



# STATE CAPTURE UNPLUGGED

COUNTERING ADMINISTRATIVE  
AND POLITICAL CORRUPTION  
IN BULGARIA



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The eleventh Corruption Assessment Report of the Center for the Study of Democracy is focused on the most potent form of corruption affecting Bulgaria: state capture. The report builds on years of CSD experience in the regular monitoring and assessing of the spread of administrative and political corruption. This is now complemented by an assessment of the mechanisms by which powerful lobbies capture government decision making to the benefit of shady business interests and the detriment of public good. The report finds that these two manifestations – administrative corruption and state capture – are closely linked because they represent different facets of the same phenomenon.



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БЪЛГАРО-ШВЕЙЦАРСКА ПРОГРАМА ЗА СЪТРУДНИЧЕСТВО

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Center for the Study of Democracy  
5 Alexander Zhendov Str.  
1113 Sofia  
tel.: (+359 2) 971 3000  
fax: (+359 2) 971 2233  
csd@online.bg  
www.csd.bg

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## LIST OF ABBREVIATIONS

BGN	Bulgarian leva
BNB	Bulgarian National Bank
CCB	Corporate Commercial Bank
CMS	Corruption Monitoring System
CPC	Commission for the Protection of Competition
CSD	Center for the Study of Democracy
CVM	Cooperation and Verification Mechanism
GLIEA	General Labor Inspectorate Executive Agency
MACPI	Monitoring Anticorruption Policy Implementation
MoI	Ministry of Interior
NBMG	New Bulgarian Media Group
NRA	National Revenue Agency
NSI	National Statistical Institute
OPAC	Operational Program Administrative Capacity
PFIA	Public Financial Inspection Agency
PPA	Public Procurement Agency
SEE	Southeast Europe
SELDI	Southeast Europe Leadership for Development and Integrity
SJC	Supreme Judicial Council
TED	Tender Electronic Daily





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## FOREWORD

For a number of years, CSD's *Corruption Monitoring System* has indicated that administrative corruption in Bulgaria shows little signs of abating. The same applies to an even more potent form of corruption – state capture. These two manifestations are closely linked because they represent different facets of the same phenomenon: corruption behavior. Rampant **administrative corruption** in the country is indicative not only of violations by public officials in their dealings with business and members of the public. Such a situation is exacerbated by high levels of **political corruption** – that is, high prevalence of corrupt transactions perpetrated by management level public officials and elected politicians. Typically, corrupt transactions occurring at the various levels of the institutions of public governance are generally congruous and precipitate each other. In the last decade, there has been increased attention to a type of bundles of corruption transactions commonly referred to as **state capture**. This refers to the practice of powerful (mostly business) actors capable of acquiring preferential treatment through complex corruption deals and other violations of the law. They achieve this by steering government policies towards furthering their private benefit rather than the public good.

The corresponding situation in the Bulgarian economy has been the monopoly position of some companies in specific markets. The same companies typically manage to obtain privileged access to public resources through government procurement contracts. State capture has also been used by shady businesses to ensure protection for their operations in the hidden or even black economies.

While both administrative corruption and state capture include abuse of public discretionary power for private gain, they differ in the way the deliberate abuse is conducted. While administrative corruption could be regarded as a single abuse transaction which is associated with single activities, state capture is rather a system of abuse transactions carried out by the same actors. This makes it possible for “captors” to systematically have their private interest served and to have long-term privileged access to public resources.

High levels of administrative corruption and state capture result in the formation of **areas with systemic problems which continuously “resist” or block most policies of prevention and repression**. These are problematic areas like:

- Procurement violations. Clientelistic or paternalistic distribution of procurement contracts to selected groups of companies.
- Hidden economy mechanisms. Systematic violation of tax and labor legislation ensuring relative economic advantages of companies.

- VAT and other tax fraud. Systematic operation of groups which extract VAT or violate the tax and excise legislation in order to generate illegal income.
- Smuggling and stable functioning of illegal markets (drugs, prostitution, car theft, trafficking in persons, etc.). Violations of the customs and tax legislation and large scale engagement in activities that are prohibited by law.
- Blocking of law enforcement institutions. Systematic corruption of law enforcement officials aimed at preventing due legal sanctions for violations of the law.
- Blocking of different institutions of the control system. Systematic violation of industry standards and other market regulatory legislation aimed at extracting additional profits and gaining undue market advantage.
- Media capture. Hidden ownership and control of media, PR and advertising contracts secure media comfort to both political and business elites.

## 1. THE STATE OF CORRUPTION IN 2015 – 2016

### Overall rate of corruption

An assessment of the level corruption and the development of anticorruption strategies and policies depend to a large extent on the way **dimensions and forms of corruption behavior** are defined and interpreted.<sup>1</sup> The overall conclusions about the corruption situation in the country for 2015 – 2016 are **not optimistic**.

### Corruption in the civil service (administrative corruption)

**Since 2011, administrative corruption has been gradually increasing and is currently at high levels.** On the whole, after 1999 (not taking into account minor fluctuations) two specific periods linked to the political cycle could be delineated: 1) 1999 – 2011, when a contradictory process of marginal decrease of administrative corruption was observed (in 1999 about 29 % of the population reported involvement in corruption transactions, while in 2011 this indicator dropped to 9.4 %); 2) after 2011, when a process of gradual increase of corruption has been observed and the administrative corruption indicator reached 22.2 % for 2016, which corresponds to the involvement of 1.3 million citizens in corruption transactions.<sup>2</sup> Data for 2016 show that the level of administrative corruption was similar to the one in 2000 (Figure 1).

The dependence of corruption levels on the political situation is clearly visible in the period 2013 – 2014 when the highest observed level of administrative corruption was registered – 29.3 % of the population 18+ reported to have participated in corruption transactions at least once in the preceding year.

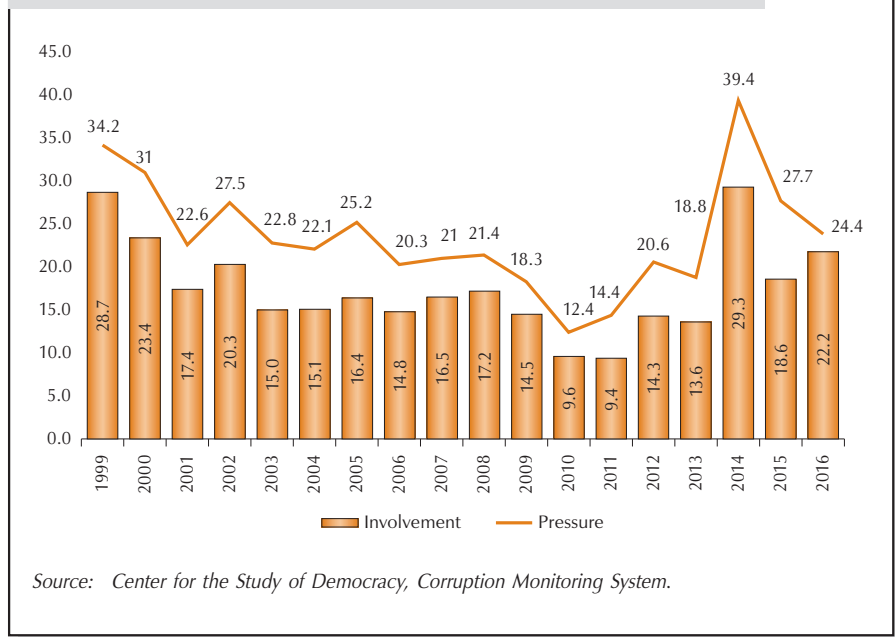
Until 2013, the dynamics of corruption followed the electoral cycle – it would decline after the stepping in of each successive government and return to higher corruption level in the end of its term. The sharp increase of corruption pressure in 2013 is explained by high levels of political instability which lead to two rounds of early parliamentary elections and mass street protests. Data for 2016 show that despite some tighter administrative control measures, administrative corruption is on the rise. In the period 2011 – 2016, the level of administrative corruption doubled.

On the one hand, Bulgaria is in unfavorable position compared to its neighbors in Southeast Europe (Figure 2). For comparison, the level of ad-

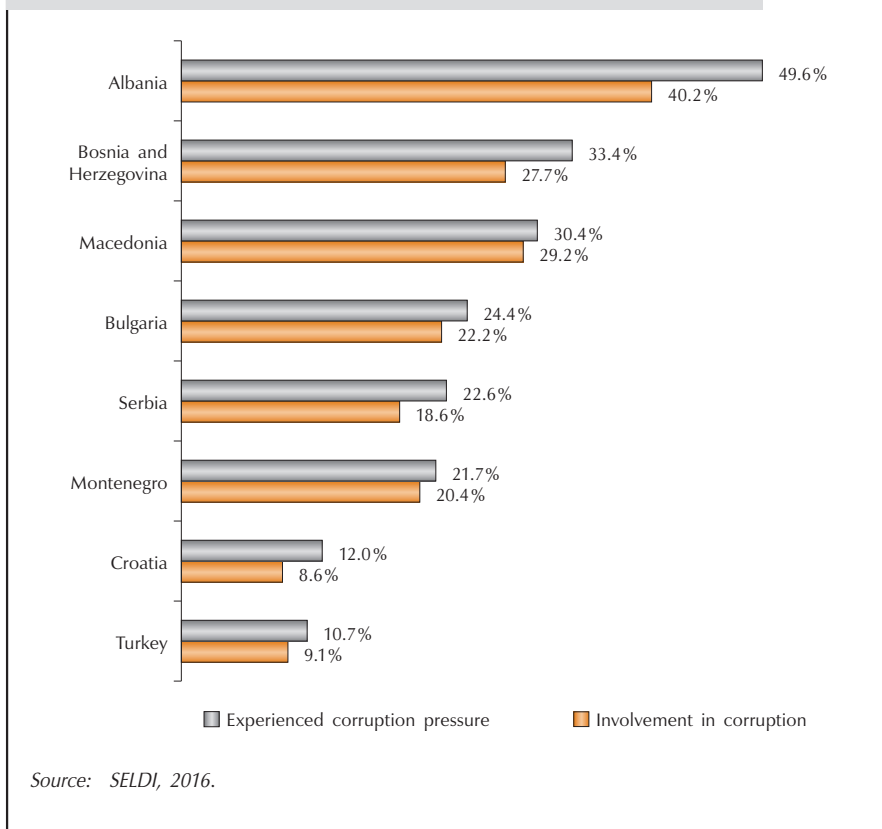
<sup>1</sup> This analysis is based on the corruption assessment methodology developed and applied by Center for the Study of Democracy since the 1990s. See further the Annex, which defines the main concepts used to measure and assess the corruption situation.

<sup>2</sup> This calculation is based on the premise that 1 % of the population aged 18 and over represent about 60,000 people. NSI data for the population by 31.12.2014 show that the population aged 15 and over was about 6,204,000, and the population aged 20 and over – 5,890,600.

**FIGURE 1. INVOLVEMENT IN CORRUPTION (EXPERIENCE WITH BRIBES AND CORRUPTION PRESSURE, % OF THE POPULATION 18 +)**



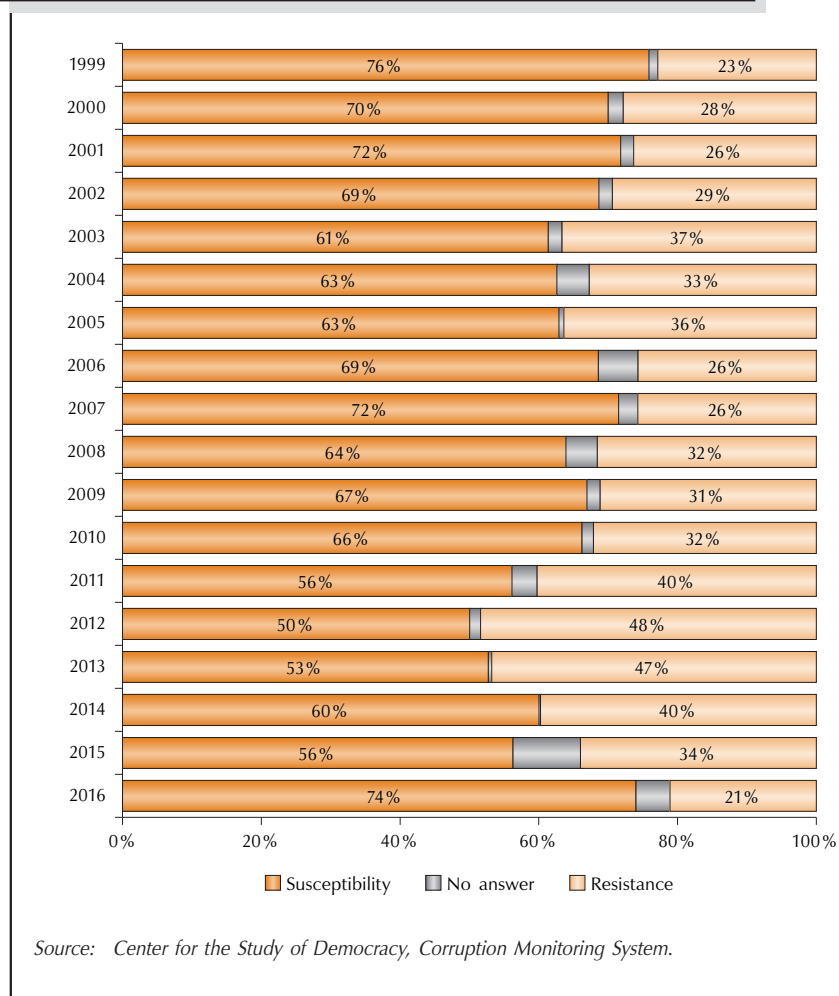
**FIGURE 2. INVOLVEMENT IN CORRUPTION IN SOUTHEAST EUROPE (EXPERIENCE WITH BRIBES AND CORRUPTION PRESSURE, % OF THE POPULATION 18 +)**



ministrative corruption indicators for 2015 had values of 8.6 % for Croatia, 9.1 % for Turkey, 18.6 % for Serbia and 40.2 % for Albania. In the period 2000 – 2002, when the first diagnostics using the CMS methodology was applied in SEE, the results for Bulgaria, though unfavorable, gave it the best relative position in the region with regards to administrative corruption.

On the other hand, the country’s position relative to other EU member states is very unfavorable. Data about corruption pressure (proposal from a public official to initiate a corruption transaction) in Bulgaria for the period 1999 – 2015 varied in the range 25-35 % of the adult population, while the EU average was 4 %, with the value for Denmark being 1 % of the population age 18 and over.<sup>3</sup>

<sup>3</sup> TNS Opinion & Social. (2014). Corruption. Special Eurobarometer 397. Brussels: Directorate-General for Home Affairs, European Commission, p. 81.

FIGURE 3. SUSCEPTIBILITY AND RESISTANCE TO CORRUPTION PRESSURE<sup>4</sup>

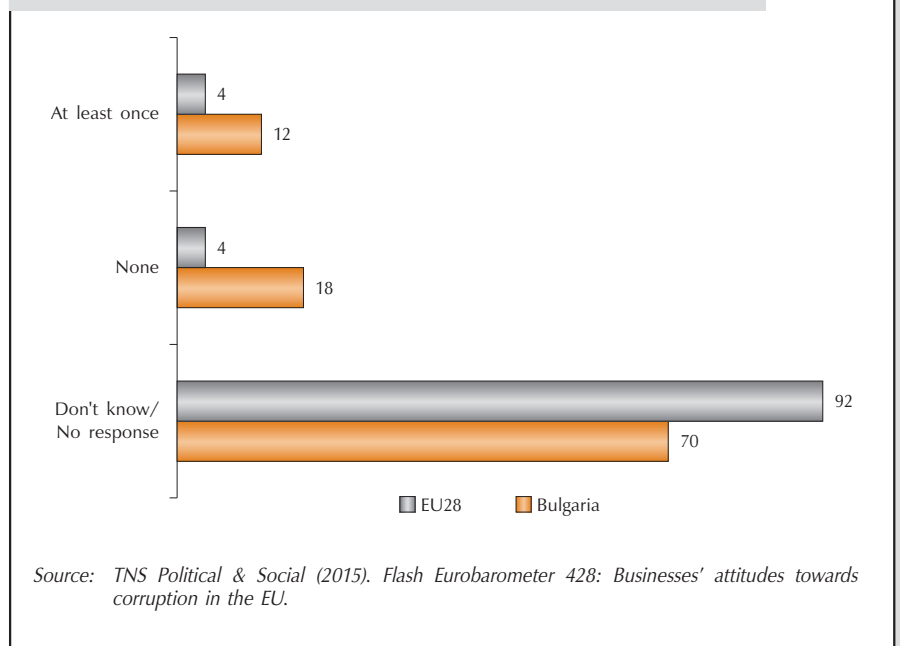
CSD data for the period after 1999 show that instances of pressure that leads to corruption transactions varied over the years in the range 30-50 % depending on the level of resistance by citizens (Figure 3). Most corruption transactions (as reported by the public) are initiated by public officials. Over the years, resistance to corruption pressure varied, but a slow improvement trend (more citizens refuse to participate in corruption deals) was observed till 2011. **Since then, it has deteriorated** and in 2015 resistance to pressure by public officials dropped to levels comparable to 1999.

Trends of the experience of the business sector with corruption are equally disturbing. In 2015, businesses reported that in 12 % of cases of contact with the public administration they experienced corruption pressure, which was higher than the EU28 average (4 %) indicating that a serious problem exists.<sup>5</sup>

<sup>4</sup> Susceptibility to corruption pressure is measured as the share of citizens who experienced corruption pressure and accepted to be involved in corruption transactions. Resistance to corruption pressure is measured as the share of citizens who experienced corruption pressure but refused to be involved in corruption transactions. Please also refer to the Annex.

<sup>5</sup> TNS Political & Social (2015). Flash Eurobarometer 428: Businesses' attitudes towards corruption in the EU.

**FIGURE 4. EXPERIENCE WITH CORRUPTION PRESSURE IN THE BUSINESS SECTOR (2015)**



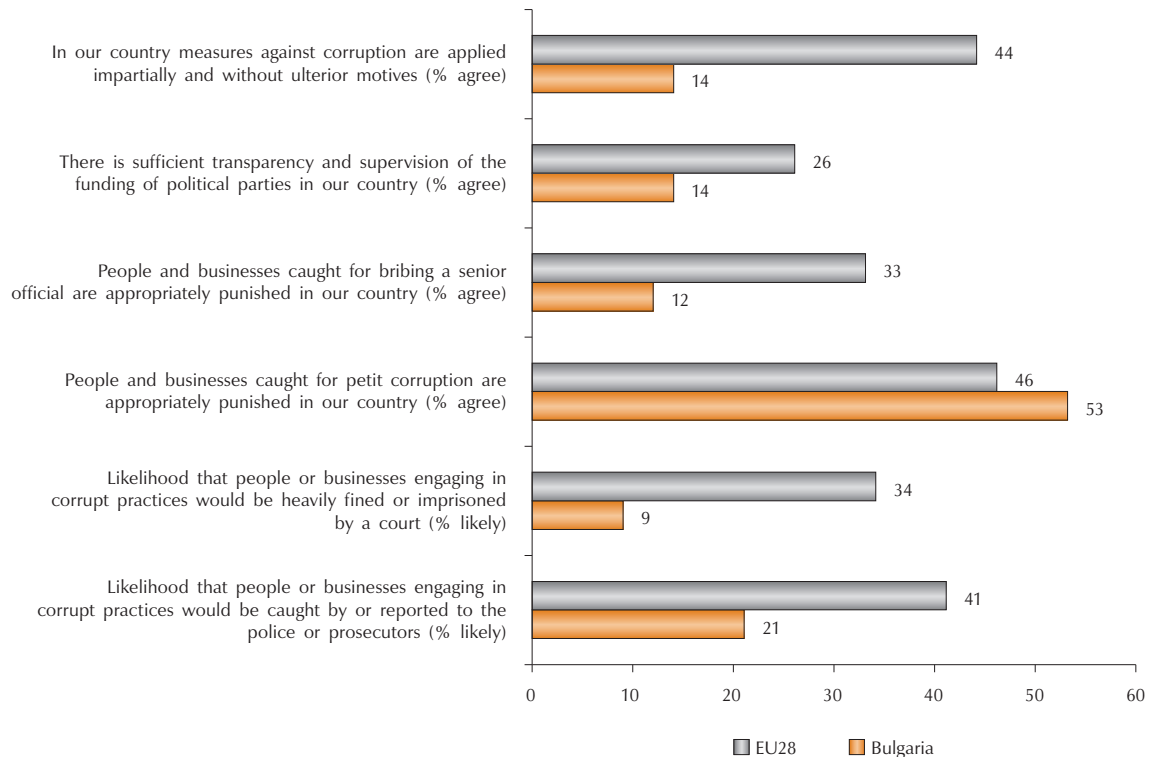
Most corruption transactions in the business sector remain unidentified and unpunished. Lack of sanctions is among the main factors that contribute to the embeddedness of different forms of corruption in the business environment. Regarding the prospects of corruption in the business sector to be identified and prosecuted the discrepancy between Bulgaria and the EU28 average is substantial. The only indicator for which in Bulgaria the probability of corruption being identified and sanctioned is higher than the EU28 average is corruption committed by lower ranking public officials.

Compared to **conventional crime**, law enforcement has not effectively started working on corruption-related crime in a way that is relevant to the volume and public risk. In the period 2010 – 2014, **cases of conventional crime and of corruption were processed in radically different ways by enforcement and judicial institutions.**

For the period 2010 – 2014, about 600 thousand victims of conventional crime were identified by surveys every year, while the police registered about 120 thousand annually, with only 34 thousand cases ending up being prosecuted (i.e., only 25 % of registered conventional crime cases and 5.7 % of committed cases of crime are being prosecuted). Regarding corruption, the number of involved citizens was 1.3 million, while only about 120-150 cases (0.01 %) reach the prosecution stage. This shows that the judiciary and the Ministry of Interior register and process a tiny portion of cases of corruption, which is fundamentally different from the way they deal with conventional crime. In addition to that, measures to counter political corruption practically do not exist (see further Table 1).

The high prevalence of corruption has turned it into **an element of the social environment**: in 2016 only about 22 % of citizens aged

**FIGURE 5. BUSINESS SECTOR EVALUATIONS OF THE ENFORCEMENT OF ANTICORRUPTION POLICIES, BULGARIA COMPARED TO EU28 (2015)**



Source: TNS Political & Social (2015). Flash Eurobarometer 428: Businesses' attitudes towards corruption in the EU.

