

Mirza Mujarić and Ismet Kumalić

8. Formal and Informal Institutions in Policy – Evidence from South East Europe

This chapter provides a systematic review of the literature and policy measures in 13 post-socialist countries, now EU member states. The chapter starts by reviewing academic literature on institutionalization of EU rules with particular focus on the resulting gap between formal and informal institutions. Then, the treatment of various forms of informality in this sample of countries by EU staff working documents (SWDs) is discussed. In its appendix, the chapter offers a discussion of specific policy measures implemented in each of these countries to tackle informality, which helps us to recognize some of the policy implications for the current aspirants to EU membership.

Keywords: informality, informal institutions in South East Europe, informal economy, informal employment, policy measures on informal employment

Introduction

The process of transposition of the EU rules and directives which makes the *acquis communautaire* and *enlargement acquis* by the candidate countries is not easy. There are many factors to be considered when adopting and sometimes imposing new rules in a country. The results are often not achieved as envisaged, and usually carry some side effects as well—particularly when combined with lack of engagement to implement the new rules. There are also many cases of backsliding from the adopted rules in favour of more short-term interests. Therefore, the main focus of transposition of the EU rules in the literature is put on their institutionalization, that is building institutions that take ownership of those rules and invest effort in their implementation. Dimitrova (2010) recognizes three results of this process: a successful one which implies that the EU rules are institutionalized in the accessing country, a failing one in which the rules are eventually reversed, and a hybrid one, which the author calls “empty shells,”

implying that the rules are transferred to the accessing country but are not implemented or respected.

The main focus of this chapter is on the “empty shells,” or rules that are adopted but poorly implemented in the 13 post-socialist countries, now EU member states. Deficient implementation brings into existence a gap between the rules and everyday practices—gaps that are usually filled with informal practices. In this chapter we review the EU staff working documents (SWD) in order to find how informal practices are discussed, and more importantly, what recommendations are given to restrain informal phenomena that filled these gaps between rules and practices.

A general finding of this chapter is that the EU reports pay little attention to the informal sector. However, we identify two broad informal phenomena that are most frequently considered: corruption on the one hand, and informal economy and informal employment on the other hand. Other informal practices remain mostly uncovered.

Our analysis consists of reviewing the SWDs for the countries in focus, both before and after these countries became EU member states. The time frame we encompassed varies from country to country and is conditioned by the availability of those documents, but in general, we sought to cover at least five years before and five years after each state’s accession to EU membership. In some cases, this chapter managed to go beyond this time frame. We also provide an overview of all case studies on policies implemented in the focus countries to curb the informal economy, which are made available by Eurofound (European Foundation for the Improvement of Living and Working Conditions).

The chapter begins by reviewing relevant literature on transposition and institutionalization of EU rules in accessing countries, and links the available literature to the INFORM theoretical framework. There follows a discussion of informal institutions evidenced in EU staff working documents. The final section offers concluding remarks and some general policy indications for future actions. A review of policy measures on tackling informal economy is given in the appendix to the chapter.

Transposition and Institutionalization of EU Rules – a Literature Review

One of the essential steps in the process of the EU enlargement is the transposition of the EU rules and directives by the candidate countries. There are 35 chapters (EU Info Centar, 2015) covering diverse fields. Aligning domestic legislation with the requirements of the EU *acquis communautaire* can involve an impressive volume of legislation, rules and norms. Along with the *acquis*, EU also promotes the less defined enlargement *acquis* which is designed to address conditions in post-socialist countries, the adoption of which is envisaged to facilitate democratic consolidation and relevant market reforms. The candidate country has to adopt the rules and norms that operate well in the atmosphere of established EU member states, but may meet challenges in environments with different cultures and traditions, where people may have developed, for various reasons, different ways of doing things in everyday life. Therefore, the process of transposition of the EU rules is complicated by the problem of adjusting formal rules to the conditions that predominate in candidate countries, even though some space for modifications is left to the accessing countries. Overall, however, accession to the EU is conditional on adoption of a number of rules, which sometimes pushes candidate countries to rush with the transposition of EU rules, with the consequence of deepening tensions between formal rules and material conditions, or of proclaiming rules that may be reversed or never enforced.

