

**SERIOUS AND ORGANISED
CRIME THREAT
ASSESSMENT
2010 – 2011**



**CENTER FOR
THE STUDY OF
DEMOCRACY**

The report *Serious and Organised Crime Threat Assessment (SOCTA)* analyses the current state and trends in serious and organised crime in Bulgaria. The report estimates the threats generated by these criminal activities and ranks them according to the harm they cause Bulgarian society. The analysis is intended to support a better informed evidence-based design of anti-crime policies.

The report has been produced in cooperation with General Directorate Combating Organised Crime and General Directorate Criminal Police of the Bulgarian Ministry of Interior, the Bulgarian National Revenue Agency, and with the expert input and advice from the UK Serious and Organised Crime Agency, the National Police Services Agency of the Netherlands, the Federal Judicial Police of Belgium, the Criminal Police of North-Rhine Westphalia, the Swedish Customs, Europol and the UN Office on Drugs and Crime (UNODC).

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EXECUTIVE SUMMARY

The organised crime threat assessment (OCTA) is the basis for the development of strategies and action plans for countering organised crime in the US and many countries in Western Europe. Such assessments are now a standard tool to assess the scale and nature of the threats and to allow formulating political and operational priorities for countering organised crime.

The European Union (EU) Serious and Organized Crime Threat Assessment (SOCTA) to be produced in 2013 will be the core element of a new 2013 – 2017 policy cycle in an effort to counter serious and transnational organised crime.

The Bulgarian Serious and Organised Crime Threat Assessment is the result of a public-private partnership between national law enforcement institutions and the Center for the Study of Democracy (CSD). The assessment was supported by DG Combating Organised Crime (DGCOC), DG Criminal Police (DGCP), the National Revenue Agency (NRA), the Customs Agency, the State Agency for National Security (SANS).

The current assessment draws on information provided by DGCOC, NRA and DGCP. Furthermore, a number of meetings and discussions were held with investigators from DGCOC and DGCP in the country, prosecutors, representatives of NRA and the Customs Agency, as well as with experts from the private sector. The assessment used a wide range of public record sources, statistical data, as well as the results from the National Crime Survey (NCS), conducted annually by the CSD.

The analytical approach adopted uses the terms **illegal markets** and **illegal activities** to define the scope of the assessment of organised crime. This allows for the inclusion not only of threats from specific criminal groups and individuals, but also a wider range of actors and threats that may be part of the legal economy and that require administrative and legislative measures to counter them.

The period reviewed in the current assessment (2010 – 2011) was marked by the beginning of the economic crisis in Bulgaria. As such, it was characterized by a significant rise in unemployment and an increase of street crime for the first time in 10 years. The analysis provides an assessment of the threats from serious and organised crime and outlines the criminal potential, the size of the profits from criminal activity and trends in the development of illegal markets. The 12 most significant organised criminal activities generated around €1.8 billion in annual turnover which is equivalent to 4.7% of the country's GDP. This ratio to the GDP indicates that the criminal economy generates much lower turnover compared to the period prior to Bulgaria's EU accession. At the same time, such size of the illegal economy poses a serious threat.

The convergence of white collar and organised crime is a key threat for Bulgaria. **This convergence has a particularly dangerous form of corporate crime, popularly known as “oligarchy”.** During the 1990s and the early 2000s, **political corruption facilitated the rise of such economic conglomerates, which later continued to use criminal methods to exploit public resources and commit tax crimes.** In some cases, the participants in this type of “crime of the elites” have also been directly linked to various other forms of traditional organised crime (distribution of drugs, the market for prostitution, VAT and excisable goods fraud).

In addition to the financial dimension of criminal markets, the **level of violence** is another critical aspect in the assessment of the actual threats from organised crime in the country. This problem had a strong impact on the political process and on the European Commission’s evaluation of the fight against organised crime in Bulgaria. The main reason is the use of violence by the so-called ‘violent entrepreneurs’ during the 1990s and the large number of publicly executed contract killings of organised crime figures. The rates of criminal bombings and homicides attributed to organised crime have been on the decline since 2001, while the number of contract killings has been steadily falling since 2003.

The trends in the development of organised criminal activities in 2010 - 2011 are divergent because **criminal markets adapt to the economic crisis in different ways.**

The most profitable organised crime activity – organised prostitution and trafficking in human beings – has contracted due to the economic turmoil in Southern Europe (Spain and Greece in particular). This criminal activity still generated the largest revenues for Bulgarian criminal networks amounting to nearly €650 million per year. In 2011, the domestic consumption of sex-services recovered from the decline in 2009 and 2010. Most revenues from the domestic market are generated by foreign visitors to Bulgaria. The continuous increase in the number of foreign visitors drives higher the levels of consumption of sex services. **The internet technologies are increasingly used by criminal networks** to offer sex services, as well as to recruit and control prostitutes. The internet guarantees greater anonymity and hinders control by law enforcement institutions, posing serious risks in the future.

The trafficking and distribution of drugs continue to pose a threat to society. Heroin trafficking through Bulgaria registered a decline in the past years due to three main factors. First, traffickers increasingly prefer alternative routes over the old Balkan route, such as the Turkish-Greek border, or through the former Soviet republics. The drop in the volumes of trafficked heroin was also due to the problems with the poppy crops in Afghanistan in 2010 and the arrests of key actors in the trafficking networks. The twofold drop in domestic sales compared to the pre-2007 period is compensated by rising numbers of users who turn to available substitutes programs. As a result, the hierarchical structures which controlled the drug market in Bulgaria until 2008 have been dismantled. In 2011, the consumption of other types of psychoactive substances (marijuana, synthetics and cocaine) recovered after a sharp drop in 2009 and 2010. The size of the **domestic drug market in 2011** is estimated at **about €180 million.**

VAT fraud related to organized crime is estimated at €350 million for 2010. VAT fraud significantly affects the competitiveness of legitimate companies that

pay their taxes. Such VAT fraud schemes are characterised by a high degree of complexity involving multiple companies and actors. The participants in fraud schemes have high social status and potential for influence over society, since many also operate in the legal economy. After a peak in 2008, the size of VAT fraud dropped by 30%, which can be explained by the impact of the economic crisis, but also by the intensified pressure by the NRA, the Ministry of Interior and SANS. However, the levels of losses incurred remain high and reach 10-11% of the VAT revenues. A good indication for the scale of this problem is the fact that, according to the NRA, nearly 20% (or about 30,000) of all active VAT-registered companies in the country are involved in different forms of VAT fraud. Bulgaria's EU accession was followed by a significant growth in international fraud schemes (e.g. missing trader intra community or "carousel" fraud). The international VAT fraud grew almost twofold – from 8% of all losses caused by VAT fraud in 2006 to 19% in 2009.

During the economic crisis the **trade in illegal cigarettes** became one of the fastest growing organised criminal activities. Within two years the size of the market tripled and in 2010 reached €250 million or 30%-40% of all tobacco products. The main threat stemming from this development is that organised crime established resilient and mutually beneficial relationships with transnational criminal networks, which provide continuous input of illegal cigarettes towards the EU countries. At the same time, the mass scale of everyday consumption of tobacco products created a significant (for the size of the country) illegal sector with 400-500 thousand consumers of illegal cigarettes and more than 15 thousand participants in criminal distribution networks. Although in 2011 the sales of illegal cigarettes dropped by 20%, this criminal market continues to pose a serious risk for the state budget. **Excise duties and VAT revenues from tobacco products provide for 10% of all budget revenues**, while in many EU countries this share is around 1.4%.

The size of **the market for illegal oil products controlled by organised crime** is comparable to the size of the illegal cigarettes market. The current assessment shows that the illegal diesel fuel accounts for nearly 95% of the illegal market for oil products. In 2007 - 2009 between 33% and 39% of the diesel fuel was sold without payment of excise duties and VAT. The losses to the state budget incurred through these sales in 2011 can be estimated at €300 million in unpaid excises and €240 million in unpaid VAT. The illegal sales of diesel fuel generate between €280 million and €430 million in revenues per year. About 50% of these run through criminal networks, some of which include both legitimate fuel distributors and criminal entrepreneurs. As many end users of oil products are big construction or transportation companies, this leads to unfair competition in these economic sectors.

The present *Serious and Organised Crime Threat Assessment* also examines a number of criminal activities that represent lower degree of threat: counterfeiting of payment means and bank-card fraud, loan sharking and extortion racketeering, and vehicle theft.

An intersection point of all these criminal activities is the use of **corruption**, as well as the **laundering of proceeds of crime**. Organised crime in Bulgaria continues to use corruption as an instrument to facilitate criminal activities and to evade criminal prosecution. There is strong evidence that over the past several years corruption related to drugs and prostitution markets has substantially

declined. The illicit cigarettes trade and VAT fraud generate significant corruption within law enforcement, state and local administration, and local level political parties.

The revenues from criminal activity remain high despite the worsened economic conditions. The greater part of the criminal networks in Bulgaria also operates legal business structures, which facilitates the legalisation of criminal proceeds. **The level of penetration of organised crime into the legal economy is significantly higher** than the levels in Western Europe.

The current analysis outlines a number of new threats. One of these is the emergence of large **resilient criminal networks for illegal distribution of tobacco products**, which have the potential to establish a criminal infrastructure to be used by other forms of organised crime. Another category of threats is associated with the use of **new technologies** in offering sex services, bank card fraud, vehicle theft, etc. As a result of increasing migration flows globally and the difficult situation at the Greek-Turkish land border in 2011, Bulgaria's entry into the Schengen area may lead to higher pressure from secondary illegal migration at the Bulgarian Greek border. Last but not least, there is a risk of new forms of trans-border tax and customs fraud stemming from the increased socio-economic tensions in Greece.

FOREWORD

Following the adoption of the *National Security Strategy* and the *Integrated Strategy for Preventing and Countering Corruption and Organised Crime*, the Bulgarian government developed a detailed *Action Plan for Preventing and Countering Organised Crime* which tasks the respective government institutions with submitting a *Serious and Organised Crime Threat Assessment (SOCTA)*. This assessment should inform the design of policies and specific operational plans for countering organised crime. It is an important part of a European-wide cycle of policy development in this area.

The *Hague Programme for Strengthening Freedom Security and Justice in the European Union*¹ defined the combat and prevention of organised crime as a priority in the framework of the Community policies. Both the Implementation Plan of the Programme² and the Commission Communication to the Council and the European Parliament of 2 June 2005³ set the task of developing a strategic concept for countering organised crime based on prevention, on a proactive information and intelligence data gathering and on cooperation between law enforcement and the judiciary, third countries and organisations. These steps started the process of developing the European Organised Crime Threat Assessment (OCTA).

The conclusions of the Hague Programme called for Europol's OCTA to become a **key element of the proactive European model of fighting crime** (European Crime Intelligence Model). This was followed by the launch of the Harmony Project⁴ by the Belgian Presidency of the EU in 2009. It has aimed at integrating the EU instruments already in existence (including the OCTA) within a more consistent and effective approach. In line with the Harmony Project a decision was adopted to introduce a new policy cycle in an effort to counter serious and transnational organised crime for the period 2013 – 2017. This cycle and the future concrete operational plans will benefit from the new edition of the Serious and Organised Crime Threat Assessment (SOCTA).⁵

¹ Council of the European Union, Brussels European Council, Presidency Conclusions: Annex 1 – *The Hague Programme for Strengthening Freedom, Security and Justice in the European Union*, Brussels, 4/5 November 2004.

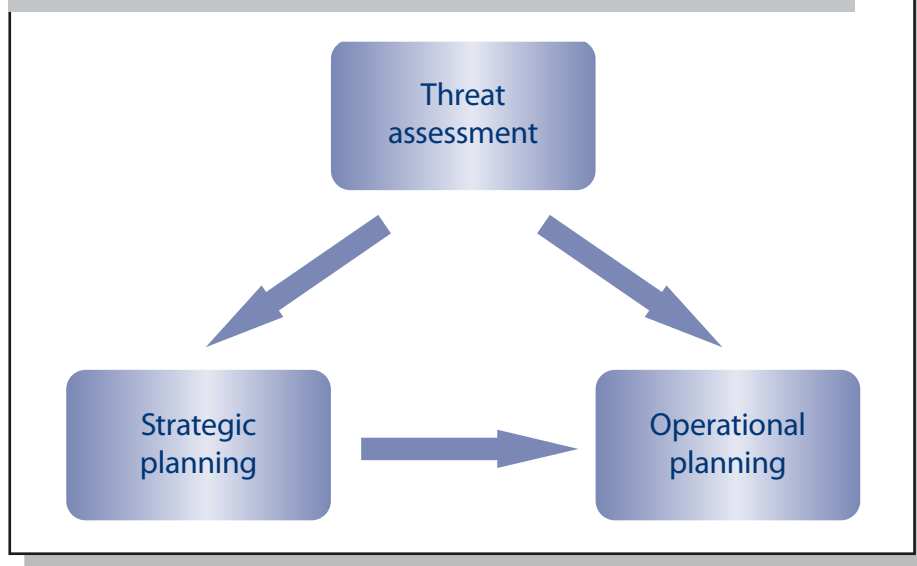
² European Union, *Council and Commission Action Plan implementing the Hague Programme on strengthening freedom, security and justice in the European Union*, Official Journal of the European Union (C 198/1) on 12 August 2005.

³ Commission Communication to the Council and the European Parliament of 2 June 2005: "Developing a strategic concept on tackling organised crime" [COM(2005) 232].

⁴ European Council conclusions on the creation and implementation of an EU policy cycle for organised and serious international crime, 3043rd Justice and Home Affairs Council meeting, Brussels, 8 and 9 November 2010.

⁵ Council of the EU (2010), *Council conclusions on the creation and implementation of a EU policy cycle for organised and serious international crime*, 3043rd Justice and Home Affairs Council meeting Brussels, 8 and 9 November 2010.

FIGURE 1. PLANNING STAGES OF THE FIGHT AGAINST SERIOUS AND ORGANISED CRIME



The Bulgarian SOCTA assesses the current threat of organised crime and estimates future risks. It draws a map of the threats for the country stemming from key crime areas and ranks them according to the harm they cause to Bulgarian society. Such prioritisation informs policy options and facilitates an optimal distribution of financial and human resources in the combat against organised crime.

The process of developing the Bulgarian SOCTA

What makes the present assessment different from past ones (for example the Ministry of Interior contribution to the Europol's OCTA) is the process of its development and the methodology used. Following the best European practices, the present assessment for the first time represented the outcome of cooperation between all relevant law enforcement agencies, as well as a private-public partnership. The assessment was developed through information and collaboration provided by representatives from the General Directorate Combating Organised Crime (GDCOC), General Directorate Criminal Police (GDPCP), the Customs Agency, the National Revenue Agency (NRA), and the Center for the Study of Democracy.

Numerous interviews were also carried out with intelligence officers and police investigators from the GDCOC and the GDPCP, as well as prosecutors and representatives from the NRA, the Customs Agency and the private sector. Additional interviews were also conducted with representatives of NGOs and with some offenders. The report also benefited from different research papers and used statistical data from the National Crime Survey (NCS).

In the process of elaborating the Bulgarian SOCTA expert advice was sought from representatives of several law enforcements institutions within the EU: the UK Serious and Organised Crime Agency (SOCA), the National Police in the Netherlands (Korps landelijke politiediensten), the Belgian Federal Police (Police judiciaire federale), the Criminal Police of North-Rhine Westphalia (Landeskriminalamt Nordrhein-Westfalen), the Sweden Customs Office, Europol and the UN Office on Drugs and Crime (UNODC).

Scope of the assessment

Assessing the threat from organised crime requires a clear definition of the scope of the terms ‘serious’ and ‘organised’ as descriptions of crime in Bulgaria. The concepts used in such an analysis should be clearly distinguished from popular clichés or political rhetoric – such as ‘mafia’ – mostly influenced by Bulgarian and foreign media. The report also avoids traditional criminological definitions of ‘organised crime’ that are based on long lists of descriptive characteristics.

The analytical scope was widened to base the assessment on terms such as **illegal markets** or **illegal activities**. This approach permitted to identify not only the threats emanating from particular criminal groups and persons, but from a broader array of legitimate or grey economy actors who may be involved in the provision of illicit goods and services or contribute to the commission of an illegal activity. This allows policy makers to consider not only law enforcement measures but also other policy options for countering organised crime.