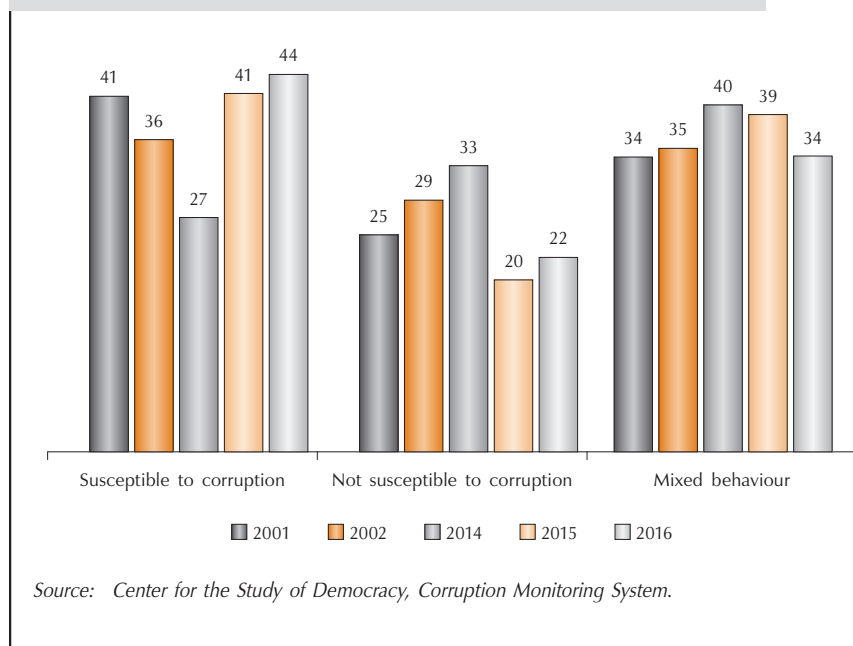
18 and over fully rejected the option of getting involved in corruption transactions. Another 34 % of the adult population hesitate and would decide depending on the situation, while about 44 % would give and accept bribes (Figure 6).

In summary, the corruption situation in Bulgaria in 2015 – 2016 could be characterized as follows:

- Critically high levels of administrative corruption;
- The few institutions which do not face corruption problems are those which do not manage substantial public resources;
- Corruption transactions are common at all levels of many public institutions and are carried out with the knowledge and/or silent acceptance of senior management. In this respect, corruption is not a matter of a “few rotten apples” but rather a systemic problem of the civil service;
- There is practically no consistent effort to counter political corruption.

The fact that corruption is widespread shows that key public institutions have been **captured** by private interests and/or that many public institutions have been in effect privatized by their employees, who



FIGURE 6. SUSCEPTIBILITY TO CORRUPTION<sup>6</sup>

use their entrusted power to obtain additional income/corruption rent. This leaves the public interest unprotected, public resources are spent ineffectively or in favor of private interests and the public sector turns into a double burden for taxpayers – through taxes as well as through corruption rent.

### The issue of evidence in anticorruption policy-making

The main value of CSD's *Corruption Monitoring System* – the latest findings of which were presented above – is in allowing policy makers and non-governmental watchdogs to see the overall dynamics of corruption in the country. This value increases when its findings are juxtaposed with other corruption-related evidence.

There are two principal ways to measure and assess the levels of conventional crime and corruption:

- Based on **judiciary and police statistics**, which account for the number of cases registered by the police, the number of cases that have entered the judiciary stage and respectively the number of verdicts. For a number of reasons, the number of registered cases is much higher than the number of indictments and final verdicts.
- Based on **victimisation surveys**, which use a representative sample of the population aged 18 and over and measure the number of victims of a crime in the last year. The discrepancy between the real number of crime instances and the cases registered by the police is due to the fact that not all crime cases are reported (latency) and that not all reported crime cases are registered (police filters).

<sup>6</sup> Share of citizens who would accept and/or give bribe in a role of citizen and/or public official.

If corruption cases are excluded, the conventional crime statistics for the period 2010 – 2014 (on average) show the following approximate proportions (Table 1)<sup>7</sup>:

**TABLE 1. OFFICIAL STATISTICS AND VICTIMISATION SURVEYS' DATA ON CORRUPTION (2010 – 2015)**

<b>Victimisation surveys (administrative corruption)<sup>8</sup></b>	<b>Values for 2015</b>
Share of the population (18+), who have been offered to participate in a corruption transaction in the course of the year	24.4 %
Share of the population (18+), who have participated in at least one corruption transaction in the course of the year	22.2 %
Estimated number of people (18+), who have participated in at least one corruption transaction in the course of the year	~1,300,000
<b>Official statistics of corruption crime</b>	
Number of corruption crimes reported to the police	No data
Number of corruption pre-trial cases – average for the period 2010 – 2015	~120-150
Share of corruption cases processed by the judiciary	~0.0115 %
Number of verdicts (2015)	72

Source: Center for the Study of Democracy, National Crime Survey, Crime Statistics of the Ministry of Interior, Report on the Enforcement of the Law and the Activities of the Public Prosecution and the Investigating Authorities in 2015.

In order to appreciate the relevance of these data, a number of assumptions need to be pointed out.

First, the indicators used by public institutions in their databases vary. In this respect, it is probable that processed cases or victims include different classification of crimes. The Uniform Information System for Countering Crime which has been in development for more than 20 years still does not operate with full functionality. The exchange of information between institutions is not operational and it is therefore practically impossible to track how cases are processed by law enforcement starting from pre-trial and reaching the court proceedings. As already mentioned, the numbers in Table 1 and Table 2 are averages and are intended only as an illustration. They are not meant as a measure of effectiveness of these institutions but rather to exemplify the major difference in the policies and institutional capacity applied by criminal justice against corruption and conventional crime.

<sup>7</sup> Data represent average values for the period 2010 – 2015 and are provided for illustrative purposes in order to show the more general proportions between the number of cases processed by law enforcement. Data vary by years, but these variations are not big enough to influence the overall proportions and the respective conclusions made. An unsolved issue regarding official statistics is their incomparability due to the lack of uniform criteria for data collection and their divergent public announcement.

<sup>8</sup> The National Crime Survey, conducted by CSD since 2002, includes a list of ten crimes like: theft, robbery, abuse, vandalism, rape, etc. For recent details, please refer to CSD Policy Brief No. 56: Dynamics of Conventional Crime in Bulgaria 2014 – 2015, Center for the Study of Democracy, July 2015.

**TABLE 2. OFFICIAL STATISTICS AND VICTIMISATION SURVEYS' DATA ON CONVENTIONAL CRIME (2010 – 2015)**

Victimisation surveys (conventional crime) <sup>1</sup>	Average values for the period 2010 – 2015
Relative share of the population (18+), which has been victim of at least one crime during the year	~10 %
Number of crime victims (based on victimisation surveys)	~600,000
<b>Official statistics (conventional crime)</b>	
Crimes reported to police by citizens	~300,000
Crimes registered by the police	~120,000
Solved cases (by the police)	~45,000 – 50,000
Number of pre-trial crime cases opened	~34,000
Share of crimes process by the judiciary relative to the total number of crimes	~5.7 %
Number of convictions (verdicts)	~15,000

Source: Center for the Study of Democracy, Corruption Monitoring System, Crime Statistics of the Ministry of Interior, Report on the Enforcement of the Law and the Activities of the Public Prosecution and the Investigating Authorities in 2015.

Second, in the case of corruption these deficiencies hardly matter as the **number of cases processed by law enforcement is negligible** compared to the real magnitude of the problem. All the instruments and potential of the MoI, other enforcement institutions and the judiciary are deployed against conventional crime. Effective or not, their enforcement is on a significant scale – around 35,000 cases are processed by the criminal justice system annually. The annual rate of crimes of corruption is comparable – in some years even higher – to that of conventional crime. For a number of reasons – chief among which is that the design of the repression mechanisms is inadequate to the magnitude of the problem – only a few cases are identified, cleared up and prosecuted. “Designed” refers to a number of components – the regulatory framework, the numbers and skills of experts, the availability of well-coordinated network of criminal justice institutions.

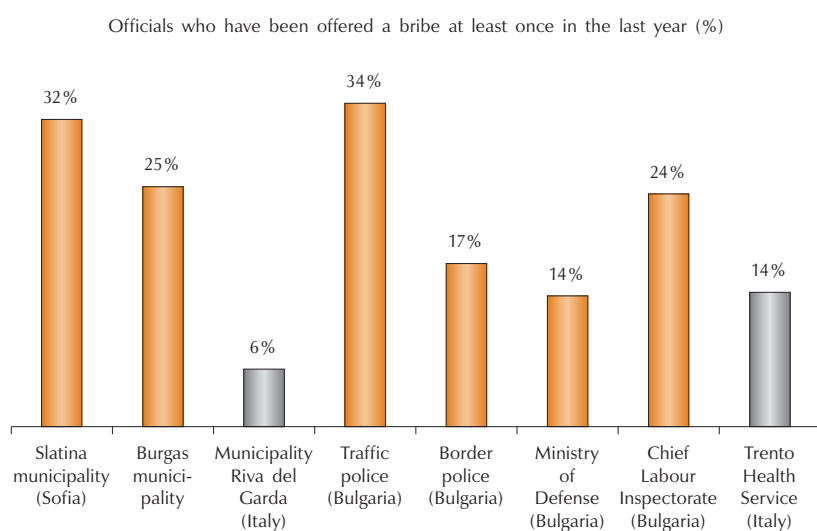
Third, many cases of unlawful private gain are processed by law enforcement as different types of abuse of power, abuse of property or other economic crimes. At present, at least with respect to senior civil servants, the **collection of evidence for illegal enrichment** proves practically impossible. Collecting **evidence of abuse of discretionary power** is even more difficult. In this respect, in most cases it proves difficult or practically impossible to find sufficient evidence for *both* private gain and abuse of public discretionary power. If unlawful gain and abuse of power were to be prosecuted separately, this would disrupt the chain of corruption transactions and would be more effective in terms of bringing perpetrators to justice.

## 2. ASSESSMENT OF PUBLIC INSTITUTIONS

### Evaluation of policy enforcement

Anticorruption policies and their effective delivery require knowledge of the actual actors and transactions, including knowledge of what motivates these actors and the circumstances of their transactions. Thus, “any credible anticorruption effort needs to proceed from a cross referencing each corruption risk with the respective anticorruption policy”.<sup>9</sup> The most appropriate point for this to be achieved is in specific public organizations. Therefore, before they are implemented national level anticorruption policies should be tested at this level.

FIGURE 7. CORRUPTION PRESSURE IN PUBLIC INSTITUTIONS (2015)



Source: CSD, *Monitoring Anti-Corruption in Europe. Bridging Policy Evaluation and Corruption Measurement*. Sofia: Center for the Study of Democracy, 2015.

Precisely such independent evaluation of anticorruption measures in border police and traffic police was conducted in early 2015 by the CSD through the **MACPI tool**.<sup>10</sup> MACPI (Monitoring Anticorruption Policy Implementation) maps and **assesses the anticorruption policies implemented in public institutions**. The diagnostic carried out with this tool shows whether the corruption vulnerabilities of a public institution are adequately addressed by anticorruption policies (corruption pressure vs policy design gap) and how effective these policies are (policy implementation gap). The analysis of the 2015 results showed that some generally well-designed

measures (in terms of coverage of corruption risks) such as rotation and video surveillance of border guards are strictly implemented (formal compliance), but effective compliance and implementation are lagging behind, and actual deviations from the policy are common and deliberate, which open potential for corruption transactions. This is often related to the inconsistent application of control and sanction measures. The implementation of anticorruption measures in traffic police is suffering from similar shortcomings (video surveillance of roadside checks, automated information system of the traffic police, etc.).

<sup>9</sup> CSD, *Monitoring Anti-Corruption in Europe. Bridging Policy Evaluation and Corruption Measurement*. Sofia: Center for the Study of Democracy, 2015, p. 145.

<sup>10</sup> Ibid.

A MACPI evaluation of several Bulgarian and Italian public institutions conducted in 2015 showed that corruption pressure on officials in select public institutions in Bulgaria is substantial. Pressure comes not only from citizens and companies who attempt to bypass rules and regulations, but also from colleagues, including superiors. Compared to the average level of corruption pressure in several Italian public institutions, pressure in Bulgarian public institutions is substantially higher (Figure 7).

### The ineffectiveness of regulatory and enforcement agencies

A major deficiency in the architecture of government bodies in Bulgaria is the dysfunctional state of most agencies trusted with ensuring compliance with laws and regulations. Referred to collectively in Bulgarian political practice as the “control system,” these include a very wide array of public bodies – independent institutions such as the central bank and the government accounts auditor, regulatory bodies overseeing sectors such as energy and utilities, inspection agencies ensuring compliance with, for example, food, transport or fire safety, internal control departments in ministries and other government bodies, as well typical law enforcement institutions such as the police (see further Box 1). A particular issue of contention has been the differentiation – as well as the complementarity – in the functions of these executive agencies in applying the law and inspecting compliance with regulations and standards from the remit of the prosecution in indicting and prosecuting crime. The defects in the work of this army (numbering over 400) of enforcement and inspection administrations includes both their capacity to identify violations and to effectively enforce sanctions. These flaws stem from low capacity – poor procedures, training or equipment – but also significantly from corruption that is low in intensity but high in scale. Making the institutions more effective, including through better coordination with the prosecution is of primary importance in reducing corruption.<sup>11</sup> The issue of such coordination should be placed again on the anticorruption policy agenda. The measures for aligning the anticorruption work of the institutions of the executive and the prosecution should include amendments to the applicable primary and secondary legislation, as well as to the internal regulations of the prosecution. These measures would pursue three broad objectives:

- improve the quality of the referrals submitted by inspection and enforcement bodies to the prosecution by making the evidence collected both specific and thorough;
- the prosecution would have a proactive role in identifying and indicting violations *within* inspection and enforcement bodies at the central and

<sup>11</sup> The reasons for the poor coordination identified by the prosecution include: most enforcement and inspection bodies are not capable of collecting and presenting quality evidence, which is useable in a court of law; referrals are often submitted without proper investigation; the tendency of imposing minimum sanctions for administrative violations; lack of feedback from the prosecution on progress on the referrals (see „Ефективно взаимодействие на Прокуратурата с контролните органи за противодействие на закононарушенията и престъпленията в защита на обществения интерес и правата на гражданите”, 2010, Available at: [http://www.opac.government.bg/archive/images/stories/docs/703\\_Doklad\\_PRB.pdf](http://www.opac.government.bg/archive/images/stories/docs/703_Doklad_PRB.pdf)). To overcome the identified problems, the prosecution developed a methodology for effective interaction with enforcement and inspection bodies, which included step-by-step practical guidelines aimed to assist prosecutors in their communication with these bodies.

local levels, thus discontinuing the practice of these bodies of taking no action in the face of blatant violations;<sup>12</sup>

- a “value for money” assessment tool would be developed to carry out annual monitoring of the correspondence between spending by these institutions and the effect of their work, including in terms of the number and value of the sanctions imposed, the number and the quality of referrals as measured by the rate of their successful prosecution, the benefits of crime prevention and the reduction of the damage incurred by crime.

A pertinent example can be found in the work of the Commission for the Protection of Competition (CPC) and the Financial Supervision Commission (FSC), which can initiate procedures for violation of free market principles and impose sanctions on individual companies. They can create conditions for the increase of corruption and hidden economy because of low efficiency and wide-spread corruption practices among the agencies’ administration. In turn, the institutional integrity of these institutions could become compromised to favor certain economic actors.

### **Box 1. The system of enforcement and inspection bodies in Bulgaria**

The system of enforcement and inspection bodies encompasses all state bodies authorized to supervise compliance with the legislation in particular spheres of public life. In exercising their powers, these bodies conduct inspections, identify violations and impose administrative sanctions to those infringing on the law. If, while exercising their powers, such bodies uncover data pointing that a criminal offence has been committed, they are obliged to refer the evidence to the prosecution where criminal proceedings should be initiated. To tackle crime and corruption with any success, it is essential that the respective control bodies and the prosecution effectively communicate and exchange information with each other.<sup>13</sup>

This network comprises a number of both central and local public bodies and/or their units. These could be grouped within the following types:

<sup>12</sup> Although the prosecution has already set itself such objectives (“being more active in exercising prosecutorial oversight over the work of the control institutions of the state”; “making the prosecution the lead institution in the work of control institutions” (<http://www.prb.bg/bg/news/proekti/rezume/>), it is not very close to achieving them.

<sup>13</sup> In 2009, in an attempt to improve its interaction with the control system, the prosecution office identified the 15 control bodies it most often interacts with. These were: the State Agency for Child Protection, the Social Assistance Agency, the GLIEA, the National Construction Control Directorate, the Regional Water and Environmental Protection Inspectorates, the Executive Forests Agency, the National Parks Directorate, the National Veterinary Service, the Regional Inspectorates for Public Health Protection and Control, the State Agency for Metrological and Technical Surveillance, the Road Transport Administration Executive Agency, the Public Financial Inspection Agency, the Consumer Protection Commission, the Customs Agency and the Post-Privatization Control Agency, transformed in 2010 into the Privatization and Post-Privatization Control Agency.



**Independent bodies:** the National Audit Office, the Bulgarian National Bank, etc.

**Administrative bodies reporting to parliament:** the Central Electoral Commission, the Energy and Water Regulatory Commission, the CPC, the Commission for Personal Data Protection, the Commission for Protection against Discrimination, the Assets Forfeiture Commission, the Commission for Prevention and Ascertainment of Conflict of Interest, the Communications Regulation Commission, the FSC, the National Social Security Institute, the National Health Insurance Fund, the Council for Electronic Media, etc.

**State agencies:** the State Agency for Metrological and Technical Surveillance, the State Agency for Child Protection, etc.

**State commissions:** the State Commission on Commodity Exchanges and Markets, the State Commission on Information Security, etc.

**Executive agencies:** the Executive Environment Agency, the Executive Forest Agency, the General Labor Inspectorate Executive Agency (GLIEA), the Public Procurement Portal, Audit of European Funds Executive Agency, the Road Transport Administration Executive Agency, the Bulgarian Drug Agency, etc.

**State bodies reporting to ministers:** the Customs Agency, the Public Financial Inspection Agency, the State Commission on Gambling, the National Revenue Agency (NRA), the Regional Water and Environmental Protection Inspectorates, the River Basin Directorates, the National Parks Directorate (reporting to the Minister of Forestry and Environmental Protection), the Bulgarian Food Safety Agency, the Directorate of Natural Parks, the Regional Directorates of Forestry, the Regional Agriculture Offices (governed by the Minister of Agriculture and Food), the Regional Education Inspectorates (reporting to the Minister of Education and Science), the National Construction Control Directorate (reporting to the Minister of Regional Development and Public Works), the Regional Health Inspectorates (governed by the Minister of Healthcare), etc.

**Inspectorates in the state administration:** all ministries as well as administrations that are not directly reporting to any particular ministry have inspectorate. Their activities are coordinated by the General Inspectorate at the Council of Ministers, which reports directly to the Prime Minister.

In 2014, (the latest publicly available data), control powers were vested in a total of 465 administrations, including 63 administrations at central level and 402 administrations at local level. The total number of administrative units authorized to establish administrative violations and impose sanctions, was 2,927 units employing 33,412

public officials (17,637 inspectors, 4,779 experts and 9,072 other officials). This means that about 23.8 % of all public administration officials have supervising powers.

The institutions with the highest number of officials with supervisory powers were the MoI (10,215 officials), the NRA (4,413 officials), the Customs Agency (2,220 officials), the Bulgarian Food Safety Agency (1,658 officials) and General Directorate Security of the Ministry of Justice (1,337 officials). The number of officials authorized to establish violations and impose sanctions at the local level was 7,663 and the municipalities with the highest number of such officials were Sofia (372 officials) and Plovdiv (227 officials).

The work of these units in 2014 resulted in the establishment of 363,633 violations and the issuance of 314,615 sanctioning orders. The highest number of violations were established by the MoI (176,606 established violations and 169,994 imposed sanctions), followed by the NRA (53,290 violations and 22,177 sanctions), the Executive Forests Agency (14,329 violations and 10,607 sanctions), the National Health Insurance Fund (13,229 violations and 12,337 sanctions), GLIEA (9,817 violations and 9,595 sanctions) and the Public Financial Inspection Agency (1,614 violations and 814 sanctions). At the local level, the most violations were established in the municipalities of Sofia (4,046 violations and 1,417 sanctions) and Plovdiv (2,620 violations and 2,207 sanctions). The fines, imposed in 2014, amounted to BGN 125,087,830 but only BGN 48,270,268 were actually collected.

In 2014, the public administration received 111,382 complaints for corruption and checked 108,313 of them (97.24 %). Most of these complaints were registered in the Sofia municipality (97,386 complaints of 87.4 % of all complaints in received in 2014). Other institutions with significant number of complaints included the administration of the government (3,393 complaints), Ministry of Agriculture and Food (2,393 complaints), MoI (1,235 complaints), the Executive Forests Agency (700 complaints) and the NRA (173 complaints). The number of cases referred to the public prosecution was 1,552 (199 cases of unlawful actions or lack of actions, 65 cases for corruption of public officials, 21 cases for violation of official duties or ethical rules, six cases of corruption of executive authorities, five cases of violation of internal rules and 1,256 cases for other violations).

Source: *State of Public Administration Report 2014*.<sup>14</sup>

<sup>14</sup> The information in the *State of Public Administration Report* is a compilation of the data which all central and local administrations provide through the special Information System for Completion of Reports on the State of the Administration (ISCRSA). The information is collected through a questionnaire and most of it is not verified. There are several disclaimers throughout the report that the figures might be inaccurate due to the fact that some administrations either have failed to submit information or have not properly understood and, respectively, filled in the questionnaire.



In view of the complex structure of forms of private gain and forms of deliberate violation of rules, law enforcement and judicial institutions in the country face serious difficulties in the prosecution of corruption behavior cases: in most cases, even though the corruption cases are “clear”, the collection of evidence that would be good enough for a court trial proves too difficult. Focusing on the most complicated way of proving corruption (proving private gain resulting from a violation of rules) does not appear to be an effective strategy. Even if the presence of both elements of corruption (gain and violation of rules) is proved, it might be impossible to prove that both elements are connected. Therefore, this widely adopted criminal justice strategy leads in many cases to failure to convict officials and is not effective (charged officials are pronounced “clean” and reclaim their positions in public institutions). To counter corruption effectively, it would be more effective to address “gain” and “violation” separately. Though violators will not be convicted for corruption but for other offences, the overall effect on corruption would most probably be positive.