There are many cases of actual backsliding from EU rules once adopted. For example, In an article from 2006¹, The Economist points to several cases in Poland and Czech Republic, where laws were either passed or postponed in order to give politicians more influence in the process of appointing civil servants. These are clear instances of laws being passed in the EU pre-accession process and then not implemented or delayed post-accession. However, the revocation of rules does not need to happen to call the adoption of the rules a failure—simply, if behaviour does not follow the adopted formal rules then the rules themselves have not achieved their intended impact. Or to put it simply, adopting all 35 chapters of the *acquis*

1 The Economist (2006). The European Union's new members: Through the looking glass. 30 November 2006, printed edition.

by a new member state does not mean that the accession process is complete in the way it was initially envisaged.

When it comes to the transfer of EU rules to candidate countries, the main focus of theoretical debate concerns the institutionalization of rules—i.e., building institutions based on the transposed rules. North (1990) defines institutions as setting “the rules of the game”. However, even though conditionality has motivated domestic institutions to adopt the EU “rules of the game”, the rules adopted were formal rules (Dimitrova, 2007), and were frequently in conflict with the “rules-in-use”—a focus of institutionalization, as suggested by Ostrom (1999).

The theoretical framework of INFORM project explains that institutions are defined in a way meant to account for both formal and informal rules and mechanisms of enforcement. First, the *rules continuum* encompasses both formal and informal rules—both rules coming from the EU *acquis communautaire* and informal rules entrenched in social values and norms. Then the rules pass through the enforcement belt, which represents the processes of recognition and implementation that rules need to acquire in order to become obligatory, followed and respected in everyday behaviour—that is, to become constraints. This implies that the rules will be interpreted and implemented by their users, and that mechanisms to sanction misinterpretation and mis-implementation will be established. Finally, formal and informal constraints shape behaviour and influence practices on the ground. When combined together, rules, enforcement belt and constraints constitute institutions. However, it is important to notice that behaviours (practices on the ground) are not seen only as rule-guided, but are also dependent on the resources available to individuals, organisations, companies and other bodies; as well as the social fields where the practices are happening (political, economic, legal, etc.).

In the short run, it can be said that behaviours are influenced and shaped mainly by formal and informal constraints. It follows that formal and informal constraints can only steer behaviour in the same direction if they are aligned with one another. Several conventionally shared beliefs are at work here, and these are visible in the literature: the first is the contention that formal rules tend to develop out of informal norms and social values (Helmke and Levitsky, 2004), and the second is the contention that through social learning some rules get followed by broader groups of society, and these are the ones most likely to be formalized (Sedelmeier, 2006). The principal postulate involved here is an organic

metaphor where there exists a logical path from informal to formal ways of doing things, which is absent due to EU conditionality. Dimitrova (2007) points out that the transposition of EU rules, which are created in different contexts and states and for a different set of preferences, in the accession process raises issues of deficits in influencing and shaping behaviours in accession countries. She also stresses (2002) that an important distinction is to be made between transfer of policy rules, on the one hand and rules that form a part of the broader institutional building, on the other. In the first case, the governments would only implement EU policies and not necessarily adopt the values behind the policies, whereas in the second case the focus is on institutionalization of rules which implies building institutions that would take ownership of the values and rules and ensure implementation of policies.

The process of transposing rules and building institutions faces unique complexities in post-socialist countries. The transformation from planned to market-oriented countries was believed to be hindered only by their authoritarian rulers who, once overthrown, will leave countries that will welcome democracy and free markets. But, overthrowing their rule proved to be only the start of a long process of state building, which uncovered many state weaknesses (Migdal, 1988). Weak states and their institutions opened up a space for many interest groups to take over particular areas, often under the cloaks of reforms, institution building and EU integration. However, Hellman (1998) and Ganev (2001) argue that the early winners of reform and institution building processes sometimes redirected the process of public policy reform to private interest. Ganev (2001) points out that the early winners first join forces with state agencies but obstruct progress once state agencies try to reassert control over public assets. After the fall of communism, the post-socialist countries were left with various stakeholders who profited from the initial waves of democratization and institution building due to an innovative and flexible policy style (Dimitrova, 2007) which won international support. However, once their power increased during the process to give them the hybrid right (formal and informal mix) of playing veto they acquired the ability to block institutional reform.

