



**CRIME WITHOUT  
PUNISHMENT**  
COUNTERING CORRUPTION  
AND ORGANIZED CRIME  
IN BULGARIA

In its ninth Corruption Assessment Report the Center for the Study of Democracy provides an overview of the state and dynamics of corruption in Bulgaria, as well as of Bulgarian anti-corruption policies and initiatives during the first two years of Bulgaria's EU membership.

The report builds on years of CSD experience in the regular monitoring of the spread of corruption and its trends, as well as in evaluating anti-corruption efforts and initiatives implemented by government institutions and civil society. Its findings are based on the state-of-the-art *Corruption Monitoring System*, and are complemented with a number of recommendations on anti-corruption policies, institutions and practical measures. In addition the report draws on the latest international studies and surveys to assess corruption levels in Bulgaria in comparison to other EU member states.

Political corruption and organized crime still remain largely crimes without punishment even after Bulgaria's accession to the EU. Notwithstanding economic growth and past progress in its anti-corruption reforms, Bulgaria still displays two major deficits for countering corruption and organized crime: namely, of political will and of administrative capacity. This year's report explores the aspects and sources of political corruption in Bulgaria, including an alarming new trend: civil society capture. The report tracks the dynamics of the hidden economy in the country and the main channels for corrupt interactions between business and politics: public procurement, concessions and land/forest swaps.



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## INTRODUCTION

The year 2008 had to demonstrate the extent to which Bulgarian public institutions were capable of meeting public expectations to actively counteract and curb corruption. **The results attained have fallen short of these expectations as well as of international transparency and accountability standards.** The negative public perception of the government's anticorruption reform efforts is additionally aggravated by the kind of political environment to be expected in 2009, which typically marks the ending of a cabinet's term of office, as well as by the global economic recession. These circumstances will weaken the political will to counter corruption, as well as the capability of building up the administrative capacity necessary for the latter.

Similarly to other new EU Member States, Bulgaria witnessed a **slowdown in its anticorruption efforts in the first two years of its full-fledged membership.** For the first time since 1998, *the Corruption Monitoring System* of the Center for the Study of Democracy registered a trend of rising corruption rate among the Bulgarian population for the 2007 – 2008 period. There was a widening gap between, on the one hand, high public expectations with regard to anticorruption initiatives and requirements stemming from EU membership, and on the other hand, **the lack of political will and administrative capacity in the legislative, executive and judicial branches to press on with anticorruption reforms.** The legislative and institutional reforms of the judiciary and law-enforcement over the past three years have failed to lead to significant tangible results in the fight against corruption and organised crime in the country. The cases of political corruption identified by civil society and the mass media, which bordered on state capture, flagrant cases of conflict of interests and the use of public resources for personal benefit were left unaddressed by the executive and legislature and were not prosecuted by the judiciary.

**The de facto impunity of high-level corruption and organised crime** in Bulgaria and the decision of the European Commission (EC) to withdraw from a Member State (for the first time in EU history) 220 million Euros worth of funds allocated to administrative modernisation, which was widely covered by the media, reinforced the perception that labelling Bulgaria "the most corrupt EU country" was justified. Should the Bulgarian authorities fail to undertake decisive actions to overcome this negative trend in 2009, public mistrust in state institutions may peak to levels so critical as to impair the latter's proper democratic functioning.

Despite the setbacks in anticorruption efforts for the 2007 – 2008 period, some **positive developments** must be emphasised as they can provide a good foundation for resuming anticorruption reforms in the country. They are mostly related to objective factors resulting from the country's accession to the EU and its stable economic growth during the last ten years, but also from some targeted anticorruption measures of the Bulgarian authorities:

- **Administrative corruption among Bulgarian business decreased by 50%** following the country's entry into the EU. The positive role of this can be attributed to the continuous gradual reduction in the share of the hidden economy and its versatile manifestations – income concealment, tax evasion and informal employment. In absolute terms, the shadow economy is estimated at about 10 billion BGN for 2008;
- By mid-2008, the Bulgarian authorities undertook numerous **legislative and administrative changes** aiming to curb the misuse and corruption in EU funds management. While the appointment of a Deputy Prime Minister for EU funds management proved to be useful and necessary, the effect of the legislative changes in the area of conflict of interests and public procurement will be impossible to evaluate before the end of 2009;
- Bulgaria closed down **duty-free trade on its external land EU borders** as one of the most significant sources of political corruption and organised crime.

The threat of **slowdown in anticorruption reforms** in Bulgaria following the country's EU accession and the potential risks thereof were **exhaustively described and analyzed in the last two Corruption Assessment Reports: *On the Eve of EU Accession: Anticorruption Reforms in Bulgaria (2006)* and *Anticorruption Reforms in Bulgaria: Key Results and Risks (2007)*.**

***Anticorruption Foresight: the Main Corruption Risks which Bulgaria Faces following its Accession to the EU***

Bulgaria's membership in the European Union will unquestionably step up the process of curbing corruption, the gray economy, and organized crime in the country, but it cannot be expected to automatically do away with their internal causes.