Against the background of the high prevalence of corruption, specialized anticorruption bodies and control system institutions prove ineffective and of low capacity. This in turn creates new corruption mechanisms making them susceptible to political interference. Revealing in this respect are cases of **selective application of anticorruption repression** by the Commission for Prevention and Ascertainment of Conflict of Interest. Selective enforcement has actually created a new layer of corruption transactions aimed at protecting elected politicians and senior civil servants from prosecution. Selective enforcement has also been used against business competitors and political opponents.

**TABLE 3. ANNUAL BUDGETS OF SOME ENFORCEMENT AND INSPECTION BODIES (THOUSAND BGN)**

Institution	2016	2015	2014	2013	2012	2011
Asset Forfeiture Commission	6,132	5,132	5,401	6,145	6,145	5,145
Commission for the Protection of Competition	3,591	3,591	3,318	3,775	3,805	3,705
Commission for Prevention and Ascertainment of Conflict of Interest	1,300	1,233	1,310	1,490	1,500	0
Financial Supervision Commission	10,442	10,172	10,430	11,867	13,689	13,638
Commission for Public Oversight of Statutory Auditors	1,286	1,086	1,086	1,235	0	0
<b>Total:</b>	<b>24,767</b>	<b>23,229</b>	<b>23,559</b>	<b>26,525</b>	<b>27,151</b>	<b>24,499</b>
National Security Service	33,916	31,616	32,984	35,254	30,940	31,240
National Audit Office	15,307	15,207	15,207	15,207	15,057	15,056

Source: Ministry of Finance.

Overall, Bulgarian regulatory agencies need to improve their oversight, reporting of sanctions and inspection procedures, because results in this respect are modest. Regulatory control has turned out to be to simply the performance of large numbers of inspections without adequate focus on the outcome. Such practices interfere with the operation of business and with its compliance with regulations, many of which require control and inspections. Furthermore, most of these public bodies lack formal risk assessment procedures and do not provide timely and comprehensive information with regard to their activities and planning.

### **Box 2. Anticorruption in the Ministry of Interior**

In the second half of 2013 and throughout 2014 the anticorruption activities of the Mol were stalled, while the work of the Internal Security Directorate was significantly compromised due to personnel reductions, reappointments, resignations and other changes. Although its activities were reinforced and anticorruption efforts were stepped up in late 2014, these developments indicate that political instability and the lack of independence of key investigative structures from the political leadership can put in question the sustainability of anticorruption efforts. In early 2016, the Ministry adopted a concept paper for prevention and countering corruption in the Ministry of Interior 2016 – 2020, based on a 3-pillar approach: training, prevention and enforcement.

Control over sensitive data and how it is used within the ministry has the potential to be strengthened through establishing two new units to manage information security and the use of internal databases located at the Internal Security Directorate. Consequently, its personnel increased to 250 people,<sup>15</sup> but the number of investigative officers involved directly in corruption checks remained unchanged. Overall, the increase of sanctions imposed (disciplinary, administrative and penal) as a result of the work of the Internal Security Directorate is expected to reduce corruption practices among police officers. There is also a slight increase in the number of disciplinary sanctions for senior police officers. There are some effects of sectorial anticorruption measures already visible, for example in the area of traffic control. An unintended consequence of the introduction of the Automated Information System for video recording of the traffic control was a sharp increase in the number of disciplinary sanctions in 2015.

A more comprehensive administrative reform and modernization of the police would require also pushing through more sensitive issues

<sup>15</sup> Ministry of Interior, Structure of the Internal Security Directorate. Available from: <https://www.mvr.bg/NR/rdonlyres/1741B92B-3A8D-416C-9346-8CDF6993DDE9/0/DVS.pdf> (Accessed 28 February 2016).

such as the long overdue separation and greater independence of the police professional management from the political leadership and the highly necessary restructuring and re-categorization of the administrative staff who have no operational duties as opposed to police officers.

Green borders are another critical area with high corruption pressure, where an integrated surveillance system has been put in place at the Bulgarian-Turkish border. Due to the high priority of border control for national security, these control measures (which also seek anticorruption effects) receive broad political support, while officers from outside border police also take part in control activities (from Frontex and SANS). Furthermore, cases of illegal migrants detected inside the country are analyzed in order to establish the point of entry and routes, upon which the Internal Security Directorate has conducted numerous operations against border guards in 2015. The main challenge remains **the lack of capacity within the MoI and specialized bodies to investigate corruption related to the smuggling of migrants.**

In comparison to the real magnitude of the problem, countering corruption in law enforcement institutions is fairly modest both in terms of allocated resources and in terms of achieved results. The statistics of the Ministry of Interior, for example, show that after 2010 the number of corruption complaints within the ministry has been on a steady decline (Table 4).

TABLE 4. COMPLAINTS OF POLICE CORRUPTION

	2008	2009	2010	2011	2012	2013	2014	2015
Cases of conflict of interest	n/a	n/a	n/a	5	4	n/a	2	n/a
Initiated (internal) investigations	n/a	n/a	n/a	n/a	115	86	59	n/a
Initiated disciplinary proceedings	121	115	135	130	100	65	32	n/a
Dismissed officers	77	64	65	97	68	38	12	27
Other sanctions	35	15	29	16	15	17	3	354
Officers relocated to another position (away from corruption risk)	9	10	14	6	49	27	10	11
Referrals to the prosecution on conventional crime charges	57	85	76	72	63	26	14	38
Preliminary investigations	27	58	73	67	103	71	27	58
Received corruption complaints	491	562	549	495	372	319	217	261

Source: Internal Security Directorate, Ministry of Interior.

Overall, most public institutions assigned to enforce the law and verify compliance with standards and regulations are failing both their remit and public trust. Their failure affects practically every aspect of social life, production and commerce, health and environment. This result should come, however, as no surprise in a political environment in which the capturing of government institutions at the highest level has become routine.

### **Box 3. Tackling traffic police corruption**

Eurobarometer survey data from the period 2006 – 2014 indicates that Bulgarian police officers are among the public officials most vulnerable to corruption pressure, with bribes elicited on an annual basis reaching between 350,000 and 400,000 EUR. Analysis of the available information reveals an important characteristic of police corruption in Bulgaria – upward of 90 % of cases are related to traffic violations. Experience from previous anti-corruption initiatives shows that traditional repressive measures are not sufficiently effective in tackling this problem, due to the large amount of financial and human resource required to address the significant number of small-scale corrupt transactions.

Removing the powers of the security police to monitor and sanction traffic violations can be noted as a positive development. Studies show that since 2006, corruption instances often involved this branch of the police force due to their large number (15 000 to 17 000) and different core competence. The measure leaves issues of traffic control entirely to the traffic police, which comprises a staff of about 1200 to 1500, thus allowing for less contact between police and drivers and more oversight of officers with sanctioning powers.

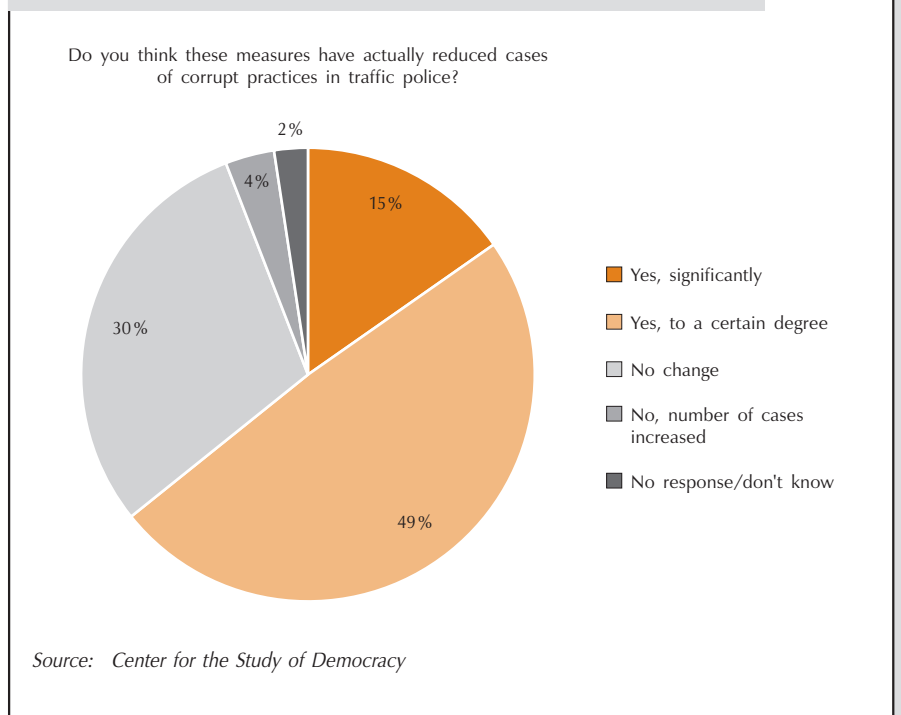
At the beginning of 2015, the automatization of the process of recording and sanctioning traffic violations was undertaken. The use of stationary cameras to record a number of pre-defined violations (mostly related to speeding) was instituted. The most widely utilized corruption enabler, the possibility for police officers to use speed measuring mobile devices and to sanction according to personal judgement, was removed. Nevertheless, the low numbers of cameras at the disposal of MoI and the lack of sufficient funding proved to be a significant challenge. To deal with this restriction, toll cameras operated by the Road Infrastructure Agency were also utilized for the purpose of recording traffic violations. In addition, cameras were installed in 30 % of traffic police vehicles by the end of 2015. The automatic processing of recorded offences has also been initiated and is carried out in a national center, thus removing the possibility to engage in corrupt practices on the local level.

Traffic police is now also required to enter in real time the personal information of offenders in a database, which retrieves information

about any irregularities (unpaid taxes or traffic insurance, lack of technical inspection, outstanding traffic fines etc.) with regard to the vehicle in question. Pulling over and checking a vehicle is to be carried out only in front of the second camera of the traffic police car, which should be with a switched-on microphone. However, a risk analysis shows that until mid-2015 there was no sufficient personnel for reviewing these recordings. As a result, in August 2015, a special control system was created and implemented in the 28 Regional Directorates. In addition, a parallel control organ was set up at the Internal Security Directorate. By the end of the year, checks have resulted in sanctions for 20-25 % of traffic police staff.

A nationally representative study carried out at the beginning of 2016 provides an assessment of the impact of the measures mentioned above.

**FIGURE 8. IMPACT OF ANTI-CORRUPTION MEASURES**



### 3. STATE CAPTURE

State capture is a complex form of corruption which has two main manifestations:

- Capture of multiple public institutions by private interests, i.e. cases when powerful business interests use different forms of corruption in order to secure a monopolistic or privileged position in a certain area;
- Capture of public institutions (privatization), i.e. cases when public institutions are used to extract rents by its employees and/or other officials at higher positions in the hierarchy of government.

These two forms of state capture are interconnected as administrative corruption (along with political corruption) is among the main state capture instruments.

#### Privatization of public institutions

The main consequences of de facto **privatization of public institutions by their employees** in Bulgaria can be used as indicators enabling the identification of this form of corruption and assessment of its magnitude.

Corruption in Bulgaria is widespread to the point that it has assumed **systemic features** and acts as an **additional tax** for access to public services.<sup>16</sup> It is something expected by both citizens and public officials. The endemic character of corruption transactions has reached a level when the government cannot effectively control its administration, but rather is committed to policies that reduce workload, increase salaries, reduce accountability, transparency and responsibility of public officials. Attempts to reform the administration are countered by claims for work overload of public institutions and low salaries of public officials.<sup>17</sup> Radical reforms in the administration are blocked and, when efforts are made, they usually boil down to reducing the number of unoccupied positions in public institutions. The lack of capacity or intention for reforms is manifested in a number of ways:

**Countering accountability and transparency.** Efforts to make the administration more transparent and responsible are most often blocked. Very often various administrations block access to information about

<sup>16</sup> This is a conclusion made in previous Corruption Assessment Reports of CSD (e.g. CSD, *Anti-Corruption Policies against State Capture*. Sofia: Center for the Study of Democracy, 2014).

<sup>17</sup> A large number of MoI officials blocked key road crossings in Sofia as part of a protest to protect their welfare benefits. Such activities are forbidden for MoI officials and in this respect protest participants should have been prosecuted. To date (based on public information) no such prosecution activities have been initiated.

their activities, thus hiding deliberate violations of the law, incompetent action of officials or publicly unacceptable facts about the activities of public institutions.<sup>18</sup> A first positive step in this respect would be allowing public access to a number of electronic public registers, including regular updates of registers and enhancing data search.

**Minimizing responsibility.** The administration is practically unpunishable for its actions: damages and unwarranted overspending are always paid by taxpayers. This applies to both the executive<sup>19</sup> and the judiciary.<sup>20</sup> Cases when publicly known systematic violations of rules – e.g. when renewable energy producers (solar) sell energy produced during night hours thus profiting from the higher prices of this type of electricity – gradually “fade out” are fairly common.

**Tolerating abuse of discretionary power.** The administration is in most cases tolerant of violations of rules by senior and junior officials. In this respect, the abuse of discretionary power (deliberately or due to incompetence) always remains hidden and unsanctioned. When violations are uncovered, in most cases the responsible officials are not sanctioned.<sup>21</sup> For example, the finding of the Ministry of Interior Inspectorate (Internal Security Directorate) that practically all traffic police officials are involved in bribery was not followed up by dismissals or other sanctions. Due to the inability of the Ministry of Interior to counter the wholesale bribery in traffic police, the leadership of the ministry decided to forbid traffic police officers to pull over drivers. In another case a whole shift of the Svilengrad Customs (33 officers) was arrested and about BGN 100,000 (the daily turnover) was found in the arrested officers. Many of the same officers have been accused of corruption on previous occasions, but have been restored at their positions by the court for “lack of evidence”.

**The low salary fallacy.** In numerous public statements directors of public institutions argue that their officials have low salaries and therefore “too close a scrutiny of their additional incomes” is socially unacceptable. Most often the definition of “low” is not based on comparisons with salaries in other public institutions in the country but with the respective salaries of officials in more advanced EU member states.

**Failed asset monitoring policies.** The implementation of one of the most important anticorruption policies – declarations on incomes and personal wealth – has practically failed: no cases of officials sanctioned for violations of these regulations are known to date. Asset declarations are generally submitted, but due to low institutional resources and absent government commitment there is practically no verification for inconsistencies and follow-up on cases of violations. There are many

<sup>18</sup> For example, the central bank provided public access to information about the salaries of its senior management after a court decision.

<sup>19</sup> The repayment of irregularly spent funds under the EU operational programs at central and local level are always at the expense of the government budget without particular sanctions of the officials responsible for the irregular spending.

<sup>20</sup> The payment of damages under judgments against Bulgaria is always at the expense of the government budget (taxpayers) and does not affect the budget of the judiciary.

<sup>21</sup> CSD, *Monitoring Anti-Corruption in Europe. Bridging Policy Evaluation and Corruption Measurement*. Sofia: Center for the Study of Democracy, 2015.



occasions of public officials with a widely known affluent lifestyle whose incomes are not investigated by inspection and enforcement authorities. A relatively new case in point – on which there has been no action by the competent authorities – are the multimillion investments of a member of parliament, who has officially declared fairly modest income and assets.

**Public officials acting as organized crime groups.** In some public institutions officials act as an organized crime group, which aim at extracting corruption rents, for example, after a long period of surveillance, a group of officials at the Executive Agency “Automobile Administration” was arrested. A similar situation took place in the State Agency for Metrological and Technical Surveillance, where an investigation found 600 gasoline stations deliberately excluded from the lists of the Agency and thus made exempt from control of their technical equipment. These practices are closely related to widespread interference of elected politicians in the work of the civil service. Immediately after stepping into power, for example, the first task of every government to date has been to “conquer” key enforcement administrations by appointing politically loyal individuals to senior positions. Cases in point are the Ministry of Interior (central and regional level), the Customs Agency, and other similar institutions. It is indicative that in political debates accusations of a party “seizing public institutions” in order to “consume power” are often traded. That these terms should become clichés reveals that various forms of political corruption, patronage and state capture have been transformed into normal practices of the political class.

## Government for hire

What appears as graft and rent-seeking in the civil service, turns into wholesale privatization of governance at the political level. Over the years, all Bulgarian government levels **have been captured by private interests**, which has reduced the effectiveness, efficiency and value of public resources spent by the government. The activity of most enforcement and inspection institutions (see Box 1) is blocked or hampered both by attempts to ensure illegitimate advantages and by private interests which effectively control the policies of government institutions. Some of the more important resources and frequently used channels to appropriate government for private benefit have included:

**Introducing new or amending existing laws in order to grant business advantages**, immunity from prosecution or block competition (lobbyist legislation). For example, in the energy sector the regulations that gave sustainable energy producers better treatment allowed them to operate at an extra high level of profit for too long a period. Many sustainable energy facilities have been put up using EU funds, but the legislation prevents the government to reduce the subsidies. Further, a recently adopted amendment to procurement legislation allowed the government to buy media time without a tender but was reedited shortly after adoption. Other new provisions of the procurement law include the opportunity for more extensive use of the emergency clause to bypass proper procurement procedures. Overall, once a “gap” providing for ways to bypass more stringent procedures is closed, others are being



opened with the justification that that many failures to complete projects are due to complicated procurement legislation.

**Political corruption** has evolved as a channel for influencing the legislature and the judiciary. Examples in this respect include the work of institutions with regard to the bankruptcy of the Corporate Commercial Bank or expenses related to the Belene Nuclear Power Plant project. In the initial states of investigation of both cases, the institutions made bold statements that those responsible will be investigated and exposed in full. At later stages, however, it turned out that full disclosure was problematic and that this was also a result of systematic errors of the investigations and delays.

**Private control of enforcement and inspection bodies.** There is extensive evidence that corrupting officials in regulatory, enforcement and inspection institutions has been one of the main methods to block investigations and counter measures against the monopoly status of some companies. These monopolies affect the quality and prices of goods, violations of labor, tax, customs and other legislation aimed at increasing profits. A recent case in point is the lack of government reaction to allegations of cartel agreements in the gasoline retail market. A positive example from the last year is the success of the government in collecting due VAT and excise taxes in markets where previously it had been deemed close to impossible: alcohol, cigarettes, and fuels. However, irrespective of massive tax fraud discovered and the large amounts of taxes collected (higher than previous years), no violators (who allegedly have violated the law for years) have officially been announced. The concrete revenues by sectors and companies have also not been officially announced.

**Corruption in the access to public resources.** This includes procurement and subsidies, where independent monitoring shows that a small group of privileged companies keep receiving large amounts of resources irrespective of the political party in power. Examples in this respect (with high value both for both the budget and taxpayers) were the procurements on the South Stream pipeline and the Hemus highway construction. It should be noted that in the beginning of 2016, the government initiated an attempt to correct these decisions: by order of the Prime Minister procurements amounting to more than BGN 2 billion were cancelled.

**Influencing public policies.** This includes numerous occasions of improper influence of government policies in various economic sectors (for example, the government is in most cases susceptible to pressure from transport companies), economic and social policies (currently the government is deliberating the nationalization of private pension savings due to poor performance of private pension funds), budget allocations and foreign policy.

**Box 4. LukOil: monopoly pricing and abuse of dominant position in the energy sector**

Bulgaria is 100 % dependent on crude oil imports from Russia. The only crude oil imported is through the LukOil Neftohim refinery, located at the Black Sea port of Bourgas. LukOil is the largest company in Bulgaria with 2013 revenues of roughly EUR 3.9 billion. Together with its wholesale and retail fuel distributing sister-company, LukOil Bulgaria, and additional aviation, ship and service companies, LukOil is also the largest taxpayer contributing a quarter of all government budget revenues. LukOil's refinery is the largest oil processing unit in the whole Balkan region.

On the back of its refining domination, LukOil Bulgaria was also able to effectively control the wholesale fuels market, not without the tacit support of the government and the anti-trust regulatory agency. The company's market dominance has been consistently backed by consecutive Bulgarian governments, which have created tough conditions for fuel imports to be competitive on the domestic market. In 2009, the country introduced a change in its excise tax law, mandating that all fuel importers must own or rent a storage facility with installed tax measurement devices. Also, they should maintain at least two-months-worth of fuel stocks mirroring the EU regulation on strategic oil reserves. LukOil was had control of a large share of the storage facilities, while Naftex (the other large storage owner) was able not to service competitive imports. The outcome of the legal change has been that importing fuel became a much more expensive business, and many large distributors preferred to follow LukOil's pricing methodology and preserve a good profit margin, rather than seek alternative supply.

Following allegations of monopoly pricing and tax avoidance in 2011 and 2012, the CPC conducted a detailed analysis of the fuels market concluding that there was no evidence of a cartel between LukOil and the largest distributors. CPC also argued that there was high concentration of the ownership of fuel storages but never began a formal probe against LukOil or Naftex. Instead, it recommended that the government should seek ways to cooperate with neighboring countries on joint use of storages for fuel imports. Four years later, the government is yet to follow up on the CPC's proposal, leaving importers in an uncompetitive market environment.

Blocking alternative foreign supply and solidifying control over the wholesale and retail market, Russian oil and oil products companies effectively prevented government institutions and national regulators from challenging their dominant position on the local market. As a result, Bulgaria has some of the highest shares of production and

distribution costs in the EU. Besides the protracted legal battle with the Bulgarian Customs Agency, neither CPC, nor the National Revenue Agency have undertaken any visible action to confirm or dispell accusations of VAT and excise and profit tax avoidance via non-transparent transfer pricing.

*Source: CSD, Energy Sector Governance and Energy (In)Security. Sofia: Center for the Study of Democracy, 2014.*

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## 4. MEDIA AND POLITICAL CORRUPTION

Political corruption flourishes where public demand for good governance is weak. This usually happens when the main feedback vehicle – mass media – is captured by business or political elites.

Media capture can take either direct or more subtle forms. In the case of Bulgaria, the most substantial deficiencies of the media model are **lack of transparency and concentration of ownership, monopoly position on the distribution market and poorly developed self-regulation mechanisms**. These deficiencies impede the counteraction of influence peddling and allow hidden control over media. Even established violations of statutory requirements have remained unpunished. At the same time, the Bulgarian legislation does not respond to the new challenges posed by online media and their potential for manipulation but rather by their owners' business interests and above all by anonymous equity.<sup>22</sup> The problems affecting media's corrupting influence include:

- Low trust in media independence. Media enjoyed the trust of merely 17 % of the Bulgarian public in 2014. At the same time, the freedom of speech in Bulgaria has hit its lowest level ranking – 113<sup>th</sup>.<sup>23</sup>
- High levels of opacity as regards ownership and funding. Loopholes remain and allow for excessive concentration, circumventing the law and concealing the practical owners. The obscure picture of media ownership has the effect of restricting the public right to information.
- Behind the scenes liaisons with politicians: media and journalists are often subjected to pressure and censorship, and act as promoters of politicians' and business interests.
- The subservient position of the media is particularly visible the local level, where local media which lack independent sources of financing rely heavily on PR contracts with local public authorities. The local elections in October-November 2015 demonstrated that regional media failed to inform the public about the important issues faced by the municipalities. Instead, they focused on marginal or sensational topics, abandoning their potential role as a mediator between the public and local politicians.

