

**SUSTAINABLE POLICY IMPACT  
THROUGH  
STATE-OF-THE-ART RESEARCH  
AND ADVOCACY**

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The Southeast Europe Leadership for Development and Integrity (SELDI) network is the largest indigenous anti-corruption and good governance coalition in the region of Southeast Europe (SEE), created by CSOs from Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo\*, The Former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey (also including partners from Moldova and Romania). SELDI pools resources and expertise from a total of 42 CSO organisations (both members and associates) to become a representative group of the regional CSO community on anti-corruption and good governance. SELDI contributes to a dynamic civil society in the region, capable of participating in public debate and influencing policy and decision-making process in the area of anti-corruption and good governance.

The publication provides a review of the architecture and key results from the main methodological instruments, applied by the Southeast Europe Leadership for Development and Integrity network in Southeast Europe. SELDI's advocacy impact, channelled through local ownership and strong public-private partnership foundation, is built upon state-of-the-art corruption and hidden economy monitoring tools. SELDI's constant drive for social innovation has pushed its members to also devise new instruments, particularly in response to recently emerged, complex and systemic corruption practices in the region. More specifically, the network has developed, and plans to apply comprehensively across the SEE, instruments to assess the state capture phenomenon and identify concrete anti-corruption implementation gaps on institutional level.



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# I. SETTING THE STANDARD FOR STATE-OF-THE-ART RESEARCH AND ADVOCACY EFFECTIVE PUBLIC-PRIVATE PARTNERSHIP

The Southeast Europe Leadership for Development and Integrity (SELDI) network implements a set of social innovation instruments in Southeast Europe (SEE). SELDI's drive to advocate knowledge-based anticorruption policies has expanded the network's presence and positioned it as a pillar of civil society action against corruption in SEE. This process began in back in 2000, as SELDI gradually developed civil society driven public-private cooperation model for the assessment of both corruption and anticorruption, tailored to the social and institutional environment of the region. Such a combined evaluation approach allows policy makers and civil society to identify the correspondence – or, more often the absence of it – between anticorruption intentions and outcomes in terms of reduced corruption.

SELDI was reinvigorated in 2012 and has grown to become the largest indigenous anticorruption coalition in the Western Balkans (WB), with more than 200 staff through its members, and established unparalleled working relations to national governments and international anticorruption organizations, allowing impact and positive spill-overs inside and outside the region. SELDI's advocacy strategy proves very effective as it combines quality research with strong public-private partnerships to produce comprehensive products: Regional Anti-Corruption Reports (RARs) with tailored policy recommendations;<sup>1</sup> and Policy Forums, organised in public-private partnership mode with European, regional and national government institutions to endorse the network's analyses and establish synergies with similar initiatives in the public and private sectors.

In its core, SELDI is a knowledge-driven coalition, focused on constantly generating tangible policy impact. This was made possible through the regular application of state-of-the-art monitoring methodologies for monitoring corruption (the *Corruption Monitoring System*) and hidden economy (the *Hidden Economy Index*) dynamics. SELDI's drive for social innovation has pushed its members to also devise new instruments, in attempt to address recently emerged, complex and systemic corruption practices in the region. More specifically, the network has developed instruments to assess the state capture phenomenon (MACPI *State Capture*) and identify concrete anti-corruption implementation gaps on institutional level (MACPI).

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<sup>1</sup> SELDI, 2014, Anti-Corruption Reloaded: Assessment of Southeast Europe, <http://seldi.net/publications/publications/anti-corruption-reloaded-assessment-of-southeast-europe/> and SELDI, 2016, Shadow Power: Assessment of Corruption and Hidden Economy in Southeast Europe, <http://seldi.net/publications/publications/shadow-power-assessment-of-corruption-and-hidden-economy-in-southeast-europe/>



**SELDI key policy recommendations for the SEE region:**

- **Effective prosecution of high-level corruption** is the only way to send a strong and immediate message that corruption would not be tolerated. Bringing crooked politicians to justice has proven very effective in strengthening anticorruption measures in Croatia and Slovenia, for example. Success in this direction would require also international support, including the involvement of EU member states law enforcement.
- An **independent corruption and anti-corruption monitoring mechanism** needs to be introduced on national and regional level in order to provide robust data and analysis and integrate both corruption diagnostics and anticorruption policy evaluation. The mechanism should be implemented through national and/or regional civil society organisations and networks, and should be independent of direct national government funding. It should serve as a vehicle for opening up administrative data and enhancing public access to information.
- **Critical sectors with high corruption and state-capture risks**, such as the energy sector, should be addressed with priority. The other priority measures include increasing competition in public procurement; improving the corporate governance of state owned enterprises; transparent management of large-scale investment projects; enhancing the accountability and independence of energy regulatory authorities.
- **International partners**, and primarily the European Commission, should **engage directly civil society organisations in the region**. This is essential for several reasons: a) for internationally supported reforms to become sustainable, they need to gain wider public acceptance and CSOs are indispensable in this process; b) involvement of CSOs is a way of guaranteeing that the accountability of governments to donors and international organisations does not take precedence over accountability to local constituencies; c) the effectiveness of international assistance would be enhanced if it utilises the monitoring and analytical skills and advocacy capabilities of CSOs.

## II. ADDRESSING THE SYSTEMATIC EFFECTS OF CORRUPTION: THE STATE CAPTURE PHENOMENON

The quest for good governance to become the rule rather than the exception in the SEE region continues. As the corruption phenomenon constantly evolves and its forms and practices shift, the SELDI members are deepening both their involvement and advocacy efforts to tackle new and more complex corruption practices. In many South European states the corruption phenomenon reaches beyond individual acts and administrative and/or petty offences (e.g. bribery) to negatively impact the quality of public governance as a whole. These systematic effects often remain a hidden, closely linked to governance mechanisms. In such an environment, systematic corruption reaches top level officials in the executive, judiciary and the legislative. These dynamics often result in the emergence of the state capture phenomenon.

State capture, despite its frequent use does not have a single definition because it is used in different contexts and covers various types of phenomena. In some cases, it is used as a term based on a definition, but could also acquire various other uses based on the common meanings of “capture.” This gives way to a wide array of applications which creates confusion. For example, state capture is used when referring to the establishment of control by one state over the resources of another state,<sup>2</sup> for the capture of the institutional capacity of the executive (or other powers) by political parties aimed at extracting corruption rents,<sup>3</sup> or when business sector entities seek to shape (by paying bribes to state officials) the “rules of the game” (legislation) in order to obtain privileged status or preferential treatment.<sup>4</sup>

The common characteristic of all forms of use of the state capture concept is that they refer to a deviant form of relations between several types of collective actors: the state (perceived as a summary label for the executive, the legislative and the judiciary), the business sector (specific business sector entities) and the political class (political networks, parties, etc.). Using the term **deviant** suggests that state capture is considered a deviation from the form of relations between

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<sup>2</sup> Brooks, G., Walsh, D., Lewis, C., & Kim, H., 2013, Preventing corruption. Investigation, enforcement, and governance. London and New York: Palgrave Macmillan., p. 115-123.

<sup>3</sup> Innes, A., 2014, The Political Economy of State Capture in Central Europe. *Journal of Common Market Studies*, 52(1), 88-104.

<sup>4</sup> Heliman, J., Jones, G., Kaufmann, D., & Schankerman, M., 2000, Measuring Governance Corruption, and State Capture. How Firms and Bureaucrats Shape the Business Environment in Transition Economies. Policy Research Working Paper No. 2312, (April), 1-51.; Hellman, J., & Schankerman, M., 2000, Intervention, Corruption and Capture: The Nexus between Enterprises and the State. *The Economics of Transition*, 8(3), 545-576.; Hellman, J., Jones, G., & Kaufmann, D., 2000, Seize the State, Seize the Day: An Empirical Analysis of State Capture and Corruption in Transition Economies. World Bank Policy Research Working Paper, (2444), 1-41.; Hellman, J., & Kaufmann, D., 2001, Confronting the Challenges of State Capture in Transition Economies. *Finance & Development*, 38(3).

these actors which is considered a norm or an ideal. In this sense, the state capture concept is purely normative: it is used to analyse deviations from a certain socioeconomic model which are generated by corruption relationships. This automatically implies that both the mechanisms and the results of state capture in different societies and states would diverge.

### a. The state capture concept

The state capture concept is most suitable for analysis of societies in which the commonly accepted normative ideal is that of a liberal social order in combination with a neo-liberal economic model. These ideal types (in the Weberian sense) presuppose specific norms for the legitimate relationships between the interests of the main actors/participants in the state capture process (state, business sector and political class): the economy has a non-monopolist structure, the state bureaucracy is neutral to the different interests in society; the political class (through parties), on the one hand, represents interests the legitimacy of which is established through general elections, and, on the other, interests which do not undermine the structure of the economy or the neutrality of the bureaucracy. The deviations from this model can vary but – when based on corruption – they constitute state capture in its various forms, depending on the active side in this process (the so called **captors**). To a large degree, the **forms and type of state capture are determined by those captors and their relative power**. Evidence from various countries shows that the capture process could be initiated by both non-state actors (e.g. business entities) and by the state – when public bodies capture businesses on behalf of officials, political groups, networks or parties. Occasionally, both processes run in parallel.

