



# Corporate Engagement in Fighting Corruption and Tax Evasion

Financial supporter -



## **Project and methodology**

This is the Final Report for the project *Corporate Engagement in Fighting Corruption and Tax Evasion*. The project, financed by the Nordic Council of Ministers, includes three partners: Transparency International Latvia (Delna, host organisation), Transparency International Finland and BEROCC, a research institute in Minsk, Belarus. The aim is to engage entrepreneurs in fighting corruption and tax evasion, with a focus on municipal construction procurements in Latvia, Belarus and Finland.

The research method used draws on micro-level observations such as surveys and interviews to qualitatively analyze the causes and effects of corruption and tax evasion in public procurements in Finland, Latvia and Belarus. This method is based on the notion that those most likely to know how much production goes unreported are entrepreneurs and company managers, because they observe misreporting of both corporate income and personal income paid to employees. Thus, they hold the information about the schemes and extent of shadow activity in a sector of the economy. Through carefully designed surveys and interviews the method allows to learn directly from entrepreneurs and managers about the current state of public procurement procedures and issues.

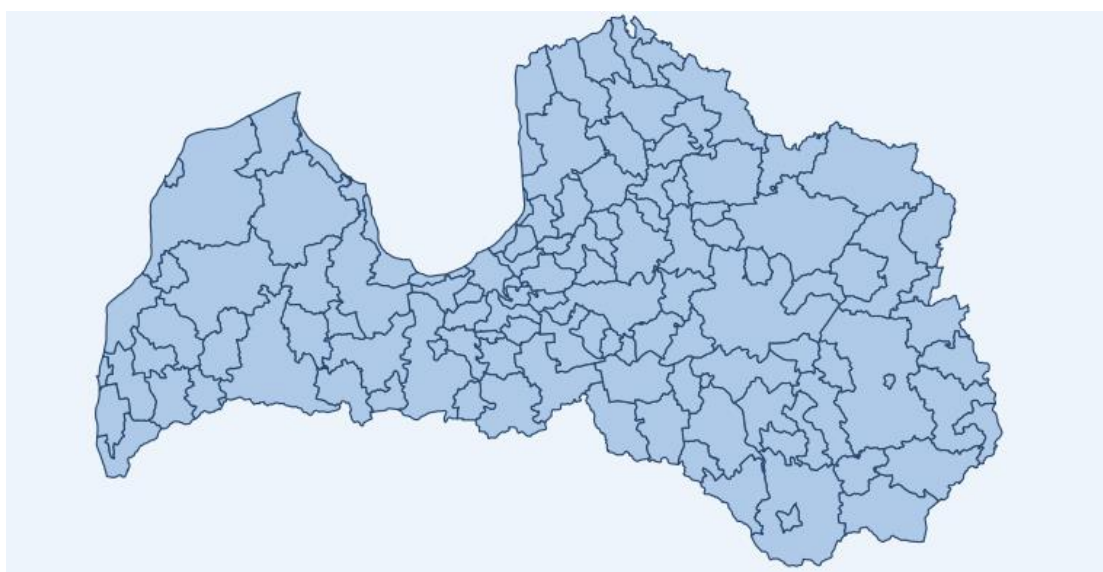
Because of the structure of the project, the research is empirical (interviews), international, comparative and practical (workshops and conference). The project has revealed new corruption and tax evasion cases and their causes, allowing for recommendations to be developed for relevant national institutions. The research also compares policies, practices and entrepreneur experiences in public procurements across the three states to transfer best practices.

The main component in the research method are deliberately constructed surveys of about 30 entrepreneurs and managers who work in construction and have participated in municipal procurements. In Latvia, there are 527 surveys done on a Likert-type scale in Finland and 50 in Belarus. The questionnaire asks company managers more detailed questions about entrepreneur participation in municipal procurement – how often do they take part, what have their experiences been like, what problems have they encountered and have they noticed any competition stifling procurement regulations or actions.

### **1. Latvia**

#### **1.1. Municipalities**

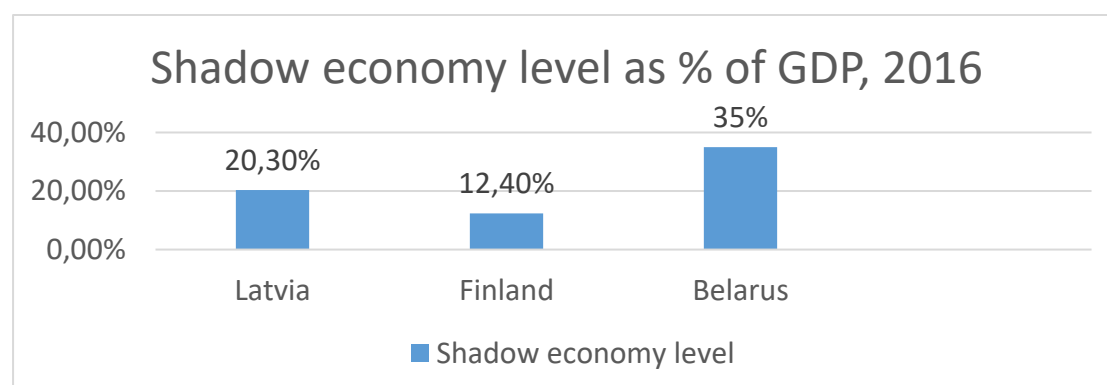
There are 119 municipalities in Latvia, out of which 110 are regions and 9 are cities. As the map of Latvia illustrates (Table 1), municipalities in Latvia are quite fractured. Often for some of the smaller municipalities this means that they lack the human resources and the expertise (see section Findings) to ensure a quality procurement, especially if they have not had experience with such a procurement before. In addition, small and fractured municipalities are harder to monitor to ensure compliance with administrative rules and therefore it is more difficult to prevent corruption and conflicts of interest.



**Table 1: Map of Latvia by municipality division**

## **1.2. Shadow economy and corruption trends in Latvia**

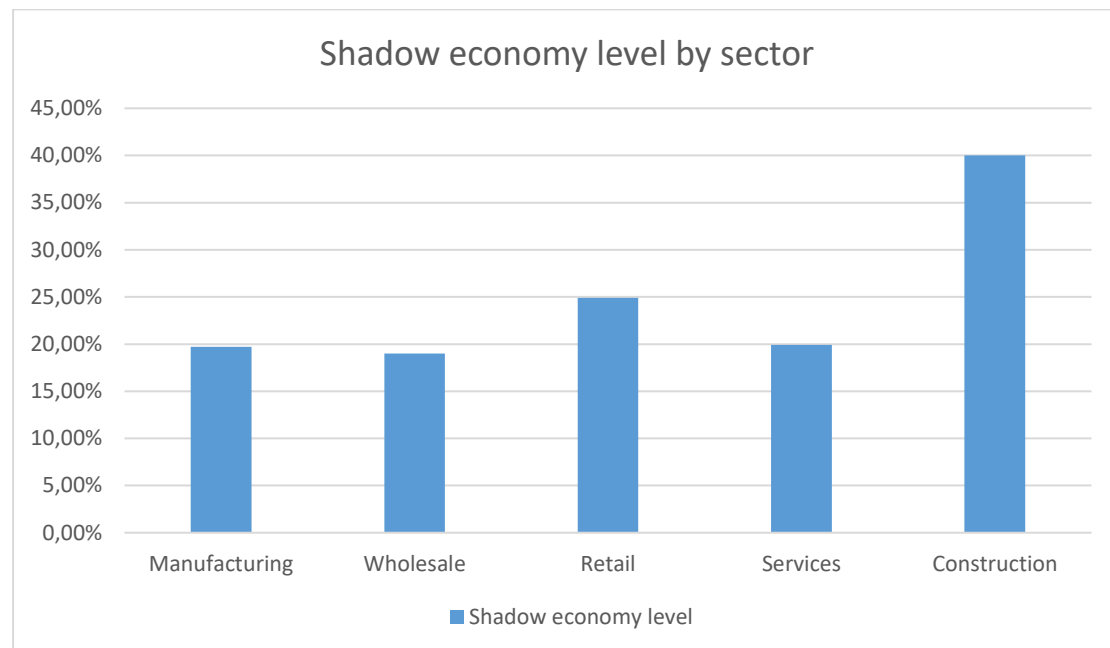
According to the most recent “Shadow Economy Index for the Baltic countries, 2009 – 2016” (Putniņš and Sauka, 2017) the shadow economy level for 2016 in Latvia is estimated to be at 20.3%, which is a 1% decrease from 2015. While overall the shadow economy level in Latvia has been declining, the consensus is that shadow economy is still a major problem that diminishes state budget contributions and fosters inequality. Similarly, in the latest Corruption Perception Index 2016, Latvia had gained two points from the previous year and now has 57 points. While this is an improvement, unfortunately Latvia lost four places in the overall ranking, showing that there is nonetheless stagnation in the fight against corruption.



**Table 2: Shadow economy level in Latvia, Finland and Belarus as % of GDP, 2016 (Source: Putniņš and Sauka, Schneider, Central Bank of Belarus)**

Most recent research on Latvia’s construction sector shows that the shadow economy level in this sector is nearly 40% (Table 3) as % of GDP, which is the highest level in comparison to other sectors of the economy. While the shadow economy level varies in other research reports, depending on the methodology used, there is agreement that unreported income, unregistered employees and envelope wages are an issue in construction, which makes this sector more prone to corruption and unfair competition. It is commonly assumed that corruption and tax evasion in construction are problems associated with the private sector.

However, 90% of respondents admitted that corruption and shadow activity are also an issue in public procurements. What are the main manifestations of this corruption and shadow activity and how do we tackle these issues?



**Table 3: Shadow economy level by sector (Source: Sauka, 2016)**

### **1.3. Jēkabpils municipality case: potential corruption in a procurement**

During the project Transparency International Latvia (TI Latvia) was contacted by a member of Jēkabpils municipality council, who informed about a potential conflict of interest and corruption risk in the procurement for the construction of a stadium close to the Jēkabpils State Gymnasium.

In the Fall of 2016 Jēkabpils municipality council decided to take out a loan for a stadium's reconstruction, whose costs were estimated to be more than EUR 1 million. There was no procurement for the stadium's reconstruction and without a decision from the municipality's council, the chairman of the council, Leonīds Salcevičs, entrusted the construction to a limited liability company (SIA) "Jēkabpils pakalpojumi", which is a 100% Jēkabpils municipality owned corporation. SIA "Jēkabpils pakalpojumi", originally a waste collection enterprise, has currently announced procurements for specific works in the reconstruction, which are won by the chairman of the council's party associate's Māris Dimants company "Jēkabpils PMK".

Once TI Latvia had learned about this case, it sent an application to the Procurement Monitoring Bureau (IUB) asking them to investigate the case and, if any misbehavior is found, to apply administrative penalties. On March 16, 2017 IUB began an administrative violation record that is still ongoing. Because of TI Latvia's initiative, on May 21<sup>st</sup> Jēkabpils stadium's reconstruction case and procurement violations were exposed in an investigative journalism story for the TV show "De Facto", raising public awareness.

This case not only clearly illustrates the conflicts of interest and corruption that exist in municipal construction procurements, but is also an example for how whistle blowing, when

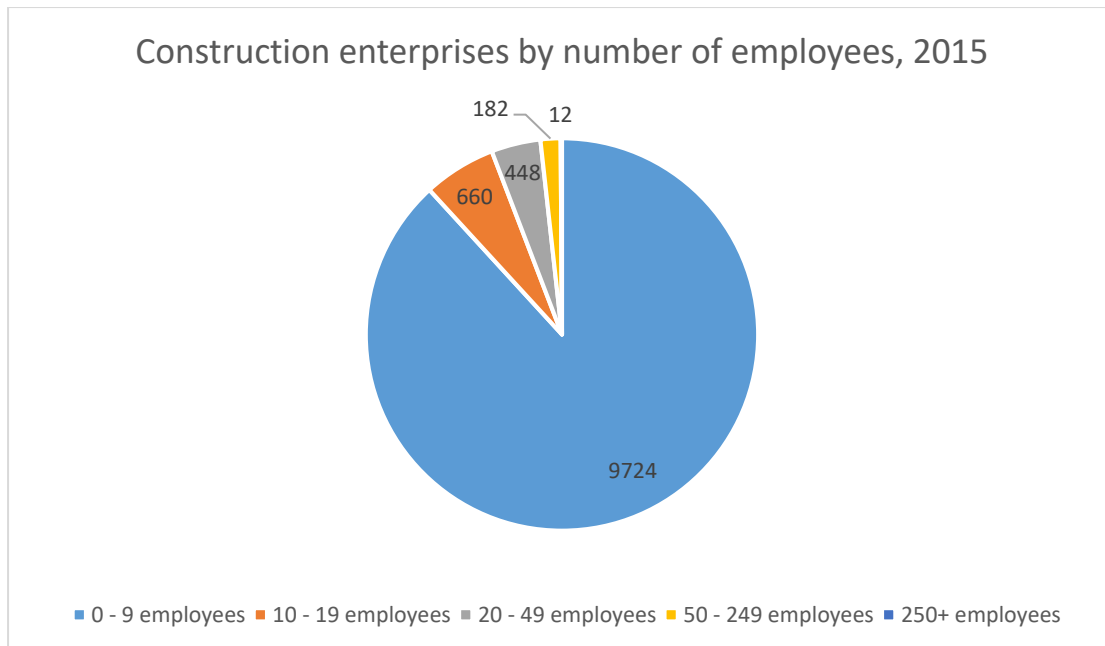
handled correctly, can lead to reporting of a misbehavior, an objective investigation and potentially punishment. Therefore, whistle blowing is a mechanism that should be promoted and encouraged to enhance transparency and prevent corruption.

