.The degree to which there are systems of accountability and transparency in an institution."

When officials have ***monopoly power*** over provision of a government good it is crucial for explaining the incidence of corruption without theft. Monopoly power could exist for the legal reason that a certain officials are the only charged with performing a certain task. Whether an officials will be in a favorable position to extract bribes from clients depends not only on whether they have a monopoly over their particular activity, but also upon the rules and regulations regarding the distribution of government goods.

The greater the amount of ***discretion*** which is given to an agent, the more opportunities there will be for agents to give "favorable" interpretations of government rules and regulations to businesses in exchange for illegal payments. For example in terms of the level of discretion, when a custom agent is allowed to apply one of several tariff rates to a product, or when a tax inspector is given substantial room to decide whether companies are given deductions or not, there will be an incentive to demand a bribe in exchange for offering favorable treatment.

Asymmetries of information present principles with a challenge in that they often find it difficult to monitor the actions of agents effectively and hold them ***accountable*** for their actions when they fell to carry out an assigned task. Political structure is crucial element in the evolution of corruption. Political structures where representative processes to enforce governmental accountability are weak or absent would be expected to provide the greatest opportunities for corruption. The ***judicial system*** also has an important role in giving opportunities for corrupt acts. But it is very important the degree of separation of power between judiciary and government because it may have very significant influence on judiciary system in playing its key role. The separation of three governmental branches in Armenia is in very low level and they are

not independent of each other. The executive power has obvious dominance over the judiciary branch. According to Samvel Khachaturyan (1997) the president of Armenia is the central person for the judiciary system. According to article 55 of the Constitution of Republic of Armenia the President of RA not only can appoint and dismiss the Chief Prosecutor but also can appoint and dismiss all judges and presidents of all courts. Ministry of Justice as a part of the executive branch has the right to control and supervise all courts. So in reality the judicial power is under the dominance of the executive branch. Political leaders who maintain very tight control over the judiciary and law-enforcement sector will typically have the capacity to undertake corrupt acts with privilege. According to the SCDU's survey results the Judicial system is the most corrupted sector. To the question "In your opinion, which sectors boast most cases of corruption" 64 percent of the answers was the judicial sector. (See Chart III) And also nearly 85 percent of the respondents agree that there is large size corruption in judicial system. (See Chart IV) So the weak and controlled judicial power creates many opportunities for political leaders as well as for public officials to act corruptly.

The *civil society's role and power* also can give the opportunity for corruption particularly the *role of media*. In Armenia the prospects of free press is limited. Sometimes press was subjected to pressure and persecution. According to Human Development Report (1999) "most papers printed in 2000-3000 copies and circulate mainly in the capital. And also the population's low purchasing power and underdeveloped advertising system contribute to the poor financial performance of the press, which in turn hinders the development of free press in Armenia."

State-owned companies have a monopoly on newspaper printing and distribution facilities, and most newspapers are permanently in debt to the printers. The State retains, through its ownership of the printing and distributing network, the potential to shut or otherwise pressure newspapers

that take too harsh an opposition position. The two most widely visible television channels belong to state television, and tend to present a positive view of officials and their activities. According to the research made by the CSDU the financial dependence of Media from the political parties, Mafiosi structures and different individual politicians makes media to serve for the narrow political circles as a weapon for achieving their purposes. There are also registered nearly two thousand Non Governmental Organizations (NGO) but the many of those are not active and have no connection with governmental institutions. So the dependence of mass media and the weak nondeveloped civil society creates an opportunity for politicians and public officials to act corruptly.

Klitgaard (1998) brings another factor, which is very important for contributing corruption – *low wages*.

"For civil servants, the reward structure within the state administration has traditionally been seen as one of the key determinants in the evolution of corruption. If officials are paid wages comparable to those available to performance, the potential gains from engaging in corruption may not be large enough in relative terms to make it worth the risk. If instead, officials in the public sector are paid wages well below those for similar duties in the private sector, then opportunities for corruption may become the principal reason for choosing a public sector post."

In Armenia this factor is very actual. Unemployment is at very high level, many people have no regular source of income and for most of those who have a regular income typically is too low to support a family. At the same time, prices have been liberalized since the independence. Thereby significantly raising the cost of living for most Armenians. So given the relative to the wage rate, it is inevitable that many employees will look for any means to supplement their meager ventures, such as bribes. According to CSDU's survey the most important reason for corruption in Armenia is the low wages. (See Chart V)

The *poor drafting of laws and regulations* also creates many opportunities for corrupt acts. For example, imprecise drafting and ill-defined terminology gives tax inspectors and custom officers a large margin of discretion, which they use to extract bribes. Particularly at the regional and local government level, tax requirements may be undocumented or not publicly available. *High tax rates* also can give opportunity for corruption. The business community in Armenia commonly argued that its total tax burden, as a share of profits, is excessive due to the simultaneous taxation of turnover, wage costs, profits, such that full compliance may leave almost no after-tax profit. Many smaller enterprises do not pay taxes, and larger firms falsify their revenues. Many interviewed businesses suggest that firm's total tax obligations are widely accepted to be negotiated settlement between a business and its tax inspector.

Literature dealing with *foreign economic aid* recognizes that government-to-government foreign economic assistance often can promote those conditions that foster corruption. This is especially the case when a significant degree of corruption is clearly present in recipient countries. According to Jim Saxton (1999) foreign aid can promote corruption by:

“Strengthening the governmental sector relative to the private sector.”

Foreign aid is usually provided from centralized government sources to centralized government recipients. This process will subsidize and strengthen the public sector of the recipient country. Because specific recipients of aid monies have economic incentives for example to reward their friends, supporters, and specific interest constituents. Because of these realities, foreign aid can in practice work to strengthen the role of the recipient countries' public sector relative to its private sector. Aid has tended to promote centralized economic control and fostered a concentration of bureaucratic power in recipient governments. This is corroborated by the fact that government-to-government transfers often lead to increase in government spending. And as one researcher concluded, “Aid does increase the size of government.” In sum, when existing regimes are corrupt, the result is that these corrupt political regimes can benefit from foreign aid become more firmly entrenched.”

The foreign aid has very important role in promoting corruption in Armenia. According to the report of the National Assembly's Temporary Committee on foreign government and

International organization's loans there were many violations in using these loans about which in more details I will speak in the next chapter.

Thus in this chapter I discussed the variety of causes and opportunities of corruption as in the world as well as in Armenia from which I would like particularly to emphasize the low wages, foreign aid, weak civil society, dependent media and weak, dependent judicial system.

THE EFFECTS OF CORRUPTION ON ECONOMIC AND POLITICAL DEVELOPMENT

The purpose of this chapter is to show the impacts that corruption has on the economic and political development of Armenia considering the experiences of other countries. But before the beginning the discussion I would like to speak a bit about the question -What is the development? If in the case of economic development we have some units and scale by which is possible to measure development, in politics however, there is agreement neither on the units nor on a single scale to measure development. Political development cannot be defined only by one definition. According to many authors political development has various definition. For example, it has been defined as administrative and legal development, democratic development etc. J.S. Nye (1996) refers the term “political Development” to the governmental structure and processes to social change. We generally assume that this means structures and processes, which are regarded as legitimate by relevant sectors of the population and effective in producing outputs desired by relevant sectors of the population. So political development according to Nye (1996) means growth in the capacity of a society’s governmental structures and processes to maintain their legitimacy over time.

