



Anastasiya Luzgina, BEROC
November 2017

Avoiding Corruption and Tax Evasion in Belarus' Construction Sector

This brief summarizes our research on the problem of corruption and tax evasion in the construction sector in Belarus. We conducted a survey of construction companies, asking them to estimate the extent of different dimensions of tax evasion and corruption within the sector. The results show the most problematic directions in the sphere. Based on international experiences, we develop recommendations of how to reduce corruption and tax evasion in construction of Belarus.



Shadow economy and the construction sector

The problem of a shadow economy is real for many countries in the world. Many countries try to minimize the level of this illegal activity. But it is very difficult to liquidate tax evasion or envelope wages fully.

In Belarus there is a lot of discussion about corruption and tax evasion limitation. The country ranked 79th in the Corruption Perception Index 2016. The situation in Belarus is much better than in Russia or Kazakhstan, but worse than in Sweden, Finland and Switzerland.

There is lack of systematically updated knowledge about the situation with corruption and tax evasion in the different economic spheres of Belarus. At the same time, there are sectors, which are more prone to develop a shadow economy. One of them is the construction sector. Multilevel chains of relations between contractors and subcontractors, numerous suppliers, and complicated procedures for facility acceptance create possibilities for illegal schemes.

Construction plays an important role in national production. In 2016, the construction sector corresponded to more than 6% of Belarusian GDP. In 2014, this indicator was above 10%. The decline can be explained by a reduction of preferential lending in housing construction and a recession in the economy. Despite the reduction in the share of GDP, around 8% of the total labor force works in construction. More than 90% of the legal entities in the sphere are presented by privately owned enterprises [8].

Taking into account the importance of construction it is necessary to emphasize that reducing the size of the shadow economy could create a better business environment, reduce companies' expenditures for resolving issues in informal ways, and increase budgetary revenues.

In this brief we present a short summary of our research "Problems of corruption and tax evasion in construction sector in Belarus", which is forthcoming in the *International Journal Entrepreneurship and Sustainability Issues*. The project was made in the framework of the project "Corporate engagement in fighting corruption and tax evasion", financed by the Nordic Council of Ministries.

Method

In order to understand the main issues and challenges in construction sector, we surveyed 50 Belarusian construction companies. We took 20 companies from Minsk and its surrounding region, and 6 organizations from each Belarusian region (Brest, Grodno, Vitebsk, Gomel, and Mogilev). The survey was based on the method used in Putnins and Sauka (2016). This method includes a questionnaire, which helps understanding the actual situation with the shadow economy in the sector. The questions of the survey were divided into three parts.

The first part included neutral questions about economic characteristics of the company, such as number of employees, profit level, the year of establishment, wage levels, and form of ownership.

The second part include more sensitive questions, but which can help us understanding the most problematic issues concerning to corruption and tax evasion. These questions concern such indicators as the level of underreported business income, the degree of underreported number of employees, the percentage of revenue that firms pay in unofficial payments to 'get things done', and main barriers to business development. In order to make the answers easier for participants, all the questions deal with the situation in the sector as a whole, and not the company in particular.

The third part of questions concerns the situation in public procurement, and includes the perception of main problems in the sphere.

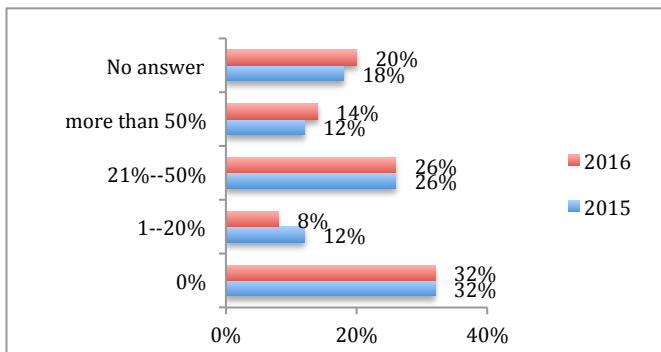


Survey results

The first part of the survey shows that there has been a decline in many of the economic indicators during the last two years. This may be one factor stimulating the sector’s development of informal activities. Indeed the results of the second part of survey demonstrate that level of shadow economy has significant dimensions. More than 60% of the respondents agree that some firms in the sector received hidden income. More than 50% of the interviewed companies believe that some organizations in the construction sector hire part of their employees unofficially. Wages in “envelopes” is also a problem for the construction companies.

