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Security and Governance Deficits: State Capture and Corruption Risks in Bulgaria

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Energy Security Challenges for Bulgaria

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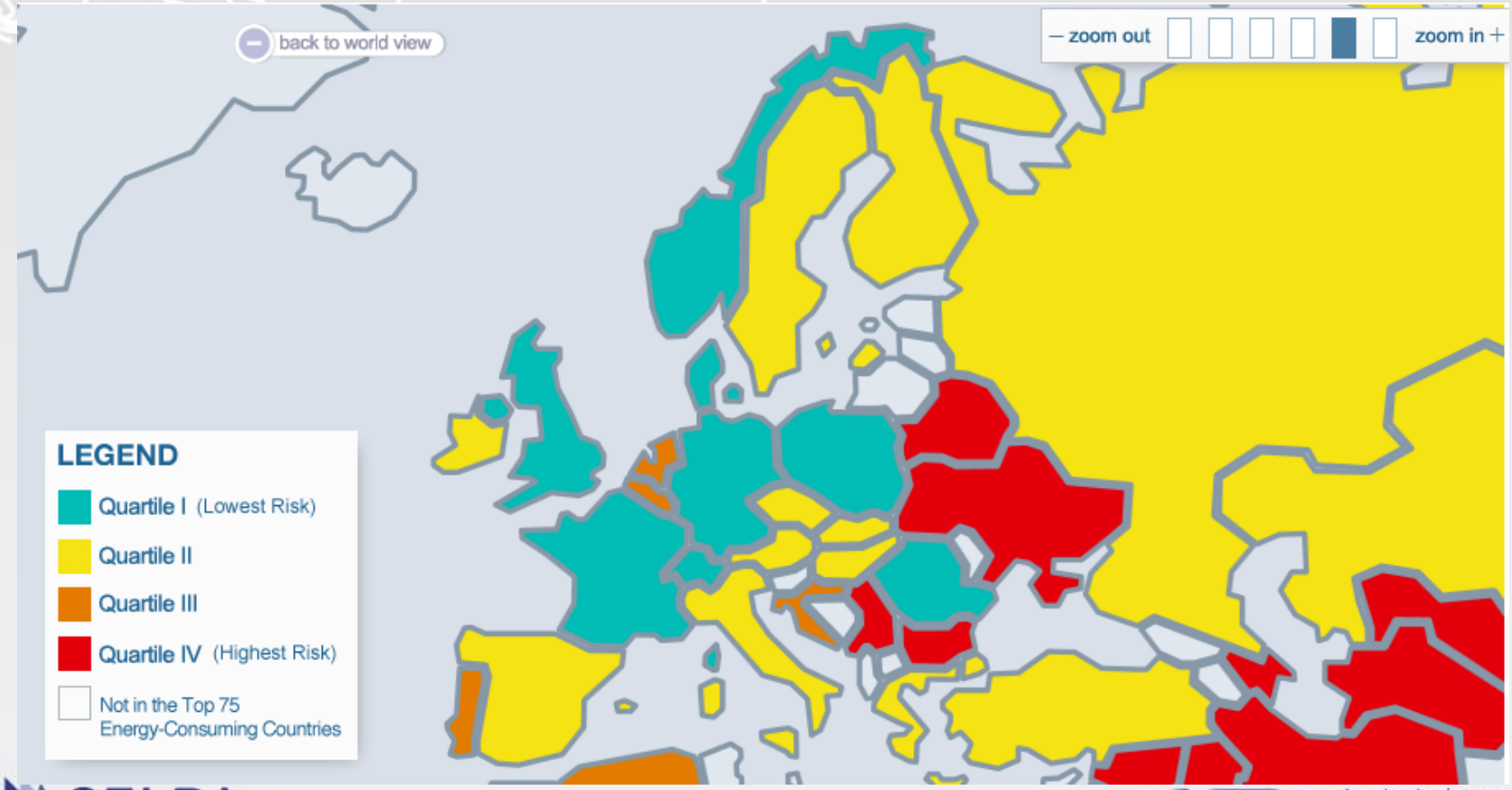
Fundamentals of Long-term Energy Security

- Reducing import dependence
- Increasing the number of suppliers
- Utilization of indigenous resources and renewable energy resources
- Reducing overall energy demand by introducing energy-efficient technologies