Hille and Knill (2006) find that the implementation of the *acquis* in accession countries has been constrained by bureaucratic capacity and institutional ability to comply. This is further deepened by the countries' inability to prevent their leading experts from attaining more lucrative

opportunities abroad. This lack of resources is also a focus of other pre-accession institutionalization studies (e.g., Seidentopf and Ziller, 1988; Verheijen, 2000). They primarily suggest that scarce financial resources and poor administrative capacity will have an impact on institution building based on the adopted EU rules.

On the other hand, Falkner et al. (2006) reject administrative capacity as a factor in compliance, and stress that a national culture of complying to requirements plays the pivotal role. A cultural inclination to comply ensures stability and longevity of adopted rules and norms. Furthermore, Sedelmeier (2006) and Epstein (2005) argue that the pre-accession period is crucial in the institutionalization process, as it allows for a period of social learning to take place. Rules that are adopted through social learning become part of the informal social values and norms, and are harder to reverse despite political actors acting as veto players and bottlenecks. It is also important to notice that country specific factors have influence on institutionalization of imported rules (Dimitrova, 2007). Dimitrova (2010) sees that the results of EU conditionality and rule transposition can be threefold:

- Reversal
- Institutionalization (alignment of formal and informal rules)
- “Empty shells” (actors ignore the new rules, parallel informal rules used) (Dimitrova, 2010: 17)

Reversal of adopted rules implies abandoning those rules and enforcing different ones instead. This is the most probable outcome when the rules adopted are not part of the EU *acquis*—most likely implemented in the first place to send a message that the accession process is progressing—and when the veto players find that it is in their interest to oppose those rules. Institutionalization, on the other hand, happens when the adopted formal rules are part of the EU *acquis* and when they conform to existing informal rules. Also, if veto players’ preferences are for the new set of formal rules, the rules have higher chances of institutionalization. And finally, ‘empty shells’ are result of formal rules being adopted as part of the EU *acquis* which conflict with existing informal rules, and opposing veto players’ preferences for maintaining the status quo.

Informal Institutions in Post-socialist Countries – Evidence from EU Reports

This section analyses the representation of the informal sector in EU reports; thus, it based on an overview of the European Commission Staff Working Documents (SWD) for 13 post-socialist countries. This includes countries that have become full members of the EU or are in the process of joining the EU. Additionally, the reports for Cyprus and Malta, located in the south of the Western Balkans (WB), were analysed. All of the above data was taken from the listed Country Reports².

Our general finding and impression is that the Reports pay little attention to the informal sector. However, they discuss the impact of some forms of informal practices such as: corruption, inefficiency of (formal) state institutions, and tax evasion. From these Reports we can conclude that all countries have made progress and that new institutions in line with the EU integration process have been established in the most countries. Despite these efforts, several Western Balkan countries (WB) continue to show the symptoms of a *captured society*. “Enterprises, institutions or powerful individuals that with their illegal activities affect policies, design the policies as well as the legislative environment and economy, and all that according to their own interests”³. The Reports cite unjustified political interference in the work of public administration, public media services and non-transparent public financing of social needs.

The Reports reveal that the continuing weakness of the rule of law negatively affects the overall climate for investment and development. A weak and inefficient judicial system, frequent changes in legislation, unfair

2 European Commission: Country Report – *Communication on EU Enlargement Policy*, Brussels SWD (2016) for countries: B&H; Montenegro; Serbia; Macedonia; Albania and Kosovo. Available on: <https://ec.europa.eu/neighbourhood-enlargement/countries/detailed-country-information>; European Commission: Country Report – *Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011*, Brussels, SWD (2017) for countries: Slovenia; Romania, Bulgaria, Hungary; Slovakia; The Czech Republic; Poland; Estonia; Latvia; Lithuania; Croatia; Cyprus and Malta. Available on: https://ec.europa.eu/info/publications/2017-european-semester-country-reports_en

3 European Commission: EU Enlargement Policy Statement for 2016: 4. Available on: <http://dei.gov.ba/dei>

competition, poor management of public finance, administrative restrictions, and an unaccountable informal sector diminish investors' interest in direct foreign and domestic investment.

