

# **CESD Anti-Corruption Strategy for the Republic of Azerbaijan**



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## **Introduction**

In the interest of fighting against corruption in an effective and enduring way, the implementation of comprehensive measures is extremely important. As such, the package of anti-corruption measures prepared by the Center for Economic and Social Development (CESD) has been developed to strengthen the fight against corruption and bribery and to achieve long-lasting results.

Corruption acts as an impediment to development in many ways and is a basic concern for many countries around the world. Many usually consider corruption to be the process of bribing officials or the extortion of bribes by officials, while others understand corruption to be theft, misappropriation of state money and wealth, or an individual's personal enrichment achieved by using his/her position. In all of these cases, the existence of corruption in the first place disturbs the construction of a legal state, is detrimental for economic and social development, contributes to the inefficient use of the society's resources and harms people with low-income. Therefore, the fight against corruption is one of the most important goals set before those countries that have chosen democratic and civil development. In recent years, the government of Azerbaijan has adopted a number of anti-corruption measures, including new laws and programs. The government established the "State Program addressed to the fight against corruption" and "Fund of the struggle against Corruption" in February 2004. The 2007-2011 "National Strategy with respect to increasing transparency" has also been accepted. The main purpose of these steps taken is to increase transparency, to eliminate circumstances creating corruption, to implement preventative measures, and to continue those effective measures.

However, research and statements of international institutions demonstrate that immense inconsistencies exist between the passing of and implementation of laws, and that Azerbaijan still has some of the highest levels of widespread corruption in the region. According to Transparency International, Azerbaijan is ranked 134 out 178 countries in the world on the 2010 Corruption Perceptions Index, which rates the perception of corruption in a country.

On the same list, Georgia is ranked 68th, Armenia 123rd, Turkey 56th, and Kazakhstan 105th place. Azerbaijan was ranked in 143rd place in 2009. In addition, Transparency International's Global Corruption Barometer report reflects that corruption in Azerbaijan has increased in comparison to 3 years ago. It should be noted that this report has been conducted in 86 countries with 91,500 respondents.

According to the report, 52 percent of respondents in Azerbaijan perceived the level of corruption had increased, 28 percent of respondents perceived that it had been reduced, and only 20% perceived corruption had remained stable. Respondents mentioned the police, civil servants, the education system, and courts as the structures most rampant with corruption.

## **Effects and consequences of corruption on the nation's economy**

At the beginning of the transition period many analysts considered that large-scale political and economic reforms based on the administrative-command system and the establishment of market economy institutions would lead to the prevention of corruption and bribery in a short period of time. However, these expectations haven't been justified. Neither the elimination of cases of corruption nor the conducts of serious measures have been felt in this area. However, the systematic character of corruption continues to impede important processes such as the development, progress, and establishment of democracy, rule of law, and the elimination of poverty. Corruption also prevents Azerbaijan from holding a respectable place amongst the other countries of the world.

Corruption hinders the formation of private property and creates destructive interference for businesses, thus hindering the formation of a middle class in the country. Another problem caused by corruption is the reduction of competition. Required bribes for any conducted work or service in government agencies limits the number of companies that can enter to the market. This ultimately forces companies that are unable or the ones that don't want to pay the required bribes to engage in the shadow economy. Corruption creates conditions such as the weakening of the quality of production of goods and of competition in the market. This minimum level of competition negatively affects consumers. They purchase low quality goods produced in poor technological conditions for considerably higher prices.

Corruption also leads to the growth of government expenditures. In addition, corruption limits the proper management of public investment projects, in turn creating a fiscal deficit. In particular, the initiation of investment projects funded by the government through procurement allows access to bribes. In order to benefit from the projects, commercial customers that possess high resources provide companies close to them with opportunities and this eliminates competition. Such cases are not only observed in countries where the actual level of corruption is high, it occurs in developed countries as well.

While reducing productivity, corruption also restricts innovation. In a corrupted system entrepreneurs and companies use a large part of their resources and individual time not for development but to the direction of corruption (bribe payments, relationships with corrupted authorities, etc.). Also, corruption limits innovation that subsequently leads to an inadequacy of legal norms of institutions that protect property rights in corrupted systems. Corruption also increases the costs of conducting business. The time spent towards paying bribes to public officials, at the same time, money, complex laws and regulations increase costs of conducted businesses. This increase of costs in turn affects consumers as the cost of goods increase.

Corruption undermines small enterprises. The high costs associated with corruption have a

larger impact on small businesses in comparison to large enterprises. In general, small businesses have less power to avoid the impact of corruption. Small businesses cannot transfer additional costs spent on highly competitive markets and businesses to consumers and as a result they fail to sustain their existence. As small enterprises play a major role in the development and prosperity of many economies, this situation seriously undermines economic growth.

In addition, corruption limits job creation in the private sector. By pushing private businesses to the shadow economy, creating barriers to enter to the market, and by increasing the costs of conducting businesses, corruption limits job creation in the private sector. This prevents companies from future development and expansion.