The role of Bulgarian media in public life came under scrutiny after several media outlets were used as an instrument for triggering political crises and for political engineering in 2013 – 2014. A loss of financial viability as a result of the economic crisis of 2009 – 2013 presented unique opportunities for Bulgarian oligarchic groups. By accumulating a

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<sup>22</sup> See further CSD, *Media (in)Dependence in Bulgaria: Risks and Trends*. Policy Brief No. 60, 2016.

<sup>23</sup> 2015 *World Press Freedom Index*, Reporters without Borders.

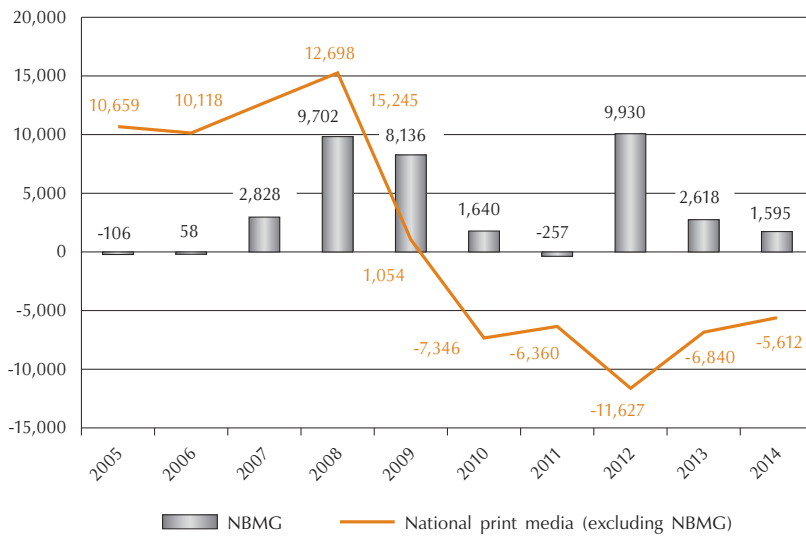
significant share of the media market, they reached an unprecedented level of political influence (including direct influence on the legislative, executive and judicial powers). The media was used as a propaganda instrument sugar-coating the process of state capture. Although media content analysis indicates that a wide spectrum of political and economic positions are reflected in Bulgarian media, coverage is often biased and unbalanced, depending on the ownership and control of specific media. One of the major threats for media's independence became the PR contracts with government agencies and with large business groups, and the tight control of media content in private media, leaving limited space for critical coverage and investigative journalism.

The fortunes of newspapers in the country are indicative of the mechanism of turning media into instrument of state capture. In the late 2000s, the German publishing group WAZ dominated the market through *24 Chasa* and *Trud* (the two largest circulation papers in Bulgaria – which, ironically, competed intensely as far as news content was concerned). WAZ later sold its stakes and void left by its withdrawal caused a heated battle involving several Bulgarian oligarchic groups and public institutions. **The major value of print media for the oligarchy**, not diminished by the crash of their financial model, is their **political influence**.

A new business model emerged with the setup of New Bulgarian Media Group (NBMG). The entry of the group itself was probably one of the most significant events in the recent history of the Bulgarian print media market. The so called “political investment” in media could be observed as early as the 1990s, with the end of the “classical” media model. “Political investments in media” usually involve initial financing provided by a business group to certain media. The financed media is tasked to provide positive coverage and/or outright propaganda for a given political party/group. In return, the party delivers a variety of favors (procurement contracts, laws and regulations in benefit of the investor, interference with/shielding from possible criminal investigations, etc.). If for any reason the political entity fails to deliver the expected favors, media support is withdrawn and replaced by intense negative coverage. Unlike previous models, NBMG went on to absorb other media outlets. The group expanded in the regional print media market as well. The threat of monopolizing the media market became even greater after the group got possession of 70 % to 80 % of the distributors of print media in Bulgaria.

The founders of the media group must have been aware that newspapers and online media alone would not be enough to muster significant political influence. A national TV (with more than one channel) had to be thrown in as well: hence the acquisition of *TV7* and *BBT/News7*. The TV business, however, requires enormous financial resources, even for a small market like Bulgaria. Financing on this scale could not be provided through the advertising budgets of the companies closely related to the later bankrupted Corporate Commercial Bank (CCB). So the NBMG-CCB model evolved to include loans made by the bank to NBMG-affiliated companies, which in turn provided loans to *TV7* and *BBT*. While the financial losses of the two TV stations at the

**FIGURE 9. PROFIT/LOSS OF NATIONAL PRINT MEDIA (EXCL. NBMG) AND NBMG (THOUSAND EUR), 2005 – 2014**



Source: CSD, *Media (In)Dependence in Bulgaria: Risks and Trends*. Policy Brief No. 60, 2016.

time of entry were reasonable, they grew exponentially after 2010, thus requiring continued borrowing. Combining the print media and the TV stations budgets of NBMG-CCB, it can be claimed that “political investments” in the dramatic 2013 amounted to over BGN 150 mln.<sup>24</sup>

The inability to be financially sustainable remains the main problem for most print media. The so called “PR media contracts” have become an important source of revenue, but they also limit the media independence. There is no publicly available data to measure the size of the market for PR contracts, or in fact the specifics of those

contracts. Sporadic referrals have been made to clauses that protect the confidentiality of actual owners or individual companies, and more generally conceal the “alignment of editorial policy and content” that can hurt the interest of the companies paying for PR services. Put simply, the effect of all these contracts is that an editorial veto is imposed on media coverage. PR contracts have an even stronger impact on the local press, where relatively small amounts can secure media comfort for mayors and local companies.

<sup>24</sup> CSD, *Media (In)Dependence in Bulgaria: Risks and Trends*. Policy Brief No. 60, 2016, page 10.



## 5. HIDDEN ECONOMY AND PROCUREMENT

Corruption payments are closely related to the overall level of institutional quality and the informal money flows within the economy, which CSD has measured since 2002 through its flagship *Hidden Economy Index*. The diagnostics of the hidden economy is important in many respects but it is paramount in differentiating between institutional imperfections and **regulatory burdens**, which cause more benign forms of informal payments and corruption, and **entrenched political – economic networks**, which are often linked to or are themselves white-collar organized crime to breed corruption loopholes and **capture the state**. These networks are effectively immune to prosecution as they either include representatives of the judiciary or create legal frameworks that legalize their corrupt transactions, e.g. through creating monopolies or when regulators turn a blind eye to glaring regulatory breaches.

The means of exchange between the public and the private parts of such networks is public procurement, including its various forms ranging from privatization to public-private partnerships. With time, and in particular during years of crises or low growth, such as the 2009 – 2016 period, these networks seal off opportunities for non-connected contenders, **reducing upward social mobility, stifling economic growth and prosperity, and pushing the most capable to move outside the country**, thus further reducing society's resilience to corruption and state capture. With the opening up of data, the strengthening of investigative journalism, civil society actions, and the peer pressure coming from other EU member-states (e.g. through the continuing rebuttal of Bulgaria's membership in the Schengen area of free movement), **such networks have become too visible in Bulgaria**, explicating to the Bulgarian public the many and diverse forms of rent extraction and their beneficiaries, as well as their links to the ruling elites. The case of the rise and fall of the Corporate Commercial Bank, and in particular the wrangling over its remaining assets, has exposed many such "loops of companies",<sup>25</sup> which are unlikely to face any form of prosecution in the foreseeable future.

### Hidden economy trends

Often participation in the hidden economy is explained only through fiscal factors, such as the size of the taxes. In many cases, however, it is not the size of the tax that precludes entrepreneurs and citizens from contributing but the procedure for its administration and the quality of the public good taxpayers gets in return. Thus the effective and efficient functioning of the regulatory agencies directly influences hidden economy

<sup>25</sup> "Loops of companies" is a phrase coined by the leader of a political party – the Movement for Rights and Freedoms – in the beginning of 2000s, when he wanted to portray how much stronger politicians are than businessmen in Bulgaria, noting there has not been any single significant business created in the country without at least his benevolent smile at them.



dynamics, as well as related corruption payments, mainly through several specifics of their administrative functions, such as:

- Cost of entering the formal market (e.g. registration of new or formalization of existing business);
- Cost of compliance with existing regulations, including transaction costs for monitoring and inspection by the regulators;
- Mechanism through which regulatory and control agencies select businesses and/or individuals for inspection.

Two public bodies in particular have direct link and responsibility to influence the hidden economy dynamics in Bulgaria. The National Revenue Agency (NRA) is the institution entrusted with the task and the highest public expectations to curb hidden economic activities. In recent years, the NRA work has been primarily directed towards the collection of social security payments (11.5 % increase in the number of checks year on year),<sup>26</sup> which is an additional factor contributing to the improvement of compliance in this particular area. This trend is also visible in CSD's 2015 *Hidden Economy Index* data. According to the latest available data, the violations that the NRA uncovered through its activities had a fiscal impact amounting to BGN 1.7 billion, roughly similar to that in previous years. It is unclear how many of those were confirmed by a court decision. Ensuring that NRA's Annual Reports contain data on the court confirmed fiscal impact of its inspection activities would be a substantial improvement of performance evaluation. In this respect NRA has continuously been improving its work by gradually introducing better risk management and targeting of inspections. In 2016, it also introduced a *Strategic Plan for the Work of the Internal Audit of the National Revenue Agency 2016 – 2018* targeting precisely the areas with highest corruption risk: interaction with customers (citizens and businesses), tax audits, inspections, and fiscal control. This strategy and continued focus on transparency and performance evaluation should enable the agency to deliver better public services in the future. In light of the Panama Papers affair and the very slow progress in bringing to justice the key players involved in the CCB case, NRA should also aim to strengthen considerably its capacity for international cooperation, as well as ensure better coordination with the public prosecution and the financial intelligence.

The General Labor Inspectorate Executive Agency (GLIEA) is the other important public body with significant role in tackling the hidden economy. In 2015, GLIEA decreased the number of inspections (50,229 against 52,543 in 2014), while increasing slightly the number of secondary or follow up inspections to strengthen enforcement.<sup>27</sup> The level of inspections still remains high compared to similar organizations in other EU member-states, meaning increased regulatory burden and corruption risk. GLIEA, similarly to the NRA, has been trying to limit these risks, for example by focusing less on microenterprises, which are more likely

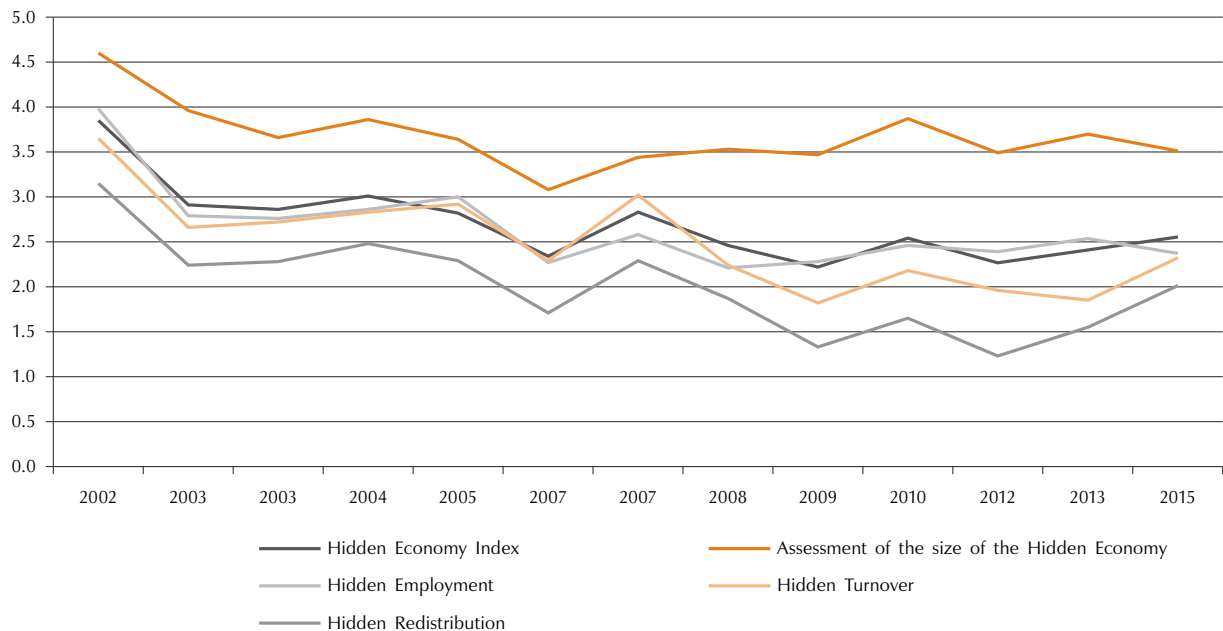
<sup>26</sup> The latest available Annual Report of the Agency is for 2014.

<sup>27</sup> According to the 2015 Annual Report of the GLIEA the number of follow on inspections increased in 2015 by 6 % and reached 12,856.

to have minor or low-impact violations. More effort is required in this respect, as well as higher education and cooperation GLIEA with citizens and businesses, as the number of uncovered violations remains stubbornly high, signifying gaps in the deterrence effect. Unlike in previous years, the majority of the uncovered violations (50.4 % of a total of 222,245) concerned health and safety, while 49.4 % were labor law violations. Non-compliance of working time regulations, working hours, and holiday entitlements represented the biggest share of labor law violations. The GLIEA also notes a decrease of the uncovered individuals with missing employment contracts, which might be the result of the more flexible rules introduced for seasonal employment in agriculture, among others.<sup>28</sup>

Prevalence of corruption is one of the substantial factors in understanding the existing hidden economy trends and dynamics. Data from the 2015 *Hidden Economy Index*, developed and implemented by the Center for the Study of Democracy, shows that **hidden employment recedes according to both business representatives and the public at large**. Reduction is observed in the cases of undeclared work. Avoidance of social and health insurance payments decreases too. This dynamic contributes to the lowest level of the “hidden employment” indicator for the 2002 – 2015 period. Nonetheless, a quarter of the persons employed still withhold some or all of the social security payments.

FIGURE 10. HIDDEN ECONOMY INDEX 2002 – 2015



Source: Survey among business representatives, 2002 – 2015, Center for the Study of Democracy.

<sup>28</sup> General Labor Inspectorate Executive Agency, Annual Reports 2014 and 2015, available from <http://www.gli.government.bg/page.php?c=40>

On the business side, business executives assess the current hidden economy levels as lower, compared to those in 2009 and 2012, but remain concerned about illegal import and exports, VAT and excise payment avoidance and fraud. Unlike the evidence of higher collection reported by the Bulgarian government, according to polled businesses, the level of VAT and excise fraud has increased to levels last seen prior to 2009. On the labor market the major challenges in reducing hidden employment prove to be the wider coverage of young employees (18-29 years of age), particularly males, and the increase of social security income for specific groups of employees. On the taxation side, in 2016 an issue which demonstrated the difficulty of introducing a more sophisticated tax system in Bulgaria without generating hidden economy and corruption has been the matter of introducing VAT for the personal use of premium goods/services listed as company expenses. Although the measure has existed in EU and in Bulgarian legislation for some time, it has never been properly administered and enforced. The measure was announced as a new initiative in the 2016 state budget discussion in parliament late in 2015, and was never properly communicated to the business and citizens to ensure compliance and proper enforcement. This is an example of how a fair tax practice might be turned into a hidden economy and corruption risk by poor implementation.

#### **Box 5. The shrinking illicit cigarettes market**

One of the areas where state capture is most visible is the collection of taxes and other revenues by the state. Here political and administrative corruption, on the one hand, and counter-efforts of law enforcement institutions, on the other, have the strongest impact.

In this respect 2015 brought certain progress. **Revenues from VAT and excise taxes were 960 mln BGN more than in 2014, a growth of 8.5 %** (while GDP grew by 3 %, per estimates of the National Statistics Institute). Based on this data, the claims that the additional revenue is due to improved performance of the revenue agency and curbing of administrative corruption seem plausible.

This positive trend is most visible with tobacco products. Analysis of CSD had indicated that in the 2009 – 2014 period illicit cigarettes became one of the largest organized crime markets. ‘Empty pack’ surveys<sup>29</sup> suggest that illicit cigarettes accounted for about 19-20 % of total cigarette consumption (Figure 10), or about 3 billion cigarettes per year. The annual lost budget revenue from illicit tobacco products is estimated at 600 mln – 650 mln BGN.

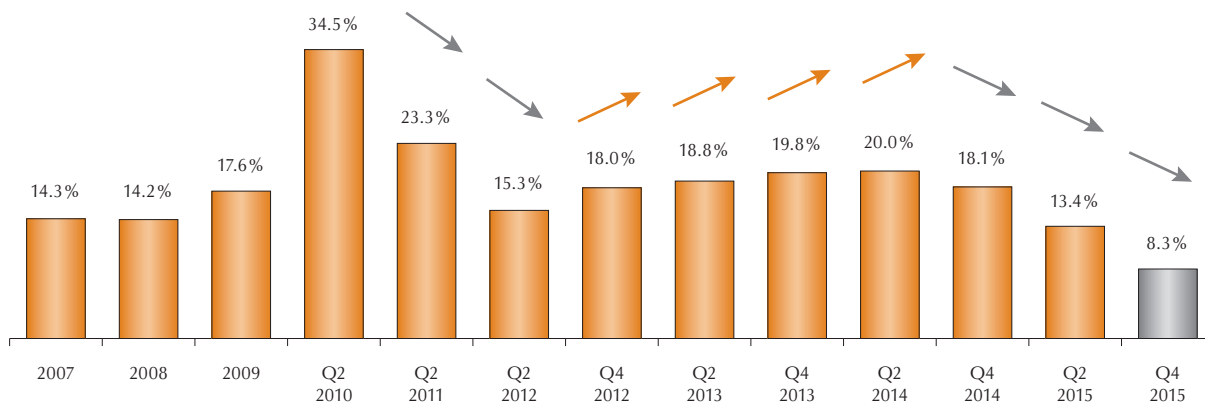
<sup>29</sup> The ‘empty pack’ method is used in the largest study of the illicit cigarette market within the EU which is conducted with the support of major cigarette producing companies. The method is based on collection and analysis of used empty cigarette packs in randomly selected areas in big cities. ‘Empty pack’ surveys in Bulgaria collect usually between 5,000 and 8,000 packs, to find out what share of them is from legal sources and what is illicit domestic production or illicit imports.

Studies of CSD have pointed out that this enormous criminal market is responsible for a large share of the corruption practices both at the political level and at the level of revenue administration and law-enforcement institutions.

The high share of the illicit cigarette market after 2009 is due to both **smuggling** and **domestic production by legal cigarette manufacturers**. The direct and constant control introduced by the government at the end of 2014 and beginning of 2015 resulted in sharp decline in the supply of illicit cigarettes in the country. Parallel with these efforts, Mol and the Customs Agency prevented any new external sources of illicit cigarettes from entering the Bulgarian market. The combined effect was steep decline in illicit cigarettes consumption, as evidenced by recent 'empty pack' surveys. In the first half of 2015, this share declined to 13.4 %, and in the second half, to 8.3 %.

These levels of illicit cigarettes consumption place Bulgaria below the average for the EU. The impact is confirmed by the **excise tax revenues from tobacco products**. In 2015, total excise tax amounted to 2,008 mln BGN, up from 1,787 mln BGN in 2014.

**FIGURE 11. SHARE OF ILLICIT CIGARETTES CONSUMPTION IN BULGARIA (2007 – 2015)**



Source: 2015 'Empty pack' surveys (part of an anti-illicit cigarette initiative of PMI, BAT, JTI, Imperial Tobacco, Bulgartabac).

## Corruption risks in public procurement

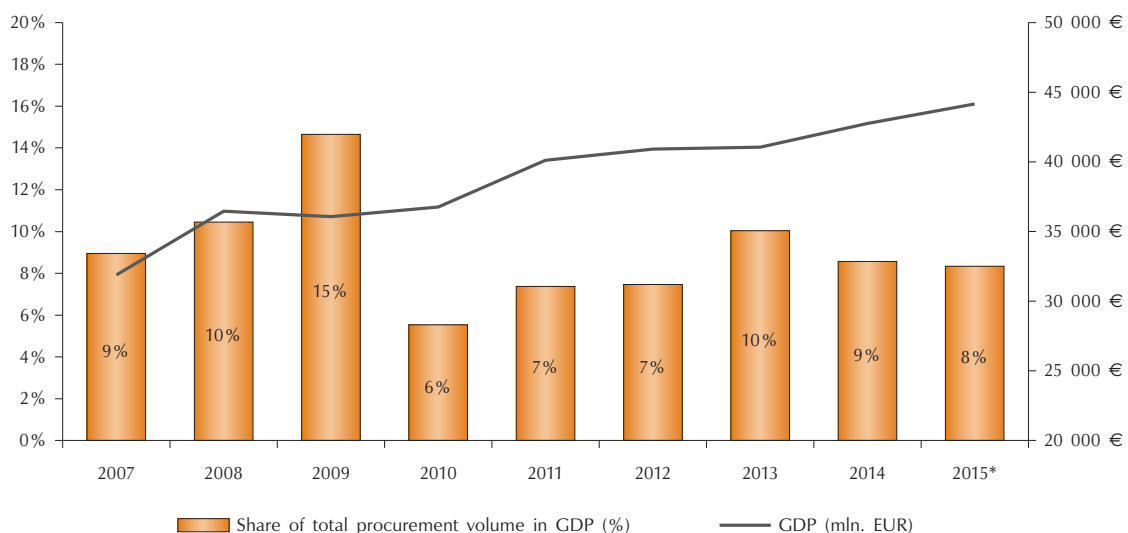
Similar to the deficiencies of the majority of regulatory and control agencies in Bulgaria, **the country continues to struggle with establishing an efficient and effective public procurement (PP) system**. The allocation of public resources remains particularistic and uncompetitive.<sup>30</sup> The Bulgarian

<sup>30</sup> CSD, *Anti-Corruption Policies against State Capture*. Sofia: Center for the Study of Democracy, 2014.