2013 International Energy Security Risk Index (2)



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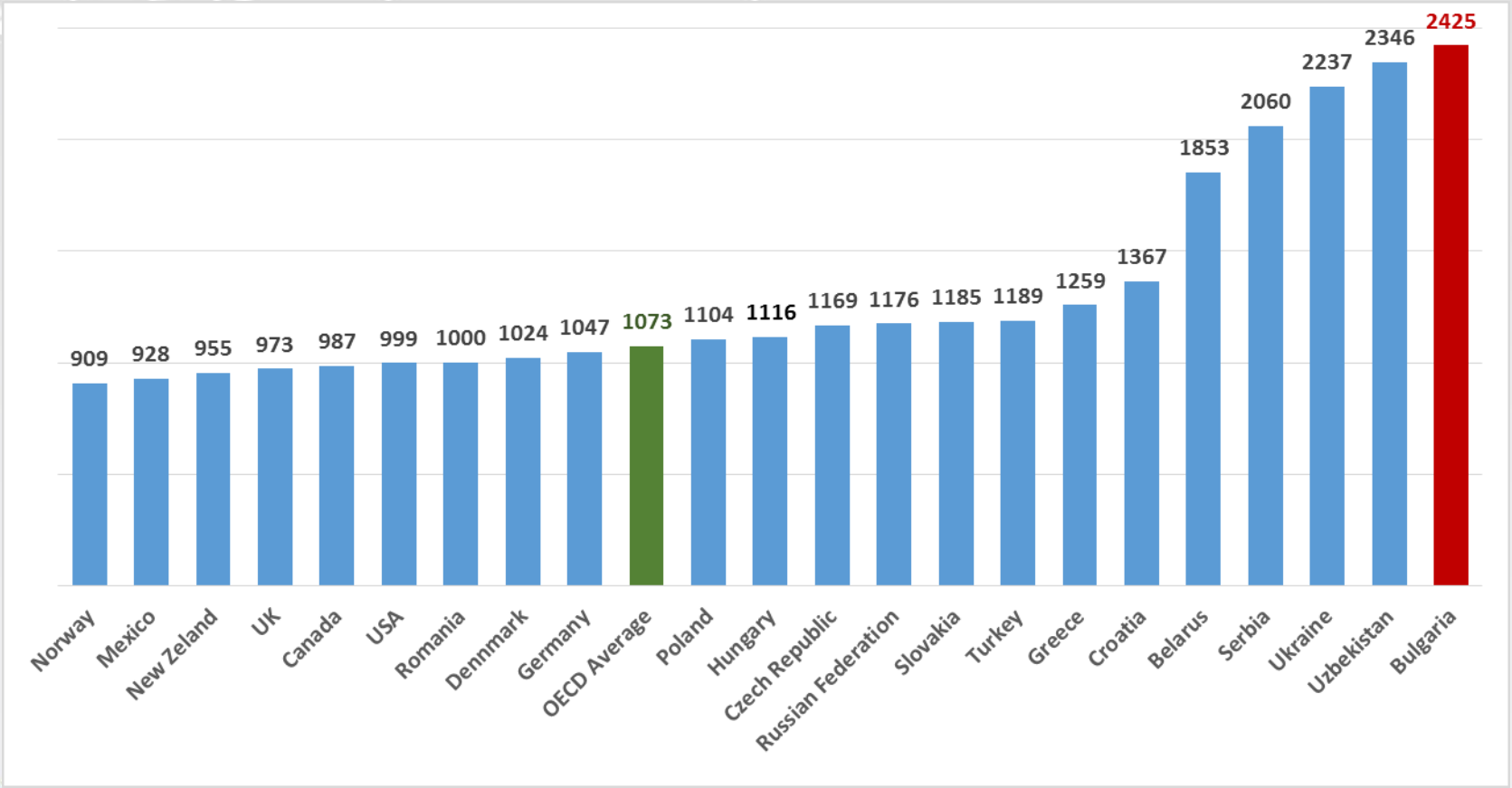
Source: Institute for 21st Century Energy

2013 International Energy Security Risk Index



Source: Institute for 21st Century Energy

Energy Security Challenges for Bulgaria

- Main energy security challenges
  - Energy expenditure intensity
  - Fossil fuels import as percentage of GDP
  - Oil & Gas import dependence
  - Energy intensity

- Main energy security risks:
  - High energy poverty
  - Low energy efficiency
  - Governance deficits (political bottleneck in tackling risks)

Energy Governance Deficits: State Capture and Corruption Risks

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Research Areas

- Governance and financial development of energy state-owned enterprises (SOEs)
  - OECD Guidelines on Corporate Governance of SOEs
  - Analysis of financial data
- Public procurement in the energy sector
- Large infrastructure projects (NPP Belene, HPP Tsankov Kamak, South Stream gas pipeline)