The definition of ‘organised crime’ adopted in this report also takes into account the slightly different meaning that this term implies in Bulgaria, in comparison to much of Western Europe or the US. The transition from centralised to a market economy and from one party system to a democracy created an environment linking criminal networks and legitimate companies in a **sympiosis between typical organised crime activities** (drugs, prostitution, contraband) and white-collar crime (tax, privatisation, public procurement fraud, political corruption). Therefore, serious fraud is an integral part of the present assessment.

One aspect of the assessment that requires a caveat is the impact of **counter-organised crime policies and actions**. There are certain radical changes in such policies and actions that may impact and significantly reduce the threat from organised crime. In the presentation of some of the data this assessment takes a historic perspective. In such instances the significant changes in counter-organised crime policies may explain the shifts in the level of the threat from organised crime. The analysis only notes the impact of such radical policy shifts and does not assess the ongoing regular counter-organised crime policies.

Report structure

The Bulgarian threat assessment was developed in several phases. The first phase consisted of a preliminary and broad research of crime data which fall within the serious and organised crime categories. In the second phase, an analysis was carried out to determine which key criminal activities or illegal markets posed the greatest threat. The last phase was dedicated to additional in-depth analyses of intelligence data and open source materials (statistical, market, criminological research).

Eight key illegal markets and activities were identified as causing the greatest harm to the economy and society. The first group of threats encompasses traditional organised crime activities (human trafficking and prostitution, drug-related crimes). The second group of threats is related to crimes against the tax system (excise and value-added tax frauds) and the illegal cigarettes trade. Two other areas – loan-sharking and counterfeiting of payment means were analysed with regard to the harm they inflict on the democratic process and the country’s

image. These are followed by motor vehicles theft. Finally, the report presents one horizontal issue, which represents the meeting point of all the criminal activities, namely money laundering.

There are a number of organised criminal activities and illegal markets that remained outside the assessment: trafficking of cultural goods, environmental crime, telephone fraud,⁶ some forms of economic crime, etc. They have been excluded for two reasons: either the preliminary analysis showed that the harm from them is not significant; or that the available data and analytical methods did not allow for a sufficiently robust assessment of the threats and harm.

⁶ This is a widespread type of fraud where victims (usually elderly citizens) are contacted by phone and are defrauded into giving large sums of money on the pretext that their family members have been in a road accident and money needs to be immediately paid to defence lawyers or police. The 2011 National Crime Survey showed that 25% of the population have received such fraudulent calls.

1. THE DYNAMICS AND CHARACTERISTICS OF ORGANISED CRIME

The period reviewed in the present report – 2010 and 2011 – was highly dynamic due to a number of socio-economic and political factors. **Bulgaria's accession to the EU in 2007 opened a wide range of new opportunities for criminals**, such as tax crimes, which prompted part of the criminal networks to shift their focus towards these new illegal activities. At the same time, 2009 was the beginning of the economic crisis in Bulgaria and a period of growing unemployment which continued throughout 2010 and 2011. Therefore, in 2009 – 2010 registered crime and crime victim surveys showed for the first time in ten years an increase. The recovery of the Bulgarian and the European economies led to a drop in crime rates in 2011.

At the same time, **some illegal markets followed different trends**. The figures below provide data on two key criminal markets, drugs and sex services, which allows for an assessment of the impact of the economic crisis.

The figures indicate that in 2011 the drugs market recovered from the sharp decline in 2009 and 2010, and returned to the pre-crisis levels of 2008. The trend in the sex services market is similar, where in 2011 the number of services used even slightly exceeds the 2008 levels.

FIGURE 2. PERCENTAGE OF THE ADULT POPULATION WHO CAN GAIN ACCESS TO ONE OF THE FOUR MAIN GROUPS OF PSYCHOACTIVE SUBSTANCES (HEROIN, COCAINE, AMPHETAMINE, CANNABIS)

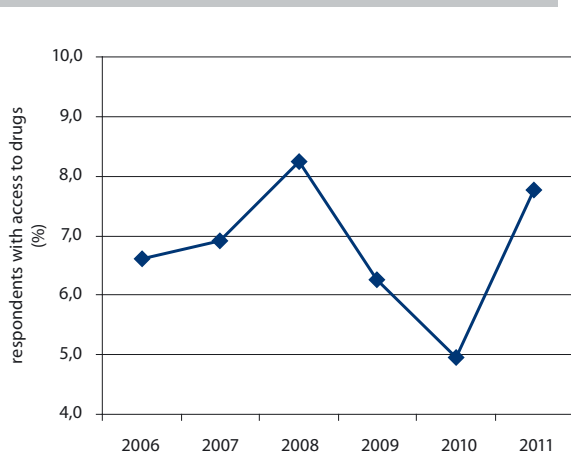
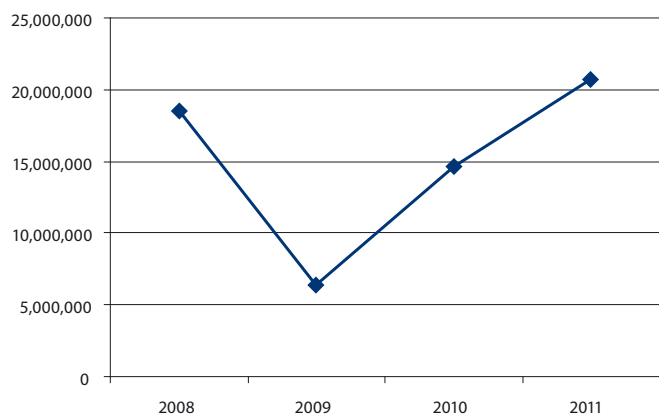


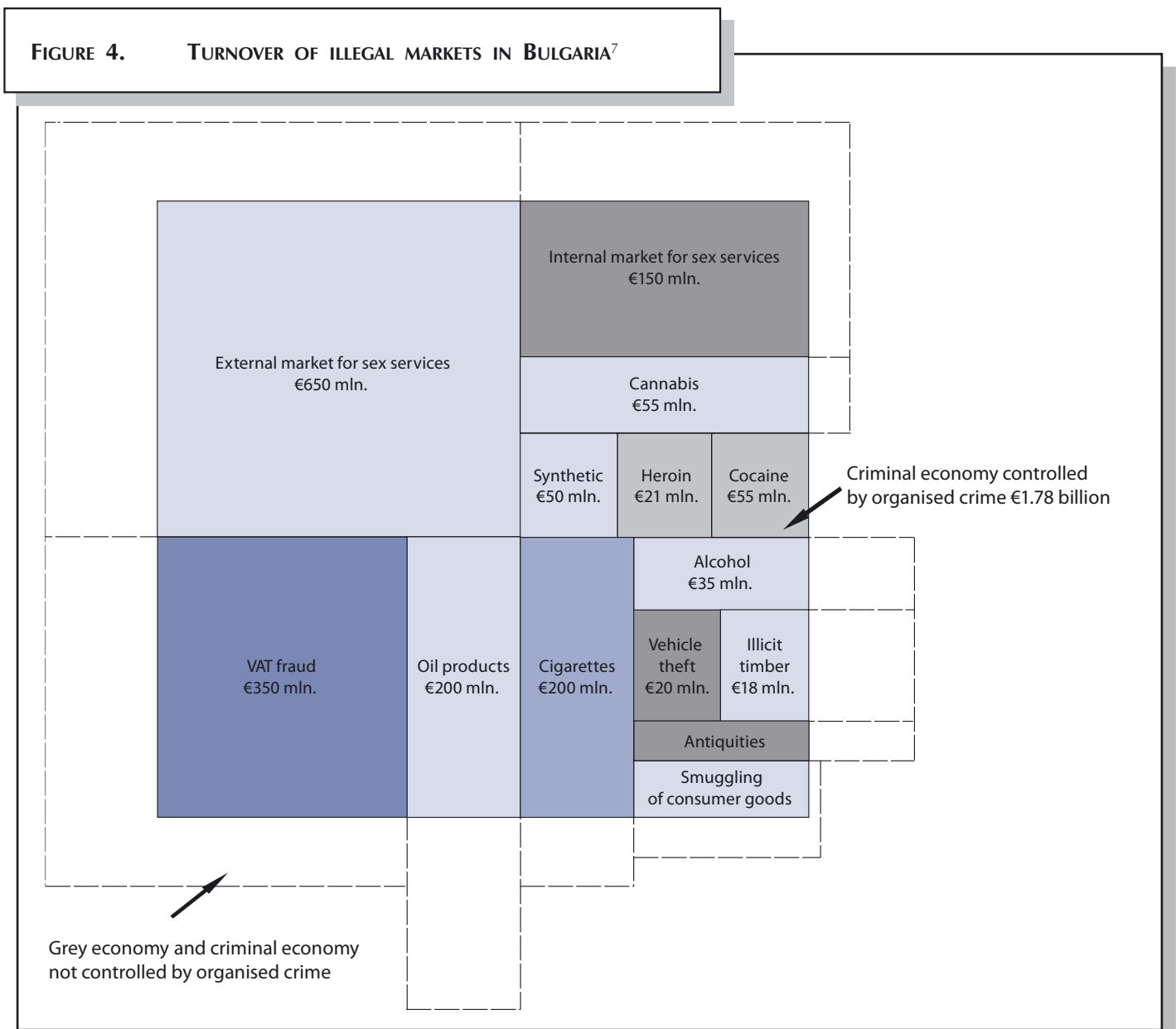
FIGURE 3. REVENUES FROM SEX SERVICES PROVIDED TO BULGARIAN CUSTOMERS (BGN)



Source: Analysis of data from the National Crime Survey

In 2009 and 2010, there were indications of a decreasing trend in other criminal markets. Vehicle theft, illegal alcohol trade and VAT fraud also decreased. An exception to this tendency was the sale of illegal cigarettes, where the market started to grow in 2009 and reached a peak in 2010, followed by a subsequent decline. The market for illegal financial services (loan sharking) also registered a continuous growth over the past few years.

The size of the illegal markets in the country defines the potential (or the limitations) of Bulgarian organised crime. The 12 most significant organised criminal activities generated around €1.8 billion in annual turnover (see Figure 4), which is equivalent to 4.7% of the country's GDP. Such levels pose a serious threat to the country's development.



⁷ This is only an illustration aiming to provide a general idea about relative revenues. Throughout the report estimates and ranges are provided and explained in more detail.

The assessment of the size of illegal goods and services controlled by organised crime allows for an estimate of the number of organised criminals involved. The persons involved in organised crime networks in 2010 – 2011 ranged between 4,000 and 5,000. The sectors with the most participants were the sex services and trafficking in persons (1,500 – 1,800 involved), the cigarettes market (1,400 – 1,600 persons dealing in wholesale) and the drugs market (1,000 – 1,200 drug dealers at all levels).

There are a number of other persons gravitating around this core group of criminals within each illegal market (especially in the smuggling and sale of consumer goods, including cigarettes, illicit alcohol, etc.), **who operate within the grey economy**. They support the functioning of the illegal market by committing a wide range of administrative violations usually not classified as crimes. In practice, however, without this infrastructure at the lowest level – constituted of a large number of socially marginalised individuals – the functioning of criminal markets would be impossible. A case in point is the distribution of illegal cigarettes, where between 5,000 and 7,000 street vendors of small quantities can be sanctioned only by an administrative penalty.⁸

The existence of this wider group of participants, typical for the lowest levels of the criminal markets, often creates the impression that there is no proper organisation. This layer is **the periphery of organised crime**. Some illegal goods and services (cigarettes, sex services, cannabis, oil products) are provided by participants who work for themselves and are not part of organised crime. They take advantage of a criminal 'ecosystem' flourishing around the core of powerful criminal organisations but manage to evade control over long periods, or pay a type of criminal rent in exchange for access to lucrative markets or for protection, usually from the competition or from prosecution. Together, these informal and illegal economic activities flow into the grey economy which is equivalent to 25 – 30% of the country's GDP, or between €9.7 – 11.7 billion for 2011.⁹

1.1. Structure and illegal markets

The functioning of **criminal organisations would be impossible without the supporting activities in the grey sector** and largely depends on the symbiosis and permeability among the criminal, grey and legal economies. The laundering of criminal proceeds¹⁰ and operation in the legal economy through legitimate businesses are typical for any bigger criminal structure. Another *modus operandi* is to maintain a wide network of different intermediaries or offshore entities which are used as proxies of the actual ownership of major Bulgarian companies. Figure 5 illustrates the share of and the links between the different segments of the Bulgarian economy.

The tobacco market is a case in point. Tobacco companies in the legal market create or exploit two different types of distribution networks. The first involves

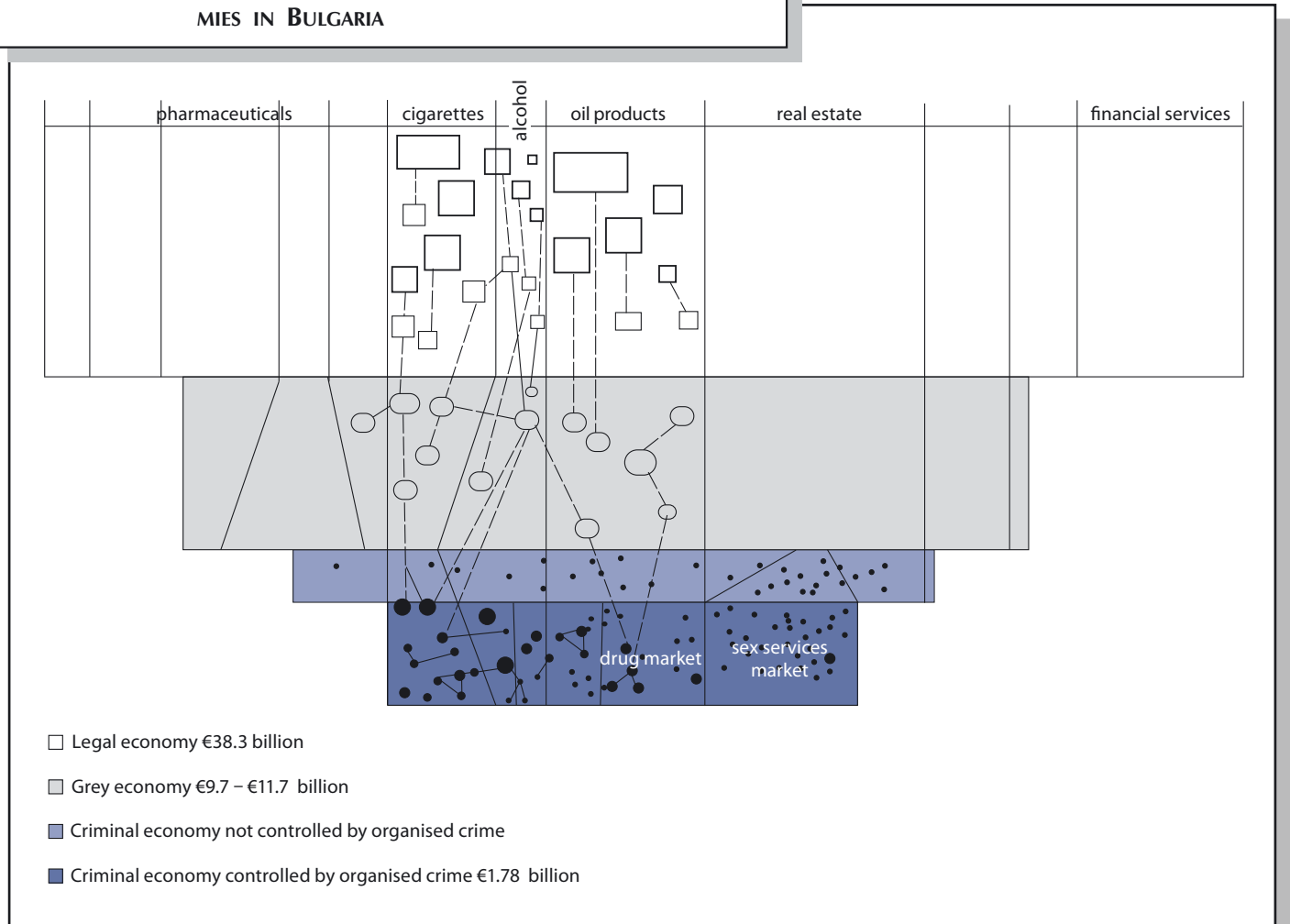
⁸ A similar problem exists in nearly all the EU member-states like Germany, France, UK, Italy and other West European states where street cigarettes sellers are immigrants from developing countries.