On the other hand, weak tax policies, public expenditures, non-enforcement of laws, including the fight against corruption and organized crime, diminish the tax base and the effectiveness of economic policies. The extent and presence of these factors indicate a high presence of informal practices in WB countries. The impacts of informality differ from country to country. The Reports show that the economic role of the informal sector ranges between 30% and 50% in Bosnia and Herzegovina, between 20% and 40% in Macedonia, between 20% and 30% in Serbia, above 33% in Albania, and is 24.5% of GDP in Montenegro (SWD 365, 2016; SWD 362, 2016; SWD 361, 2016; SWD 364, 2016; SWD 360, 2016).

Post-socialist countries that have successfully implemented reforms required by the *acquis communautaire* are now full members of the EU. However, they have not resolved all of the challenges related to informality and are below the EU average with regard to tax evasion, corruption, and employment. The share of the informal sector in Latvia is 21% of GDP (SWD 79, 2017) and the share in Estonia is between 15% and 26% (SWD 72, 2017).

Although the EU reports do not provide much quantitative data for all countries regarding the informal sector, the analysis of corruption, unemployment, tax evasion, the independence of the judiciary and public administration indirectly indicates the presence and influence of informal practices. Below is a brief overview of the findings on the countries studied listed in the Reports.

Corruption is widespread in all studied countries. Although almost all countries have made progress in fighting corruption in recent years, some have recorded an increase in corruption, such as Cyprus. Across the countries studied, corruption is present in almost all public institutions and sectors, though the prevalence and impact of corruption varies. Poor institutional capacity for law enforcement combined with the widespread corruption has a negative impact on the business environment and the development of the private sector, particularly in Bulgaria, Kosovo, Montenegro, and Macedonia. According to the Reports, public procurement is the segment most susceptible to corruption. *“Corruption in public procurement takes several forms. The most common forms of corruption include collusive bidding, tailor-made specifications for particular*

companies, conflict of interests in the evaluation of bids, involvement of bidders in the design of specifications, abuse of negotiated procedures or abuse of emergency grounds to justify the use of non-competitive or fast-track procedures, and amendments to the contract terms after concluding the contract” (SWD 89, 2017: 45).

Slovenia has the least pronounced perception of corruption, but even there 37% of companies declared that they could not win tenders due to corruption. In Lithuania, the percentage is somewhat higher, around 39%, while perception of corruption remains higher in the following countries: The Czech Republic 41%, Romania 52%, Slovakia 54%, and Bulgaria 60%. Over 40% of public procurement contracts are awarded on the basis of only one tender in Slovenia. Likewise, the largest number of competitive bidders are excluded from the offer. After political instability, corruption is reported as the second most problematic factor for business in Hungary. In the Czech Republic, after ineffective government bureaucracy and tax regulations, corruption is regarded as the third most troublesome factor for doing business. The studies carried out in Cyprus underline the perception that patronage, bribery, and abuse of power are significant problems in public administration, and 87% of entrepreneurs confirmed that corruption hinders competition. In Romania, corruption is generally considered as a major problem. In Serbia, as in Albania, corruption is widespread and represents a serious problem, despite efforts to prevent and fight against corruption. Progress has been made in Bosnia and Herzegovina following the adoption of action plans at different levels of government, but the fragmentation of the country diminishes the effectiveness of implementation. In Kosovo, which is at the initial stage of preparation for fighting corruption, there is no political will to solve the problem in a comprehensive way (SWD 89, 2017; SWD 80, 2017; SWD 69, 2017; SWD 88, 2017; SWD 90, 2017; SWD 68, 2017; SWD 72, 2017; SWD 78, 2017).

As stated in the Reports, in some countries, the practice of “pocket payment” has developed. “Pocket payment” is most widespread in the health sector. In Cyprus, this form of payment in the health sector reached 50% (EU average is 15%), in Latvia it is 39%. Informal payments “under the table” in Slovakia are up to 23% and potentially hinder equal access to services (SWD 78, 2017; SWD 79, 2017). In the case of Hungary, the share of that payment method, which includes the estimated amount of informal payments, is 27% compared to 17.6% in the EU. Patients use informal payments to avoid long waiting lists or to seek access to preferential treatment (SWD 82, 2017).

