

C. THE FIGHT AGAINST CORRUPTION IN THE ECONOMY

The need to fight corruption in the economy could not be overstated, as this is the domain of the so-called „big“ corruption characteristic for illegal transfers of considerable resources. Corruption flourishes on the pitfalls and the unintended consequences of the economic reform whose major goals are to define the new role of the state and its agencies within the institutional framework of transition, to transform ownership in the course of privatization, to create a favorable environment and rules promoting competitive markets, to create productive methods of interaction between the public administration and private business, to stimulate the growth of market institutions and promote self-regulation in private business. All of these goals have a strong anti-corruption potential but they will hardly work without explicit measures targeting various corrupt practices in the economy.

The new configuration of public and private interests in the process of transition to a market economy coupled with the lack of mature mechanisms of prevention has become a breeding ground of for various illegal and semi-legal activities which usually surface in the form of the so-called hidden or „gray“ economy defined by the criminal symbiosis of organized crime, semi-legal business entities and corrupt administrators. A particular challenge in the process of transition from a centralized to a market economy comes from the transformation of ownership and redefinition of property rights. In the assessment of the corrupt practices in the economy we should note the contradictory logic of the long-term general anti-corruption potential of the reform, on the one hand, and the lack of transparency in privatization deals, the remaining over-bureaucratized procedures, the lack of effective state control and regulation of market participants, on the other hand. It should also be noted that corruption and bureaucratic routine are among the major impediments to the growth of investor interest in Bulgaria.

C.1. Corruption and Privatization

The process of privatization is the sector of the reform in which the risk of corrupt practices is the greatest. The general conclusion that progress in the course of the reform goes hand in hand with existing bureaucratic procedures breeding corruption is true for the process divestiture; as a result, reform measures remain to a large extent ineffective.

If we consider the current state involvement in the economy we should note that **the share of state ownership has continued to decline in the year 2000, thus limiting the potential for corruption on this basis.** So far, 75 per cent of the state-owned asset targeted by the privatization program have been divested. According to the Privatization Agency 663

of the 673 transactions planned for the year 2000 have already taken place.

At the same time, the state has kept a strong presence in the economy. Thus additional efforts are necessary in order to complete the process of privatization and further limit the opportunities for corruption. There are still about 600 state-owned enterprises (excluding companies in the energy sector, railways, the utilities and the public health not targeted by the privatization program yet). By the yearend of 2001 divestiture in industry, construction, transportation, agriculture and services is expected to be over. Within the same time frame all currently open procedures of liquidation should be completed too - no additional liquidation procedures are expected to take place further.

The state continues to have residual ownership stakes in the equity of a large number of partially privatized enterprises. By mid-year the sale of these residual equity stakes should have been divested as planned in the privatization program for the year 2000 but so far this hasn't been done. This delay creates additional opportunities for corruption - not only it shows administrative incapacity but also a bureaucratic reluctance to permanently give up the opportunity for direct influence in the work of companies functioning as private business entities. The presence of state officials on boards of directors and other managing bodies of joint-stock companies with private majority ownership perpetuates informal links between private business and state agencies, create conflict of interests and undermine the spirit of the reform. **An accelerated sale in the year 2001 of the shares owned by the state in the partially privatized companies** through all available methods (direct sale for cash, centralized public tenders, offering on the stock market, etc.) **will be the best litmus test for the commitment of the state to do away with corruption.**

Divestiture in the sphere of social services, including companies with monopoly power, has begun since mid-2000. The role of these enterprises in the national economy requires special strategies for restructuring and privatization guaranteeing transparency and competition.

Regarding the methods of divestiture used in the year 2000 did not witness any significant change, which would limit the opportunities for corruption. **Negotiations with potential buyers remained the preferred method**, even in cases of sale of small and medium size enterprises. The recommendations of the business community and the international financial institutions for wider use of the mechanisms of competitive tender auctions and the stock exchange remain just a wish, or in the best case scenario, declarations of intent in official government documents with no further follow-up.