⁹ Center for Study of Democracy (2011), *Dynamics of the Hidden Economy in Bulgaria and the Global Economic Crisis*, Sofia: CSD.

¹⁰ Indications of property acquisitions exists in several sectors in the legal economy in Bulgaria, but also in a number of other EU member-states.

withholding the payment of some VAT through distribution companies which can be defined as grey enterprises. The second network is a purely criminal scheme involving the sale of established cigarette brands without paying excise and VAT through a periphery of criminal companies. This example also shows how criminal structures from one illegal market are linked to criminal networks from other black markets.

FIGURE 5. THE STRUCTURE OF THE CRIMINAL-GREY-LEGAL ECONOMIES IN BULGARIA



The intertwining of big corporations and distribution companies from the grey and illicit markets is an example of a key threat – the convergence of white collar and organised criminals. **High level corporate criminals known as ‘oligarchs’** operate not only in Bulgaria but in most of Eastern Europe. Behind their legitimate corporate façade, oligarchs may be directly involved in criminal activities (VAT or excisable goods fraud, etc.) and rely heavily on illicit lobbying and corruption in their usual business practices. During the 1990s and the early 2000s, **political corruption facilitated the rise of such economic conglomerates**, initially via rigged privatisation deals, and later **continued to exploit public resources** through rigged public procurement tenders. Unlike Western Europe and the US, in Bulgaria white collar criminals may be directly linked to various other forms of organised crime.

There are two major threats emerging from this constellation. The first is related to the inability of law enforcement and the judiciary to reach **the top levels of organised crime**, as these largely **reside in the legal economy and have political leverage**. As a result, whenever law enforcement institutions effectively crack down on low-level criminal structures these are immediately re-established by the structures at the higher levels. The second important threat is related to the persistent public and media perception that some big Bulgarian economic entities are involved in organised crime. This perception is often exploited by political parties who tacitly favour some and publicly denounce other oligarchs thus seeking populist effects.

1.2. Corruption and violence

Apart from the financial dimension of criminal markets, the level of violence is another critical aspect in the assessment of the actual threats from organised crime in the country. The violence used by the so-called 'violent entrepreneurs' during the 1990s and the large number of murders of individuals associated with organised crime between 2000 and 2007 had a strong impact on the political process in the country, as well as on the European Commission's evaluation of the fight against organised crime in Bulgaria (see Figure 6).

Decline in violence is usually indicative of attempts by organised crime to regulate illegal markets and settle accounts through other means. Over the last decade, organised crime in Bulgaria has undergone a transformation. The conversion of criminal capital into legitimate business structures led to greater demand and potential of corruption as an instrument. On the one hand, corruption is a tool that can be used to regulate criminal markets through corrupting law enforcement. On the other hand, corruption is used to settle business conflicts (through leverage in the judiciary) and to take control of additional economic resources (through manipulation of public procurement).

Unlike petty corruption which is measured by various survey methods, there are no widely used methods to measure corruption used by organised crime. The corruption mechanisms and schemes used by organised crime in Bulgaria are not very different from those identified in other European countries.¹¹ EU member states register varying levels of this type of corruption. In Spain, for example, it was identified that 17% of crime groups use corruption as a tool to exert influence¹². In Belgium, 23% of crime groups are likely to use some form of influence, with the private sector, police and customs named as most affected.¹³ Analysis of a sample of 104 criminal groups unveiled that information about

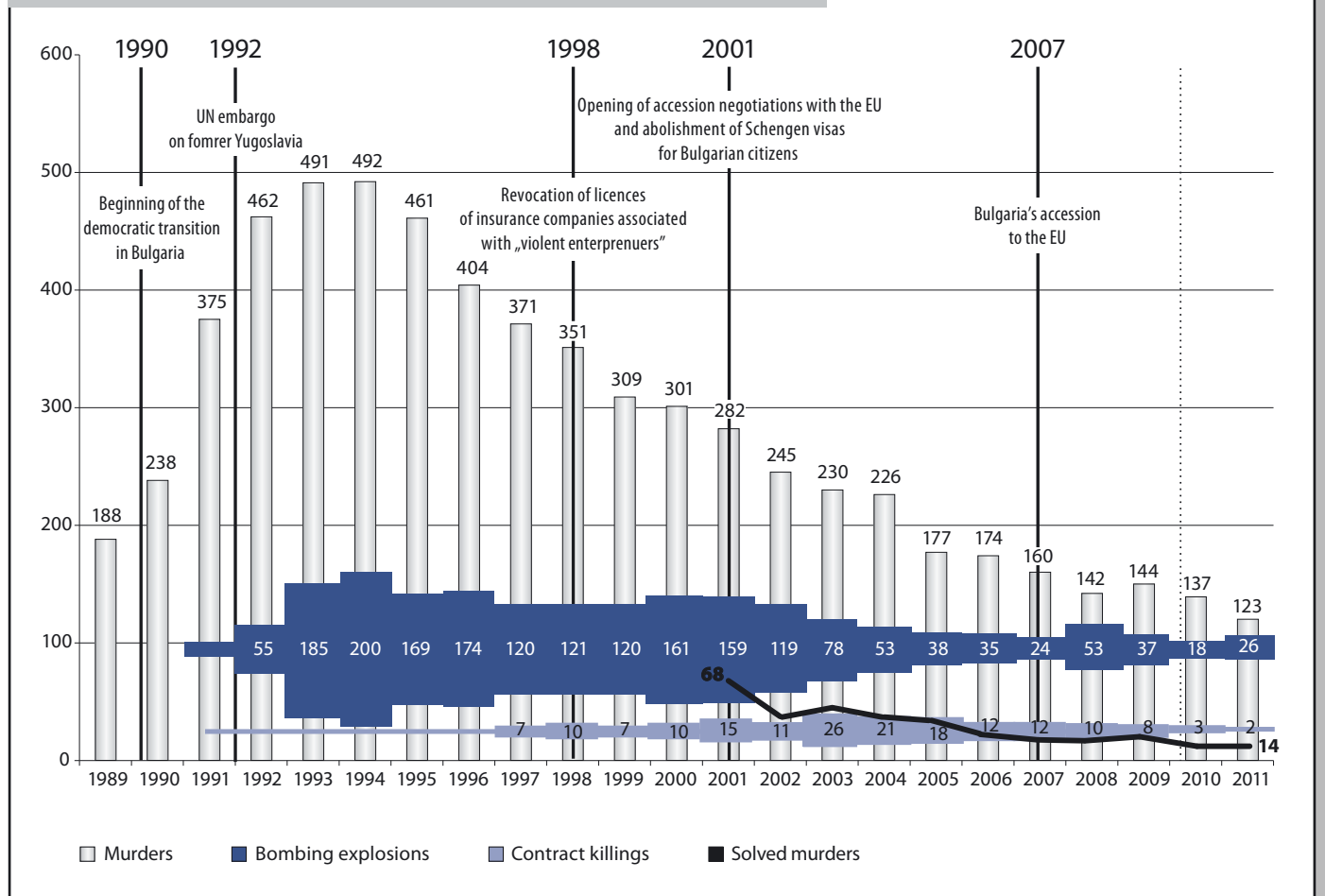
¹¹ Center for the Study of Democracy (2010) 'Examining the links between organised crime and corruption'. This study, carried out by CSD on behalf of the European Commission examines how organised crime uses corruption in EU-27. One of the seven country studies included in the report is on corruption and organised crime in Bulgaria.

¹² Spain: Ministry of Interior (2010) Situación 2009 – Crimen Organizado en España

¹³ Service de la Politique Criminelle, *Rapport annuel 2007 sur la criminalité organisée en Belgique (2005 – 2006)*.

corruption use existed about 45% of the groups. However, these findings do not allow outlining any tendencies¹⁴ or making international comparisons¹⁵.

FIGURE 6. ORGANISED CRIME AND VIOLENCE DURING THE DEMOCRATIC TRANSITION (1989 – 2011)



Source: Data from the Ministry of Interior

The analysis identified different tendencies over the past years in the use of corruption within the criminal activities reviewed in the current report. In the drugs market corrupt influence has abated in recent years due to the dismantlement of hierarchical structures and control over particular territories. In previous years, the territorial zoning of the drug market in some parts of the country was associated with corruption in the police structures.¹⁶

¹⁴ Unlike corruption affecting businesses and households, which is measured with different sociological methods, there are no widely accepted instruments for measuring the corrupt influence exerted by organised crime.

¹⁵ Law enforcement institutions in countries from the EU have adopted different definitions of the term "corruption".

¹⁶ Center for the Study of Democracy (2007): "Organised crime in Bulgaria – markets and trends", p. 39.

Similarly, the increased use of the Internet in the sex services market limited the contact of criminals with police officers, as well as the corruption pressure that criminals exert on them. The rise in illegal cigarettes sales, on the other hand, indicates one area where organised crime resorts often to corruption.

The most serious political corruption concerns political parties at the local level. In some municipalities organised crime leaders have either established their own political parties, or managed to become members of local municipal councils. These political posts are then used to trade in influence or to exert influence over local law-enforcement or judiciary, as well as to rig public tenders.

The oligarchs present a particular threat, as they have undue influence over local authorities, as well as some Members of Parliament. The main factor is the oligarchs' local political and economic influence, as well as the illegal practices which dominate some sectors of the economy (timber and metal scrap trade, excisable goods trade, and energy). One especially detrimental practice is the buying of electoral votes. Waste-disposal industry oligarchs, in particular, (who are the largest employer of members of the Roma minority) use their influence to manipulate the electoral voting of many Roma communities.

2. PROSTITUTION AND TRAFFICKING IN PERSONS

Organised prostitution and trafficking in persons represent possibly the most significant source of income for organised crime in Bulgaria. Trafficking is further related to four main criminal activities: sexual exploitation, labour exploitation, mendicity and pick-pocketing, and selling of newborn babies. Human trafficking for sexual exploitation is the most socially damaging but also the most lucrative. On the other hand, both the exploitation of children for forced begging and the smuggling of newborn babies have a long-term adverse social effect and cause widely shared public concern. Compared to the trafficking for sexual exploitation, however, they represent a far lesser threat in terms of scale and potential of the organised crime groups involved.

One reason for this is that human trafficking for sexual exploitation is closely related to organised prostitution inside the country. Despite the recently observed fragmentation of the prostitution market, some of the criminal groups which control organised prostitution are also involved in human trafficking. For the past several years, the sex services sector in Bulgaria has become better established and public tolerance of prostitution has increased. Over 20% of the Bulgarian citizens consider paying for sex an acceptable practice and over 36% of them support the legalisation of prostitution.¹⁷

2.1. Trends

During the period 2010 – 2011 several trends have emerged:

- Diversification of provision: under the growing pressure on organised crime from law enforcement starting back in 2007 the tightly controlled domestic prostitution market started to fragment. As a result, small groups of pimps and prostitutes are less prone to be integrated in bigger and hierarchically structured criminal groups, preferring instead to form informal networks operating according to market rules.
- The economic downturn reduced the demand for paid sex and the revenues of organised crime. In 2009, the revenues from the domestic market decreased by 50 – 70% compared to previous years.¹⁸ In addition, the crisis in neighbouring Greece also resulted in a smaller number of clients in the border regions.

¹⁷ According to data from the National Crime Survey (2011).

¹⁸ National Crime Survey data.

- Since 2010, shrinking demand and pressure from law enforcement authorities specifically directed at the clubs for sex services has led to the closure of many of these previously busy establishments.
- Organised crime undertook two distinctive strategies aimed at compensating for lost revenues:
 - ◊ Expanding human trafficking and prostitution in foreign countries;
 - ◊ Increasing the use of internet (through dating sites, use of social networks and chatting services) for attracting clients and recruiting girls into prostitution, establishing more call-girl services, etc.

As a result of the joint efforts of the law enforcement authorities of Bulgaria, France, Belgium, and the Netherlands, the Bulgarian prostitution trafficking has redirected its attention towards Germany¹⁹. In addition, the fall in demand for sex services in some West European countries pushed a good part of the criminal networks to turn to other, more lucrative markets or to Bulgaria.

2.2. Market size

The domestic market for sex services is much smaller compared to the market for organised prostitution abroad. The registered cases of victims of human trafficking in the European countries are indicative for the extent of the problem.²⁰ Bulgaria appears to be the leading source country for victims of trafficking in Germany and Greece and the second most important for Netherlands when taking into account number of cases per capita for 2009.

A good starting point for assessing the value of the sex services sold abroad are the registered cases of cross-border traffic of women for sexual exploitation. Based on these, it can be estimated that between 11,000 and 21,000 Bulgarian prostitutes are exploited abroad.²¹ If an average of 18,000 is considered, and given that a single prostitute generates about €300 daily with around 270 working days annually, the overall revenues amount to **€1.46 billion per year**. Only part of the money, though, remains within Bulgarian criminal groups, and even smaller part is returned to Bulgaria.

There are two approaches to estimating the revenues from the domestic sex trade. One approach uses the number of prostitutes and their average workload

¹⁹ This conclusion is drawn upon information from field interviews with pimps and data for number of identified victims of human trafficking in Germany (Bundeskriminalamt, *Trafficking in Human Beings National Situation Report 2010*, Berlin 2011).

²⁰ The trafficking in human beings is defined as recruitment, transportation and subsequent exploitation of persons. Previous research and expert assessments on the share of involuntary prostitution abroad (i.e. related to some form of exploitation) amounts for 5-10% of Bulgarian sex workers abroad.

²¹ Data on registered cases of human trafficking originating from Bulgaria (1015 victims) is based on review of the published reports of the National Rapporteurs on Human Trafficking in the Member States of the EU for the period 2005-2009. For further details on the methodology applied for these estimations, please refer to: Centre for the Study of Democracy (2007), *Organised Crime in Bulgaria: Markets and Trends*, p. 123-125.

and income. The number of sex workers is estimated to be between 6,000 and 10,000; 33% of them are engaged in street prostitution, 61% – work in-doors (offices, clubs, erotic bars, etc.), and 6% – in escort V.I.P. services.²² The estimate based on this approach is that the annual revenues may be between €123 million and €205 million per year.

An alternative approach is based on consumer surveys. In 2010, the share of men who admitted the use of sex services was 1.9 – 2.8% of the adult population, or between 61,000 and 88,000 clients.²³ This would suggest that the size of the domestic market is between €5 million and €9 million. During the past few years there has been a steady rise of the number of regular clients (adult men who paid for sex in the preceding month) – between 2008 and 2010 their numbers doubled.²⁴

The relatively small number of Bulgarian clients and the large number of prostitutes suggest that most revenues from the domestic market are generated by foreign visitors to Bulgaria. They use sex services either during their stay or while transiting through Bulgaria. In 2010, at least 380,000 foreign tourists used sex services,²⁵ generating at least €13 million in revenues. If short term business visitors and the transit truck drivers are added, this number would most likely more than double.

In terms of sex workers per capita, Bulgaria ranks as an average European country – 1.46 of every 1,000 persons of the adult population over 15 years. The prevalence of sex services' use among adult men shows that between 3.8 and 5.9% of the male population in the age-group of the over 15 years of age had paid for sex at least once in their lives.²⁶ This is a relatively low percentage when compared to other European countries (16.7% – 45% in Italy or 13.5% – 21.6% in the Netherlands).²⁷

2.3. Structure and organisation

Prostitution in Bulgaria is mainly concentrated at bigger regional centres (Sofia, Plovdiv, Varna, Burgas), the bigger winter and summer tourist resorts and in the regions along the border with Greece. Three general types of prostitution could be distinguished: street prostitution, club prostitution and elite prostitution. The criminal networks which control this market in big cities like Sofia and Varna, may have as many as 4 or 5 levels in their organisations. Prostitutes are at the lowest level and pimps are the second level. At the third level are the criminals who collect the rackets (these could be club managers). At the top levels are

²² *Sex Work in Europe. A mapping of the prostitution scene in 25 European countries.* Annex 4: National Reports, Bulgaria, TAMPEP, 2009: 26-39.

²³ National Crime Survey data.

²⁴ Ibid.

²⁵ In 2010, Bulgaria was visited by 8,374,034 foreigners: 50% of them were tourists, while the rest were traveling on business or for other purposes. About 86% of the visitors represent the age group 18 – 55 and 50% of them were men (data from the National Tourist Agency). A study among male tourists at the Black Sea resorts showed that 21.5% of them used sexual services, and that most of them used these twice during their stay (39.5%). (*Prostitutsia i seksualna eksploatacija*, Risk Monitor, 2010, p. 46).

