

## D. CORRUPTION IN THE ECONOMY

In the case of weak institutions, low administrative capacity and lack of traditions, the state's interference with the economy results in conflicting public and private interests, which create favorable environment for corruption. In this relation the spheres most susceptible to corruption risks in Bulgaria are: the state's intervention in the economy both as a shareholder and a regulator, fiscal policy, public procurement, customs, privatization and post-privatization control, and the underground economy. Introducing adequate and transparent public sector management and ensuring free competition in the private sector are the basic prerequisites for an effective anti-corruption policy in the economy.

### Corruption in Transition - the Bulgarian Case

The absence of basic economic rules, combined with the state monopoly over economic resources and the slow privatization and restructuring created a favorable environment for the appearance of corruption in the beginning of transition. The lack of political will, vision and know-how for carrying out economic reforms in Bulgaria in the beginning and mid 1990s prolonged the institutional vacuum and led to two major cycles of siphoning public resources into private hands.

The first one constituted of decapitalization and unregulated privatization of state-owned enterprises through the control of their entry and exit resources by private enterprises.

The second one involved the use of financial institutions for lending to related parties, who never returned the loans.

The unregulated concentration of economic power in private hands paved the way for the development of underground economic activities, money laundering and corruption. Powerful economic groups realized their interest in preserving the *status quo* and launched attempts to capture the state through the corruption of public officials.

### D.1. State Intervention in the Economy and Corruption

Economic policy liberalization and restraint of direct government intervention in the economy through subsidies and administered prices promote competition and limit the possibilities for administrative pressure and corruption. In the case of Bulgaria, where administrative and institutional capacity for the implementation of existing economic rules is still low, any further increase of state intervention in the economy is likely to create additional incentives for embezzlement and corruption.

In 2002 the government introduced several controversial measures for

intervention in the economy, which reduced business environment transparency and increased corruption incentives. The most notable among these were:

- the imposition of higher import duties for certain products;
- the introduction of subsidies for grain producers and exporters;
- the sale of bankrupt state-owned shipbuilder to another state-owned enterprise - the Bulgarian Maritime Fleet.

Such measures benefit closed-group economic interests and present a suitable precedent for future pressure on government policies. Therefore, the Bulgarian government should try to ensure adequate enforcement of existing rules before introducing new ones.

State aid is one of the major channels of government intervention in the economy. The lack of transparent rules and criteria for state aid disbursement, coupled with low administrative capacity, increase the risks of private interest pressure and misuse of public funds. After a long delay, in 2002 Parliament has adopted a *Law on State Aid* (LSA) (State Gazette no. 28/2002), which regulates the rules and conditions for control over state aid disbursement, as well as for evaluation of its compliance with the principles of free and fair competition. **The provisions of the law and the introduction of a public state aid registry are prerequisites for more transparency and better control over government decisions in this area.** However, it is still early to give a definitive evaluation of the actual LSA enforcement as practical implementation is limited. So far, the *Commission for Protection of Competition* (CPC), which is authorized by law to control state aid, in practice only registers and analyzes government decisions on subsidizing. The administrative capacity of the Commission to implement the law's provisions should be strengthened considerably to reach levels of effective control over state aid decisions. The Government should also take appropriate measures to insulate CPC's decisions against possible corruption pressures from interested parties. In this regard Parliament should consider introducing stricter fines for administrative offences and eliminating CPC discretionary power to exempt certain economic agents from obligations under the law. State aid for public monopolies did not decline in 2002, although the Government had taken explicit obligations to reduce it. As percent of GDP state aid in Bulgaria is not higher than the EU countries average but it might be expected that its distortionary effect on the economy is higher due to the poorer administrative and economic development of the country. The establishment of a new state-owned airline carrier with public resources in 2002 might create undesired state aid increase for the sector in the future. At the same time this would increase direct state intervention in the economy and would raise doubts of protection of particular private interests through public resources.

A major channel for state intervention in the economy, which is not regulated by the *Law on State Aid*, is the subsidizing of farmers and agricultural producers. Justified public suspicion of fraud and corruption in the past calls for careful monitoring and control over public agricultural subsidies. The amendments to the *Law on Support for Agricultural Producers* (LSAP) (State Gazette, no. 96/2002), which have been adopted by Parliament in 2002, are not definitive towards reducing the corruption

potential in the area of agricultural aid. On one hand, they reduce the risks of corruption by defining more precisely the goals and responsibilities of *State Fund Zemedelie*, taking into account the specific requirements of SAPARD EU pre-accession program. On the other hand, the amendments stipulate an increase in financing for the *Fund* (from 0.15% to 0.5% of GDP) and grant preferences to registered agricultural producers. As there is no visible improvement in the *Fund's* administrative capacity, this increases the potential for corruption. The Government should adopt with priority the following measures to curb corruption in agricultural support:

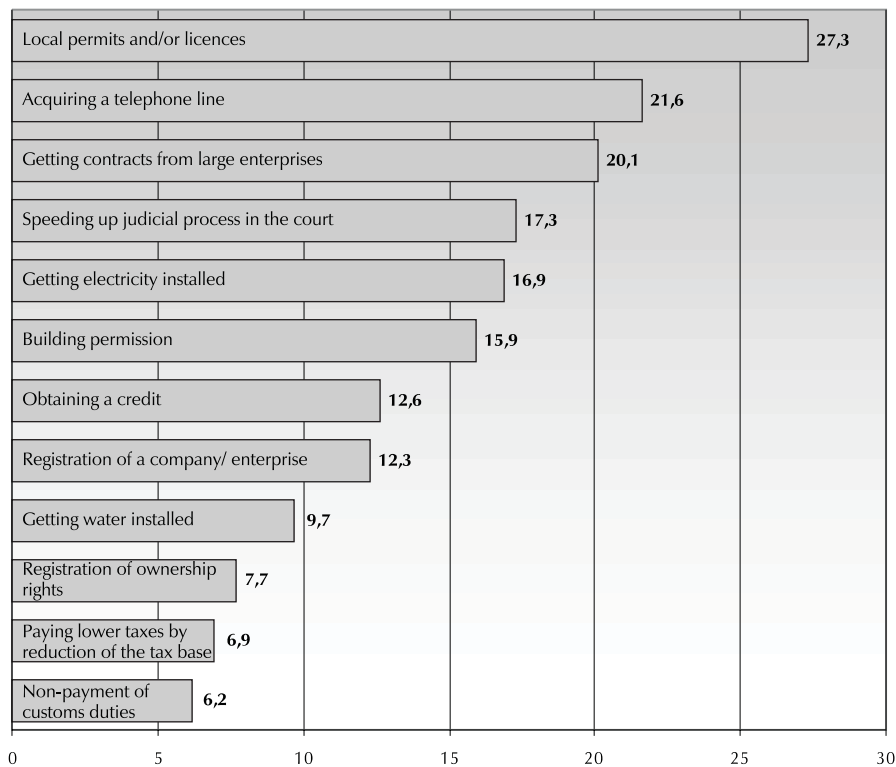
- **define a ceiling** as percent of GDP for state agricultural support;
- publicize widely the *Annual Report on the State and Development of Agriculture*, which stipulates annual agricultural subsidies;
- strengthen considerably the administrative capacity for internal financial control of *State Fund Zemedelie* and the *Ministry of Agriculture and Forestry*.