Although the term “corruption” generally has a negative connotation, it according to many authors can in some circumstances be a distinctly beneficial phenomenon. For example

Nathaniel Leff's (1964) article "Economic Development Through Bureaucratic Corruption" is the most frequently cited source for the argument that "corruption in the form of bribing can be an important arm in the hands of entrepreneurs seeking to do business with a hostile or indifferent government and may, indeed stimulate the development process." According to Leff (1964) in many developing countries excessive bureaucratic control and regulations creates serious uncertainty for entrepreneurs. So the bribery can help bureaucrats to get around excessive regulations and minimize uncertainty over enforcement. Then Leff see corruption as a auction mechanism where the most efficient firm will be able to pay the highest bribe for government single license or permit. In addition some authors argued that bribery could enhance efficiency by cutting the considerable time needed to process permits and paperwork.

In contrast to this many scholars such as Daniel Kaufmann (1997) argued that

"On closer examination this arguments is full of holes. First it ignores the enormous degree of discretion that many politicians and bureaucrats can have, particularly in corrupt societies. They Have discretion over the creation, proliferation, and interpretation of conterproductive regulations. Thus instead of corruption being the grease for the squeaky wheels of a rigid administration, it becomes the fuel for excessive and discretionary regulations. This is one mechanism whereby corruption feeds on itself."

In addition available empirical evidence refutes the "speed money" argument by showing a positive relationship between the extent of bribery and the amount of time that enterprise managers spend with public official. Responses from more than 3,000 firms in 59 countries surveyed in the World Economic Forum's Global Competitiveness Survey for 1997 indicate that enterprises reporting a greater incidence of bribing also tend to spend a greater share of management time with bureaucrats and public officials negotiating licenses, permits, signatures, and taxes. Cheryl and Kaufmann (1998)

According to many authors' investigations the excessive tolerance of corruption can have serious negative effects on economic and political development. According to John L. Mikesell

(1995 p.65) “Not only is the budget a financial accounting of the receipts and expenditures of the government, it also sets forth a plan for allocating resources – between public and private sectors and within the public sector – to meet national objectives. Budget preparation, discussion, and approval thus must be at the hearth of public decision making.” Even in a market economy, the budget represents the basic national economic plan, the chosen mix of public and private sector use of national resources. So in presenting the negative effects of corruption on economic and political development I would like to begin from the fact that corruption tends to shift government spending away from the social areas towards the construction of unneeded projects or lower quality investments in infrastructure. In most corrupted countries, corrupt politicians tend to choose investment projects not on the bases of their intrinsic economic worth, but on the opportunity for bribes and kickbacks these projects presents. Vito Tanzi (1995) for properly addressing corruption in public spending makes a distinction between political or high level and administrative or bureaucratic corruption. Political corruption takes place when political decisions are made about the budget; the administrative corruption takes place during the budget execution. Political corruption has particularly damaging effects on the allocation of resources because it tends to divert resources away from the function to which they would have been allocated in the absence of corruption. Tanzi and Davoodi (1997 p.10) found that "corruption tends to be associated with higher public investment and high corruptions tends to reduce Government revenue, which in its place reduces the resources available to finance spending, including public investment." High corruption also tends to be associated with poor quality of infrastructure, this reduce its contribution to output. Tanzi and Davoodi's findings shows that large-scale corruption indeed have powerful effects on both the quality and the quantity of public investment. Because most current spending by governments reflects entitlements or previous

commitments such as pensions, interest payments on public debt, salaries, and subsidies politicians have, in short run limited discretion to influence it. In contrast, there is nothing routine about the capital investment and its composition. Capital spending is highly discretionary. In formulating the capital investments, senior political figures must make the basic decisions. These decisions determine the size of the total public investment budget, the general composition of that budget, the choice of specific projects and their geographical location, and even the design of each project. Senior officials may have complete discretion over these decisions especially when a country's controlling or auditing institutions are not well developed and institutional control are weak. For Armenia I can say there are some independent audit offices such as KPMG, AMIO, Hay Audit, etc. According to the deputy director of KPMG's office in Armenia the auditing institutions are not yet well developed in Armenia. KPMG mainly make an audit in private sector such as banks and in some private companies. The orders for audit KPMG mainly receives from the other countries, which have made investments in Armenia and by the words of deputy director of KPMG they never have made audit in any governmental structure. So we can say in Armenia audit as an independent watchdog system for controlling the public spending and revenue collection doesn't exist. The experience with public sector projects especially in developing countries including Armenia is full with stories about roads that are pocked and with patholes soon after completion, power plants that experience regular reconstruction. According to Arshak Sadoyan (Deputy of NA of Armenia) there was directed a huge amount of money for the reconstruction of energetic system the main part of which was embezzled by high-ranking officials. (20.07.2000, Azg) NA's Temporary Commission on Foreign Governments' and international organizations' loans report that from the 57.4 million dollars loan given to Hrazdan Power Plant 55 million dollar was embezzled and actually the

State loss 55 million dollar (03.02.1999, Azg) So when corrupt politicians influence the approval of an investment project the rate of return as calculated by cost-benefit analysis ceases to be the criterion for project selection. When corruption plays a large role in the selection of projects, some projects are completed but never used. Others are so poorly built that they will need continues repair and their output capacity will disappoint. In these circumstances, it is not surprising that capital spending often fails to generate the economic growth.

According to Tanzi (1995) "the widespread corruption in the investment budget will not only reduce the rate of return to new investment in a country, but will also affect the rate of return the country gets from its existing infrastructure." As corruption has long been around the existing infrastructure has also been contaminated because past investments were administered or distorted by corruption. Moreover, higher spending on capital projects will reduce the resources available for other spending. Of other spending categories, one not protected by entitlements is operation and maintenance the current public spending required to keep the existing physical infrastructure in good working order. Too often, new projects are undertaken while the existing infrastructure is left to deteriorate. In cases of extreme corruption, the physical infrastructure will need to be rebuilt, thus allowing corrupt officials the opportunity to extract additional commissions from new investment projects. So corruption affects the development by reducing the efficiency of public investments directed it toward unneeded projects and during the long-term corruption it distracts the existing infrastructures which are also very important for political and economic development.

Corruption not only affects the budget investments but also reduces the budget revenues, which is very crucial for further development. As we know corruption can lead to tax evasion and poor tax administration. In many cases tax collections is much lower than estimated tax

bases. Tax evasion takes place when taxpayers manipulate their accounts or their declarations to reduce their tax payments. However some tax evasions exist because of corruption. In Armenia there are cases that businessmen pay bribes to senior tax or custom officials, to secure a formal certificate of exemption from tax duty. Sometimes businessmen just pay bribes to low level officials to secure the same treatment. According to CSDU's survey nearly 69 percent of the respondents agree that tax collectors are largely corrupted. (See, Chart IV) Some high ranking officials may through the effecting on tax and custom officials create favorable tax policies for their relatives, friends and also for their own businesses. Which promotes creation of monopolies and oligopolies, hinder competition and undermine the image of the government as a facilitator of private sector growth. For example one of big shareholders of the oil imported company "Kemon" is the relative of the former prime minister Hrand Bagradyan and the Other big shareholder is the deputy of NA (03.12.1999, Azg) And according to the vice minister of the State Revenues the consumed amount of oil is not corresponding with the presented data in tax reports of oil companies. So there was imported a huge amount of oil in shadow ways, which are not taxed because of the support of powerful politicians costing the country large amounts in forgone revenue. (19.07.2000, Azg) There are many examples where interviewed businessmen assert that there are many cases that custom inspectors from the Yerevan without any explanation may keep the imported good in the custom department and return only after the extortion some extra bribes. And a businessman explains such cases that in custom or tax departments there are stated some secret limits on some imported and produced goods. And if you exceed that limit you may threaten the interests of some monopolists or some powerful politicians. In these cases there even may be confiscated imported goods or closed the enterprises. Thus corrupt practices in tax and custom administration do great damage to the revenue collection. If we take that

nearly 87 percent of the State Budget is coming from the tax revenues (State Budget of Armenia 2000) the corruption will have deadly impact on political and economic development.

