

# 1. PUBLIC PROCUREMENT: A DRIVING FORCE AND INSTRUMENT OF POLITICAL CORRUPTION

## 1.1. POLITICAL ECONOMY OF CORRUPTION IN PUBLIC PROCUREMENT

As varied as they are, abuses in the area of public procurement aim at re-directing financial resources from public spending units and state-owned or municipal enterprises to the private benefit of individuals who are responsible for procurement decisions. Corruption in public procurement could be seen through two supplementing economic models. The first one is the **principal-agent model**. It explains **the opportunities** for gaining private benefit by disposing of taxpayers' money. Budget spending management in modern democratic systems implies the **delegation of rights and responsibilities** from the citizens (the principal) to the elected politicians (the agent) and even to deeper levels of the political structure. Here the mandate is not fully specified. Decision-makers have some discretionary powers because voters cannot predict all the decisions of politicians and senior officials concerning public spending in the election process. Voters can only demand from them to keep up with their programs and promises and to hold them accountable based on the results.

This mandate is not only incomplete; it is also very heterogeneous. It is a projection of the choice made by the general public, striking a balance between different social interests and views on public spending. In short, **the incompleteness and heterogeneity** of the mandate are incentives for the mandate holder (the agent) to deviate from it.

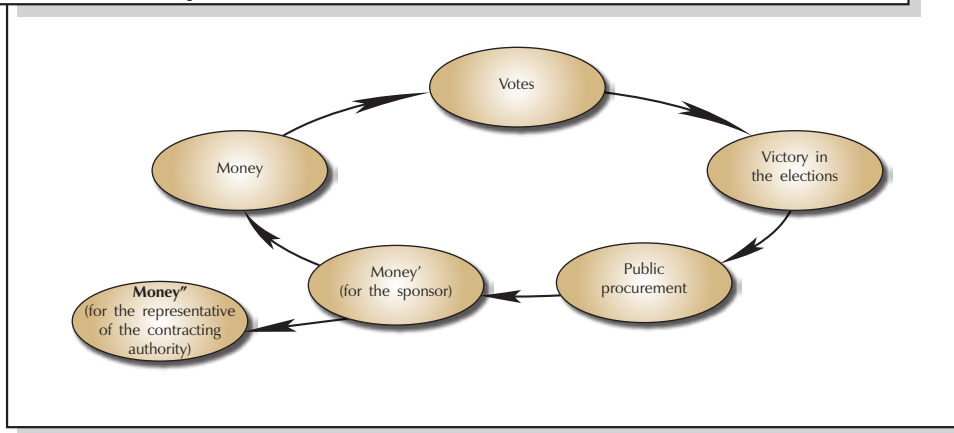
Within the framework of this conceptual construct, the measures to counteract abuses in the management of budget spending are primarily related to making the mandate more specific, i.e. providing the details with regard to the responsibilities of contracting authorities in the public procurement process and reducing the scope of administrative discretionary powers in the contract awarding process. The tendency to ensure detailed and comprehensive regulation of these procedures and the emphasis laid on lawfulness in the control phase have been the manifestations of this logic so far. But the mandate can be made more specific also by clearer definition of the objectives to be attained. This is the rationale underlying **the increased relative share of expediency criteria** at the expense of the narrower lawfulness criteria prevailing so far in the assessment and control of public procurement. This transition is largely the key to the synthesis of the legal and economic levers of the anti-corruption policy in the public procurement sphere.

The second conceptual approach to curbing corruption in public procurement builds on the classical individual behavioral model to explain and counteract crime

in general. It explains **the individual motivation** for the use of opportunities for the extraction of private benefit (formulated above in the principal-agent model). The classic individual behavioral model stems from the expected personal benefit and the individual price that the perpetrator expects to pay, depending on the likelihood of detection and punishment. Hence, counteracting measures are most likely to be effective, are to be done at the level of individual incentives and disincentives concerning the corrupt interaction between the bribing party and the bribed party. They relate to the opportunities to detect, prove and punish the abuse which, in turn, correlates with the efficiency of the internal financial control system and the judiciary.

Corruption in the public procurement has its specific drives and brakes, putting the two anti-corruption models described above in a different light. What makes it different from the other types of fiscal corruption is the fact that it largely determines **the objectives and tools of political clientelism**. The mechanism is all too familiar. Like everywhere else in the world, political parties need the financial support of the business community for their electoral campaigns. Unlike in developed democracies, however, in the Bulgarian practices this support is considered as a business investment **not** to the benefit of the public but as a private investment of the respective sponsoring business in exchange of which the return is guaranteed in the form of privileges and benefits in the distribution of the public good once the sponsored party or “independent” candidate comes to power. This means privileged access to public procurement contracts, concession agreements and other forms of directing public resources into private accounts. Of course, part of these resources end up in the private accounts of those who make the decisions or exercise political control. This is not at the expense of the contractors; it is at the expense of taxpayers. Without competition, suppliers can always internalize the costs incurred for private incentives in the price of their supplies. Figure 1 illustrates, in principle, the cycle of such political “investment”. The sponsoring business supports the electoral campaign of its political ally. The objective of the sponsorship is victory in the elections, i.e. the conversion of money into votes. The business receives a return on its investment ( $M'$ ) through public procurement contracts awarded by those in government while the responsible officials get their personal benefit ( $M''$ ).

