

## Economic Program

In 2010, the Economic Program of the Center for the Study of Democracy focused its work on five main topics: good governance in the energy sector; hidden economy and undeclared work; development of the civil society in Bulgaria; knowledge economy and competitiveness, as well as assessment of the impact of the EU funds.

### 2010 Highlights:

- **Good governance in the energy sector.** The Economic Program elaborated a series of analyses on energy sector governance in Bulgaria, including cases of fraud and corruption in large infrastructure projects and related to them public procurements, energy efficiency issues, status of key sub-sectors, comment on the draft *Energy Strategy of Bulgaria 2020*, green energy in Bulgaria and consumers' willingness to pay for clean energy, etc.
- **Hidden economy, corruption and money laundering.** The Economic Program examined the practices for countering undeclared work in EU Member States and studied the feasibility of creating an European platform to prevent and fight undeclared work. Specific recommendations to the European Commission were made. CSD published a *Money Laundering Investigation Manual* in cooperation with several state institutions. It also published an official statement in the framework of the European Commission's public consultation to develop a uniform methodology for diagnosis of corruption at EU level.
- **Strengthening the civil society in Bulgaria.** In 2010 the Economic Program worked on improving the governance of the Bulgarian NGO sector and on countering the "civil society capture" phenomenon. CSD carried out a series of five seminars and roundtables on the topic, and presented the report *Civil Society in Bulgaria: Trends and Risks*.
- **Competitiveness and knowledge economy.** With the participation of the Center for the Study of Democracy in 2010 Bulgaria was included for the fifth time in the annual competitive economies ranking – the World Competitiveness Yearbook 2010 by IMD (Institute for Management Development). Bulgaria dropped to rank 53 among the 58 leading national and regional economies. The Economic Program prepared and presented the annual report *Innovation.bg 2010*, which analyzes the state of the national innovation system and makes recommendations for improving the innovation potential of the Bulgarian economy.
- **Evaluating the impact of EU funds in Bulgaria.** As part of a European network of experts, the Economic Program prepared two reports on the impact of European Regional Development Fund financing on Bulgaria. The reports

describe the causes of the low absorption levels of ERDF financing and the future challenges that the managing authorities should address in order to increase their effectiveness.

### I. Good Governance in the Energy Sector

The energy sector in Bulgaria is facing many challenges related to good governance and energy security – issues that in recent years occupied the front pages of the Bulgarian media with news and analyses for fraud, nepotism and political corruption. The calls for reform and the introduction of competitive markets have increased in recent years, simultaneously with a decrease in available resources and increasing pressure from various lobby groups as the economic crisis has affected negatively public finances.

In 2010, the Economic Program continued to work on the energy security and diversification topic. During the first two weeks of April 2010 the Bulgarian government and media announced details of abuses and irregularities of public procurement in the Bulgarian energy sector and proposed ideas for restructuring, which confirmed the existence of serious governance problems in the sector. These findings were not new. In 2006 – 2007 the Center for the Study of Democracy published a detailed analysis of the most common bad management practices in the energy sector with relation to public procurement. The conclusions and recommendations of this anal-



*From left to right: Mr. Ruslan Stefanov, Director of the Economic Program at the Center for the Study of Democracy; Mr. Traicho Traikov, Minister of Economy, Energy and Tourism and Dr. Ognian Shentov, Chairman, Center for the Study of Democracy at the round table on Energy Policy and Energy Diversification, held on May 18, 2010*

ysis applied with full force in 2010. In this context the Economic Program prepared a media note *Exposing Bad Governance in the Energy Sector: Reinventing the Wheel?* The program also presented data from a survey on the topic *Are Bulgarian consumers willing to pay for clean energy?*

On 18 May 2010 the Center for the Study of Democracy organized a round table on Energy Policy and Energy Diversification. During the round table CSD presented a policy brief *The Energy Sector of Bulgaria*, elaborated jointly with the Atlantic Council of the United States. It presents the main challenges that the energy sector in Bulgaria faced in 2010. The analysis notes that energy markets remain highly monopolized in Bulgaria. For example, prices are still adjusted based on reference values or formulas – a sign of intransparency and very low competition levels.