Taking the available academic and policy works into account, The Center for the Study of Democracy (CSD)<sup>5</sup> has come to **define state capture** as a combination of different forms of corruption which have a single objective: to **secure wholesale** (by default) and **long term privileges to captors by exploiting the power of government for private benefit**. Most forms of state capture have some common characteristics:

- They are realized through corruption transactions and mechanisms. Therefore, state capture incorporates most characteristics of corruption relations.
- State capture schemes are not a mass phenomenon (do not include large population groups) but refer to actors (most often collective actors, including networks) who have high leveraging power and command of substantial resources and influence capacity.
- State capture is not an ad hoc action (i.e. aiming at solving a specific problem or a reaction in a specific situation) but is systematic. Its objective is to achieve sustained advantage in a given sphere.

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<sup>5</sup> Founded in late 1989, the Center for the Study of Democracy (CSD) is an interdisciplinary public policy institute dedicated to the values of democracy and market economy. For more details see CSD nomy. For more details see CSD XXX webpage at <http://www.csd.bg/index.php?id=2>

- State capture is one of the possible competition tools. It is used to achieve differential advantage for a given actor (network) and based on that – possibility to extract differential resource advantage.

Analytically state capture could be decomposed into the following elements:

**Actors:** three types of actors are most often involved: private interest (business entities), networks/institutions of the state, and parties/networks representing different political interests. Each of these actors could play an active role (and obtain captor status) in the different capture types mechanisms, and the results of the process would differ.

**Results:** these are privileges and status the captor obtains, and the results for society in select sectors. The principal result for the captor is the ability to enjoy undue advantages, extract corruption rents and ultimately become a “free rider”. If the captor is a company capture would ultimately result in monopoly position in a given market (as capture would enable undue market concentration); captor’s interest would have a priority over the public interest and, eventually, the ability to block attempts to deprive the captor of this position. When the captors are state institutions or political entities, result would be the ability to extract corruption rents; however, the capture status would need to include business partners, who would provide (e.g. financially) the rent itself. Additional forms in this respect would be appropriations of public resources (government and other assistance funds).

**Mechanisms:** the methods used to achieve captor status (except competition and excellence). The basic channels (methods) to achieve undue advantage (e.g. illegitimate market concentration) could be:

- Laws or regulations which ensure market advantage or exemption from prosecution (lobbyist legislation);
- Political corruption aimed at influencing the executive, or the legislative. In certain situations, preferential access to the judiciary could also be ensured.
- Judiciary corruption to ensure exemption from prosecution or favourable decisions of courts;
- Institutional corruption: buying civil servants in public institutions to ensure inaction on cases of market concentration and its consequences. The latter could be numerous, ranging from diminished quality of goods and services and ending with violation of tax, customs and other regulations in order to increase profits.
- Corruption in the access to public resources – procurement contracts and subsidies. Important in this respect is that regardless of the government in power, captors have privileged access;
- Influencing the design of public policies. This includes captors influencing sector policies, economic policy, budget allocations, and even foreign policy decisions (lobbying for agreements with specific countries, modification of international agreements, and partial closure of domestic markets).

The combination of corruption forms used to achieve state capture varies depending on the specific situation and governance model in a given country. Therefore, the **main (starting) indicator for identifying the presence of state capture** is the existence/prevalence of captors, i.e. undue concentration (by sectors, markets, etc.) of resources and/or power in certain actors. The prevalence of different forms of corruption used to achieve state capture is a secondary group of indicators because they describe the specific mechanisms through which a state capture situation has been achieved or how it operates.<sup>6</sup> State capture involves the concentration of means (forms of corruption) around a limited group of actors. In this respect the assessment of state capture should necessarily start with the result/outcome indicators (market concentration).

State capture is a virtual privatization of the state, or rather **privatisation of certain state functions**. In some countries (e.g. Russia) a reverse process has also been observed – when government institutions are used by politicians to extract undue advantages from businesses.<sup>7</sup>

## b. Forms of state capture

TABLE 1. FORMS OF STATE CAPTURE

<b>Business capture</b>	The active side of capture (captors) are business entities which use different forms of corruption to influence legislation affecting the business sector and other social areas and the implementation of legislation and rules in order to acquire privileged status.
<b>Government/political capture</b>	The active side are state institutions and/or political networks/parties. Typically captured are business structures which ensure kickbacks after being provided with contract assignments (procurement or other) by institutional actors. The incentive for captors is the appropriation of corruption rents. The incentive for the captured business structures is part of the corruption rent and their eventual privileged position in a given market.
<b>Judiciary capture</b>	The active side would be networks of judiciary officials who use their discretionary power to appropriate corruption rents and sell their services to the executive, to the business sector or to organized crime. This type of capture would be possible in cases when the judiciary is relatively independent from the executive and the legislative (e.g. once elected/appointed, including by the executive and/or the legislature, magistrates have immunity for a certain period of time).
<b>Black economy capture</b>	The active side are typically organized crime groups who capture state institutions (typically the judiciary, but also the executive) in order to ensure systematic violations of the law and regulations for conducting black sector activities (on a large scale) and launder the profits.

<sup>6</sup> Furthermore, prevalence of capture related form of corruption could show a mass phenomenon which could be randomly distributed among actors (pointing to different forms of corruption) and not concentrated at specific actors (capture).

<sup>7</sup> See Yakovlev, A., 2006, The evolution of business – state interaction in Russia: From state capture to business capture? *Europe-Asia Studies*, 58(7), 1033-1056.

### c. Innovation in state capture assessment

To address the complex challenges of state capture, CSD has developed an innovative instrument, currently being applied in five European countries (Bulgaria, Italy, Spain, Romania and the Czech Republic) and with prospects of comprehensive implementation throughout Western Balkans region, as part of the SELDI network. *MACPI State Capture* is an instrument developed specifically for measuring state capture.

Sources of data for *MACPI State Capture* are econometric data and indicators on the one hand and an online quantitative survey among experts and public officials on the other hand. Preferably, at least 50 public officials and 100 experts are recruited to participate in the survey for a country estimate. Experts could include: NGO employees with expertise on corruption, conflict of interest, market competitiveness, etc.; academia representatives with expertise on corruption, conflict of interest, market competitiveness, etc.; ex-public officials who are familiar with at least some of the public organizations included in the survey; heads of large businesses who are familiar with at least some of the public organizations included in the survey and other relevant groups.

*MACPI State Capture* starts with econometric analysis of NACE sectors which picks larger (in terms of turnover) economic sectors as well as potentially problematic sectors (again based on econometric data) in the assessed country. The survey among experts is 20-30 minutes long and consists of two part – assessment of public organizations which have direct regulatory and control functions related to the market and the economic activities in the country. Typical examples are customs, antitrust bodies, revenue bodies, local government etc. while parliament, judiciary, president, and cabinet are not included in the survey, but are assessed with other tools.

Based on the quantitative survey, several indicators are computed for the assessed countries, among them are ineffectiveness of the anti-corruption policies, ineffectiveness of the regulatory public organizations, estimated sector monopolization, and others.

Finally, *MACPI State Capture* envisages several case studies for those of the economic sectors and public organizations which are assessed as most problematic. Case studies for public organizations should be preferably based on hard data: statistical and econometric data, *MACPI* monitoring of the organization, etc. Case studies for high-risk economic sectors should also be based mainly on quantitative analyses like market concentration, procurement concentration, etc.



### III. MONITORING ANTICORRUPTION POLICY IMPLEMENTATION (MACPI) AT INSTITUTIONAL LEVEL

Corruption and measures to counteract it have been subject to so much research and political attention that it would seem that their every aspect must have been explored. Yet, as discussed above, corruption proves bafflingly resilient, always finding new conduits for spreading; squeezed temporarily out of one public sector, it reappears in another. It could only benefit the anticorruption effort, therefore, if **novel methods for analysis and prevention** were also found **on different levels of governance**.

Corruption has been blamed for contributing to just about every contemporary problem – from a degrading natural environment to international conflict. What is certain, however, is that it undermines one of the fundamental civic rights – the right to good governance. The ill effects of the denial of this right manifest themselves at the societal level – the list ranges from mistrust of public institutions to the various forms of discrimination. The practical mechanisms of the denial, however, are to be found in the operation of specific public sector institutions. The rule of law is compromised not by some grand invisible force called ‘corruption’ but by the daily micro-level choices of concrete public officials, individual citizens, businesses. It is by understanding and thus guiding these choices that a lasting good governance effect can only be produced.