**Figure 1. Political economy of corruption in public procurement**



Except for the final stage M'', this scheme was openly defended and justified in a series of public statements of the MRF leader Ahmed Dogan in 2005 and 2006. Its ideological rationale is that by supporting their business sponsors political parties create jobs in their constituencies and enhance the standards of living of their voters. Insofar as all parties have their constellations or "loops" of businesses, society does not lose anything in the end. According to Mr. Dogan, parties compete for the interest of their members and that of society as a whole through their loops of businesses.<sup>2</sup> The problem with this conceptual scheme for legitimization of party-related loops of businesses is that it makes the market economy redundant to a great extent. One can ask the following question: why are market competition and transaction costs necessary if political parties can so efficiently allocate the scarce resources in the economy through political competition?

The above illustration is too schematic to fully reflect the whole diversity of the process. Unlike ordinary investments, political ones are associated with greater risks and uncertainty. They arise from the uncertain outcome of the political competition, the uncertain outcome of the campaign, as well as from the balance of forces within the supported party and hence the relative weight of the commitments to other sponsors. Furthermore, the financial parameters of the investment are clear enough, unlike its rate of return. What is paid for before the elections is the membership fee for the club of those who stand close to the government but the benefit from that membership is determined later on as the price of additional payments which might go to the officials in charge rather than directly to the political party. Besides, as major as it is, public procurement is only one element of the benefits from the membership of the club. The others might be related to concession arrangements, subcontracting for foreign contractors, issuance of licenses and permits for various activities and transactions, political shielding of the circumvention of the law, government posts abroad which are important for the business, and so forth.

<sup>2</sup> See *Report of the MRF Chairman*, Dr. Ahmed Dogan before the Delegates and Guests of the Sixth MRF National Conference, 1 April 2006; available online at: <http://www.dps.bg/cgi-bin/e-cms/vis/vis.pl?s=001&p=0037&n=000001&>

On the other hand, we can hardly put all the business partners of those in government under the same common denominator. Most of them compete for a membership in the club and their costs of avoiding risks during the electoral campaign are the greatest. Others, being companies owned by the party leaders or functionaries themselves join automatically. They do not need to make any investment in the party. Conversely, parties and other sponsors invest in them, involving them as partners, consultants or subcontractors for their supplies. Still others are so closely identified with a specific political party that their business cycle largely reflects the life cycle of the party. There is also the group of those who have managed to outgrow their initial one-party affiliation and are now big enough to expect membership in any club, i.e. their money is welcome everywhere even at a later stage when the risks and uncertainty are reduced.

The level of government matters as well. In the case of local government, the smaller the municipality, the less the uncertainty and hence the greater the opportunities for local businesses to determine the membership and decisions of the municipal leadership. Of course, it is the objective of each business to expand and go beyond the boundaries of the region. Therefore, businesses need to invest in the central government, members of parliament, and senior government officials. Even further, the division of the public resources which takes place at the local level is still relatively small due to the incomplete fiscal decentralization in the country.

Large-scale corruption in Bulgaria underwent several stages during the country's transition to a market economy. In the early 1990's, when democracy and the rule of law were quite fragile, political corruption was mainly in the form of pumping resources out of the state-owned enterprises and their preparation for cheap privatization. The newly established private businesses stood at the input and output of state-owned enterprises with the participation of the management of the latter. Against the backdrop of the underdeveloped market economy and the price liberalization, they got the opportunity to bleed state-owned enterprises out and the state budget thanks to the soft budget constraints prior to the introduction of the currency board arrangements. Thus, the economic shock-therapy and financial liberalization of the early 1990's, together with the delayed structural reforms and the soft budget constraints, created opportunities for channeling assets of the public sector to privileged private groups. After the crisis in 1996-7 and the introduction of the currency board, those structures which were the main factor for the delay of the reform processes turned into major participants in the privatization. That process created the specific Bulgarian features of what the World Bank experts called "state capture".<sup>3</sup>

That early post-communist stage of development of Bulgarian business generated also a specific form of financing of political parties through institutionalized administrative corruption which, for many years, determined the high corruption risk in the customs administration and the links of parties to organized crime.