²⁶ Data from the National Crime Survey of the CSD.

²⁷ ProCon, org. "Percentage of Men (by Country) Who Paid for Sex at Least Once: The Johns Chart". Prostitution.ProCon.org.

criminal bosses or their top managers who control the sex club networks. During the last two years a number of these bosses in Sofia and Varna came under public scrutiny as a result of police operations. The result was a reduction of the size of their operations and a larger number of independent sex workers. On the other hand, new criminals coming from the lower levels in the hierarchy are gradually replacing the old bosses.

A new challenge is the increased use of internet as a medium to offer sex services – between 800 – 1,200 unique sex services offers are posted on web sites each month. The risks stem from the greater anonymity and the difficulties in identifying the women and the criminal networks behind these offers. The web is adapted by organised prostitution networks to their usual *modus operandi*: old owners of brothels and erotic bars now publish ads for sex services on their own web-pages or use existing sites that offer escort services or place free advertisements. The difference is that prostitutes who offer services via the internet, no longer serve clients at brothels but operate more like a call-girl service.²⁸

A tendency towards further fragmentation is also discernible in human trafficking for sexual exploitation. In most of the country's regions the prevailing criminal structure is represented by one pimp who controls 2 – 3 girls, though organised groups with 10 or more girls exist. In the majority of cases the pimps are not residing in the destination country but instead they use the services of the so-called 'first girl' to collect the proceeds from prostitution. The mechanisms for exerting control over the girls include withholding their ID documents, indebtedness, frequent repositioning from place to place, the use of violence (used less frequently in the last years) and intimidation, etc. Organised prostitution abroad operates through loose networks built on a regional principle, rather than a hierarchical structure. The bigger groups specializing in human trafficking are mostly ethnicity-based.

2.4. Harm

Among the main negative impacts directly or indirectly related to the prostitution market and trafficking in persons are the following:

- The **Roma community** is particularly vulnerable to different forms of trafficking. Some forms (e.g. trafficking for pick-pocketing or begging and selling of newborn babies) are observed only in Roma communities.
- **Money laundering.** Both the domestic and the markets of sex services abroad generate a considerable inflow of money which is laundered into the legal economy. This often distorts whole economic sectors in some parts of the country and undermines the free competition principle by side-lining the companies which abide by the market rules.
- Sexual exploitation often includes **exploitation of minors** for sexual purposes (especially through the domestic trafficking and the street prostitution networks).

²⁸ Source: analysis of over 90 internet websites with sex services offers (including specialised sites for escort services and websites for free advertisements).

- **Public health harm.** The rise in demand and the offering of sex services in the country and abroad is directly related to an increase in the number of cases of such socially significant infectious diseases like syphilis and HIV/AIDS.

2.5. Outlook

Several factors contribute to the steady growth of the domestic market for sex services. The most important is the rise of the number of foreign visitors to the country. Currently, sex tourism occupies the larger share of the sex services market in the country. The increasing number of tourists is expected to further push up demand in the next years.

Internet-based recruiting of young women for paid sex through the use of social networks, dating sites and chat software is increasing. The large scale introduction of the internet for offering sex services is implying greater anonymity and a much more difficult control by law enforcement, which would probably foster rapid growth.

Meanwhile, the continuing economic crisis and high levels of unemployment are conducive to higher levels of vulnerability of certain social groups which are the potential target of human traffickers. The demographic trends of dwindling numbers of women in the age group between 18 and 26 years, when combined with a growing demand for sex services, will inevitably lead to shifting the recruitment of girls for prostitutes towards bigger cities, rather than from rural regions. In the future, this will be a factor for transforming Bulgaria from a source into a destination country for the traffickers of human beings for sexual exploitation.

3. TRAFFICKING AND DISTRIBUTION OF ILLICIT DRUGS

Cross-border trafficking and trading in illicit drugs are among the essential income sources for organised crime in Bulgaria and pose a high public threat. The prevalence of drug use is closely linked to the levels of petty crime, the number of road accidents and the prevalence of certain socially significant diseases (e.g. HIV/AIDS, hepatitis). The illegal distribution of drugs also breeds violence more often compared to other organised crime activities.

Bulgaria is a transit country for drug trafficking and the role of Bulgarian organised crime groups is shaped by the geographic location of the country on the Balkan route for smuggling heroin from Afghanistan to Western Europe, as well as for smuggling synthetic drugs and precursors from Europe towards the Middle East. Bulgarian citizens are also involved in transnational organised crime networks which are trafficking cocaine from South America (including through Africa) towards Europe. Currently, the participation of Bulgarian citizens in these criminal networks is most often at the low and the middle level, but there are certain exceptions which pose a real threat for making the country an entrance point and transit territory for the cocaine trafficking to Western Europe.

The Bulgarian market for illicit drugs is relatively small in size compared to most drug markets in Western Europe. Nevertheless, it comprises many actors with substantial financial potential and influence. During the last 20 years there has been a well-established retail market for heroin, and growing markets for synthetic drugs, cannabis and cocaine.

Small amounts of cannabis and limited amounts of synthetic drugs (mostly amphetamines), are also produced in Bulgaria which by and large meets domestic demand.

3.1. Trends

3.1.1. International drug trafficking

There was a significant decrease in the heroin trafficking over the past years, although heroin remains the illegal drug of choice for smuggling through the country. Heroin traffickers increasingly prefer the alternative Silk route over the Balkan route. The drop in the volumes of trafficked heroin was also due to the problems with the poppy crops in Afghanistan in 2010 and the arrests of key actors in the trafficking networks during several successful international law enforcement operations. The tightened cross-border control at the Bulgarian-Turkish border in the last years has also diverted the trafficking channels through the Turkish-Greek border and the Caucasus.

The second most often trafficked illicit drugs through Bulgaria are synthetic drugs, mostly amphetamines and ecstasy. In 2010 and 2011 there was a boom in the smuggling and distribution of the so called 'designer drugs' or 'legal highs' originating from China or India.²⁹ The introduction of new law amendments in the last 2 years for faster criminalization of the identified new synthetic drugs is expected to diminish the trafficked and distributed volumes of these substances in the country.

The data on Bulgarian citizens arrested abroad for 2010 – 2011 shows a decreasing number of arrests in relation to transnational drug trafficking for all kinds of drugs. This trend could partially be explained by the shrinking of the drug markets in Western Europe due to the economic crisis.

3.1.2. Distribution of illicit drugs

The hierarchical structures and the strict territorial zoning which had been characteristic of the drug market in Bulgaria until 2007 – 2008 have been dismantled in the past three years, most apparently at the heroin market. There are several factors which have contributed to these developments. First of all, this is the steady dwindling of the heroin use in the last 10 years, which was further facilitated by a heroin 'drought' on the streets in 2010 and 2011, and led to sharp drop in heroin use. This forced most users to turn to available substitutes such as methadone. In 2011, the officially registered patients in substitution programmes reached 3,279. A substantial share of these methadone patients started to sell part of their methadone at the black market and as a result many heroin users partially or fully substituted the heroin with methadone. A good indicator for this trend is the amount of methadone imported in Bulgaria – according to the Ministry of Health the imported methadone has grown from 38.2 kg in 2007 to 77.5 kg in 2010. The heroin shortage has also led to deterioration of purity and rise in the retail prices of the drug on the streets.

In 2009 and 2010, most of the middle and high level players of heroin criminal networks were arrested. The combined effect of strong law enforcement pressure and the heroin shortage led to turning the drug market back to the fragmented state typical for the early 1990s. The key difference from the 1990s is that the prevalent consumption in 2011 is not that of heroin, but of amphetamines and cannabis. Cocaine consumption is also increasing.

3.1.3. Production of illicit drugs

Up to 2007, Bulgaria was among the European countries with a large scale production of amphetamines not only intended to meet the demand of the domestic market but also trafficked to the Middle East. While the EU still remains one of the big producers of illegal synthetic drugs, in Bulgaria there was a sharp downturn in the production intended for export.³⁰ Bulgarian criminals partially relocated their production facilities close to the Middle East. Yet, small scale production of amphetamines and methamphetamines intended mostly to meet demand at the domestic market still continues. There is also a decrease

²⁹ Between 1997 and 2010, the European early warning system on new psychoactive substances has identified over 150 new substances which were being monitored.

³⁰ According to UNODC data in 2010, 80% of the dismantled illicit drug laboratories were in the EU (UNODC World Drug Report 2010).

in the outdoor cultivation of cannabis in the Southwest of Bulgaria, which is partially due to the increase of the in-door and greenhouse cultivation.

3.2. Scale of the problem

The Bulgarian heroin market comprises between 10,000 and 12,000 users³¹ who consume around 2 tons of heroin (at 15 – 31% street purity) annually. Taking into account that the retail price of the drug is €15 – €30 per gram³² and the figures above, the value of the market can be estimated to be €14 – €28 million.

The cannabis market is one of the most rapidly expanding in the last 5 years, especially among 15 – 34 year olds. From 2007 to 2008, the share of young adults who have used cannabis in the preceding 30 days has doubled. According to European Monitoring Centre on Drugs and Drug Addictions (EMCDDA) data, regular cannabis users in Bulgaria number 55,000 – 88,000 and recreational users amount to another 51,000 – 83,000. The overall consumption of cannabis could be estimated at 6.6 – 14.7 tons annually; taking into account that the retail price is €6.3 per gram, the value of the market could be expected to be €41.4 – €92.6 mln.

The other growing drug market in Bulgaria is the cocaine market. According to EMCDDA data, the share of the young adults (15 – 34 years old) who have used cocaine in the preceding 30 days has doubled from 0.4% to 0.8%. The estimates show that regular cocaine users in Bulgaria (using it 4 or more times per month) are 4,000 – 8,000, while the recreational users are 20,000 – 40,000.³³ The overall consumption of cocaine in Bulgaria could be estimated at 300 kg with street purity annually. With a street price of €70 per gram, the annual value of the market could be estimated at €22.3 – €80.3 million.

The synthetic drugs market (amphetamines and methamphetamines) has also expanded in the last 4 – 5 years. For the period 2005 – 2008, EMCDDA data show that the share of young adults (15 – 34 years old) who have used amphetamines in the preceding 30 days has **almost tripled from 0.4% up to 1.1%**. The estimates show that the group of synthetic drugs users is around 46,000 people and the annual consumption amounts to 2.2 – 5.6 tons. Considering that the average street price is €14 per gram, the value of the market could be estimated at €31.3 – €78.8 million.³⁴

³¹ This estimate takes into account the increased number of users in substitution programmes.

³² The data for average street prices, purity, etc., used in this report has been taken from the Statistical Bulletins of the European Monitoring Centre for Drugs and Drug Addictions (EMCDDA).

³³ The estimate is based on consumption data by EMCDDA and the RAND methodology (Kilmer, B. & R. Liccardo Pacula (2009) – Estimating the size of the global drug market. A demand-side approach. RAND).

³⁴ The assessment is based on consumption data from the National Crime Survey. It builds upon the methodology developed by RAND.

3.3. Structure and organisation of the market

For a long period, the drug market in Bulgaria had been structured and divided among hierarchically organised crime groups following the principles of territorial zoning and product segmentation. These hierarchically organised crime groups within every territory were structured in a way that each level of the organisation was rendering part of their profit to the level above. Different drugs were served by independent distribution networks; for instance, heroin dealers were not allowed to trade in cocaine or cannabis.

In the period 2008 – 2009, due to arrests of actors from all levels of production, trafficking and distribution, and the shrinking of the heroin market, the existing criminal structures started to disappear and the markets became fragmented. As a result, the organisation of drug trafficking and distribution became populated (much like in other EU countries) by many independent actors and small groups vying for control of certain neighbourhoods. The cocaine and synthetic drugs markets are centred on night clubs in cities. These markets are structured around loose crime networks, within which criminals provide different services – e.g. production (cannabis, amphetamines), trafficking (cocaine, heroin) or distribution. The distribution of cannabis is also very often undertaken by independent small producers or long-time users within their own informal networks.

3.4. Harm

The heroin market has particularly adverse effects on Bulgarian society. The main harm associated with heroin use is increased level of crime, particularly domestic violence, vandalism, petty theft, assaults, burglary, etc. The economic crisis and increased unemployment affect significantly the group of problem drug users and further worsen the situation. The recent fragmentation of the drug markets and the attempts of various new players to take over new territories would most probably lead to increased use of violence.

In addition, drug use adversely affects public health. The injecting drug use is directly linked to the transmission of a number of blood borne infections like HIV, hepatitis B and C. According to the Ministry of Health by 2011 in Bulgaria there were 1,438 HIV positive persons, 21% of whom were injecting drug users; in the last years, over 1/3 of all new registered HIV cases are among this group. The data of the National Centre for Addictions shows that over 60% of injecting drug users are infected with hepatitis C. The use of synthetic drugs and cocaine is also related to the number of the road accidents in the country.

The recruitment of drug mules for the transnational cocaine trafficking networks among the vulnerable groups of the population is also an issue of concern.

3.5. Outlook

The overall decrease of heroin use among the population is accompanied by its growing use among marginalized groups, especially the Roma. This trend will most likely lead to a peak in the petty crime committed by members of these communities, as well as a steady increase of the blood borne infections

among them. The increase of the infectious diseases within these communities will be further aggravated by the overall low education status and the poor access to healthcare.

The latest UNODC reports show 7% increase in lands with poppy crops in Afghanistan in 2011 compared to 2010 and 61% increase in the opium produced. This new yield is expected to lead to more heroin with better quality on the streets in 2012, and become a catalyst of the processes described so far.

The steady increase of users and respectively the demand on the street for cannabis, synthetic drugs and cocaine is expected to raise the production of cannabis and amphetamines within the country as well as the trafficking of cocaine, hashish and designer drugs towards Bulgaria. In the eastern part of Bulgaria there is a trend towards higher spread of methamphetamine use, which is replacing the amphetamines. This is an indicator that the methamphetamine production technology is becoming more widespread. The risk of addiction to methamphetamine is high and a rise in demand is likely to be observed in the next years.

Several factors are expected to affect drug trafficking in the short term as well. The good yield of the poppy crops in 2011 is expected to increase the volume of drugs smuggled through Bulgaria in the period 2012 – 2013. The rising demand for cocaine and synthetic drugs will also lead to growth of the cocaine traffic and the traffic of precursors for amphetamine and methamphetamine. The new role of Afghanistan as a world leading hashish producer might also lead to an increase of the hashish trafficked through the country via the traditional Balkan heroin route, accompanied by a spill over effect with higher supply of hashish on the domestic market.

The in-door production of cannabis will continue to grow due to lack of control of the growing and selling of cannabis seeds in Netherlands; the lack of incrimination for possession of cannabis seeds in Bulgaria. Moreover the in-door cultivation allows more yields (3 – 4 yields per year) than outdoor cultivation. An important emerging threat is also the use of internet for illegal trade and distribution of cannabis seeds and designer drugs.

4. VAT FRAUD

Value added tax (VAT) fraud schemes are a major source of revenues for organised crime. EU estimates of the losses from unpaid VAT are in the range of €60 to €100 billion per year.³⁵ As a result, member states lose between 11% and 13% from the liable VAT contributions.³⁶ The threat from VAT fraud is of significance as VAT contributions account for approximately 20% of the state budget revenues in the EU Member States.³⁷

VAT fraud can be divided into two broad categories: unorganised and organised VAT fraud schemes.³⁸ The **organised VAT fraud** is characterized by a higher degree of sophistication. It is considered a form of organised crime since it involves organised abuse of tax credit through fraudulent networks based on fake transactions and traders. These schemes include two or more companies which reduce their VAT liabilities, evade VAT taxation, or seek improper refunding of VAT. **Unorganised VAT fraud** schemes include attempts by companies to reduce or evade VAT liabilities by recording lower sales in the books, or failing to record net revenues from real transactions. In many cases the companies using such schemes are part of the grey economy.

Bulgaria's EU accession in 2007 created new opportunities for organised VAT fraud. The fraud schemes specific for Bulgaria (i.e. the X-type schemes, fraud related to so-called VAT accounts) were replaced by new criminal opportunities, such as the VAT carousel fraud, connected to the intra community trade. The threat from criminal networks and organised criminal groups involved in VAT fraud lies in their potential to influence political and economic processes. The criminal networks involved in VAT fraud usually include accountants and lawyers with the necessary qualifications, experience, social status and opportunities to influence public officials.