The revised government strategy for privatization represents a corrective measure regarding the instruments and modalities of privatization for the purpose of allowing the political authorities to keep at least partial public and investor support as well as trust in its capacity of managing privatization in an honest and transparent manner.

In all of its major policy papers *Coalition 2000* recommends to the privatizing bodies to use transparent public procedures with clear rules for competition and equal treatment. The special recommendation of the Second Policy Forum of *Coalition 2000* in December, 1999 on the need for general rules of negotiations with potential buyers regarding the

application of this method of divestiture was accepted as part of the necessary changes to be introduced in the process of privatization. In spite of the delay, the long-awaited implementation of such measures should further limit opportunities for corruption.

The discussion of the fight against corruption in the economy should not ignore the instances of **corruption of high government officials**. At present, six cases of alleged corruption in the course of privatization involving ministers and deputy-ministers in governments of the ruling coalition are currently under investigation; the officials allegedly involved in illegal activities have been dismissed. These developments may be a sign of a new style of government - they show the growing commitment of the authorities to get rid of the existing corrupt practices. The effectiveness of the measures undertaken in this respect, however, will ultimately depend on the effectiveness of the law enforcement system and its independence from the incumbent political authorities.

Post-privatization control has been actively debated in public this year and political speculations on this issue have been abundant. In its current state post-privatization control is poorly regulated in the legislation; the scarcity of information creates an impression of a biased approach of the state administration in favor of the buyers in certain privatization transactions. It would be unrealistic, however, to insist on revision of certain „shady deals“ as the fight against corruption by canceling the deals with alleged corruption involved might lead to new corrupt practices by further delaying privatization and giving administrators and private businessmen new opportunities for collaboration in favor of special interests. Solving the existing problems and avoiding serious unexpected consequences of the process requires a reasonable and flexible approach to the implementation of investment projects and involvement of an optimal number of the employees in privatized companies. A major element of this approach should be the adoption, unification and observation of **clear and transparent rules and procedures for post-privatization control** which will bring to a minimum the existing temptations for an administrator to get involved in illegal or improper activities; without such procedures no provisions for post-privatization control included in the contracts with private investors could be effectively implemented.

The same approach should apply to the related issue of **compliance with concession contracts** taking into consideration the longer time frame of these deals as well as the lack of experience in this respect. It is logical to expect that with the end of the process of privatization *per se* certain officials may try to use these particular contracts for illegal gains as the other opportunities will have significantly diminished.

As the „stormy privatization“ is coming to an end the opportunities for illegal gains of public officials at the expense of the public interest will substantially decrease. Nevertheless, even though most of the transformation of ownership has been accomplished, privatization should continue with clear, detailed and transparent rules and under strict civil control. This is of particular importance for the transactions yet to come involving the utilities and other large companies of strategic importance for their respective industries as well as the social services sector. In this sense, **the amendments to the Privatization Law, proposed by the government, and the new strategy which targets many of the pitfalls**

of privatization so far should make the necessary corrections in implementation mechanisms and help achieve the fundamental goals of the process.

An important element of the anti-corruption measures in the economy would be further progress in the field of **corporate governance reform**. The weaker and less effective corporate governance is, the greater the opportunities for corruption are. *Coalition 2000* is working in close collaboration with the Corporate Governance Initiative in Bulgaria (www.csd.bg/cgi) whose goal is to stimulate and support the reform of corporate management in Bulgaria. Among the individual steps to undertake in this respect with expected significant effect for limiting the incentives and opportunities for corrupt behavior we should note the promotion of such principles of modern corporate governance as access to information about the structure of ownership and possible equity crossholding, strict sanctions for abuse of insider information, appointment of external directors in the governing bodies of the companies, regular independent audit and publication of its findings, creation of effective legal and institutional environment for protection of creditor rights, etc.