The other effect of reduced revenue is the budget deficit. Corruption reduces State revenues, which in its place raise the budget deficit. According to Miksell(1995 p ?)

“The effects of continuing large budget deficits are expected to be largely long term. First international capital market effects promise to reduce standards of living. Second federal deficits threaten long-term economic growth in the national saving may be used to finance investment or accommodate government deficits. Given the overall saving rate, the deficits absorbs savings that otherwise could have been productively invested.

Third continuing large deficits leaving higher interest obligations in the future. That means each succeeding congress will find a large usually increasing share of federal resources to be already committed, not to provide services to those paying taxes in that year but to cover interest or funds spent to provide service in the past.”

Finally, to the extent the deficit remains a political issue it constrains the capacity of the federal government to respond to legitimate national concerns. In a deficit dominated climate, the first reaction to any policy initiative, whether it is national healthcare reform, welfare reform is not whether a problem exists that the federal government might try to resolve but what the deficit impact of the response might be.”

Another factor hampering growth and contributing to the expansion of the shadow economy is the bureaucratic red tape. Interactions by business with the Armenian Government can be frustrating and lengthy. For example 67 percent of a sample firms in Armenia report that their management currently devote over 15 percent of their time to delay with the government. This is over seven times the incidence reported for Organization for Economic Cooperation and Development (OECD), more than twice in Central and East European Countries (CEE) (See Chart VI) And also from the results of survey of foreign investors reveal that the red tape and corruption in Armenia today by 78.2 percent of respondents is considered a main factor inhibiting business activity in Armenia. (See, Chart VII) Further 87 percent of current investors agreed that 'Business frequently have to pay some irregular “additional or facilitator” payment to get things done. And 90 percent of the investors agreed that successful business in Armenia is frequently based on relationship with powerful/economic groups in the country. The experts'

opinion fully coincides with current investor's opinion. Moreover, Government experts are more insistent on this point than non-government experts. (See. Table I) Thus the factors such as poor tax administration, bureaucratic red tape contribute to the expansion of shadow economy in Armenia. According to the report of Interparty Social-Economic Council the tax system is the legal labyrinth for businesses which is the main reason that some of them leave the country or go underground. (07.07.2000, Azg) In Armenia about the shadow economy there are many different data. Some high-ranking officials witnessed 40-60 percent, which means that in Armenia half of the real amount of money circulation is not taxed. According to interviews with tax officials the large part of the “shadow economy” in reality pay taxes which do not go to the pocket of the State but becomes fashionable houses or luxury cars for many public officials. If we take that nearly 800 million dollars is circulated out of the banking system, that is not taxed, and If we consider that our Gross Domestic Product (GDP) is 2 billion this date is very threatening for our economy. (11.09.1999, Azg)

The prevalence of corruption arguably influences on the economic environment through the creation of significantly higher levels of risk and uncertainty in economic transactions. Uncertainty is present both in the context of individual economic transactions and in terms of heightened fears about future developments in the broader economic environment in question. For business it is difficult to flourish in uncertain environment. Uncertainty with regard to domestic politics can reduce incentive for investment directly and through its impacts on government institutions. For example, during 1998 the majority of Ministers in the Kocharian Government changed and management of Customs changed three times. The appropriateness of these changes is not questioned. But an inevitable result of change is uncertainty, which discourages investment and may result in inconsistent performance of governmental institutions.

These impacts are likely to be severe if changes of top officials is rapid and widespread throughout the organization and if unsystematic. Interviews with various experts, both in and out of government indicate that changes in top officials of a ministry or agency typically result in widespread changes throughout the entire organization. These changes are frequently based primarily on political considerations, rather than knowledge or skills. Small entrepreneurs may be affected in many developing countries and transition economies.⁴ Evidence from private sector assessments suggests that corruption increase the costs of doing business that small firms bear a disproportionately large share of these costs and that bribes can prevent firm from growing. Many businesses prefer to operate underground shutout the administrative approval processes by paying bribes because the regulatory and administrative requirements of starting and operating business involve extra documentation and fees. For example the process of registering can take months because registrations need to be obtained in a prescribed sequence, such that one cannot initiate all procedures simultaneously. So the costs of corruption and bureaucratic delays may price some potential new businesses out of market or drive them underground. Similarly the costs of compliance affect existing businesses through changing requirements, the need for regular recertification, and onerous record keeping requirements.

According to World Bank Development (1997) foreign direct investment may still flow to countries in which corruption is systemic but only if bribery is affordable and results are predictable. (See, Chart VIII) Corruption can have a negative effect on foreign investment. For most foreign firms corruption is a cost of doing business to be recouped from revenues. If the costs become too high or unpredictable, foreign firms will disengage. Or foreign investors may shun the country altogether. High levels of corruption add to the risk of a country being

⁴ Transport Intermediary Survey, Georgia and Armenia

marginalized in the international economy. So uncertain environment, big bureaucratic red tape, and poor tax and custom administration reduce not only domestic investments but also Foreign Direct Investments (FDI) which is very crucial factor for economic development for any country. According to World Bank report the total investment in Armenia equals 8.8 percent of GDP among the lowest in the Former Soviet Union (FSU) and Eastern Europe. And also FDI are in very low level.

Corruption can affect on human capital formation, which is the most important input in the process of production and transformation that is called economic development. First corruption weakens tax administration and can lead to tax evasion and improper tax exemptions as discussed above. Therefore, for a given tax system, the higher the level of corruption, the lower the revenue and the lower the resources available for funding public provision of certain service, including education. Second corruption increase the operating cost of government and therefore reduces the resources available for other uses, including the financing of social spending that is crucial to the formation of human capital. In fact, higher corruption is found to be associated with lower education and health spending. According to quantitative analysis made by Mauro Paolo (1997) government expenditure on education is negatively and significantly associated with higher levels of corruption. Corruption also will likely decrease the effectiveness of aid flows, which could have negative effects on the development. For Armenia the only fact that from the 382 million dollar received loans 152,51 was actual loss to the State from which 90 million was embezzled. (03.02.1999, Azg) (See Table 20) So 152 million stayed as a debt on the shoulders of the future generations, which will be significant obstacle for further economic development.

Capital outflow also may have negative effect on the development. Capital accumulated by corruption that winds up in Swiss banks is a net loss for the developing country. These costs can be considerable. For example one source estimates that from 1954-1959 four Latin American dictators (Peron, Peres, Jinenz, and Batista) removed a total of 1.15 billion from their countries. For Armenia there is no exact data about the capital outflow but according to rumors as saying goes “there is no smoke without fire” the Armenian former president Levon Ter- Petrosyan and also other high ranking officials have millions of dollars in Swiss banks and fashionable houses in various European countries.