4.1. Scale of the problem and trends

For the past ten years the losses to the state budget from **organised VAT fraud** amount to at least €2.56 billion.³⁹ Similar to other EU member states, in Bulgaria

³⁵ European Parliament, Committee on Economic and Monetary Affairs: Draft report on coordinated strategy to improve the fight against fiscal fraud, 16 April 2008.

³⁶ Center for the Study of Democracy (2010), *Organised crime threat assessment. Methodological problems and international experience*, Sofia:CSD.

³⁷ Ibid.

³⁸ Most tax administrations define organised tax fraud as a mechanism for improper deduction or refund by one company of tax that has been unlawfully charged and unpaid by another company.

³⁹ This estimate, along with other assessments cited in this section of the report related to the size, trends and sectoral specifics of VAT fraud are based on the tax gap analysis of the National Revenue Agency from 2011.

the overall VAT gap is much wider than the gap caused by organised VAT fraud.⁴⁰ In the UK for instance, while the total VAT gap for 2009 – 2010 is £11.4 billion, the losses incurred by missing trader intra community fraud (MTIC) are about £1.8 billion (or 2.2% of collected VAT).⁴¹

Against this background, Bulgaria's organised tax fraud is much higher taken as a percentage of collected VAT (11.1% for 2010; Table 4). Organised VAT fraud reached its highest levels in 2008 and 2009. The levels of organised fraud decreased after 2009, but remained above the levels registered prior to Bulgaria's EU accession. The decline registered in the past three years is explained by economic slowdown in the country, but also by intensified law enforcement efforts to tackle tax fraud.

TABLE 4. ORGANISED VAT FRAUD GAP AND VAT REVENUES (2005 – 2009)

VAT gap	2005	2006	2007	2008.	2009	2010
VAT revenues (€ billion)	2.4	2.9	3.3	3.8	3.27	3.3
Organised VAT fraud gap (€ million)	246	244	349	504	413	358 (forecast)
Fraud gap / total VAT revenues	10%	8.2%	10.3%	13%	12.6%	11.1%

Source: NRA, Tax gap analysis 2011

The following trends were identified for the period 2005 – 2010:

- The number of high risk companies involved in VAT fraud decreased. This indicates a certain consolidation of criminal businesses, as the size of the fraud remained at relatively high levels. However, the companies involved in VAT fraud (including buffer and shell companies) are 20% (approx. 30,000) of all active VAT-registered companies. As one fraud scheme may involve several dozen companies, the number of individual criminals controlling these companies is significantly smaller.
- The losses incurred by MTIC increased significantly after Bulgaria's accession to the EU. While in 2006 such schemes generated 8% of the organised VAT fraud gap, their sized doubled after 2007 to 19% of the gap (Table 5).

⁴⁰ This figure is not public.

⁴¹ HMRC: "Measuring tax gaps 2011. An official statistics release", 21 September 2011.

TABLE 5. ORGANISED VAT FRAUD GAP: SHARE OF FRAUDS BY TYPE OF DELIVERY (IN % OF THE TOTAL VAT GAP)

	2005	2006	2007	2008	2009
Deliveries in the country	88.9%	92.3%	83.6%	79.8%	81.1%
International transactions (total)	11.1%	7.7%	16.1%	20.2%	18.9%
Export	2.1%	1.7%	2.3%	0.5%	0.8%
Intra community deliveries	0.0%	0.0%	2.9%	2.6%	1.6%
Import	9.0%	6.0%	1.8%	0.9%	0.3%
Intra community acquisitions	0%	0%	9.1%	16.2%	16.2%

Source: National Revenue Agency, Tax gap analysis 2011

4.2. Business sectors at risk

The risk of **unorganised VAT fraud** in Bulgaria is higher for wholesale trade in oil products⁴² and agricultural production. In the retail trade the goods at higher risk include food products (mainly in small shops), clothes and shoes. The VAT schemes often include mid and large size tax payers.

Three major risk categories can be identified:

- Approximately 30% of all organised fraud schemes occurred in the construction sector (construction and installation services, steel fitting, etc.)
- 13% of the frauds were related to production and trade in agricultural and food products (grain, sugar, meat, grapes, herbs and spices).
- 15% of frauds were registered in the services sector (advertising and other services)

The organised VAT fraud with oil products formed a significantly lower share of the total organised VAT fraud – 2%.

The economic crisis affected the exposure of certain economic sectors to VAT abuses. For example, while until 2008 vehicle trade generated 5.2% of the losses from VAT fraud, this percentage declined to 1.23% in 2009 due to the collapse of the automotive market. However, there was only an insignificant decline in the relatively high levels of VAT fraud in the construction business, and this sector remains high risk.

⁴² Trade in petrol products was identified also by Europol as a sector with high exposure to VAT fraud in the EU.

4.3. VAT fraud schemes

As outlined above, the unorganised VAT fraud includes a wide range of methods for **hiding VAT liability**. More often than not the lines between unorganised and organised fraud are blurred, as the same persons or companies could be involved in both types of VAT abuse.

Unorganised fraud schemes

The unorganised VAT evasion aims at reducing the tax liability stemming from real transactions. This involves concealing taxable receipts coming from the production and sale of real products and services. Sales are not recorded in the books, or are recorded at lower than actual values and/or quantities. Alternatively, conventional evasion may be effected through overvaluing of input costs and claiming larger VAT refunds.

VAT evasion and non-payment of excise liabilities in Bulgaria most frequently occur in the **distribution of fuels and oil products**. The main mechanisms include sales without documents, fictitious purchases, sale of derivatives levied with high excise tax rates and sale of petroleum products with low excise duties without documents or with falsified documents, fictitious fuel exports, sale of marked fuel for heating purposes.

Organised VAT fraud

The mechanisms of organised VAT fraud usually involve several companies. Besides illegal VAT refunds as a result of underestimation of income or overstatement of expenses, there are schemes relying on fictitious transactions. The most frequent schemes of VAT fraud are the following:

- **Fictitious exports:** the exporter carries the transaction on paper, applying the zero VAT rate on exports and claiming tax credit on the inputs, while actually selling the products on the domestic market without sales invoices, i.e. without paying VAT. A safer version would use real exports but would overstate the quantities exported, or the exported goods would not correspond in quality and type to the declared products.
- **Missing trader fraud:** a chain of fictitious transactions in which one of the traders (a phantom) takes on all accumulated VAT liabilities and disappears without paying them to the state budget, while the rest of the traders in the chain have claimed tax credit and received VAT refunds. Another option is to transfer the accumulated liabilities to an insolvent trader (often low social status person) instead of using a missing trader, as the latter is easier to detect before the refund is completed. Legitimate companies often become involved in this scheme, willingly or not.
- **Carousel fraud:** the missing/insolvent trader fraud is implemented through repeated rounds of cross border (intra community) transactions. This, on the one hand, makes tracking and countering it more difficult and slow, while

on the other it multiplies the cash return on the missing-trader fraud. The magnitude of the problem derives from the lack of customs control over goods flows. The carousel fraud is not widespread in Bulgaria. Most registered cases are related to sales of **meat products**.

The fraud related to deliveries within the country is characterized by the establishment of clusters of companies registered by proxies who accumulate – through a number of fictitious transactions – large VAT liabilities payable to real companies, thus reducing their contributions to the budget. In most cases the transactions are related to **construction and installation services** at prices much higher than the market ones. In some cases the services are not provided at all.

Most registered cases of MTIC fraud involve transactions between Bulgarian companies and companies registered in Greece or Romania, as well as shell companies based in third countries. The schemes include fictitious import and export of high-value goods (mobile phones, computer chips, but recently also sugar and fuels) that accumulate large VAT liabilities.

4.4. Harm

Besides the obvious harm to the public sector, VAT fraud affects the private sector as well, as it creates **unfair competition** and **distorts the market**. Companies that manage to reduce their tax liabilities through fraud receive competitive advantage over regular tax payers. The direct financial losses for bona fide taxpayers could also be significant – if they involuntarily become participants in the fraudulent schemes they risk being denied tax credit.

The potential of criminal networks involved in VAT fraud to corrupt is significant due to the participation of persons with high social status, as well as legitimate companies and oligarchs. They exert corrupt influence over the tax administration (to facilitate fraud schemes), the law enforcement institutions, the judiciary as well as over political parties in order to evade criminal prosecution.

4.5. Outlook

The main characteristic of organised VAT fraud – the involvement of numerous traders which manage to benefit without their profits being affected – implies that unlike other types of illegal activities/markets, there is no direct competition between organised criminal groups.⁴³ Furthermore, the trend in the EU is towards sharing of knowledge, skills and resources between different organised criminal groups and fraud participants at various levels, which enables them to evade law enforcement measures. Criminal networks in countries with weaker regulatory environments also get involved at the money laundering phase.

According to the NRA, the current trend in Bulgaria is towards a decline in the size of VAT fraud, although the levels of losses incurred are expected to remain higher than the average for the past six years. Furthermore, one of the important features of VAT fraud is the ability to adapt easily to changing circumstances.

⁴³ Europol: OCTA 2011

International carousel fraud may be reproduced in more complex mechanisms involving more entities in more countries than previous fraud schemes. Differences in tax rates in the EU countries to some extent stimulate the use of this scheme. Cooperation and information exchange between countries conducting investigations into intra community VAT fraud are not always effective.

The expansion of digital technology in the storage and distribution of information, the rapid development of internet applications and electronic payment services also facilitates the emergence of schemes that can be used to perform this type of fraud.

5. THE ILLEGAL CIGARETTES MARKET

In 2009 and 2010, the sale of contraband tobacco products (both legally produced and counterfeit) became one of the fastest growing organised criminal activities. In 2010, the total revenues from the sale of illegal tobacco products reached €250 million, or 16 – 18% of total consumption: the legal market amounted to €1.24 billion. The size of the illegal market, in terms of cigarettes sticks,⁴⁴ reached between 30% and 40% of all cigarettes sold.

There are two major criminal threats stemming from this development. The first is the mass scale of this illegal activity – within two years the size of the illegal market tripled. As such, it became a major source of financing of organised crime and impacted other criminal markets. The second threat is related to the expansion of the criminal structures involved in this type of illegal activity. In 2009 – 2010, the customer base grew to over half a million smokers, while the number of retail dealers multiplied. Cross-border smuggling and domestic supply routes and distribution infrastructure became well established.

The expansion of the illegal market was mainly caused by the increase in cigarette prices⁴⁵ which was the result of the alignment of Bulgaria's minimal excise tax levels with EU's after 2007. Cigarettes in Bulgaria became, in relative terms, the most expensive in the EU.⁴⁶ In particular, the sharp increase of the price of the lowest class cigarettes fuelled the demand for low-cost cigarettes. Growth of the illegal cigarette market was also facilitated by the economic crisis and unemployment growth that further increased the demand for illicit tobacco products.

5.1. Assessment of the illegal market

The majority of illegal cigarettes sold in Bulgaria are legally produced – the so called 'illicit whites'⁴⁷ – not counterfeit cigarettes. They are either produced abroad and then smuggled in Bulgaria, or produced domestically and illegally

⁴⁴ The tobacco industry uses as a basic category the number of pieces of cigarettes. Bulk tobacco is also measured in this category. Other measurement categories include the cigarette pack with 20 cigarettes per pack, the master box which contains 500 cigarette packs or 10,000 cigarette pieces, the standard container with 10 million pieces or 500,000 packs or 1,000 master boxes.

⁴⁵ Between 2008 and 2010, the prices of midrange cigarettes in Bulgaria increased by 65% – 70%.

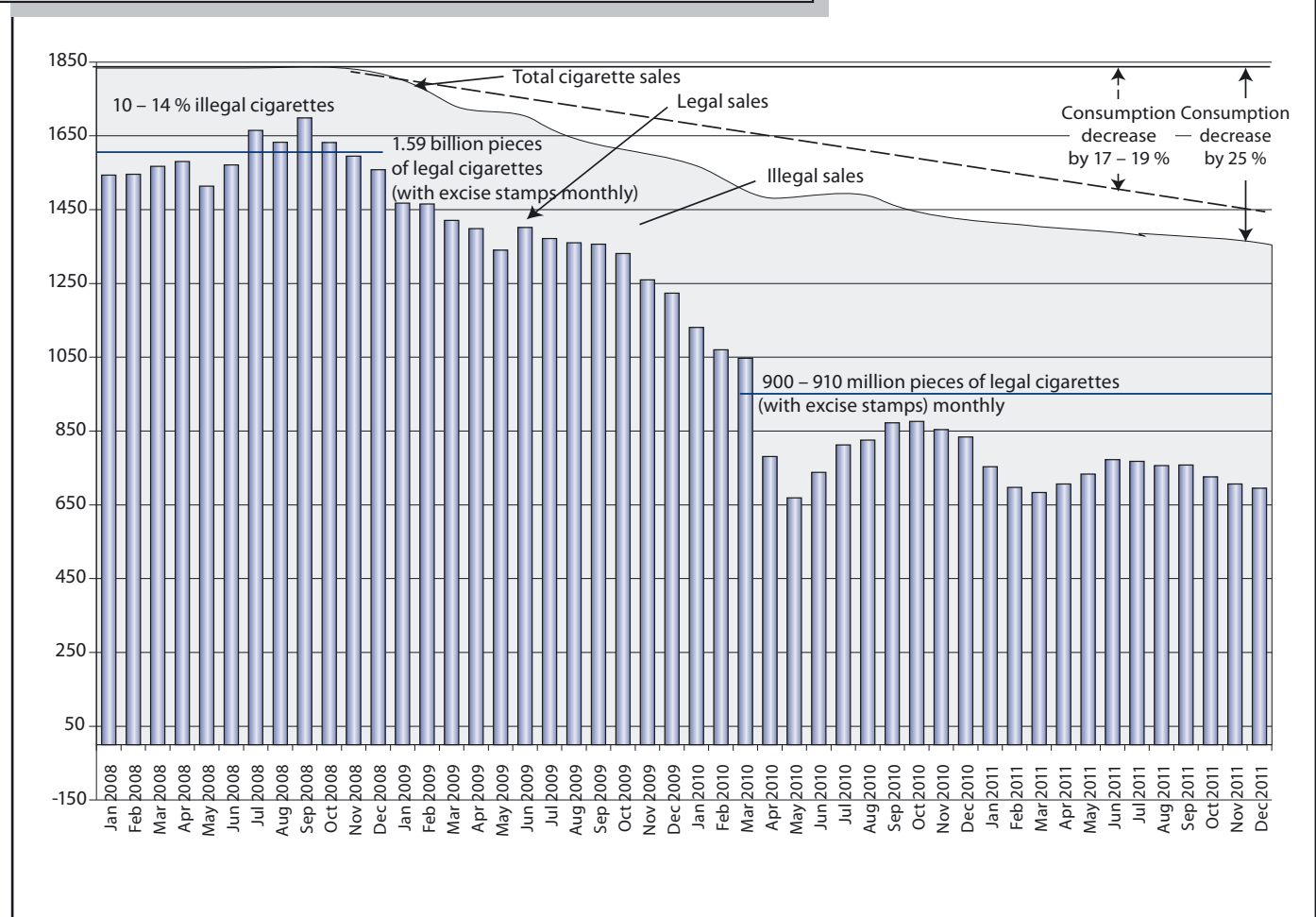
⁴⁶ This calculation is made by using the affordability ratio which measures the number of mid-range priced packs of cigarettes that could be bought on a disposable monthly income.

⁴⁷ Illicit whites are of low quality, and although they are legally produced their price is low.

distributed, avoiding VAT and excise taxes. 'Empty pack' surveys⁴⁸ indicate that the consumption of illicit tobacco in big Bulgarian cities increased from 14% in 2008 to 34% in 2010.⁴⁹ **In many small towns, border or rural areas the illegal trade exceeded 50% in 2010.** According to estimates based on the empty pack method, by the end of 2011 the situation improved as illegal cigarette consumption dropped to 19% of the total consumption of tobacco products.

However, alternative assessments which take into account some drawbacks of the empty pack methodology indicate that the consumption of illegal tobacco products is higher, and dropped from 40% in 2010 to between **25% and 30%**

FIGURE 7. CONSUMPTION OF LEGAL AND ILLEGAL CIGARETTES (2008 - 2011)



Source: Estimates based on data from Nielsen retail audit (Monthly Retail Audit 2008 – 2011); the empty pack surveys; National Crime Survey (2008 – 2011).