Unregistered firms are a big threat to having a well-developed construction sector. More than 60% of the interviewed companies agree with the existence of unregistered companies. Such non-official organizations create unfair competition in the sector and decrease the level of budget revenues. Many of the unregistered companies work in the sphere of home improvements and renovations.

Figure 1. Estimation of the approximate level of hidden salaries (“wages in the envelopes”) in construction industry

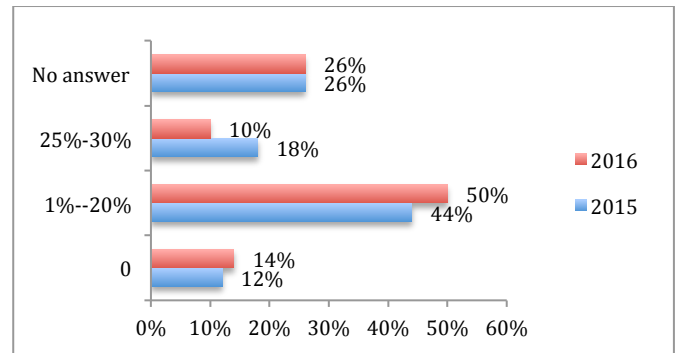


Notes: X-axis is the percentage of respondents that agree with the statement. Source: Results of the survey

The survey results allow us to conclude that the state budget loses part of its corporate income taxes, taxes on wages and social contributions due to the existence of hidden incomes, wages in envelopes, and unregistered companies and employees.

The last, but not the least, question in the second part of the survey was about main obstacles and barriers for operating in the construction sphere. Most of the respondents underlined three groups of barriers. One of them is the administrative challenge, including high level of taxation, inconsequent business legislation, and attitude of the government towards business in general. The second barrier includes economic problems such as lack of funds for business investments, payment behavior of clients, low product or service demand from customers, low access to credits, and inflation. The third group of problems in the construction sector is related to the shadow economy. A large part of the enterprises experiences a problem of high competition from illegal business and corruption. At the same time, a positive thing is that the majority of respondents does not consider crime and racketeering as a threat for the sector.

Figure 2. Estimation of approximate share of unregistered firms production in the total output in construction industry



Notes: The X-axis is the percentage of respondents that agree with the statement. Source: Results of the survey

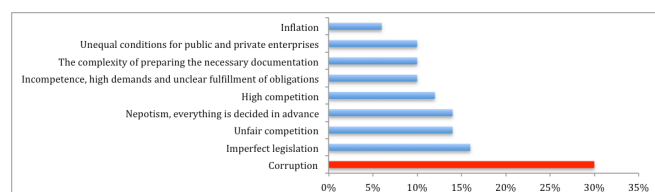
In the third part of the survey, companies were asked about their participation in public procurement tenders. About 42% of all respondents did not have this experience over the past two years. One of the questions was about competition among construction companies. About 40% of all respondents underlined that they have lost at least one public tender because of unfair competition. Given that only 58% of the companies participated in tenders, we can



conclude that unfair competition is a widespread problem for the majority of public procurement auction participants. Imperfect legislation is another problem for the companies. 46% of all respondents believe that the quality of legislation in the sphere is unsatisfactory. Only 12% of the companies did not see any problems in the national legislation.

At the end of the interview, companies were asked to list three main problems in the sphere of public procurement. The answers are shown in Figure 3.

Figure 3. Main problems that companies face when participating in public procurement tenders



Notes: The X-axis is the percentage of respondents that agree with the statement. Source: Results of the survey

The most common answer was corruption. Unfair competition and nepotism were also quite common problems in the public procurement sphere. Among administrative barriers, companies emphasized the complexity of documentation preparation and imperfect legislation. Important economic problems were inflation and unequal conditions for public and private enterprises.

International experiences and recommendations in fighting corruption and tax evasion in the construction sector

Corruption and tax evasion can be stimulated by different factors. One of the main preconditions of the shadow economy in the Belarusian construction sector is inconsistent and frequently changing legislation. For example, public procurements are regulated by the Presidential

Decree (Ukaz) on procurement of goods (works, services) in construction. However, this regulation document expires at the end of 2018. Before 2017, such operations were regulated by several legislative acts. Developing understandable and sustainable legislation, which creates clear rules for participants of the market, is very important to increase transparency and openness of the market [11; 12; 13; 15; 18].

Another problem concerns the relations of contractors and sub-contractors. In many cases negotiations between parties are closed and non-transparent. So, it is very difficult to estimate the effectiveness of costs and proper use of funds.