Corruption may dissipate the important asset of political legitimacy, which most governments seek to preserve and build on. One of the major tasks of any regime is the building of its own legitimacy a resource which will enable it to gain more easily the support and the assistance of the public in connection with development. By destroying the legitimacy of political structure in the eyes of those who have power to do something about the situation; corruption can contribute to instability and possible national disintegration.

According to Theodor M. Smith (1971) “Corruption may tend to destroy some of a new nation’s greatest potential assets, the enthusiasm, idealism and sympathy of its youth. In the event that the idealism and enthusiasm of the younger generation turns to cynicism, not only political stability but long run economic development efforts are bound to be affected.”

Politicians and civil servants as an elite should give purpose to national effort. In so doing they cannot avoid setting an example others will follow. If the elite is believed to be widely and thoroughly corrupt, the man-in-the street will see little reason why he too should not gather what he can for himself and his loved ones. So corruption among an elite not only debases standards popularly perceived, it forces people to undertake the underhanded approach out of self-defence.

They feel they must resort to corrupt practices just to get their due, not to secure in ordinate returns. Corruption causes decisions to be weighted in terms of money, not in terms of human need. David H. Bayley(1966)

And more important that corruption may threaten the democratic development. People may existing poor socials-economic conditions and widespread corruption link with the process of democratization. Which in turn creates serious obstacles for further democratization.

Thus as we have seen high and rising corruption by effecting on the effectiveness of social spending; eroding the tax and custom administrations; and destroying the legitimacy of existing political system may effect very negatively on the political and economic development

HOW TO COMBAT AGAINST CORRUPTION

In this chapter I will concentrate mainly on the policies reducing corruption taking into account the experience of other countries, which have succeeded in their fight against corruption. And according to these findings there will be suggested policies for the reduction of corruption existing in Armenia

At first I would like to bring some points of views about the corruption eradication. Some scholars believe that corruption cannot be eradicated. For example Yeh (1987, P15) has argued that "the systematic sharing of bribes between cadres at different levels of responsibility have made it hopeless to fight corruption in Mainland China." But if corruption cannot be eradicated it does not mean that corruption cannot be taken under the control. Another assumption made by several scholars is that, changing political or economic system could solve the problem of corruption. Deng (1985, p 59) There are some types of corruption that exist in every political

system and changing the political system does not eradicate corruption. According to Holmes (1993, p.49) "Although it is accepted that corruption rates vary and that they may and do alter with changing circumstances, and although it is accepted that corruption may be more or less under the control or out of control, the notion that it can be eradicated is rejected." In thinking about how can be corruption lowered there are many policies suggested by the World Bank, International Monetary Fund, and Transparency International and etc. According to World Bank the institutional strengthening is a key part of country anticorruption strategies. One of the most important institutions is a professional and well-motivated *civil service*. The selection and promotion in civil service should be merit based rather than patronage. Pay of civil servants is also very important issue. In some countries including Armenia pay is one of the major causes of corruption (See Chart IV). The longer the pay remains inadequate, the more bureaucratic corruption becomes entrenched. For example we have the experience of Singapore which had dramatically reduced corruption by increasing salaries. And Singapore is the only Asian country, which is in the 'top ten' least corrupt countries by Transparency international's Index. In civil service should be established Ethics codes and institutional values, which help to protect a civil service's integrity and professionalism. The civil service should be protected from the unwarranted political interference. Such civil service would not only be a protection against corruption but would also guarantee that goods and services would be delivered efficiently. Thus civil service reform is one of the most important part in fighting against corruption.

The other important institution that needs to be reformed is the *judicial system*. Enforcement of anticorruption legislation requires an efficient, accountable judiciary. Reform of judicial system should concentrate on the independence of this branch. The procedures for selection and removal of judges should be defined properly, should be improved court administration and case-

flow management which in some countries may last months. The courts will be effective, if there is strict mechanisms to enforce judgments. The strict enforcement of rules and regulations is very important combating corruption. If an official knows that rules and regulations are strictly and consistently enforced he/she will less likely engage in corrupt behavior. Should be reduced ex parte communication between judge and litigants. Courts decisions should be published. Regular publication of consultation documents about the new laws is good practice everywhere. So anticorruption bodies appear to be promising if there is a strong and independent judiciary.

The ***Budget Reform*** is the other factor combating corruption. Government should undertake only what it can do well within its resource constraints. Government should develop well-functioning budget processes, allocate resources strategically, and enable programs and projects to be implemented efficiently and effectively. There should be frequent reports to the legislature on budget implementation that enable comparisons to be made between budgeted and actual revenues and expenditures. A legal framework for public expenditure management should combine legal principles with economic consideration as well as management rules. It should ensure that public resources are used within the limits set by the Legislative Branch and in compliance with the allocation schedule authorized in the budget document. Therefore, changing or amending the budget legislation should be a lengthy and painstaking process. Government departments and agencies should be encouraged to produce annual reports on their activities, achievements, and financial results, and national governments should report these in consolidated form. The publication of government budgets and their availability in easy-to read summary form also may help to control corruption.

Good financial management system is also a powerful instrument for preventing, discovering, or facilitating the punishment of fraud and corruption. They allocate clear

responsibilities for managing resources, reveal improper action and unauthorized expenditures facilitate audit by creating audit trails, and protect honest staff. By reducing opportunities for corruption and increasing the risks of detection, good financial management systems help change corrupt conduct from " high profit/low risk" to "high risk/low profit." According to World Bank (1997) many of the Bank's borrowers have weak government financial management systems. Which permits widescale fraud, and inefficient use of loans provided by the World Bank.

Audit and control are viewed as a valuable instrument for improving government fiscal management and for increasing the efficiency in the allocation of public financial resources. The introduction or reinforcement of auditing would be particularly important because it intervenes before resources are committed. Therefore, corrupt activities could be stopped before they would have an impact on the use of resources. Current budgetary practices in many countries suggest that after the completion of the budgetary cycle-budget preparation and implementation-results must be assessed retrospectively so that officials can be held accountable for results achieved.

Tax and customs departments as we have seen are the locus of major fraud and corruption and thus are candidates for inclusion in national strategies to control corruption. Tax system must be reformed to reduce the tax burden. The tax law should be simplified and strictly defined because imprecise drafting and ill-defined terminology give tax inspectors a large margin of discretion and facilitate corruption. Organizational restructuring, for example, separating the tax assessment function from the collection function and staff rotation can also help to reduce opportunities for corruption, as can control systems that require supervisors to attest that they have checked the work of subordinates.

Civil society and the media are crucial to creating and maintaining an atmosphere in public life that discourage fraud and corruption, Indeed, they are arguably the two most important

factors in eliminating systemic corruption in public institutions. They may play an important role as watchdogs of public sector.

State should launch *anticorruption campaigns*. Several post-communist states - including Bulgaria, Czech, Poland, Russia and Slovakia - have launched so-called 'Clean Hands' campaigns. Such campaigns can have a legitimizing effect, in that they usually suggest that the state is serious about fighting corruption. But if they are poorly managed, they can have either little or a negative impact. Their impact fades over time if they are too prolonged, since citizens become almost immune to them, and the campaign begins to sound like mere rhetoric. They can even exert a negative influence if they stay merely at the level of declarations and are not accompanied by meaningful action.