⁴⁸ The 'empty pack' method is used in the largest study of the illegal 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.

⁴⁹ This means that in 2008, 14 out of every 100 packs were without excise stamps and paid VAT, while in 2010 34 out of 100 were without paid duties. The percentage for 2010 is based on data from cities included in the 2007 survey. Counting the towns which were included in the additional survey due to the new sharp increase in consumption of illegal cigarettes in small towns and border areas, the percentage of illegal cigarette packs is 43.4%.

of the total market in 2011 (or between 3.6 billion and 4.6 billion illicit cigarette sticks per year).⁵⁰

It should be noted that around 20% of the illegal market is not associated with organised crime but is related to the so-called 'shuttle traders'.⁵¹ By the end of 2011, the illegal cigarette trade associated with organised crime amounted to an equivalent of **23 – 25 smuggled containers per month**.⁵²

In addition to the distribution of smuggled cigarettes, certain quantities of legally manufactured or imported cigarettes for which importers or local manufacturers pay excise taxes end up illegally sold in Bulgaria. The scheme involves mainly retail distributors who (usually by creating shell companies) avoid paying VAT on the value-added of retail sales. At least 1 billion cigarette sticks in 2011 have been subject to this type of fraud.⁵³

5.2. Structure and organisation of criminal networks

Monthly sales of nearly 300 million cigarette sticks suggest hundreds of thousands of consumers and thousands of participants in the illegal distribution.

The daily illegal sales are estimated at 500,000 cigarette packs, which indicates that the retail distributors involved are between 5,000 and 10,000⁵⁴ selling between 5 and 10 cartons (1 carton contains 10 cigarette packs) of cigarettes per day.⁵⁵ If distributors at the mid and high level, shuttle traders, security providers, couriers, those working in warehouses and retail storage were to be

⁵⁰ These additional assessments take into account the shortcomings of the empty pack method which does not cover smaller towns and villages. They take into account the sharp fall in the legal market of about 19 billion pieces in 2008 to around 9 billion cigarette pieces in late 2011. According to retail surveys, the decline in consumption among the population above 15 years is 17 – 19% for the period 2008 – 2011, as the decline affects both the number of smokers and average volumes of consumed cigarettes. This means that the entire cigarette market (legal and illegal) should be about 15.5 billion cigarette sticks, or a decrease of about 30% in terms of cigarette sticks. According to an unpublished assessment of the National Revenue Agency, based on analysis of consumer surveys, the size of the illegal cigarettes market is closer to the levels indicated by the empty pack surveys.

⁵¹ The shuttle trade includes contraband of cigarettes through the western border of Bulgaria with Serbia and Macedonia, where excise duties are lower, smuggling of duty-free cigarettes purchased at the Turkish border, as well as small scale contraband from Greece. Although some elements of these contraband activities are organised, it can be assumed that there is no organised crime involved in this type of trade.

⁵² The 2011 seizures of illicit tobacco by the Ministry of Interior and the Customs Agency averaged 5 containers per month. However it is difficult to estimate the losses of criminal networks from these seizures, as part of the seized cigarettes were designated for external markets. According to a 2011 report by the Customs Agency, only one fourth of the illegal cigarettes seized by the agency are designated for the domestic market.

⁵³ The starting point of this analysis is the difference between the quantities of cigarettes sold according to market surveys among retailers (known as retail surveys) and those for which official duties were paid according to the Customs Agency. The difference was about 2.1 billion cigarettes in 2011. Further analysis showed that approximately 1 billion pieces are 'lost' due to VAT fraud, and another 1.1 billion pieces are most likely on the move between distribution warehouses and retail outlets.

⁵⁴ The estimate includes different types of distributors for which cigarettes are just one of their income sources, including those working in small stores, coffee shops, kiosks, taxi drivers in mid-sized towns, public and private sector employees who sell to friends and colleagues.

⁵⁵ This includes illegal bulk tobacco which is estimated at 5 – 10% of the consumption of illegal tobacco products.

added, the total number of regular participants in the illegal cigarette trade would amount to as many as 15,000.

At the same time, due to legislative loopholes, many participants in the illegal cigarettes trade prefer this type of activity due to the lower risk compared to other criminal markets, in particular drugs.

Since 2009, seizures and subsequent investigations have uncovered many different criminal organisations and illegal transactions. Some examples include: major legal cigarette manufacturers in the Balkans providing Bulgarian criminal networks with access to their brands; large importers involved in international networks for distribution of low brand cigarettes (illicit whites); small illegal factories with wholesale networks, regional wholesale and retail sale networks, 'ant smuggling' by small criminal groups who buy and sell cigarettes to retailers.

The analysis shows that hundreds of stable criminal structures have emerged within two years. The typical criminal network functions at one or two levels and does not cover the entire range of activities related to importing and distribution of illegal cigarettes. They usually focus on a particular phase of the process. For instance, large-scale importers and the manufacturers do not control the wholesale and retail trade; mid-level networks do not engage in import and manufacturing.

At the highest level of this structure are Bulgarian and Greek entrepreneurs with significant financial resources, including 2 – 3 legitimate manufacturers and 5 – 7 importers. The manufacturers provide part of their production to criminal entrepreneurs who avoid paying excise duties and/or VAT on the quantities they sell. These entrepreneurs use two main schemes. The most commonly used one includes fictitious export and relocation of the products to warehouses for illegal distribution. In the second scheme, cigarettes are exported and following a complex string of transfers of ownership, they are eventually smuggled back into the country.

Large-scale importers work mainly with the so-called 'Greek hub'⁵⁶: a concentration of criminal networks in large Greek ports which controls the contraband of cigarettes via Greece. The criminal entrepreneurs smuggle illicit whites, manufactured in the Middle East (mainly in Dubai), Greece, the former Soviet republics or even Southeast Asia. The illicit whites are sold by producers legally to importers. After being resold and reshipped several times, including through duty free zones (e.g. Mersin in Turkey), they are smuggled into illegal warehouses in Greece, and are then further exported to other EU countries, including Bulgaria.

Another source of illegal cigarettes in Greece are the local illicit production facilities which usually produce counterfeits of leading brands. Several factories were uncovered in the past few years. The contraband imports are negotiated

⁵⁶ The Greek hub has a long tradition in the provision of logistics for contraband imports of cigarettes of lead international brands into the Balkans since the early 1990s. The schemes range from duty free imports to entirely illegal methods such as the collection with boats of cigarettes thrown out in the sea from ships. The Greek hub is of European importance, as it supplies the largest illegal cigarette markets in Europe: the UK, the Netherlands, Germany and Central European countries.

between large importers/manufacturers and Bulgarian mid-level criminal entrepreneurs.

Despite this evolution of criminal networks engaged in cigarette import and distribution between 2009 and 2011, increased control at the Bulgarian – Greek border and a number of seizures of large volumes of illegal cigarettes forced smugglers to abandon the import of large quantities in containers. They started importing smaller quantities, including through the green borders. The importation of illegal cigarettes with forged documents through the Turkish border has also been significantly disrupted by law enforcement.

At the same time, the consumption of illicit whites in Bulgaria has been gradually overtaken by illegal cigarettes of legitimate well-known local brands. The quantities of illicit Karelia (Greece), or King Tobacco (Bulgaria) cigarettes seized by the authorities have increased.⁵⁷ The same brands dominate the data collected by the empty pack surveys. This tendency presents a significant threat, as the sources of this type of illegal cigarettes are local producers with large share of the legitimate market.

5.3. Risks and harm

The risks and harm differ according to the size of the administrative region of Bulgaria, its proximity to international borders, local criminal traditions, as well as the operational activity and level of control imposed by local police and customs.

Table 6 below shows the estimated turnover generated by illegal cigarette trade by administrative region, as well as the estimated number of distributors. This assessment is based on the average number of illegal cigarette packs estimated to have been sold per month in each area. For instance, in the biggest market for illegal cigarettes, Sofia, the average daily sales of between about 80,000 packs generate a monthly turnover of €2.45 million.⁵⁸

The illegal distribution of tobacco products is a growing threat, especially since over the past 10 years the dependence of the government budget on excise taxes has grown immensely. In 2010 and 2011, the revenue from excise taxes accounted for 8.0 – 8.2% of all tax revenues to the state budget. In most Western EU member states excise taxes form only 1.5% of the state budget revenues. In 2010, the Ministry of Finance expected VAT and excise revenues from tobacco products to provide 15% (€1.47 billion) of the total budget revenues. Instead, they provided only for 9.57% (€0.93 billion). The market for illegal cigarettes in 2010 represented 0.85% of the country's GDP. For comparison, the revenues from illegal cigarette trade amount to €5.5 billion in Germany and €4.2 billion in the UK which is equivalent to 0.2% of their GDP.

⁵⁷ Such cigarettes seized by authorities or detected in empty pack surveys usually bear a “duty free” stamp or non-Bulgarian language warning signs, indicating that they have been meant for export or actually exported and smuggled back in Bulgaria.

⁵⁸ The estimates are based on analysis of the decline in regional sales of legal cigarettes between 2008 and 2011, as well as on differences in the level of consumption for the same period.

TABLE 6. ESTIMATED TURNOVER OF THE ILLEGAL CIGARETTE DISTRIBUTION BY ADMINISTRATIVE DISTRICT

Region	Number of illegal packs sold per day	Number of retail distributors	Number of mid/low level wholesalers	Monthly turnover from illegal sales (million €)
Sofia city	75 – 80,000	790 – 1,580	90 – 160	2.4
Plovdiv district	45,000	450 – 900	45 – 90	1.4
Burgas district	42,000	420 – 845	42 – 85	1.3
Varna district	32,000	320 – 640	32 – 64	0.97
Districts Stara Zagora, Pazardzhik, Pleven, Blagoevgrad, Dobrich, Haskovo, V. Tarnovo, Ruse	15 – 23,000	150 – 460	15 – 46	0.48 – 0.7
Sofia region, districts Vratsa, Shumen, Montana, Razgrad, Targovishte, Vidin	8 – 14,000	85 – 150	8 – 15	0.26 – 0.46
Districts Pernik, Yambol, Lovech, Kyustendil, shuttle traders, Gabrovo, Sliven, Smolyan, Silistra, Kardzhali	5 – 7,000	85 – 150	8 – 15	0.17 – 0.24

Source: Estimates based on data on official sales from three major tobacco companies (2008-2011); data on consumption from the National Crime Survey and market retail surveys.

The illegal cigarettes market also brings social harm as it creates conditions for illegal employment of a large number of people (approx. 15,000). Despite downward trends, at least 400 – 500 thousand people are expected to continue to consume illicit tobacco products in the near future. The mass scale of this criminal activity creates a certain culture of illegality and a grey zone which is comparable to the effect of the prohibition of alcohol in the US in the 1920s.

In the long run, there are also threats related to the potential growth in involvement of Bulgarian criminals in international criminal structures related to cigarettes contraband and increased violence related to turf battles in the domestic market.

The illegal distribution of tobacco products is a generator of corruption, which in some regions affects various levels of the law enforcement institutions, customs and the judiciary. In some cases entire shifts of customs officers, security police officers, mid and high level police officers receive additional monthly payments from the illegal trade in tobacco products. The private sector is also affected by corruption, where private security personnel in public and private institutions engage in retail distribution of illicit cigarettes.

The increasing share of cigarettes sold without excise stamps, produced by large Bulgarian manufacturers also presents a serious political risk.

6. THE MARKET FOR ILLEGAL OIL PRODUCTS

The oil products market is the biggest legal market in the country, amounting to €4 – 4.5 billion annual sales to end customers. The revenues from excise duties and VAT on oil products are the largest contributor to the state budget (larger than corporate or personal income tax revenues). Over the past five years the excise revenues from petroleum products provided between 47% and 50% of all excise duty revenues, according to the Ministry of Finance.

In 2011, the revenues to the state budget from excise taxes on oil products amounted to €0.95 billion. In addition, the expected revenues from VAT on the basic fuel types (diesel fuel, petrol, liquefied petroleum gas) were in the range of €800 – 900 million. The significant size of the domestic fuels market and high levels of expected tax revenues create a risk of significant losses for the state budget even if the percentage of illegal sales is relatively small. The harmonisation of the Bulgarian excise taxation levels with those in the EU, in combination with the rise in oil prices globally, determined the growing demand for illegal fuel over the past few years. This illegal market not only poses a great financial threat to the state budget but it affects negatively competition in transportation and construction industries.

6.1. Scale of the problem and trends

International oil companies operating in Bulgaria estimate the share of the illegal sales of oil products at between 20% and 40% of the market, equalling an annual turnover of €0.8 – 1.8 billion.⁵⁹

Estimates for the period 2007 – 2009 show that the sales of diesel fuel formed the largest segment of the illegal fuels market (Table 7). The differences between officially registered sales and the actual consumption are in the range of 32% to 39%.

⁵⁹ The lack of comparable data from independent sources is a hindrance to the assessment of the illegal fuel market. Unlike the markets for other excise goods, market surveys on oil products (retailer surveys or self-assessments of end users) are incomplete or inaccessible. The main source of information is the data provided by the Customs Agency or the National Revenue Agency, as well as the statistical data on energy consumption by the National Statistical Institute. These alternative data avenues cover only part of the fuel consumption, and do not include studies on large consumers of petrol products, such as companies in the transportation, industrial production or construction sector. There are no reliable methods for assessment of illegal sales, comparable to the use of the empty cigarette packs studies used in the assessment of the illegal cigarette market.

TABLE 7. ASSESSMENT OF THE SIZE OF THE ILLEGAL FUEL MARKET⁶⁰

	Consumption	Diesel fuel /thousand litres/	Gasoline /thousand litres/
2007	Actual	2,557,617	627,505
	Declared	1,726,000	597,000
	Undeclared	831,617	30,505
	% of undeclared	32.5	4.9
2008	Actual	2,816,161	655,988
	Declared	1,730,000	598,000
	Undeclared	1,086,161	57,988
	% of undeclared	38.6	9.7
2009	Actual	2,485,257	624,619
	Declared	1,697,000	616,000
	Undeclared	788,257	8,619
	% of undeclared	31.7	1.4

Source: Calculations based on National Statistical Institute data on energy balance and other statistical data; consumer surveys

Available data also show that the overall consumption of diesel fuel decreased after 2009 (Table 8), despite the economic growth and rising exports in 2010 and 2011.

TABLE 8. VOLUME OF DIESEL AND PETROL WITH PAID EXCISE DUTY

	2007	2008	2009	2010	2011
Fuel /thousand litres/	2,323,000	2,328,000	2,313,000	2,432,599	2,319,890

Source: National Statistical Institute (data for 2007-2009), Customs Agency (data for 2010-2011)

Between 2010 and 2011 the illegal fuel market shrank due to a number of factors:

⁶⁰ The calculations are based on actual fuel consumption according to official data on energy consumption provided by the National Statistical Institute (NSI). The actual consumption is calculated based on the number of motor vehicles and their average annual fuel consumption. This estimate is based on a detailed typology of vehicles in order to achieve an accurate assessment of the various differences in consumption, average annual mileage. Vehicles with suspended licenses and those older than 20 years were excluded from the calculation. In addition, the results were reduced by 30%.

- Market surveys show that due to several macroeconomic factors and the high oil prices the fuel consumption dropped in 2010 by 4%, following a 10% drop in the year before.
- In 2011, a number of measures targeting fictitious exports resulted in a drop of the excise tax recovered by fuel exporters by €100 million compared to 2010. At the same time, given a 41.5% increase in the volume and value of intra community trade and exports of fuels, it can be assumed that the decreased levels of recovered fuel excise taxes indicate decreased losses from fictitious exports.⁶¹
- Data by the National Revenue Agency (NRA) showed that the installation of a real time connection between the NRA and the registers of more than 3,000 petrol stations led to a 20% increase of declared sales by 'white pumpers' (smaller independent distributors with less than 6 petrol stations). This trend concerns only one part of the illegal market for oil products. Petrol stations sell fuel products mainly to individual customers and small companies. The major end consumers of illegal diesel were unaffected by this measure, as in most cases they run their own internal petrol stations.

