



## POLICY BRIEF No. 20

If corruption between the private and public sectors persists, it would impede real innovative, competitive and fair business practices that are the true foundations of a free market economy, therefore obstructing the overall socio-economic progress of a country.

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## Introduction

An inefficient and ineffective bureaucratic system coupled with practices of non-compliance, especially corruption, pose a significant threat to a country's socio-economic progress. Reports on corruption in Macedonia note that the many cumbersome regulatory procedures that exist, together with the burdensome public administrative process, create many opportunities for corruptive practices. This is especially significant in the private sector, where businesses frequently complain about the existence of red tape in governmental institutions and argue that it hinders their businesses from becoming fully productive.

The Human Rights (HR) Report (2016), published by the United States Department of State, argues that government interference in private businesses in Macedonia has been

widespread. The wiretapping scandal, which made public illicit conversations between government officials in 2015, has shown that the government had directly and indirectly controlled a large share of private sector companies and had extorted funds from them. In return, these companies have predominantly collaborated with the government and had routinely won government tenders. Armed with ambiguous, often contradictory, and fast-changing business legislation, inspection bodies visited uncooperative companies and imposed heavy penalties on them. For these businesses, inspectors have a predetermined penalty, while other companies pay regular fees in order to avoid government harassment. In general, the wiretapping scandal showed ethical and moral misconduct by government officials where officials were revealed to have participated in corruptive practices and political power abuse, which included breaches of fundamental civil rights, judicial independence, media freedom, fair elections, politicization of public institutions and corruption in various fields.

This paper examines the current situation of corruption and other non-compliance practices between the government and the private sector. It analyses how such practices obstruct healthy economic progress of the private sector in Macedonia and identifies the types of non-compliance practices that are prevalent. Furthermore, the paper reveals real accounts/case studies of businesses that have faced different levels of corruption and examines the different dimensions of corruptive practices. It offers policy recommendations on how to alleviate the problem of non-compliant practices based on empirical findings about corruption in the private sector. The paper also should serve as catalyst to spur a higher interest and further research in this area.

According to the United Nations Office of Drugs and Crime report on the impact of bribery and other crimes on the private enterprises of Macedonia that targeted years

2011/2012, 6.5 per cent was the average prevalence of business bribery in Macedonia. This means that at least one out of every 15 businesses in the five economic sectors surveyed who had contact with a public official had, in the 12 months prior to the survey, paid a bribe (receipt of money, a gift or other counter favor). Additionally, business representatives in Macedonia ranked corruption as the 5th most significant obstacle to doing business. In those years, businesses that were involved in bribes paid an average of 4.8 bribes to public officials in the 12 months prior to the survey. The prevalence of bribery was widespread, although it varied across business sectors: Building and Construction (11.7 percent); Wholesale trade and Retail trade (7.5 percent); Manufacturing, Electricity, Gas and Water supply (5.1 percent); and Accommodation and Food service activities and Transportation and Storage combined (3.8 percent). Half of

the reported bribes, or 52%, were paid in the form of food and drink, while the mean amount paid per bribe was 689 euros. Furthermore, for 36.1 percent or over one third of all bribery cases, the payment of the bribery was either explicitly or implicitly requested by the public official or requested through a third party on behalf of the official, while in 57.5 per cent of cases it was offered by a business representative without prior request. The prevalence rate of bribes paid to public officials is highest for customs officers (6.3%) and land registry officers (3.4%) which corresponds with the current reports that customs and construction public administration are among the most corrupt. The main purposes of paying bribes are to speed up a procedure (50%) and to make the finalization of a procedure possible (12%), which corresponds to the current view that cumbersome and burdensome procedures are the reasons why non-compliance practices are flour-





ishing in Macedonia.

This report has noted two very worrying facts about the Macedonian private sector. Those are that 22.2 percent of the bribes served no specific immediate purpose, and over one-fifth of the business representatives did not report bribery because informal gifts or payments to a public servant are considered signs of gratitude. These facts show that non-compliance practices have become so common and intertwined in everyday business practice in Macedonia that they have become something normal, customary, and set a predisposed standard for achieving business priorities.