Energy Security Framework

- **Availability of resources**: a sustainable strategy for Bulgaria has to incorporate a sizeable use of unconventional energy sources and map a route to the economy's transition to a more sustainable energy model.
- **Reliability:**
  - measures to reduce the demand for energy
  - government's decisions for the construction of future energy projects are based on the projects' potential to diversify supply sources and ensure an uninterrupted energy supply

Energy Security Framework (2)

- **Environmental sustainability**:
  - Sustainable energy future through lowcarbon growth
  - Enhancing the energy efficiency of buildings and lowering the energy intensity of the economy
- **Affordability:**
  - Energy poverty
  - Energy efficiency / energy intensity
  - Alternative energy supplies and tapping

Information Sources

- Structured data:
  - Official statistics (Eurostat, IEA, NSI, MIE, PPA, BNB, SEWRC)
  - SOEs data (SOEs, MF)
  - Public procurement data (aggregated data – PPA, SOEs)
- Unstructured (qualitative) data
  - In-depth interviews (working discussions)
  - Official documents (reports, data sheets, legislation)
  - Media publications
  - Unclassified (leaked) contracts
- Research papers

Governance Deficits in Large Infrastructure Projects

- Projects: NPP Belene, HPP Tsankov Kamak, South Stream gas pipeline
- Governance deficits manifested in:
  - Conflicts of interests and political brokerage at all projects' phases
  - Lack of and barriers to independent technical and economic expertise
  - Politicians direct intervention on operational management of SOEs and national regulators, incl. through frequent change of top-management
  - Ineffective control institutions (fragile democratic state)
  - Violation of free market and competition rules to the advantage of particular economic interests
  - Lack of transparency and abuse of public funds in the management of SOEs
  - Favorable environment for corruption
  - Human resource deficits in SOEs and the national regulator

Governance Deficits in Large Infrastructure Projects (2)

- Lack of justification for the realization of the proposed projects, incl. irrespective of national and European strategic goals;
- Data manipulation in order to justify the need for realization of the project without any cost-benefit analysis of alternatives or the study of other spheres where planned public funds could be invested;
- Start of the projects based on pure political decisions and not on data-driven analyses;
- Decisions about large projects, which could lead to long-term financial debts that have to be paid later on by the taxpayers, often taken without any political consensus;
- The EPC contractors of major projects have been chosen prior to the contractor selection procedure

Governance Deficits in Large Infrastructure Projects (3)

- The financial parameters of the projects are often not clear and it is far from certain to what extent public finance may be used and whether there will be state guarantees and state forfeit in case of failure. It is an unwritten law that projects are advertised on their lowest contractual price, which is done in order to mislead the wide public, even though in reality these projects would cost a lot more.
- Aggressive local consultants with direct, unauthorized and non-transparent access to the main political and administrative factors, could influence the decision-making process.
- Lack of clear structure for project planning with established milestones and progress report indicators, together with proofreading of discrepancies.
- Final project costs often multiplied in comparison to the initially contracted.

Governance of State-Owned Enterprises

- Accountability and transparency
  - Legal regulations (Decree No 114 on monitoring and control of the financial condition of SOEs …, 2010)
    - Quarterly and annual profit and loss accounts
    - Balance sheet statements and additional financial analysis based on the presented results
- Financial results

Governance of State-Owned Enterprises

- Accountability and transparency:
  - Most companies publish the bare minimum of financial data required by Decree 114;
  - Reports by a number of SOEs lack the required additional performance analysis;
  - In many cases, published reports are characterized by a lack of consistency for consecutive reporting periods, this hampering a comparison in time;
  - Discrepancies between the annual reports uploaded on the MF web-site and on SOEs owns web-sites
  - Required additional financial analysis is not available