The internal risks have already been identified by Bulgarian society as well as by our European partners: **political corruption and organized crime, and the impunity from criminal prosecution** of members of corrupt political-cum-business networks.

New challenges have emerged, and efforts must now shift to correcting the structural and institutional deficiencies that breed corruption with a special focus on the **efficiency of the**

**judiciary and law enforcement**, on an unyielding enforcement of anticorruption rules, as well as on effective criminal sanctions for corrupt practices.

Given the current environment of **de facto impunity for political corruption**, there is a real threat that the opportunities brought about by EU membership will be hijacked by private interests. This may revive administrative corruption, especially given the likely **decline in the intensity of international monitoring and its disciplining effects on the government**. The extent to which the management of EU funds in the 2007–2013 period is effective and transparent will be a good indicator of the capacity of the Bulgarian state, business and civil society to effectively counter corruption.

Source: *Anticorruption Reforms in Bulgaria: Key Results and Risks (2007), On the Eve of EU Accession: Anticorruption Reforms in Bulgaria (2006)*, Center for the Study of Democracy

Two years following Bulgaria's accession to the EU, **the key challenge** before the country is still the **de facto impunity of high-level corruption and organised crime**. This is why the Introduction to this Corruption Assessment Report focuses on the specialized anticorruption infrastructure and the judiciary<sup>1</sup>, which are still incapable of meeting public expectations in addressing the issues of corruption as the top-ranking problem for the country. Bulgarian society has yet to witness the implementation of **effective anticorruption judicial sanctions against at least a single Bulgarian cabinet minister or MP, or against at least a single firm (or its executives or upper management) participating in the so-called party loops of companies**. The attainment of substantive results in counteracting organized crime and political corruption requires efforts on a much larger scale and depends on numerous additional factors, which are discussed in the remaining sections of the report:

- The First Part of the report provides a reliable picture of corruption attitudes, pressure and victimization amongst businesses and the population in the country over the past year on the basis of the *Corruption Monitoring System*.
- Part Two accounts for the fact that countering political corruption can only be effective through political measures centered on working mechanisms of internal and external political ethics – **political will for dismantling the corrupt oligarchic loops of companies** and winning back the state from criminal networks;
- Part Three of this Report focuses on the need for an effective regulatory framework ensuring adequate control mechanisms, which

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<sup>1</sup> For a more detailed description of the institutional and functional shortcomings of Bulgaria's anticorruption infrastructure and the judiciary, see section 3 of *Anti-Corruption Reforms in Bulgaria: Key Results and Risks (2007)*, Center for the Study of Democracy. A comprehensive analysis of anticorruption reforms in the judiciary is contained in the *Corruption Assessment Report (2003)*, Center for the Study of Democracy.

would complement rather than impede or constitute an extra burden for law enforcement (MoI, the State Agency for National Security /SANS/, the investigation service, the Prosecution and the Courts), by means of the sustainable and targeted **enhancement of administrative capacity** in key areas associated with high corruption risk, such as state budget revenues, public procurement and concessions, land and forests swaps, etc.

## Development and Effectiveness of the Anticorruption Infrastructure in Bulgaria

As early as the year prior to Bulgaria's accession to the European Union, the country could count on a relatively well established anticorruption infrastructure, which, though only formally, had most of the necessary elements in place. Civil society structures in the country are also relatively well developed<sup>2</sup>: NGOs have established themselves as cornerstones in the country's democratic transition and are definitely an integral part of anticorruption efforts. Over the past two years, **the state anticorruption infrastructure was not utilized properly** and in compliance with the new risks associated with Bulgaria's EU membership. Meanwhile, the anticorruption initiatives of Bulgarian civil society were highly constrained by the inadequacy of resources or their inappropriate allocation as well as by attempts at "civil society capture". Concentrating European funds and programmes into the hands of the public administration has not only led to high corruption risks, but has also resulted in suppressing critical (and constructive) anticorruption initiatives which have been replaced by PR and media campaigns and the formation of **NGO "loops"** set up by high-level civil servants and politicians for the sole purpose of misappropriating EU funds. The obvious **mismatch between the public administration's actions or failures to act and public attitudes with respect to the corruption situation** called for certain changes in the second half of 2007 and in 2008.

In the first place, the process of formulating **anticorruption policies** continued throughout 2008, though it was driven mainly by strong domestic and international pressures. Many of the **existing strategies and documents** on corruption countering and prevention were or still are undergoing a **process of updating** (*Strategy for Transparent Governance and for Prevention and Counteraction of Corruption for the Period 2006 – 2008; Action Plan on the Implementation of the Benchmarks in the Areas of Judiciary Reform, Fight against Corruption and Organized Crime*). The adoption of new strategies and policies is also underway (*Ministry of Justice Concept Paper on State Criminal Justice Policy*). **However, no evaluations are carried out to measure the effect of these strategies and policies.** Regardless of the fact that the *System of Indicators for Assessment of the Implementation of the Strategy for Transparent Governance and for Prevention and Counteraction of Corruption for the Period 2006 – 2008* was developed by the Center for the Study of Democracy and adopted in May of 2006 by the Commission for the Prevention and Counteraction of

<sup>2</sup> For instance, see the annual *Nations in Transition* reports by the Freedom House. According to the latest reports from 2007 and 2008, the civil society index in Bulgaria has improved considerably since 1998, approximating that of the 10 new Member States (from 3,75 in 1998 it reached 2.50 in 2008, against an average of 1,75 for the new Member States; the index varies from the highest level of 1 to the lowest level of 7).