According to the author's calculations on the data from the Business Environment and *Enterprise Performance Survey (BEEPS) IV-V* by the European Bank of Reconstruction and development (EBRD), the trend of non-compliance practices tends to remain stagnant without any significant change in a positive or negative direction for a period of 5 years (from 2008/2009 to 2012/2013). Although the following data might show an improvement, the trends tend to be stagnant, which is due to the lower sample size of the survey in later years. Only 181 firms were interviewed in 2012/2013, while 366 firms were interviewed in the earlier period. Almost half (47%) of the firms engaged in providing payments/informal gifts to public officials in 2008/2009 while this percentage was 35% in 2012/2013. When considering dealing with customs/imports, 89 businesses were involved in paying unofficial payments/gifts to deal with customs procedures in 2008/2009 while

20% of business were involved in non-compliant practices when dealing with custom procedures in 2012/2013. Finally, the most alarming fact is that 117 business or 32% of all interviewed in 2008/2009 have payed unofficial payments/gifts when dealing with courts while 23% of businesses were involved in non-compliant practices when dealing with courts in 2012/2013.

According to the COCTM (2014) report, the legal framework of the Macedonian Criminal Code is comprehensive and conforms to international and European standards. It is updated continuously according to the Group of States against Corruption (GRECO) and the European Commission progress report recommendations. The Criminal Code of Macedonia has been harmonized with international standards by introducing amendments between 2011 and 2014, as well as harmonizing the Code with the provision of the Criminal Law Convention on Corruption of the Council of Europe, alongside the United Nations Convention against Corruption. As such, the Criminal Code of Macedonia is very much in line with international standards. The code encompasses the standard provisions concerning bribery as well as a provision to prevent trading of influence, abuse of public office, and bribery in the public sector. In total the Criminal code identifies 19 criminal acts of corruption (COCTM, 2014). Similarly, the EU Progress Reports from 2015 and 2016 indicate that the country has achieved a certain level of preparation for fighting against corruption. More specifically, the legislative and institutional frameworks for prevention of and fighting against corruption

have been developed.

Even though the legal framework is sound, enforcement is weak, and the public is skeptical of the government's willingness to fight against all levels of corruption and non-compliance practices. Investors and businesspeople have reported that they are still being solicited for bribes, especially for public procurements and government projects. Additionally, investors also complain about political interferences as well as slow and inefficient legal proceedings as constraints to business growth<sup>1</sup>. The EU Progress Report 2016 notes that business development suffers from weak and uneven law enforcement. More specifically, obtaining licenses and permits for business operations tend to be easier for foreign than for domestic businesses. Furthermore, there is a tendency for muddy and often biased interpretations of business regulations, especially by local administration (i.e. civil servants). This tendency, as well as uneven enforcement of rules and contracts, adds to the enhancement of non-compliant practices such as bribery, misuse of official position, and other corruptive practices. Likewise, the Human Rights Report (2016) also notes that the government attempted to reduce competition in the private sector by driving out firms and companies that were independent or held opposing views to the government. This was done through weakening them in order to make them susceptible to a takeover by pro-government companies through selective withholding of payments to businesses for government contracts while continuing to pay competitors who were connected to the government.

<sup>1</sup> Investment Climate Statements for 2016, Bureau of Economic and Business Affairs:

<https://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm?year=2016&dclid=254389#wrapper>

Notwithstanding, these troubling practices go even deeper, as it is common for some members of the parliament or local governors to be business owners or to be indirectly involved in business practices and to be closely related to wealthy private businessmen and firms. This not only infers conflict of interest at the highest level but additionally contributes to the unequal distribution of wealth and income in Macedonia. The Corruption Perception Index (CPI) (2016) states that such practices have offered companies, networks and individuals undue influence on laws and institutions in order to shape policies, legal environment and the wider economy to suit their own interests.

## Evidence of corruption

Macedonia was ranked 54th out of 113 countries in 2016 regarding its adherence to the rule of law, according to the World Justice Project Report<sup>2</sup>. Though it seems as high ranking, Macedonia had a higher ranking in the period 2012/2013 than in 2016. Macedonia dropped 9% in overall score for adherence to the rule of law in 2016 compared to 2012/2013. Furthermore, in 2016, Macedonia dropped in all 8 factors that compose and are important for a just, impartial and fair rule of law. More importantly, regulatory enforcement and constraints on government powers displayed one of the sharpest declines of 16% in the four year period according to the report. This also falls in

line with the EU Progress Report 2016, which observes that law enforcement and enforcement of regulations are often biased and promote favoritism. The decline of these factors shows that the rule of law in Macedonia continuously faces perilous influences that encourage defiance of the basic principles of a fair and just democratic society. Experts and citizens in Macedonia think the civil justice and criminal system are highly corruptive, biased and open to governmental influence. This public opinion is often founded upon actual corruption and is not merely a public perception. The factors show that red tape is highly persistent and exists in the Macedonian regulatory and legal framework. The legislative red tape facilitates the presence of corruptive practices, bribe, informal gifts, cronyism, favoritism, impunity, and the misuse of governmental power, which creates gross disparities between Macedonian businesses.