Modern E-Government system adoption can support increased transparency between contractors and sub-contractors, as well as improve the quality of state services. One of the directions in this sphere is the transition towards full electronic document management. [3; 4; 6].

Another risk is related to public procurement procedure. Direct communications between public tender participants and organizers create possibilities for unfair competition. There is substantial international evidence showing that full digitalization of the process would improve the transparency of the public procurement procedure [3; 4; 21]. For example, good reference points for implementation of such digitalization can be the Georgian or Ukrainian experiences of electronic tenders. These two countries have relatively similar institutional environment and heritage as Belarus.

The problem of tax evasion is often related with payments in cash. Such transactions are less transparent and visible for authorities. According to national legislation operations between legal entities should be in cashless form. But there are exceptions to the rule [20]. In this regards the level of tax evasion would be decreased if payments in cash will be minimized.

Another concern is the efficiency of the public procurement procedures. During public



procurement auctions in construction, price plays the most important role. The share of "Bid Price" criterion in total volume of all criteria can be up to 50%. The project with the lowest price has the best chance to win the tender. This is not always reasonable. Moreover, some companies hire disabled people that allow them to obtain preferential treatment in the public procurement procedure – for example, apply special correction indicators to the final price. In many cases it is better to install more expensive but high efficiency (more qualitative or ecological) equipment instead of buying cheap but low quality ones. Of course, even in EU legislation, the cost or price of projects is a very important criterion. But then it is often defined as a price-quality ratio. In this regards, the quality of the project can be estimated from the environmental, qualitative or social side [12; 19].

One more issue according to survey results is the problem of unregistered labor force in construction. It can be partly resolved by ID card implementation for all workers and employers in construction sector. In Finland, for example, all workers in construction must have such cards during workdays. Tax authorities can check the availability of the cards at any time [17].

Conclusion

Our survey of Belarusian construction companies confirmed wide exposure of the sector to tax evasion and corruption. The majority of the respondents agreed that some companies hire unregistered workers, pay wages in envelopes, or have hidden income. The most common answer to the main problems in the public procurement sphere was corruption. Based on international experience and national peculiarities, it is advisable to propose the following measures to reduce corruption and tax evasion in construction sector:

1. Adoption of sustainable legislation.
2. E-Government system development.

3. Modernization of the electronic tender system to require no direct contacts between organizers and tender participants.

4. Reduction of the possibilities of making payments in cash.

5. Implementation of a price-quality ratio as one of the main criteria for choosing the winner of tenders.

6. Introduction of ID cards for all employees and employers in the construction sector.

These and other measures are likely to significantly improve the business environment in the construction sector.

References

- [1] Anderson, E. 2013. Municipal "Best Practices": Preventing Fraud, Bribery and Corruption, International Centre for Criminal Law Reform and Criminal Justice Policy. Available on the Internet: <http://icclr.law.ubc.ca/sites/icclr.law.ubc.ca/files/publications/pdfs/Municipal%20Best%20Practices%20-%20Preventing%20Fraud%2C%20Bribery%20and%20Corruption%20FINAL.pdf>.
- [2] Fazekas, M., Toth, I.J., King, L.P. 2013. Corruption manual for beginners: "Corruption techniques" in public procurement with examples from Hungary, Working Paper series: CRCB-WP/2013:01 Version 2.0, Budapest, Hungary. Available on the Internet: http://www.crcb.eu/wp-content/uploads/2013/12/Fazekas-Toth-King_Corruption-manual-for-beginners_v2_2013.pdf.
- [3] Krasny, A. 2014. Georgia E-Government. Available on the Internet: <https://www2.deloitte.com/content/dam/Deloitte/ua/Documents/public-sector/e-government/Electronic%20government%20of%20Georgia.pdf>.
- [4] Luzgina, A. International experience of the e-Government System development/ A. Luzgina //Journal of the Belarusian State University. Economics. – Minsk, 2017. – P.76-83.
- [5] Luzgina, A., Laukkanen E., Larjavaara I., Viavode I., Volberts J. ,Corporate engagement in fighting corruption and tax evasion in construction sector", forthcoming in "Entrepreneurship and sustainability issues"
- [6] Naumov, A. 2014. Georgia E-experience for Belarus. Available on the Internet: <http://e-gov.by/best-practices/elektronnyj-opyt-gruzii-dlya-belarusi>.