There are some countries that have succeeded in their anticorruption fight. For example Hong Kong and Singapore have shifted quickly from being very corrupt to being relatively clean. In addition to this Botswana is regarded as one of the least corrupt countries, Chile, Malaysia, and Portugal have undergone significant improvements over the past years. And also Bolivia, the Philippines, Poland and Uganda have also scored successes recently. The main policies implemented by those countries in their fighting against corruption were the creation of anticorruption bodies, such as the Independent Commission Against Corruption in Hong Kong, reform of the civil service, strengthening the auditor general's office and implementing anticorruption public information campaign. But the survey respondents in those countries did not think highly of such anticorruption bodies. To be credible, they felt, such institutions had to go hand in hand with a good example set by honest leadership. Otherwise anticorruption bodies are easily rendered useless or, worse, misused for political gain. The cleanup of the Philippine tax inspectorate is strong illustration of effective institutional reform. The process includes the

immediate firing of corrupt personnel, the professionalization of the staff, new control systems, and new performance assessment systems. In the Philippines, tax reforms were implemented simultaneously with the institutional revamping, tax rates were simplified, and exemptions were significantly reduced. These measures severely curtailed the incentives and discretion to extract bribes.

According to the Transparency International's Index Armenia is one of the most corrupted countries. In Armenia all the branches and all the institutions of government are highly corrupted. For Armenia all above suggested policies are very important for effectively combating corruption but I would like to stress some preconditions for implementing successful anticorruption campaign.

1. If we look at the legislative branch of Armenia then we' will see that the majority of deputies of our parliament are powerful businessmen. They were elected by bribing people and getting into the parliament their goal is of course not to serve for the public good but for their personal advantage by paying less taxes, creating new businesses etc. People taking some little amount of money for electing those deputies they will have to pay much more in the future because of the above mentioned factors. So one of the important factor combating corruption in Armenia is to be *free and fair elections*.
2. The other precondition is *awareness of people*, about why corruption constitute a problem in society about why free and fair elections are important for having welfare and prosperous country. According to many scholars it is one of the most effective way in long run reducing corruption. Thus it is generally accepted that corruption is controlled only when citizens no longer tolerate it

3. And the third precondition as we saw from the experience of other countries is the honest leader, who will be a good example for other politicians and public officials, who unfortunately is absent in Armenia.

Thus honest leader, public awareness, and free and fair elections are the preconditions for the effective beginning of anticorruption campaign in Armenia.

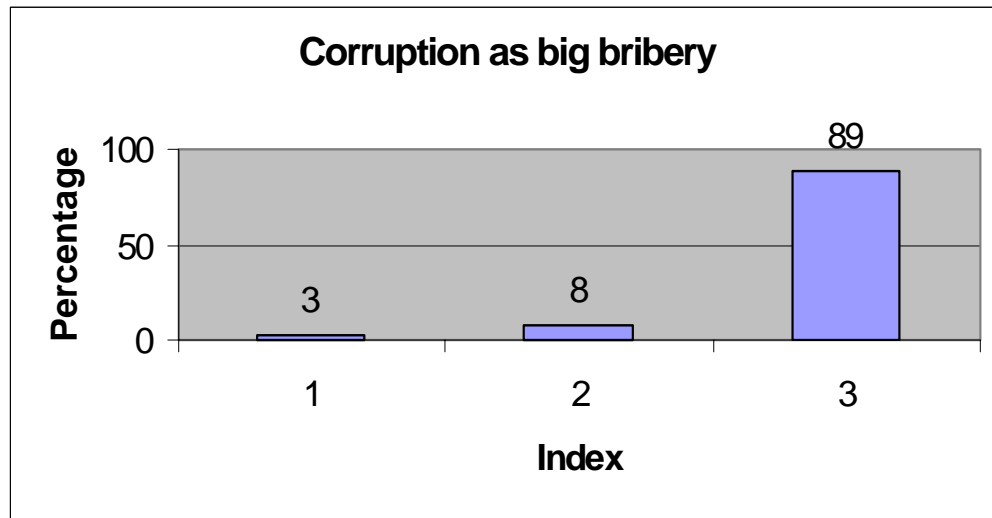
In this chapter I tried to introduce the policies and reforms which may help to reduce corruption in Armenia. But the effective implementation of those policies in Armenia is preconditioned by free and fair elections, politically educated people, and honest leader.

CONCLUSION

We have seen that high levels of corruption have very harmful effects on economic and political development as in other countries as well as in Armenia. Corruption is deeply rooted in Armenian society. Indeed, It is coming from the soviet times, when people had no power and the government decided everything. So people during the past seven decades learned not to make any decision. People lost their ability to think and make decisions for themselves. But the democratic system is not something that give everyone everything that they want, but it demand the participation of everyone, people should fight for their well-being themselves. They should learn the ways to control the government. Yes I stress the fair and free elections because if people sell their power of electing they will lose their power to demand anything from the elected officials. For controlling corruption is very important consolidated democratic institutions especially free and fair elections, people should understand that this is the basic decision they may make. So the democratic institutions are very important for combating

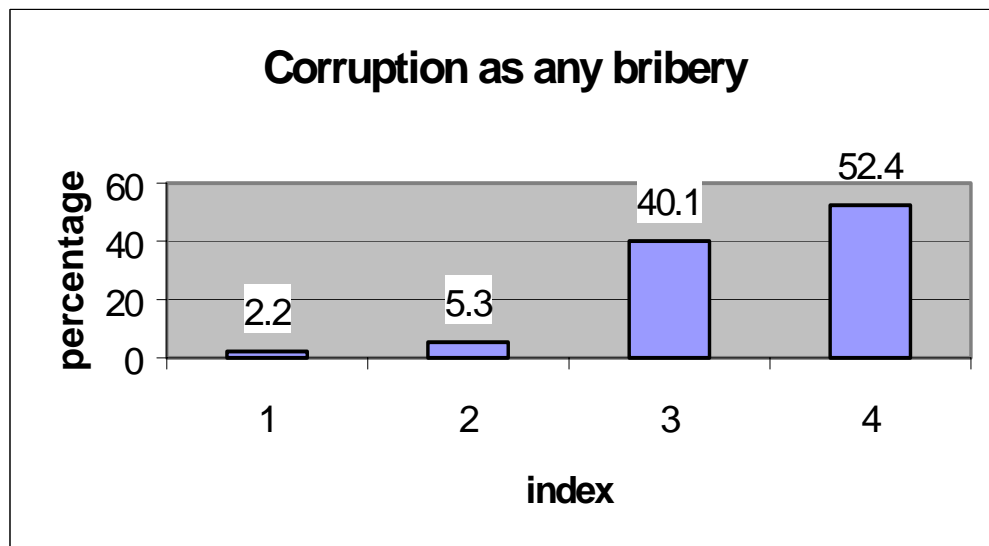
corruption. Only by having established democratic institutions we may win the fight against corruption.