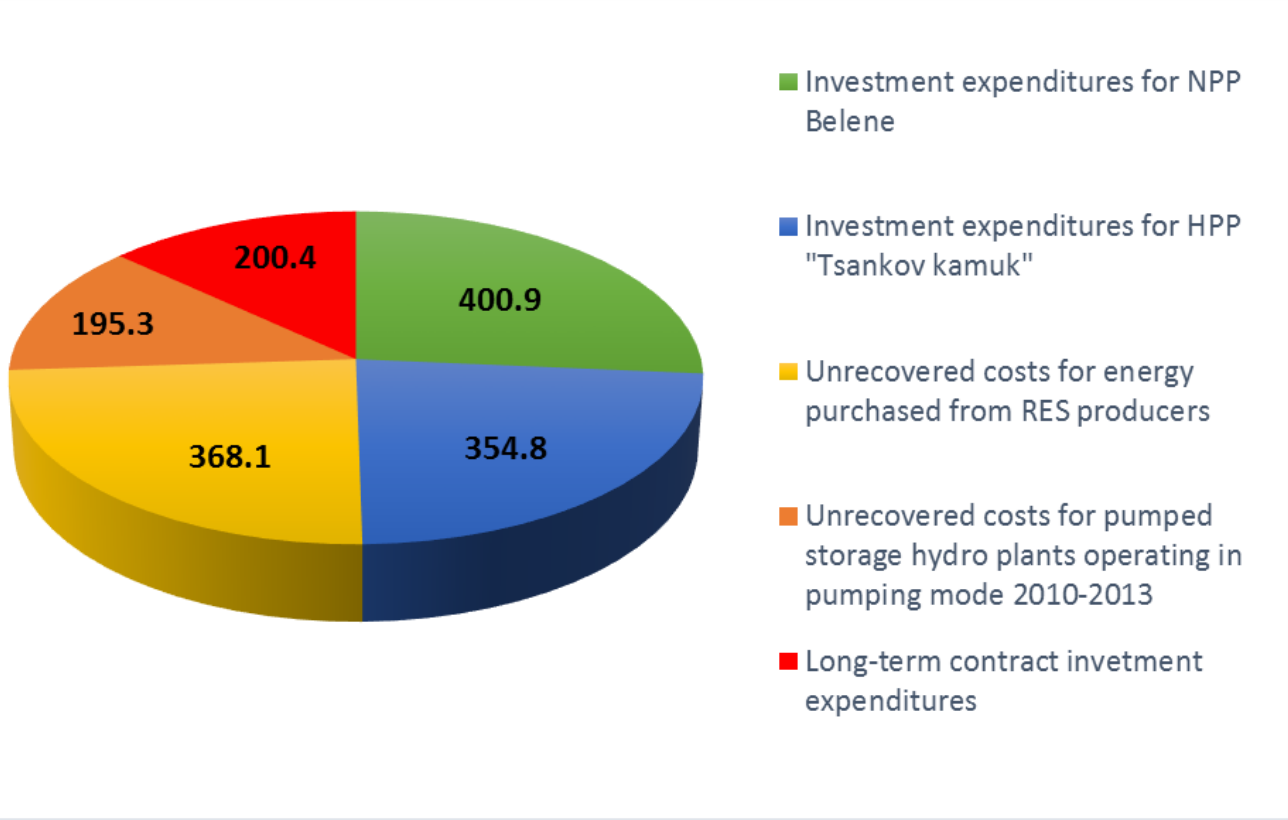
Results: Financial / Political Dependence

- Comparative Prices for Gas Pipelines with similar to the South Stream capacities

Project	Country/Project	Diameter	Cost (EUR mln./km)
South Stream	Russia, South Stream	1420	7.4
OPAL	Germany, Nord Stream	1420	2.1
NEL	Germany, Nord Stream	1420	2.3
Gazelle	Czech Republic, Nord Stream	1420	2.4

Results: Financial / Political Dependence (2)

- Structure of accumulated debt by NEC for the period of 2010 – 2014 (EUR mln.)



Political Risks for Bulgarian Energy Security

- The negative influence of the traditional energy security risks is amplified by bad governance and state capture in the sector, which impedes the formation of a coherent national energy strategy.

- Energy SOE have been engaged in large, inflated deals, which largely outweigh the administrative and financial capacity of the national industries, leaving both the enterprises and the country exposed to increased risk of financial and political dependence.

- The energy dependence of the country has been used by Russia as a political tool to influence the government's decision-making.

- The lack of comprehensive and in-depth monitoring of the energy policy development because of its innate technical complexity and notorious lack of transparency has undermined the ability of the civil society sector to have an effective impact on decision-making in general, and as concerns anti-corruption and good governance, in particular.

Political Risks for Bulgarian Energy Security

- State capture mechanisms undermine additionally the fragile democratic institutions
- “Price of dependence” is paid by end customers through higher cost of energy resources
- Create favorable environment for corruption, strengthening the links between organized crime groups, policy makers and economic oligarchs
- Hamper energy internal market integration, liberalization and diversification and thus, decrease the national energy security
- The prevalence of state capture mechanisms often leads the governments to suboptimal decisions that side-line their own planning and investment needs
- Weak public procurement legislation and law enforcement
- Continuation of bilateral instead of multilateral or regional approach to energy security policy

Recommendations

- Independent annual review of the national energy security risks and targets
- Creation of an effective legal and regulatory framework for SOEs
- Introduction of compulsory corporate governance standards for state-owned companies
- Development of indigenous energy resources and diversification of gas supply
- Development of regional gas and power markets
- Improvement of energy efficiency
- Prioritization of large investments projects, synchronized with the EU priorities and preliminary cost-benefit analysis and compulsory feasibility assessment

Thank you!

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