And finally, corruption is a threat to the full collection of state revenues. In other words, tax evasion cases are more highly evident in those countries where corruption is higher. By not declaring their actual income, taxpayers avoid full tax payment. At the same time, taxpayers prefer to pay bribes instead of taxes. This situation may lead to the reduction of the state income and to weakening of the financial opportunities of the state funds.

Corruption has a negative impact on the levels of domestic and foreign investments. Thus, an environment where corruption exists creates additional costs to conduct business operations and weakens rules and regulations and therefore discourages investors to invest money in such an environment. At the same time, a high degree of uncertainty created by corruption is a discouragement for investors to invest.

## **Requirements of international organizations in the fight against corruption**

Its wide scale of corruption prevents Azerbaijan from becoming a member of many respected international organizations. For example, corruption in Azerbaijan obstructed its path to joining the World Trade Organization. In addition, the anti-corruption policies of a government are an integral part of the accession process to the European Union (EU). For the prevention of corruption, the European Union requires the implementation of the following measures from candidate countries:

- The candidate countries must adopt anti-corruption programs and clearly define liabilities arising from the programs and to carry out reforms on the defined liabilities. Regular monitoring will be carried out during the implementation of the program commitments.
- Specific anti-corruption standards should be adopted and the best practices of member states in this area should be applied.
- The implementation of transparent monitoring both by independent bodies and civil society.
- State agencies are to ensure transparency in management.

The implementation of the above requirements is the basic condition considered for access to the EU. While operating the monitoring in candidate countries the EU considers the processes of their anti-corruption policies' adaptation to the requirements of the EU.

## **Conclusion**

At present, the strengthening of anti-corruption measures is being observed in Azerbaijan. Anti-corruption conferences are being held in ministries, and personnel reforms are being carried out. So far, results are the dismissal of a number of personnel of state organizations that conducted corrupt practices while performing official duties. It still remains a question how anti-corruption measures will affect the country's economy and the market segments. In fact, the effectiveness of the fight against corruption depends on the active participation of citizens.

If we look at the statistics of the first half of 2005 to 2010 we can see an increase in the number of corruption related criminal cases. Of course, this is not rapid growth, but there is some change.

Let us mention that administrative methods of the struggle against corruption are used frequently in Azerbaijan. In a number of cases, short-term cover of administrative methods, at the same time the fact that these methods are not subject to all the officials, reduces the importance of the administrative reforms. Administrative methods were the most used methods in former Soviet republics.

The social needs are defined as one of the major reasons of corruption. It is considered that not only in Azerbaijan, but also in other developing countries direct participation of civil servants in cases of bribery and corruption are connected with their low-income. The experience of developed and developing countries indicates that electronic reforms in the fight against corruption are the most effective methods in the implementation of the fight against corruption.

## **Proposals Package**

In order to increase the efficiency of the struggle against corruption in the Republic of Azerbaijan, the following measures are considered appropriate:

### ***Structural Reform***

The Center for Economic and Social Development offers new structural reforms in Azerbaijan in order to fight corruption. In order to achieve efficiency in governance and to effectively fight against corruption and bureaucratic impediments, some government institutions should be merged and some of them must be given independent status. Structural reforms should cover different areas of economic management.

Recommended reforms include:

- The abolishment of “Azersu” OJSC and Amelioration & Water Supply OJSC; creation of State Water Agency based on these two bodies;
- Azerenerji OJSC should be merged to State Oil Company;
- State Customs Committee should be abolished and merged to the Ministry of Taxes as a separate department;
- Ministry of Agriculture should merge to the Ministry of Economic Development;
- State Social Protection Fund should merge to the Ministry of Social Protection of Labour and People as a separate department;
- Anti-Monopoly Department under the Ministry of Economic Development should be given independent status.
- Abolishment of the Ministry of Industry and Energy and transferring its authority to the State Oil Company. The creation of a Fuel and Energy Department under the Ministry of Economic Development is also necessary.
- Supervisory Boards should be created in ministries that work with people on a daily basis. In addition to the presence of government institutional members, members of civil society organizations should also be presented on these boards.
- The duties of operating tax payments on import-export operations should be taken away from the State Customs Committee and be given to the Ministry of Taxes
- For the purpose of reducing the level of corruption in foreign trade relations, the

accession process to the World Trade Organization should be accelerated

### ***Administrative reforms***

In order to fight against corruption effectively the implementation of administrative reforms should be strengthened, the reforms should include all state institutions, and all persons involved in corruption should be included objectively without discrimination.

The Law on "conflicts of interest" must be passed - Although the law of anti-corruption has been adopted, the provision of "conflict of interest" has not been implemented. No system implementing the monitoring of 'conflicts of interest' exists.

The field of Legislation for government procurements should be strengthened for the purpose of fighting against corruption and appropriate measures should be conducted to empower functions towards control.