6.2. Organisation and structure of the illegal market

Various players are involved in the illegal market for oil products. Although some tax avoidance schemes originate within legitimate companies, the direct participants in the criminal schemes are often fictitious traders at the wholesale or retail level. Criminal networks which do not use a legitimate business structure as a front are rather the exception. The reason is that unlike the trade in other excise goods, distribution and sale of oil products requires certain infrastructure which cannot be easily concealed. Not all illegal fuel smuggling and trade is a form of organised crime. Often, individual companies or private individuals may illegally import fuel for their own consumption.

Unlike petrol, the illegal diesel fuel is mainly sold outside regular petrol stations. The main consumers of illegal diesel are **companies whose competitiveness depends on fuel costs** (mainly construction and transport companies).

The most common schemes are related to avoidance of VAT payments, while the excise duties are paid. Some frequently used schemes include:

- The fuel products are officially imported, the excise duty is paid. The fuel is then resold to fictitious companies usually nominally owned by poor and marginalised individuals. These companies sell the fuel without paying VAT.
- Derivatives levied with higher excise duties (obtained by processing of oil products levied with low excise duties) are sold by producers without documents or with forged documents (e.g. showing that the product is not subject to high excise duty). The payment of VAT and excise duties is thus avoided.

⁶¹ The measures introduced by the Customs Agency included introduction of mandatory electronic measuring equipment on all fuel storage facilities in the country, directly linking to the Agency's monitoring system. All fuel-tank trucks were also installed with GPS equipment linking to the database.

- Marked fuel⁶² for heating or agricultural purposes is redirected and sold to illegitimate users (e.g. transport companies or private individuals), thus withholding part of the excise duty.
- Imported oil products (including intra community deliveries) are actually sold, but the paid VAT is compensated by purchases of fictitious goods and services from phantom companies. The value of the purchase equals the value of the imported fuel.
- Fictitious refuelling of river and sea vessels ('bunkering'): during refuelling of ships in ports or outside the territorial waters (of fishing vessels) the fuel is re-imported and sold.

Another major source of illegal oil products is the fictitiously exported diesel fuel from domestic production. A network of companies purchases the fuel and registers it as exported at their own risk, using corrupt customs officials. There are two options – the export is only on paper, or the fuel actually crosses the border and is smuggled back in the country, while the containers are documented as empty. It is subsequently sold to industrial consumers, transportation or construction companies, which through their internal petrol stations use it for their own needs. This scheme is extremely difficult to uncover, as the transactions are conducted only by high-level employees of the companies involved. Furthermore, the fuel is mixed with diesel on which excise taxes and VAT have been paid. Sea and river borders in particular pose a great risk of smuggling.

6.3. Harm

As outlined above, the diesel fuel trade accounts for 95% – 98% of the market for illegal oil products. The illegal diesel fuel market is estimated at 26% – 35% of all sales in 2010 and 2011⁶³ or between 800 million and 1 billion litres annually.⁶⁴ Consequently, the losses to the state budget are in the range of approximately **€300 million in unpaid excise duties and €240 million in unpaid VAT.**

The illegal sales of diesel fuel generate between €280 and €430 million per year.⁶⁵ The companies using illegal fuel decrease their costs and pose a risk to the competitiveness of regular fuel buyers.

⁶² Such fuel is usually coloured in a way that allows authorities to detect that it is meant to be used for heating rather than transport.

⁶³ These are preliminary estimates, based on the 2009 data provided above. The calculation also takes into account data on paid excise duties (see Table 3), as well as data on change in consumption for 2010 and 2011.

⁶⁴ The more conservative forecast of the size of the illegal market is from the National Revenue Agency, which assumes that the 2011 fall in diesel fuel consumption (as indicated by the Customs Agency data), as well as the measures undertaken by the NRA and the Customs have resulted in a contraction of the illicit diesel market back to the 2009 levels. The argument put forward by CSD analysts is that in 2011 the size of the illicit fuels market increased beyond the 2009 levels due to the growth in the grey economy, the increase in international road transport (due to booming exports), and high oil prices.

⁶⁵ The estimate is based on intelligence data suggesting that the price of 1 litre illegally sold diesel is 20 – 30 cents cheaper than the legal sales.

6.4. Forecast

The trend of increasing international oil prices is likely to continue over the next three years. The planned hikes of excise levels on some fuels, diesel in particular, would put additional price pressure on end users. Under continuing economic stagnation these factors will create growing demand for illegal diesel fuel.

The involvement of illegal fuel distributors that are part of or associated with former major racketeering structures poses a long term risk to the fuel market.

7. COUNTERFEITING OF PAYMENT MEANS AND BANK CARD FRAUD

The counterfeiting of means of payment and crimes related to electronic payment instruments include two criminal activities that are different in terms of structure, technology and participants: production of counterfeit banknotes and theft of bank card data. The second category also includes cyber-crimes involving drawing on bank accounts through the internet. The victim of all these is the banking system.

Of these crime categories, crimes related to electronic payment instruments pose the most significant threat. Over the past few years many car thieves and other criminal entrepreneurs with technical skills and international experience were drawn to this criminal activity which many found to be low-risk. The victims of these crimes include mostly foreign citizens and banks. The threats from offences related to electronic payment instruments and internet fraud related to bank accounts are insignificant in financial terms compared to other European countries.

7.1. Trends

Due to joint law enforcement operations by the Bulgarian police and the US Secret Service over the past years, Bulgaria ceased to be one of the main hubs for production of counterfeit dollar bills. Furthermore, although there are some printing shops for counterfeit euro bills left in Bulgaria their output has become much smaller.⁶⁶

According to data from the European Central Bank and the US Federal reserve, the global scale of production and distribution of counterfeit dollars and euros has remained relatively stable over the past few years. Data from the Bulgarian National Bank (BNB) show that the registered volume of counterfeit euro bills in 2011 is larger than the year before. At the same time the detection in 2010 of a large printing house producing counterfeit Bulgarian levs led to a fivefold drop in the volume of counterfeit Bulgarian levs identified by the BNB in 2011.

Data provided by a number of banks, as well as the National Crime Survey (NCS), indicate that the number of victims of electronic payment instruments fraud has increased over the past years.⁶⁷ The size of this criminal activity in absolute terms still remains low compared to Western Europe: NCS indicates

⁶⁶ Five such printing shops were uncovered by the Bulgarian police in 2010 and 2011.

⁶⁷ The National Crime Survey indicates that the latency of these crimes remains high – only 30% of all victims reported to the police. However, 94% of them reported the crimes to their banks.

that in 2010 only 0.9% of all card holders became victims of bank card-related crimes (6.4% in the UK in 2009, according to the Home Office).

Due to the relatively small sums held in bank accounts and the low limits on cash withdrawals in Bulgaria, criminal networks prefer to target foreigners who use ATMs (automated teller machines), usually in tourist areas. In 2011, only 44% of the population possessed bank cards (50% in 2010). Bank card holders used their cards for payments or purchases much less frequently than consumers in the EU.

In the past two years, skimming devices placed by Bulgarian criminal groups have been registered in most EU countries and the US. The withdrawal of funds, using stolen bank card data, takes place in countries where the ATMs and POS (point of sale) terminals do not maintain the global EMV standard⁶⁸ for inter-operation of chip cards (Caribbean, Africa, South America and Australia). In Bulgaria about 26% of the cash withdrawal machines still do not comply with the EMV standard (in most EU countries the compliance with EMV is in 100% of the cases). This means that the country remains an attractive target for criminal networks.

The theft of card data over the internet inflicts even smaller financial losses than the credit card skimming. There are limited opportunities in Bulgaria for substantial income from this type of crime. Eurobarometer's survey indicates that in 2010, only 5% of the population used the internet to purchase goods and/or services, while in the EU the percentage is 40%. The usage of online banking in 2010 - 2011 remained unchanged, and is at the lowest level in the EU at only 3.5% of the population. In the Netherlands and the Nordic countries over 50% of the population uses online banking.⁶⁹

7.2. Structure and organisation of the illegal activities

The criminal networks engaged in counterfeiting of banknotes and bank cards differ substantially in structure and organisation. The production of counterfeit banknotes requires bigger investments in printing equipment and paper. In most cases it is linked to some legal printing activity, but also to other types of illegal printing (counterfeit vignette stickers, excise stamps for cigarettes). The distribution is often carried out by separate criminal structures within the distribution network of EU countries.

The theft of bank card data requires much smaller investments and a simpler structure. There are a number smaller groups operating, as well as some larger criminal groups who operate on several continents and generate substantial profits. The technical skills required for manufacturing of a skimming device are not particularly sophisticated. There are several regions within the country besides

⁶⁸ The global EMV standard is a joint effort of Europay, Mastercard and Visa to ensure security and global interoperability of IC cards ('Chip cards') and IC capable POS terminals and ATM's, for authenticating credit and debit card payments. EMV financial transactions are more secure against fraud than traditional credit card payments which use the data encoded in a magnetic stripe on the back of the card.

⁶⁹ Eurobarometer (2011): *Special Eurobarometer 359: Attitudes on Data Protection and Electronic Identity in the European Union*

Sofia known for the production and distribution of skimming devices (Silistra, Ruse, Plovdiv Burgas, Stara Zagora). The risk of detection is higher at the lowest levels of the criminal structure – the people that withdraw cash from ATMs with counterfeit cards, those who transport and install the skimming device, or the usually low income proxies to whose accounts criminals transfer the money stolen through phishing-type fraud.

7.3. Harm

According to the European Central Bank in 2010 about 364,000 counterfeit banknotes worth €21 million were withdrawn from circulation. Official estimates from the US show that the counterfeit dollars in circulation globally have a total value of between \$60 and \$80 million.

Given the high production costs and the discount at which producers sell counterfeit banknotes for distribution, the revenues of organised crime in Bulgaria are in the range of a few million Bulgarian lev. The losses related to data theft with counterfeit bank cards are much higher. Europol estimates the losses for the EU in 2011 at €1.5 billion. In 2006 – 2007, the losses in the US ranged between \$6 and \$7 billion per year.

Bulgarian banks' losses caused by internet fraud and counterfeit banknotes or bank cards are considerably lower than those of banks in other countries, or compared to other types of fraud affecting the banking sector in the country. Data from some of the biggest banks in Bulgaria showed that losses to individual banks are well under €1 million per year.

The harm, therefore, falls into three categories which are not measurable in financial terms: (1) the country's image is damaged due to the large number of Bulgarian criminals operating internationally; (2) a significant portion of the profits generated through counterfeiting/account data theft are laundered in Bulgaria; (3) this type of illegal activity is often used as a source of financing of other criminal activities.

7.4. Outlook

There are no economic or other factors that can lead to an increase in the production of counterfeit banknotes in the upcoming years. This illegal activity is not expected to pose any significant threats to the Bulgarian banking system, at least until the country's Eurozone entry.

Card-related fraud will continue to affect the banking system in Bulgaria, although there is a declining tendency in the EU as a whole. This threat stems from the large growth potential in online banking and bank card use in Bulgaria. In 2010, the bank card payments have increased by 45% on an annual basis, while the average number of transactions rose by 25.3%.

The criminal prosecution of offences related to counterfeiting of payment methods faces a number of obstacles which could encourage the involvement of organised crime in this illegal activity. Part of the criminal activities (the skimming and withdrawals from bank accounts) take place outside the country and the

victims are also based in other countries. The technical aspects and untraditional forensics create difficulties for the prosecution. As a result, the general impression amongst judges and prosecutors is that the counterfeiting of payment methods poses a low threat to society.

The significance of bank account fraud through the internet is unlikely to increase due to the low level of online banking usage in the country, as well as increased security measures implemented by banks in Bulgaria. Internet shopping is growing rapidly. Although the economic crisis might slow down this process, the vulnerability of the Bulgarian banking system is likely to gradually increase.

8. LOAN SHARKING AND EXTORTION RACKETEERING

Illegal lending – known as loan sharking – is one of the serious threats that society faces. Victims of loan sharks are individuals as well as companies. Loan sharks usually lend money to firms operating in the grey economy which cannot resort to legal banking. They constitute an important part of the financial infrastructure that has maintained the high level of the grey economy for almost two decades. Loan sharks fund different levels of organised crime as well: from petty criminals to high-level transactions of illegal goods.

By controlling a big share of socially disadvantaged people in some communities – especially small towns and Roma communities – they undermine the democratic processes, becoming a key player in the process of votes rigging during local government or parliament elections. The participation in loan sharking of legal entrepreneurs or prominent personalities facilitates corruption.

The collection of debts accrued through loan sharking intertwines with extortion racketeering. Though the role of the extortionist security firms of the 1990s is incomparable to the current state of the private security sector, there are security companies that are still controlled by organised crime. They are also related to some forms of racketeering and debt collection.

8.1. Trends

Over the past two years, loan sharking has become well established. Several factors contributed to the rising demand of this service as well as the provision of illicit loans. In the first place, it is the economic crisis that has made a growing number of people and companies encounter difficulty in servicing their debts to banks and other financial institutions. In 2011, overdue long term debts went up to 15% of the total credit portfolio of banks. Private individuals and companies went into the grey economy which deprived some of them of access to licit financial resources. These two factors have led to the rising demand for illicit forms of financing.

The drop of real estate value made real estate development and trade unattractive investment opportunity for criminals. Loan sharking turned into a very attractive investment alternative for both criminals (mainly those involved in drug and

cigarette distribution, trafficking in human beings) and legitimate businessmen. They became the main source of capital for loan sharks.

Over the past decade, extortion racketeering has been decreasing. According to the National Crime Survey (NCS), in 2005, 9% of the companies fell victim to racketeering, while in 2010 their number dropped to 3.3%. The share of extortions for money also decreased. In 2005, 56% of extortion cases were for money, in 2010 their percentage fell to 43.

Some of the loan sharks were really active during the local elections in 2011. Local oligarchs⁷⁰ resorted to their influence over socially disadvantaged and debtors in attempt to manipulate the election results.

With the increasing debts of citizens and companies, some illegal forms of debt collection gained momentum, such as resorting to different forms of intimidation and even violence. On the one hand, some traditional debt collection services by private security companies were revived. On the other, some legitimate companies for debt collection increased their use of illegal methods of coercion to collect debts.

8.2. Structure and organisation

Loan sharking is a well-established business in almost all cities of the country: ranging from small towns with several loan sharks to big regional cities with dozens of such individuals. Some communities with high unemployment rates are badly affected and in practice there is no Roma neighbourhood without at least one loan shark.

Some loan sharks work under the cover of legitimate business structures: financial institutions,⁷¹ pawn shops or even food stores. These businesses are used to identify prospective victims and launder profits. Other loan sharks operate entirely illegally. In most cases loan sharks operate only in part with personal funds, with the rest of their capital borrowed from (criminal) entrepreneurs. Some loan sharks are not part of organised criminal networks and run their own operation and interface directly with victims. In other cases they operate as part of networks and hierarchical structures. In the latter case, only loan sharks at the lowest level give loans directly to the user, while profits are shared with higher-level loan sharks. Each level in this structure lends to the lower level at higher interest than they have borrowed the money. At the lowest level interests may reach 100% per month. Capital controlled by loan sharks at the highest level may exceed €500,000.

Loan interest rates vary a lot and many factors are considered in their formulation. Loan guaranties used include are (1) property mortgage contract in favour of the loan shark; (2) promissory notes; (3) debit cards with their PINs

⁷⁰ Oligarchs are businessmen, who own companies thriving on public contracts from the local administration for waste disposal, maintaining roads, public construction and renovation projects.

⁷¹ The public register of financial institutions of the Bulgarian National Bank indicates that there are about 137 registered firms which claim to provide "loans coming financial resources collected in ways other than public deposits and other reimbursable funds."

(the state usually pays pensions and social assistance directly to bank accounts with debit cards); (4) valuables (gold, cars).

8.3. Harm

The financial harm inflicted by loan sharks is difficult to measure but given the estimated turnover of tens of millions of levs, victims may pay millions of levs in interest rates. The significant point here is the social damage caused by loan sharks. Very often the financial situation of the victims gets worse after taking a loan from a loan shark. In some communities loan sharks establish economic and political control because a large portion of the population – up to 10% of the population of small towns and 50% of the population of some Roma communities – becomes dependent on their services.

The most worrisome damage of loan sharking is the undermining of the electoral process. Some loan sharks have been known to be closely linked with local political parties, which allow them to get protection from the ranks of elected politicians. Other loan sharks are used by local businessmen as intermediaries in purchasing votes during local elections. Such businessmen then use the political clout to win public contracts (usually in construction, waste collection).