Corruption (CPCC), it has not yet been implemented into practice. No clear achievements can be pointed out showcasing the capacity of CPCC for the effective implementing and updating of the governmental anticorruption strategy following the implementation of two technical assistance PHARE projects worth over 3 million Euros for the 2006 – 2008 period.

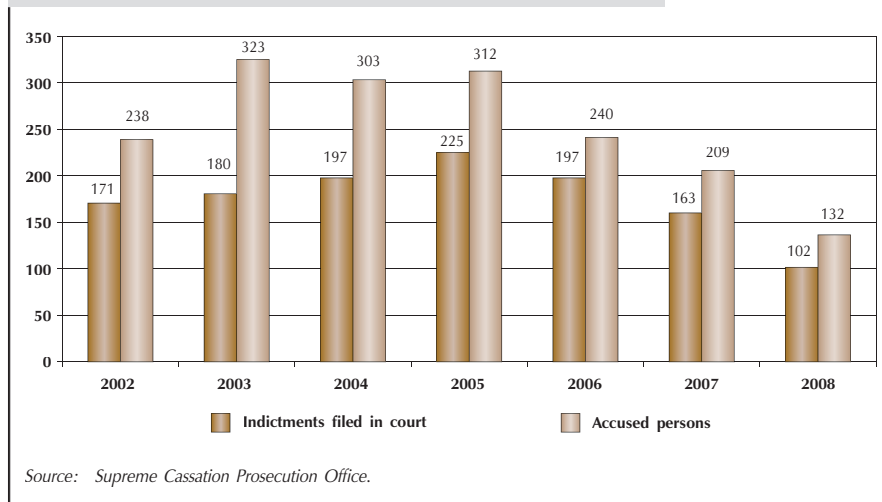
Secondly, legal **instruments, and in particular their** effective enforcement, are of unquestionable significance to the proper functioning of the state anticorruption infrastructure and policy. Irrespective of this, it was only at the end of 2008 that legislative steps were taken to address the loopholes allowing for the high degree of impunity for corrupt practices with highly adverse public effects, such as the adoption of the *Act on the Prevention and Detection of Conflict of Interests, the Public Procurements Amendment Act, the Forests Amendment Act, etc.* Although the adopted legislative reforms are a step in the right direction, the possible **effects of applying in practice the new provisions will be known only towards the end of 2009 and the beginning of 2010.**

Thirdly, **the unsolved corruption problems have influenced the evolution of the institutional mechanisms** for countering corruption and organised crime in Bulgaria in 2008. Together with the anticorruption units set up with the three branches of government, some **newly established bodies became operational** and new institutional mechanisms were introduced at the end of 2007 and in 2008. A new standing Supreme Judicial Council and an Inspectorate under the Supreme Judicial Council were elected. The State Agency for National Security /SANS/ was established; a new Unit for the Counteraction of Crimes against the EU Financial System was set up at the Supreme Cassation Prosecution Office; a special inter-agency task force for combating irregularities under the SAPARD Programme in the Republic of Bulgaria, comprising representatives of the Prosecution Office, the National Investigation Service, SANS, Mol, the State Agriculture Fund and the National Revenue Agency, was created. It is still early to assess the overall effect of their operation, but it has to be reiterated that **neither the standing Supreme Judicial Council, nor SANS have so far met their stated goals or the high public expectations with respect to their duties.** Political infighting in the course of their establishment (and, in some instances, in their operation) prevailed over the specific outcomes in combating corruption and organized crime in the judiciary and among high-level officials.

### Anticorruption Initiatives of the Judiciary

The highest anticorruption expectations of Bulgarian society are associated with the operation of the judiciary and, more specifically, of its two branches with the greatest responsibility for countering and preventing corruption and organized crime: namely, the prosecution office and the courts. Irrespective of the numerous positive changes introduced in the organisation and operation of the judiciary prior to and following the country's accession to the EU, intended to improve its accountability and effectiveness, the practical achievements in countering corruption and organized crime remain unimpressive.