- [7] Official website of Transparency International. Available on the Internet: <https://www.transparency.org/>.
- [8] Official website of Belarusian National Statistical Committee. Available on the Internet: <http://www.belstat.gov.by>.
- [9] Official website of the European Commission. Available on the Internet: https://ec.europa.eu/commission/index_en.
- [10] On procurements of goods (works, services) [Electronic source] // Decree of the President of the Republic of Belarus/ 20.10.2016 # 380. Rus.: О закупках товаров (работ, услуг) при строительстве, Указ Президента Республики Беларусь от 20.10.2016, №380. - Mode of access: <http://www.pravo.by/document/?guid=3871&p0=P31600380>.
- [11] On public procurements of goods [Electronic source] // Law of the Republic of Belarus/ 13.07.2012, # 419-3. Rus.: О государственных закупках товаров, работ услуг Закон Республики Беларусь от 13 июля 2012 г. № 419-3. - Mode of access: <http://www.pravo.by/document/?guid=3871&p0=h11200419&p1=2>.
- [12] On organization and conduct of the procurement of goods (works, services) procedures and settlements between customer and contractor in facilities construction [Electronic source] // Resolution of the Council of Ministers of the Republic of Belarus / 31.12.2014, # 88.: Rus: Об организации и проведении процедур закупок товаров (работ, услуг) и расчетах между заказчиком и подрядчиком при строительстве объектов, Постановление Совета Министров Республики Беларусь №88 от 31.12.2014. - Mode of access: <http://www.pravo.by/document/?guid=3871&p0=C2140088>.
- [13] Putnis, J.T., Sauka, A. 2016. Shadow economy index for the Baltic countries 2009 – 2016. The Center for Sustainable Business at SSE Riga. - 47 p.
- [14] Pelipas, I., Tochitskaya, I. 2016. Problems of corruption in the assessments of small and medium enterprises. Available on the Internet:
- [15] Procurement in construction, what has been changed since January 1, 2017. Available on the Internet: http://www.mas.by/ru/news_ru/view/zakupki-v-stroitelstve-cto-izmenilos-s-1-janvarja-2017-goda-852/
- [16] Preventing corruption in public procurements. 2016. OECD Publishing. Available on the Internet: <http://www.oecd.org/gov/ethics/Corruption-in-Public-Procurement-Brochure.pdf>.
- [17] Briganti, F., Machalska, M., Steinmeyer, Heinz-Dietrich, Buelen, W. 2015. Social Identity cards in the European construction industry, edited by Buelen W. Available on the Internet: <http://www.efbww.org/pdfs/EFBWW-FIEC%20report%20on%20social%20ID%20cards%20in%20the%20construction%20industry.pdf>.
- [18] Zaiats, D. 2015. The authorities will strengthen the fight against the shadow economy [Electronic resource]. - Mode of access: <https://news.tut.by/economics/465337.html>.
- [19] On public procurement and repealing Directive 2004/18/EC [Electronic resource]// Directive 2014/24/EU of the European Parliament and of the Council / 26 February 2014. - Mode of access: <https://news.tut.by/economics/465337.html>.
- [20] On making amendments and alterations to Instruction on the procedure of conducting cash transactions and the procedure of the cash settlement in Belarusian rubles on the territory of the Republic of Belarus // Resolution of the National Bank of the Republic of Belarus / 31.03.2014. #199. Rus: - О внесении дополнений и изменений в Инструкцию о порядке ведения кассовых операций и порядке расчетов наличными денежными средствами в белорусских рублях на территории Республики Беларусь. Mode of access: <http://pravo.by/document/?guid=12551&p0=B21428983&p1=1&p5=0>.
- [21] Prozorro [Electronic source]. – Mode of access: <https://prozorro.gov.ua/en>.





Anastasiya Luzgina

Belarusian Economic Research and Outreach
Center (BEROC)

luzgina@beroc.by

www.eng.beroc.by

Anastasiya Luzgina is Researcher at BEROC. She received her Bachelor's degree from Belarusian State Economic University in 2001. She has a Ph.D. in Economics from Belarusian State University. Luzgina received the academic title of docent in 2016.

freepolicybriefs.com

The Forum for Research on Eastern Europe and Emerging Economies is a network of academic experts on economic issues in Eastern Europe and the former Soviet Union at BEROC (Minsk), BICEPS (Riga), CEFIR (Moscow), CenEA (Szczecin), KEI (Kiev) and SITE (Stockholm). The weekly FREE Network Policy Brief Series provides research-based analyses of economic policy issues relevant to Eastern Europe and emerging markets.