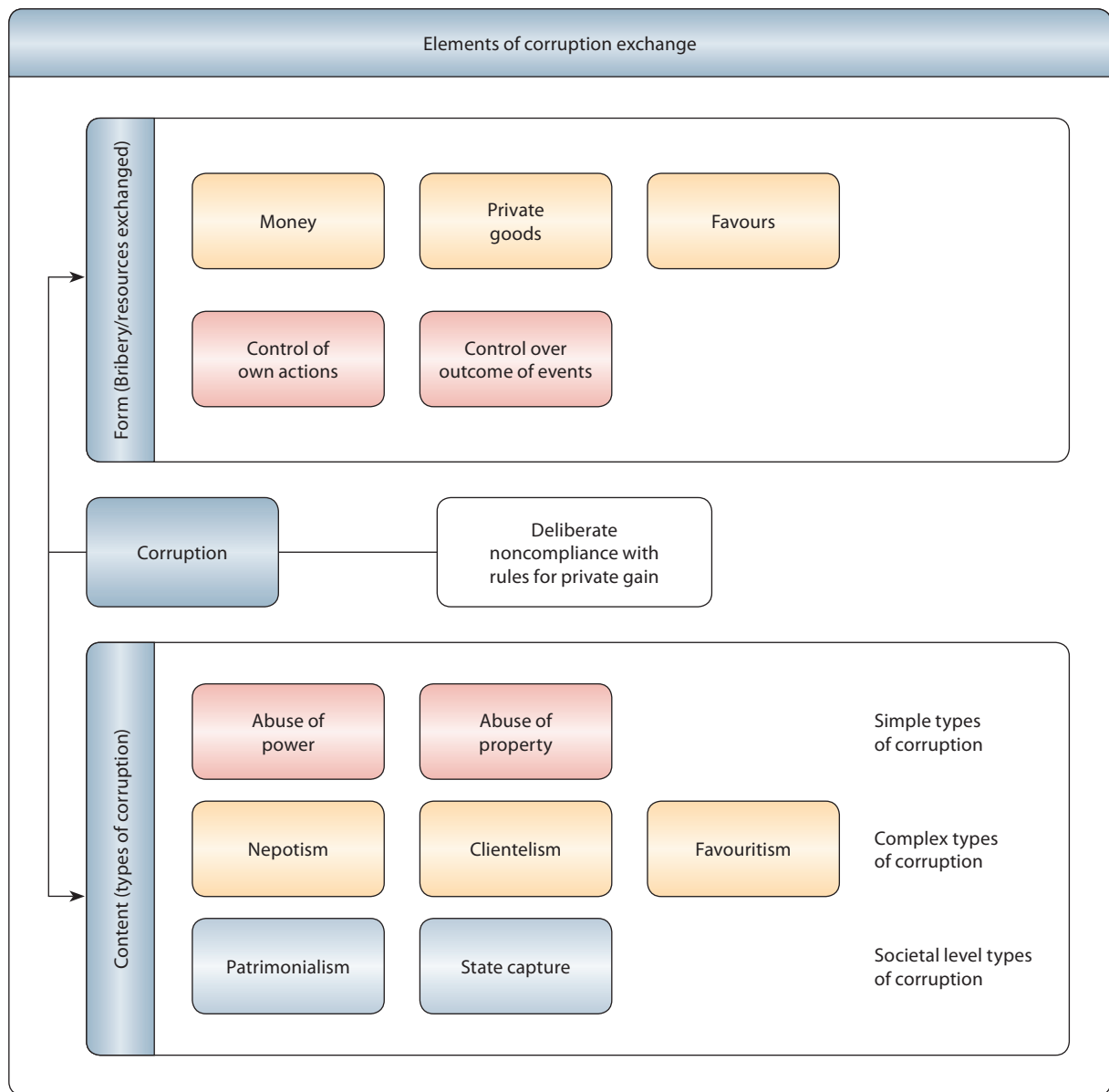
Scale matters in policy making. The numerous initiatives evaluating anticorruption policies have found many deficiencies, but they have rarely faulted these policies for being too general. While suitable for the politics of anticorruption, grand strategies have been of limited utility in actual policy design. What anticorruption needs now are not more strategies but the **ability to tailor prevention and enforcement policies to the specific circumstances of specific public organisations**. Effective policies and their cost-efficient delivery require that policy designers zoom in on the actual actors and transactions; that they understand what drives these actors and adjust their anticorruption interventions accordingly.

**Scaling down the focus of anticorruption policy** making has a number of general advantages:

- It would empower **accountability demands** by targeting them at the point of delivery of public services. While much attention has been paid – and justifiably so – to the accountability of elected politicians for the failure of anticorruption efforts, the senior management of public organisations has largely been spared such demands.
- It would allow **anticorruption policy to balance proscriptions with prescriptions**. It is not by chance that anticorruption policies at the



FIGURE 1. THE ELEMENTS OF CORRUPTION EXCHANGE



Source: CSD.

national level have been mostly confined to an expansion of the range of incriminated practices. As national policies find it difficult to account for the multitude of circumstances that give rise to the various types of corruption, they opt for the supposedly fail-proof tool – make it a crime. While being important in the overall anticorruption architecture – raising the costs and risks of corruption should be a permanent feature of policy – such an approach can turn counterproductive if implemented alone. Law enforcement is an expensive solution to social problems, especially for latent ones such as corruption (and even more so in countries where it is widespread). In order to complement inves-

tigation with incentivisation policies should be able to account for the drivers of specific actors – both civic clients and public officials – in the specific conditions of specific public organisations.

- By seeking to understand how national policies translate – or more often do not – into **organisational level protocols**, watchdogs and policy makers would gain an insight into the arguably key factor for the success or failure of anticorruption efforts: the processes and implementation procedures in public organisations. It is most often through the absence of standard protocols, operating procedures and due processes in these organisations that otherwise well designed policies fail to deliver.
- Developing tools for the evaluation – and hence the redesign – of policies at the level of individual organisations would allow the introduction of **anticorruption benchmarking among public sector institutions** both within and across countries. The absence of such benchmarking has plagued anticorruption efforts at the national and EU levels. Benchmarking would, in turn, facilitate the development of anticorruption policy templates for the various types of public institutions, thus assisting their policy design and delivery efforts.

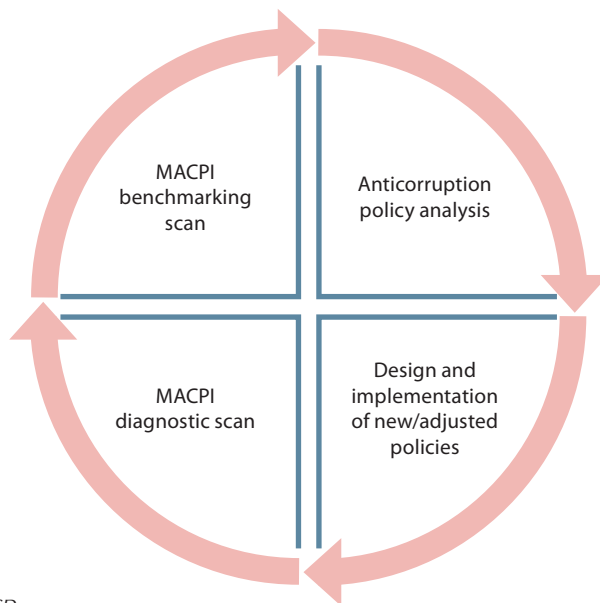
A **shift of focus from the national to the institutional level** will benefit the EU anticorruption efforts as well. All the channels through which the European Commission seeks to engage member states in the follow-up to the EU Anticorruption Report – programming for the EU structural funds, the Cooperation and Verification Mechanism, the European Semester – one way or another end up dealing with specific public institutions in the member states. The significance of the public institution level in anticorruption has been recognised in the EU Anticorruption Report, which acknowledges that where strategic programmes have been lacking, corruption has been reduced by preventive systems and practices involving the suppliers and recipients of public services. One of the thematic ex-ante conditionalities of the European structural and investment funds relates to the institutional capacity and efficiency of the public administration. Anticorruption would feature in the non-binding guidelines being developed for member states on how to strengthen the functioning of public sector institutions and invest in administrative capacity.

### **a. The anti-corruption enforcement blueprint**

It is in response to the above that the Center for the Study of Democracy has, for more than 25 years, sought to build bridges between the evaluation of anticorruption policies and the measurement of corruption. The *Monitoring Anticorruption Policy Implementation (MACPI)* instrument was born of the understanding that innovation in anticorruption is as important as it is in other social and economic fields. MACPI provides the anticorruption community with a precision-guided tool, which gives exhaustive feedback on the enforcement of policies.

MACPI is premised on the notion that the content of corruption at the macro level (society) and micro level (public organisation) differ substantially. While micro level corruption transactions represent cases

FIGURE 2. MACPI IMPLEMENTATION CYCLE



Source: CSD.

of deliberate noncompliance with rules and regulations for some kind of private gain, at the macro level corruption can be described as a governance regime, which allows policies deviating from the public good to be put forward. Although bringing about macro level political change has proven a demanding and often elusive longer-term objective, most national governments in the EU confine themselves to national level anticorruption policies. To reduce the prevalence of actual corrupt transactions these policies need to be translated into mechanisms and protocols that operate in individual public organisations. This, however, has rarely been the case.

MACPI is capable of mapping and assessing the anticorruption policies implemented in public organisations. This includes a set of qualitative and quantitative instruments (MACPI tool), which: (i) review all cross-sections of activities of the organisation and types of associated corruption risks; (ii) identify corruption vulnerability zones – in other words, mechanisms of noncompliance with rules that make it possible for public officials to enrich themselves at the expense of the public; and (iii) map and assess anticorruption policies. The diagnostic carried out with MACPI produces findings in the following fields of inquiry:

- the level of corruption vulnerability of a public organisation for each of its specific activities;
- the coverage of the activities of the organisation by anticorruption policies, and the effectiveness of these policies;
- the level of implementation of anticorruption policies.

MACPI ascertains whether the corruption vulnerabilities of a public organisation are adequately addressed by anticorruption policies and how effective these policies are. The tool also informs policy makers on the existence of two gaps:

- an implementation gap – there is only formal compliance with anticorruption policies;
- a policy design gap – corruption vulnerabilities are not addressed by any policy.