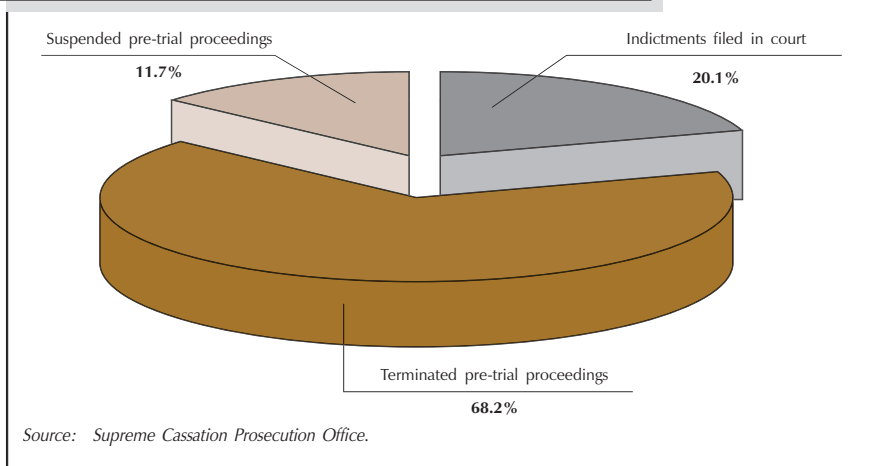
FIGURE 1. PRE-TRIAL PROCEEDINGS AND INDICTMENTS FILED FOR CORRUPTION OFFENCES<sup>3</sup> IN THE PERIOD 01.2002 – 09.2008.



The 2007 – 2008 period even witnessed a **decrease in the intensity of criminal prosecution of corruption and organised crime offences**, which could not be attributed to a decrease in the number of such offences in the country. Between 2005 and 2008, the number of indictments filed in courts for offences related to organised crime and corruption decreased by more than 30%<sup>4</sup>. In the 2004 – 2007 period, almost **80% of the pre-trial proceedings initiated for corruption offences did not end up in the courts** and were suspended or terminated at the pre-trial phase. Indictments were filed in court in just a fifth of the cases. This is due both to the lack of training and ineffective performance of investigative

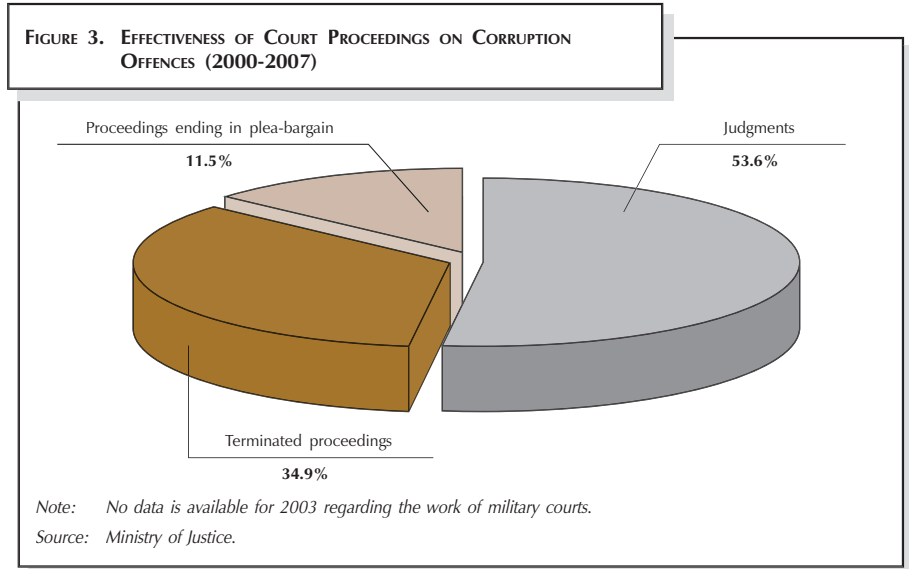
authorities and omissions in the prosecution office operation as the *dominus litis* or “process owner” in pre-trial proceedings. Moreover, over the 2000 – 2007 period, a considerable portion of the corruption cases brought to court did not end in convictions. Over a third of the court proceedings were terminated and the defendants received no conviction at all, which meant that public resources (both money and time) were consumed for expensive criminal trials with no effective outcome.

FIGURE 2. EFFECTIVENESS OF PRE-TRIAL PROCEEDINGS ON CORRUPTION OFFENCES (2004 – 2007)