All studied countries have made steps forward in institution building and the adoption of anti-corruption strategies and policies. Issues of the efficiency of institutions and governance in the public sector are the main challenges facing the fight against corruption at all levels. The low level of processed corruption cases, especially for high-level individuals, creates the perception that corruption is an acceptable behaviour. The high level of corruption in the studied countries confirms the significant role of informality in creating a business environment.

The Reports find tax evasion in all studied countries. Tax evasion is a consequence of the weakness of tax policy and the high participation in the informal sector. "Poor tax authorities, high levels of tax evasion and undeclared work and, consequently, relatively low tax revenues provide limited fiscal space" (SWD 68, 2017: 21). Tax debts, tax evasion, and the grey economy are the main challenges for establishing tax discipline. Despite progress in public finance and tax discipline, there lacks an effective framework of tax risk management. According to assessments presented in the Reports, the extent of tax fraud in Croatia is 35% of net tax revenues, while the extent of tax fraud is 24% in Poland, and 18% in Hungary, all above the EU average of 14% (SWD 76, 2017; SWD 86, 2017; SWD 82, 2017). The Report shows that various factors, including the weaknesses in tax policy, corruption, uninsured labour force, informal employment, unfair competition, non-enforcement of laws, organized crime, and tax fraud, reduce public revenues and strengthen the informal sector. In Serbia, tax evasion is also affected by the lack of harmonization of tax legislation with the code of conduct for business taxation. Weak institutions and the informal sector in Albania have resulted in an informal exchange of assets, which leads to disputes that further burden the courts and cause additional loss of tax revenues. "However, patterns of tax fraud are constantly changing as fraudsters adapt to new rules, exploit loopholes and move to new sectors. The objective of the changes is to improve tax collection and simplify tax obligations for taxpayers via consolidation of tax and customs administrations" (SWD 86, 2017: 17).

Countries that record high rates of unemployment also have high participation in the informal sector. In Serbia, Albania, Bosnia and Herzegovina, Macedonia and Kosovo, more than one fifth of the working age population is unemployed. With limited employment opportunities, informal employment is a strategy for survival. Furthermore, "Informal employment includes work without a formal contract, but also under-reported

remuneration ('envelope wages') or evasion of social security contributions" (SWD 68, 2017: 31). There is an important difference between registered (statistical) labour force data, and the informal labour market, which is highlighted in the EU Reports. In Montenegro, every third person works in the informal sector, which is not included in statistics. Similarly, in Macedonia, it is estimated that over 20% of employees work in the informal sector, and in Albania about 40% work in the informal sector (SWD 360, 2016; SWD 362, 2016; SWD 364, 2016). In Bosnia and Herzegovina, the active population rate is 44%, and the employment rate is 32%, this difference of 12% indicates a high level of employment in the informal sector (SWD 365, 2016). There is a similar situation in Bulgaria and Romania where the rate of undocumented workers ranges between 15% and 20%. In Romania, "undeclared work remains prevalent, also reducing both labour supply and fiscal revenue. National data estimate people in the informal economy at around 1.2 million" (SWD 88, 2017: 2, 20). Countries that have become full members of the EU have lower unemployment rates. Cyprus and Croatia have the highest unemployment rates of 13%, followed by Slovakia and Latvia with 10%: the unemployment rate in each of these countries is above the EU average (SWD 78, 2017; SWD 76, 2017; SWD 90, 2017; SWD 79, 2017). In the Czech Republic, Estonia, Malta, and Poland, unemployment rates are below the EU average. In Latvia, the payment of wages in the "envelope" is in decline, although estimates demonstrate that participation is still high (18% of real wages in 2015). In these countries, there is frequent and increasing migration to other EU countries. While this reduces unemployment, it also results in shortages of qualified labour. In the case of Poland, 2.4 million Poles migrated out of the country, with no intention of returning. 14% of Bulgarian citizens live abroad. Labour shortages are "compensated" by migration from other countries. The Reports show that all countries are facing the problem of unemployment of vulnerable groups. The largest number among the unemployed are young people, women, "low skill" workers, elderly, women with young children, and Roma people. In Serbia, only 18.5% of Roma people aged 20 to 64 were engaged in "paid jobs," in Slovakia 25%, and in Bulgaria 26% (SWD 361, 2016; SWD 90, 2017). The difference between the participation in employment of women and men indicates that labour market conditions are still unfavourable for women. The unpaid work of women remains a challenge. "The absence of state services for child care in rural areas increases women's unpaid household

work” (SWD 364, 2016: 54). Unemployment benefits the informal sector that further affects job creation, including those for young people, “Informal work concerns especially young workers and long-term unemployed” (SWD 362, 2016: 28).