#### **1.4. Construction sector features and tax evasion**

While conflicts of interest are an issue in municipal construction procurements, they do not have an obvious link to shadow activity. One of the conclusions drawn during the project was that in construction, especially for large-scale projects, and because of the specific nature of some construction works, there are long construction contracting chains without proper supervision, that lead to tax evasion among some of the sub-contractors at the end of these chains.

Latvia's legislation stipulates that the contracting municipality, when evaluating potential construction companies for a procurement, only considers the social security and tax payments of prime-contractors. If a prime-contractor has a tax debt above EUR 150, they are immediately removed from the procurement competition. However, these rules do not apply to hired sub-contractors, whose tax and social security payments are not monitored at all, and tax evasion and envelope wages are usually the most common among them. Municipality contractors, when evaluating a procurement candidate, should be made responsible to also check the sub-contractors', that a prime contractor plans to work with, tax and social payments in the past 12 months.

According to data from the Central Statistics Bureau (Table 4), in 2015 there were 11 026 active construction enterprises in Latvia, out of which 9724, or a little more than 88%, were companies with 0 – 9 employees. These companies mostly operate as sub-contractors, especially for large scale projects, and are at greater risk of evading tax. Since they form the majority of active construction enterprises, Latvia's legislation and procurement regulation should focus on advancing their tax payments and corporate social responsibility. Therefore, this project mostly focuses on the issues that these small and medium sized businesses have identified, since they form the basis of Latvia's construction sector. Out of the 30 interviews conducted, 25 were with companies that are mostly hired as sub-contractors and can thus account for their perspective.



**Table 4: Construction enterprises in Latvia by number of employees, 2015 (Source: Central Statistics Bureau)**

### **1.5. Main findings**

While it is certain that corruption and shadow activity in municipal construction procurements exists, it is necessary to identify its causes and to find appropriate recommendations for solving these issues. During the interviews, each entrepreneur was asked to identify the three main issues that lead to corruption and tax evasion in municipal procurements. While the issues named varied depending on the enterprise's size and experience, they included:

1. Evaluation criterion: 90% of respondents agreed that usually the offers are evaluated based on price, which often leads to unjustifiably cheap offers, that foster tax evasion and payment of envelope wages to guarantee these low prices and to remain competitive. Similarly, there is uncertainty among entrepreneurs that shifting to evaluating the financially most advantageous offer would foster competition and improve the quality of work;
2. Qualification requirements: 90% of respondents claimed that often the procurement work did not justify the high qualification requirements as set by the municipality in the procurement. This stifles the competition and growth of some of the smaller and medium sized companies, since only large scale companies or prime contractors can win the tenders;
3. Conflicts of interest: nearly 60% of respondents claimed that they had potentially come across a conflict of interest in a municipal procurement competition, where the qualification requirements were written for one already known winner. This problem also partially stems from a lack of standardization in the writing up of the procurement regulation;
4. Contractors lack of competence: there are overall 119 municipalities in Latvia, which is a lot for the size of the country and for the number of inhabitants. While larger municipalities can ensure the human resources and expertise to write good quality

procurements, as stated by 50% of respondents, smaller municipalities often cannot guarantee that they have the knowledge and the experience to write a procurement regulation, especially for large-scale projects;

5. Tax burden: 60% of respondents named high tax rates and the micro-enterprise tax regime as reasons for tax evasion in the construction sector.

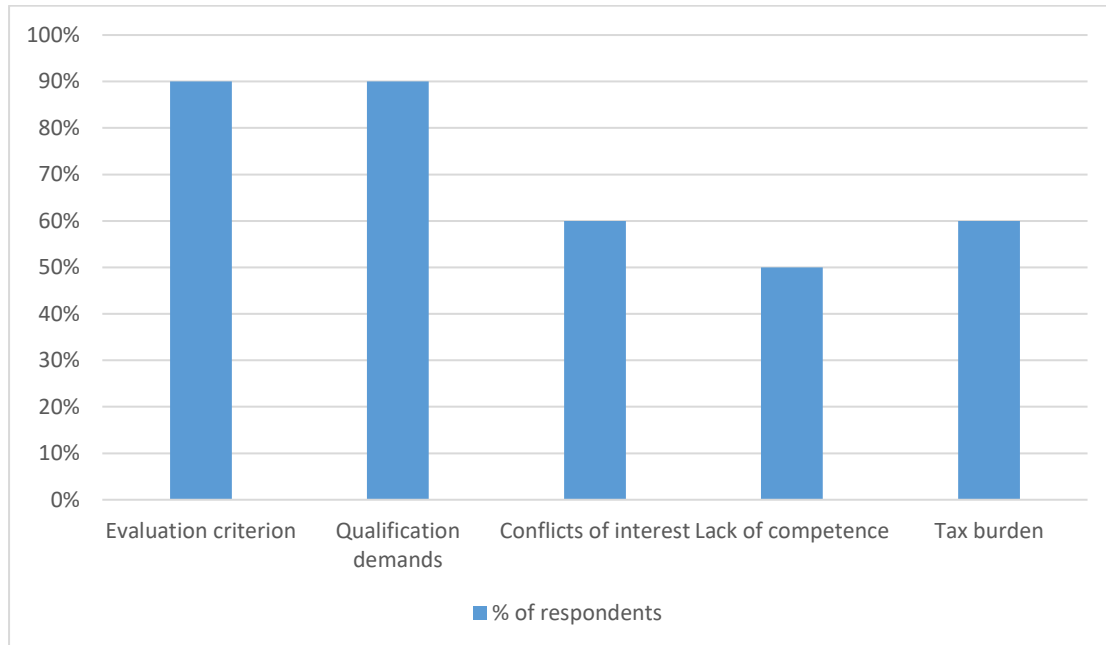


Table 5: % of respondents that had identified it as an issue

### **1.6. What did entrepreneurs have to say?**

#### Evaluation criterion:

*“The basic problem is that the procurement winner is chosen based on price...the lowest price can differ by even 30%...we cannot compete with such an offer...it is obvious that there is something...that they are not paying something...maybe taxes.”*

#### Unreasonable qualification requirements:

*“Inexplicable and confusing procurement qualification demands – redundant, fake, puzzling and exaggerated demands.”*

#### Conflicts of interest:

*“Unfortunately these competitions are prepared for certain applicants, and it’s difficult to enter them if you lack the right experience or reviews...you can call this unfair competition.”*

#### Contractors lack of competence:

*“The municipality procurement personnel have no qualifications...they do not have understanding, they do not know how to work with the procurement regulation...they have too many schemes, they complicate everything.”*

#### Tax burden:

*“In the whole sector, does not matter if you are big or small, there is illegal employment and envelope wages...just so at least you can exist...and so that people would also make a decent living...we would love to pay all our taxes, but if they are so high, they just force the enterprise to ultimately avoid them.”*

### **1.7. Conclusions**

The problems in the construction procurement process identified during the interviews are complex and interrelated. Lack of competence from the procurement personnel leads to low quality procurements, unreasonable qualification demands and mistakes in the technical specifications. In addition, this means that offers are usually evaluated based on price – the simplest and supposedly most objective criterion. However, to offer the lowest price entrepreneurs often evade taxes and pay envelope wages, or save on quality materials and labor.

What are the main conclusions that can be drawn from the complex problems that exist in municipal construction procurements? Corruption and shadow activity in municipal construction procurements are the result of:

- Long contracting chains without proper supervision: due to the specific nature of some construction works in larger projects the municipality must attract prime-contractors, that often do not do the construction works themselves but later hire sub-contractors to complete the project. The contracting municipality is not liable to check the tax payments of the sub-contractors, who are usually more prone to tax evasion, partially because they must work for very low prices and would not be able to exist if they paid tax. On the other hand, prime-contractors are not allowed to have a tax debt above EUR 150, but usually they are also larger companies with more strongly developed policies of corporate social responsibility, more resources and a reputation to maintain, thus they are less likely to evade tax and pay envelope wages. As Table 6 illustrates, larger companies A – C paid significantly more in social tax than smaller companies D – K. This indicates that companies’ D – K have either much lower wages, or probably pay envelope wages. Moreover their tax payments are not monitored by the contracting municipality thus enabling tax evasion.





**Table 6: Social tax paid in thousands EUR by company in 2014 (Cemex, 2015)**

- Lowest price as the prevailing evaluation criterion: entrepreneurs remarked that evaluating an offer based on price is not a problem as such, because there are objective reasons for differences in price (cheaper materials used, more convenient geographical location, materials already in stock, etc.). However, the problem is that sometimes these prices are not the result of cost-effectiveness or do not represent the legitimate market price, but are attained by evading tax. As a result, occasionally the low prices offered in tenders are dumping prices and result in tax evasion and envelope wages. Low priced work also results in low quality work.
- Lack of standardized qualification requirements: currently municipalities are left to write their own qualification requirements, even though they often lack the experience and the expertise. According to the respondents, sometimes the demands in the qualification requirements do not make any sense, are too high for the planned works and can easily be manipulated. Examples include a case when one municipality had a tender for a cobble stone road reconstruction, and the requirement was that the winning candidate should have previous experience in working with color black cobble stone. This raises questions whether it truly matters what color cobble stone you have worked with, was this a fair requirement, or perhaps these requirements were set so one company would win? Clearly, lack of standardization and supervision in drafting procurements leads to corruption and misbehavior. However, there are other examples of cases when the contracting municipality, without the appropriate knowledge on construction, has in ignorance set the requirements too high, thus curbing competition, especially hindering small and medium sized enterprises.

### **1.8. Current initiatives to solve construction sector problems related to corruption and shadow activity**

The interviews conducted reveal that currently the problems associated with municipal procurements in construction are extensive. To mitigate these problems in May, 2016 the

largest construction associations and government representatives signed a Memorandum of Understanding. Their resolutions include:

- 1) a general agreement in the construction sector regarding the minimum wage;**
- 2) introducing identity cards in construction;**
- 3) improving public procurement legislation and procedures;**
- 4) introducing standardized contracts;**
- 5) determining solidary responsibility for sub-contractor tax payments.**

See below for further explanation on each of these resolutions and how they would contribute towards the fight against corruption and shadow economy.

1. A general agreement in the construction sector regarding the minimum wage:

Representatives from the construction sector would come together and decide on the minimum wage that must be paid out to all construction employees. The aim is to introduce a unified payment system in the construction sector by forming a general agreement on the minimum wage level in profession groups. This would foster competition and would lower the risks from dumping and unreasonably cheap offers, particularly in public procurements. This would also shrink the remuneration gap in the sector, and would prevent envelope wages. This initiative should have come into effect on January 1<sup>st</sup>, 2017, the deadline had been extended to February 20h, 2017, but nothing in this area has happened yet.

2. Introducing identity cards in construction:

Identity cards have been a contentious issue among construction sector representatives, as some see it as a good initiative to prevent shadow activity, especially unregistered workers on site and envelope wages. While others argue that ID cards will be difficult to introduce, to monitor and probably would not give the expected results. These identity cards would include the worker's name, the company that he or she works for, as well as their qualification. When scanning the ID card, it will register the hours worked. This would improve builders' qualifications and would allow to identify them, fostering on site safety. In addition, it would log the actual hours worked therefore preventing envelope wages and improving co-operation between all the parties involved. This ID system would come into effect on January 1<sup>st</sup>, 2019.

3. Improved public procurement legislation:

To improve public procurement legislation and procedures, there are two proposals:

1. To introduce construction enterprise classification system, which would be linked to public procurements. Each enterprise would get a specific grade, based on their size, turnover, experience, tax payments, etc., that would also qualify them for tenders. However, currently not all entrepreneurs support the proposed classification system, that is being introduced under the Ministry of Economics' supervision. TI Latvia also recommends that the classification system should be introduced in a way that does not hinder the competition of small and medium sized businesses, which is the present fear;
2. To develop the methodology and guidelines for evaluating the financially most advantageous bid. The Partnership of Latvian Construction Entrepreneurs together with the Organization of Architects of Latvia has recently developed and

presented in March, 2017 the guidelines and the criterions based on which to evaluate the financially most advantageous offer.

4. Standardized contracts in construction:

A fair and uniform contract standard especially for public procurements would fix many of the problems identified during the interviews. Standardized contracts would make it easier for municipality representatives to devise the procurement, it would lessen the administrative burden placed on construction enterprises, and it would make the whole process fairer, more transparent and efficient. Standardized contracts go together with improved public procurement legislation since they would allow to evaluate the financially most advantageous offer rather than always choosing the cheapest bid. This should come into effect on January 1<sup>st</sup>, 2018.