The existence of public or private monopolies in the economy distorts free market forces and leads to the concentration of considerable resources in few economic agents, which is a powerful prerequisite for the appearance of corruption. Surveys of small and medium-sized enterprises (SMEs) show that **corruption pressure from public and private companies with considerable market power remained high in 2002. There is no notable progress in state monopolies liberalization, which preserves possibilities for corruption in their customer relationships.**

The areas most often reported by SMEs for requiring additional unregulated payments are fixed line telephone and electricity supply. In this relation, the government and the responsible ministries should, in parallel to gradual liberalization, embark on measures for improvement of internal control enforcement rules and administrative sanctions in public monopolies.

The lack of adequate administrative capacity and experience in anti-trust regulation enforcement, and the low financial and

**FIGURE 20. SERVICES CONCENTRATING SMEs' INFORMAL PAYMENTS (RELATIVE SHARE OF SMEs, WHICH MADE INFORMAL PAYMENTS IN ORDER TO OBTAIN SERVICES) (%)**



Source: Vitosha Research, Integra, Corruption in Small and Medium-Sized Enterprises, June 2002.

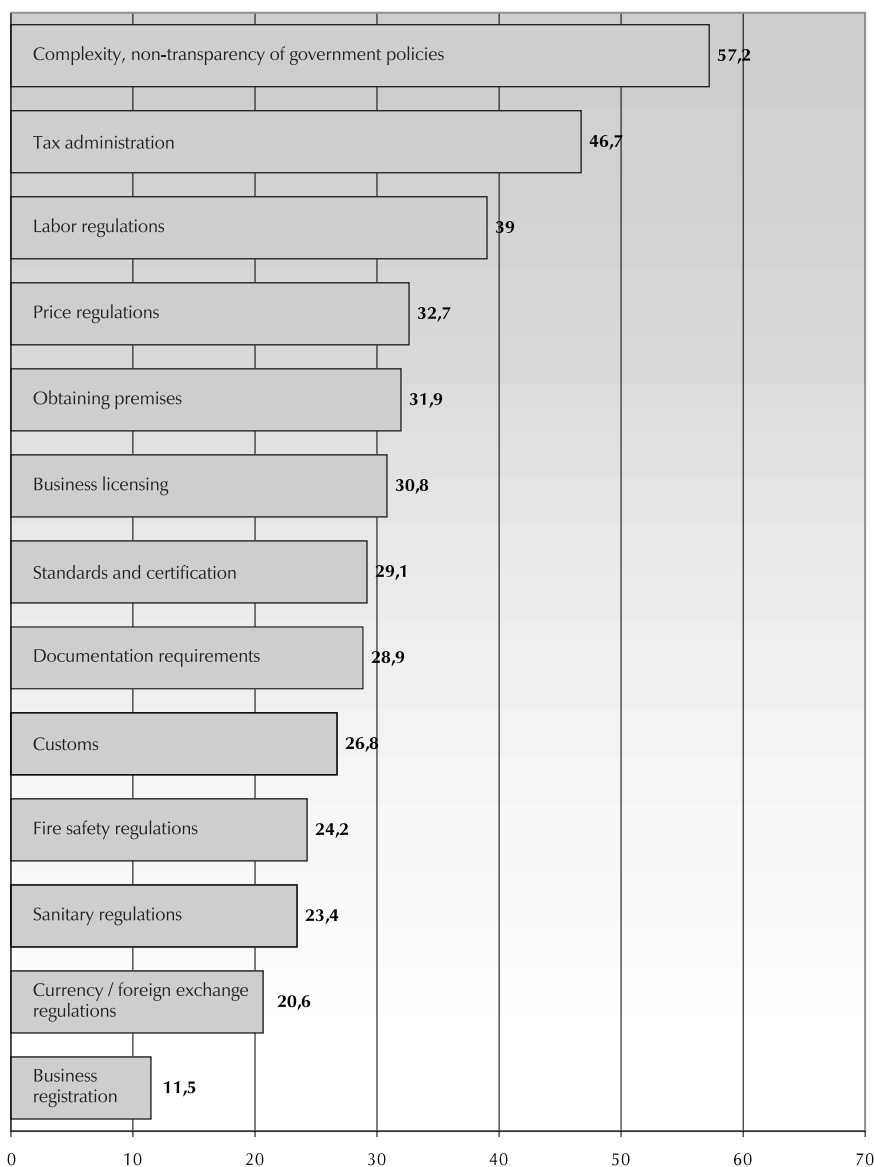
material sanctions imposed for breaching the existing regulations, result in ineffective protection against excessive market power concentration. In 2002 the Government launched legislative efforts to increase CPC powers. In November the Council of Ministers adopted a *Draft Law on Amendments to the Law on Protection of Competition*, which contains two major anti-corruption provisions:

- An increase in CPC's authority to block excessive horizontal and vertical market concentration in the economy;
- Stricter parliamentary control over CPC's activities.

The amendments, however, are still pending in Parliament.

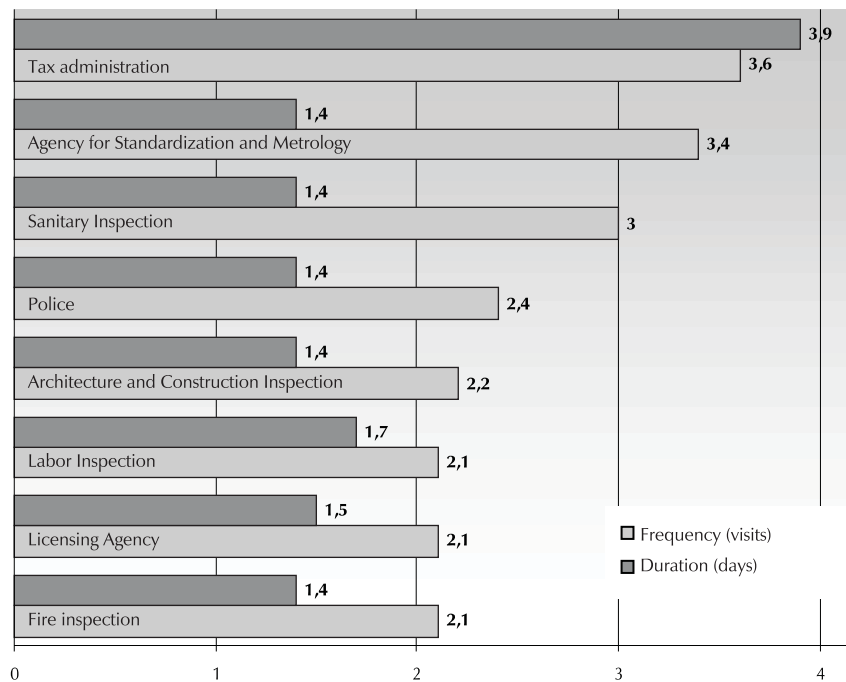
Limiting the freedom of economic activity through burdensome state regulation concentrates additional power in state administration and is a source of corruption. Government's policy towards business regulation in Bulgaria remains unfocused and unclear. **Government's regulatory intervention in the economy is considerable and remains one of the major sources of corrupt practices.** In May 2002 the Council of Ministers decided to ease 120 and abolish 74 of the existing 360 regulatory regimes. But by the end of 2002 there was no information that any part of this decision had been practically enforced. Meanwhile, new licensing and permit regimes constantly come into force. The number of regulatory regimes creates only a small part of the corruption problem in this area. **Bureaucratic administration** and frequent and long personal contacts between authorized officials and business management are the