Dr. Ognian Shentov, Chairman of the Center for the Study of Democracy remarked that Bulgaria needs to diversify both energy sources and transportation routes, with the help of its EU and US partners. Mr. Traicho Traikov, Minister of Economy, Energy and Tourism highlighted that the focus of the Ministry's work is on bringing more

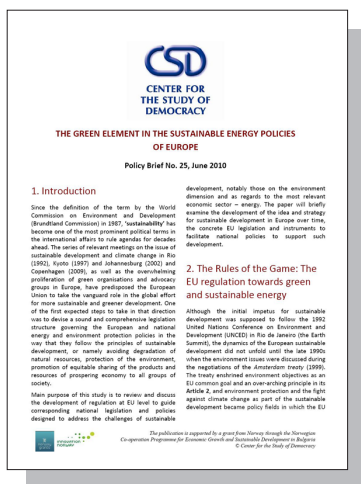
transparency and diversification to the energy sector and stated the need for Bulgaria to benefit from European and American technology and know-how. The Minister agreed that the Bulgarian energy sector is in need of reforms such as liberalization, optimization of pricing and the development of an updated energy strategy until 2020. The biggest clash the Minister saw between the need of large investments and the low purchasing power of the Bulgarian population. The three top priorities mentioned by the Minister were: diversification, energy efficiency and increase of the share of green energy at affordable prices.



In May 2010 the Economic Program elaborated a policy brief on the *Energy Efficiency in Bulgaria: The Case for Market-Based Approach and Transparency*. The analysis underlines that overall, the Bulgarian economy seems to have completed the transition from heavy industry to less energy intensive light industry and thus already picked the low hanging fruit of natural gains in efficiency. The country is probably at a point, as some experts argue, from which onwards any additional gain in efficiency will have to be attained

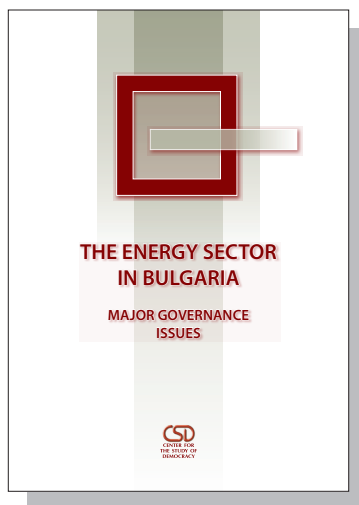
through advances in technologies of energy production, conversion, transportation, and use of energy which will call for cost-effective approach and a strong incentive system.

Two months later the Economic Program elaborated a *Commentary on the Draft Energy Strategy of Bulgaria 2020*. According to the commentary, unlike previous drafts of the strategy where no policies and major projects were regarded in detail, the current concept puts focus on vision and goals. The commentary warned that considering the traditional lack of transparency and the mismanagement in the sector over the past two decades, the draft of the Energy Strategy is loaded with many expectations.



In June 2010, the Economic Program prepared a policy brief on the topic *The Green Element in the Sustainable Energy Policies of Europe*. The analysis makes a review of the development of regulation at EU level, to guide corresponding national legislation and policies designed to address the challenges of sustainable development in environment and energy. It contains the history of the concept and the strategy for sustainable develop-

ment in Europe, the specific EU legislation and the tools supporting national policies in this area. CSD also raised the issue of the impact of EU's green policies and their financing in Bulgaria with the media note *Green Energy in Bulgaria?* On the one hand, green energy remains one of the most valuable resources that the Bulgarian government could take advantage of in order to diversify energy sources and liberalize the energy market. On the other hand it is a source of pressure on the prices and can provide access for criminal capital to national assets, taking in account the existing lax control mechanisms for stimulating its development.



CSD also published a report *The Energy Sector in Bulgaria: Major Governance Issues*. The report analyzes the major governance issues of the energy sector in Bulgaria, as well as the common energy crimes. It makes an overview of the 2020 Strategy and presents a recommended governance approach. According to the conclusions of the report, the most significant sources of bad governance in the sector are: the implementation of major infrastructure projects and related public procurement, the management of

state-owned energy companies, mixing political with professional management of the sector, etc. Every fourth public procurement contract is concluded in the energy sector, making it one of the largest spenders of taxpayers' money. The major infrastructure projects in energy require investments equal in value to the entire EU assistance budget for Bulgaria, foreseen in the seven-year European framework for 2007 – 2013. This increases the risks for abuse.