5. Determining solidary responsibility for sub-contractor tax payments:

The prime contractor would be responsible to monitor the tax payments of the sub-contractors that they hire, to mitigate tax avoidance towards the end of long contracting chains. There is currently still a debate ongoing about how this would work and if this should be introduced at all.

In addition to the memorandum of understanding there is also a State Institution Work Plan on limiting shadow economy and promoting fair competition. All the above-mentioned points that were included in the memorandum of understanding are also covered in the plan. However, the plan also comes with some supplements and it goes into more detail regarding the responsible institutions for implementing these initiatives, it explains their reasoning and monitors how the implementation process is going.

### **1.9. Recommendations**

The relevant state institutions in Latvia together with construction sector organizations and NGO's have signed a Memorandum of Understanding and have devised a plan to tackle the shadow economy in the construction sector, proposing multiple changes to make the procurement process more transparent, fair and to lessen the administrative burden. While these changes are a welcome step in battling some of the issues identified, the project results have produced some additional recommendations:

1. Clearly defined contractual obligations of the contracting municipality, prime contractor and sub-contractor per the FIDIC Red and Yellow Construction work contract regulation books;
2. Growing the contractors' competences by transferring best practices and expertise in drafting procurements from larger municipalities to smaller municipalities, developing networking events and making it possible for smaller municipalities to hire procurement experts from larger municipalities as consultants;
3. Improve the whistle blowing mechanisms in Latvia to enhance entrepreneur engagement in tackling corruption and shadow activity and to protect the entrepreneurs that do report misbehavior;
4. When evaluating the financially most advantageous offer the contractor should take into consideration the prime contractors hired sub-contractors tax payments during the past 12 months;

5. The State Revenue Service should eliminate or reconsider the functions of the Enhanced Cooperation Program (Padziļinātās sadarbības programma) also known as the 'white list'. When entrepreneurs were asked about the effectiveness of the 'white list' they remarked that they do not see any advantages from being on such a list, while quite a lot of effort needs to be invested in order to get on the list.

These recommendations were the result of the interviews conducted and were also discussed during the fourth project workshop in Riga on May 24<sup>th</sup>. Entrepreneurs agreed that contracts and regulation need to be standardized, and perhaps municipal contractors' competences can be grown by creating a centralized procurement office. Overall, entrepreneurs and state institution representatives supported these recommendations.

## **2. Finland**

### **2.1. The role of public procurements**

In Finland, since 2007, public procurement regulation has been based on a European Union Consistent Act on Public Procurement (348/2007), the latest renewal of which has just passed Parliament (1397/2016). The act aims to foster and clarify cooperation between public officials and to ensure the impartial treatment of all tenders. The revised act, in affect starting from January 1<sup>st</sup>, 2017, includes the principles of the corresponding E.U.-directive (COM/2011/0896 final) as well as the legal praxis of the European Court of Justice.

There is limited empirical evidence about how the revised act works. However, for the construction sector the threshold values remain unchanged. In the acts of 2007 and 2016, the threshold values were 150 000 euros; all procurements above this threshold should be put to tender. Below that threshold contractors can in-place the procurement without an open call for tenders. The key criterion in a procurement is overall economic efficiency, which is not the same as the lowest bid. If the chosen bid is not the lowest, the procurement can be challenged in Market Court. In the case law, however, there are only around 20 court sentences under the term "corruption". Thus, most of the sentences are considered under a different term.

Overall, public procurements total to around EUR 35 billion annually, from which around two thirds are municipal procurements. The exact amount is unknown, since the annual HILMA-statistics on public procurements include data on ex ante costs of which 80 to 85 percent are notifications. Table 2 depicts total ex ante costs in 2008 and 2015, for a given procurement. Over time the number of notifications has not increased, while the total of ex ante costs has more than doubled. According to Statistics Finland, half of the contracts go to big firms with more than 249 employees.<sup>1</sup>

**Table 2. Price-notified public procurement in 2015.**

Type	Number of notifications		Ex ante costs in €	
	In 2015	In 2008	In 2015	In 2008
Goods	5 444	6694	4 055 133 500	1 545 604 578
Services	7 945	6411	12 382 054 215	4 223 728 006
Construction	4 379	3473	7 410 896 446	3 754 848 693
Other	148	258	114 924 000	50 382 590

<sup>1</sup> See: [http://tilastokeskus.fi/til/inn/2014/inn\\_2014\\_2016-06-02\\_tau\\_017\\_fi.html](http://tilastokeskus.fi/til/inn/2014/inn_2014_2016-06-02_tau_017_fi.html)

How can municipalities achieve overall economic efficiency? The key players in the procurement process are communal procurement units, and their comprehension of the overall economic efficiency. Competitive bidding is open for municipality owned companies as well, given that those companies are treated in the same way as if they were private companies. In the bidding process, procurement units can also include some social and even ethical criteria, if those are consistent with the nature of the procurement.

Issues like these make it difficult to keep the bidding process transparent and fluid. In many municipalities, there are only a few working officials with a limited access to tenders' background and working history data. Thus, raising questions like who truly owns the tendering firm, where do they pay their taxes, do they have unpaid or unarranged tax debts and if they do, how much. The fact that procurement units make important decisions with limited data and under a strict timetable, depicts a challenging working environment, that is vulnerable to inappropriate rent seeking such as corruption. In the annual corruption reports from the Finnish Central Criminal Police, there has been a continual pattern of such problems. Unfortunately, the latest revision of the public procurement act does not make significant amends to the procurement process.

According to the Central Criminal Police, corruption crimes can be strongly correlated with the desire for power. This sometimes takes places in municipalities, such as smaller municipalities with opaque and informal decision making processes. In such municipalities, "old boys' networks" may constitute a lasting and even a socially accepted decision making tradition, which are very open to conflicts of interest. This was a key finding from the National Integrity System assessment (Transparency International Finland, 2012). An example of this are so called double roles, where political decision makers become part of the bidding process through companies owned by their friends, colleagues or relatives. Without the access to substantially better background data, it is hard to identify and tackle such problems.

In the case history, the construction sector is well represented:

- Six people were arrested in May, 2012 by an order from the Helsinki District Court in a corruption investigation of the Helsinki city building contracts.
- Destia, a state-owned road construction company, is examined for alleged treason in January 2013.
- Former Mayor of the City of Espoo and the director of Espoo's Technical and Environment Services, received bribery charges linked to major construction companies in 2010.
- In the Guggenheim Helsinki Plan, the art museum's director was not impartial in his position according to the Parliamentary Ombudsman's investigation released in May 2013.
- Former Mayor of Vantaa is accused in 2013 of a €500,000 benefit from Forma Futura in 2006-2011.

The process of corporatizing public services has made it more difficult to recognise conflicts of interest. The procurement process is increasingly coordinated at the level of consolidated companies. They then operate in a form that are comparable to private corporations, where transparency is required from public institutions, as stipulated in the act of Act on the Openness of Government Activities (621/1999), is no longer present.<sup>2</sup> An example of this is

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<sup>2</sup> Ks. mm. Korruptiorikollisuus 2014 – 2015. Rikoskomisario Juuso Oilinki, Keskusrikospoliisi, Korruption torjunta.

the metro construction project from Helsinki to Espoo. The coordination of all contracting and subcontracting were given to one private company, which did not inform the city of Espoo about the difficulties with the decided time table, resulting in substantial excess costs.

## **2.2. Topics discussed in the project**

The public procurement act and the way it is implemented does not rule out the possibility of tax evasion and corruption, in other words, there are many loopholes. First, if some firms can propose a 20 to 25 percent cheaper bid due to international tax arrangements, that is not competitive tendering. Second, the contracts do not appear transparent to ordinary citizens, such as the tax payers who finance them. Third, procurement units make their decisions without knowing the tendering firms' real owners, as well as their commitment to societal obligations in their firms' previous working history. Fourth, there is still a possibility for additional ex post invoicing in addition to the costs given at the stage of tendering. Lastly, there is no law-based whistleblowing channel with efficient whistle-blower protection. Of course there are more considerable disadvantages to the public procurement act, but the following topics are the focus of this project.

### *Restricting aggressive tax planning*

The tendering firms tax position is hard to verify, especially in a case when a contracting firm or their subcontractors operate from other E.U.-countries or from third countries outside the E.U. A way to improve fair competition and to empower the bargaining position of small and medium size enterprises is to improve the tendering firms' tax position on transparency. Thanks to the research done on several tax-leaks, it showed that massive tax evasion by means of aggressive tax planning entities such as the European Union, the United States and organisations like the Organisation of Economic Co-operation and Development (OECD) were pushed to prepare a comprehensive proposal against aggressive tax planning.

In the Anti-Tax Avoidance Directive, the E.U. proposes legally-binding anti-abuse measures that all Member States should apply against common forms of aggressive tax planning. The goal is to ensure a more fair and stable environment for businesses, by introducing a minimum level of protection against corporate tax avoidance throughout the E.U.<sup>3</sup> However, it is difficult to what extent the suggested means are used in a way that public procurement units would potentially be clear to the tendering firms' tax footprint. Considering the conflicts of interest between countries and interest groups, it is possible that several years are needed for their goal to be reached. Meanwhile, other possible means should be considered about how to avoid a situation in which firms can tender with a minimum level of taxes compared to other competitors.

### *Public contract register*

Act on the Openness of Government Activities (621/1999) stipulates that all documents that are not declared secret are public. Local Government Act (365/1999) stipulates that people should be able to verify the use of their taxes. The Act on Public Contracts (348/2007) stipulates that all contracts are public after they are signed -- but, in practice, they are not. The documents are filed and the public can gain restricted access to them at a municipality

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[https://www.poliisi.fi/instancedata/prime\\_product\\_julkaisu/intermin/embeds/poliisiwwwstructure/31549\\_Korruptiorikollisuuskatsaus\\_2014\\_-\\_2015\\_20150623.pdf?9e4314f06c9dd288](https://www.poliisi.fi/instancedata/prime_product_julkaisu/intermin/embeds/poliisiwwwstructure/31549_Korruptiorikollisuuskatsaus_2014_-_2015_20150623.pdf?9e4314f06c9dd288)

<sup>3</sup> See: [http://ec.europa.eu/taxation\\_customs/business/company-tax/anti-tax-avoidance-package\\_en](http://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package_en)

office. Strangely, there have been no steps taken to make these documents public online like most municipality council political decisions. It is possible to voluntarily deliver contracts to the database of the Ministry on Interior, but municipalities seldom do. TI Finland has presented the idea of an obligatory register, but discussion on a public contract register has not yet received the necessary support from politicians.

#### *Extending access to tendering firms' background data*

From a technical point of view, the tendering firms' background history could be stored in registers, like the Business Information System (YTJ). For the purposes of public procurement units, access to firm-specific data should be extended with law-based insurances, firms' balance sheet and applicable collective agreements. The question is, how to compile them all in one online register? In the latest program against tax evasion and economic crime, there is a proposal of creating such a register.

#### *Restricting additional ex post invoicing*

Competitive tendering is conditional to given ex ante costs, which may result in being too low, considering the "true costs" of the procurement. In such cases, it is possible to charge for the "extra work", not anticipated at the stage of competitive tendering. Therefore, ex post costs may be more than ex ante costs, and there are no effective ways to find if the "extra work" was needed and how big was the difference between ex ante and ex post costs.

#### *Reinforcement of whistle-blower protection*

According to the United Nations Convention Against Corruption (UNCAC, art. 33) reinforcement of whistle-blower protection should be considered in countries that have ratified the convention. Finland ratified the convention in January, 2006, but the questions of whistle-blower protection and a sophisticated whistle-blower channel remain unanswered. When it comes to tax evasion, supervision is carried out based on suggestions from individuals. On the other hand, in larger firms there are many voluntary systems already in place. From 2015 to 2016 there was a tripartite working group assessing the need for a universal whistle-blower system, but the work ended without a consensus. Could the construction sector lead the way by developing a tip-based system covering all malpractice, including corruption?