According to the Global Competitiveness Report<sup>3</sup> (2016), Macedonia has been ranked 60th out of 140 countries. In relation to the private sector, Macedonia has improved in the fight against corruption, bribery and the burden of government and customs regulations. Nevertheless, there is still a need for continuous progress in these areas, in order to get rid of corruption and to improve the business climate in order to provide a fair and efficient environment for all businesses. According to the report, the worst rankings

that Macedonia receives continue to be the efficiency of the legal framework, favoritism in decisions of government officials, and organized crime, as well as undue influence. The recent evidence of public sector interference in the private sector definitely impacts these factors negatively.

### Personal accounts from businesses

In the following section, case studies/accounts of businesses will be presented that reflect the concrete effects of corruption on business operations for two different types of businesses. These accounts were gathered by the researcher in August 2017. There are several notes about these case studies that the reader should take into consideration. Firstly, the accounts were chosen on the basis of willingness and trust to communicate these experiences to the researcher. Secondly, the businesses represent the most common business size in Macedonia (small and medium), and finally the businesses represent different industries in Macedonia, in order to show that corruptive practices are present across the spectrum of business operations in Macedonia.

A small business owner in the catering industry in a town in Macedonia has already closed his business due to constant harassment from the state inspection services (state retail and commerce inspectorate and the revenue and tax inspectorate) and the police. The owner mentions that even though his business fulfilled all the conditions required to work,

2 The WJP Rule of Law Index is derived from more than 110,000 households and 2,700 expert surveys in 113 countries and jurisdictions. The Index is the world's most comprehensive data set of its kind and the only to rely solely on primary data, measuring a nation's adherence to the rule of law from the perspective of how ordinary people experience it.

3 The Global Competitiveness Report is an annual report developed by the World Economic Forum which ranks countries by the level of competitiveness. The report integrates macroeconomic and microeconomic aspects as well as legal and regulatory evaluation to create one single index of competitiveness. The index assesses the ability of countries to provide high levels of prosperity.

the owner faced over 200 inspection controls within 1100 days. In addition to these illogical inspection controls, this business owner received constant harassment from the police, in that they were conducting meaningless controls on the grounds of allegations that were never found to be true, and in all of these over 200 inspection controls, this business owner was never found guilty or paid a fine. Furthermore, this harassment did not stop there, the government agency that allows and issues a license for building an extra patio and gazebo for his coffee shop officially misinformed him that such a license is not needed, which later led to the demolition of the newly-erected construction and took a toll on his business operations. Because of these meaningless controls by the police and inspection services, the business owner was pressured into informally seeking a favor for the controls to stop from a mayor in the neighboring municipality, which only

temporarily proved to be successful. Tragically, this owner agreed to be fined by an inspector on the grounds of a fabricated deed, which the inspector would subsequently help him to contest. The inspector notified the owner that he was ordered by his supervisor in the governmental agency to fine the business owner in order not to lose his job. ***Because of such pressure and harassment the business owner chose that the best and most painless option was to close his business since he mistrusted that the system would do anything about solving his problem.***

The manager of a medium-sized business in the food production industry thinks that political connections and personal connections of businesses and government officials are the main problems that cause not only harassment and pressure but also unlawful competition. The business has never suffered a penalty or a fine due

to having improper documents but the manager is continuously harassed by the tax and revenue inspection controls because of illogical allegations. This is because the competitors that have contacts with the officials often send these public officials to exert pressure and harassment in order to hurt the business. The manager states that in Macedonia there is a sort of ***“well-mannered corruption” where, due to the continuous changes of the laws, regulations and licenses for conducting businesses, the inspection services usually gain an upper hand and have the chance to fine or penalize businesses for not having the proper documents.*** Additionally, red tape increases the probability that businesses will ask for a favor of public officials where instead of waiting for 15 days for the proper document to be issued, the business will receive it in 1 day. Usually, corruptive practices between businesses and officials are carried out through favors and





not through receiving informal gifts or money. These favors tend to be employing relatives of the public official in the businesses. Additionally, government officials tend to know which businesses do not follow rules, and thus going to such businesses to ask for favors is a regular tactic. Finally, ***businesses that tend not to follow rules are the ones that initiate and get involved in corruptive practices with government officials.***