Chart I¹



Source: Civil Society Development Union (1999) Public Opinion Survey

Chart II²

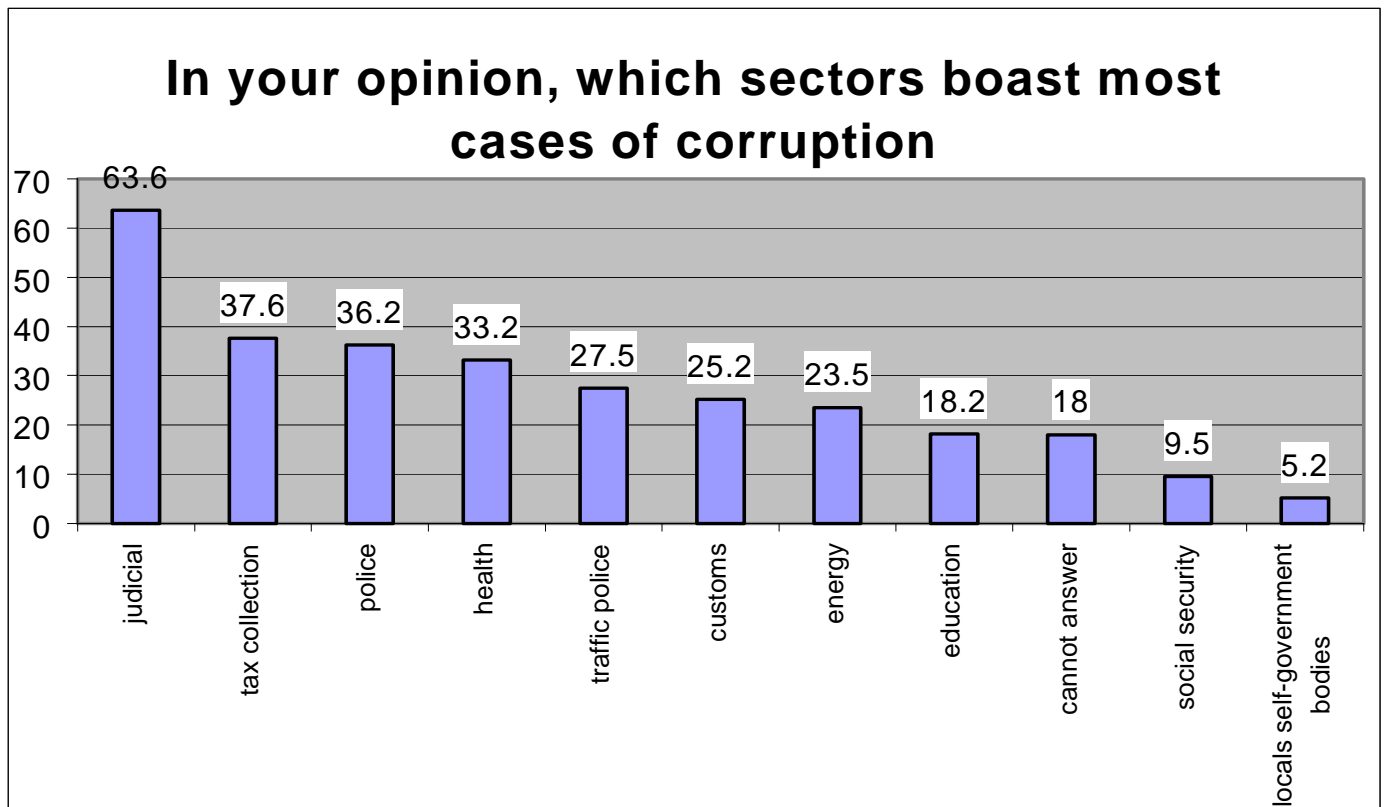


Source: Civil Society Development Union (1999) Public Opinion Survey

¹ The index includes the following examples
taking money by a high level officials for providing certain service
taking money for "closing a case" in the Prosecution office

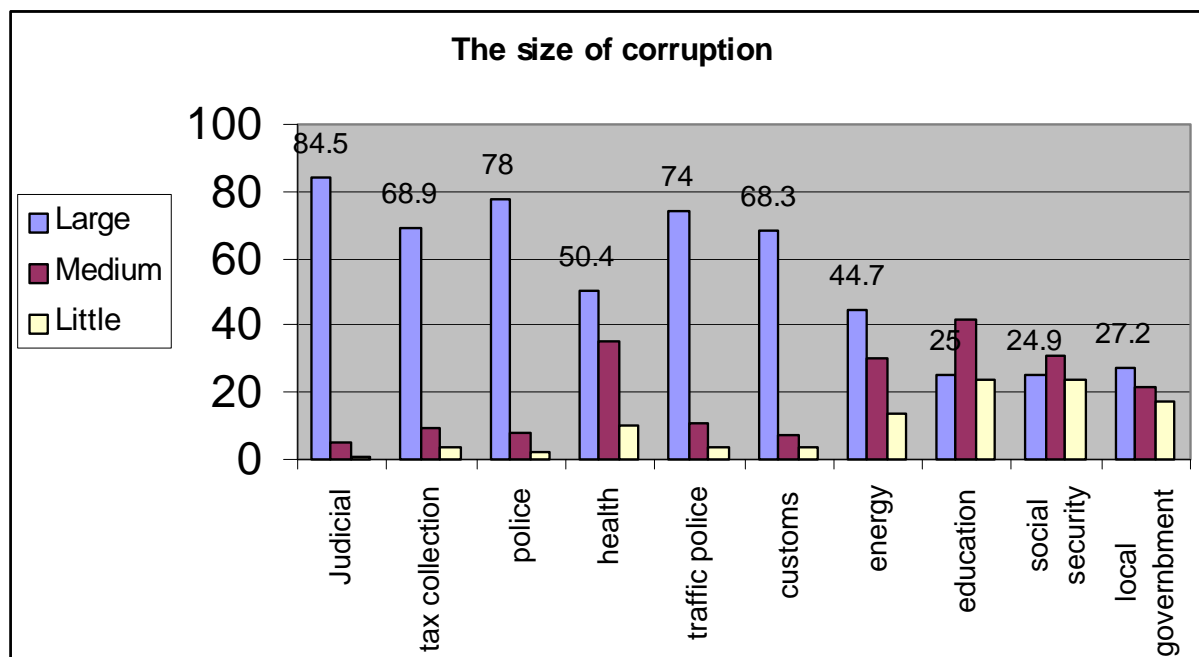
² The index includes the following examples
taking money by a high level officials for providing certain service
taking money for "closing a case" in the Prosecution office
a nurse taking money from the patient