EU membership has had an important contribution towards improving public spending, mainly with respect to enhancing transparency and accountability but also to streamlining relevant legislation and providing for stricter control and oversight of public procurement procedures involving EU financing. However, the latter has also significantly impacted the public procurement domain by further increasing corruption risks, as EU funds gradually replaced national financing in many sectors, and as the effects of the introduction of new rules wore out. In 2016, **public procurement has again been associated with oligarchic networks and state capture**, after the Prime Minister abruptly cancelled key contracting procedures in infrastructure, printing of identity documents, etc., citing only public concern with the procedures, for some of which the government had gone an extra mile to push through just a few months ago, e.g. by updating the annual budget for 2015.

On average, from 2007 to 2015 public procurement made up 9 % of Bulgaria's gross domestic product (GDP) (Figure 12). While small by EU standards, public procurement grew steadily from EUR 1 billion in the early 2000s to a peak of just above EUR 5 billion in 2009 before dropping to EUR 3 billion in 2010 in the wake of the Eurozone crisis. Both peak years of public procurement contracting since Bulgaria's EU accession – 2009 and 2013 coincided with parliamentary elections. In both years, the non-cyclical spike in public procurement came in the months just before the elections, clearly indicating the intent of incumbent governments to win voter support through the allocation of public funds.<sup>31</sup>

**FIGURE 12. SHARE OF THE TOTAL PUBLIC PROCUREMENT VOLUME TO GDP IN BULGARIA (2007 – 2015)**



\* Preliminary data

Source: PPA, NSI, 2015.

<sup>31</sup> CSD, *On the Eve of EU Accession: Anti-corruption Reforms in Bulgaria*. Sofia: Center for the Study of Democracy, 2006.

EU funds have been playing an increasingly important role in the public procurement market, providing for roughly a quarter of all procurement announcements. This has added pressure on the Bulgarian authorities to spend funds at any cost before their eligibility period runs out, leading to spikes in EU funds' financed public procurement in the years 2009 and 2014.<sup>32</sup> At the same time, the European Commission (EC) has pointed out on many occasions the continuing inability of the country to properly manage EU funds. For example, irregularities in the management of the Phare and Sapard pre-accession funds exposed by the EC, coupled with the lack of adequate ex-ante and ex-post controls, and the tenuous response of the Bulgarian government to those findings, led to the forfeiture of EUR 220 million from the national Phare program, as well as to the freezing of EU funds earmarked for road infrastructure development.<sup>33</sup> At the end of 2013, suspension of payments was also imposed upon Operational Program Environment, particularly due to public procurement irregularities.

#### **Box 6. Public procurement trends in the Bulgarian construction sector**

Both the number and value of public procurement contracts for construction works marked a significant increase between 2010 and 2015. Their numbers rose from 1,269 in 2010 to 2,842 in 2015. The respective increase in the total value was from EUR 728 million to EUR 1,326 million. The spike was even sharper in the period 2010 – 2013 (from EUR 728 million to EUR 2,047 million), the last year in which EU funds from the 2007 – 2013 period could be contracted. There was also a clear trend of concentration of public procurement contracts in construction works vis-à-vis the supply of goods and services, and in larger value contracts within construction works. While in terms of numbers the share of the construction works contracts remained relatively stable, their share in the total value of public procurement contracts has increased steadily to over 50 % in 2013. This rising concentration of public procurement in construction works has been attributable entirely to the rise of large-scale public procurement contracts and the increasing weight of EU financing. Large-scale contracts for construction works with value above EUR 1.1 million have risen to 43 % of the total public procurement value in Bulgaria.

Concentration of public procurement is also visible at below sector levels. The top 40 procurement winners from the Tenders Electronic Daily (TED) database account for 62 % of the total procurement volume in construction (in the same database). Four

<sup>32</sup> EU funds are disbursed at 7-year budget cycles (2007 – 2013) under the so-called “n+2” rule, meaning that money has to be contracted at the latest by year *n* (e.g. 2013) and invoiced by year *n*+2 (e.g. 2015) or has to be returned to the EU budget.

<sup>33</sup> CSD, *Crime without Punishment: Countering Corruption and Organized Crime in Bulgaria* Sofia: Center for the Study of Democracy, 2009.



companies account for 23 % of all TED records. In 2013, the top 40 construction companies controlled 23 % of the total value of the public procurement market in Bulgaria, which was more than double their share in the last pre-crisis year 2008. After the economic crisis began in 2008 – 2009, EU funding replaced national funding in large-scale public procurement of construction works (reaching 78 % in 2013). It could be expected that – other things being equal – with the rise of the EU funding share in their turnover, and as they become more accustomed to EU funding and oversight rules, incumbent companies will try to find ways of capturing EU funds in similar ways as they have done with national public procurement.

*Source: Stefanov, R., Yalamov, T. and Karaboev, S. (2015). The Bulgarian public procurement market: Corruption risks and dynamics in the construction sector, In Mungiu-Pippidi, A. (Ed.), Government Favouritism in Europe. Barbara Budrich Publishers: Opladen, Berlin, Toronto.<sup>34</sup>*

The findings of the main control bodies of public procurement in Bulgaria – the Public Procurement Agency (PPA), the National Audit Office (NAO) and the Public Financial Inspection Agency (PFIA) confirm the existence of high levels of corruption risk in the PP process. Violations of the public procurement law and procedures uncovered by the PFIA remain very high. In 2014, out of 2,440 checked contracts 924 were discovered to contain violations. Similarly, the ex-ante control performed by the PPA on EU financed public procurement showed high number of violations. As of 2014, some 30 % of the checked procedures were not fully compliant with the law.

**Risks of corruption are exacerbated by frequent legislative changes to the *Public Procurement Act*** citing EU legal approximation as the underlying reason. While the EU has enacted only two major changes in public procurement in the past decade, Bulgarian lawmakers have introduced a total of 27 sets of amendments to the public procurement law since 2005. This indicates that while EU accession apparently led to the creation of new and more legal constraints to corruption, its implementation remains problematic.

Public procurement in Bulgaria remains trapped in the wider governance problems of the country, which still display the main features of a particularistic regime. Declining private sector opportunities in the wake of the Eurozone crisis in 2009 and the rising pressure on the Bulgarian authorities to deliver full EU funds absorption by the end of the EU funding cycle in 2013 have led to concentration of procurement resources and market leverage in the public administration. This, as well as the lack of trust in national law enforcement, has kept Bulgaria high on the radar of the EU anti-fraud office OLAF. In 2015, Bulgaria

<sup>34</sup> The firm-level analysis is based on a database with 4,928 procurement contracts between 2009 and 2014 from the TED structured dataset, and a manually constructed database using a sample of the top 40 construction companies, ranked according to their total turnover for the period of 2008 – 2013.

remained, together with Romania, the country with the most cases of incoming information and initiated investigations by OLAF. The overwhelming majority of cases reported to OLAF from Bulgaria come from private sources, and not the legally mandated for the matter public institutions, which is another testament to **the very low trust of citizens in Bulgarian public institutions.**<sup>35</sup>

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<sup>35</sup> According to the OLAF Report 2015, the organisation received altogether 34 information signals from Bulgaria, of which 32 were from private sources. OLAF initiated 19 investigations for Bulgaria in 2015.





## 6. LEGISLATIVE DEVELOPMENTS

### Adoption of special anticorruption legislation

As a major follow-up step to the adoption of the *National Strategy for Prevention and Countering Corruption for 2015 – 2020* (9 of April 2015) a draft *Law on Preventing Corruption among Persons Occupying High Public Offices* was submitted to Parliament. Although it was widely publicized and publicly debated, the draft did not receive the necessary majority in parliament and at the beginning of September 2015 was rejected at first reading, temporarily precluding further debates on the law, and effectively blocking the anticorruption policy of the executive for the whole 2015. In 2016, a second attempt to initiate a new debate on an amended version of the Draft was undertaken but is not yet adopted.<sup>36</sup> This development from the very beginning of the process showed obvious reluctance by MPs to contribute to improving and adopting a law on anticorruption measures that could be directed also against themselves.

The draft law retains essential provisions of the current *Public Disclosure of Senior Public Officials Financial Interests Act* and the *Conflict of Interest Prevention and Ascertainment Act*, offers some new solutions. In its most important points the draft provided for: a definition of corruption conduct; the establishment of a single anticorruption body – the National Bureau of Preventing Corruption and Forfeiture of Illegally Acquired Assets that should unite four existing bodies – the Commission for Prevention and Ascertainment of Conflict of Interest, the Asset Forfeiture Commission, the Center for Prevention and Combating Corruption and Organized Crime (known as BORKOR) and unit of the National Audit Office which receives and verifies assets declarations; periodic external audit of the Bureau and integrity checks for its inspectors; new regulations on declaring assets and conflicts of interest for a larger scope of circumstances and a wider range of public officials,<sup>37</sup> as well as full property checks and proceedings on conflicts of interest, including such based on anonymous complaints; protection of whistleblowers of conflicts of interest or unjustified wealth, etc.

One of the main deficiencies of the draft law is the definition of corruption conduct covering conflict of interest and unlawful enrichment. This leaves many forms of unlawful private gain and types of abuse of power out and thus substantially limits the countering of corruption.

Some powers of the proposed new body are subject to discussion or criticism (such as the power to request disclosure of bank secrecy, insurance and tax secrecy, to have access to the database of the Central Credit Register, etc.). Among the most disputable points is also

<sup>36</sup> The draft is available at: [http://www.parliament.bg/bills/43/602-01-18\\_Proekt\\_na\\_ZPKONPI.PDF](http://www.parliament.bg/bills/43/602-01-18_Proekt_na_ZPKONPI.PDF)

<sup>37</sup> The draft law covers a wide range of positions – senior government and other officials, persons with authority in public spending, and several categories of persons in administrations with increased corruption risk.

the expanded scope of the obligation to declare assets and income, including in cases of cohabitation of conjugal principals, which has lasted more than two years, the proposed lower amount of “significant discrepancy” between assets and net income (BGN 120,000, not as far – BGN 250,000) to initiate a procedure for confiscation of illegally acquired property, anonymous whistleblowers (or anonymous complaints), the constitution of the new body, and the mechanisms which could enable effective oversight over it.

The adoption of an improved special anticorruption legislation would help to overcome a number of deficiencies in the implementation of the current legal framework (some of which have become notorious cases), through creating a single regulation and a consolidated anticorruption body.

The merging of several existing bodies with relatively different functions into a new institution creates certain risks, especially when done without a proper impact analysis. Furthermore, such a law would have limited value if not backed up by corresponding enforcement capacity, both in terms of the integrity of government institutions and in terms of resources available to institutions to enforce adequate anticorruption controls in different areas. In order to adopt legislation that would be effective it should provide for a clear and transparent procedure for establishment of such an anticorruption body and guarantees that the election of the director, vice-directors, directors of territorial units and the selection and appointment of all civil servants would be based on objective criteria (professional skills, experience and integrity, lack of political affiliation, etc.), enshrined in law, and not the result of political appointments and tacit deals. This will be also one of the prerequisites for its political independence.

## Missing Legislative reforms in critical areas

As repeatedly noted in the previous Corruption Assessment Reports, in the process of EU accession Bulgaria brought its criminal law in compliance with the main international standards and requirements in the field of anticorruption: the main forms of corruption have been incriminated, most corruption-related offences have been made grave crimes that can be investigated using surveillance techniques.<sup>38</sup> However, persistently high levels of corruption and unpunished corrupt behavior (low number of opened cases and even fewer cases ending with conviction, lenient sanctions and no successfully completed high-profile cases) indicate problems in the legislation and its ineffective enforcement both at the pre-trial stage and the subsequent trial proceedings.

An adequate penal foundation for preventing and combating corruption requires reconsidering and updating of main provisions in the *Criminal Code* that refer to different forms of corrupt behavior. Among them are out-of-date provisions, for instance as regards communist era “economic crimes” (which are inadequate for successfully countering serious economic

<sup>38</sup> See: CSD, *Anti-Corruption Policies against State Capture*. Sofia: Center for the Study of Democracy, 2014, p. 47, and other previous Corruption Assessment Reports, available at: [www.csd.bg](http://www.csd.bg)

crime), the provisions incriminating malfeasance in office (not relevant or effective and prone to misuse).<sup>39</sup>

Placed under discussion for more than 10 years, the provision envisaging criminal liability for **provocation to bribery** (the premeditated creation of an environment or conditions which provoke offering, giving or receiving a bribe with the aim of causing damage to the individual who gives or receives such bribe)<sup>40</sup> still provokes search of reasonable alternatives. Making provocation to bribery legal under strict conditions, especially in terms of the potential preventive effect it may have, could be considered as a matter of a separate penal act. The proposal, which should be submitted to a broad public discussion, is the introduction of a new technique – **the use of an agent provocateur** while minimizing any risks for abuse. This can be done through judicial control, which must ensure that the provocation would be allowed only to persons for whom there is sufficient operational information that they are corrupt, though no concrete evidence. **Only a court** should be able to assess and decide whether to allow the use of this tool.<sup>41</sup> This technique would differ from the use of undercover agents by security services and the police.

Furthermore, when using this tool judicial control must be continued after the operation. If there are gaps in the work of the agent the court should not approve the results and the operation would remain without any consequences. If the court finds that the operation had taken place lawfully, it would approve the results and terminate the term of office, labor or service contract of the person against whom the operation was conducted. This kind of legalized provocation does not lead to criminal liability and does not contradict established democratic legislative standards and the jurisprudence of the ECHR. There are grounds to expect that this would be an effective tool that would lead to greater restraint for corrupt officials to accept bribes, as well as to easier removal of such officials from positions that make them susceptible to bribery.

In Bulgaria, there is neither a specific legislation on **lobbying** nor an explicit obligation for registration of lobbyists or reporting of contacts between public officials and lobbyists. Every new government in office has put forward proposals but no such law has yet been adopted. Eventually such legislation is likely to be adopted but, similarly to the legislation on conflicts of interest, this will take time and, most likely, some form of external pressure, since incumbent governments do not have an interest in adopting such legislation. In Bulgaria, the term “lobbyist” has already acquired negative connotation as it is often associated with corrupt practices, public scandals of alleged immoral and/or undue influence of private interests on public policies and legislation as well

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<sup>39</sup> CSD, *On the Eve of EU Accession: Anti-corruption Reforms in Bulgaria*. Sofia: Center for the Study of Democracy, 2006, p.64, and other previous Corruption Assessment Reports, available at: [www.csd.bg](http://www.csd.bg)

<sup>40</sup> Ibid.

<sup>41</sup> This tool would not be applied to persons whose office is established by the Constitution – MPs, the president, constitutional judges, senior magistrates and the Ombudsman.

as with expedited preparation and adoption of laws, behind which are seen lobbyist interests. The lack of legislation on lobbying in Bulgaria has made it even more difficult to differentiate between positive and negative lobbying, which has contributed to the largely distrustful public attitude towards lobbyism.

Effective **arrangements for encouraging whistleblowing** are not yet in place. The *Administrative Procedure Code* and the *Prevention and Ascertainment of Conflict of Interest Act* contain provisions on the protection of whistleblowers' identities, while the *Criminal Procedure Code* requires members of the public – and specifically public officials – who have come across information about the commission of a crime to inform the competent authorities. However, no adequate steps have been taken to strengthen the protection of whistleblowers.

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## 7. CAPTURING THE JUDICIARY

A number of events in 2015 – 2016 indicate that there are a number of **inappropriate liaisons between elected politicians and magistrates**. The lack of investigation and prosecution of flagrant cases in which senior magistrates had allegedly been involved or cases that generate doubts about undue political interference justify not only for attacks against the independence of the judiciary, but also for its use for the protection of illegitimate interests. Public statements made by senior judges about corrupting influence over the judiciary by political and oligarchic circles remained without any consequences. One recent case in point is the statement of a group of judges that the system of random allocation of court cases is used for corrupt purposes, which also were not followed by any reaction. Parallel to this, continuing disclosure of scandalous stories about magistrates – often seedy – further discredited the judiciary. Failed or rigged elections of magistrates to management positions show that not only is there pressure on the judiciary from the outside, but there is also a willingness among particular circle of senior magistrates to serve political interests rather than to serve impartial justice. This environment, which continues even after the separation of SJC into prosecutorial and judicial chambers, facilitates capturing of the judiciary.

There has been no change in the practice of adopting strategic documents without much practical value but aimed mostly at simulating action, in view of forthcoming external evaluations and monitoring (such as the EU Anticorruption Report, CVM reports, etc.). Thus, in addition to the 2015 update of its *Anticorruption Strategy*, the government adopted an updated strategy to continue with judicial reform, outlining the goals and measures for the next seven years. A roadmap for the implementation of the strategy was adopted in 2016 and funding for the first measures have already been secured through the EU co-funded operational programs. Behind the officially declared main objectives (such as guaranteeing the independence of the court and the other judicial authorities, improving legal education, reducing the workload of magistrates and the various units of the judiciary, disciplinary proceedings, guarantees for the rule of law, protection of human rights, access to justice and humanity of justice, building trust in justice, etc.) it did not provide for specific working mechanisms and procedures. Furthermore, the parliament approved the strategy at the end of January 2015 in a revised and less effective version.

**Constitutional amendments**, concerning judicial reform, adopted in a more limited version than the submitted one, ended up with even lower chances of bringing about significant change.

Parliamentary appointments to the Supreme Judicial Council are to be made by at least two thirds' majority, creating risks for political stalemates.

The Council was separated into judicial and prosecutorial chambers, but members elected by judges did not prevail over parliament appointees in the judicial chamber, compromising judicial independence. Political appointees ended up equal in number to those elected by prosecutors in the prosecutorial chamber, thus keeping Prosecutor General's decisive vote and unlimited powers intact. The constitutional amendments defining the composition of the two chambers of the SJC restricted further the accountability of the Prosecutor's Office. Under the new rules, the future prosecutors' chamber is dominated by prosecutors. This, together with the centralized and hierarchical structure of the Prosecutor's Office, which has been preserved despite justified and repeated criticism, will further strengthen the powers of the Prosecutor General without any adequate safeguards against potential abuse.

Despite the constitutional amendments, the composition of the SJC and the rules for the election of its members were not changed. The reluctance to undertake more serious changes to the constitutional model of the judiciary was again justified by Constitutional Court rulings and claims that only a Grand National Assembly is authorized to make such changes. This model has already proved its ineffectiveness leading to the formation of a stable political majority within the SJC, through which all key decisions are being easily passed. This problem became clearly visible during a series of controversial decisions adopted by the SJC, including the dismissal of the Council's former head (formally known as the official representative of the council), proposed, discussed and voted on within 24 hours without any substantive justification whatsoever. Different options have already been formulated, ranging from decreasing the number of SJC members elected by the parliament to depriving the Prosecutor General and the chairs of the two supreme courts from their ex officio membership.

The Council's secret ballot provision was repealed thus bringing in open ballot and opportunities to further regulate the matter in the forthcoming amendments in the Law on the Judiciary. The judicial inspectorate's new powers for integrity, conflict of interest and property checks of magistrates were also adopted.

Among the important factors for the unsatisfactory results of **criminal justice** against corruption are the problems within the system itself: the existence of long accumulated systematic problems in the management of the judiciary, including the practice of appointment, career development, election of heads of courts and prosecutor's offices, performance appraisal, disciplinary practices, etc. In 2015, the governing body of the judiciary was involved in various inconsistent decisions or decisions taken under apparent external influence (elections of heads of key courts – Supreme Court of Cassation, Sofia Appellate Court and others). SJC's disciplinary practice continued to be extremely selective and mostly reactive – the most stringent disciplinary sanctions were imposed as a result of a public outcry.

The SJC continued to implement its *Strategy for Prevention and Fight against Corruption in the Judiciary*, adopted in 2013. The strategy is implemented



through annual action plans adopted by the council, which list the necessary measures and the deadlines for their execution. So far, however, no impact assessment of the already implemented measures has been done. In its progress reports, the Council focuses exclusively on checking the status of implementation of the measures and there is no evaluation as to whether these measures have actually contributed to the achievement of the strategy's goals.

The latest amendments of the *Law on the Judiciary* deprived the SJC of its role in the prevention of corruption transferring them to the Council's Inspectorate. As a result, the council's committee on professional ethics and prevention of corruption will no longer deal with the issue of corruption, for which it has already developed a certain capacity. At the same time, no mechanism was envisaged for transferring this capacity, including the staff, to the inspectorate thus putting at risk the sustainability of the work done so far.

Despite its formal independence from the other branches of power, the SCJ failed to adequately react to political pressure from the parliament and the executive. Recent cases such as allowing the Prime Minister to personally attend a council's session without being duly invited and failing to properly respond to calls for resignation made by two of the ruling political parties in parliament, left the impression that the council has little capacity to oppose to political interference.

The insufficient accountability of the Prosecutor's Office remains neglected by the reforms. The parliament missed the opportunity to obtain a proactive role in the process of overseeing the work of the Prosecutor's Office. During the early stages of the discussions on the constitutional amendments, there was a proposal for empowering the National Assembly to request special reports from the Prosecutor General on specific topics related to penal policy and the prevention and fight against crime. In the course of the debates, however, this proposal was narrowed down to the right of the Prosecutor General to decide if and when to present such reports.

Additional reporting by the Prosecutor General to parliament as a minimum requirement to ensure accountability remains only optional. There is still no effective mechanism allowing the parliament to exercise oversight over the work of the Prosecutor's Office. Before the constitutional amendments the parliament was only allowed to hold a hearing on the annual report of the Prosecutor General and then adopt it by a decision. This procedure, which survived the amendments, has already demonstrated its ineffectiveness. The parliament started to delay the hearing and adoption of the report, which was used as an excuse by the Prosecutor's Office not to make it public.

Therefore, this rule should be revised and the role and responsibility of the parliament should be increased by allowing the parliament to define the minimum scope and structure of the report and to return it for additional information if its contents do not meet the requirements.



### Box 7. Lacking accountability and insufficient performance of the prosecution

The lack of adequate mechanisms for external oversight of the work of the Prosecutor's Office and the ineffective internal control mechanisms make the institution practically unaccountable. At the same time, the number of cases in which citizens file successful claims against and obtain compensation from the Prosecutor's Office remains significant. In 2015, they were 308 and the Prosecutor's Office was sentenced to pay BGN 2,495,245 as compensation.

At the same time, the efficiency of work of the prosecution against corruption crime and especially against high-level corruption remains low.