### **2.3. The data**

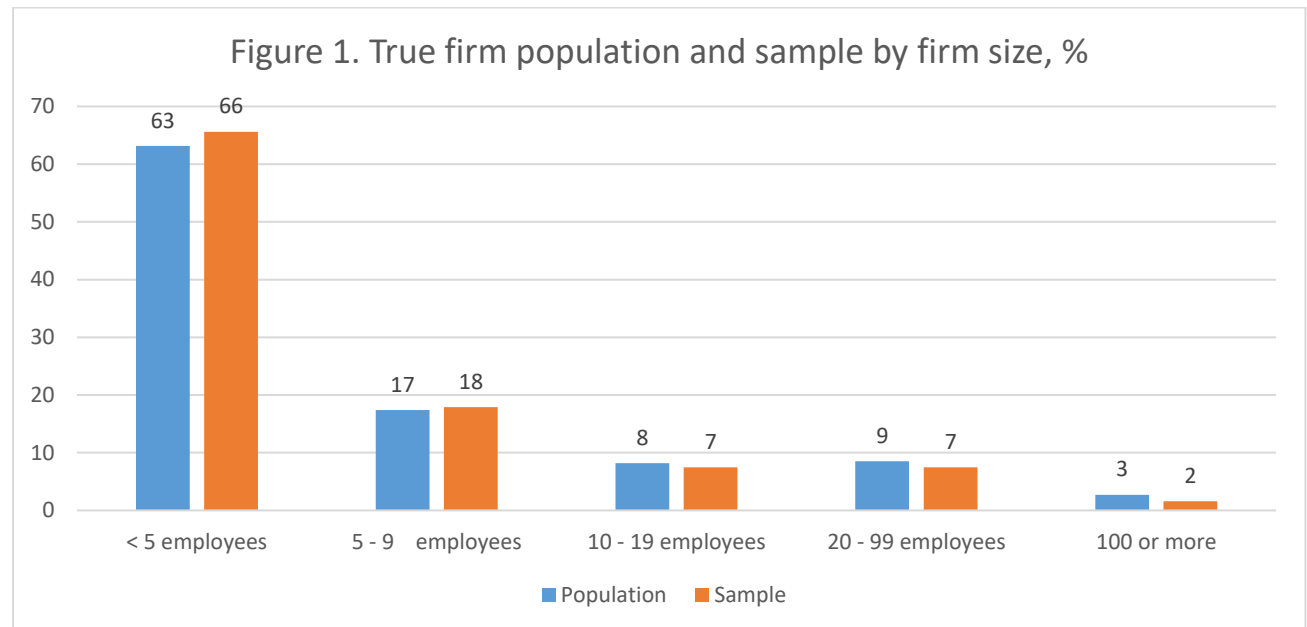
Suomen Tilaajavastuu Oy, a firm founded for the data delivery of contractors' liability, for the use of their register, containing around 50 000 firms operating in the construction field. Since the true population of firms can be measured by the size of the firm, a sampling of firm size was used, including data on turnover.<sup>4</sup> Together with our national partner a questionnaire was prepared on their webpage, which was then open for discussion for a week. Within that timeframe, 527 answers were given to 20 questions and arguments, distributed on a Likert-type scale.

The conclusions that were drawn are depicted in Figure 1. The sample is consistent with the true firm population -- all the relative frequencies in the sample are closely correlated to real frequencies in the real population. Thus, the sample is a representative case of Finland according to firm size. Secondly, in the case of Finland, the share of small firms with less than

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<sup>4</sup> The size classes were as follows: 1: 0 - 4 employees / 1 - 199 000 € turnover; 2: 5 - 9 employees / 200 - 399 000 € turnover; 3: 10 - 19 employees / 400 - 999 000 € turnover; 4-5: 20 - 99 employees / 1000 - 9999 000 € turnover; 6-7: 100 - 499 employees / million or more as turnover.

five employees comprises two thirds of the firms in the sample. Only two per cent of firms have 100 or more employees. This is largely how construction markets operate today, such as Finland. There is a small selection of large firms that are including long subcontractor chains. The actor at the end of these chains are typically small firms. Unfortunately, it is hard to identify how long firms have been established. Though most firms do not stay afloat for long or some change their logo or name to appear as though they are a new firm.



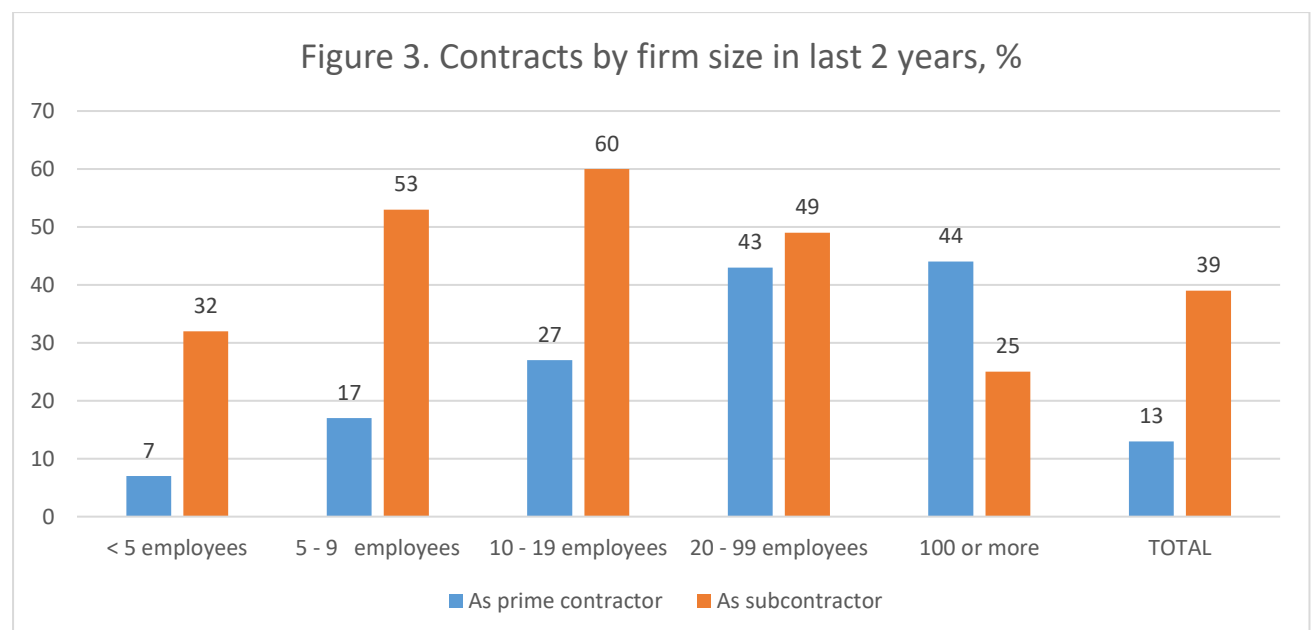
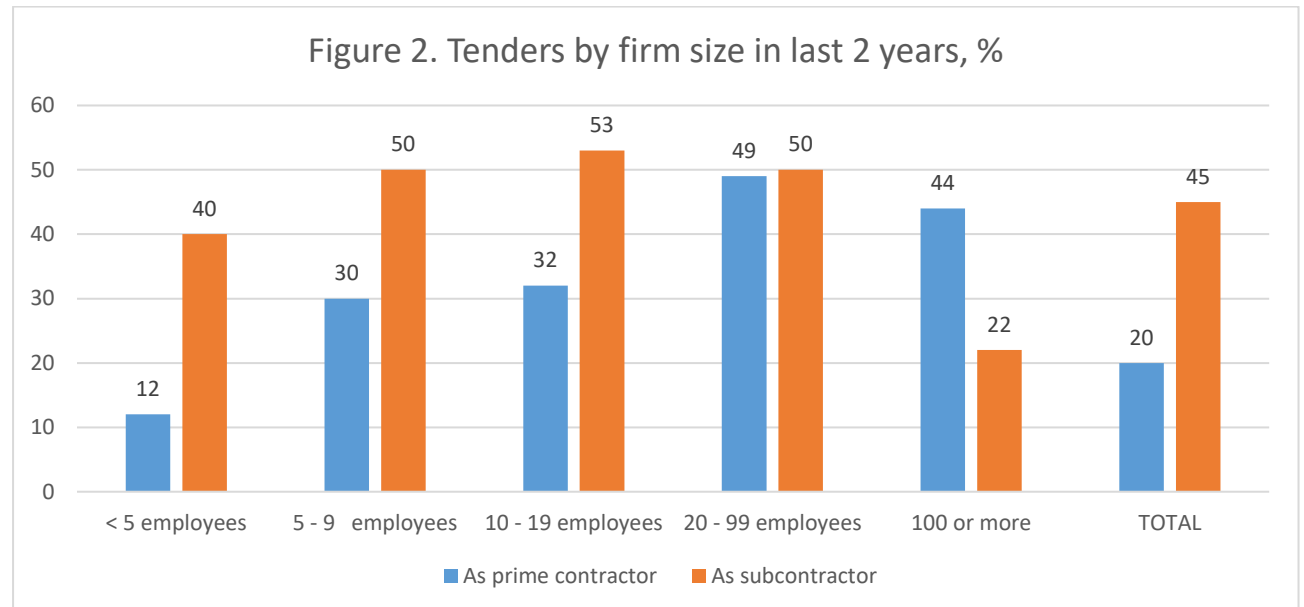
During the last two years, as depicted in Figure 2, 20 percent of firms have participated in competitive tendering as a prime contractor and 45 percent as a sub-contractor. Those who participated as prime contractors were usually the larger firms, with 20 employees or more. Of micro firms with less than 5 employees, only 12 percent participated in competitive tendering as a prime contractor. Sub-contracting, however, is more equally distributed over the firm size. Even 40 percent of micro firms with less than 5 employees have participated in competitive tendering as a sub-contractor.

When applied to contracts, the picture depicted in Figure 3 is in two parts: a sub-contractor and as a subcontractor. The most successful firms in subcontracting were of medium size, i.e. with 5 to 99 employees. The highest figure (60 percent) are from firms with 10 to 19 employees, and the smallest figure are from firms with 100 or more employees. On the other hand, prime contracting increases almost linearly from the smallest to the largest firms. During the past two years, only 7 percent of micro firms and 44 percent of large firms have done contracts as a prime contractor.

The results depicted in Figure 2 suggest that only one percent of micro firms' tendering rounds are successful, in other words, they lead to a contract as a prime contractor. As the firm's size increases, from 20 to 99 employees, the probability of getting a contract rises by 21 percent. Whereas, when it comes to sub-contracting, the differences between size are smaller. As the firm size increases from less than 5 employees to 10 – 19 employees, the probability of sub-contracting increases from 13 to 32 percent, after which the probability decreases, only 6 percent for the largest firms.



It is unclear why the probability changes so drastically. However, there is no evidence to argue in opposition -- this is only present in the sample, not in the true firm population. If these results are not falsified, it can be argued that this pattern reflects the true scale of economics in Finland. Most work is done through sub-contracting, where the size is not competitive factor as prime contracting.