8.4. Outlook

The forecasts of financial institutions are that in 2012 and 2013 bad loans in the banking system will continue to rise and reach 17% of the total bank portfolio. That means that the demand of illicit loans would keep its high and stable rates.

With the growing number of debtors, an assumption could be made that loan sharks would have larger resources at their disposal to manipulate the electoral process during the upcoming Parliamentary elections in 2013.

9. VEHICLE THEFT

The threat from criminal groups related to car theft has substantially declined in recent years. Bulgarian criminal networks are involved in the theft of vehicles within the country, as well as in international trafficking. Most vehicle thefts in Bulgaria are related to organised crime.⁷² Usually passenger cars are stolen but also trucks, motorbikes and construction equipment. While in the 1990s the massive scale of car-theft attracted some non-professional car-thieves, today it is mainly an organised crime activity. Stolen vehicles are used for the following purposes:

- to be sold on the local used-car market or exported and sold in Western Europe, the Middle East, or the former Soviet Union;
- to be sold for spare parts in car scrapyards;
- to be disposed as scrap metal;
- to commit other crimes;
- to extort ransom from the car owner.⁷³

The different reasons for stealing a vehicle indicate that car-theft is linked to several legitimate markets: of used and new cars, the spare vehicle-parts market, and the scrap metal market. Therefore, this activity is related to the entire economic situation in the country.

9.1. Trends

After a high point of almost 15,000 stolen cars per year in the mid-1990s, car-theft dropped to 3,802 in 2010 and then to 3,200 in 2011. The clear downward trend in vehicle thefts over the 2009 – 2011 period is partially due to the overall decline in demand for used and new cars in Bulgaria. The economic crisis and high unemployment rate also affect the car market (for both new and second hand cars) which was in stagnation in 2011. On the other hand, the economic crisis stimulated various other forms of crime, such as insurance and lease fraud related to cars. Despite the abolition in 2007 of physical controls over the transfer of vehicle registration, there are other preventive measures contributing to the decline in thefts. In 2010, the Ministry of Interior, the Guarantee Fund and the Financial Supervision Commission started to use a common information database where all total damages paid by car insurers are registered. This meas-

⁷² In Bulgaria joy-riding thefts are very rare.

⁷³ In 2000 – 2005, these reached over 50% of all car-thefts. See: Center for the Study of Democracy (2006), *Crime Trends in Bulgaria 2000 – 2005*, Sofia, CSD.

ure impacted car insurance fraud, as well as vehicle theft. Furthermore, the authorities started to conduct regular inspections of car scrapyards. Car owners encountering financial difficulties sold their cars to thieves to **collect insurance pay-outs or reduce their lease-related debt**.⁷⁴ Low car demand forced some thieves to shift from the theft of luxury to the theft of low-priced cars.

Data from the National Crime Survey shows that over the past few years there has been a decrease in ransom-related car thefts, mainly because of the low prices of used-cars and the improvement in the system of car-theft insurance payouts. Meanwhile, the increase in the price of scrap metal has led to more stolen cars being sold for scrap metal yards. The stagnation of the car market increased the demand for spare parts which affected the number of stolen cars and sold to 'chop shops.' As far as international traffic to and via Bulgaria is concerned, there are relatively low rates of theft committed in Western Europe due to the drop in demand in Bulgaria and criminals' shift to other types of crime.

9.2. Criminal structures

Vehicle theft is only one aspect of the illegal business of criminal networks. They are concentrated in administrative region capitals, big cities and tourist resorts, and in Sofia, where 50% of vehicle thefts occur. With the fall in used-car demand in the past few years, many car thieves turned to other criminal activities, mainly to bank card fraud.

Car theft for the purposes of scrap metal recycling and spare parts, as well as the theft of mid-sized family cars are often committed by small and mostly ad hoc criminal groups. Luxury car-theft or thefts related to ransom seeking, on the other hand, involve more complex criminal networks.

The theft of luxury cars is organised by **criminal entrepreneurs** who usually have legal business structures and connections that allow them to export the stolen car abroad or sell it in Bulgaria to affluent customers. These entrepreneurs are likely to hire small crews of professional car thieves who commit the theft, transport the stolen vehicle and arrange its sale. The theft crews may only have one professional or technically savvy thief. Other crew members are involved in supporting activities, such as: surveillance, support during the theft, transportation to another city in Bulgaria or abroad, replacing identification numbers (mechanics/car servicing workshops), forgery of documents, registration of the stolen vehicle, and its resale. Bulgarian criminal networks abroad (e.g. in Spain or Italy) are structured in a similar way: car theft crews are hired by locally established criminal entrepreneurs funding the car theft. These entrepreneurs are usually in contact with used-car dealers or other criminal entrepreneurs in Bulgaria who arrange the sale or the export of the vehicle towards other countries. Investigating the entrepreneurs is difficult due to the fact that in most cases the criminal activity is coordinated by their subordinates, and the entrepreneurs have no direct contact with the stolen car or the money obtained from its sale / ransom.

⁷⁴ In Bulgaria lease contracts require the customer to make payments for up 90% even on a 2 year lease contract, thus leaving minimal repayments due at the end of the contract.

9.3. Harm

Car theft inflicts financial damage to car owners, and insurance and leasing companies. In 2010 alone, harm caused by luxury car theft was estimated between €7 and €14 million and theft of the lower class cars between €5.5 and €11.5 million (with a total ranging between €13 and €26 million).⁷⁵

9.4. Outlook

The likelihood of a protracted economic slump in Bulgaria and the EU means that there will not be significant changes in the trends in vehicle theft. The increasing role of the internet in the sale of stolen vehicles and as well as in the procurement of electronic devices for decoding of car immobilizers need to be taken into account.

⁷⁵ In contrast to Western Europe, in Bulgaria the average value of stolen cars is lower due to the fact that most are sold for scrap metal, spare parts, extortion or commitment of other crimes. Only 20% of stolen cars cost more than €7,500.

10. LAUNDERING THE PROCEEDS OF CRIME

Money laundering is where all criminal markets and activities intersect with the legal economy, with the aim of legalising the proceeds of illegal activities. There are two different streams of criminal proceeds in Bulgaria depending on where the crimes had taken place: the first stream comes from crimes committed in Bulgaria, while the second comes from crimes committed abroad either by Bulgarian or by foreign criminals who may use Bulgaria as a money-laundering destination.

10.1. Trends

There are two general factors that determine money laundering trends: developments in the illegal markets, and the broader financial and economic environment. The conclusion from the trends in the various illegal markets outlined in previous chapters is that in the past two years there has been a decline in the overall volume of laundered proceeds. Several factors, related to the economic downturn in 2009 – 2011, led to restructuring of the streams of revenues from criminal activities:

- The continuing decline in foreign direct investments (FDI) in Bulgaria: FDI dropped 48.3% between January – November 2011 compared to the same period in 2010.
- The downturn in the construction sector narrowed the opportunities of using real-estate development as a way of laundering criminal money, as compared with the period before 2009. Part of foreign real-estate investments are carried out via offshore companies' accounts in foreign banks, which makes it difficult to establish the actual beneficiary.⁷⁶
- Despite the general drop in the volume of trade on the Bulgarian Stock Exchange, the growing size of trade in the unofficial segment (the unofficial regulated market) and in the over-the-counter trade in 2010 and 2011 were perceived as an emerging risk for money laundering.⁷⁷

The world economic and financial crisis highlighted the changing patterns in the interaction between criminal money and the banking sector. As a result of the crisis and liquidity issues that the banking sector faced, many financial institutions resorted to survival tactics, such as lowering due diligence standards and growing reluctance in reporting suspicious transactions out of fear of scaring away potential clients.

⁷⁶ State Agency for National Security (2011), Extract from the *Annual report on national security for 2010*, p. 25.

⁷⁷ *Ibid.*, p. 27.

10.2. Structure and organisation

A good part of the proceeds generated from organised crime is laundered using very simple schemes. The majority of the participants in the illegal markets do not generate enough financial resources that even require money laundering. In the illegal cigarettes market, for instance, the money left to be laundered does not exceed 15% of all proceeds (or €30 million out of €200 million total market turnover). The majority of illegal market actors are at the retail level where they hardly earn enough to support a modest standard of living. Even at the whole-sale level some participants maintain luxury lifestyle and fund other criminal activities, instead of laundering the criminal proceeds. At the mid-level of criminal markets criminals often buy small real estate property or start a business, which in most cases supports the criminal activity or money laundering itself – entertainment facilities, construction, transport, hospitality industry, agriculture, etc.

Only at the higher level of criminal networks (e.g. VAT fraud schemes) the laundering of proceeds may involve more complicated schemes that include offshore companies and/or complex financial instruments such as the stock exchange. As the majority of the offshore financial centres have strict banking secrecy laws, they are attractive to criminal networks. Internet banking has further facilitated the management of criminal proceeds placed abroad.

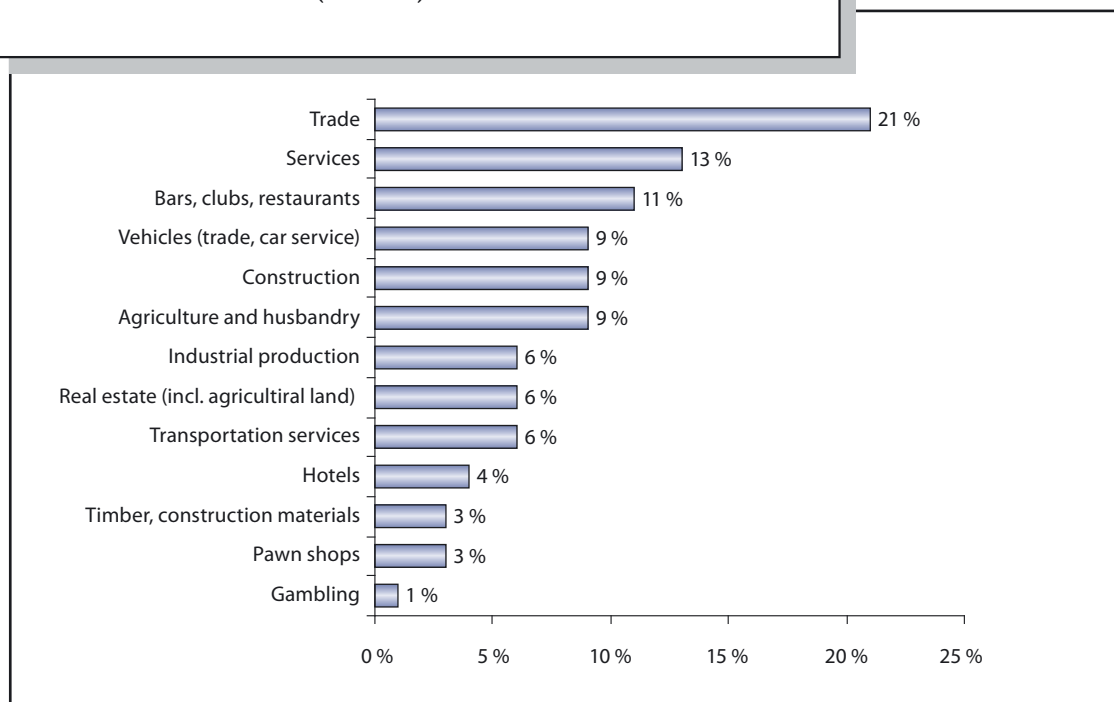
In 2010, investing money of illicit origin was mainly focused on four distinctive sectors: 1) trade (including dealing in real estate property) – 31%; 2) construction – 27%; 3) gambling – 18%, and 4) tourism – 10%.⁷⁸ The money is invested using different schemes and pertains to crimes committed either abroad or in Bulgaria.

During the past 20 years money laundering was not a law enforcement priority and the majority of the criminal entrepreneurs in Bulgaria have established some forms of legal business. In the field of organised tax fraud the use of legitimate business structure is a necessary part of the criminal activity. But even in other forms of organised crime (narcotics, prostitution, racketeering, etc.) the majority of the criminal groups control some legal business structure.⁷⁹ **Bulgarian criminal groups participate in the legal economy at higher rates than groups in Western Europe.** This represents a challenge to attempt to investigate money laundering and to uproot corruption.

⁷⁸ State Agency for National Security data.

⁷⁹ In most of the cases the assets or the real estate are transferred to their parents or close relatives, or to other proxies.

FIGURE 8. THE LEGAL BUSINESS OF ORGANISED CRIMINAL GROUPS (N = 101)⁸⁰



In some cases this business is used as a logistical support for criminal activities and for money laundering itself. Therefore the type of legal business structure sometimes depends on the illegal activities of the group. For example, drug traffickers, cigarettes smugglers, or human traffickers may invest in transportation companies; human smugglers may use legally registered firms to employ immigrants; shops are used for distributing illegal excise goods, etc.

The more complex money laundering schemes both in Bulgaria and abroad include the use or misuse of the banking system, currency exchange offices, and financial companies. In the last years, one of the most widely used schemes involved obtaining mortgage to buy real estate property, which is then repaid with money from criminal activities. Among the other widely used money laundering schemes in Bulgaria is claiming profits from gambling; or declaring revenues from profits from stock exchange trades. The majority of the complex money laundering schemes involve notaries, accountants, lawyers, and financial experts. In larger criminal groups bosses may assign the control of such operations to particular persons. There are no specialist money launderers who provide money-laundering services to other criminals.

10.3. Harm

The socio-economic harm includes effects such as:

⁸⁰ The analysis of a sample of 160 criminal groups, whose main criminal activity was drugs trafficking, trafficking in people, counterfeit currency, illicit arms production / trafficking. The data showed that 101 groups (or 2/3 of the total) had a legal business.

- Directing significant investments not towards sectors with maximum rates of return but towards sectors where the detection of money laundering is difficult;
- Undermining fair competition and increasing the risk for economic bubbles in some sectors (e.g. real estate);
- Price distortion especially in the real estate sector;
- Increasing the levels of corruption, especially in the private sector with the purpose of avoiding AML measures or preventing the issuance of Suspicious Activity Reports (SAR).

10.4. Outlook

The ongoing economic downturn will continue to impact on the banks, which means that in a short-term perspective the risks related to the lowering of the anti-money laundering standards could be expected. The economic crisis may push some professions – lawyers, accountants, notaries – suffering from lower demand of their legitimate services to turn to money laundering schemes. Finally, the development of internet technologies will lead to the further spread of money laundering schemes via the internet.

11. FUTURE RISKS AND THREATS

The current *Serious and Organised Crime Threat Assessment* comprises only the criminal activities posing the greatest threat and inflicting the most significant harm to the Bulgarian society. A number of criminal markets were not analysed: trade in antiquities, arms trade, illegal gambling, illegal migration, illegal logging, real estate fraud, corruption in public procurement, including embezzlement of EU funds.

In view of all these criminal markets and activities it can be concluded that the **influence of organised crime over Bulgaria's economy is significant**. Over the past decade, despite the continuous decline in the influence exerted by organised crime (especially with respect to different forms of racketeering), the share of criminal economy continues to pose a serious risk to the legitimate national economy, deforming its competitiveness and threatening the democratic functioning of public institutions.

The main threat posed to Bulgarian society stems from organised criminal activities or markets that are at levels significantly higher than in other EU Member States: the market for sex services controlled by organised crime (especially trafficking in human beings), VAT fraud and the markets for excisable goods (mainly tobacco and oil products). A serious challenge remains the use of political corruption by oligarchs.

The current assessment report was carried out against the background of the economic crisis and outlines two types of threats. **Traditional threats** are related to the emerging of big resilient criminal networks involved in illegal trade in tobacco products that could form the architecture of new types of organised crime. **Non-traditional** threats refer to the use of the Internet in the sex services market, in bank fraud or even in car theft, etc. Although extortion and racketeering by organised crime are at relatively low levels the risk associated with them has not been completely eliminated.

The socio-economic and political changes taking place in the past several months in the countries from the Middle East and North Africa are prerequisites for the risk of higher migration pressure on Bulgaria as a country neighboring with Greece and Turkey. This risk is associated with the possibility of secondary flows of illegal migrants from the Middle East and North Africa, who enter Greece to be redirected through Bulgaria after the country's entry into the Schengen area.

The risk of trans-border tax and customs fraud should not be underestimated, given the continuous economic downturn, as well as the increasing trade in illegal cigarettes and oil products in neighbouring Greece.

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