The *Report on the Enforcement of the Law and the Activities of the Public Prosecution and the Investigating Authorities in 2015* contains the admission that "despite some increase in the number of newly instituted cases and prosecutorial acts brought to court in comparison to 2014, the total number of bribery cases remains small, and for not very serious crimes". According to the data provided, as in previous reporting periods 60.6 % of all pre-trial proceedings for bribery are formed for minor cases of active bribery, many of which are attempts to conceal violations of the *Road Traffic Act*.

The data indicate low detection of general economic crimes – Art. 219 and Art. 220 *Criminal Code*, and of official malfeasance – Art. 282 CC – (convicted 12, acquitted – 13), although they contain an essential element of corruption.

In 2015, 153 proceedings for corruption crimes of **significant public interest** were observed by the prosecution, 13 pre-trial proceedings were submitted to court and there were two effectively convicted individuals. The largest share (33.2 % or 95 cases) of all 286 returned cases of crimes of significant public interest are those for corruption offenses in which there is an increase compared to 2014 (27.8 % or 82 cases), indicating that the deficiencies in investigating these matters had not been removed.

There is a lack of progress in the above areas as well as in countering bribery offenses in general.

A special cross government unit for investigating corrupt acts of officials occupying senior government and other positions (Specialized Unit "Anti-corruption") was established by an agreement between the Prosecutor's Office, the MoI and the State Agency for National Security on 24 March 2015. Internal rules for the organization and operation of the unit were adopted. Until October 2015, the

unit brought charges against 12 magistrates (eight judges, three prosecutors and one investigator), including seven magistrates at managerial positions. A total of 161 inquiries for crimes committed by magistrates were launched and 88 of them were completed. Eight magistrates were brought to court, including six judges (four of them at managerial positions), one prosecutor (also at managerial position) and one investigator. Ten pre-trial proceedings against senior public officials were also launched, 11 persons were charged and four persons were brought to court.

*Source: Report on the Enforcement of the Law and the Activities of the Public Prosecution and the Investigating Authorities in 2015, (published on 10 May 2016, available at: <http://www.prb.bg/bg/news/aktualno/godishen-doklad-za-2015-g/>); Report on the 2015 Action Plan on the Implementation of the Recommendations of the Report of the European Commission of January 2015 under the Cooperation and Verification Mechanism (adopted by the government on 10 March 2016).*

Long-standing problems with the prosecution's **pre-trial performance** prove one of the obstacles to a breakthrough in countering state capture and high level corruption. A number of high-profile cases with significant political impact were launched and heavily advertised but none of them ended up in convictions against senior politicians or public officials. These include, among others, the case for thousands of voting ballots found in a printing company and allegedly produced in violation of the law, the case against the former chair of the Commission for Prevention and Ascertainment of Conflict of Interest (a case in which the most important evidence was stolen in the course of the proceedings), the case against a former Deputy Speaker of the National Assembly, the series of cases against a former interior minister, etc. The lack of results in any of these cases increased the perceptions about the political influence of the Prosecutor General (without any checks and balances), which prevents the normal functioning of both the judiciary and the entire political system. On the one hand, the current status quo (prosecution powers and untouchability) of the Prosecutor General is in the interests of politicians who are discredited in their past or present. For their "exoneration" they need liaisons with magistrates and achieve it if necessary at the cost of pressure and influence. On the other hand, political protection is desired by a number of members of the judiciary to attain career, positions and "protection" from liability.

The highly centralized and hierarchical structure of the Prosecutor's Office and the unlimited powers of the Prosecutor General without any accountability for a 7-year term of office need to be reformed. Initial steps to limit the considerable leverage of the Prosecutor General to put pressure on individual magistrates and politicians, as well as to serve partisan political interests should include: reduction of the Prosecutor General's term of office from 7 to 5 years and introduction of regular assessment of his/her and the Prosecution performance; introduction of rules, restricting the power of the Prosecution to perform the so-called "inquiries" on persons who have allegedly committed a crime (these

inquiries are not part of the criminal proceedings and the persons on whom they are performed do not have the procedural rights to defend themselves during the proceedings; at the same time, they represent a very strong instrument by which any prosecutor can seriously damage the public standing of an individual or disrupt the work of an institution); strengthening the specialized unit to combat corruption, financial and tax fraud and smuggling, led currently by the Prosecutor General, expanding its powers to investigate and prosecute high level corruption; this unit should be led by a senior prosecutor with the rank of a deputy prosecutor general or special prosecutor appointed by the Plenum of SJC under the rules and procedures for electing Prosecutor General.

Alternatively, another option would be the creation of an independent body to prosecute high-level corruption – in or outside the Prosecution. It could be led by a prosecutor with the rank of deputy prosecutor general, nominated by the Minister of Justice and elected by the SJC, with its own separate mandate (not coinciding with the term of office of the Prosecutor General), situated outside of the team of the Prosecutor General. The head of this body – in cooperation with the Minister of Justice and with the assistance of respective European experts – should select and nominate the members of the team to be elected by the SJC.

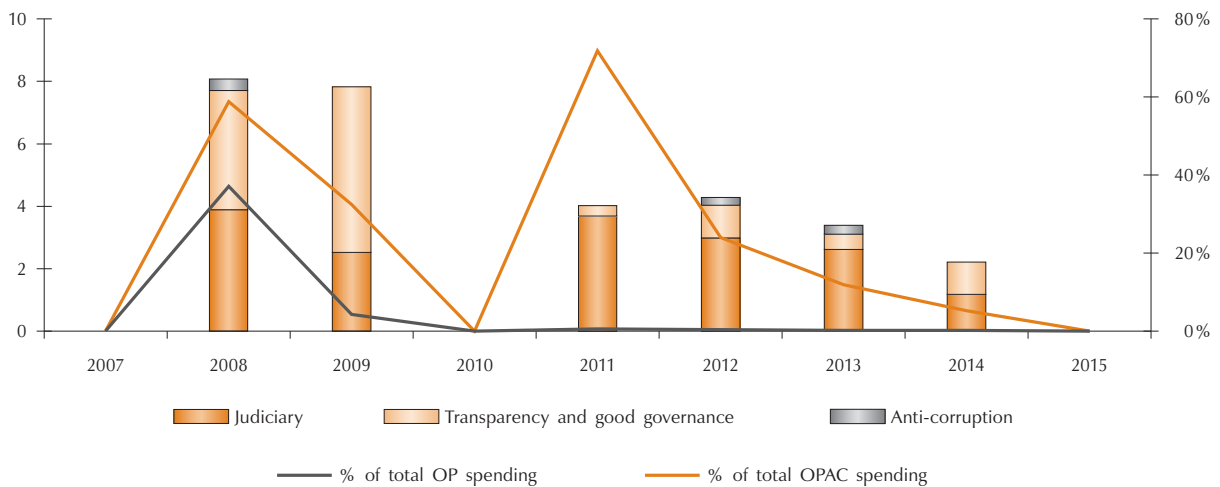
Another non-traditional option that could be considered, would be the **introduction of judicial control over a wider range of prosecutorial acts**: for instance, every act of termination of a case, even when it is not requested by the person concerned; opportunity for anyone who has received a refusal to institute pre-trial proceedings on his/her complaint, to ask the court (and not only by the higher prosecutor) to rule on the decree for the refusal. This would lead to additional burden on the courts, but would provide independent oversight. This is an extreme measure that could hardly be applied in the current constitutional framework. However, it should be considered in the future and could be undertaken if other measures fail to provide the expected results and the existing deadlock would be not resolved.

To overcome the extremely large deficits in the governance and the performance of the judicial branch, including the unaccountable power of the Prosecutor General, and to counter effectively its capturing by illegitimate political interests require more fundamental and successive constitutional and legislative changes.

## 8. EU FUNDING FOR ANTICORRUPTION REFORMS IN BULGARIA

Despite the growing importance of anticorruption at the EU level (as evidenced, for example, by the publication of the *EU Anticorruption Report* in 2014), **EU's financial assistance does not match this challenge**. Such imbalance is particularly visible in Bulgaria: funding for anticorruption has been sporadic despite the existence of a post-accession monitoring instrument in the justice and home affairs area (the CVM). Data show that after 2009 the financial resources allocated for anticorruption, judiciary, transparency and good governance projects<sup>42</sup> significantly decrease (Figure 13).

**FIGURE 13. TOTAL ACTUAL PAYMENTS IN SUPPORT OF ANTICORRUPTION-RELATED ACTIONS DURING THE 2007 – 2013 PROGRAMING PERIOD (MILLION EUR)**



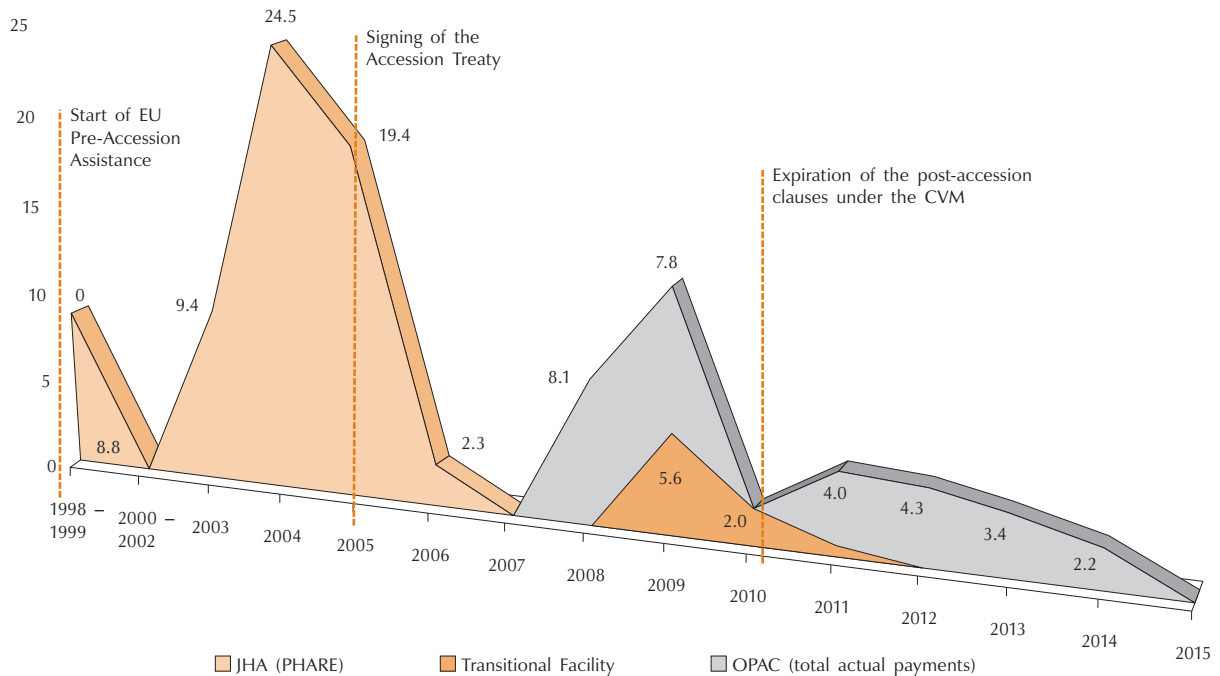
Source: Managing Authorities of OPAC. Note: As of 31.08.2015..

An overview of the EU financial support for anticorruption-related actions since the beginning of the pre-accession programs, more specifically the Phare program from 1998, reveals an even more telling trend. Irrespective of the actual amount of financial support through the years, Bulgaria seems to be delivering on its anticorruption commitment and

<sup>42</sup> "Anticorruption" includes specific projects containing the keywords "corruption" and/or "anticorruption", as well as projects related to organized crime and/or EU funds fraud. "Judiciary" includes projects from the following sub-priorities on Judiciary from Priority Axes 1, 2 and 3 – 1.5; 2.4; and 3.3. "Transparency and good governance" includes projects from the OPAC database, containing the keywords "good governance" and/or "transparency. Duplicates have been removed.

compliance with EC recommendations (under both pre- and post-accession monitoring mechanisms) only when closing in on a major step towards EU accession or in case any other related conditionalities exist. In the first instance, during the country's pre-accession period, the allocation of anticorruption-related funding mounted on two particular occasions – in the very beginning of the Phare program and towards the signing of the Treaty of Accession in 2005. In the post-accession phase support by OPAC and the 2007 Transitional Facility increased prior to 2010, before scaling down, which coincided with the expiration of the CVM's suspension clauses (Figure 14).

**FIGURE 14. DYNAMICS OF THE OVERALL FUNDING FOR ANTICORRUPTION-RELATED ACTIONS TO BULGARIA (ACTUAL EU PAYMENTS, MILLION EUR, 1998 – 2015)**



Note: The values for 2015 include total actual payments until 31.08.2015.  
 Source: Managing Authorities of the EU operational programs in Bulgaria; Ministry of Finance, 2015.

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## THE WAY AHEAD

For two decades, consecutive Bulgarian governments have pretended to be intent on reducing corruption but have in practice undermined any meaningful measures against it. As a result, critical sectors of the public administration and the judiciary have become dysfunctional to the extent that nothing short of a drastic shake-up would have any impact.

As already pointed out, corruption in the public administration and among elected politicians are mutually constitutive. In Bulgaria, administrative corruption has turned into a kind of additional tax paid by individuals and businesses for access to public services, while state capture is expanding and now involves officials at all levels of government in corruption relations with the consent – if not encouragement – of the political class. This has resulted in the emergence of predatory networks, which successfully use corruption to extract economic and political advantages while simultaneously blocking all attempts to introduce anticorruption reforms and policies.

In such a context, there are two imperative – that is, both urgent and profound – reforms that need to be placed on the immediate anticorruption agenda of the country. These are intended to **tackle simultaneously administrative corruption and state capture.**

### **1. A restart of the system of enforcement and inspection agencies.**

Recurring problems in the work of regulatory, enforcement and inspections institutions indicate that they function highly ineffectively and are captured by political-business networks. In many institutions, competence and capacity are in short supply; this in turn is used to justify inaction and/or conceal corruption relations. The main problems which a restart of the system of these institutions should aim to resolve are, at the very least, the following:

- Political interference in their work should be discontinued. The discretionary power exercised by some government institutions should be balanced with effective oversight by other public institutions and/or civil society organizations and media under conditions of adequate transparency.
- There should be effective monitoring of the incomes and assets of public officials, including officials in regulatory, enforcement and inspection institutions, as well as oversight of improper contacts of officials.
- There should be full transparency of the results and effectiveness of the work of control institutions and accountability of their senior management.
- The resources available to control institutions should correspond to the amount of work they are expected to do.
- A review should be undertaken to determine which functions

currently performed by these institutions should be left to market mechanisms and civic oversight.

- A regulatory assessment of the remit of regulatory, enforcement and inspection institutions should be carried out in order to identify excessive or redundant regulations. Overregulation and an increase of the supervisory and enforcement powers of public administrations which are not capable of exercising even their current functions can only create a breeding ground for corruption.

Such a restart should be the first step of a radical and comprehensive administrative reform.

## **2. Establishment of an independent anticorruption prosecution.**

The establishment of a specialized independent body which would investigate and prosecute the most serious cases of corruption is necessary. The new entity should include prosecutors and – in order to ensure its independence from the executive and the judiciary – they should be recruited, employed and dismissed based on specific rules and procedures, different from the rules and procedures of the judiciary. Officials in the new entity should only be accountable to its director – a senior prosecutor with the rank of a deputy prosecutor general or special prosecutor appointed by the Plenum of the SJC under the rules and procedures for electing Prosecutor General. In both scenarios the director should be independent from the Prosecutor General.

The new institution should be granted full investigative rights and responsibilities as provided for in the *Criminal Procedure Code*. The specific groups of crimes the new institution should prosecute should be strictly defined in order to guarantee that activities would only be focused on the most serious corruption cases. In this respect, in addition to a concrete list of crimes from the *Criminal Code*, other criteria should be added in order to specify the cases that are in the competence of the new institution (e.g. type of office held by the offender, value of the object of the crime, etc.).

Despite some recent measures (high profile investigations of allegedly corrupt officials in key public institutions, the cancellation of compromised procurement tenders, a reduction in the level of cross-border smuggling), anticorruption policies are incommensurate with the magnitude of the problem facing the institutions of government in Bulgaria. The glaring discrepancy between the wide spread of corruption as established by the *Corruption Monitoring System* and the modest results of the criminal justice system warrants the urgent adoption of the two measures outlined above.

Corrupt officials in the enforcement and inspection agencies can be expected to put up resistance against profound reforms. The grip of shadow political and business networks on the decision making process in government will make the establishment of an independent prosecution a difficult task. Years of anticorruption stalling allowed the emergence of a cross party constituency capable of blocking any reforms that could make a difference.



In such a context, the only way forward for the anticorruption agenda is through coalition building. This means the active involvement of the three major stakeholders against state capture – reformist politicians, civil society organizations and international partners (governments and international organizations). This approach has been advocated by CSD for some years: “A partnership triangulation is possibly the shortest way to describe the formula for the success of reforms in transition. This includes reformist politicians, active civil society and political and financial support from international partners.”<sup>43</sup>

Such a triangulation is required to compensate both absent political resolve, as well as corruption and low capacity in the civil service, especially in the enforcement and inspection services of government. Short of the involvement of international partners, powerful lobbies will block any far-reaching decisions in government; without the input and support of civil society, a government would be suspected of responding to foreign rather than domestic demand. Collaboration with partner governments and law enforcement and financial intelligence institutions outside Bulgaria is especially warranted with respect to economic crimes (which are often international in scope and nature and affect international investors) involving complex schemes at the level of the senior civil service. Non-governmental organizations, on the other hand, play a critical role in channeling public energy and reform ideas; they also bring to bear the capacity to monitor and provide expertise to the design of policies.

Overall, curbing state capture in Bulgaria can only be achieved through the sustained and coordinated drive of these stakeholders located at the critical junctures of society and politics – government decision making, civil society and international engagement.

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<sup>43</sup> Shentov, O. (2008). Opening remarks. Democracy that Delivers: Unlocking the Potential of Transition. Sofia: Center for the Study of Democracy/USAID, p. 17.





## ANNEX. ASSESSMENT METHODOLOGY\*

The assessment methodology used to evaluate the corruption situation in the country is based on theoretical developments in two broad areas: administrative corruption and state capture. These are in essence different forms of corruption that are interconnected but have different manifestations, forms and societal implications. State capture has its roots in administrative corruption and would be practically impossible without widespread corruptness of officials at non-executive positions. However, state capture is a form of “superstructure”, which directs, amplifies and stabilizes administrative corruption making it even more difficult to identify, investigate and prosecute.

### Administrative corruption

#### Elements of corruption behaviour

The most common way to define corruption behaviour is by defining it as a specific activity occurring inside the interaction between collective actors (public organisations or institutions) and their clients (private individuals or companies). The most frequently used models of this activity is the Principal-Agent-Third party model (PA). In this model the principal is the collective actor which is represented by the director of a public institution (or other type of public organisation). The role of the Agent is “played” by officials working for the public institution, or people hired by the principal. The main obligation of the agent is that he executes the orders of the principal and serves and protects his interest. The agent should not abuse the rights which he has been given by the principal and breach the trust of the principal by serving his own interest or other private interests.

The most common definition of corruption (V. Tanzi) is that it is abuse of public authority (power) for private gain. In terms of the PA model corruption would be abuse of power or trust (given by the principal) by the agent in favour of his private interest (gain).

In view of the PA model, the specific characteristics of public institutions are:

- The power of both the principal and the agent are forms of public power, which is used (utilised) in favour of the common (public) good (the People, who are the supreme principal of all public authority).
- Public authority has complex structure which is differentiated by regions (central and local), sectors (economy, security, education, etc.) and types of authority (executive, legislative, judiciary). The principals

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\* CSD, State Capture Diagnostics Roadmap, Sofia: Center for the Study of Democracy, 2016.

of most public institutions are subordinated to public institutions and officials of higher rank within a complex system of distribution of authority, responsibilities and subordination.

From the complex structure of public authority, it follows that many principals can in turn be agents of the superior level of public authority. Respectively abuse of public authority can have complex structure and include several levels of public authority. Therefore, the agents are not only officials who communicate directly with citizens (third party) but also officials who at the same time are themselves principals at different levels. In view of the hierarchy of public authority the superior principals are those positions of authority which are occupied by elected officials and who represent and serve the interests of the population which has elected them (the public interest).

In view of the structure of public authority, corruption could be subdivided into political and administrative. Administrative corruption would include abuse for gain behaviour of officials at the lowest administrative level – those who directly communicate with clients (citizens or companies). Political corruption would include abuse for gain behaviour of officials at the political level of public authority, i.e. those who occupy the highest levels of the hierarchy and are essentially political appointments (the level directly associated with elections and are appointees of the ruling party).

An important indicator for political corruption is the replacement of larger parts of the administration (including officials who are not political appointees) with the change of the ruling party after elections. The main reason for such reshuffles is the need of the political class to use the administration for corruption transactions and extraction of corruption rent for services to private interests.