FIGURE 21. REGULATORY CONSTRAINTS TO BULGARIAN BUSINESS (% OF COMPANIES, WHICH DEEM PROBLEMS „SERIOUS“ OR „EXTREMELY SERIOUS“)



Source: „Self-Assessment of Administrative Barriers to Investment: Results of the Administrative and Regulatory Cost Survey“ FIAS, November 2002

**FIGURE 22. FREQUENCY AND LENGTH OF INSPECTIONS IN BULGARIA**



Source: „Self-Assessment of Administrative Barriers to Investment: Results of the Administrative and Regulatory Cost Survey“ FIAS, November 2002

major motives for businesses to offer bribes. Regime administration has not improved in 2002, although work on the supply of better administrative services and the creation of one-stop shops continues. Bulgaria's accession into the European Union implies a further increase in regulatory regimes. Therefore, Bulgaria needs a clear national business regulation policy and an adequate administrative capacity for quick and transparent enforcement of existing regimes. Otherwise, corruption in regime administration will persist, or even increase.

### Regulation and Corruption in Construction Building

The problem with business regulation concerns all industries but is most visible in construction building. The existing legislative framework in the industry creates favorable environment for the development of corruption. Corrupt practices exist along the whole process of constructing a building - it starts with obtaining design permits, goes through the actual construction of the object and ends with the inclusion of the building into the official town infrastructure. Practical experience shows that, on average, construction businesses need 3 months to obtain all permits (more than 8) for starting an investment project. Additionally, it takes another 4.5 months to obtain final approval for the launch of the project. At the same time the *Law on the Structure of Territories* stipulates that all these activities should be completed within a month. This pressures investors into seeking illegal means of obtaining permits and shortening proceedings, most often though offering bribes.

## D.2. State - Business Relations. Corporate Governance and corruption

The lack of advanced corporate governance culture and legitimate mechanisms for access of competing economic interest to the process of national economic policy building lead businesses to exert increased corruption pressure on government decisions.

Bulgarian businesses, especially SMEs, are poorly informed about future government intentions and about the implementation rules of governmental regulations and initiatives. The information policies of different ministries and agencies lack coordination and consistency. The *Register of the Administrative Structures and the Acts of the Administrative Bodies*

was updated in 2002 but the information it provided remained well below business needs. The lack of readily available information on governmental intentions and initiatives in the economy leads to **information asymmetry between the administration and the business. This creates administrative monopoly on information resources, which is a strong tool for corruption pressure on businesses.**

The work on improving corporate governance has a strong anti-corruption impact because it **reduces demand** for corrupt practices. Good corporate governance means: more transparency and responsibility in company and management activities; no potential conflicts of interest; adequate protection of minority shareholders' rights; responsible management of remaining state shares in privatized enterprises; and existence of professional and ethical rules for curbing corruption.

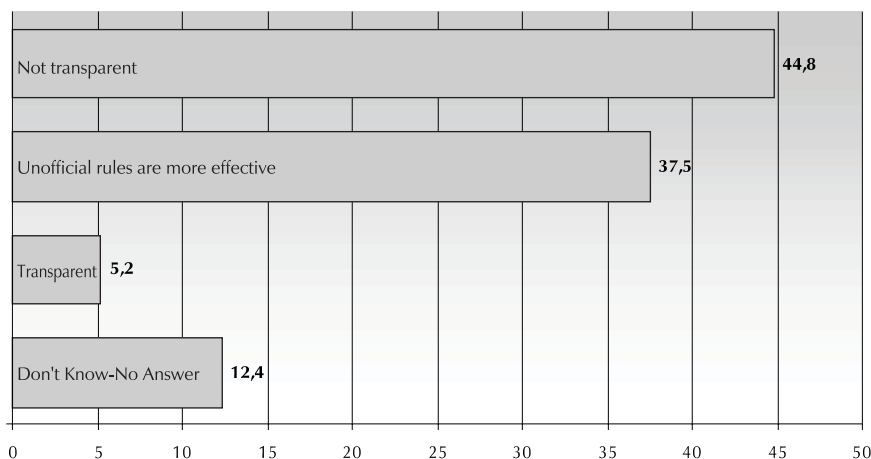
*The Law on Amendments to the Law on Public Offering of Securities*

(LPOS) adopted in 2002 has been the **major contribution** for the year **towards improving corporate governance in Bulgaria.** They improve significantly the following groups of relations, which have been haunted by corruption for years - capital increase; investor protection; bid mechanisms; and information disclosure. Additionally, the amendments upgrade the status, functions and authority of the *State Securities and Exchange Commission* (SSEC).

The actual anti-corruption impact of the amendments cannot be assessed yet because of scarce practical implementation. So far there have been no indications whatsoever that companies have accepted and implement these favorable amendments, nor that SSEC and business associations have managed to introduce effective self-regulations with anti-corruption potential. For the time-being good corporate governance codes are the exception rather than the rule. Government discussions about the amendments to the *Commercial Code's* insolvency regulations and about the introduction of a new chapter on *Corporate Governance* are a positive, though belated, step in the right direction. These are pending Government obligations under the *National Anti-Corruption Strategy*.

The amendments to LPOS introduce mandatory issuance of freely transferable and tradable rights to capital increase, which will give considerable protection to minority shareholders. Although it is too early to assess the full impact of this particular change it is indicative that **there have been no reports on misuse of capital increases in 2002.**

**FIGURE 23. TRANSPARENCY OF RULES AND CRITERIA OF ADMINISTRATIVE PROCEDURES (%)**



Source: Vitosha Research, Integra, Corruption in Small and Medium-Sized Enterprises, June 2002.

**Additionally the amendments ensure more instruments for the protection of minority shareholders' and investors' rights - stricter rules for bidding and public company delisting mechanisms;** less possibilities for illegal use (siphoning) of company assets by management; and increase in the controlling authority of the shareholders meeting.

For the first time Parliament introduced a clause in LPOS, which **requires that at least 1/3 of the management or supervisory boards' members of public companies be independent.** Independent members will guarantee minority shareholders' rights, which will bear direct effect on the improvement of Corporate Governance and hence on the anti-corruption measures. New texts in the law **regulate conflicts of interest**, which together with the provision of insider information, are considerable potential sources of corruption.