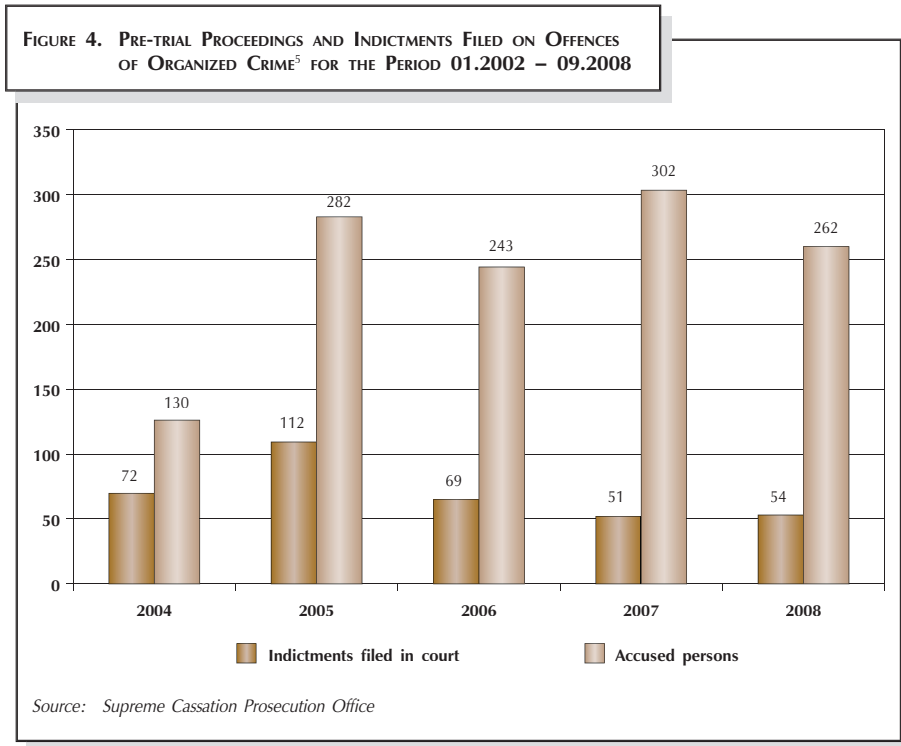


<sup>3</sup> Cases on corruption offences include those outlined in articles 224, 225b-225c, 282-283a, 301-307 Penal Code.

<sup>4</sup> Based on the first nine months of 2008.



Despite the fact that declines in the instances of criminal prosecution for corruption and organized crime offences are a cause for concern, it must also be stressed that numerous **improvements have been introduced in the functioning of Bulgaria's judiciary** over the past two years. The judiciary was relieved of the superfluous function of registering commercial companies. Its



accountability was improved through the introduction of public presentations of activity reports and statistics. Specialized corruption-busting units were set up within and outside the judiciary. The facilities and procurement of equipment for the judiciary and the magistrates was improved, although the resources allocated to their needs remain, by absolute terms, at one of the lowest levels in Europe<sup>6</sup>. There has been a rise in **public expectations with respect to the specific results that need to be achieved by the prosecution office and the courts in effectively sanctioning corruption and organized crime.** In this respect,

<sup>5</sup> Cases related to organized crime offences also include the provisions under articles 116, para 1, item 10, Article 131, para 1, item 8, Article 142, para 2, item 8, Article 155, para 5, item 1, Article 159, para 4, Article 159c, Article. 199, para 1, item 5, Article 213a, para 3, item 3, Article 235, para 4, Article 242, para 1, letter "g", Article 253, para 3, item 1, Article 280, para 2, item 5, Article 321-321a, Article 330, para 2, item 4, Article 346, para 6, Article 354a PC.

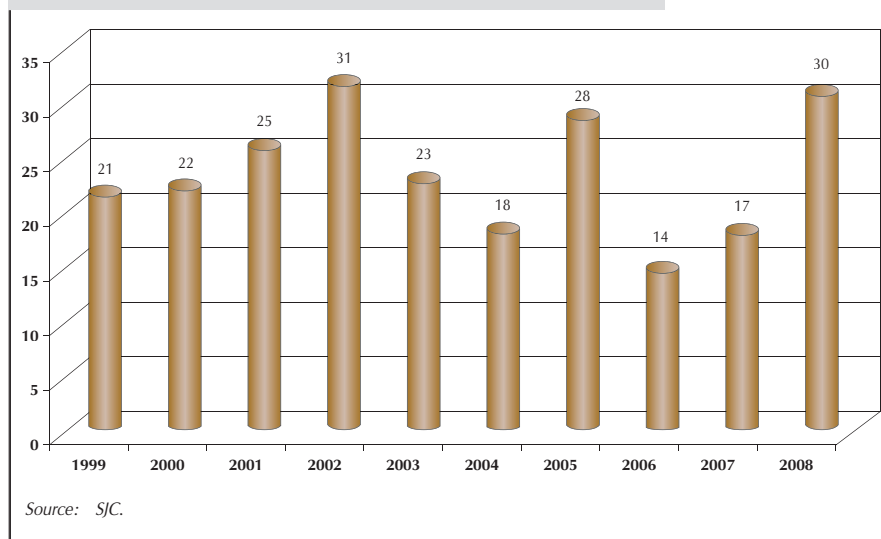
<sup>6</sup> *European Judicial Systems*, 2008 Edition, European Commission for the Efficiency of Justice, Council of Europe, 2008.

the Prosecution Office announced several initiatives at the beginning of 2008, such as the formation of task forces for resolving quickly specific cases of corruption and organized crime. These initiatives should yield concrete results during the first half of 2009, or will otherwise add to the long list of unfulfilled anticorruption promises.

As regards prosecuting and sanctioning corruption-related offences, a substantive breakthrough will hardly be possible in the fight against corruption given **the current constitutional model of the judiciary** and the overall system of separation of powers. Despite certain modifications over the course of the EU accession talks aimed at improving the accountability of the prosecution office and the court, such a model of an independent judiciary comprising the investigation service, the prosecution office and the courts remains unprotected from interference on the part of the legislature and the executive, whose will and actions determine to a great degree the fate and performance of the third branch of power. Meanwhile, political loyalty or links to shady and even criminal groups and individuals have further marred the independence of investigators, prosecutors and judges on numerous occasions. The preservation within the judiciary of the now virtually powerless – albeit autonomous and independent – Investigation Service, and the transfer of its functions to police investigators completed immediately prior to Bulgaria's accession to the EU and in response to the EC requirement to overcome the dualism of pre-trial proceedings, has not enhanced the efficiency of pre-trial proceedings, but has instead generated new problems, the solution to which still needs to be found. Meanwhile, the uniform model of recruitment and management of the judiciary does not allow for differentiating between the skills and responsibilities required of each unit within the system with respect to the detection, successful prosecution and sanctioning of corruption offences.