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<sup>3</sup> Hellman, Joel S., Geraint Jones and Daniel Kaufman *Seize the State Seize the Day: State Capture, Corruption and Influence in Transition*, World Bank Policy Research Working Paper No. 2444, September 2000

In the early years of the transition, new democratic entities could not rely on the financial support of businesses. They were either too weak and inexperienced in political investment or genetically linked to the former communist party. Therefore, the only venue they had was the government, which brought about a more rudimentary form of using administrative instead of political corruption for party financing. At that point of time, the long suppressed consumption unleashed a real boom in the importation of consumer goods, on most of which high customs duties or even excise taxes were levied. The tariff and excise tax evasion brought huge profits to the importers as a trade-off to a payment of a certain rate for each container imported. Participants in those schemes say that a certain portion of each bribe paid to the customs administration was distributed further up to the chain of government all the way to party treasuries. At the end of the 1990's, many customs duties were either reduced or removed and the scope of excise duties was confined to the typical excise goods (fuels, tobacco, alcohol and some luxury products).

At the same time, parties already had their business partners and this primitive form of party financing through customs corruption became relatively inefficient. Some smuggling channels were legalized and moved away from the gray sector of the economy, while others, where customs duties, VAT and excise taxes continued to be the sources of considerable profit, shifted to the black sector. Besides, the target of political corruption moved toward the privatization process rather than imports. The consequences of those early forms of using organized administrative corruption for financing political parties continue to shape the specific features of the corrupt and criminal environment in Bulgaria. On the one hand, they determine the deep links among smuggling channels, businesses and politicians and, on the other, they demoralized the regular customs officers for a long time to come and impeded anti-corruption measures.

Today, the political corruption in Bulgaria takes much more developed and larger-scale forms, where public procurement occupies a sizeable place. After the privatization process was basically completed in the beginning of this decade, public procurement and concessions became a major sphere of large-scale corruption. Their place on the top of the pyramid of corrupt practices is determined by the large financial resources distributed within the public procurement system, and the related opportunities for personal enrichment. Also, precisely for that reason, financial abuse cannot happen without the involvement of and protection by high-level officials, and, finally, by the enormous economic and fiscal price that society has to pay.

On the other hand, the relative weight of financial abuse by sectoral contracting authorities is increasing. Such restructuring of the conventional corrupt practices depends also on the growing share of contracting authorities in this sector, and the relatively limited opportunities for public control. The third chapter of this study deals with the corruption risk and corrupt practices in the public procurement for the energy sector in Bulgaria.

## 1.2. RESPONSIBILITY: POLITICAL OR ADMINISTRATIVE, COLLECTIVE OR INDIVIDUAL

Unlike the other cases of fiscal corruption, public procurement involves mainly high-level corruption. The head of the institution or enterprise in the public sector is fully responsible for the awarding and implementation of public procurement contracts. The appointments of the leader are typically political, as are those of the board members in state-owned and municipal enterprises. Nevertheless, the cases of such corruption almost never reach the stage of holding anyone politically accountable. Rather, they often end with claims and disputes about the political merit for the detection of abuse at the lower levels of government. From here then the tendency of those in government<sup>4</sup> to explain public procurement corruption, at least the violations reported, as being part of the administrative corruption.

There is another common and disputable argument in the public debate concerning the anti-corruption measures in the public procurement sphere. Even when the issue is considered within the framework of political corruption, the tendency is to associate it primarily with the financing of political parties. Hence the anti-corruption measures tend to focus on the increase of government subsidies for parties. It is important then to examine these two theses from the perspective of the anti-corruption policy.

**First**, is it possible for some of the abuses in this sphere to be in the scope of administrative corruption, i.e. to be unrelated to any collective partisan interests or individual interests of those in government? In other words, is it possible for the acquisition of goods and services in the public sector to bypass the political leader and be the result of action at the lower levels of government? Such a risk exists mainly in the case of small public procurement contracts in central government institutions, as well as in municipal procedures or contracts in hospitals, schools and others. But it also exists in large-scale procurement procedures which require high level of professional expertise. In cases like this it is possible for the experts to set such public procurement parameters or assess bids in a way that gives advantage to a specific bidder. However, the opportunities for this type of corruption at the expert level are quite limited. This would mean that there are no other bidders or experts to address the head of the institution with their arguments and that there is no pressure on the head from above or from outside by competitors. Moreover, consultants are involved when the specificities of the public procurement procedure are as complicated. In fact, if there is a corrupt scheme, it would be activated as early as the stage of the selection of a consultant so that to ensure advantages for a given bidder through the parameters of the public procurement procedure.