### Structure of corruption behaviour

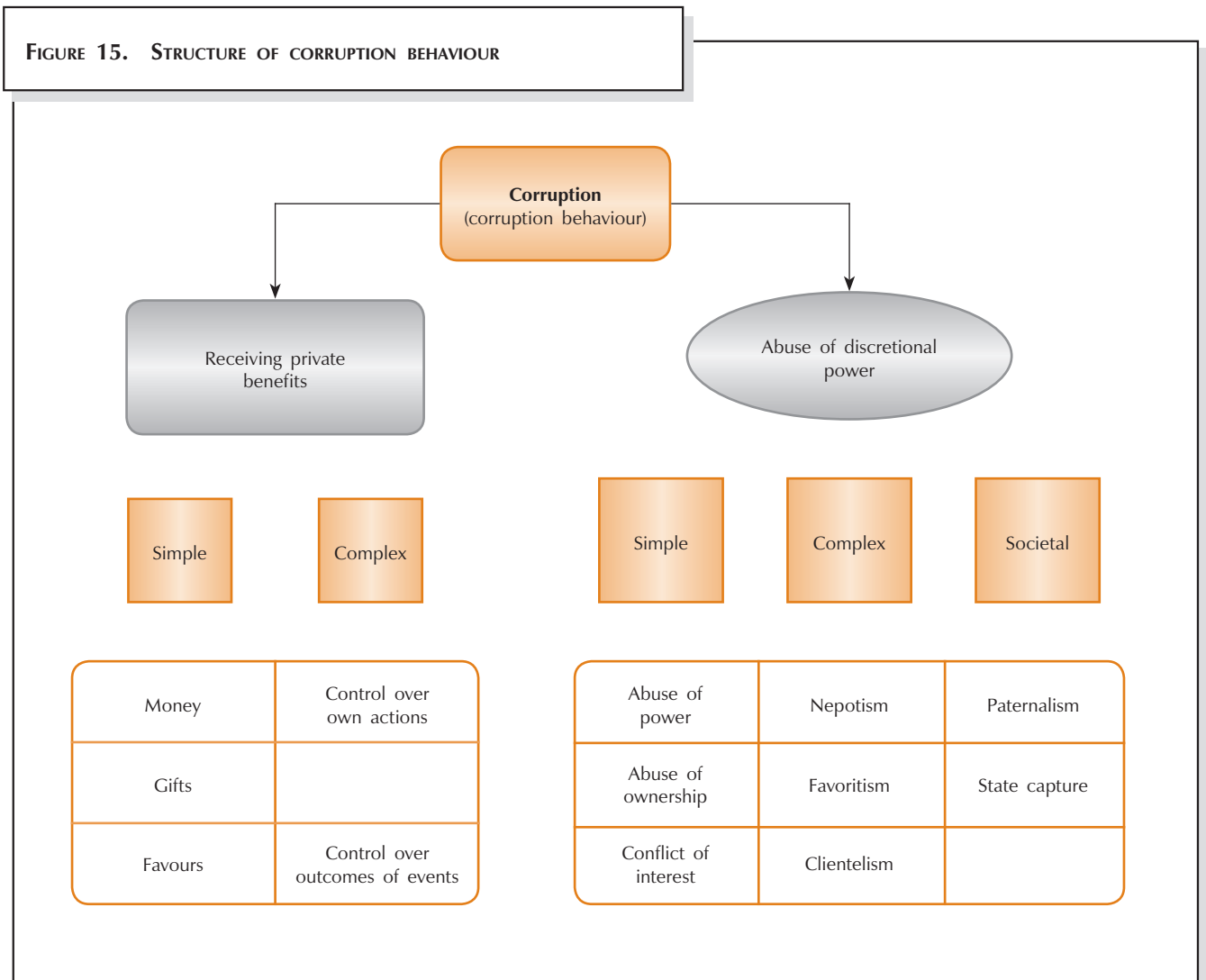
Despite the theoretical debates on the dimension of corruption behaviour, several issues are important for corruption assessment and anticorruption efforts:

First, corruption transactions can be subdivided into two elements – form and content. Form is related to the private gain received by officials. Content refers to the type of abuse of discretionary power. Every corruption transaction includes both form and content.

Second, abuse of discretionary power can be identified only in the context of a system of laws, rules and regulations which govern the activity of public institutions. This system defines which transactions constitute abuse. In this respect the content of corruption behaviour is essentially deliberate abuse of existing rules. The problem of identification of corruption behaviour is often that deliberate abuse could be masked as incompetence and/or lack of motivation.<sup>44</sup>

<sup>44</sup> This characteristic of corruption behaviour is referred to as “mimicry” – See Gambetta, D., 2002. Corruption: An Analytical Map. In S. Kotkin & A. Sajo, eds. *Political Corruption in Transition: A Sceptic's Handbook*. Budapest: CEU Press, pp. 33-56.

The assessment of the level of corruption and the elaboration of anticorruption strategies and policies is dependent on the way the forms and dimension of corruption behaviour are interpreted. One way to operationalise such an interpretation is to separately decomposed its multitude of forms (gain) and contents (abuse of discretionary power). Such a decomposition directly impacts the design of anticorruption legislation, anticorruption strategies and policies, and corruption assessment and measurement.<sup>45</sup>



Third, the multitude of forms and content element of corruption behaviour combine in a multitude of different ways. The need to identify gain in combination with deliberate abuse of rules makes identification and prosecution of corruption behaviour a difficult and often impossible task.

<sup>45</sup> For example, the draft of the Law on Countering Corruption among Officials at High Positions of Public Authority (paragraph 2.1) defines: “Corruption behaviour, according to this law, is when an official, as a result of occupying high position of public authority, receives gains leading to illegal increase of his, or people related to him, personally possessed assets or when he executes his office responsibilities in conflict of interest.”

### Levels of analysis

At the macro level, corruption could be interpreted as:

- Model of governance. This is governance which is characterised by paternalism – systematic promotion of private interests at the expense of the public interest as a result of deliberate decisions of the ruling party (government) and not by universalism – governance that treats all private interests as equal.<sup>46</sup>
- Diversion from the model of good governance. Governance that spend public funds in favour of private interests and not in favour of the public interest. As public interests are not defined per se, they should be formulated by parties and competing definitions should receive public support at elections. In this respect the problem in many countries is that public interest definitions that have received the predominant electoral support are, after elections, replaced by policies favouring private interests or by mismanagement of public resources.

The macro aspects of corruption describe above are realised through a multitude of micro-corruption transactions. In most cases they include deliberate abuse of rules combined with personal gain for empowered officials who enforce the transactions.

### Measuring and assessing administrative corruption

In the outlined context, the measurement and the assessment of corruption would include the assessment of all components of corruption at all levels of public authority. This would be possible if we could measure/assess:

- The prevalence (magnitude) of all acts of personal gain (form) or,
- The prevalence of different types of corruption practices (content).

As a rule, the measurement and assessment of cases of personal gain is a proxy indicator for the level of administrative corruption because it is based on measuring the incidence of bribes. What remains outside this measurement are, more complex gain patterns as mutual services, linked decisions in different spheres, the revolving doors phenomenon and others. Defined in this way the indicator used (experience with corruption) is the closest possible approximation to the concept of administrative corruption. The CMS of CSD uses this concept to measure the level and the dynamics of administrative corruption.

### The Corruption Monitoring System

The corruption monitoring system (CMS) was designed and developed by CSD in 1998<sup>47</sup> (*Clean future*, 1998, pp. 64-91). Introduced at a time

<sup>46</sup> The typical example of paternalism in Bulgaria are the activities of “agents/subjects, who distribute the “portions” (public resources or the authority to distribute public resources) in favour of parties with their “circles of companies”.

<sup>47</sup> Center for the Study of Democracy, *Clean future*., pp. 64-91.

when corruption measurement was confined to public perceptions, the CMS launched a measure of the corruption victimisation of individuals by officials accounting for their direct experience with various corruption patterns. Based on CMS diagnostics assessments could be made about the dynamics of prevalence of corruption behaviour patterns in a society.

The CMS methodology ensures comparability of data across countries and registers the actual level and trends of direct involvement in administrative corruption, as well as the public attitudes, assessments and expectations in relation to corruption. CMS diagnostics is being implemented in Bulgaria since 1998,<sup>48</sup> at the regional level (Southeast Europe) in 2001, 2002 and 2014,<sup>49</sup> in select years in Georgia and Moldova. Some CMS concepts have also been modified and included in the Eurobarometer surveys on corruption; this makes CMS data comparable to Eurobarometer data.<sup>50</sup>

The CMS is one of the possible measurement approaches to corruption. Its principal objective is to provide statistical estimates of the prevalence of the most common incidents of corruption and has diagnostic and descriptive functions.

In the CMS context, corruption is conceptualized as a specific type of social behaviour, which includes specific forms of interaction between actors, attitudes associated with these interactions and a set of perceptions which relate to the interactions (serving both as reflections of the interaction and prerequisites which define the behaviour strategy of the actors). Corruption refers to a specific group of interactions: citizens receive public services from public organizations (institutions) by contacting officials, who are employed of these organizations. Corruption is described through the Principal-Agent model: citizens (clients) interact with organisations (principal) through officials (agents); agents act on behalf of the principal who defines their rights and obligations and entrust them with certain discretionary power. Corruption is an interaction in which officers in public institutions (agents) abuse the discretionary power they entrusted with by the public organisation (principal) in their interaction with citizens (clients).

This definition has two key elements which need to be further operationalized: “abuse” and “benefit”. Both should be present for certain behaviour to be categorized as corruption. The relation between these concepts could be defined as a “form-content” relationship. The “benefit” is the form of the transaction, while the “abuse” refers to the content of the transaction – the type of resource that is being offered in exchange for a benefit. Varieties of corruption behaviour arise because

<sup>48</sup> All corruption assessment reports published since 1998 can be found at the web page of CSD at: <http://www.csd.bg/artShow.php?id=1339>

<sup>49</sup> A. Stoyanov et al., eds., *Anticorruption in Southeast Europe: First steps and policies* (Sofia: Center for the Study of Democracy, 2002). Additional information is also available at the SELDI web page: [www.seldi.net](http://www.seldi.net)

<sup>50</sup> TNS Opinion & Social, *Corruption. Special Eurobarometer 374* (Brussels: Directorate-General Home Affairs, European Commission, 2012); TNS Opinion&Social, *Corruption. Special Eurobarometer 397* (Brussels: Directorate-General for Home Affairs, European Commission, 2014).

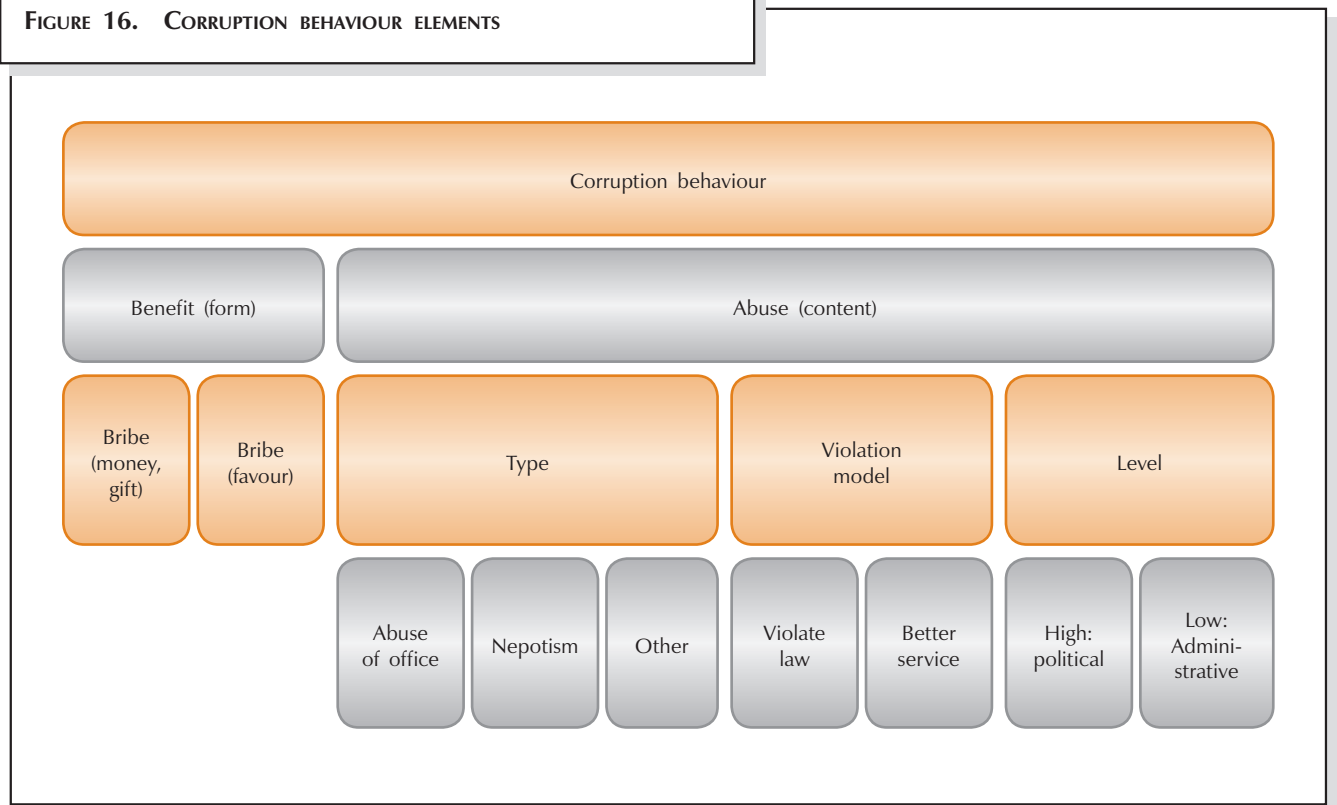
of the variation in both form and content: of the benefits that are being extended from clients to agents and of the types of abuse of public power are the content of the exchange. The most common word used to label the forms of corruption is bribe. Regarding content variations in corruption behaviour could be numerous, but they depend on what is being done, how it is done and who is the perpetrator. In more concrete terms the above variation in corruption behaviour could be summarized in four sub concepts (Figure 16):

- **Form.** Bribe is the common label of the private benefit that is being exchanged. The most common forms of bribes include money, gifts or favours. The latter could be linked to types of corruption behaviour. It is important to note that bribes are the empirical manifestation of corrupt behaviour but receive their corruption load only in conjunction with the other aspects of corruption.
- **Type.** Entrusted discretionary power can be abused in many different ways (trading in influence, nepotism, clientelism, etc.).
- **Level.** Agents at different levels could abuse discretionary power and this might not always be directly linked to specific clients (level).
- **Violation model** refers to the model of abuse of discretionary power and could be split into two broad categories: 1) violation of existing laws and/or institutional norms; 2) provision of a better service. In some societies and cultures, additional benefits extended to agents could be regarded (by custom, law, tradition, etc.) as normal behaviour when/if provided services are normal or better; in such cases additional benefits take the form of a tip and not the form of a bribe.

While the above abstract summary model of corruption behaviour could further be specified in order to list most possible variations of form and content, it is important to note that form and content could easily be used as proxies to each other. If there is a bribe, there is most probably some kind of abuse; on the other hand, if there is an abuse, there probably is some material gain. Therefore, in order to measure the prevalence of corruption behaviour, attempt should be made to either measure the number of bribe incidents, or the number of abuses of different types. In empirical terms, the easier way to “access” to corrupt behaviour is through identification of instances of bribery. Types, violation models and levels are more difficult to observe and account for as they always tend to be hidden and/or deliberately obscured. Even when the latter is the case, there is always a possibility that a violation has occurred without any personal benefit for the offender (the official).

The specific objective of the CMS is to address the most common forms of abuse. In terms of the above classification this would be **low level (administrative) corruption of all types and violation models**. The reason for choosing such a criterion is expected prevalence that could be registered with random sample techniques: low level (administrative) corruption of all types and violation models. The proxy to these abuses is the occurrence of bribery which is defined as benefit received informally by the agent (the public official) in the form of money, gift or favour. It is an addition to public services clients are entitled to, given the organization of the public service system of a country.

FIGURE 16. CORRUPTION BEHAVIOUR ELEMENTS



### CMS indicators and indexes

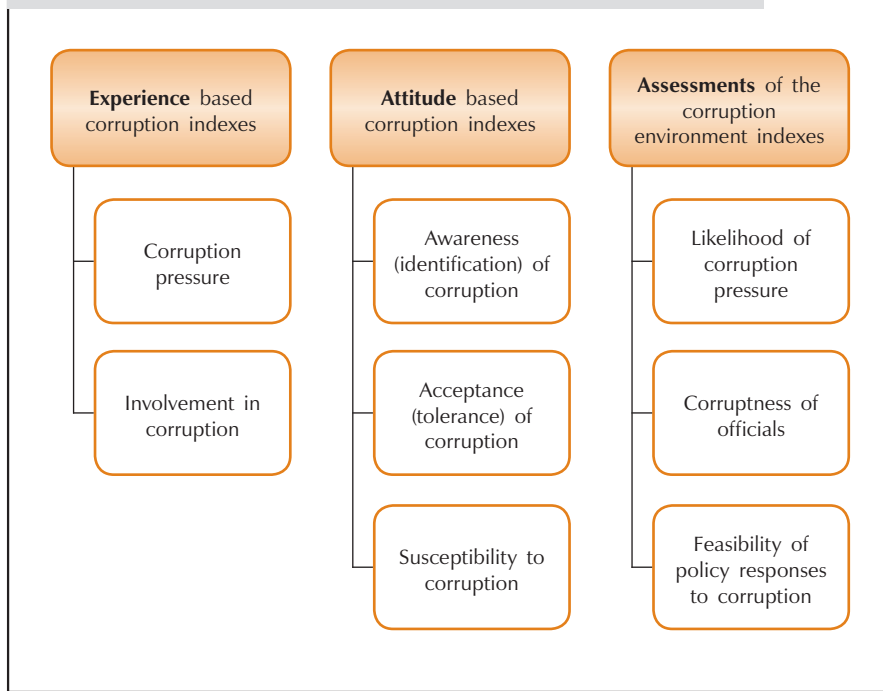
The main indicators of the CMS describe corruption (as a social phenomenon) using three groups of concepts: experience, attitudes, and perceptions (Figure 17).

Information on CMS indicators is collected through a survey questionnaire. Indicators are first decomposed into survey questions and, at the analysis stage, the information is aggregated to form the CMS indexes. This allows for a more robust interpretation of findings and has been a way to keep findings aligned to the theoretical background of the study.

Over the years two methods of aggregation have been used: 1) quasi normalization procedure which calculates individual respondent scores for each respondent and “places” scores on a scale ranging from 0 (“best value” in terms of corruption) to 10 (“worst value” in terms of corruption); 2) direct allocation of respondents into specific (for each indicator) categories. Essentially both procedures render similar results, but have some important differences. The advantages of the first method (normalization), used till 2011, are that all indexes use the same scale and are in this way comparable in terms of values. The disadvantage of the index calculated in this way is that it is not directly interpretable. The conclusions that can be made would be based on time series and evaluation of dynamics over time. However, an index of 0.5 or 5.6 does not directly relate to the content of questions and the specific aspects of the concept it represents. Another disadvantage is that possibilities for statistical analysis of data are largely limited.



**FIGURE 17. STRUCTURE OF THE CORRUPTION MONITORING SYSTEM INDEXES**



The main advantages of the direct allocation method (conditional recoding of variables that compose each indicator) are two. First, results are directly interpretable in terms of content. In this way the index is more or less “self-explanatory” and needs little input explanations as to what is measured and presented. Second, the index variables provide all possibilities for statistical analyses and tests. A limitation in this respect is that index variables are measured on weak scales (nominal).

A comparison of results between quazi-normalization and conditional recoding calculation methodologies is presented below for one of the most

important and widely commented indexes: involvement in corruption transactions.

<b>Experience based corruption indexes</b>	
Involvement in corruption	Involvement in corruption captures the instances when citizens make informal payments to public officials. The concrete questions used to gather information about this indicator are victimization questions and reflect experience during the last year. The indicator summarizes citizens’ reports and divides them into two categories: people without corruption experience (have not given bribes) and people with corruption experience (have given bribes at least once during the last year).
Corruption pressure	Corruption pressure reflects instances of initiation of bribe seeking by public officials: directly by asking for an informal payment or indirectly by “hinting” that informal payment would lead to a positive (for the citizen) outcome. CMS results have shown that pressure has been a decisive factor for involvement. Most corruption transactions occur after the active solicitation of payments by officials.
<b>Attitude based corruption indexes</b>	Direct involvement in corruption transactions is accompanied by the prevalence of specific attitudes towards corruption and corruption behaviour and by perception of the spread of corruption in society. Ideally low levels of involvement in corruption would be paired with negative attitudes towards corrupt behaviour and perceptions that corruption is rare and unlikely. This does not mean that perceptions and attitudes directly determine corruption behaviour of citizens. Rather they could influence behaviour to a certain degree but essentially express the general social and political atmosphere in society related to corruption.

Awareness (identification) of corruption	Awareness (identification) of corruption is an index accounting for the level of understanding of citizens as to what constitutes corruption behaviour. The index differentiates between three categories of awareness: high (citizens who identify all or most of the common corruption behaviour patterns as corruption), moderate (many of the common corruption practices are identified but some forms of corruption are classified as “normal behaviour”), low (few corruption patterns are identified as corruption).
Acceptance (tolerance) of corruption behaviour	Acceptance (tolerance) of corruption behaviour. While awareness captures the knowledge component, acceptability of corruption captures tolerance (or lack of tolerance) towards corruption. It summarizes citizens’ assessments of the acceptability for members of the parliament or the government as well as officials at ministries, municipalities and mayoralities to take gifts, money, favours or receive a free lunch (get “a treat”) in return to solving someone’s personal problems.
Susceptibility to corruption	Susceptibility to corruption reflects the tendency of the respondents to react in two hypothetical situations – one involves being in the role of an underpaid public official and accepting or denying a bribe that was offered, the other situation asks about giving a bribe to a corrupt public official, if one had a major problem to solve and was asked explicitly for a bribe (cash). Declaring the denying of a bribe in both situations is interpreted as the respondent being not susceptible to corruption, accepting/giving a bribe in both is interpreted as susceptibility, while giving/taking a bribe in one of the situations and not in the other is defined as “mixed behaviour”.
<b>Assessments of the corruption environment indexes</b>	The experience with corruption and the attitudes towards corruption, as well as the general current sentiment and level of trust towards public institutions in society determine the public’s assessment of the corruptness of the environment
Likelihood of corruption pressure	Likelihood of corruption pressure is an index measuring expectations of citizens for the likelihood to face corruption pressure in interaction with public officials. Overall this is an index gauging perceptions of the corruptness of the environment. In principle corruption theory considers that people would be more likely to “use” corruption patterns if they assess the environment is intrinsically corrupt.
Corruptness of officials	Corruptness of officials is an index reflecting perceptions of the integrity reputation of different groups of public officials; it thus constitutes an estimate by the public of the corruptness of the various public services. The interpretation of this index is specific, as it is an assessment of attitudes of citizens towards public officials rather than a measure of the prevalence of corruption in the respective offices. The added value of this index is that it helps identify top ranking sectors affected by corruption or being least trusted by the public.
Feasibility of policy responses	Feasibility of policy responses to corruption is an indicator capturing the “public thinking” about policy responses to corruption. More specifically it evaluates potential public trust in the government’s willingness and/or capacity to tackle corruption, as well as the potential support for anti-corruption policies.

## State capture

### Definitions

Hellman, Jones and Kaufman distinguish three types of corruption relationship between the state and the private firms including: **influence**, administrative corruption and state capture.<sup>51</sup> Each of them has specific characteristics which are very important for the understanding of the mechanisms of principal-agent interaction. Influence or lobbying, as is commonly known, represents a firm/state relationship, in which a private interest becomes an agent of influence relying mainly on the firm's owner's ties, size, history of repeated interaction with state officials to persuade the authorities (the principal) to act on their behalf. Hence, relations are determined more by power status, rather than by illicit transactions. **Administrative corruption**, on the other hand, is the act of making private payments to officials to deliberately distort the execution of the (externally) prescribed rules. In this case certain officials act as a tool of the private interests without directly influencing the rule-making procedures.