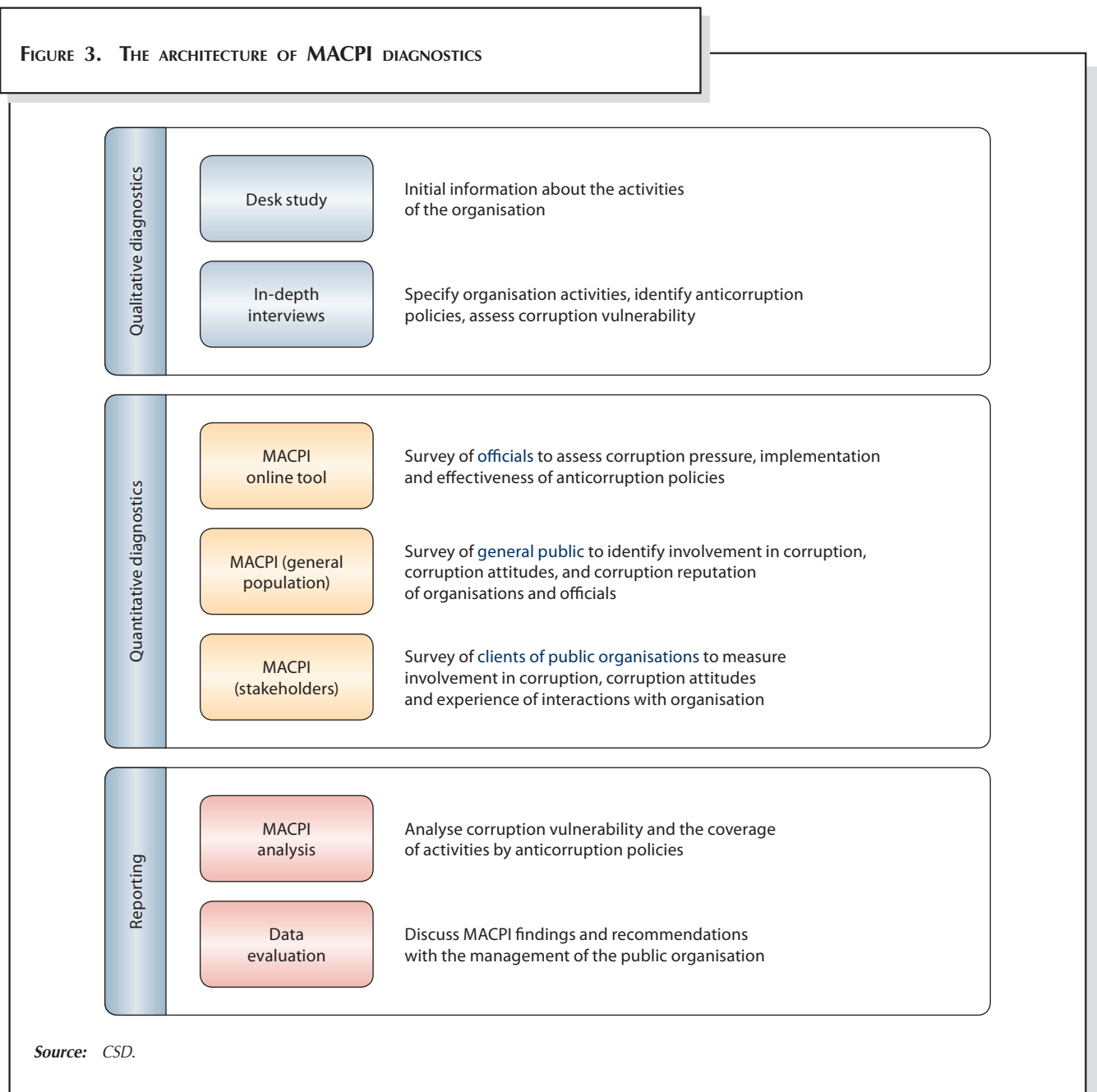
The identification of the two gaps is the first stage of the MACPI cycle. Based on the benchmarking results of MACPI diagnostics policy-makers

can then make adjustments to policies and introduce a new round of diagnostics in the second stage.<sup>8</sup>

## b. The policy implications

MACPI comes at a time of search of the reasons for the limited progress against corruption in many countries and has implications for policy making at the national and EU levels. The tool operationalises the need for monitoring the implementation of anticorruption policies and is suitable as an input to policy design.

FIGURE 3. THE ARCHITECTURE OF MACPI DIAGNOSTICS



<sup>8</sup> For further methodological discussion of MACPI and the result of the mapping see CSD, 2015, Mapping Anticorruption Enforcement Instruments, <http://www.csd.bg/artShow.php?id=17394>

At the national level, policies should be MACPI tested before implementation; only after successful results (confirmed by MACPI), the policy should be recommended for adoption. Anticorruption policies at the national level that do not have any implementability at the organisational level should be discouraged.

Anticorruption policy has been mainstreamed in the EU economic governance and in the programming of the European funds, which means that the need will arise to evaluate the anticorruption preparedness of national public institutions. Given that anticorruption would feature in the nonbinding guidelines being developed for member states on how to strengthen the functioning of their public sector institutions and invest in administrative capacity, MACPI can be valuable in producing evaluation findings used to formulate targeted solutions. The improvement of administrative capacity in the member states following European Semester recommendations can also benefit from the capacity of MACPI to overhaul integrity measures and procedures in the institutions of economic governance.

MACPI provides the missing link between the measurable evaluation of specific public services and the design of anticorruption policies targeting their actual corruption vulnerabilities.

### **c. Tangible results – the case of the Bulgarian Border police**

MACPI was tested in number of public organisations and six municipalities in Italy and Bulgaria.<sup>9</sup> The piloting results demonstrate that it is predominantly general anticorruption policies that are applied, with few measures tailored to the specific vulnerabilities of the organisations. This emphasises the need for prioritising the public organisation level in the anticorruption policy process.

The most important vulnerability identified in the Border Police was related to organized passage of illegal immigrants which involves corruption transactions with agents from the Border Police who facilitate the passage of organised groups often traveling openly by bus. This vulnerability is related to the main function of Border Police and therefore there are different very specific policy measures which address it. Since corruption is a major part of the problem, these measures could be considered to be of anticorruption nature. However, in this case the focus of management is not so much on reducing corruption but on preventing illegal passage. Prevention can be achieved, inter alia, by decreasing petty corruption (bribery of border guards). Higher forms of corruption in other departments were often not considered possible at all or were considered only hypothetically possible and experts were not willing to discuss particular mechanisms in these cases. From these preliminary meetings, it could be concluded that corruption vulnerabilities at the border checkpoints are openly recognised and discussed, and there are

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<sup>9</sup> Border Police and Slatina Municipality, Ministry of Defense, General Labour Inspectorate Executive Agency, Bourgas Municipality, Ministry of Interior, Traffic Police in Bulgaria and the Health Service of Trento and Municipality of Riva del Garda in Italy.

attempts to cover these corruption vulnerabilities with specific policy measures. However, hidden corruption vulnerabilities (not recognised and discussed) could still be possible for the other activities. Such corruption risks are addressed with more general anti-corruption policies such as the requirement by all employees to submit annually declarations of assets.<sup>10</sup>

**TABLE 2. CORRUPTION VULNERABILITY ZONES IN THE BULGARIAN BORDER POLICE**

	Abuse of power	Abuse of property	Nepotism	Clientelism	Aggregate vulnerability for activity
Human resources	P*		P	P	High
Public procurement	P	P		P	High
Preventive investigation	P			P	Medium
Border security (green border)	P		P	P	High
Investigations carried out by investigating officers	P		P	P	High
Information activities	P				Medium
Border checkpoints	P			P	Medium
Administrative and punitive	P		P	P	High
Aggregate vulnerability for type of corruption	High	Low	High	High	

\* "P" is a variable with two values – present and absent.

Source: CSD.

The value of the MACPI design lies not only in the innovative methods used but also in its potential to become the basis for benchmarking of similar public organisations across countries or of the same organisation over time. A common aspect of the findings for the organisations Bulgaria and Italy, for example, is that general anticorruption policies prevail. They are concentrated in several areas: anticorruption training, modelling behaviour of officials (codes of conduct, etc.) and creating channels for citizen feedback. Specific polices targeting concrete activities and types of corruption are relatively rare. MACPI indicators are also useful to monitor various areas of interest across institutions and countries:

- similarities between organisations;
- similarities and differences between countries;
- specific patterns of anticorruption policy indicators;
- specific patterns in the evaluation of anticorruption policy coverage of activities.

<sup>10</sup> For detailed results and impact of the MACPI methodology see CSD, 2016, Monitoring Anti-Corruption in Europe. Bridging Policy Evaluation and Corruption Measurement, <http://www.csd.bg/artShow.php?id=17391>



## IV. STATE-OF-THE-ART CORRUPTION MONITORING

In 1998 the Center for the Study of Democracy (CSD) pioneered victimization-based approach to the corruption monitoring, bringing awareness and giving voice to a complex, socially and politically sensitive issue. The *Corruption Monitoring System (CMS)* has been developed and evolved as the **premier corruption monitoring instrument in Southeast Europe** through its regular application by the SELDI network. The CMS allows comparability of data across countries and registers the actual level and trends of direct involvement in administrative corruption. SELDI implemented the CMS throughout the SEE region in 2001,<sup>11</sup> 2002,<sup>12</sup> 2014 and 2016.<sup>13</sup> Throughout the years, CMS implementation was also executed in Georgia and Moldova, while some CMS concepts have also been modified and included in the Eurobarometer surveys on corruption; this makes CMS data comparable to Eurobarometer data.<sup>14</sup>

The CMS was introduced at a time when corruption measurement was confined to public perceptions, the CMS launched a measure of the corruption victimisation of individuals by public officials accounting for their direct experience with various corruption patterns. Based on CMS diagnostics, assessments could be made about the dynamics of the prevalence of corruption patterns in a society.