C.2. Corruption and Business Environment

The year 2000 can be described as the period of **laying the foundations for limiting the corruption pressure on business**. It marks the beginning of active efforts of the state institutions to abolish and bring down the number of licensing, registration and consultation regimes. This has happened in the course of a debate with wide public participation involving business associations as collective intermediaries between private business and the state. Obviously, the corruption pressure continues to be very strong - the „unofficial“ payments for obtaining import and export licenses are still widespread, which also shows that the state has not retreated enough from economic activities and the efforts

to ease bureaucratic restrictions and routine are yet to produce substantial results.

In general, it could be concluded that in spite of the progress in limiting the obstacles to business **bureaucratic red-tape has not been overcome and there has not been enough progress toward transparency and accountability**. The space within which private business interacts with state institutions remains a high-risk zone of corruption.

The government deserves credit for its work towards lowering administrative barriers to

BUSINESS ELITE ASSESSMENTS OF THE ENVIRONMENT FOR ECONOMIC ACTIVITY (%)

	Fully agree	Rather agree	Rather disagree	Fully disagree
The influence of the „power groups“ in the Bulgarian economy is strong	27,5	43,2	21,5	7,8
In Bulgaria state interference in the private sector is too big	18,8	41,0	27,1	13,1
The private business in Bulgaria faces many administrative obstacles	56,8	33,4	5,4	4,5
The Bulgarian public administration is independent and is not influenced by some private economic interests	3,9	12,4	44,4	39,3
The taxation in Bulgaria is good and stimulates the development of businesses	2,6	5,8	41,9	49,6

Source: *Coalition 2000 CMS*, Business Elite Survey (October, 2000)

entrepreneurship, business and trade - 55 regimes have been abolished or eased; in addition, 40 regimes are expected to be eased by the yearend of 2000. The Council of Ministers has approved and submitted to the National Assembly draft laws for easing 44 more regimes. The number of regimes, either abolished or eased, as well as those expected to be abolished or eased in the near future is 166 of a total of about 400 in existence. It is not unrealistic to expect that in the coming years the assessment of the business community for the environment in Bulgaria will reflect an improved business climate.

The high level of corruption is not just one of the major factors for **the low level of competitiveness of the Bulgarian economy** - it also reinforces the perception that the business climate in Bulgaria is not very favorable. A KPMG study on the barriers to foreign investment in Bulgaria in the year 2000 identified it as the fourth largest obstacle, coming right after the cumbersome bureaucracy, the incoherent and unstable legal system and the limited purchasing power of the population.

- In the course of the **adoption of the budget** for the year 2001 a number of changes in the tax laws are expected to be introduced with the purpose of creating a favorable environment for both big and small business, stimulating investment and diminishing the tax burden on the population. The changes in the Tax Procedure Code are supposed to provide support to businesses in their efforts to achieve profitability as well as decrease the incentives for giving a bribe in cases of tax fraud or ambiguous interpretation of legislative texts.
- In Bulgaria there is little strategic vision or accomplishments in the field of **interaction between private business and state institutions**. This relationship lacks regulation and transparency, which naturally spurs suspicion of corruption in the interaction between private and public entities. State institutions have not come up yet with clear rules of communication with the public and work with the business community. There have been multiple cases of total disregard of proposals coming from the business community by the executive and the legislature just because of the lack of a clear policy on the subject matter of these proposals and existing fear of being accused of illegal or improper contacts with private business. This situation necessitates adoption and strict application of rules and regulations which could both provide transparency and reciprocity and promote a cooperative relationship between the state and private business fully in compliance with the laws and free of corrupt practices.
- In the year 2000 there were initial efforts to formulate **rules and norms of ethical behavior** in business and to seek better understanding of the potential of self-regulation as a means of fighting corruption within the private sector itself. The Forum of Bulgarian Business Leaders adopted a *Handbook for the Preparation of a Code of Fair Business Practices* - a document which should be given wide publicity; all professional and business associations, individual businesses and other interested parties should be involved in its discussion and follow-up activities.
- The assessment of the business environment should also cover the issue of the **scope and the strength of the „gray“ economy as a**

source of corrupt practices. According to experts of *Coalition 2000* its share in the GDP of Bulgaria has been between 32 and 35 per cent over the last few years, which creates a large potential for corruption. In this respect anti-corruption measures should include further work on the implementation of the institutional reform with the goal of moving these activities out of the shade and bringing them to legality.