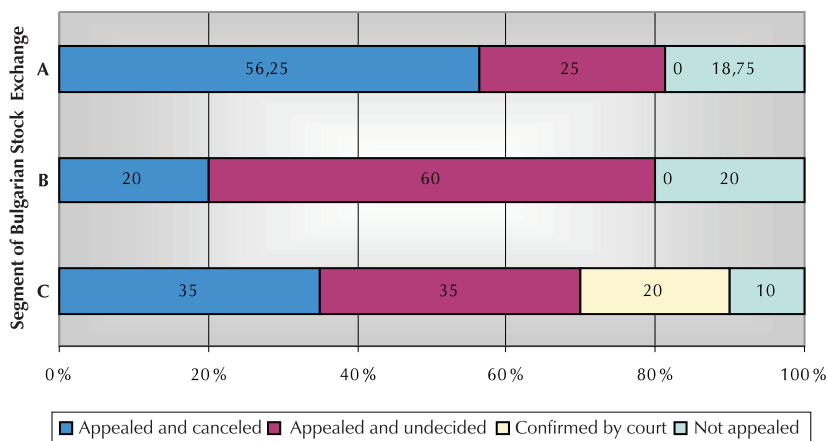
Another positive amendment to LPOS is the obligatory introduction of the position Director for Investor Relations. Thus, the changes to the Law create favorable conditions for corporate management boards to serve in the best interest of the company, rather than in their own or that of the major shareholder.

In 2002 Parliament adopted several clauses particularly aimed at improving public company transparency. Public companies will have to submit more frequently their financial reports, provide faster ad hoc information to SSEC and compile their balances according to the International Accounting Standards. SSEC's capacity to enforce these changes will be critical in revealing their anti-corruption potential.

SSEC's record of enforcement capacity is rather poor. In 2001 it failed to sanction 85.7 % of all violations of information disclosure regulations on

Section A of the Bulgarian Stock Exchange (BSE). Almost all sanctions imposed by SSEC are taken to court and in only 20-30 % of the cases fines become effective. Court proceedings take on average over two years.

**FIGURE 24. DISTRIBUTION OF PANEL SANCTIONS FOR DISCLOSURE FAILURES (%)**



Source: OECD, Second Meeting of the South Eastern Europe Corporate Governance Roundtable.

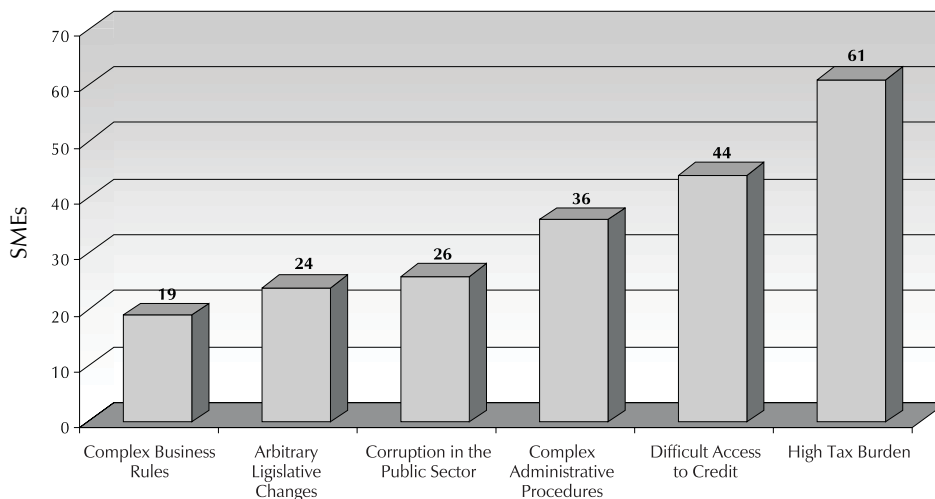
### D.3. Public Expenditure Management, Tax Policy, Gray Economy and Corruption

Lack of transparency in the accumulation and redistribution of public resources through the budget distorts market functioning and results in the emergence of gray economy and corruption. Low administrative capacity to manage and control state revenues and expenditures magnify these distortionary effects in Bulgaria. In this regard there are several major areas, in which corruption pressures exist: enforcement of tax, social security and customs laws, public procurement mechanisms, redistribution of municipal resources through the central budget, and health care funds management.

#### D.3.1. Taxes, Social Security Burden and Gray Economy

High taxes and social security contributions, in association with opaque and ineffective administration, lead to the emergence of a big gray sector in the economy and hence of corruption. In 2002 the Government reduced only marginally the tax and social security burden, which remained rather high for a transition economy. There has been no change in the level of unrecorded economic activity, which according to different estimates ranges between 25% and 40% of GDP. Unrecorded company turnover forms the bulk of unofficial payments (bribes) in the economy.

FIGURE 25. MAIN IMPEDIMENTS TO SME DEVELOPMENT\* (%)



Source: Vitoshka Research, Integra, Corruption in Small and Medium-Sized Enterprises, June 2002

(\*) Note: The sum of percents exceeds 100 because the respondents gave more than one answer.

The share of the gray economy and its corrupt practices can be best reduced through a **combination of tax and social security contributions reduction and improvement in company reporting.**

**Corruption pressure remains high in the areas of tax administration and enforcement.** The major reasons behind such unfavorable score are:

- Frequent changes in tax legislation, which do not leave enough accommodation time for economic agents and the administration;
- Rich possibilities for administrative discretion in tax law enforcement;
- Constant and long tax inspections, which are costly to companies and leave a lot of room for personal interaction between company managers and tax administrators;
- Low opportunity costs of tax evasion through corrupt practices for both businesses and tax administration officials;



- Lack of adequate personal safety protection for tax administration officials;
- Insufficient administrative capacity for proper implementation of existing tax rules and regulations.

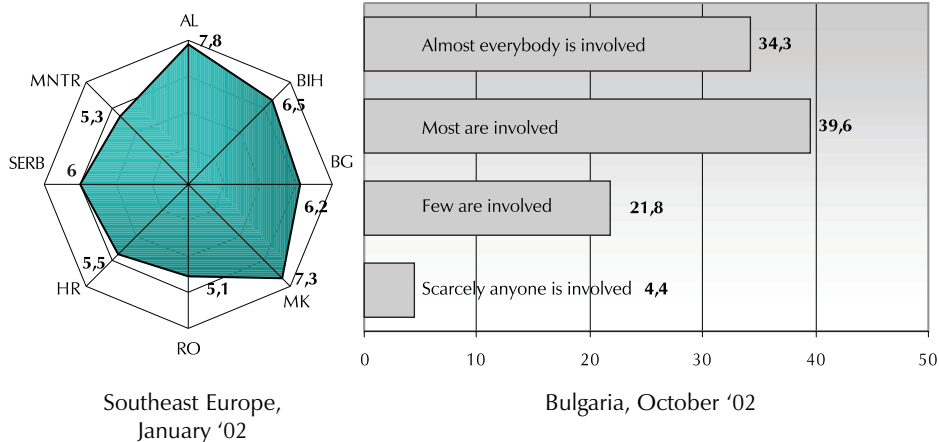
The tax changes introduced by the Government through the *Law on State Budget for 2003* follow a strategy for **reduction in direct and increase in indirect taxation reliance**. Such strategy, however, **does not eliminate corruption pressure but only redirects its impact inside the tax administration**. The Government should put more efforts to improve tax administration mechanisms. Like in previous years, in 2002 Parliament adopted the amendments to tax legislation at its last seating for the year. This last minute decision-making creates favorable conditions for preference seeking and increases the instability of the business environment. It seems that Government changes its tax policy stance to allow more tax breaks and preferences, which will result in more corruption should there be no adequate improvement in tax administration's collection and control capacity.