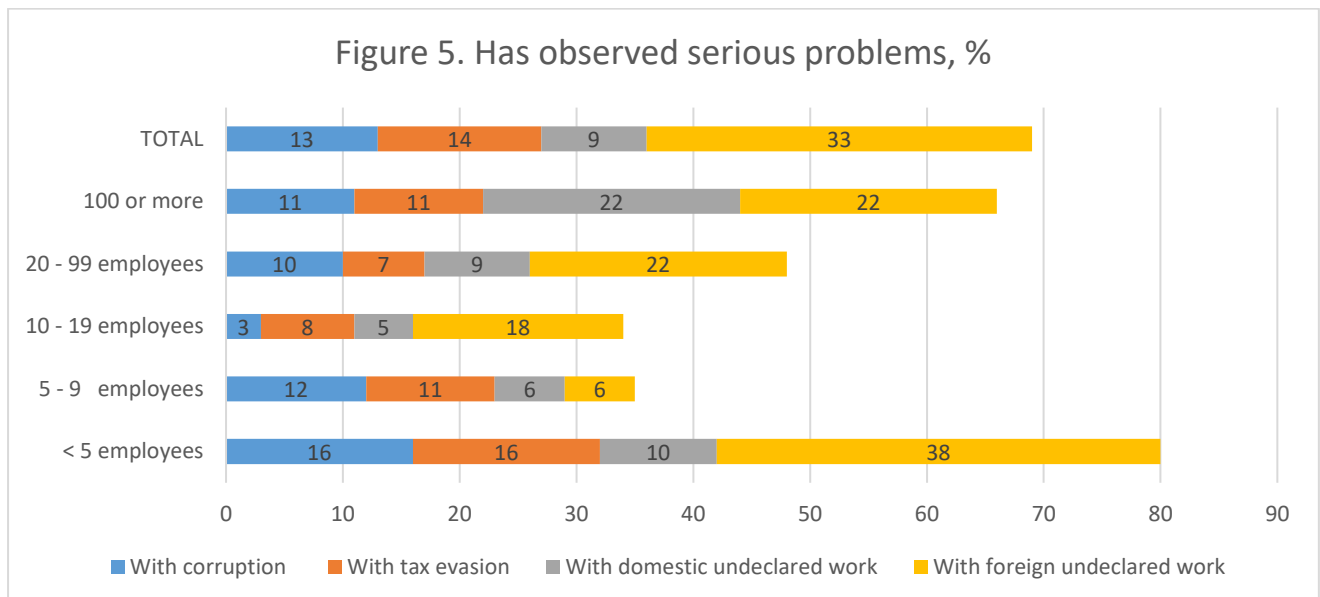
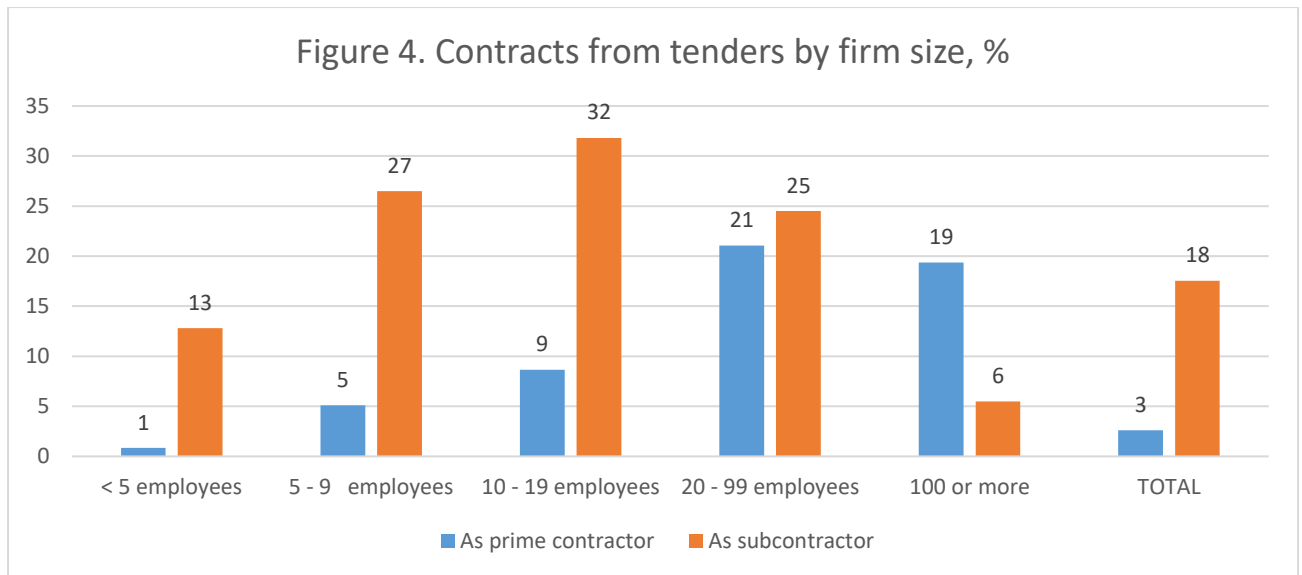
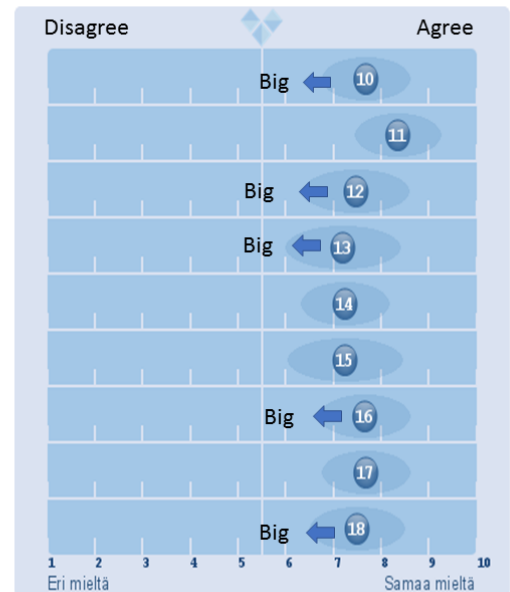


Figure 5 shows the relative share of firms that have been had problems with corruption, tax evasion, domestic undeclared work and foreign undeclared work. The results suggest that micro firms have observed more problems across the board. Among micro firms, most problems (38 per cent) arise from work aboard. In relation to corruption and tax evasion, micro firms are slightly overrepresented as well. Secondly, the results suggest that the number of problems observed is less so in firms with 5 to 19 employees. Unfortunately, the data does not explain why that is the case but they do suggest that in large firms with 100 employees or more the share of observed problems was high (or as high as in micro firms if foreign undeclared work was excluded from the data.) Third, the results suggest that foreign undeclared work is a serious problem within the biggest firms as well. Finally, in firms with 100 or more employees domestic undeclared work is also an issue.

Finally, firms were asked to respond to the following eight arguments arising from the Finnish Q & A described in chapter 2.3. The arguments were distributed on a Likert-type scale, where 1 refers to total disagreement and 10 to total agreement. The neutral point, where the firm does not take a stance, is 5,5. The results are depicted in Figure 6, where the circled argument numbers show the average stance and the arrows point to the average stance of large firms. In instances where there is no arrow, the stance of big firms is close to that of all firms.

Figure 6. What should be done?

10. Big international firms can submit lower bids because of their lighter real taxation.
11. Communal procurement units should have register-based means for checking the tendering firms compliance with their societal obligations.
12. It should be possible to restrict ex post invoicing beyond what originally was agreed in the phase of competitive tendering.
13. There is need for a public net-based contract register, containing all relevant information.
14. The needed regulation already exists. Therefore, the focus should be in correcting the faults still existing in the implementation of the existing regulation.
15. Long subcontracting chains as such create a problem, and they should be shortened.
16. Competitive dialogue restricts transparency of tendering and often leads to a consultant-dominated tendering process.
17. Restricting malpractice calls for better whistleblower protection.
18. Whistleblower protection as such is not enough. A law-enforced reporting channel, giving protection for those who are reported too, is needed.



When it comes to sample averages, they are all on the agree-side of the Figure. In questions 11 and 10 that stipulate that “communal procurement units should have register-based means for checking the tendering firms’ compliance with their societal obligations” and that “big international firms can submit lower bids because of their lighter real taxation” most firms agreed with both questions. Whereas in questions 13, 14 and 15 that stipulate that “there is a need for a public net-based contract register, containing all relevant information”, “the focus should be in correcting the faults still existing in the implementation of the existing regulation”, and “long subcontracting chains as such create a problem, and they should be shortened” firms tended to agree less. All other questions, like questions 17 and 18, regarding better whistle-blower protection, are in the neutral range of the spectrum.

However, differences between sample averages are so small that the results should be looked at by firm size. Therefore the size of the firm matters, especially in questions 10, 12, 13, 16 and 18, suggesting that large firms’ opinions vary from smaller firms. In some questions this makes sense, but in some it is difficult to judge why larger firms do not actually take a strong stance. In question 10, where restrictions for tax avoidance possibilities are suggested, it is understandable that large firms who have more extensive tax planning than others do not regard it as a problem.

This is similar in question 12, where restrictions to ex-post invoicing, mostly used by prime contractors, are suggested. Similarly, in question 16, where restrictions to so-called competitive dialogue, which also favours prime contractors. It is interesting why large firms do not support a law-enforced reporting channel for whistle-blowers, as suggested in question 18. The need for a public contract register, as suggested in question 13, still needs to be discussed, since one could argue that reforms like those would finally benefit the big firms too.

## 2.4. Conclusions

Viewing countries comparatively on hidden crime like tax evasion and corruption is difficult to do. The focus in the Finnish discussion was on the necessary regulatory framework needed to

tackle problems like corruption and tax evasion. The suggested policy interventions vary from restrictions to international tax avoidance schemes to empowerment of register-based control services in municipalities.

It was tested that the construction firms' understanding of suggested policy interventions by means of a net-based inquiry compared to a representative sample of Finnish construction firms. The answers from 527 firms suggest that corruption and tax evasion exists in Finland as well. Sample firms and their representatives consider corruption and tax evasion a serious problem in public construction projects.

It was found that the smallest micro firms, that usually operate as sub-contractors, report more problems connected with the use of foreign undeclared work. Micro firms also see more need to counteraction. It was concluded that this must be because of the way sub-contracting is organised in construction markets. Sub-contractor chains may have tens of firms under the prime contractor. Thus, what happens in the end of the sub-contractor chain is not necessarily known to the prime contractor nor the subscriber, such as a procurement unit of a municipality.

The question arose, what should be done to mitigate issues like tax evasion and corruption? The focus seems to be shifting from new laws against corruption and tax evasion to register-based means for checking in real time what is the present situation. It seems evident that the long sub-contracting chains, as such restrict transparency, especially in the case when sub-contracting crosses national border lines, are in cases of foreign work.

Suggestions for the future:

- Better means for checking the tendering firms' compliance with their societal obligations (like knowledge on possible tax debts and other possible misbehaviour);
- restrictions to tax avoidance schemes (utilised by big international firms and firms operating in many countries);
- restrictions to ex post invoicing beyond what was agreed at the stage of competitive tendering (and possibilities to compare ex ante and ex post costs at project level);
- better whistle-blower protection and a law-enforced reporting channel for misbehaviour;
- restrictions to so called competitive dialogue (between big firms and communal procurement units).

Why firms voted the way they did is a matter of further discussion. The data provided only shows the stances taken by the firms in the sample, not the reasons behind the stances. In the Helsinki workshop discussion, a national platform, possibly connected with *Suomen Tilaajavastuu Oy* (Finland's contractors' liability ltd) and its data delivery services, was suggested. The platform should include prime contractors and sub-contractors, subscribers from the state and municipalities, labour market sides and NGOs working for open public contracting and transparency.

The key finding of this report suggests that the size of the firm matters. The larger the firms are, the less they support restrictions to ex post invoicing, net-based contract register, restrictions to competitive dialogue and law-enforced reporting channel for whistleblowing. This may be simply because of their market position vis a vis smaller firms or sub-contractors, and must be clarified in the future work. Empowerment of the micro-firms' position in competitive tendering should be included in the national action program against tax evasion and corruption.

### **3. Belarus**

### 3.1. Construction Enterprises in Belarus

Construction is an important component of the Belarusian economy. However, in recent years, the importance of the construction sector has slightly decreased. Such trends are primarily explained by reduction in the volume of construction of housing due to soft loans, as well as slowing business activity, external factors and reduction in domestic demand.

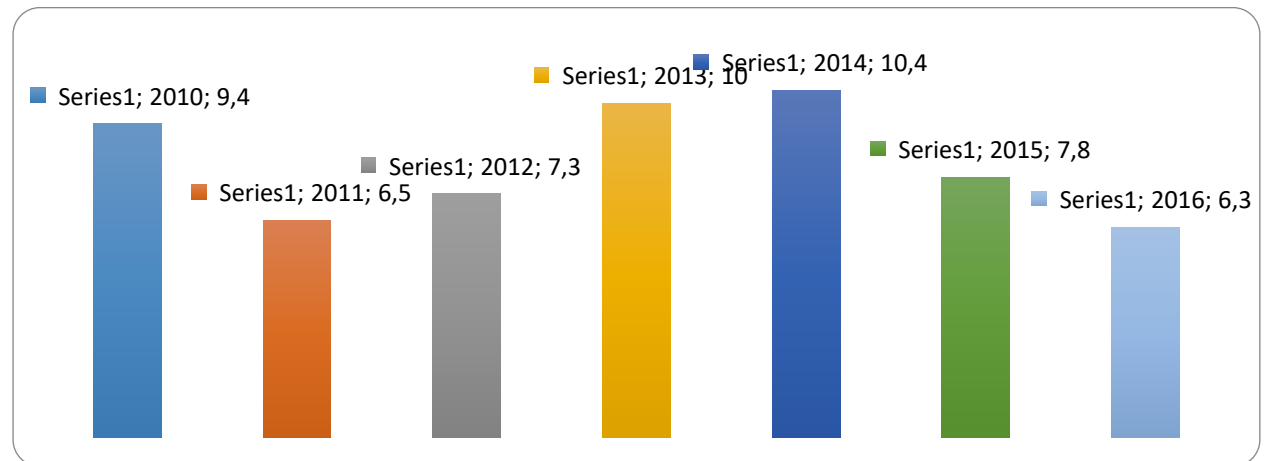


Figure 1. Construction Share of GDP

Source: National Statistical Committee of the Republic of Belarus

Most construction enterprises are privately owned. Of the 7.5 thousand construction companies that are registered, more than 90% of them are small and medium-sized businesses and have less than 100 people.

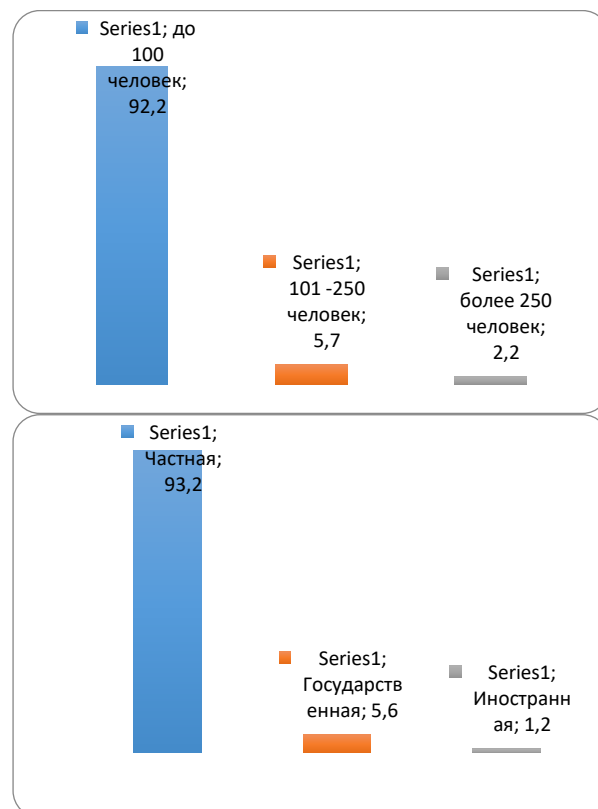


Figure 2. Structure of Construction Sector<sup>5</sup> Organizations by Number of Employees on January 1, 2016 (%)

Figure 3. Structure of Construction Sector Organizations by Ownership Form on January 1, 2016 (%)

Source: National Statistical Committee of the Republic of Belarus

Despite the decline in the pace of construction in recent years, this sector still plays a decisive role in the country's economy. A high share of private capital demonstrates the attractiveness of construction for business. At the same time, foreign investors are represented insignificantly on the construction market. It should be noted that the development of the construction sector depends on the economic and legal environment, as well as on transparency and openness of transactions. One of the problems limiting the growth of the efficiency of the construction sector of the country is the presence of elements of the shadow economy in this sector.