Significant efforts have been invested by governments, NGOs and international institutions in scaling back corruption in Southeast Europe. Where these efforts have had success it should be attributed partly to an increased body of knowledge about the manifestations, underlying causes and incidence of corruption in a transition environment. The EU approach in this respect has also been changing. While earlier priority had been given to input indicators (regulations, procedures, etc.) focus now has shifted to output indicators (actual impact). Member states have also contributed to understanding corruption and recommending action through the mechanism of peer reviews. Still, “identifying anti-corruption progress remains largely arbitrary. Corruption [...] is an evolving concept. Understanding corruption and obtaining reliable information about its dynamics are crucial to the implementation of successful prevention and control policies.”<sup>15</sup> It is with this purpose in mind that SELDI developed

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<sup>11</sup> SELDI, 2001, Background Document on Corruption in Southeast Europe, <http://seldi.net/publications/publications/background-document-on-corruption-in-southeast-europe/>

<sup>12</sup> SELDI, 2002, Anti-Corruption in Southeast Europe: First Steps and Policies, <http://seldi.net/publications/publications/anti-corruption-in-southeast-europe-first-steps-and-policies/>

<sup>13</sup> See SELDI, 2014, Anti-Corruption Reloaded: Assessment of Southeast Europe, <http://seldi.net/publications/publications/anti-corruption-reloaded-assessment-of-southeast-europe/> and SELDI, 2016, Shadow Power: Assessment of Corruption and Hidden Economy in Southeast Europe, <http://seldi.net/publications/publications/shadow-power-assessment-of-corruption-and-hidden-economy-in-southeast-europe/>

<sup>14</sup> TNS Political & Social, March 2014 and TNS Opinion & Social, February 2014.

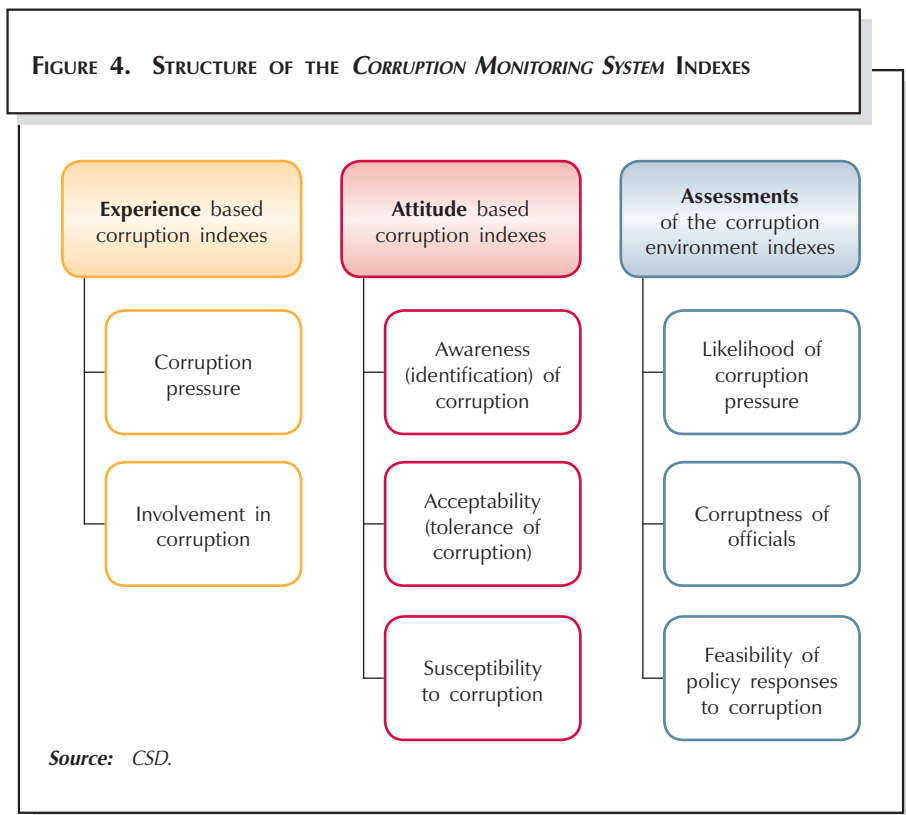
<sup>15</sup> CSD, 2007, The Future of Corruption Benchmarking in the EU, <http://www.csd.bg/artShow.php?id=8469>



its *Corruption Monitoring System (CMS)*. Designed by the Center for the Study of Democracy, the CMS has been recognised by the UN as a best practice in corruption monitoring. Introduced at a time when corruption measurement was confined to public perceptions, the CMS transformed monitoring by introducing a measure of the **victimisation** of individuals by corrupt officials accounting for their **direct experience** with various corruption patterns. It allows assessments to be made about the dynamics of proliferation of corruption behaviour patterns (prevalence of corrupt transactions) in a society. The CMS methodology ensures comparability of data across countries and registers the **actual level and trends** of corruption, as well as the public attitudes, assessments and expectations in relation to corruption.

The major outputs of CMS are the *Corruption Indexes*.<sup>16</sup> They are based on surveys included in the CMS and summarise the most important aspects of corruption behaviour patterns. The main indicators of the CMS describe corruption as a social phenomenon using three groups of sub-concepts:

- experience,
- attitudes, and
- perceptions (Figure 2).



The CMS gauges the principle empirical manifestations of administrative corruption patterns. In terms of definition, administrative corruption includes the extension of benefits (money, gifts, and favours) by citizens in exchange for services they obtain by public officials. The **experience** aspect of administrative corruption contains two indicators:

- **Involvement in corruption** captures the instances when citizens make informal payments to public officials. The concrete questions used to gather information about this indicator are victimisation questions and reflect experience during the preceding year. The index summarises citizens’

reports and divides them into two categories: people without corruption experience (have not given bribes) and people with

<sup>16</sup> Every index is based on the aggregation of data from several variables (research questions).

corruption experience (have given bribes at least once during the preceding year).<sup>17</sup>

- **Corruption pressure** reflects instances of initiation of bribe seeking by public officials: directly by asking for an informal payment or indirectly by implying that an informal payment would lead to a positive (for the citizen) outcome. CMS results have shown that pressure has been a decisive factor for involvement. Most corruption transactions occur after the active solicitation of payments by officials.

Direct involvement in corruption transactions is accompanied by the prevalence of specific **attitudes** towards corruption and corruption behaviour and by perception of the spread of corruption in society. Ideally, low levels of involvement in corruption would be paired with negative attitudes towards corrupt behaviour and perceptions that corruption is rare and unlikely. This does not mean that perceptions and attitudes directly determine corruption behaviour of citizens. Rather they could influence behaviour to a certain degree but essentially express the general social and political atmosphere in society related to corruption.

The indexes capturing different aspects of attitudes towards and perceptions of corruption included in the CMS are:

- **Awareness (identification) of corruption** is an index accounting for the level of understanding of citizens as to what constitutes corruption behaviour. The index differentiates between three categories of awareness: high (citizens who identify all or most of the common corruption behaviour patterns as corruption), moderate (many of the common corruption practices are identified but some forms of corruption are classified as “normal behaviour”), low (few corruption patterns are identified as corruption).
- **Acceptability (tolerance) of corrupt behaviour.** While awareness captures the knowledge component, acceptability of corruption captures tolerance (or lack of tolerance) towards corruption. It summarizes citizens’ assessments of the acceptability for members of parliament or government as well as civil servants at ministries, municipalities and mayoralities to take gifts, money, favours or receive a free lunch (“get a treat”) in return to solving someone’s problems.
- **Susceptibility to corruption** reflects the tendency of the respondents to react in two hypothetical situations – one involves being in the role of an underpaid public official and accepting or denying a bribe that was offered; the other situation asks about giving a bribe to a corrupt public official, if one had a major problem to solve and was asked explicitly for a bribe in cash. Declaring the denying of a bribe in both situations is interpreted as the respondent being not susceptible

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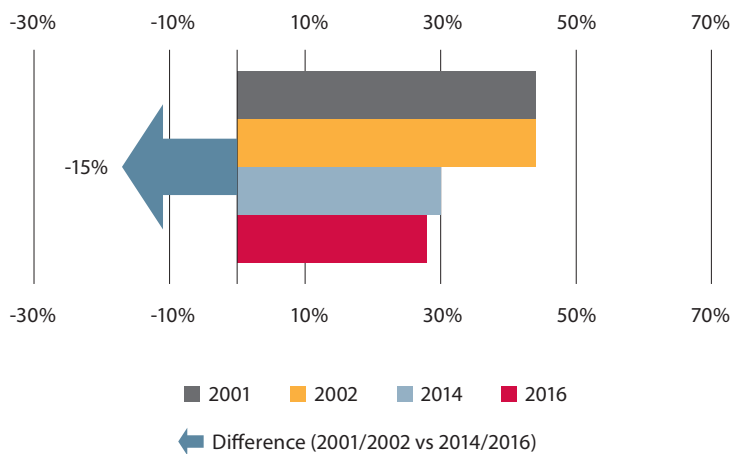
<sup>17</sup> Over the years the wording of questions has been preserved in order to ensure comparability of data. However, calculation methodology has been modified. Prior to 2013 indexes were calculated based on a normalisation procedure and their values ranged from 0 to 10. While this is a standard procedure, it has created difficulties in the concrete interpretation of index values. To overcome this difficulty the aggregation procedure has been modified and uses direct recoding of response groups. This makes it possible to position respondents into distinct and directly interpretable categories referring to different aspects of corruption behaviour patterns.