It can be concluded from the Reports that legal insecurity, distrust in state institutions and predictability of regulatory, tax, and other policies discourage investors and contribute to lower growth rates. “Legal certainty, trust in the quality and predictability of regulatory, tax and other policies and institutions are important factors that could allow an increase in the investment rate. The rule of law and an independent judiciary are also essential in this context” (SWD 86, 2017: 2). This presents a systemic threat to the rule of law, creates legal insecurity, and supports informal practices. Legal uncertainty has a negative impact on entrepreneurship and the development of the private sector. “The private sector is underdeveloped and hampered by weaknesses in the rule of law” (SWD 361, 2016: 25). Moreover, “the low trust in the judicial system and public institutions hinders private investment” (SWD 68, 2017: 3). In addition to the legal uncertainty of the studied countries, they also face the problem of the quality and efficiency of the judiciary, as is stated in the case of Cyprus: “the low quality of Cypriot regulations and inadequate enforcement due to lengthy administrative and court proceedings weaken the effectiveness of Cyprus’ legislation and overall legal certainty” (SWD 78, 2017: 45). However, the judiciary is not only slow and inefficient, it is also faced with the lack of responsibility of judicial officers and is subject to undue political influence. “The judiciary is still vulnerable to undue political influence and rule of law institutions suffer from lack of funding and human resources” (SWD 363, 2016: 5). Insufficient political support for reform, as well as fragmentation of the public sector, hinder efforts towards institutional and legislative reforms. The Reports conclude that all countries have an obligation to improve their judicial system and make it independent and efficient. “Intensified efforts are needed to strengthen the rule of law to ensure that regulatory improvements translate into an improved investment climate” (SWD 360, 2016: 26). In many countries of the Western Balkans, the legal framework is still not in line with European standards, leaving room for political influence on the recruitment and appointment of judges and prosecutors. The present public comments on investigations and current cases, including those at the highest political levels, further aggravate the judicial independence:

“Bulgaria is among the weakest in the EU in terms of accountability, rule of law and control of corruption” of all full EU members (SWD 68, 2017: 38). According to the Reports, declared political commitments to fight against corruption have not shown sufficient concrete results.

Altogether weak rule of law, widespread corruption and inefficient administration continue to harm the business environment. “Trust in the public institutions is undermined by a high perceived level of corruption” (SWD 78, 2017: 30). Repeated survey findings highlight the perception that patronage, bribery or abuse of power are significant problems in public administration (World Bank, 2015). Institutions are especially weak when it comes to indicators of competitiveness, due to weak protection of property rights, the protection of intellectual property, as well as the independence of the judiciary and the transparency of government policy (Bulgaria and Romania). The unstable regulatory environment is one of the biggest obstacles to doing business in Hungary. In Slovakia “shortcomings in public administration have been identified as one of the obstacles to improving the business environment” (SWD 90, 2017: 33).

In almost all countries, the inefficient judicial system and the lack of qualified labor force negatively impacts the investments needed to support growth and convergence. “The business environment in the Czech Republic is characterised by a heavy regulatory burden and numerous administrative barriers, which act as an impediment to both private and public-sector investment” (SWD 69, 2017: 24). Malta successfully implemented reforms and established an acceptable business environment. As a result, newly established companies can start working within two or three days by filing a short electronic form on an online portal after a two-step process. Unlike Malta, in Bosnia and Herzegovina “the business environment remains difficult: business registration procedures remain cumbersome and costly, and the requirement for a company to register in both entities if it has a commercial presence has not been addressed” (SWD 365, 2016: 53). Estonia achieves the best performance in digital public services, which is evidenced by its shift from fourth place in 2015 to first in 2016. In WB countries, “elections are seen as an opportunity to achieve political control over wider administration, including independent institutions” (EC, 2016: 6). Despite updated civil service legislation, the structure of public administration in most countries remains complex and does not provide sufficient accountability. There is a crucial influence of political interest on the election or appointment of the management positions of regulatory

bodies,. This hinders the achievement of a high quality regulatory environment guaranteed by independent and responsible oversight. Therefore, citizens' rights to good governance, access to information, and administrative justice are limited. The introduction of e-government services remains a priority, as it can be a key factor in increased transparency, speed, and consistency in public services. Based on the Reports, it can be concluded that all countries have made progress in strengthening the institutional framework and business environment, but there are still many challenges that each country needs to resolve and eliminate in order to bring the business environment to an acceptable level.