### **3.2. Shadow Economy**

As for the total level of shadow economy in the country, the data on this issue vary greatly. The Ministry of Taxes and Duties, as well as the National Statistical Committee of the Republic of Belarus speak of a level not exceeding 11-12% of GDP. At the same time, the National Bank's experts admit that this indicator can reach a level of 35% of GDP. The methodology of calculation and systematic is of great importance in this matter. The lack of constant monitoring of the situation and the established methodology give rise to certain ambiguity and inconsistency of the data.

Despite the lack of detailed data, experts and representatives of official authorities say that the construction sector is one of the most problematic sectors of the Belarusian economy in terms of non-transparency of transactions and corruption. Problems arise both at the stage of public procurements and in economic activity of the organizations of the construction sector themselves. A survey was conducted of the companies of the construction sector to realize the real situation in the field of shadow economy and understanding the prerequisites for its development. The basis for the survey was a method developed by Latvian experts Arnis Sauka and Talis Putnis.

Although the survey was anonymous, many respondents were cautious about some of the survey questions. Therefore, this report can be considered as one of the stages of work on assessing and monitoring the level of shadow economy in the country. It made it possible to identify the most problematic places, which made it possible to develop recommendations for reducing corruption and tax evasion in the construction sector.

### **3.3. Survey Results**

50 companies of the construction sector took part in the survey. At the same time, 20 companies were interviewed in Minsk. In each regional centre, 6 construction organizations were interviewed. Most respondents had a private form of ownership. At the same time, 28% of the companies surveyed were state ones.

In general, the selection of construction companies reflects the nationwide structure of the construction sector, depending on the size. Small and medium-sized enterprises account for almost 43% of all respondents. Another 26.5% can be attributed to microenterprises and individual entrepreneurs. At the same time, only slightly more than 30% of the companies surveyed can be considered large ones. The division of companies by size was based on the number of employees. In accordance with the Belarusian legislation, large companies include

organizations with more than 250 employees. Microenterprises have a staff of no more than 15 employees. At the same time, the number of employees in small and medium-sized businesses can vary from 16 to 250 people.

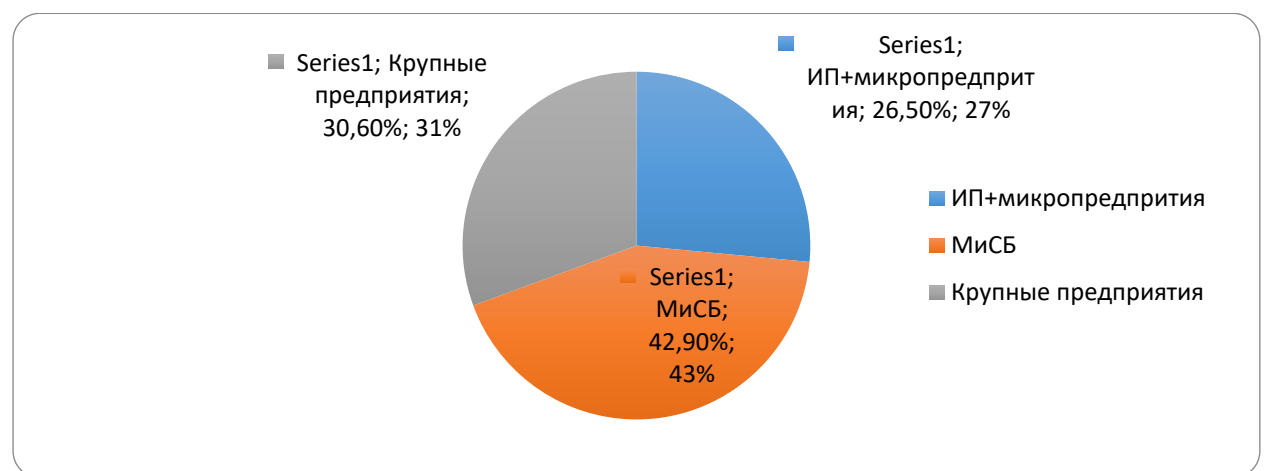


Figure 4. Distribution of the Enterprises Depending on Their Size  
Source: survey results

The survey results and the official statistics show the deterioration of economic indicators in the construction sector, which in turn often leads to the stimulation of growth in the informal sector.

This assumption is confirmed in the answers to questions related to the existence of shadow economy. More than 60% of respondents noted that some construction organizations receive a part of their income in hidden form. At the same time, 18% just refused to answer the question posed. Among the respondents, about 50% believe that construction companies do not always show the actual number of employees. A certain number of people hired can be employed unofficially.

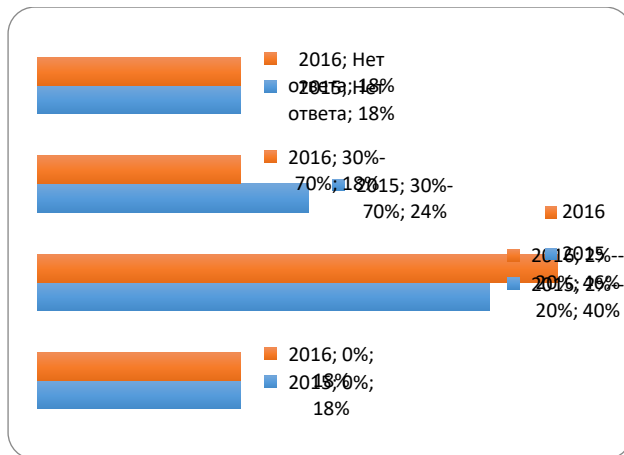


Figure 8. Estimation of the Approximate Level of Understatement of Business Income in the Construction Sector (*horizontal axis – the share of companies that agree with this assessment*)

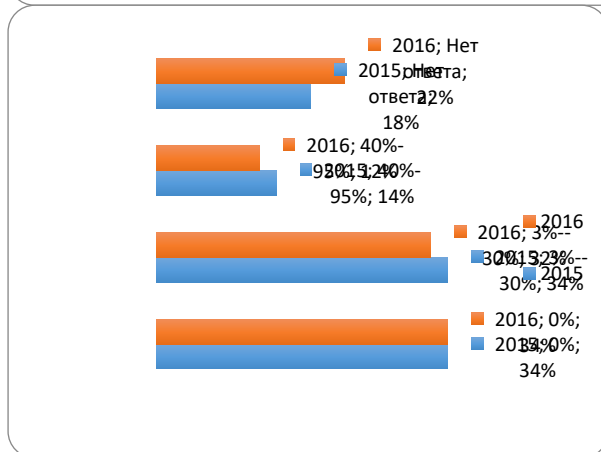


Figure 9. Estimate of the Approximate Share of Unregistered Workers among the Total Number Employed in Construction (*horizontal axis – the share of companies that agree with this assessment*)

Source: survey results

As it turned out during the survey, there is also the problem of paying envelope wages for the construction sector. Approximately 50% of the surveyed companies agreed with this statement. Among the total number of respondents, 26% believe that the share of hidden salaries both in 2015 and 2016 ranged from 21% to 50%. Part of the respondents said that unofficial payments to their employees could reach more than 50% of the total amount of payments (12% of companies in 2015 and 14% of companies in 2016 noted such a possibility). At the same time, some firms refused to answer the question posed. It is also alarming that about 60% of the companies surveyed believe that part of the industry's production is carried out by unregistered companies.

On the one hand, it means tax gap for the state, but on the other, the absence of any control over the activities of such pseudo-firms. As an example of such illegal production, the provision of repair services for apartments and private houses by officially unregistered building brigades can be mentioned.



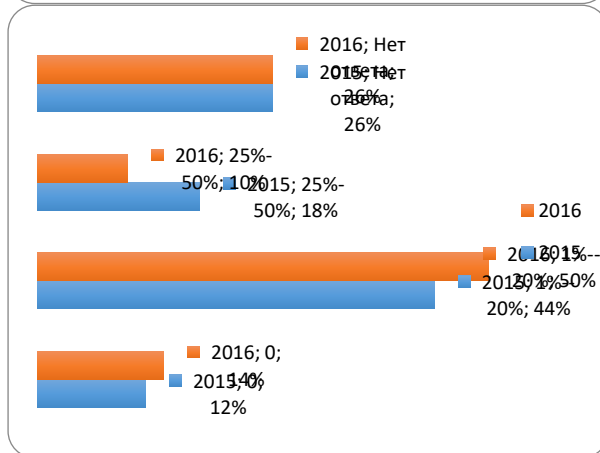
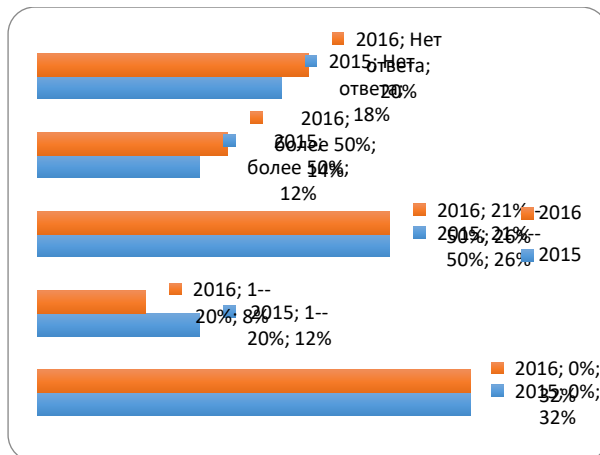


Figure 10. Estimate of the Approximate Level of Hidden Salaries in the Sector in the Total Amount (*horizontal axis – the share of companies that agree with this assessment*)

Figure 11. Estimate of the Share of Production in the Construction Sector, Carried Out by Unregistered Companies (*horizontal axis – the share of companies that agree with this assessment*)

Source: survey results

Based on the foregoing, it can be assumed that the Belarusian budget has lost some of the revenues in the form of taxes on corporate income, social contributions and payroll taxes due to under-estimation of official incomes by the construction sector companies, the total salary budget, as well as the informal hiring of some employees.

As for issues directly related to corruption schemes, not every company surveyed agreed to answer to them. While asking about the share of income that firms pay unofficially to settle various issues, more than 30% of respondents noted that its share can vary within 10%. Some companies said that this figure could reach up to 30% of profit. Approximately similar division of responses was received on the question of the share of contractual value, which is usually offered by companies in the form of unofficial payments to receive a government order. More than a quarter of the companies surveyed refused to answer these questions.

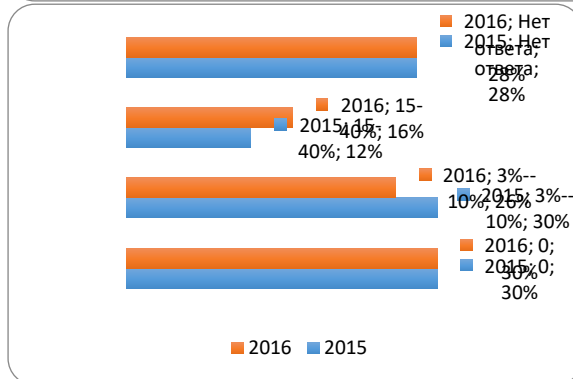
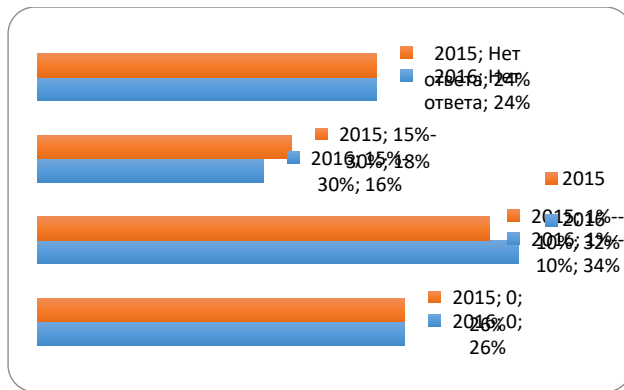


Figure 12. Estimation of the Share of Total Income Paid by Firms in the Form of Unofficial Payments the Issue Has Been Resolved in their Favour (horizontal axis – the share of companies that agree with this assessment)

Figure 13. Estimate of the Contractual Share, Paid by the Companies Illegally to Conclude Contracts with the State (horizontal axis – the share of companies that agree with this assessment)

Source: survey results

Also, enterprises were asked to agree or refuse with statements that may be obstacles to business development.