In 2002 the *Ministry of Labor and Social Policy (MLSP)* and the *Ministry of Finance (MoF)* initiated the **introduction of social security contribution floors** for the different branches and professions. The Government claims the measure will increase National Social Security Fund revenues. While the latter is very possible, the floors **might also bring business flight into the gray economy with an increase of corruption in the overseeing administration**, especially in the short run. The true costs of social security contribution floors will only be fully assessable in 2004. However, it should be noted that MLSP succeeded in minimizing the distortionary effects of the measure by forcing direct negotiations between employers and trade unions who managed to agree on their 2003 levels.

In 2002 the government adopted measures, which have real potential to reduce corruption in the tax and social security area in the medium run:

- a detailed tax policy for the 2003 - 2005 period;
- a *Law on National Revenue Agency*. The Agency will collect most public revenues. It is planned to start operation in the beginning of 2005;

**FIGURE 26. SPREAD OF CORRUPTION AMONG TAX OFFICIALS\* (GENERAL PUBLIC) (%)**



Source: CMS of *Coalition 2000*, October 2002; SELDI, January 2002

(\*) Note: The maximum value of the index is 10.0 indicating the highest possible level of corruption. The minimum value is 0.0 indicating total absence of corruption.

Legend: AL - Albania; BIH - Bosnia and Herzegovina; BG - Bulgaria; MK - Macedonia; RO - Romania; HR - Croatia; SERB - Serbia; MNTR - Montenegro.

- consultations with stakeholders on future tax legislation changes;
- better coordination between the *Ministry of Finance* and the *Ministry of Interior* to improve tax collection.

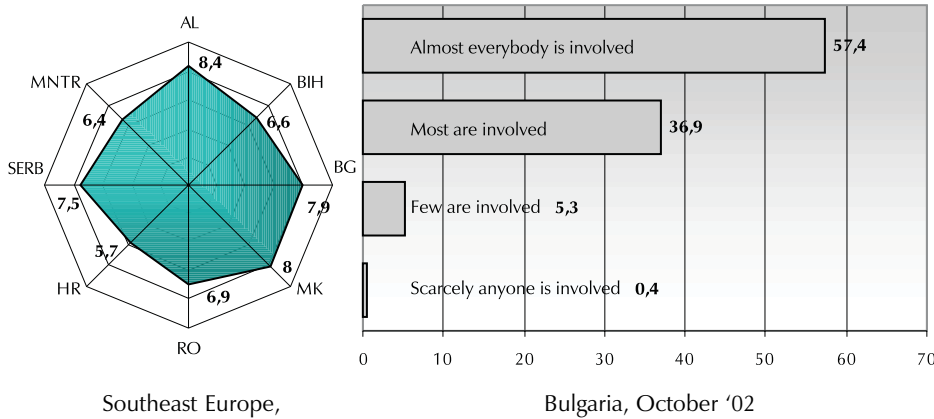
Additionally, MoF declared that it had launched a campaign to check whether the values of luxury property and declared incomes of its owners match. The successful completion of this campaign will demonstrate political will and administrative ability in the Government to cope with pervasive tax evasion. According to MoF data the budget loses annually above BGL 1.1 bln. in social security and personal income tax revenues from evasion, while unpaid company tax liabilities towards mid-2002 have amounted to BGL 928 mln.

### D.3.2. Customs and Corruption

Globalization and the continuous increase in international trade flows render the *Customs Agency* a control point of significant economic resources and increase the potential risks of power abuse and corruption. The *Customs Agency* collects the bulk of value added tax, which is the primary budget tax revenue. Additionally, evading VAT and customs duties through corrupt practices gives companies considerable competitive edge over their rivals, which stimulates the offering of unofficial payments to customs officials.

**Despite launched customs reforms in the beginning of 2002, society preserved its opinion that corruption is wide spread among customs officials.** An indirect proof that being a customs officer „pays off“ is the unusually high demand for customs jobs. In 2002 38 people applied for 1 customs officer place, while the country average ratio was 25/1. At the same time in a number of surveys conducted during the year businesses pinpoint unfair competition, which in its greatest part comes through illegal

FIGURE 27. SPREAD OF CORRUPTION AMONG CUSTOMS OFFICERS (GENERAL PUBLIC) (%)



Source: CMS of Coalition 2000, October 2002; SELDI, January 2002

imports, as one of the major setbacks to their development.

The activities of *Crown Agents* consultants were the basic tool of Government's efforts on reforms and countering corruption in the customs system in 2002. Although it is rather early to give conclusive assessment of *Crown Agents*' effectiveness, the results they have achieved in 2002 seem to be modest:

- most of the existing channels and schemes for gray imports are still operational. Some of them have been modified to adapt to changes in customs control mechanisms (e.g. import of fruits and vegetables from Turkey, Greece and Macedonia, fuel imports, „Chinese imports“);
- increase in revenues is not exceptional but follows the trend of the last four years;
- the first results from the functioning of mobile groups for customs control produce skepticism among observers about their effectiveness.

Still there have been a number of **positive signs** in 2002, which directly or indirectly point to a decrease in the customs corruption potential:

- customs fraud detection increased by 70% on the previous year;
- contraband channels lost political protection;
- the Government and the EU closed the Customs Union negotiation chapter;
- an *Ethics Code for Customs Officials* was adopted;
- the *Customs Agency* increased its internal control capacity through its participation in projects with anti-corruption elements financed by the World bank and EU;
- the *Customs Agency* signed a memorandum of understanding with the *Ministry of Interior* and the *State Internal Financial Control Agency*.

Accelerating reforms and increasing their combined positive effect necessitate the practical implementation or completion of a number of measures, part of which have been included in the *National Anti-Corruption Program*. The following several steps should be launched with priority:

- **Developing new forms of cooperation between law enforcement agencies to stop and prevent contraband, trafficking, illegal imports and corrupt practices that go with them.** New, contemporary models of cooperation between customs authorities and the *Ministry of Interior* and the *National Investigation Service* should be introduced to replace the bureaucratic and ineffective mechanisms of the past;
- Ensuring information exchange between customs and tax authorities through the **introduction of mandatory mechanisms for constant juxtaposition of data from customs and tax declarations** to ensure maximal compliance;
- **Completing and launching the Bulgarian Integrated Customs Information System.** Additionally, a system for mutual exchange of information should be created between Bulgarian border customs points and those of neighboring countries;
- The *Customs Agency* should regularly release publicly its financial results.