Administrative corruption thrives when the capacity of the state to provide public goods is insufficient. In other words, this is the form of corruption that occurs in weak democracy where the existing mechanisms of accountability and control do not work. The state institutions function in a perverse manner by the laws of free market competition – the one, who is able to pay the most, receives a good-quality public service. Institutional exploitation is visible also in the judiciary, where in essence prosecutors and judges are not appointed based on objective merit-based criteria but after lobbying from outside private actors. Hence, the judiciary is unable to fulfil one of its main functions to check the power of the executive and interpret the fairness of legislative decisions.

Finally, when **systematic corruption** can lead to a permanent symbiosis between the ruling authorities and private interests, which transforms of state/national interests into private ones and consequently to the state capture. The phenomenon refers to the situation when private interests use corruption to mould institutions in such a way as to preserve a monopoly on resources in key economic sectors. Vested interests are able to influence policy-makers in introducing loopholes built in institutional arrangements. They often use the system of public funds allocation to sustain otherwise largely uncompetitive businesses in strategic economic sectors, where clientelistic networks can exploit enormous rents from the corporate governance of SOEs, the management of large-scale projects, and the allocation of public procurement.

The companies engaging in influencing decision-makers via illicit payments are called **captors**. Their ability to transform laws and change the regulatory framework in their own interest is provoked by their inability to succeed in a competitive environment where innovation and efficiency determine profit margins. Instead they take advantage of the state's preferential treatment, secured through personal connections to politicians. **Victims of state capture** are all kinds of different institutions including the

<sup>51</sup> Hellman, J., Jones, G., & Kaufmann, D. (2000). *Seize the state, seize the day: State capture, corruption and influence in transition*. Washington: World Bank Research Working Paper.

judiciary, the regulatory agencies, the state-owned companies but also the parliament and the executive bodies. Policy-makers that act as agents of such captive oligarchs or themselves being the captors might not at all want to reform the system, which threatens the status-quo.

Most analyses define state capture as illegal or illegitimate influence on the business environments by actors, which have sufficient power to realise such an influence. The most common objective is acquiring economic advantage. The latter is pursued systematically and most often through illegitimate methods. Therefore, the achieved outcomes/results are in most cases also illegitimate. Several problems need to be addressed in this respect. State capture most commonly refers to **basic public functions of modern states** as:

- Providing social services
- Assistance to vulnerable groups
- Maintenance of social, market and political order
- Protection of a given territory

In view of the fact that modern states concentrate about 30-50 % of produced GDP, illegitimate access to this public resource could ensure substantial advantages for certain actors. The immediate benefit of public officials would be private gain, while the benefit for captor actors would be undue illegitimate advantage. The latter includes the violation or bypassing of existing legitimate mechanisms of access to and distribution of public resources. This becomes especially evident when corruption is systemic and coverts into an additional tax for access to public goods. At the macro level such access differentiation mechanism could be summarised as particularism in the access to public resources (precondition) or as violation of good governance principles (result).

**In state capture situations social and market order violations** have several specific characteristics:

- It is enforced by actors with **considerable market or social power** and are most often based in the business sector (i.e. actors are single companies or groups of companies);
- Violations are practiced **systematically** (on a permanent basis);
- Violations result in the **distortion of market order** in favour of certain companies;
- **The means** of achieving market order distortion could vary. Different forms of corruption are often used but are often complemented by other strategies.

For a given actor (captor) capturing the state would practically mean that he is **no longer pressed to conform with market rules and is able to extract undue advantages and/or rents**. He could in this way:

- Acquire monopoly status in a given sector;
- Effectively counter attempts to limit his market power;
- Have privileged access to public resources and effectively block attempts to be deprived of this privilege;

- Be able to ensure legal advantages by modification of rules and legislation;
- Be able to control media and influence public opinion;
- Block investigations or court proceeding against his actions or business.

An institution would be captured, if a certain part of its transactions or services is provided through corruption based transactions (clientelist or other). The real (effective) functions of the public institution are in this way substantially diverted from the formally prescribed. For example, if an institution as the competition regulatory body is captured, it would (though deliberate action or lack of action) fail to counter monopolies or cartel agreements in certain sectors or markets. This is possible in sectors with high minimum capital requirements and few big actors (energy, transport, trade with fuels, construction, garbage collection, etc.), which capture the state to ensure monopoly or cartels. A second possible scenario would be in cases of public institutions where corruption is rampant (e.g. traffic control or customs administration) institutions privatised though mass prevalence of corruption transactions would be a convenient capture target for the first capture scenario (control by big market actors) or an object of exchange in the system of political corruption (high level public officials sell services to captors).

One of the most prevalent practices for capturing the state is through political party financing, which contributes to the symbiosis between political and economic interests. An apt example is the creation of strong clientelistic ties between the major political parties and their regional bases of support.<sup>52</sup> Political parties are often the main tool for capturing institutions via wide-spread nepotism guaranteeing loyalty, on the one hand, and promoting the personal interests of a large group of people, on the other.<sup>53</sup> What differentiates corruption and clientelism is that the former is individual strategic behaviour, while the second is a social structure. Clientelism can occur on its own, but usually they go together, especially in the environment of post-communist countries.<sup>54</sup>

The power that the ruling political parties receive is so great that its structure overlaps with the state structure. Hence, the state structure reflects the operation of the party, whose primary goal is to preserve its electoral position. This leads to the replacement of experts in high positions in state companies or in institutions with party members, whereas appointments are driven by party loyalty and not merit.<sup>55</sup> Moreover, rent-seeking behaviour by politically linked private interests affects the independence of funding bodies, which distort the business environment and skew the process of market liberalization and privatization to benefit third parties. The fusion of corporate and party interests provides opportunities for the captors to extract goods and to consolidate their ruling position and to abuse their power. Along with the power that the

<sup>52</sup> Gërxfhani, K., & Schram, A. (2009). Clientelism and Polarized Voting: Empirical Evidence. *Public Choice*, 305-317.

<sup>53</sup> Pestic, V. (2007). *State Capture and Widespread Corruption in Serbia*. Center for European Policy Studies (CEPS) Working Document.

<sup>54</sup> Stephen Kotkin and András Sajó, *Political Corruption in Transition: A Sceptic's Handbook*.

<sup>55</sup> *Ibid.*

politicians obtain through their posts, their position is also supported by the influence they have over state companies.

Previous research has shown that state capture is prevalent in countries emerging from dictatorial regimes, where democratic institutions are weak and could be easily manipulated.<sup>56</sup> In countries of transition, collusive ties between private businesses and the newly-created public institutions, still governed by the old elite, becomes the basis for the concentration of public resources in private interests.<sup>57</sup> The dismantling of old repressive institutions or practices creates opportunities for skilful actors to use networks and capabilities honed during authoritarian rule to gain control of state resources. This is possible when the regulatory framework of the economy is weak and easily manipulated by and for the private interest. There is a vicious circle between weak governmental structures and state capture, in which the former reinforces the latter in transition countries. The result of state capture of strategic economic sectors combined with weak governance is that legitimate businesses get pushed out of the market leading to a rise of the unofficial economy.<sup>58</sup>

The most commonly used definitions of state capture include the degree of unjustified restriction on competition and unfair concentration of market power. The state can be captured by private or foreign interests; however, in some cases the state can also capture the private sector. Another way of defining the issue is by differentiating between corruption, viewed as overstepping the rules, and state capture, which manifests itself in changing or benefitting from the rules.

Some of the critical indicators of state capture include:

- Legislative amendments to allow public procurement concentration via in-built loopholes
- Judicial dependence
- Clientelism and/or particularism in public procurement
- Regulatory capture for control
- Non transparent party financing

### Outcomes of state capture

Countries in transition usually go through an initial boom that then often gives away stagnation as vested interests prevent a wide-scale economic reform.<sup>59</sup> For example, in the SEE and parts of CEE regions, governance

<sup>56</sup> Hellman, J., Jones, G., & Kaufmann, D. (2000). *Seize the state, seize the day: State capture, corruption and influence in transition*. Washington: World Bank Research Working Paper.

<sup>57</sup> Hellman, J. Kaufman, D. (2000) A). *Confronting the Challenge of State Capture in Transition Economies*. International Monetary Fund Publishing.

<sup>58</sup> Ouzounov, A. Nikolay. *Facing the Challenge: Corruption, State Capture and the Role of Multinational Business*.

Morck, R., Wolfenzon, D., & Yeung, B. (2005). *Corporate Governance, Economic Entrenchment, and Growth*. *Journal of Economic Literature*, 655-720.

<sup>59</sup> Murgasova, Z., Ilahi, N., Miniane, J., Scott, A., & Vladkova-Hollar, I. (2015). *The Western Balkans: 15 Years of Economic Transition*. Washington D.C.: IMF.



deficits and the still pervasive influence of the state in all economic sectors remain a deep-seated obstacle to economic convergence with the EU. State capture impedes high economic growth, motivating rent-seeking economic behaviour based on public funds allocation rather than value-added creation. Deficits in the public funds mismanagement creates prerequisites for systemic corruption in public procurement, which in less-developed economies leads to unhealthy market concentration and detrimental fiscal effects. The capture of public procurement could ultimately result in “misguided selection of projects”, “spending structure distortion” and “distorted political competition”.<sup>60</sup> The latter is directly related to rent extraction, which is facilitated by high-level government officials, while rents-receivers reinvest the corruption proceeds into election campaigns tilting the scales in favour of a particular party, usually the ruling one.<sup>61</sup>

The capture of public funds allocation goes beyond the public procurement sector. The target of well-organized corruption schemes are also state subsidies in key government-regulated sectors such as energy production and distribution, health services, agriculture and even banking.<sup>62</sup> Using relatively little resources, captors are able to reap enormous benefits by shifting the policy of a government towards preferential treatment of one industry.<sup>63</sup> Easing of licensing regimes, the allocation of quotas, the conclusion of long-term agreements with private actors or direct subsidies could be inscribed into law making capture practices legal and often unobjectionable. By creating a legal construct surrounding an economic transaction, captured government officials are able to defend the status-quo and fend any potential allegations against their integrity.

State capture practices could be further legitimized by foreign economic initiatives such as direct loans from international financial institutions for politically-driven projects. This has been one of the critiques of development aid, part of which has in many cases been deviated by government officials to closely-linked firms or most blatantly in their personal bank accounts.<sup>64</sup> State capture also influences negatively the reputation of the country as a safe destination for foreign direct investment. Foreign investors could be potentially deterred from opening businesses in a country driven by wide-ranging corrupt practices.<sup>65</sup> Using

<sup>60</sup> Fazekas, Mihaly and Péter András Lukács. (2015). The political economy of grand corruption in public procurement in the construction sector of Hungary. Report Deliverable from the FP7-funded Anti-Corruption Policies Revisited (ANTICORRP) project.

<sup>61</sup> Piga, G. (2011). A fighting chance against corruption in public procurement? In S. Rose-Ackerman & T. Soreide (Eds.), *International Handbook on the Economics of Corruption*, Volume Two (pp. 141-181). Cheltenham, UK: Edward Elgar.

<sup>62</sup> CSD. (2014). *Energy Sector Governance and Energy (In)Security in Bulgaria*, Sofia, p. 114, p. 34.

Kenny, Charles. (2008). *Grand Corruption in Utilities*. World Bank Policy Research Working Paper No. 4805.

<sup>63</sup> Shentov, O., Stefanov, R., & Todorov, B. (2014). *Anti-Corruption Reloaded: Assessment of Southeast Europe*. Sofia: Southeastern Europe Leadership for Development Initiative.

<sup>64</sup> Bamuamba, Clement B. (2002). *Political corruption in Congo Zaire: Its impact on development*. Saint Mary's University.

<sup>65</sup> Foo, J., Sung, J. (2002). The Impact of Governance Obstacles and State Capture of Transition Countries on Foreign Direct Investment. *The Journal of Business in Developing Nations*.

data from the BEEP survey, the EBRD, IMF, and the World Bank, a 2002 study found an inverse correlation between the level of state capture in a country and the amount of FDI.<sup>66</sup> The influence of infrastructure development and business governance indicators has been isolated to make the results statistically significant. A later paper by Jensen confirmed the results of other research by using the OLS and Tobit models to show that the lack of economic reform and the capture of state institutions by private interests lead to lower FDI flows.<sup>67</sup> In a captured economy, overall economic growth also lags behind as only the captors are able to effectively expand their business, while other market participants stagnate. Even though a capture-free economy that is operating under a liberalized, transparent regulatory framework is likely to benefit all of the population by increasing business opportunities and raising living standards, it would disproportionately affect captor-firms, who do not have an incentive of fostering a competitive system.<sup>68</sup>

Hence, state capture could also be linked with the persistence of poverty and inequality in less-developed countries or countries in transitions. Poverty seems to be closely correlated with administrative corruption as the misallocation of public funds drains the institutional capacity of a country pushing people to seek an alternative way of “getting things done”. In addition, funds earmarked for the improvement of general welfare could often end up in the pockets of captors creating a vicious cycle reinforcing the spread of corruption. The concentration of large amounts of funds in the hands of few well-connected firms consequently breeds inequality.

Finally, state capture fuels the deterioration of transparency standards. Transparency refers to the degree of state’s decision-making openness and degree of disclosure of interactions that could easily influence decisions. Moreover, transparency is a key tool for promoting democratic accountability and the efficient functioning of institutions.<sup>69</sup> The lack of transparency of public transactions allows captors to draft new laws or change existing legislation without public scrutiny. Similarly, the deficit in publicly-available and easily-accessible data about public procurement contracts aids the allocation of enormous amounts of public funds to previously-determined companies. Another apt example is the non-transparent corporate governance of state-owned enterprises, which often do not publish timely financial reports or justifications for key management decisions.<sup>70</sup> More transparency means that trading influence becomes more difficult and carries consequences for the reputation of the captor-firms.<sup>71</sup> The lack of transparency and well-articulated

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<sup>66</sup> Ibid.

<sup>67</sup> Jensen, Nathan. (2006). Economic reform, state capture, and international investment in transition economies. 30 *Fordham Int’l L.J.* 45, December.

<sup>68</sup> Rose-Ackerman, Susan, “Political Corruption and Democracy” (1999). Faculty Scholarship Series. Paper 592.

<sup>69</sup> Hellman, J. Kaufman, D. (2000) A). Confronting the Challenge of State Capture in Transition Economies. In: *Finance and Development*, September 2001, Vol. 38, Number 3.

<sup>70</sup> OECD (2015), *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, 2015 Edition, OECD Publishing, Paris.

<sup>71</sup> Pradhan, S., Anderson, J., Hellman, J., Jones, G., Moore, B., Muller, H., Ryterman, R., Sutch, H. (2000). *Anticorruption in Transition-A Contribution to the Policy Debate*. Washington: World Bank.



democratic representation is not only a consequence of state capture but also a cause for the phenomenon. In a predation model of state-capture, powerful interest groups would tend to take advantage of the transparency deficits and disconnect between the civil society and governing institutions to transform the regulatory environment in their favor. However, by doing this, they are also managing to reinforce bad practices as a way of maintaining the status-quo.

Initial steps to identify the key state capture risk areas (such as public procurement, subsidies, distribution of EU funds, media, civil society, regulatory and judiciary capture), as well as the availability of public data, and form a concept for state capture measuring. Possible ideas for potential measurement tools include:

- Concentration of market power – differentiation between the naturally-produced market concentration and state-capture-driven market concentration.
- Information on contracts, licenses and public resource allocation transparency
- Voters' analysis and election results through the calculation of the capture of voters.
- Embrace a sectorial or area approach to state capture – some possible indicators are public procurement particularism and judicial dependence.
- Checklists on integrity to evaluate governance standards.
- Exploring the content of wiretapped recordings, whistleblowing information to reveal hidden procedures of designing legislation, of judicial dependence, political control over regulatory bodies and public procurement allocation.

At the societal level, state capture characterises a situation where a company has acquired a long term dominant position in a given market or economic sector. Most often this is within the boundaries of the national state. Such dominance is regarded as undue advantage and should (as a rule) be countered by relevant legislation and enforcement institutions. Preconditions for considering the existence state capture would be:

- Absence of natural monopolies;
- Existence of legislation countering all forms of market concentration;
- Existence of institution designed to enforce the legislation.

As such legislation and relevant public institutions exist in all EU countries, the existence of market concentration would imply either poor institutional capacity or deliberate inaction due to corruption or other motivating interests (e.g. political pressure, which also could be motivated by corruption; in such a case the public institution would be agent of corrupt political will).

Some important state capture characteristics include:

- State capture is not a mass phenomenon, as monopoly status could by definition not include many actors. Also by definition captor

companies are a limited number; usually these are companies with substantial market power.

- State capture is systematic and long term. Its objective is to obtain a privileged status (monopoly) and then exploit the acquired undue advantage. In this respect procurement success of companies depending on the political cycle is rather not an indicator of state capture but of mass political corruption and clientelism (short term system of transactions and gain). Politically dependent procurement success would therefore rather be temporary privatisation of the state by the political class than long term privatisation (capture) of the state by big business. In captured states business favourites usually do not change with the change of government.

Analytically state capture could be decomposed into the following elements:

Outcome: market concentration. Illegitimate market concentration is the main indicator for the existence of state capture.

Results: these are processes and effects which are consequences of market concentration and show how market concentration is used. Respectively, what damages (losses) certain market concentrations impose on the public interest or other private interests.

Means: the methods used to achieve the market concentration status (except completion and excellence). The basic channels (methods) to achieve undue market advantage could be:

- Laws or regulations which ensure market advantage or exempt from prosecution (lobbyist legislation);
- Political corruption aimed at influencing the executive or the legislative. In certain situations, access to the judiciary could also be ensured.
- Judiciary corruption to ensure exempt from prosecution or favourable decisions of courts;
- Institutional corruption: buying officials in public institutions to ensure inaction on cases of market concentration and its consequences. The latter could be numerous, ranging from quality of goods and services and ending with violation of tax, customs and other regulations in order to increase profits.
- Corruption in the access to public resources – procurement contracts and subsidies. Important in this respect is that irrespective of the government in power, captors have privileged access;
- Influence on the design of public policies. This includes captors influence on sector policies, economic policy, government budget execution and even foreign policy decisions (lobbying for contacts with specific countries, modification of international agreements to ensure national sovereignty and partial closure of domestic markets).

The combination of corruption forms used to achieve state capture varies depending on the specific situation and governance models in a given country. Therefore, the main (starting) indicator for identifying the existence of state capture is market concentration (by sectors, markets,

etc.). The prevalence of different forms of corruption used to achieve state capture is a secondary group of indicators because they describe the specific mechanisms through which a state capture situation has been achieved or how it operates.<sup>72</sup> State capture is characterised with the concentration of means (forms of corruption) around a limited group of actors. In this respect research on state capture should necessarily start with the outcome indicators (market concentration). State capture is privatization of the state, or rather privatisation of certain state functions. In some countries (e.g. Russia) a reverse process has also been observed – when government agencies or institutions are used by politicians to extract undue advantages from businesses.

### State capture diagnostics areas

State capture is to a large degree hidden phenomenon and is closely connected to governance mechanisms. At present it reaches top level officials in the executive, judiciary and the legislative. It is therefore difficult to directly address state capture phenomena. Rather the **initial focus should be on major outcomes of state capture in critical sectors and zones.**

The approach outlined below is incremental. Its first target would be the **mapping of the most common state capture critical zones** (procurement and market concentration). Depending on the results further research would sequentially focus on captured institutions and prevalence of state capture mechanisms/practices. An important characteristic of **initial state capture diagnostics** is that it should be **based on sectors or institutions.**

### State capture risk zones

The principal risk zones for state capture that would be relatively easy to assess (based on big data analysis instruments) are procurement and market concentration.

State capture in **procurement** could be analysed by sectors and would characterise a situation when companies or group of companies:

- Concentrate (attract) predominant volume of procurement in a given market on a systematic basis;
- Companies have exceptionally high success rates in procurement tenders on a long term basis;
- Changes of government lead to substantial changes in the successful bidders in a given procurement market.

Once some elements of the above situation are identified, further research would be necessary to explore what mechanisms (means) of state capture have been deployed: political corruption, legislative corruption (favourable amendments in legislation), blocking of the activities of

<sup>72</sup> Furthermore, prevalence of capture related form of corruption could show a mass phenomenon which could be randomly distributed among actors (pointing to different forms of corruption) and not concentrated at specific actors (capture).

control institutions (oversight bodies, tax and customs administration, etc.), judiciary corruption (blocking investigation, prosecution and court efforts to identify and sanction violation of laws).

State capture resulting in **illegitimate market** concentration should also be explored by sectors. State capture in this respect would include:

- Existence of sectors with monopolies and/or cartels in the long term
- Failure of government control bodies to identify and sanction illegitimate market concentration
- Deliberate government or legislative activity facilitating establishment or continuing existence of market concentration
- Failure of law enforcement to sanction/counter market concentration or use of law enforcement to undermine competition

State capture resulting in continuing **“smooth operation” of big black and grey markets** (drugs, smuggling, trafficking of people, VAT and other types of tax fraud, substantial volume of organised crime operations).

### Captured public institutions or institutional areas

A captured public institution could exist in two principal situations:

- 1) **Institutions which are critical in countering different types of fraud or other types of violation of rules** that enhance various forms of state capture. In this respect critical institutions that could be targeted are related to procurement, competition, enforcement of industry and trade standards, tax administration and judiciary.
- 2) **Institutions with important controls or other social functions but have been “privatised” by their respective officials.** This situation is tolerated by the government as these institutions are also part of the state capture mechanism. The main indicator in this respect is the level of institutional corruption and respectively of corruption pressure associated with captured institutions. Common problematic institutions in post-communist countries are traffic police and other police departments, customs, some parts of the health care system.

Instrument that could be used in the diagnostics of this type is **MACPI**.<sup>73</sup> The instrument focuses on corruption pressure and corruption mechanisms at the **institutional level**. It evaluates the level of corruption risk, the prevalence of corruption risk related interactions inside the public institution and the existence of anticorruption policies. In this respect high corruption risk in combination with intensive corruption related internal transactions of officials and lack of effective anticorruption measures is the **indicator of a captured institution** (either privatised by insiders and offering corruption services or captured by outsiders to protect their interest).

<sup>73</sup> A Stoyanov, A Gerganov, A Di Nicola, F Costantino (2015) Monitoring Anti-Corruption in Europe. Bridging Policy Evaluation and Corruption Measurement. Center for the Study of Democracy.



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