to corruption, while accepting/giving a bribe in both is interpreted as susceptibility, while giving/taking a bribe in one of the situations and not in the other is defined as “mixed behaviour”.<sup>18</sup>

### a. Evolution of the SEE corruption environment

In the past nearly two decades CMS results have shown that the main factors influencing corrupt behaviour of citizens in SEE countries are rooted in the interactions between citizens and officials. Corruption pressure appears to be the most potent factor that pushed people to engage in corrupt transactions (see Figure 5 below). Attitudes and perception have minor importance but tend to follow the overall dynamics of corruption prevalence and determine the likelihood of success of anticorruption efforts. Results show that achieving success in terms of bringing corruption levels close to EU average is likely to require massive and sustained efforts in the next two decades. The case of Bulgaria shows that progress is reversible, and anticorruption efforts should be sustained over extensive periods of time. The case of Croatia indicates that strong conditionality before accession gives results but the anticorruption drive and institutional mechanisms need to be sustained and further strengthened.

**FIGURE 5. CORRUPTION PRESSURE IS ABATING, ALBEIT SLOWLY\***



\* Average share of those reporting to have experienced demands for bribes (pressure) from public officials in Albania, BA, Bulgaria, Croatia, The Former Yugoslav Republic of Macedonia, Montenegro and Serbia. The difference is calculated by averaging the 2001 and 2002 surveys in one pair and 2014 and 2016 in another.

Source: SELDI Corruption Monitoring System, 2016.

The predominant public attitude towards corruption in the region is negative. In many countries this goes hand in hand with relatively high levels of involvement in corruption transactions: corruption has evolved into a necessary evil and this tends to discourage public confidence in the ability of government to enforce anticorruption policies. Some of the countries, like Albania and Kosovo\* face considerable challenges in countering corruption, and would require wide ranging reforms. In others there is still fear among the population to disclose corruption attitude and experience, which hampers civil society activities in countering corruption. Data suggested that low administrative corruption in parts of the

<sup>18</sup> For detailed methodological elaboration see SELDI, 2014, Anti-Corruption Reloaded: Assessment of Southeast Europe, pp. 136-146, [http://seldi.net/fileadmin/public/PDF/Publications/RAR/SELDI\\_Regional\\_Anticorruption\\_Report\\_Final\\_Revised.pdf](http://seldi.net/fileadmin/public/PDF/Publications/RAR/SELDI_Regional_Anticorruption_Report_Final_Revised.pdf)

\* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.

region, notably Turkey, The Former Yugoslav Republic of Macedonia, and to some extent Serbia could be related to less political freedom and even fear of repression.

In the period since 2001 – 2002 (the first regional implementation of the SELDI CMS) most countries have registered progress<sup>19</sup> with respect to most CMS dimensions (indexes): lower levels of corruption pressure and involvement in corruption, lower tolerance, lower susceptibility, increased resilience, etc. In view of the initial level of corruption prevalence, however, this progress could be considered marginal. There has not been an anticorruption breakthrough in any of the countries in the region.

Unstable and controversial effects of government actions can be clearly illustrated with the case of Bulgaria: annual implementation of the CMS has shown an uneven marginal progress (reduction) with respect to administrative corruption in the period 1999 – 2013.<sup>20</sup> However, the 2014 round of diagnostics registered serious deterioration and has seen prevalence return to levels even higher than those observed in 2001 – 2002. Despite the introduction of the Cooperation and Verification Mechanism the country has regressed, which points to the complexity of tackling systemic and political corruption, as well as the importance of political and judicial leadership in the country for achieving progress.

In all countries future anticorruption efforts will need to deal with a major challenge: the magnitude of prevalence of administrative corruption (even in countries where it is relatively low) makes it practically impossible for law enforcement to identify and prosecute offenders. In addition, as CMS results show, oversight institutions and law enforcement are also among the primary targets of corruption.

## **b. Corruption monitoring in SEE: mapping recent regional trends and dynamics**

If corruption in SEE is beyond the odd bribe or the occasional rigged tender, understanding its scope and dynamics requires a gauge which gives both a broad overview and is capable of zooming in on specific sectors or practices. In 2016, SELDI continued its corruption monitoring activities in the region by implementing the CMS in nine countries<sup>21</sup>.

The 2016 findings indicate that while there are considerable differences between the most and least corrupt countries, the overall level of corruption is sufficiently high for it to be of serious concern to the

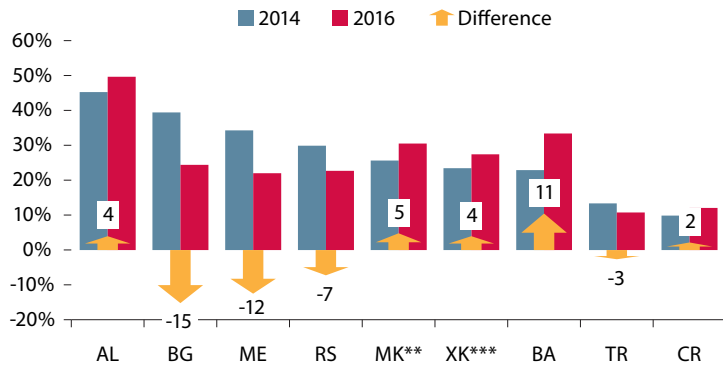
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<sup>19</sup> The dynamics of corruption indexes for each country has been included in the country profiles in Chapters II and III. See also SELDI, 2002, *Anti-Corruption in Southeast Europe: First Steps and Policies*, <http://seldi.net/publications/publications/anti-corruption-in-southeast-europe-first-steps-and-policies/>

<sup>20</sup> In the period 1999 – 2003, CMS diagnostics had been implemented on a quarterly basis.

<sup>21</sup> Albania, Bosnia and Herzegovina (BA), Bulgaria, Croatia, Kosovo\*, The Former Yugoslav Republic of Macedonia, Montenegro, Serbia and Turkey

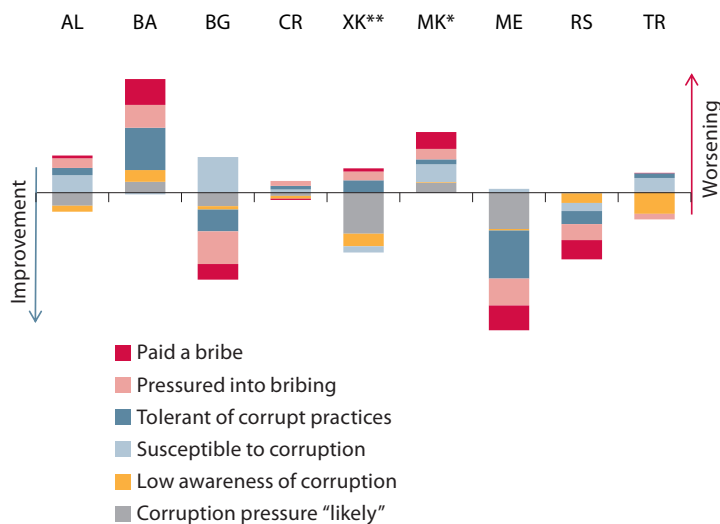
FIGURE 6. CHANGES IN CORRUPTION PRESSURE BY COUNTRY\*



\* Share of those reporting to have experienced demands for bribes from public officials.  
 \*\* The Former Yugoslav Republic of Macedonia.  
 \*\*\* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.

Source: SELDI Corruption Monitoring System, 2016.

FIGURE 7. OVERALL CHANGES IN CORRUPTION LEVELS (2016 VS 2014)



\* The Former Yugoslav Republic of Macedonia (FYROM).  
 \*\* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.

Source: SELDI Corruption Monitoring System, 2016.

stakeholders of good governance. In terms of dynamics, the CMS finds that the general levels of corruption in the SELDI countries have gone down and citizens have become more demanding of good governance since the early 2000s. The key measure in the SELDI CMS of the corruptness of government services is corruption pressure – the incidence of implicit or explicit rent-seeking by public officials in their dealings with members of the public. With respect to corruption pressure, the general trend illustrated in Figure 5 is contrasted with much greater variability both within and between countries in the comparison between the findings of the 2016 and 2014 CMS rounds (see Figure 6 below). The more tangible reductions have notably taken place in countries under more EU scrutiny but also with fairly high levels of corruption pressure – such as Bulgaria (and EU member) or Montenegro (the closest EU hopeful from the Western Balkans at the moment).

However, overall small improvements have been insufficient to turn the tide on corruption in the SELDI countries and it remains very high. On average, corruption pressure is 25.9 % – hardly a percentage decline since 2014, when the regional mean was 27.1 %. Such aggregate measures have their usefulness for general political assessments but need to be broken down into specific aspects if they are to inform

policy making. Being a crime of opportunity makes corruption dependent on a multitude of factors shaping the behaviour of individuals, businesses and public officials.