**Table 2. Possible Obstacles for Business Development in the Construction Sector**

	Strongly agree	Agree	Rather agree than disagree	Disagree	Strongly disagree
Possible obstacles	%	%	%	%	%
High level of taxes	36,0%	50,0%	14,0%	0,0%	0,0%
Frequent changes in tax policy	14,0%	46,0%	36,0%	4,0%	0,0%
Inconsistency of legislation in the sphere of business regulation	26,0%	40,0%	28,0%	6,0%	0,0%
Imperfection of business legislation due to poor quality of administration and staff shortages	16,0%	32,0%	32,0%	20,0%	0,0%

Provision of insufficient information by official authorities to small and medium-sized businesses	14,0%	32,0%	36,0%	18,0%	0,0%
Lack of certain consulting advice on marketing, financial and psychological problems	12,0%	20,0%	40,0%	26,0%	2,0%
Lack of funds for business investment	26,0%	42,0%	22,0%	8,0%	2,0%
Limited opportunities for obtaining loans	20,0%	38,0%	32,0%	8,0%	2,0%
A large number of tax audits	12,0%	30,0%	50,0%	8,0%	0,0%
Crime rate and racketeering	2,0%	8,0%	24,0%	52,0%	14,0%
Low customer payment discipline	18,4%	49,0%	24,5%	6,1%	2,0%
Unsatisfactory attitude to business by the state	20,0%	28,0%	32,0%	16,0%	4,0%
High time costs for negotiations with tax inspectors	10,0%	26,0%	40,0%	20,0%	4,0%
State corruption	18,0%	34,0%	18,0%	28,0%	2,0%
Weak interest of employees	12,0%	26,0%	22,0%	32,0%	8,0%
High level of competitiveness from the official business	10,0%	26,0%	44,0%	20,0%	0,0%
High level of competitiveness from the unofficial business	8,2%	30,6%	32,7%	22,4%	6,1%
Low level of purchasing power	44,0%	38,0%	14,0%	2,0%	2,0%
Lack of skilled workers	12,0%	28,0%	22,0%	32,0%	6,0%
Lack of qualified managers	20,0%	14,0%	38,0%	26,0%	2,0%
Inflation	22,0%	54,0%	24,0%	0,0%	0,0%
Low demand from customers	26,0%	34,0%	22,0%	16,0%	2,0%
Impossibility of growth at new markets	24,0%	28,0%	34,0%	12,0%	2,0%

Source: survey results

The mentioned statements can be divided into 3 groups. These are administrative obstacles, economic difficulties and problems associated with the functioning of shadow economy. Based on the survey results, it can be concluded that all three groups of factors have a negative impact on business development to a lesser or greater extent. Companies are primarily concerned with tax issues, unsatisfactory state-to-business relations, as well as inconsistency of legislation in business regulation. Among the economic factors, high level of inflation, credit provision problems, the inability to grow in new markets, as well as low demand from customers and buyers can be identified. As for questions about corruption, most respondents confirmed the impact of this negative factor. More than 50% of respondents

believe that corruption has a negative impact on business development and 18% of them noted that they rather agree than disagree with this statement. At the same time, 30% of respondents did not agree with this fact. An approximately similar structure of answers is observed about the assertion about the negative impact of competitiveness from the unofficial business. A positive fact is that most organizations have excluded racket as an obstacle for business development.

Thus, the problems of corruption and the existence of shadow economy worry most of the companies surveyed, the dissatisfaction with the level of corruption is more pronounced. It should be noted that inefficient state regulation, as well as economic problems indirectly create the basis for the development of shady schemes both in the economy and in the construction sector.

In the third part of the survey conducted, respondents were asked to answer questions related to the implementation of public procurements. It should be noted that this list of questions was perceived negatively and some respondents refused to answer most of the questions posed about public procurements. Of the fifty companies, 29 said they had participated in public procurement over the past two years. At the same time, 24 companies underlined that during this period they could win the tender.

Speaking about the number of organizations participating in a single tender for public procurement, the opinions of the respondents were divided as well. Of the total number of respondents, 20% of companies said that in tenders where they took part, usually up to 5 companies were declared, but 42% of construction companies mentioned that the number of competitors could vary from 6 to 20 companies.

Thus, in this sector, there is a high level of competitiveness between participants of the construction market. However, the presence of competitiveness does not always avoid corruption transactions and schemes. For example, answering the question about what percentage of tenders in public procurement your company lost due to unfair competitiveness, 40% of respondents said that such cases were. Proceeding from the fact that more than 40% of the companies surveyed have not participated in tenders at all within the last two years, it can be assumed that most of the companies that had such experience believe that they faced unfair competitiveness.

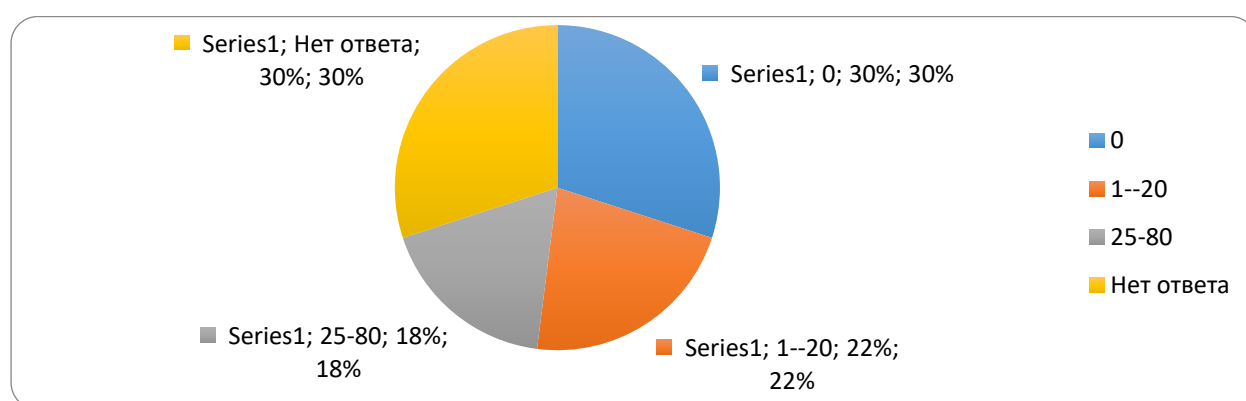


Figure 14. Answer to the question: On average, what % of the public procurement tenders your company lost due to unfair competitiveness  
Source: survey results

Based on the answers received, one of the reasons composing problems in public procurement field is the imperfection of legislation. Only 8% of organizations noted that they are satisfied with the legislation on public procurement. At the same time, 42% of respondents found it difficult to answer, which can be explained by the lack of experience of companies'

participation in such tenders. At the same time, 46% of the respondents, that is, most of those who participated in public procurement over the last two years, declared dissatisfaction with the current legislation in the field of regulation of public procurement.

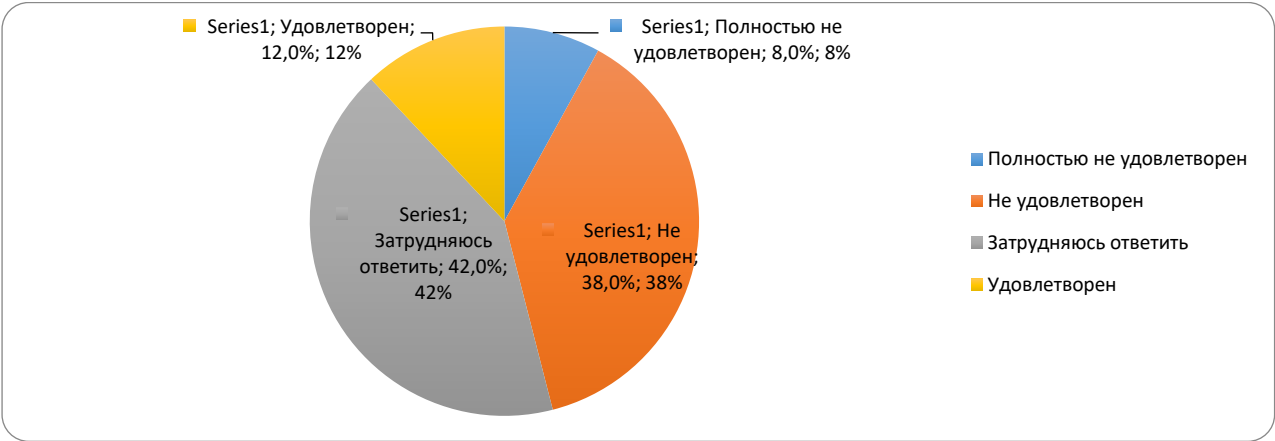


Figure 15. The Level of Satisfaction with the Quality of Legislation in the Field of Public Procurement  
Source: survey results

A special role in the research is studying the main problems that companies face when participating in public procurement tenders. As part of the survey, companies were asked to name three main problems in this field. Respondents named a wide range of problems in the survey. The majority of the answers received is presented below:

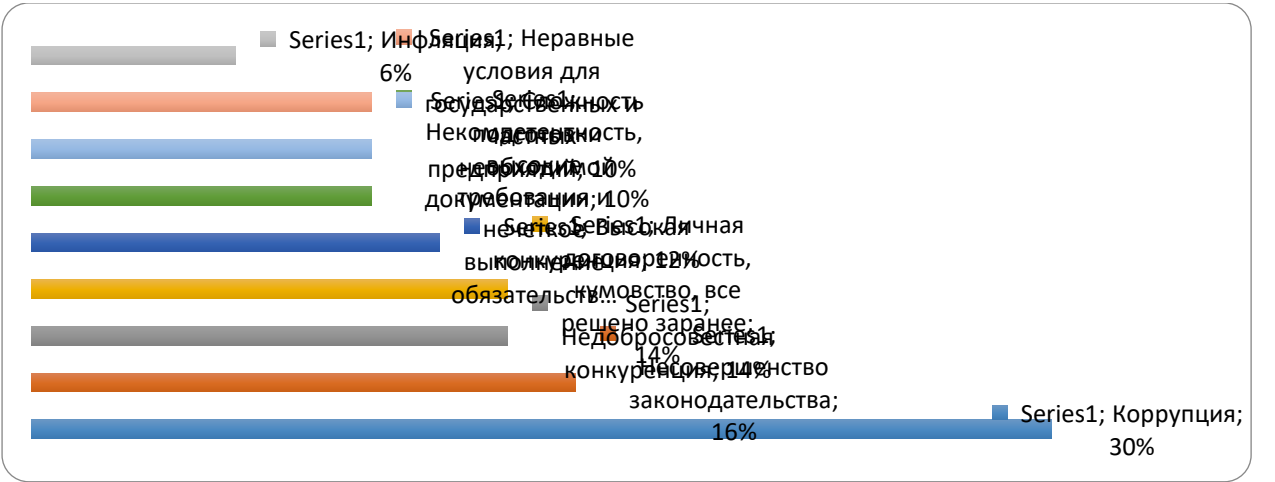


Figure 16. The Key Problems the Companies Face while Participating in the Public Procurement Tenders  
Source: survey results

As we can see on the diagram, the most topical issue in the field of public procurement is the problem of corruption. This factor was identified by 30% of respondents. In addition, a number of companies noted that unfair competition and cronyism have a negative impact on public procurement as well. Among the administrative barriers, the greatest attention is paid to the imperfection of the legislation and the complexity of the documentation. Finally, among the economic difficulties, the companies are mostly concerned of the problems working with customers and the inequality of conditions for the work of private and public companies.

### 3.4. Recommendations

Thus, based on the analysis, we can conclude that Belarusian construction companies face problems and risks in their activity. Undoubtedly, one of the important conditions that indirectly stimulate the growth of corrupt transactions and the development of shadow economy is the inconsistency and variability of legislation. Because the conditions for public procurement are constantly changing, it is very difficult for companies to strictly observe them.

In accordance with the new legislation, procurement of goods in construction can be carried out as bidding, negotiations or stock trading, but for the procurements of works and services, it is necessary to apply contractual biddings or negotiations. In the legislation on public procurement in general (except for construction), the ways of their implementation are more diverse. At the same time, contract tendering in construction is mandatory only for housing construction, construction of which fully or partially is financed from budgetary funds, if the total cost is more than 6 thousand base units<sup>6</sup>, as well as in the construction of facilities at the expense of the resources of state organizations and business entities with a share of state ownership, if the cost of construction is more than 100 thousand base units. The bidding is optional if the bidding is declared invalid because the winner is not determined or refused the contract. Also, it is possible to exclude the bidding procedure when concluding contracts between the general contractor and subcontractors.

Thus, these changes in legislation, on the one hand, simplify the procurement process and the selection of contractors and subcontractors, but on the other hand, they do not significantly improve the transparency of transactions. In addition, the adopted norms will only last two years. After this, cardinal changes can occur again. In this case, instability and the complexity of legislation is often one of the factors in the development of grey market. In this regard, it would be optimal to develop the basic legislative norms governing the construction sector and then implement only their improvement.