Representatives of the CSD Economic Program participated in many international events related to improving the management in the Bulgarian energy, such as:

- The Transparency Working Group meetings of the European Nuclear Energy Forum (Brussels, 28.06.2010);
- The Regional Conference on Energy Efficiency of the US Department of Energy (Istanbul, 3-4.06.2010);
- The conference in the framework of the Extractive Industries

Transparency Initiative (Kiev, 5-6.11.2010);

- The regional conferences of the European Parliament for Energy Development in Bulgaria, Cyprus and Greece, held in Sofia (12.05.2010), Nicosia (10-13.10.2010) and Thessaloniki (26.11.2010);
- The science conference on climate change, organized by the University of Oslo, Norway (25-26.11.2010).

## II. Hidden Economy and Money Laundering

In 2010 the Economic Program of the Center for the Study of Democracy examined the institutional framework and the measures implemented to counter undeclared work in the EU Member States. In addition to the analysis, the Center for the Study of Democracy organized on 4 and 11 May 2010 two seminars to explore the feasibility of establishing an European platform to prevent and fight undeclared work, in cooperation

**Figure 1. Regional variations in the nature of undeclared work in the European Union (% of presence of undeclared work in the various forms of employment)**



Source: Eurobarometer



*Mr. Tzvetan Tzvetanov, Deputy Prime Minister and Minister of the Interior (left) and Dr. Ognian Shentov, Chairman, Center for the Study of Democracy during the round table on Anti-Money Laundering in Bulgaria: Key Policy Issues and Impact Instruments, 16 February 2010*

with Regioplan, a Dutch research institute. Representatives of ministries of labour and social policy and ministries of finance, labor inspectorates, research institutes, trade unions and employers' organizations from Central, Southern and Eastern Europe participated in the workshops. They discussed the differences in the institutional frameworks and methods of inspection in their countries, existing policy measures to combat undeclared work, best practices for cross-border cooperation and difficulties that the enforcement bodies at national and international level encounter in this regard.

After conducting several seminars, dedicated to various regions of Europe, the organizers summarized in a report to the European Commission the opinions

and recommendations of the participants from the EU-27 countries regarding the creation of an European platform to prevent and fight undeclared work.

In the field of economic crime and money laundering the Economic Program worked on building national capacity to investigate money laundering and analyze the new forms of economic crime – misuse of EU funds, VAT fraud, fraud with grants and public procurement contracts, etc. As a result of CSD's cooperation with the government bodies with authority to combat money laundering – the Supreme Prosecutor's Office of Cassation of the Republic of Bulgaria, the National Investigation Service, the Ministry of Interior, the State Agency National Security (SANS) and the Commission for Establishing

of Property Acquired from Criminal Activity, and with the law enforcement agencies of other countries, a *Money Laundering Investigation Manual* was prepared. The relevant state institutions will use the manual for training their staff to better combat money laundering. It is part of the measures of the Bulgarian government to combat corruption and organized crime under the Mechanism for Cooperation and Verification.

On 16 February 2010 the Center for the Study of Democracy organized a round table on Anti-Money Laundering in Bulgaria: Key Policy Issues and Impact Instruments, to present the *Money Laundering Investigation Manual*. During the round table Dr. Ognian Shentov, Chairman of the Center for the Study of Democracy underlined that money laundering is a threat to national security as large shares of the profits from money laundering are reinvested in political campaigns – buying political patronage, instead of entering the formal economy. According to the presented data the revenues from money laundering amount to BGN 4 – 5 billion per year, which means that relatively insignificant number of the crimes related to money laundering reaches the courts.



During the round table in February 2010 the CSD experts also presented a policy brief on the *Investigation of Money Laundering: An Institutional Approach*. The policy brief presented the experience, acquired during the preparation of the manual, which is not available for public use. According to the authors, despite the various legislative initiatives and the constantly growing number of indictments for money laundering brought by the prosecution in the courts in the last decade, the prosecution of money laundering in Bulgaria remains low in numbers and scale. The reason lies both in the factual complexity of the crime and the objective difficulty of its investigation, as well as in its complex nature, which requires the cooperation of many institutions, usually at the international level.



As a continuation of its long standing work on the construction and testing of methodologies for measuring corruption in Bulgaria and in Southeast Europe, in November 2010 the Center for the Study of Democracy presented to the European Commission its opinion on the development of a European dimension for corruption diagnostics. The opinion was elaborated in response to the public *Consultation on a Future*

*Reporting and Monitoring Mechanism on EU Member States Progress on Fighting Corruption*, launched by the European Commission. CSD recommends that the EC introduces a mechanism for regular monitoring of the state and level of corruption in the Member States, based on already existing methodologies. In this regard, CSD's experience with the *Corruption Monitoring System*, which it has been using in Bulgaria for measuring the corruption risk and the number of corruption practices in the public and the private sector, can be particularly useful. The consultation is conducted under the European Commission's Stockholm Program for interior policy, justice and security.