Conclusions and Policy Implications Presented in the EU documents

High levels of corruption, tax policy weakness, underdeveloped labor markets, legal insecurity and inefficient administration in the studied countries are indicators of underdeveloped formal institutions. Strengthening formal institutions and eliminating weaknesses remain among the main challenges for all countries. Many countries, through formal procedures and institutions, have adopted various strategies for eliminating related problems, but their implementation is still inefficient and insufficiently effective, sometimes even counterproductive in terms of diverging from the EU *acquis*. In order to ensure the reduction of informal practices that detract institutional effectiveness, additional and comprehensive measures are needed.

Control of corruption is a key challenge for all countries. The stated political commitments in the fight against corruption have not been translated into concrete actions. The Reports recommend that all countries should establish independent and specialized anti-corruption institutions. Corruption in all forms should be legally and publicly sanctioned, and property acquired by corruption should be seized and used to finance the education system and the protection of socially vulnerable persons. Political declarations of commitment to anti-corruption activities should be implemented, and instances of non-enforcement must be sanctioned.

According to the Reports, corruption is most pronounced in the public procurement system. Most EU recommendations go in the direction that it is necessary to change public procurement regulations in order to strengthen competition and transparency. Procedures must be clear, simple, and pre-established. Furthermore, it is necessary to establish and strengthen control mechanisms for rapid action and elimination of irregularities in the creation of amendments to existing regulations. Offenders should be punished in a timely and effective manner. The fight against organized crime in the public procurement system must be comprehensive in order to dismantle corrupt networks. Finally, the EU Reports recommend that anti-corruption institutions and authorities have the capacity to disclose criminal networks and the power to seize assets and initiate systematic financial investigations.

Apart from corruption, another informal phenomenon emerges as frequent in the EU country reports. High unemployment rates are accompanied by high levels of participation in the informal employment sector. Unemployment problems are to be tackled by creating a stimulating business environment for entrepreneurship, with attention to the domestic and foreign investors. Simplified procedures that are implemented include legalizing work, increased access to financial resources, tax relief in the first years of business, and advisory and educational assistance for startups and small businesses. This will encourage participants in the informal sector to formalize their businesses. Growth of investments and reduction of the informal sector entails new employment, which reduces unemployment. In order to overcome the challenge of employing people in vulnerable social categories, state intervention is required through additional education, retraining, credit rating, and stimulative systems. As stated in the Reports, special attention should be paid to young and elderly people whose rates of unemployment are the highest. In the appendix to this chapter, we offer an overview of policies the 13 post-socialist countries, now member states, have implemented in order to curb the practices related to informal economy and particularly informal employment. The analysis is separated by country and serves as an overview of more and less efficient measures that have been undertaken recently.

Many countries have improved the business environment by updating laws on general administrative procedures, but there is still a problem of cross-sectoral differences in administrative procedures. The structure of state administration, in most countries, is still complex and unresponsive.

In the EU Reports, countries are encouraged to find the appropriate balance between central, regional, and local authorities to improve the implementation of reforms in providing services to citizens. Citizens have the right to good governance, access to information, and efficient administration. Administrative procedures must be simplified, understandable, and publicly available. The introduction of e-government services remains a priority as a key factor for transparency, speed, and consistency in public services (as demonstrated by the example of Estonia).

Our analysis of the Reports indicates that informal practices are widespread in the studied countries. The prominence of informal practices results in a very noticeable informal sector that diminishes potential economic development opportunities. Political will needs to be ensured in order to adopt a comprehensive strategy to tackle negative informalities. The gap that appears between the will to pass laws and the will to implement them indicates the irresponsibility of the ruling political structure that governs formal institutions. It is necessary to maintain pressure on governing structures to ensure implementation.

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