The figure above shows the combined dynamics of six variables in the CMS, which measure the key aspects of corruption behaviour: how likely does the public believe rent-seeking pressure from officials would be; how tolerant is the public of the various corrupt practices; the share of those who fail to identify otherwise mainstream corrupt practices as “corruption” (have “low awareness” of corruption); the share of those pressured by public officials into bribing; the share of individuals who would become corrupt in a hypothetical situation of being offered a bribe as a public official (susceptibility); the share of individuals who report having paid a bribe in the preceding year. As noted above, in an environment where corruption is a common occurrence its various proxies are not necessarily in unison. Thus, while in countries such as BA, The Former Yugoslav Republic of Macedonia, Montenegro or Serbia all aspects of corruption either improve or deteriorate together, in others developments are mixed. Notably, where all components change in unison, this is accompanied by tangible changes in behaviour (more/less involvement in bribery); where results are inconclusive, behaviour has hardly changed.

### c. MACPI Macro

The *MACPI Macro* instrument is a newly developed by CSD methodology, which can be used as to reinforce the results of the CVM and provide overall assessment of the specific corruption macro-environment. *MACPI Macro* is a specialized sub-tool from the MACPI toolset focused on more general assessment of national-level anticorruption policies and key public organizations. An online survey among experts and public officials is conducted with questions about country-level anticorruption policies, government agencies and other key regulating bodies. *MACPI Macro* can be used as a stand-alone country-level assessment tool as well as a first step in conducting deeper MACPI assessments at the level of high-risk public organizations, which can be selected based on the results from *MACPI Macro*, the CMS, etc.

*MACPI Macro* is an invaluable tool for evaluation of national anticorruption strategies and general assessment of the national-level anticorruption policies and measures typically listed in such documents. *MACPI Macro* should not be regarded as a replacement for MACPI at the level of public organizations, but as a rough estimate of the general corruption/anticorruption environment in a country and as a guide for further focused MACPI monitoring of particular public organizations.

*MACPI Macro* is conducted among a large sample of experts and executive-level public officials with at least 100 external experts and 50 executive-level officials. External experts can be NGO representatives, Scholars (Academia), ex-public officials, business executives, etc. The answers of the two groups of respondents are juxtaposed and large differences in the assessments are analyzed or/and investigate further with more sensitive MACPI tools at the level of public organizations.

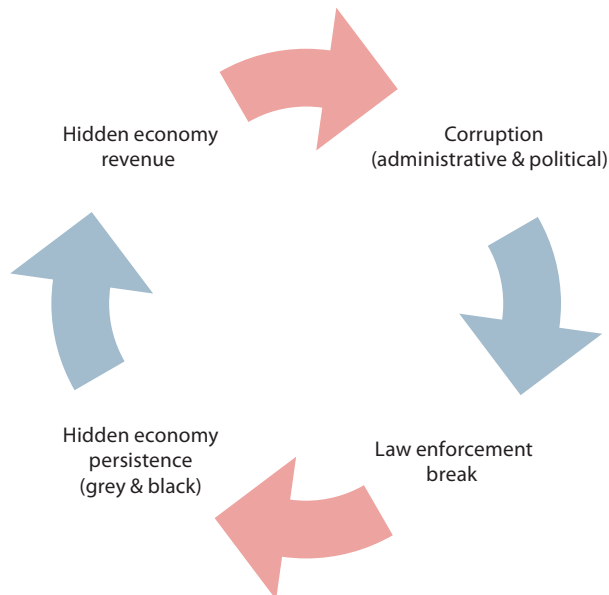
*MACPI Macro* is a quantitative tool which results in several indicators assessing national-level anticorruption policies in terms of their

implementability, formal and real implementation, and effectiveness on the one hand and on the other – assessing the transparency, integrity, and effectiveness of different key public organizations in general and in the context of corruption and anticorruption actions.

## V. HIDDEN ECONOMY: CORRUPTION'S PARTNER IN CRIME

If the corruption of government cannot be properly evaluated without accounting for the degree of correspondence – or lack of it – between official rules and prevailing social norms and values, neither can it be understood without reference to its doppelgänger in the economy. As with bribery, the hidden economy emerges where there is a tension between the formal intentions of laws and regulations and the daily choices of individuals and businesses. A persistent and sizable hidden economy also signals institutional inefficiency. **Corruption appears at the juncture where the formal and informal economies meet**, where businesses and individuals pay an informal rent or capture institutions to stay hidden, in compliant or to facilitate cheaper and smoother legalisation of their products or services.<sup>22</sup>

FIGURE 8. THE CORRUPTION – HIDDEN ECONOMY NEXUS



Source: SELDI, 2016.

The vicious circle between corruption and hidden economy **harms economic growth** through fuelling unfair competition, providing a pool of cheap talent for hire for black and grey businesses, and perpetuating a large amount of unaccounted for financial and other resources.<sup>23</sup> This requires a refocusing of the anticorruption debate away from sheer law enforcement towards more economic grounded rationale, such as addressing the nexus between corruption and hidden economy.

The hidden economy phenomenon distinguishes between four types:

- **Official economy** (legal and reported);
- **Informal economy** (legal, yet unreported). It includes home-made produce and domestic labour, unpaid voluntary work, some of the

<sup>22</sup> CSD, 2011, The Hidden Economy in Bulgaria and the Global Economic Crisis, <http://www.csd.bg/artShow.php?id=15798>

<sup>23</sup> CSD, 2015, Financing of Organised Crime, <http://www.csd.bg/artShow.php?id=17317>; See also CSD, 2010, Examining the Links between Organised Crime and Corruption, <http://www.csd.bg/artShow.php?id=15192>

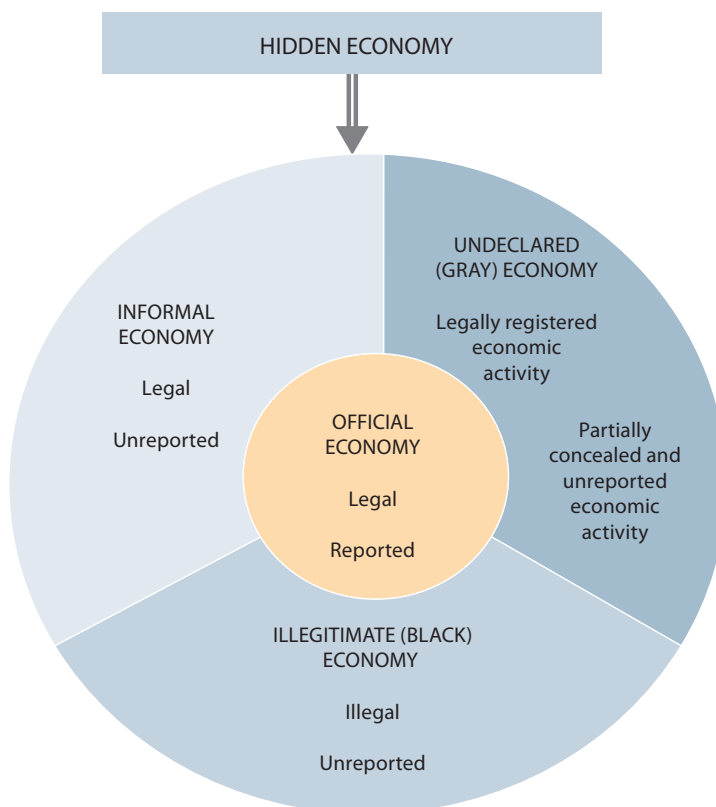


activities of the self-employed and small businesses with no obligation to declare their activities, etc.;

- **Illegal (black) economy** (illegal and unreported). It includes illegal activities or unlawful production of commodities, as well as economic activities carried out by illegal economic entities;
- **Undeclared (gray) economy** (legal, yet unreported). It includes underreporting the activities of legally-operating businesses, not registering the entire staff, as well as underreporting income. This concept also covers tax evasion and the avoidance of social and healthcare security payments. The term hidden economy covers the latter three phenomena, namely, informal, illegal (black), and undeclared (gray) economy, all three of which are not reported to the authorities.<sup>24</sup>

### a. Hidden economy monitoring

FIGURE 9. THE ARCHITECTURE OF THE HIDDEN ECONOMY



Source: SELDI.

With this in mind the Center for the Study of Democracy has devised a *Hidden Economy Index (HEI)*. Hidden economy surveys has been carried out by CSD in Bulgaria since 2002. Based on data from these surveys, a system of synthetic measurements in the form of composite indices for assessment of the hidden economy was developed. The reason for choosing these particular indicators was to reduce the multiple aspects of the hidden economy phenomenon to a manageable number of illustrative and easy to interpret the indices.

The CSD HEI is composed of two main indices – *Business Hidden Economy Index* and *Hidden Economic Activity of the Population Index*. Combined, the Hidden Economy Indexes in Bulgaria, represent the longest available time series for Bulgaria obtained through reliable, transparent and consistent over time methodology.