The **Supreme Judicial Council still remains ineffective** as regards imposing disciplinary sanctions for violations committed by magistrates. In spite the series of legislative reforms implemented over the past ten years in this field, the number of disciplinary proceedings instituted by the Supreme Judicial Council has remained at the same low level, ranging between 20 to 30 proceedings per year. Neither the transformation of the Supreme Judicial Council into a standing body, nor the statutory power of a specified number of Council Members to institute disciplinary proceedings could bring about the expected change. It was only with **the establishment of the Inspectorate under the Supreme Judicial Council that a significant rise in the number of disciplinary proceedings against magistrates occurred**, with almost half of the total number of proceedings during the first eleven months of 2008 being instituted at the Inspectorate's initiative.

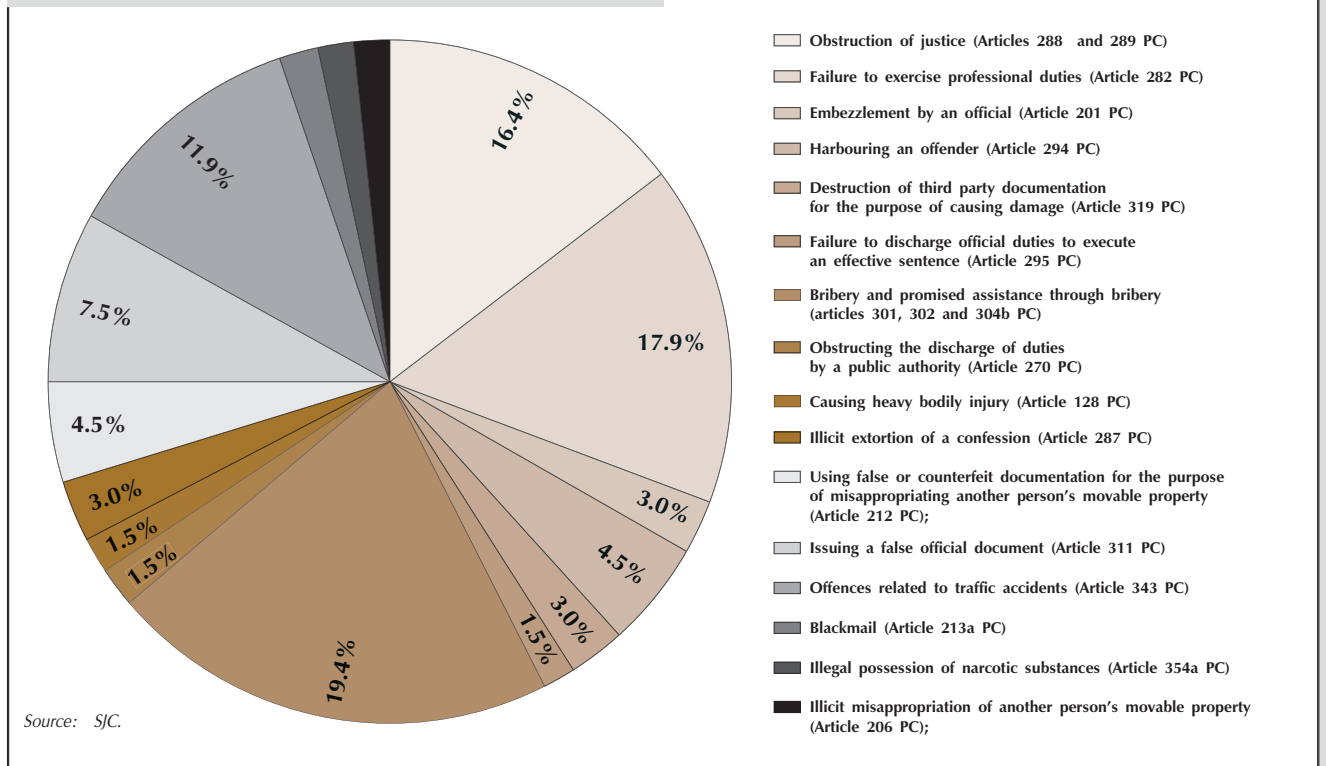
FIGURE 5. DISCIPLINARY PROCEEDINGS INSTITUTED BY THE SJC  
(1999 – 2008)



It is worth noting that during the first eleven months of 2008, the Supreme Judicial Council exercised its powers to initiate disciplinary proceedings at the initiative of a specified number of its members only three times. Moreover, during the same period, the Council upheld the sanctions proposed in half of the proceedings only (52.4%), whereas in the other cases either the proposals were rejected or the proceedings were terminated. Also, quite frequently, the Supreme Judicial Council did not confirm the more lenient disciplinary sanctions (admonition and reprimand) imposed by judiciary administrative heads: during the first 11 months of 2008, the Council repealed those sanctions in more than a quarter of the cases (26.8%).