Corruption and other non-compliant practices arise due to government interference, corruptive public officials, businesses that tend not to follow laws and regulations because of political connections and red tape/burdensome regulatory procedures that often create space for corruption. The existence of all these factors cre-

ates high inequality in economic performance among business in Macedonia, and this disparity creates an unfair competitive advantage for firms that are able to cater to the needs of corruptive government officials, while the others fall victims to it. In time, such corruptive practices can pressure businesses or business owners to close down operations or to get involved in the same practices that they have so vehemently fought against. This creates economic progress for some private sector businesses while for the rest it creates passiveness, faithlessness and uncertainty toward the government, thus limiting their opportunity for economic progress and growth. If this continues to be the case, it would consequentially show that economic progress is based upon corruption and not on

real innovative, competitive and fair business practices that are the true foundations of a real free market economy, which in turn is the basis of a well-developed country.

## Recommendations

Data, interviews and reports by international organizations about non-compliant practices indicate a systematic problem. Red tape, uninformed or corrupt public officials, businesses that do not follow laws and regulations, and political connections tend to be reasons why corruption flourishes. In order to confront and overcome these troubling tendencies, five steps should be taken into consideration in order to diminish and finally eradicate corruption between the government and



the private sector:

### 1. Loosen red tape and train public officials

In general, the **government should try to loosen burdensome documentation for acquiring business licenses and other documentation for conducting business practices**. Businesses tend to get involved in petty corruption with public officials in order to speed up the process for getting the proper documentation, so, shortening the time needed to acquire the proper documentation for any sort of license will greatly diminish corruptive practices. Additionally, the government should offer training to public officials when changes of the regulatory and legal framework that is directed for the private sector are implemented. In this way, public officials will be able to effectively and efficiently provide the needed services to businesses and it will lower the chance of businesses offering favors/bribes that will lead officials to misuse their positions.

### 2. Higher salaries and harsher penalties for public officials

**Increasing the salaries for public officials that tend to have direct contact with the private sector will discourage businesses to consciously initiate corruptive practices and will motivate them to follow the procedures accordingly**. An increase of salary should be focused towards public officials such as inspectors or administrative clerks that conduct documentation, customs procedures or issue licenses/permits to businesses. This will also stop arbitrariness of inspections. In line with this, **harsher penalties should be introduced to these public officials in order to discourage not only businesses but**

**officials from getting involved in non-compliance practices**. If an official is found guilty of misuse of public office, this official should be immediately expelled from the position and should receive an infinite ban in applying for any type of public service position or job. Relating to this, public officials and sectors that have direct contact with the private sector should face a semiannual inspection by the anti-corruption body in order to oversee if public officials have been fair and transparent in their public service.

### 3. Organize regular exchange of information sharing with businesses

In order to incentivize businesses to follow the laws and regulations and to eradicate their involvement in non-compliant practices, the **government should establish semi-annual meetings with the chambers of commerce and industry branch associations in order to engage in information sharing and consultations on future laws and regulations and the problems of the current regulatory and legal framework**. In this way the government can diminish the existence of red tape by finding out what issues Macedonian industries are facing and can directly be informed about what kind of corruptive and non-compliant practices are causing troubles in the private sector.

### 4. End employment based on political parties

A big issue with corruption and non-compliance practices between the government and the private sector is political connections. Employment in the public sector should not be on the basis of political party affiliation. More importantly, employment in the public sector that tends to have direct

contact with the private sector should be more scrupulous. **Public officials such as inspectors or administrative clerks that conduct documentation, customs procedures or issue licenses/permits to businesses should be employed on the basis of experience and knowledge, and such officials should be scrutinized by conducting, on a continuous basis, conflict of interest analyses**.

### 5. Raising awareness campaign on the fight against corruption

A national campaign for raising awareness would aim to promote to the public: the importance of fighting corruption and non-compliance practices in the private sector, the negative consequence of such practices on the economic progress of Macedonia, and how such practices induce wealth and income inequality and unfair competition. **The campaign will inform all stakeholders (public, government officials, the media, civil society and the private sector) which corrupt and non-compliance practices exist, how stakeholders are able to report such practices, and how they are protected from retaliatory practices if they report corruption**. Such a national level campaign can be implemented through a cooperation agreement between the Ministry of Justice, the State Commission on Prevention of Corruption, the Agency of Administration, the Financial Police Office, the Customs Administration of Macedonia, the Tax and Revenue Office, and the State Retail and Commerce Inspection. The campaign would contain a series of press conferences, workshops and round tables organized for the main stakeholders including decision-makers, civil servants, media and civil society.



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