To put it in brief, it is not impossible for corruption in the public procurement sphere to result from the lack of control over the lower levels of government, i.e. to be more of the administrative type than of the political type of corruption. In reality, however, this option seems to be more of an exception than a rule in

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<sup>4</sup> A recent example to this effect is the scandal with the abuses in the district heating company in Sofia (Toplofikatsia).

large-scale public procurement contracts. It affects mainly small public procurement contracts. In 2006, the value of the contracts below the thresholds set out by the Public Procurement Act accounted for 6.3 % of all contracts. Although this small share was due mainly to the huge contract for the construction of Belene NPP, which was worth 7.82 billion leva, even without it, small contracts did not exceed 19 % of the total value. It is even more important that the “small” corruption in the public procurement sphere does not relieve those in government from responsibility. In general, the corruption in the public procurement sphere is dominated by well-structured networks of targeted investments rather than by occasional actions of individuals at the lower levels of government due to negligence of their superiors. Therefore, this study is interested in analyzing this type of corruption as the driving force and tool of high-level corruption. This leads us to the **second** question: what is the driving force of corruption in the public procurement sphere – the need for financing political parties or the individual aspiration of politicians for private benefit?

When the objective is power, the benefits from the unlawful awarding of public procurement might go to the respective political party, i.e. to be associated with the financing of political activities aimed at coming to power. The roots of the use of government power for financing political parties are very deep indeed, dating back to the long years of the symbiosis between the party and the state. Some argue that, in such cases, the objective is not personal gains but it is the party itself or, even during the transition years, democracy itself. Is it possible that the ultimate goal of the abuse of public procurement would be the victory of the party cause rather than the victory of the people identifying themselves with it? Hopefully, politicians view power only as a tool to resolve the problems of their voters before they tackle their own problems. In this sense, in theory, it is possible to assume that if corruption in the public procurement sphere is used for financing political parties, it might not necessarily be directed to personal benefits. In practice, however, where corruption is used for undemocratic and non-transparent transferring of public resources to partisan treasuries, the ultimate goal is more power for the leaders and functionaries of the respective party. The purpose and use of government powers is another issue but it would hardly be realistic to accept that they are related primarily and only to the interests of their voters. They are more closely linked to personal interests, no matter whether the personal gain from coming to power is expressed in the form of money, power, or simply a lucrative public or corporate position. In the end, the benefit for the party as motivation for financial abuse within the public procurement sphere is ultimately aimed at personal benefit.

Advanced democracies try to restrict these opportunities through greater transparency of party financing and accountability of political parties. In Bulgaria as well, anti-corruption measures are, first and foremost, oriented toward legislation concerning the financing of political parties. In this context, the thesis that an effective anti-corruption measure is the increase of the budget subsidies for political parties has become increasingly relevant. The argument goes that if parties had “enough” money, they would not use government power to derive financial benefits. So far though, there is no sound evidence to confirm this thesis neither in theory, nor in practice both at the individual level (pay rise for government officials) and at the group (party) level. This thesis would have some limited justifications if the

use of power for financing parties or benefiting party sponsors was totally selfless, i.e. geared only toward the attainment of the party goals and in the interests of its members or supporters. Even in such a case there would hardly be a level of subsidy to be sufficient for all participants, i.e. to optimally reduce the economic incentives for political parties to resort to financing through political clientelism.

More frequently, high-level corruption results not from the striving to finance party activities and goals but from the aspiration of individual senior functionaries to use the government power to their own benefit, including direct financial gains. In this sense, high-level corruption results from the lack of inner-party democracy, transparency and control. After 16 years of transition, the political parties in Bulgaria today have unstable and frequently small or amorphous membership, incomplete structures, and therefore fragile democratic traditions. In short, parties lack sufficiently effective protection from being used for personal enrichment by individual senior functionaries. This drives away some of their supporters which, in turn, makes their dependence on political entrepreneurs and coalition or financial trade-offs bigger, increasing the risks of voter apathy and marginalization of the election process as a result.

The organizational weakness of political parties is among the major reasons for the lack of democratic control over the inner-party decision-making process. This explains the existing tendency in Bulgarian politics to rely more on the leader than on the party and the ideas it puts forward, i.e. to seek the “messiah” instead of the full use of the tools for civil control over holders of elective office. The result is a certain level of popular withdrawal from conventional parties and the search for some new forms of civic association and non-partisan representation.

In a nutshell, the crisis of political representation in Bulgaria - largely the result of voters being disillusioned by high-level corruption - has caused the main political parties to be dominated by a strong leader and has blurred the ideological distinctions between them. Political corruption has thrown political representation in the country into a downward spiral. In turn, the resulting emergence of domineering party leaders is isolating the parties from their voters and is increasing the risk of corruption. The fortunes of leaders thus end up depending not so much on the support of voters and sympathizers but rather on their ability to manipulate the party's top brass.