Chart III



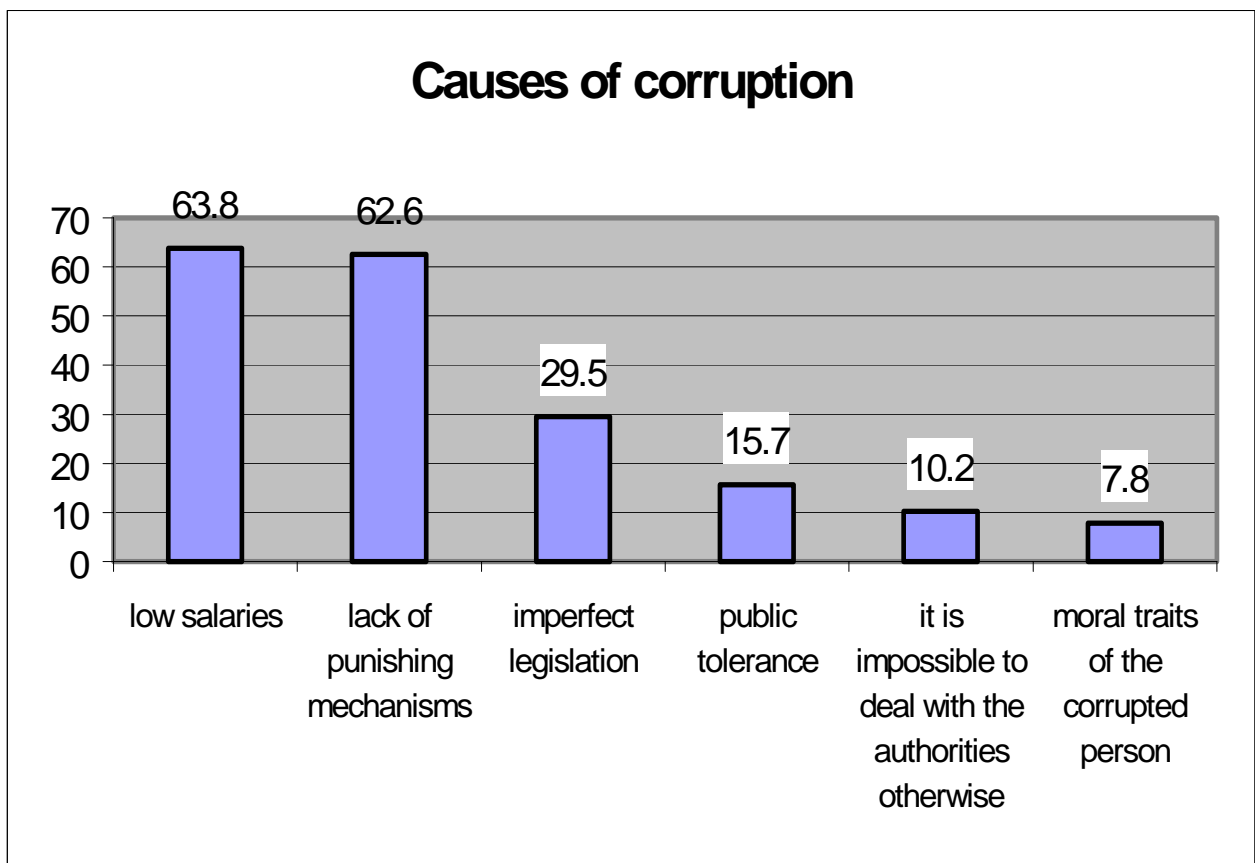
Source: Civil Society Development Union (1999) Public Opinion Survey

Chart IV



Source: Civil Society Development Union (1999) Public Opinion Survey

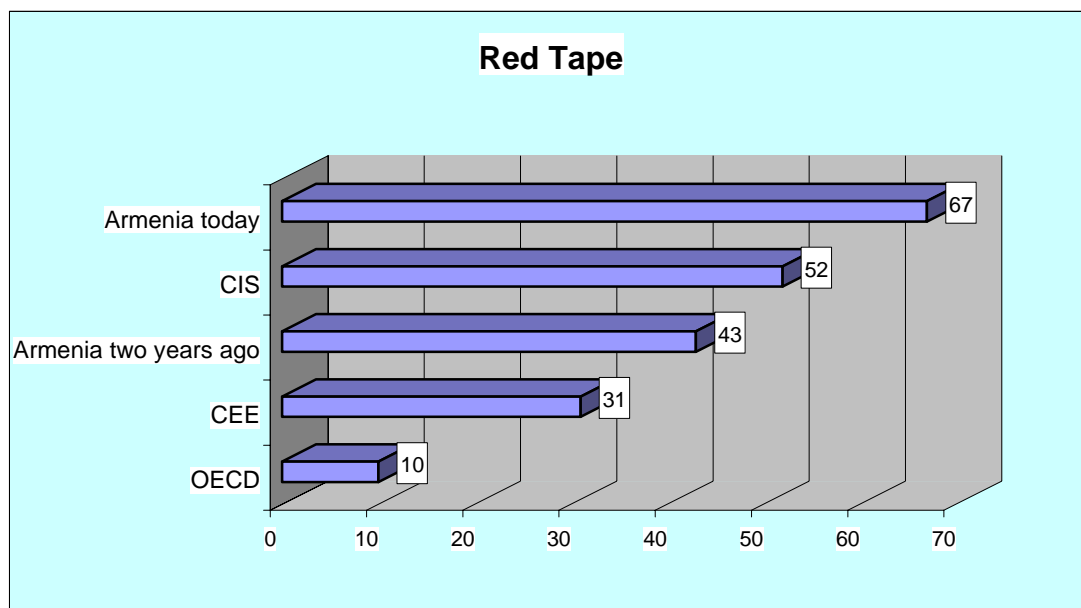
Chart V



Source: Civil Society Development Union (1999) Public Opinion Survey

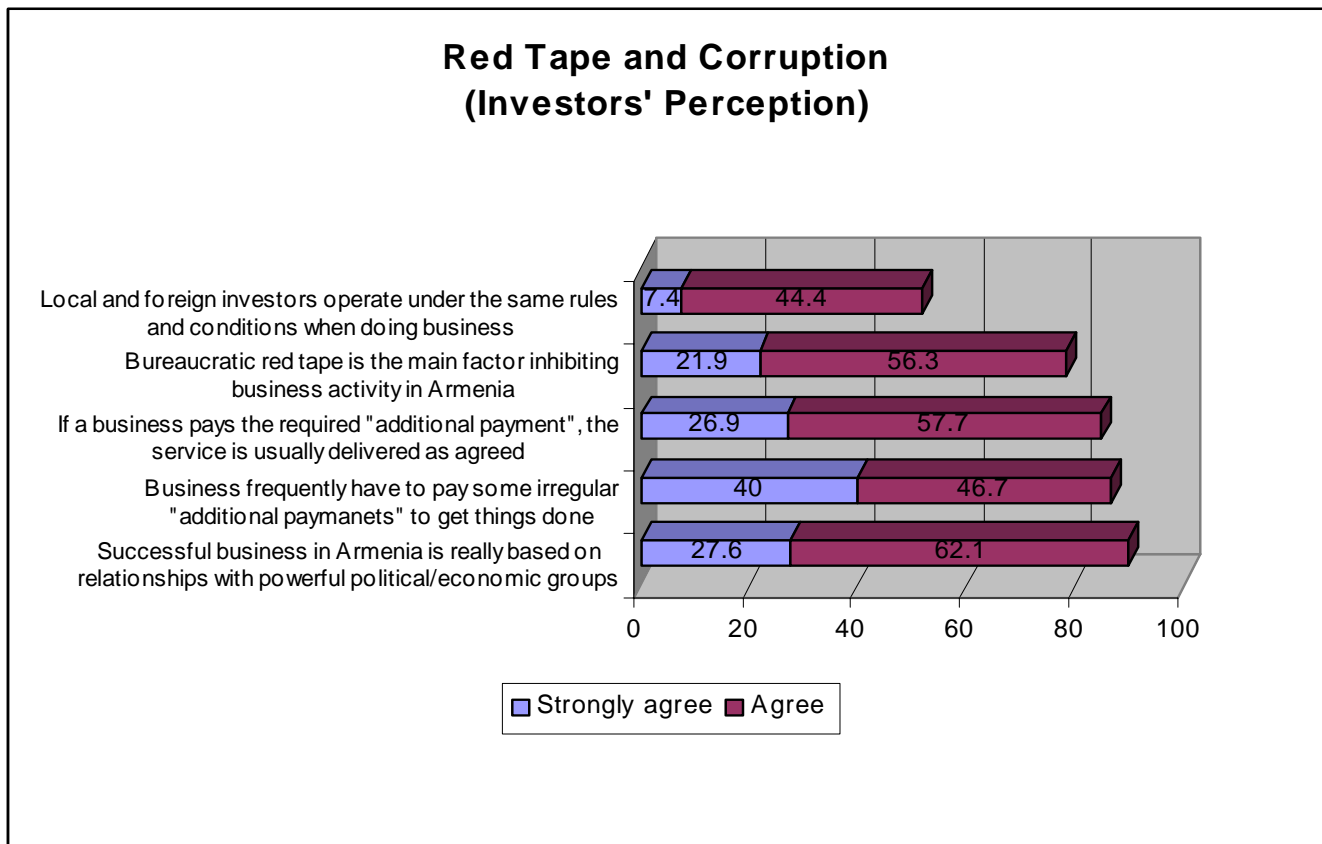
Chart VI

The percentage of Firms devoting more than 15% of the Manager's time to negotiating with officials