Although the much debated and long overdue replacement of the *absolute* immunity of judges, prosecutors and investigators from criminal prosecution by *functional* immunity was finally adopted by means of relevant legislative changes, **the expected rise in the number of criminal proceedings against magistrates has failed to materialise.** From the beginning of 2006 till the end of November, 2008, only sixty-seven pre-trial proceedings were initiated against magistrates for all types of offences, eight of which were against administrative heads or their deputies, sixteen against judges, fifteen against prosecutors, eighteen against investigators and ten against judicial clerks. Of these proceedings, thirty (44.7%) ended in indictments, fifteen (22.3%) were terminated, and the remaining twenty-two (32.8%) are still pending. Out of the cases brought to court, six ended in convictions and four in acquittals (all acquittals were appealed before the higher instance court by the prosecution office). The lack of convincing criminal prosecutions against magistrates is all the more striking against the background of continuing admissions by senior judges regarding **the sustained corruptive influence of political and oligarchic interests in the judiciary.**

FIGURE 6. PRE-TRIAL PROCEEDINGS INSTITUTED AGAINST MAGISTRATES (01.2006 – 11.2008)



The number of criminal proceedings for corruption-related offences against magistrates is even smaller. Over the course of nearly three years the cases when proceedings were initiated for the most widespread offence of bribery numbered merely thirteen.

**The small number of disciplinary and criminal corruption proceedings against magistrates** is of even greater concern in view of the considerable amount of corruption-related whistle-blowing in the judiciary. Just for the period between January and July of 2008, the Commission on Professional Ethics and Corruption Prevention of the Supreme Judicial Council received 674 complaints and tips from citizens. For the same period, the Commission reviewed 1346 cases, and sent letters on 874 (42.2%) of these; 489 required an inspection and reply by the relevant judicial body and 105 were referred to the competent SJC Inspectorate); in 280 of the cases (20.8%) citizens were notified that the complaint was outside the competence of the Commission, and in 472 (35.1%) the complaint was attached to a case file for information. Owing to the lack of investigative powers and the impossibility to prove the existence of corrupt practices, the main activity of the Commission so far has been merely to receive, review and refer complaints to the competent authorities. Indeed, the statistics on disciplinary proceedings and criminal prosecutions against magistrates reveal that very few of the complaints and tips referred were followed by some action, which further reinforces the impression **of the de facto impunity of members of the judiciary from criminal prosecution**. Although the Commission does not have specific powers in this respect, it could and should commit more actively to both summarizing and analyzing the complaints received, it should

propose appropriate measures based on such analysis, and it should supervise and monitor the development and resolution of specific cases that have been forwarded to other bodies.

\* \* \*

More than a decade ago, **Bulgaria's civil society initiated a public debate on corruption**, creating instruments and mechanisms in countering it in partnerships with public institutions. For ten consecutive years, the *Corruption Monitoring System* developed by the Center for the Study of Democracy has served as a reliable tool for identifying and analyzing corruption risks. The anticorruption policy forums initiated in 1998 and numerous national and local level projects continue to serve as working platforms for effective public-private partnership and for reducing the impact of corruption in Bulgaria.





## 1. SPREAD OF CORRUPTION IN BULGARIA – CONTRADICTIONARY TRENDS IN 2008

Bulgaria has been a member of the European Union for two years. The past one year put to the test the ability of Bulgarian government institutions to meet the commitments taken on with regard to countering corruption. The progress made has been unsatisfactory. Corruption, along with organized crime and the ineffective functioning of the judicial system, is still an extremely serious problem of Bulgarian society. This applies not only to administrative, but also to political and institutional corruption involving the political elite, MPs, high-ranking government officials, and magistrates.

In this context, the findings of the *Corruption Monitoring System (CMS)*<sup>7</sup> in 2008 not only measure the level of corruption, but also facilitate the clearer identification of the new challenges facing anti-corruption policies and actions.

### ***Corruption Monitoring System***

The *Corruption Monitoring System (CMS)* has been designed and developed by the Center for the Study of Democracy and Vitosha Research. CMS was the first of its kind in post-socialist countries to combine significant research resources and powerful anti-corruption potential. The purpose of CMS is to measure the level of corruption in this country, as well as to identify related public perceptions, opinions, and expectations. It has already been eleven years since CMS was first put to use in 1998 and one of its notable benefits is the accumulation of data on the structure and dynamics of corrupt practices in Bulgaria. CMS has gained acknowledgement from the UN as a best practice national system for monitoring corruption. It has several important advantages:

- Coherence with the UN victimization approach to measuring administrative corruption levels;
- Reliance on diverse sources of information and combining quantitative and qualitative methods for monitoring and assessment;

<sup>7</sup> A detailed outline of the CMS methodology is found in *Clean Future. Anti-Corruption Action Plan. Monitoring. Corruption Assessment Indexes*, Center for the Study of Democracy, Sofia, 1998

- Use of nationally and internationally established methods and indicators for assessment of the actual spread of corruption and its public perception;
- Dynamic comparability of the monitoring findings regarding the scope, areas, and forms of corruption;
- Comparability of the information on Bulgaria with that on other European countries.