- **Corruption is intricately linked with the different forms of illegal import and export activities, which represent a large portion of the „gray“ economy.**

Moreover, the more corrupt law enforcement bodies are, the greater the scope and size of smuggling. According to experts of *Coalition 2000* over the last few years a constant criminal interaction between smugglers and state officials practically at all levels has been forged in Bulgaria.

Elaborate schemes for serving the combined interests of both smugglers and corrupt officials have come into being.

The report on *Corruption and Illegal Trafficking: Monitoring and Prevention*, prepared by Center for the Study of Democracy, throws light on the scope and size of the phenomenon by providing data on the so-called **unregulated payments** (the bulk of which represent pure instances of bribery) in cross-border transportation of goods. Such payments amount annually to BGN 1.5 m. for the import of citrus fruit, BGN 2 m. for coffee beans, BGN 3 m. for cosmetics, BGN 1 m. for computer hardware, about BGN 10 m. for oil and fuels, BGN 8 m. for tobacco products, BGN 3.2 m. for alcohol drinks. The persisting levels of smuggling and the accompanying

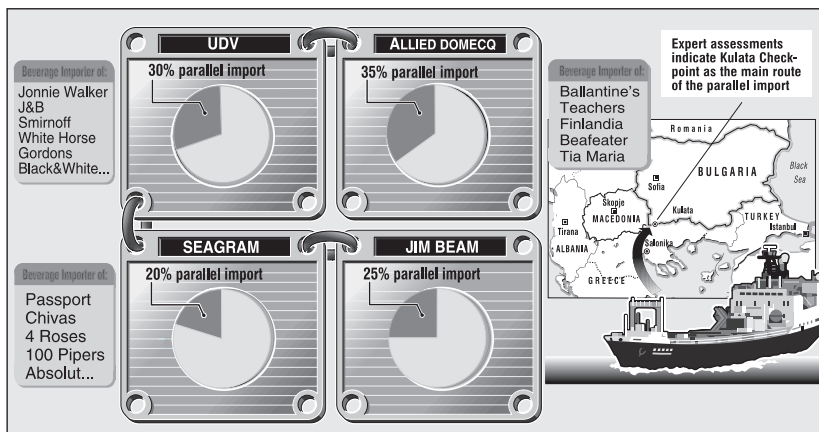
practices of corruption deprive the state of legitimate income and deal a serious blow to the competitiveness of local economy. At the same time, the cash generated in these activities is used to provide a political cover for semi-criminal interests as well as to finance all kinds of dealings, legal and illegal alike.

The efforts of the government to contain illegal trafficking and bring **the import of certain goods to a legal status** in the

PARALLEL CLASSIFICATION OF ILLEGAL TRAFFICKING AND CORRUPTION

Type of Trafficking	Forms of Corruption
Small-scale smuggling („suitcase trade“)	Administrative corruption
Smuggling channels	Corruption networks
Trafficking sponsored at the political level	„Grand“ corruption

MONITORING OF THE LEGITIMATE IMPORT OF BRAND SPIRITS FOR THE FIRST HALF OF 2000



Source: *Coalition 2000*

year 2000 (alcohol drinks, detergents, etc.) have had some effect - the illegal import of liquor to Bulgaria is considered to be limited to 25-30 per cent of the total as compared to almost 90 per cent in the year 1998.

For the measures aimed at imposing limits and gaining control over illegal trafficking and related activities to be successful a more effective legal and institutional framework should be created. An important measure in this respect could be the creation of an information system to be used by the different branches of the state apparatus involved in prevention and monitoring of these criminal activities; the cooperation of interested NGO and other parties, both at a domestic and international level, should be sought in this matter.