### D.3.3. Public Expenditure Management and Corruption

In view of the low administrative capacity for management and control of public expenditures reducing their overall amount would lower corruption pressure in the country. The *Law on State Budget of Republic of Bulgaria for 2002* sets consolidated non-interest expenditures at 38% of GDP, which is a 1% increase over 2001. The level of central and local government expenditures remains high for the particular stage of development of the economy and the state administration. Their level is appropriately lowered to 36% of GDP for 2003. However, the actual expenditures at the end of the year will most probably stand at 2-3% higher. At the same time according to National Statistical Institute data government consumption expenditure was 9.8% of GDP (BGL 1.4 bln.) for the first half of 2002, unchanged over 2001. **This level is considered appropriate to prevent excessive corruption and should not be exceeded in the future. At the same time the government should undertake more decisive action to cut the overall state burden, measured by non-interest expenditures to GDP, to below 30%.**

Like previous years, 2002 witnessed a **series of irregularities in budget resources management, which create an environment favorable to corruption:**

- Budget organizations have not made sufficient efforts to collect their receivables;
- The government has redistributed considerable budget surpluses without relevant authorization from Parliament;
- Additional resources have been made available to organizations, over and above their budgets.

In view of the above Parliament should considerably strengthen the controlling authority of the *National Audit Office*. At present the latter can only detect and describe offences. It should be authorized to stop irregular use of public resources and to indict those responsible. The *State Internal Financial Control Agency* (SIFCA), which has greater executive powers, is still too slow to react and in many cases it detects offences only after the respective terms of limitation for administrative liability have expired.

On the positive side, the government has taken some measures to improve the transparency of the budget procedure for 2003, which would allow better control over **public spending decisions:**

- The preparation of budget 2003 has begun earlier than in previous years;
- All primary budget authorizing offices have been required to present their own three year expenditure frameworks, subject to centrally determined ceilings;
- The *Report on Budget 2003* is more detailed and complete than any one in the past.

**More measures should be introduced to guarantee long-term containment of corruption risks in the area of public spending:**

- Completion MoF and primary budget authorizing offices' capacity for strategic programming of expenses;

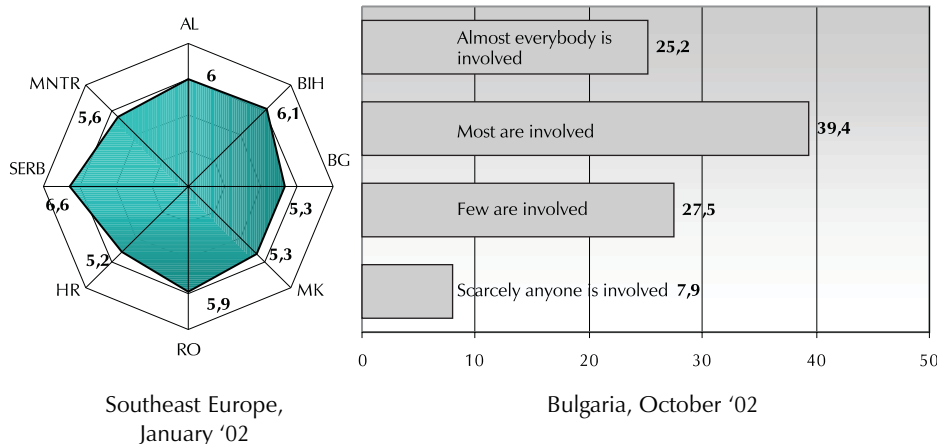
- Considerable improvement of accounting transparency and strengthening of accountability for budget surpluses redistribution;
- Strengthening SIFCA and *Central Audit Office's* supervision and control functions. The Office's recommendations should be obligatory for all state entities;
- Improvement of financial management capacity at the local level (especially in small municipalities).

Public opinion continues to associate with corruption and abuse two main areas of significant public resource spending and redistribution - **municipal budget adjustment and health care.**

**The central government has been adjusting municipal budgets for years, through a complex mechanism of subsidies, which enables direct political control over local governments and creates favorable prerequisites for the use of public resources for party purposes. The Government has preserved this mechanism in 2002.** With view of reducing its corruption potential, local governments should be allowed to develop local revenue sources and use them fully, while central and local spending responsibilities should be clearly defined. In 2002 the Government adopted a *Strategy for Financial Decentralization*, which lays the foundation for solving the above-identified problems. However, its practical implementation has been delayed until 2004, which shows the government's willingness to retain its control on local level before the local elections due in the fall of 2003.

According to *Ministry of Healthcare* data for 2002 **unofficial payments in the healthcare system amount to BGL 200 - 260 mln. (i.e. about 20% of government spending on healthcare).** Additionally, experts from the *National Health Insurance Fund* estimate that between BGL 10 mln. and BGL 20 mln. (5-10% of total budget costs) of reimbursement payments for medicines have been absorbed through fraud. This data exemplifies the **huge corruption potential of the healthcare system in its present state. In view of contain-**

**FIGURE 28. SPREAD OF CORRUPTION AMONG DOCTORS (GENERAL PUBLIC) (%)**



Source: CMS of Coalition 2000, October 2002; SELDI, January 2002

**ing this potential concentrated and consistent efforts are needed in several directions:**

- Gradual increase in healthcare budget under strict observance of financial discipline;

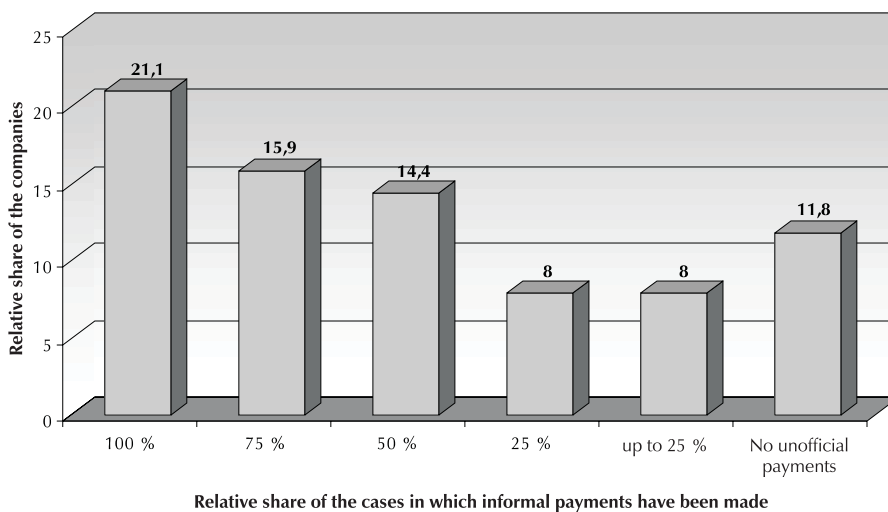
- Improvement of specialized doctors' remuneration;
- Reduction in the number of hospitals and transition to a single source healthcare financing;
- Introduction of stricter and more effective control over reimbursement of medicines costs, in view of their substantial rise in the future;
- Creation of favorable conditions for supply of private healthcare services, including private healthcare insurance.