<sup>24</sup> CSD, 2015, Hidden Economy Indexes in Bulgaria 2002 – 2015: Results and Methodological Notes, <http://www.csd.bg/artShow.php?id=17759>

*The Business Hidden Economy Index* consists of the following indices:

1. **Size of the hidden economy** – this index summarizes subjective perceptions of business representatives of the scope of the hidden economy in the country as a whole, and by sector. It includes two sub-indices: 1.1. Subjective assessment of the share of the hidden economy in the country as a whole; 1.2. Subjective assessment of the share of the hidden economy by sector.
2. **Hidden labour relations** – reflects the practice of employing workers without formal contracts, or under contracts which do not reflect actual remuneration. It has two sub-indices: 2.1. The share of employees without a contract in the respective sector; 2.2. The share of the employees under contracts with “hidden clauses” in the respective sector (envelope wages).
3. **Hidden turnover** – captures the extent to which different ways for hiding turnover are prevalent in the respective sector. The index includes the following sub-indices: 3.1. Reporting lower than the actual turnover; 3.2. Reporting lower than the actual profit.

Similar indicators and indices were also constructed on the basis of data from surveys of the Bulgarian population. For example, for the undeclared work/employment a sub-index “Undeclared Employment Relations” of the *Index of the Hidden Economic Activity of the Population* is used, gathering data on the share of employees without a registered labour contract or a contract with “hidden clauses” (envelope wages), as well as the level of unpaid social security and healthcare contributions. This index is comprised of several basic indicators:

1. Share of workers without a registered labour contract (for primary or secondary employment);
2. Share of workers under a contract with “hidden clauses” (for primary or secondary employment) (envelope wages); Share of workers with no social security;
3. Share of workers with no healthcare security;
4. Size of remuneration, on which social and healthcare contributions are paid.

## **b. Responding to the hidden economy threat in SEE**

Historically, countries which have managed to achieve a breakthrough from a state of systemic corruption such as the one observed in SEE countries to a state of good governance have benefited from simultaneous broad-based economic growth, which has uplifted prosperity and strengthened citizens’ demands for corruption free public services and institutions. Countries in the region have clearly failed to achieve such broad-based economic growth. The hidden economy, which is a mirror indication of systemic corruption, has continued forming between a fourth and a third of national economies in the region. **Tackling these high levels of hidden economy provides a more politically palpable venue for reducing corruption opportunities in SEE.** It is also more readily understandable to the main street and resonates more readily

with the everyday concerns of citizens in the region such as poverty, unemployment and low incomes. Involvement in the hidden economy is often socially embedded, culturally and educationally predetermined, and not just a matter of a rational choice maximising personal utility.

Therefore, **effective anti-hidden economy policy** would not be simply an economic or fiscal policy, but rather a **comprehensive social policy**. Governments in the region should design comprehensive strategies for tackling the hidden economy similar to the ones devoted to anticorruption, which should be linked to the ultimate goals of dynamic economic convergence to the EU. Some specific recommendations, which can complement the points from the previous section should include:

- National statistical institutes should implement the Eurostat/OECD methodology for non-observed economy adjustments to GDP and publish timely and comprehensive descriptions of imputations by non-exhaustiveness type and economic sector. Mirror statistics should be used to calibrate international trade statistics and to use as proxy for contraband and trade-related tax evasion.
- Prioritise and sequence reforms on tax gap areas, which have the strongest negative social impact (e.g. evasion of healthcare insurance contributions and quality improvement in Kosovo\*, missing contracts and social security system in Turkey, excise duty evasion in BA and Albania). The areas should be widely consulted with businesses and the public.
- Introduce policies facilitating the formalisation of whole economic value chains (or significant long parts of it) and clusters of economic actors and relationships as opposed to focusing on case-by-case legalisation by increased penalties and probability of non-compliance detection.
- In countries where remittances are important source of investments in the hidden economy (The Former Yugoslav Republic of Macedonia, Kosovo\* and BA) policies should seek to reduce the cost of transfer of remittances and match domestic entrepreneurship development schemes and foreign donor programmes offering special incentives for legalisation of workers abroad.
- Conduct regular tax gap assessments (including per type of tax), following a common methodology and adjust policies according to their findings.

### c. Latest hidden economy trends and dynamics: hidden employment in SEE

Despite considerable interest in studying the hidden economy, there had been no recent comparable data on hidden employment for SEE. SELDI filled this gap by its 2016 by integrating the *Hidden Economic Activity of the Population Survey* within the *Corruption Monitoring System* implementation

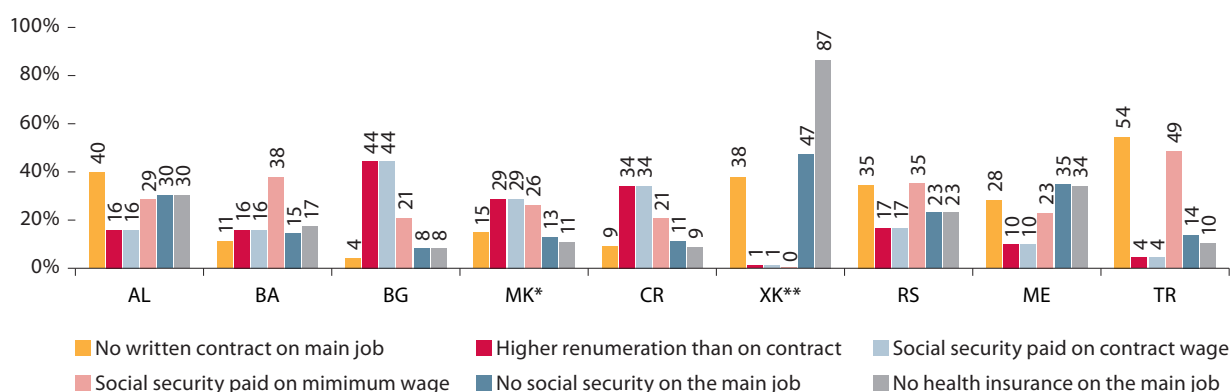
\* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.

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round.<sup>25</sup> The findings of this round of monitoring proceeded from a broader definition of the hidden economy in which a person is counted as being in the hidden economy if engaged in at least one of six hiding practices.<sup>26</sup>

Hidden employment in the SEE countries is not only at different levels, but there are different patterns of hiding, which calls for different solutions. More than half of all hidden Turkish employment, for example, is of individuals without formal contracts; the main reason for this is evasion of social security contributions, which seems tolerated by the authorities. In Serbia, Kosovo\* and Albania more than a third of those in hidden employment do not have labour contracts. Bulgaria, which addressed this practice some time ago by a combination of mandatory contract registration and subsequent inspections, enjoys a low rate of only 1 % of employed and 4 % of those in hidden employment being without labour contracts.<sup>27</sup>

FIGURE 10. SHARES OF THE DIFFERENT TYPES OF HIDDEN EMPLOYMENT IN SEE



\* The Former Yugoslav Republic of Macedonia (FYROM).

\*\* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.

Source: SELDI Hidden Economy Survey, 2016.

Virtually all (87 %) Kosovars in hidden employment completely withhold health insurance contributions. This correlates with the fact that Kosovars –

<sup>25</sup> For detailed results and analysis see SELDI, 2016, Shadow Power: Assessment of Corruption and Hidden Economy in Southeast Europe, <http://seldi.net/publications/publications/shadow-power-assessment-of-corruption-and-hidden-economy-in-southeast-europe/>

<sup>26</sup> No written contract with the employer on the main job; The actual remuneration for the month preceding the survey was higher than the one written in the contract with the main employer, but was agreed verbally with him/her; There is no social security on the main job; The base for the social security paid is at the minimum wage, although the actual salary is higher; The base for the social security paid is the amount written in the contract and not the actual received, which is higher; There is no health insurance on the main job.

\* This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.

<sup>27</sup> CSD, 2006, On the Eve of EU Accession: Anti-Corruption Reforms in Bulgaria, <http://www.csd.bg/artShow.php?id=7298>

especially those in smaller villages – are quite unsatisfied by access to healthcare, the quality of health services, and prevailing corruption. Similarly, the other countries with severe problems in funding healthcare through dedicated taxes are Montenegro and Albania, where a third of those in hidden employment do not pay health and social security contributions at all. Relatively better off in this respect is Bulgaria, although the amounts collected are not enough to provide quality healthcare services for all. Healthcare, is probably one of the most vivid examples how corruption erodes trust in public institutions, fuelling the hiding of health care contributions further diminishing the governments' ability to fund the ever increasing bills in this domain.

Even more importantly, hidden employment arrangements place people in vulnerable position. It is not surprising, therefore, that they are more often subject to corruption pressure – both because of work-related incidents (inspections that find out irregularities or corruption initiated by the business) and home related (access to health, access to finance and access to education require social and health security paid, high wages on record, etc.). In the SELDI *Hidden Economy Survey 2016*, 34 % of those hiding employment experienced corruption pressure, compared to 29 % of the people in the formal sector. The unemployed are least likely to be asked for a bribe – only 22 % of them experienced corruption pressure.

\* \* \*

The discussion above presented several innovative SELDI instruments, implemented by a critical mass of civil society organisations in the SEE. The application of *the Monitoring Anticorruption Policy Implementation (MACPI) tool*, *MACPI State Capture*, *the Corruption Monitoring System* and *MACPI Macro*, and the *Hidden Economy Index* allows for generating a comprehensive, cross-country comparable body of corruption monitoring research; enhancing the enforcement of anti-corruption policies on institutional level; and for further unravelling the threats of the newly emerging phenomenon, state capture.