Based on national and international experience, it is possible to raise the problem of the relationship between the contractor and subcontractors. In Belarus, as in some other countries, these operations remain relatively non-transparent even for those projects that are implemented at the expense of budgetary funds. In conditions of a multi-level structure of interaction between subcontractors, it is very difficult to trace the effectiveness of the use of funds. In addition, the issue of transparency of the procurement process arises, if the bidding was declared invalid. In this case, it is possible to apply the negotiation procedure, which reduces the level of openness of the transaction as well.

Based on the conducted survey of companies, there is a problem of subjectivity of the procurement process. This means that the process cannot be carried out without direct interaction between the tender organizers and the contractors. Minimizing the human factor reduces the risk of abuse. This is especially true for public procurement field. Therefore, in our opinion, automation and general openness of the process are very important while implementing of public procurement bidding in the construction sector. This will reduce the level of corruption without upgrading of penalties.

A positive example in this field is the experience of Georgia. In this country, tenders are conducted based on the Agency for Public Procurement in electronic form. The organizers of the tender do not know who of the suppliers participate in, since each participant is assigned his own impersonal number. In addition, information about the tender is known in advance and is constantly available on the Internet. It is possible to get acquainted with the required documentation at any time and, thus, to prepare for the tender timely. Each participant of the tender can challenge the decisions made in an electronic dispute resolution court. After the tender, information about the winner becomes fully open. Also, you can see what payments

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<sup>6</sup> Since January 1, 2017, the amount of the base value in the Republic of Belarus is 23 Belarusian rubles or 12.5 euro in equivalent.

were made and get acquainted with the history of previous tenders on the website of public procurement.

The experience of Georgia is an example of the implementation of the policy in the field of open data. The essence of the work of this system means access of an ordinary user to any source of information, except secret one, in a machine-readable format. In Russia, for example, this process is regulated by the Law on Open Data. A permanent dialogue between the state and society on the need to open this or that information is being conducted. One of the problems that experts face in the development of this direction is the presence of errors in huge arrays of information, for example, when publishing data on public procurement, some technical errors can be made. However, based on Russian experience, it can be concluded that these inaccuracies can be corrected by developing appropriate software. Thus, the more detailed information is published on the ongoing transactions, procedures and processes, the higher the interaction between society and the state and the more difficult it is to hide the facts of abuse, including in the construction sector.

The next problem in the framework of construction is the verification of compliance of construction facilities with the norms of the Belarusian legislation. Since in this case, the facility commissioning or non-commissioning depends on the decision of specific individuals from state authorities, this is also the field for corrupt schemes. In this field, it is possible to propose the establishment of independent organizations that would be interested in the fact that the objects inspected by them meet all the regulatory requirements, being commissioned on time. They will act as advisers and give an independent assessment of compliance.

These services can be compared with independent audit firms, which help their clients to order their accounting without imposing any sanctions on them.

An important stage in reducing the level of shadow economy is the digitalization of the work of state authorities, as well as the transfer of the interaction between the state and business entities to the electronic format. So, in this case, we should consider building an e-government system. It should be noted that in Belarus, there is still no clear plan of action for the development of such a system, as well as a regulatory or legislative act that could clearly regulate this sphere. There is only the program "Electronic Belarus". If we turn to the experience of Estonia, for example, in this country practically all state procedures can be carried out on-line. The exclusion of personal contact when obtaining permits and licenses between the state institutions and legal entities and physical persons excludes the possibility of corrupt schemes.

Among other things, it is required to consider the opportunity for organizing state procedures on the blockade principle. In this case, all the participants of this network can see all the operations being performed. In addition, the committed transaction cannot be cancelled or revoked, which allows tracking the chain of actions for a procedure.

In continuation of the foregoing, we can also point out the need to create an effective electronic document flow between state authorities, customers and contractors in construction. Now, the exchange of documents in electronic format is still duplicated by documents on paper medium. Economic efficiency and more open degree of electronic documents will reduce the time and administrative costs, as well as increase the transparency of transactions.

Thus, it is necessary to think about the quickest introduction of a full-scale digitalization of document circulation and the establishment of an e-government system to reduce the level of corruption and grey schemes in construction.

Possible risks in this direction may be related to the cost of the changes being made. Belarus is several times larger than the population of each of the Baltic States, Georgia or Finland. In this regard, the restructuring of the work of state authorities will be associated with significant material costs. Therefore, to adapt the world experience to national characteristics and implementation only effective projects into operation throughout the

country, consideration should be given to partial base of the e-government system establishment, including in the field of regulation and control of the construction sector, on the basis of pilot projects. In this case, the implementation of certain actions in the field of the electrification of processes will not be accompanied by substantial capital investments. Successful projects should be further developed throughout the state, but less effective ones can be completed with minimal losses.

An important measure towards tax evasion and reducing the risk of corruption schemes in the construction sector is the development of non-cash settlements. Although companies and organizations must implement and accept non-cash payments, there remains a certain share of transactions in cash. This mainly applies to transactions between legal entities and physical persons. One of the measures to reduce the share of cash payments in settlements could be a reduction in the maximum amounts for conducting transactions in cash.

One of the most common examples of tax evasion is the execution of finishing works in private houses or apartments by unregistered construction brigades or the lack of proper registration of contracts by legally functioning construction companies. In general, this of course applies to small firms and individual entrepreneurs. Also, the problem is payment for the builder work. Currently, there is the possibility of hiring employees for minimum payment. In this case, the additional payments are in the form of unaccounted earnings.

Partial solution to this problem could be the introduction of ID cards for each employee. In this case, it would be clear how many people work and how their work is evaluated. In this case, the experience of Finland could be useful for Belarus. In this country, every hired worker of a construction company and employer must have his own ID card on which the surname and name of the employee, the taxpayer's number and the name of the employer are indicated. Tax authorities can check on-line the information on the ID card. The reliability of the information indicated on the card is checked by special labour inspectors. Sometimes checks are also conducted with the participation of police and tax authorities. In case of revealed violations personal responsibility is imposed.

The introduction of cards made it possible to identify all workers and employers employed in the construction of a facility. At present, it is not difficult to obtain information about all workers and companies employed in construction. In addition, the openness of the taxpayer's number allows monitoring the timely payment of income tax.

An important factor in conducting tenders for public procurement in construction sector is the price. In our opinion, it is not always justifiable to assign crucial importance to this criterion. Some construction organizations find opportunities to use correction factors for the price (for example, when hiring disabled workers) and unreasonably win the tender. In this case, in addition to the price, it is advisable to consider, as the key criteria, such indicators as the performance of the tender object and its financial returns. In addition, it is possible to revise the list of entities that have benefits when participating in tenders.

Finally, as the practice of Georgia shows, the level of corruption can be reduced, providing employees of state bodies with fair wages for their labour. The growth of people's material security increases the value of their employment in the public sector. At the same time, material interest can be created not only by raising the level of wages, but also by offering a social package. The formation of effective control and punishment system for unlawful actions is an important, but not the only element in the fight against corruption, including the construction sector. In this respect, the openness and transparency of the work of state authorities, as well as the possibility of permanent dialogue between public authorities and the public is of great importance.

### **3.5. Conclusions**



Based on the analysis, we can identify the main factors contributing to the development of corruption and tax evasion in the construction sector of the Republic of Belarus:

1. The inconsistency and variability of the legislation, the complexity of processing the necessary documentation for participation in tenders for public procurement. Until 2017, the implementation of procurement, fully or partly carried out at the expense of budgetary funds, funds of state extra-budgetary funds and procurements from non-state sources was regulated by various legislative acts. Since this year, all procurements in the construction sector should be conducted in accordance with Presidential Decree of the Republic of Belarus No. 380 "On Procurement of Goods (Work, Services) during Construction".
2. The problem of the subjectivity of the procurement process. Procurements in the construction sector cannot be carried out without personal interaction between the organizers of the tender and contractors.
3. A large number of inspections of the compliance of the construction facilities put into operation with the norms of the Belarusian legislation.
4. A large number of subcontract organizations, which can work within the framework of a single project, create conditions for reducing the transparency of the construction sector.
5. Lack of standardized contracts in the conclusion of agreements in construction.
6. Duplication of paper and electronic document flow.
7. Competitiveness from illegal business. Currently, there is the possibility of hiring employees for minimum payment. In this case, the additional payments are in the form of unaccounted earnings. As an example, the execution of finishing works in private houses or apartments by unregistered construction brigades or the lack of proper registration of contracts by legally functioning construction companies can be mentioned.
8. Not always equal conditions for public and private enterprises involved in public procurement, as well as the availability of benefits for certain categories of organizations.

Based on the existing problems and taking into account the world experience, it is possible to propose the following recommendations for combating corruption and tax evasion in the construction sector of the Republic of Belarus:

1. Carry out work on simplification of the national legislation in the construction sector and ensure its stability.
2. Minimize the human factor in the implementation of public procurement by automating the process, fully transferring it into electronic form and ensuring the transparency of public procurement data.
3. The current control for the compliance with the national legislation while renting out a real estate may be entrusted to independent organizations that will act as consultants and give an independent conformity assessment.
4. Accelerate the process of building the E-Government system by digitizing the process of work of state structures and transferring to the electronic format the interaction of the state with the population and business entities.
5. To minimize unnecessary costs in improving regulation and introducing innovative control methods in the construction sector, consideration should be given to launching pilot projects. Their success will determine the need to introduce new solutions throughout the country.

6. Reduce the opportunities for payment for services and goods in construction in cash (for example, under contracts between the developer and physical persons) by reducing the maximum amounts for making transactions in cash.

7. Introduce identification cards for each employee and employer.

8. Attract high-quality and motivated professionals to the public sector, including by raising the salaries of public officers.

9. The price does not always have to be a decisive factor when conducting tenders in public procurement. It is necessary to increase the dependence of the results of the tender on such factors as the technological (constructive) complexity of the facility and its expected financial returns.

10. Conduct constant monitoring of the level of the shadow economy in the context of industries. It is possible to take a technique of calculation of the shadow economy index as a basis, which is defined in three Baltic States.

### **Final Conclusions**

The three partner states have slightly different shadow economy and corruption situations. In Finland, that often ranks as one of the most transparent countries in the world, it is uncommon to talk about corruption and shadow economy. In Latvia, there have been a lot of discussions about how to solve the problems associated with shadow economy and corruption, and in Belarus the topic is not widely discussed. Nonetheless, there were three overlapping conclusions drawn in the three partner states:

1. The effect of long construction contracting chains on shadow economy and corruption;
2. The role of small and medium sized businesses in the fight against shadow economy and corruption;
3. The need for enhanced whistle blowing mechanisms and protection.

- **Long construction contracting chains**

As the results from the three partner states indicate, and this is probably true for most states, in large scale project construction it is accepted to have long contracting chains with multiple prime contractors and sub-contractors. Often it is difficult to monitor tax compliance towards the end of these chains, therefore it is more likely that the small sub-contractors that are hired will avoid tax. This is also linked to the second conclusion about how most construction companies are small or medium sized. It is difficult to eliminate long contracting chains in construction because a lot of the works done are very specific. However, a mechanism should be introduced whereby tax compliance towards the end of these chains is ensured.

One of the recommendations drawn during the research that could be applicable to all three partner states is that the municipality contractor, when evaluating a procurement candidate, should be made responsible to also check the sub-contractors', that a prime contractor plans to work with, tax and social security payments in the past 12 months.

Currently municipality contractors are only liable to check whether prime contractors have any tax debts, and if they do, they are immediately excluded from participating in the tender. The same rule should also apply to the hired sub-contractors. The prime contractor should inform the municipality about the sub-contractors that it plans to work with, who submit their

tax receipts as part of the procurement application process, and if they have any unpaid tax, they would be removed from the tender.

- **Small construction enterprises**

The three partner states found that most construction enterprises in their respective countries were small, with 0 – 9 employees. The research also found that these are the companies that find the greatest problems in the municipal procurement process, suffer more from unfair treatment, unfair competition and shadow activity. Thus, the research was mostly done with a focus on these small companies and the recommendations were developed in a way not to hinder the competition of the smaller companies.

The small enterprises form the backbone of the construction sector, because they mostly operate as sub-contractors and are the ones doing the construction works. Therefore, when working on improving public procurement legislation or procedures, these smaller companies should not be forgotten. For example, in the case of Latvia this means that when the construction enterprise grades or classification are introduced, this should be done in a way whereby small enterprises are not excluded from taking part in large scale construction project tenders.

- **Improved whistle blowing mechanisms**

The three partner states had a focus in their research on promoting whistle blowing and whistle blower protection. In Latvia, Finland and Belarus the current whistle blower legislation is incomplete, and clear channels for whistle blowing should be promoted. In addition, whistle blower protection should be improved to ensure that once violations have been reported, the informants cannot be mistreated or accused of disloyalty.

This project did allow for one whistle blowing case to be exposed in Latvia, in the procurement for the construction of a stadium in Jēkabpils municipality. This case clearly indicated the role that NGOs, such as TI Latvia, should play to advance whistle blowing as a tool for enhanced transparency in the public procurement process.

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