#### D.3.4. Public Procurement and Corruption

Public procurement is the major mechanism for channeling public funds and resources to the private sector. The substantial amount of funds being transferred and the inadequate administrative control in Bulgaria render public procurement as one of the major corruption risk areas. Therefore, public procurement must be thoroughly regulated and its administration should be transparent and competent.

For the past several years public procurement in Bulgaria has amounted to above BGL 1 bln. a year. **According to business surveys public procurement contracting is a major source of corruption in the country, which generates considerable unofficial revenues for state administration officials.** Conservative estimates put the figure of unofficial payments for 2002 at BGN 15 mln. Furthermore, corruption in public procurement is systemic - more than half of companies who have taken part in public procurement tenders state that they have made unofficial payments to receive every second contract.

**FIGURE 29. RELATIVE SHARE OF AWARDED PUBLIC PROCUREMENT CONTRACTS FOR WHICH COMPANIES MADE INFORMAL PAYMENTS**

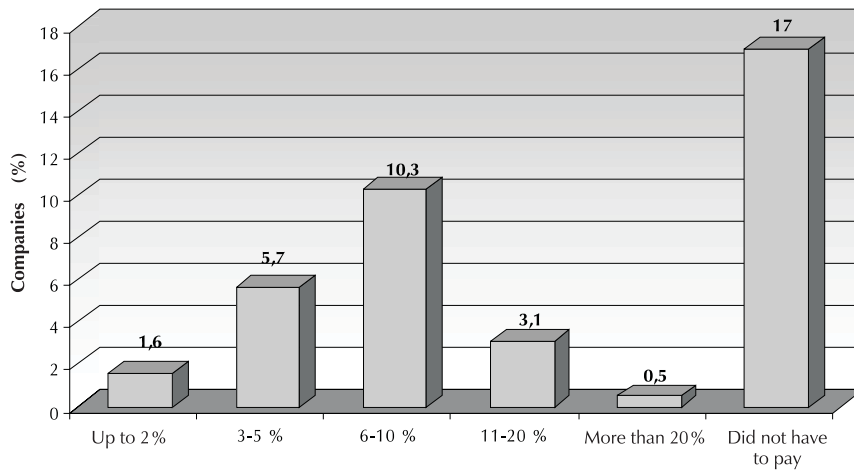


Source: Vitosh Research, Integra, Corruption in Small and Medium-Sized Enterprises, June 2002.

**Irregularities in public procurement contracting are especially severe in Bulgarian municipalities.** These require additional attention in at least two directions:

- Improvement of the administrative capacity for public resource management in Bulgarian municipalities;
- Strengthening control mechanisms (both preliminary and subsequent) of public procurement.

**FIGURE 30. AVERAGE SIZE OF INFORMAL PAYMENTS MADE TO OBTAIN PUBLIC PROCUREMENT CONTRACTS AS A RELATIVE SHARE OF THE CONTRACT VALUE**



Source: Vitosha Research, Integra, Corruption in Small and Medium-Sized Enterprises, June 2002.

It is important that these measures be implemented before the completion of fiscal decentralization.

In April 2002 Parliament adopted a *Law on Amendments to the Law on Public Procurement (LPP)* (State Gazette no. 45/2002). The main amendments with anti-corruption bearing are:

- **Improved transparency and control** mechanisms through better access to evaluation committees' records; precise specification of contracting procedures; improved publicity rules; faster court appeal mechanisms; and

a wider use of commodity exchanges;

- **Optimization and reduction in time periods** for public procurement announcement; for drawing statements on offences; and for dispute resolution;
- **Provisions for more competition** through broadening and precise specification of legal object and subjects under LPP; definition of tender documentation pricing mechanisms; separating participation and execution guarantees; and banning contracting without specified time limits.

There is still not enough data to assess objectively whether these new law provisions have been effectively enforced in the practice.

In spite of good legislative progress in 2002, more measures should be taken to curb corruption in public procurement, the most important of which are:

- Establishing an independent *Agency on Public Procurement* responsible for the overall execution and monitoring of public procurement;
- The *Central Audit Office* and the *State Internal Financial Control Agency* should be authorized to perform **preliminary control** over public procurement, i.e. before contracting. Additionally, their efforts should be better coordinated;
- **Complex procurement cases**, in which only part of the activities envisaged fall under the application scope of LPP, **should be better regulated**. In such cases law provisions should be applied even if only one of the activities falls into the scope of the law;
- Evaluation committees' technical skills should be improved, while their members' administrative and criminal liability should be defined more clearly.

#### D.4. State Asset Management, Privatization and Post-Privatization Control

According to public opinion polls state asset management, privatization and concessions continue to be the areas most burdened with corrupt practices in 2002.

In the beginning of 2002 Parliament adopted a *Law on Privatization and Post-Privatization Control* (LPPC), which replaced the old 1992 privatization law. The new law aims at transparent, fast and economically effective privatization under equal investor treatment. It contains a number of **anti-corruption elements**:

- It repeals all preferences given to any class of investors;
- It institutes the practice that non-monetary means of payment can only be used in sales of a specified list of enterprises;
- It introduces more transparent sales methods - public tender, auction, publicly announced competition and offering of shares through the stock exchange
- It defines the *Privatization Agency* as the only body authorized and responsible for privatization;
- It stipulates the introduction of public registries on privatization and post-privatization control.

The new privatization model has already proven its transparency and fiscal effectiveness. In 2002 privatization revenues have amounted to BGL 207 mln. from 262 deals. Transparency and absence of corruption allegations is rewarding, as has been best proven in the banking privatization of 2002. In an open and competitive procedure, the *Banking Consolidation Company* has succeeded in attracting the third largest EU bank to acquire 80% of Biochim Bank for EUR 82.5 mln.

**However, only a limited part of LPPC's anticorruption potential materialized in 2002.** Practically none of the bylaws to LPPC has been adopted in the stipulated two months period. The government's inability to enforce the law's provisions in time resulted in sluggish privatization and failure of the privatization program for 2002. This in return has increased opportunities for interested parties to adjust to the new situation and indirectly has raised the corruption potential in privatization. A good example in this direction is the slow and difficult execution of the biggest privatization deals for 2002 - those of *Bulgartabak* and *Bulgarian Telecommunications Company*. The court's controversial intervention in both cases, to stop sales to internationally recognized foreign investors, has left doubts of the existence of political intervention and corruption in the judiciary. At the same time the *Privatization Agency* has failed to provide convincing enough proof that no conflict of interest or any wrongdoing has occurred in the two deals. In addition to delays in LPPC's enforcement, in 2002 Parliament adopted a number of amendments to the existing privatization texts, some of which seem to serve specific private interests and might be connected to corruption. Especially worrying in this respect are actions attempting to include more enterprises in the list of non-privatizable ones. *International fair, Plovdiv* has already been added to the list and MPs have persistently demanded that the *Bulgarian Maritime Fleet* and the *Bulgarian River Fleet* be included too.