The removal of the Anti-monopoly Department from the composition of the Ministry of Economic Development and the establishment of a separate Competition Protection Agency to conduct its operations should be initiated . The Agency should be authorized with power to interfere to the market and conduct activities to prevent monopolies in the market. Competition Protection agencies operate in the majority of countries in the Commonwealth of Independent States (CIS).

The implementation of Audits in State companies must be adapted to international standards. The enhancement of transparency and the application of international standards in the National Anti-Corruption Strategy are considered the most important elements of this area.

A risk analysis of the Tax Code should be conducted. The implementation of a risk analysis in the Tax Code is recommended by an independent and well-known foreign company which can clearly determine how the Tax Code can create a probability for corruption.

### ***Financial reforms***

- I.* A special amount controlled by the Financial Monitoring Service must be justified both by economic and legal point of view. These limits should not bring about interventions to the activities of small and medium enterprises. The Limit must be adapted accordingly to the simplified tax turnover limits legislatively defined in the "Tax Code".
- II.* For the purpose to prevent corruption, the Financial Monitoring Service's employees should be provided with appropriate trainings. These trainings lead to the enhancement of knowledge and capacity of the general body of a newly formed organization.

- III. New policies should be determined into State budget funds allocated to the unaudited budgets of municipalities.
- IV. License fees should be reduced. The high prices for license fees solicit more business people not to obtain the licenses and to operate in the shadow economy.
- V. Expanded use of non-cash payments should be strengthened
- VI. Cash payments should be prohibited in state agencies. Citizens, entrepreneurs must disburse payments only through banks
- VII. For the purpose of non-cash payments both in Commercial organizations and in Sales outlets, stimulus activities by the Central Bank and other corresponding government agencies should be carried out
- VIII. The credit granting mechanism of banks should to be simplified – In the majority of commercial banks bribes and so called "hat" (referred to cases of giving or taking bribes) can be found. And these cases caused by corruption leads to the increase of the cost of credit, and as a result brings about negative influences to the real economy

### ***Structural reforms in the public***

- I. The role of civil society in the fight against corruption should be increased
- II. The accountability of government agencies should be in front of civil society;
- III. Participation of civil society in anti-corruption measures must be provided;
- IV. Monitoring of the state anti-corruption bodies by civilians should be increased – The experiences of different countries shows that, among the methods of the fight against corruption, public monitoring and active engagement of civil society plays an important role. Governmental authorities that fight against reasons leading to corruption and its results will fail to attain desired results if it lacks of large-scale public support.
- V. In order to have a positive effect in empowering fight against corruption, the role of civil society institutions at state procurement should be increased – As a matter of fact current state procurements take place in a closed conditions and this creates opportunity for the corruption to occur.

### ***E-reforms***

- I. In the fight against corruption, elements of e-government should be utilized;
- II. E-government elements should not only be adopted to the businesses but also to the activities of state agencies
- III. E-government elements should be used in provision of the government agencies' activities, in reporting, and in transferring of electronic data. Citizens should carry out

these types of procedures not by corresponding with the government agencies but by performing online document access, by means of new electronic procedures

- IV. Changes of property in connection with the registration of privatization auctions should be conducted by means of electronics.
- V. Free pass registration of citizens to the auctions must be provided;
- VI. In the next stage the auctions must be performed by means of an on-line system - This will initiate the creation of a competitive environment in the privatization's auctions, will provide transparency of the processes of privatization and auctions, and may allow to determine the results of investment contests beforehand
- VII. References and Requirements must be provided by means of electronics – In developed and developing countries, public utility loans, residence references have been set by electronic means. Citizens of such countries can obtain any reference without having to attend their state agencies, by means of electronic devices.
- VIII. Electronic audit system should be implemented by the Ministry of Taxes -The implementation of this system can lead to enhancement of the transparency in auditing and facilitation of the audit process; (the auditor will be able to electronically standardize audit forms and formats, which can improve both the quality and consistency of the audit working papers)
- IX. For the development of E-commerce this field should be exempted from VAT – This may lead to the development and with equal effect initiate legalization of the e-commerce.
- X. As in a number of European countries, quarterly reports should be replaced with annual report. This may lead to reduction of direct communications between tax inspectors and owners.

### ***Social reform***

- I. In order to fight against corruption effectively and provide sustainability, those who make decisions of removal of corruption- generating factors must be provided with adequate social protection;
- II. Within the framework of anti-corruption reforms wages of officials should be increased. Officials working in the State institutions and agencies and those commonly working with citizens must be provided with better wages and enhanced social protection
- III. As in a number of developing countries, the implementation of some social privileges to officials must be provided. Just as in Turkey, officials must be provided with certain concessions, particularly on transport and communal services, and furthermore, officials secured with social concessions must be divided into categories in terms of getting concessions. Application of the concessions to only 1st category operating officials is expedient

IV. In the fight against corruption, for implementing and strengthening of social reforms, structural reforms in government agencies must be conducted. Expanded personnel must be liquidated. Within the framework of ministries and committees, departments and Committees that repeat each other's work should be abolished. While being expedient, this action makes it easy to save funds and also allows to have enough financial base available to increase salaries.

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