### III. Competitiveness and Knowledge Economy

In 2010, the Economic Program continued its work on researching and advocating for knowledge economy in Bulgaria and Europe. CSD experts took part in the elaboration of the report *Innovation.bg 2010 – The Innovation Policy of Bulgaria: Opportunities for the Next Decade*. The report analyzes the state of the national innovation system and

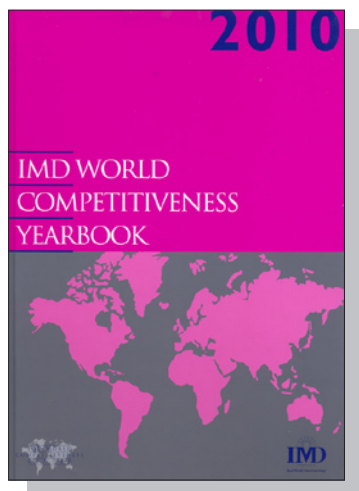
makes recommendations for improvement of the innovation potential of the Bulgarian economy.

The fourth survey of innovation activity of Bulgarian business (INA-4), revealed a considerable increase of innovation activity of the Bulgarian enterprises in 2009 (71% of the companies performed innovation activity) compared to 2008 (43%). This reflects the positive consequences of the country's accession to the European Union and the efforts of the business to respond to the requirements of the competitive European markets and legislation. The crisis encouraged enterprises to seek ways to differentiate their products and services, as well as to send clearer messages to consumers, which led to a particularly strong increase of marketing innovations. At the same time the 2010 report underlines that the innovation activity of Bulgarian businesses experienced the impact of the economic crisis directly through the fall of public and private R&D funding, as well as indirectly through the deterioration of the overall business and innovation environment (higher risk aversion, personnel reductions, consumer markets stagnation, etc.). The long delayed reforms in science and education, the lack of systematic and institutional interaction between them and the business sector, as well as the inefficient management and utilization of European funds allotted for economic modernization of the country additionally exacerbated the problems caused by the crisis.

In 2010, the Economic Program of the Center for the Study of Democracy continued to examine the trends and developments of the factors, which determine the Bulgarian competitiveness and its position relative to other economies. On 19 May 2010, CSD presented the results for Bulgaria of the *IMD World Competitiveness Yearbook 2010*. The previous four issues of the Yearbook had a direct impact on





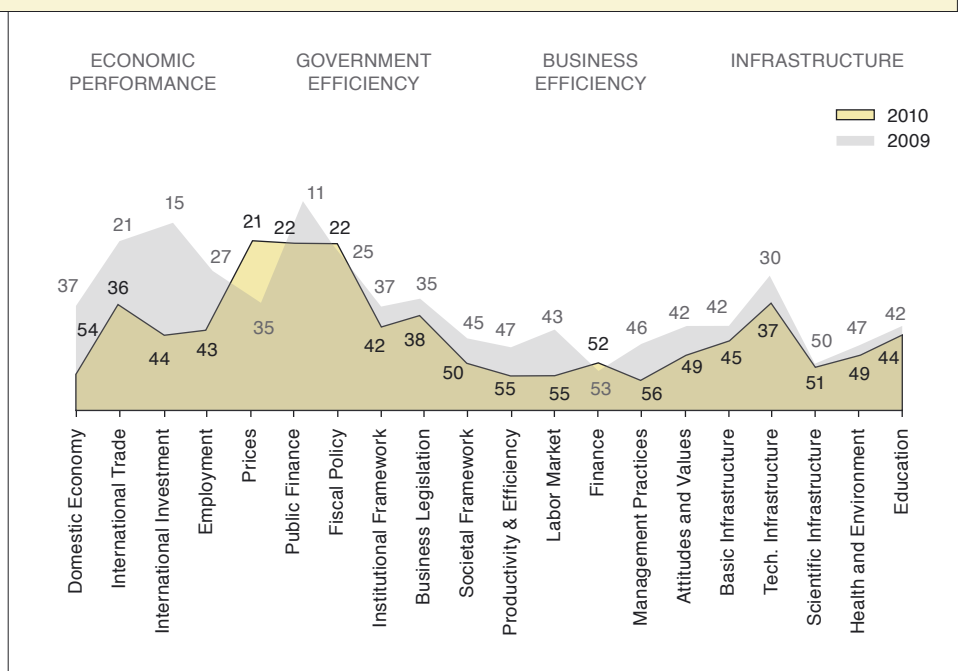


Bulgarian competitiveness policy-making, and were quoted in strategic policy documents of the Bulgarian government. International investors monitor very