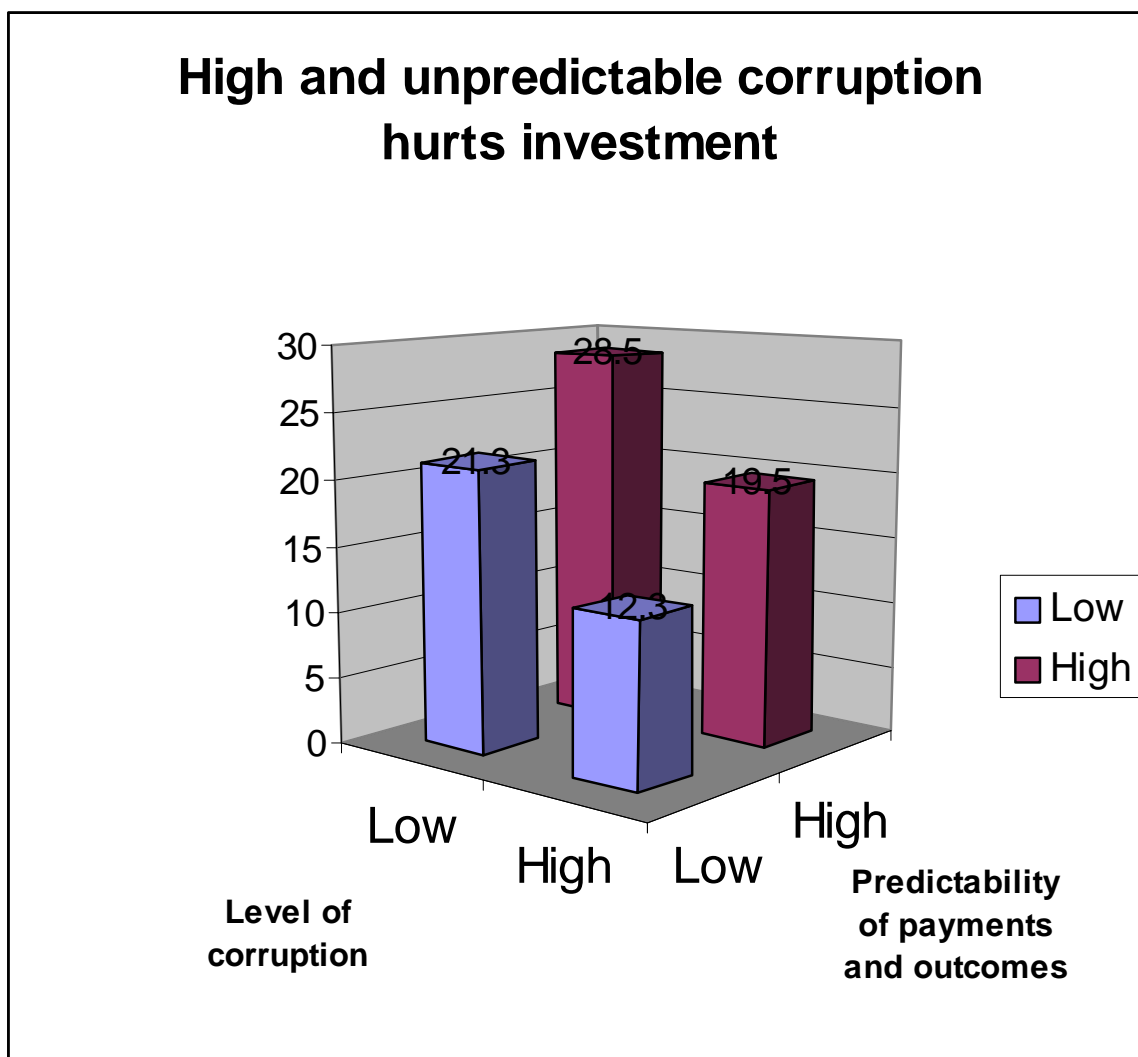
Source: 1998 Survey on Investors conducted by Republic of Armenia Ministry of Industry and Trade and Center for Policy Analysis

Chart VII



Source: 1998 Survey on Investors conducted by Republic of Armenia Ministry of Industry and Trade and Center for Policy Analysis

Chart VIII



Source: World Bank staff calculations based on data from the private sector survey conducted for this Report. World Development Report, 1997

Table 1

Attitudes Towards Red Tape and Corruption

Red Tape (Means on scale of 1-4 where 1 is strongly disagree and 4 is strongly agree)

	Gov. Experts	Non-Gov Experts	Combined
Bureaucratic red tape is the main factor inhibiting business activity in Armenia	3.1	2.8	2.9
Local and foreign investors operate under the same conditions when doing business	2.4	2.1	2.3
Business frequently have to pay some irregular “additional payments” to get things done	3.1	3.2	3.1
If a business pays the required “additional payments” the service usually delivered as agreed	2.9	2.9	2.9
Successful Business in Armenia is really based on relationship with powerful political/economic groups	3.2	3.3	3.2

Source: 1998 Survey on Investors conducted by Republic of Armenia Ministry of Industry and Trade and Center for Policy Analysis

Table 2

			Amounts to be spent (million \$)					
Name of Loan	Loan amount (million \$)	The part spent (million \$)	Spent inefficiently	Spent not for the purpose	Embezz- led	Misappro- piations suspected	Expected Loss to the state	Actual loss to the state
1.Chinese loan	4.8	4.13	3.5		0.2			0.2
2.Zvartnots cargo	22.8	16.7		16.7			4.4	
3.Irrigation rehab. Loan	57.15	25.0		3.5	2.5	1.0		3.5
4.Hrazdan power plant	57.4	55.0			55.0			55.0
5. Highway program	16.0	16.0	12.6	3.4	0.35			0.35
6. Disaster zone	30.8	30.8			6.8	0.12		6.92
7. Large agro market	15.0	1.4			1.4			1.4
8. Commodity loans 1996-97	30.0	30.0			1.68	3.74		5.42
9.Commodity loans wheat 1998	15.0	15.0				3.6		3.6
10. Commodity loans 1992- 97 violations					2.0			2.0
11. Power system loan	13.7	10.2			0.76			0.76
12. Russian Federation loans	73.7	73.7			2.9	39.73		42.63
13. Turkmen loan	34	34			12.0	13.0		25.0
14. Management system reform loan	12	10.73	0.9	0.86	4.41	1.32		5.73
TOTAL	382.5	322.6	17.0	24.46	90	62.51	4.4	152.51

Source: Report by the Temporary Commission of the National Assembly, 1998

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