**TABLE 8. IMPLEMENTATION OF THE ANNUAL PRIVATIZATION PLAN BY NOVEMBER 31, 2002**

Indicators	Plan	Report	Implementation Ratio
Deals	349	71	20,3%
Minority Packages	315	48	15,2%
Payments Contracted (thous. BGN)	748 493	316 558	42,3%
Privatization Costs (thous. BGN)	25 277	5 612	22,2%

Source: Privatization Agency

LPPC regulates the establishment of an **Agency Post-Privatization Control Agency (PPCA)** - a specialized governmental body to oversee and control the proper execution of buyer obligations undertaken in privatization contracts. PPCA has been established with a six months' delay and still lacks adequate financial backing. **PPCA**

**has considerable controlling powers**, which in combination with an explicit ban on renegotiation of privatization deals might be a **prerequisite for corruption pressure from buyers**. To avoid such pressures the government should:

- Ensure maximal transparency of PPCA's functioning;
- Supply the Agency with an adequate technical base and resources to perform its duties.

In 2002 the *Post-Privatization Control Agency* presented its first report on the observation of buyers' contractual obligations undertaken in 2 500 deals concluded in the 1993 - 2001 period. In spite of the many contractual offences detected the probability that the state will recover at least part of the estimated losses is very low taking into consideration that many of the envisaged enterprises have already undergone substantial changes. **However, bearing in mind that privatization has been one of the major channels for money laundering, the report should be used by the prosecution to check incorrect buyers.** Until the end of 2002 the prosecution has examined 210 privatization deals and has sent to court 86 of them. No court decision has yet been taken on any of them.

**TABLE 9. ESTIMATED BUDGET LOSSES DUE TO BUYERS' FAILURE TO FULFILL CONTRACTUAL OBLIGATIONS IN THE PERIOD 1993 - 2001.**

Estimated Losses	Mln. BGN
Reduction in contracted prices	6.7
Reduction in agreed level of investment	280.8
Default on agreed level of investment	480.0
Default on price payments	77.8
Default on interest and penalty payments	38.3
Labor obligations penalties	103.0
Other penalties	60.0
<b>Total</b>	<b>1046.6</b>

Source: Agency for Post-Privatization Control

The delays in the privatization process lead to the preservation of state's participation in the management structures of enterprises, which might lead to corruption pressures in two directions. First, the ruling party might use management board seats to pay back for electoral support. Second, the participation of state administration representatives in company management creates strong

vested interests for delaying privatization further. **The problem with management and advisory board assignments of administration officials has not been resolved in 2002.** It is even more acute in big Bulgarian municipalities. The upcoming local elections in the fall of 2003 might make things even worse. In 2002 some MPs have proposed that state officials be banned from participation in more than one management or supervisory board, while their salary is limited to not more than two times the country average. Politically appealing as they are, such proposals will not solve the problem but will only alter the forms of corruption.

**Concessions and big infrastructure projects are areas, which contain substantial corruption potential, because they transfer exclusive rights of public resource management into private hands for considerable periods of time and they still lack adequate legal framework.** The government should ensure more transparency in both areas in view of their significant increase in the coming years.

The lack of clearly-defined rules for concession-granting and low subsequent control on their execution has resulted in 2002 in a number of public scandals and contract breaks in cases of municipal utilities and coastal strips concessions.

The upcoming privatization and concession-granting in the energy sector has already raised concerns and corruption allegations. In 2002 the respected German multinational *RWE* has declared that there have been groups in the *Ministry of Energy (MoE)*, who backed private interests to prevent its daughter company *Rheinbrown* from obtaining a mining concession on the *Maritsa-Iztok* coal mines. In spite of MoE declarations that it strictly abides by the new *Law on Concessions*, the apparent inconsistency between its actions and that of some MPs and the stated governmental policy for attracting more quality investors in the country, raises justified concerns of existing corrupt practices in this area. Moreover so, the rest of the candidates who have stated their willingness to obtain this concession are being closely associated by society with corruption in other areas in the past.

Similarly, private interests seem to raise corruption concerns and to block the Bulgarian participation in the *Bourgas - Alexandrupolis* oil pipeline construction. The apparent support of a high ranking official from the *Ministry of Regional Development and Public Works* for one of the candidates to the project, as well as the public concession of the Minister that he has resigned because he has been unable to contain corruption within the Ministry, show that urgent anti-corruption measures are needed in this area.

#### D.5. Black Economy and Corruption

**Organized crime is clearly the most important source of grand (political) corruption.** Therefore, if the government aims at coping with corruption in the long run, it should concentrate on containing the black economy.

From the second half of the nineties, **organized crime has undertaken the following steps towards its integration into the**

**Bulgarian business and politics:**

- through privatization, control of imports and exports, racketeering, establishing monopolies in a number of the most profitable economic sectors, etc.
- redistribution of the profit from economic activity (import and export of raw materials and commodities, wholesale of agricultural and industrial production, financial institutions, tourism, etc.).
- control over the „black economy“ (revenues from petty crime, car theft, drug trafficking and drug distribution, prostitution, human trafficking, counterfeiting of money and securities, etc.).
- venturing into new methods for financial crime (cyber crime, credit card fraud, etc.)
- creation of durable corruption networks through redistribution of „dirty money“ among the lobbies of the organized crime in government structures.

*Source: Center for the Study of Democracy, The Economy of Crime, Discussion Topics for international conference in November 2002*

**In 2002 the government has launched efforts to block some of the main sources of finance for the organized crime in Bulgaria**, through customs reforms and improvements in the work of specialized units to the *Ministry of Interior*. In view of sustaining good results in countering corruption and the black economy, the **government should considerably improve coordination between government institutions. Additionally the Government should strengthen anti-money laundering measures and ensure their effective implementation**. Parliament's delay to adopt the *Law on the Amendments to the Law on Measures against Money Laundering* creates possibilities for organized crime to conceal important tracks.

The legislative framework for countering organized crime has not been improved in 2002. In this relation the following laws should be adopted and/or amended with priority:

- *Law on the Financing of Political Parties* - all sources of financing to the political parties should be clearly defined and publicly known;
- *Draft Law on Publicity and Registration of Lobbyists and Lobbying Activity* - it should guarantee full transparency of lobbying activities;
- *Draft Law on the Forfeiture to the State of Property Acquired through Illegal Activities* - it should ensure an adequate and transparent mechanism on forfeiture of property acquired through illegal means, while guaranteeing property rights.

\* \* \*

In response to increased public pressure, in 2002 the Government has undertaken **a series of anti-corruption initiatives** in the economy. Relatively few of them, however, have been put to practice. Their

combined effect on limiting corruption can be assessed as **moderately positive**. In this view further efforts in a number of areas are needed to complete reforms:

- Improve administrative capacity to implement and control government intervention policies in the economy;
- Reform of the judiciary to reduce the scope of its discretionary judgments in the economy;
- Priority completion of the legislative and institutional framework for countering organized crime;
- Ensure strong consensual political support for reforms, as improved effectiveness in limiting corruption might lead to increased counteractive pressures from hurt economic agents.