closely the IMD competitiveness ranking, which makes its 2010 results even more important for the countries involved against the background of the continuing crisis in Europe. In 2010, the Yearbook places Bulgaria's competitiveness at rank 53 among the 58 leading national and regional economies. According to the report, Bulgaria should address the following five major challenges:

- Improve the business environment through better law enforcement to reduce the concentration of power in oligopolic markets and the gray economy, corruption and organized crime;
- Increase public administration capacity for managing EU funds;
- Elaborate a clear and integrated mid- and long-term innovation and ICT policy, combined with stable finan-

**Figure 2. Competitiveness Landscape of Bulgaria, World Competitiveness Yearbook, IMD, 2009 and 2010**



cial and economic policy for leading the economy onto higher value added path;

- Tackle high resource intensity of production;
- Unlock market demand.

The Bulgarian business leaders assessed the transparency of the government policy in 2010 more positively compared to 2009. They also assessed positively the flexibility of the labour market. The Cost of Living index in Bulgaria takes one of the leading places in comparison to other European and American cities, which can be perceived as a competitive advantage, if combined with better infrastructure or available quality workforce. Bulgaria's corporate income tax remains the lowest in Europe, and the business survey confirmed that the low corporate tax rate supports the entrepreneurial activity.

On invitation by MEP Iliana Ivanova, CSD representative presented the macroeconomic and social effects of the economic crisis in Bulgaria, based on data from the *World Competitiveness Yearbook 2010*, during the international workshop *The Impact of the Crisis on the New Member States – Non-Eurozone New Member States in the European Parliament in Brussels* (9.12.2010).

#### IV. Evaluating the Impact of EU Funds

In 2010, the Economic Program of the Center for the Study of Democracy analyzed the impact and the efficiency of EU's Cohesion Policy in Bulgaria. It elaborated two reports on the activity of the Structural Funds and in particular the operational programs (OP) financed by the European Regional Development Fund (ERDF). CSD representatives participated in three meetings of the DG Regional Policy Expert Evaluation Network in Brussels.

The first report focused on ERDF financing of innovation in Bulgaria. The analysis notes the low level of signed contracts and disbursed amounts as a share of the foreseen budget of Operational Programme Development of the Competitiveness of the Bulgarian Economy 2007 – 2013. Despite the low number of completed projects by 2009, the analysis points out that the financing of innovation, provided by ERDF, will most probably have a significant impact on the development of the Bulgarian economy since its amount is comparable to the total national financing of innovation activities of enterprises.

The analysis lists several reasons for the low absorption rates of EU funds for innovation:

- The Bulgarian enterprises, especially SMEs, as well as individual researchers often encounter difficulties in the preparation of projects for EU funds due to the lack of own resources, necessary for elaborating the project proposal, the feasibility studies and for covering ongoing costs;
- The low levels of administrative capacity of the management of the operational program responsible for funding innovation persist due to the initial lack of experience, consequent late launch of the funding schemes and high personnel turnover;
- The excessive red-tape, significant delays in payments, extensive checks and audits in implementing the funding procedures;
- The Bulgarian enterprises, intermediary organizations and Bulgarian public authorities lack understanding of the innovation characteristics of the Bulgarian economy, which hampers the innovative planning, design and implementation of adequate measures to support innovation.

The second report encompassed all economic areas, supported by ERDF in

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Bulgaria. According to the report, in a situation of decreasing budget revenues the role of the ERDF and the Cohesion Fund increases considerably, since they have turned into key instruments for countering the economic crisis in Bulgaria. The EU funds are of particular importance to the regional development of the country. By June 2010 only 4.6 % of the foreseen ERDF budgets have been disbursed to beneficiaries. The Managing Authorities

declare their intentions to improve and simplify the procedures. Many of these bodies however are still in the process of institutional restructuring and training of employees. According to interviews with representatives of the business most of the enterprises feel discouraged to reapply for funding. Hence, one of the main challenges that the Bulgarian government should overcome is restoring the trust in the management of ERDF funds.