The criteria for assessment of the progress made in countering corruption have increasingly been shifting from parallels with the past to international comparative analyses outlining the country's place and prospects as an EU member. That is the reason why the Report presents data from some international studies on different aspects of the spread of corruption, its proportions and dynamics. Thus, for instance, public perceptions of the level of corruption in this country are registered by the Corruption Perception Index of Transparency International. Yet, sweeping conclusions based on a single synthetic index that reflects largely subjective opinions can be misleading. By contrast, CMS also provides information about the spread of corruption practices (experience with corruption). Surveys based on different sources tend to have divergent findings about the scope and dynamics of corrupt practices. The careful analysis of these sometimes contradictory tendencies is crucial for correctly pinpointing the high-risk areas for the spread of corruption and for outlining adequate anti-corruption policies and measures. Conclusions in the Corruption Assessment Report are therefore based on a more detailed account of data obtained by CMS and other national studies, as well as by some international surveys that together help reveal the complex nature of the spread of corruption in Bulgaria.

**The most notable positive developments regarding the levels and tendencies in the spread of corruption in this country** can be summed up as follows:

First, **corruption victimization in the business sector has been on the decline since 2004** (as measured by the incidence of corruption-related payments made by businesses). The level of corruption victimization (i.e. the objective, rather than subjective, assessment of the corruption situation) has dropped by half – the index reflecting this level fell from 1.1<sup>8</sup> in April 2004 to 0.4 in August 2008.

Second, **the share of companies experiencing corruption pressure by public administration officials has been on the decline** as well. The value of the aggregate index reflecting the rate of corruption pressure on businesses fell from 2.4 (April 2004) to 1.5 (August 2008).

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<sup>8</sup> The maximum value of this and all other indexes referred to below is 10 (highest rate of corruption victimization), while the minimum value is 0 (absence of corruption).

Third, **according to entrepreneurs and managers, corruption in business has been decreasing.** The value of the index reflecting their subjective assessment of the spread of corruption fell from 6.0 (April 2004) to 5.8 (August 2008).

Fourth, **corruption is increasingly less likely to be perceived as an effective tool for addressing private problems** by Bulgarian business managers. The index measuring these attitudes among entrepreneurs and managers displays a positive trend and has dropped from 5.6 in April 2004 to 3.3 in August 2008.

Set against the registered positive trends in the business sector, a number of **negative findings about the spread of administrative corruption among the population** stand out:

First, unlike the decline in corrupt practices in business, **there persists the alarming tendency over the past four years towards an increase in corruption pressure on Bulgarian citizens.** The index reflecting this level has doubled in August 2008 (1.7) compared to March 2004 when it was at its all-time low (0.8).

Second, **the registered incidence of acts of corruption committed by Bulgarian citizens has equally been on the increase** – the value of the respective index rose from 0.3 in March 2004 to 0.7 in August 2008.

Third, **Bulgarian citizens' general assessment of the social environment in terms of corruption is that it has been deteriorating.** The value of the index reflecting subjective perceptions of the spread of corruption grew from 6.3 (March 2004) to 6.9 (August 2008). Furthermore, corruption is increasingly perceived as an effective instrument for solving private problems – the respective index rose from 6.5 in March 2004 to 7.2 in August 2008.

Fourth, **corruption definitely emerges as the single most serious problem facing this country** – two-thirds of Bulgarian citizens (64.7%) are of this opinion. The share of those holding this view has more than doubled over the past four years (31% in March 2004).

Overall, the general conclusion is that the **business sector is displaying visible and lasting positive changes in terms of reducing corruption. However, its level is rising in citizens' daily interaction with members of the public administration.** Public attention is further centered on **political corruption** involving high-ranking government officials, politicians, and magistrates. This largely results from the public disclosure of several major corruption scandals, which has raised public sensitivity about manifestations of political corruption, bringing it to the fore as a key problem of Bulgarian society.

## 1.1. Levels and Dynamics of Corruption

The analysis of the spread of corruption in this country distinguishes between two important aspects: first, the level of 'actual corruption' and second, that of 'potential corruption'. Committed acts of corruption are designated as 'actual corruption' while the solicitation of corruption transactions<sup>9</sup> is termed 'potential corruption'. The level of the latter essentially reflects the amount of corruption pressure exerted by those who solicit corruption.

### *Corruption Victimization of the Population and the Business Sector*

The general levels of actual and potential corruption are measured through two synthetic corruption indexes:

1. **Involvement in corruption transactions.** This index is calculated based on the frequency of self-reported instances when citizens and businesses informally provided money, gifts, or favors in order to have a problem solved. It reflects the level of actual corruption in the country over a definite period of time.
2. **Corruption pressure.** It is constructed on the basis of the frequency of self-reported cases when citizens and businesspersons were asked for money, gifts, or favors in order to have a problem of theirs solved. It reflects the level of potential corruption in this country.

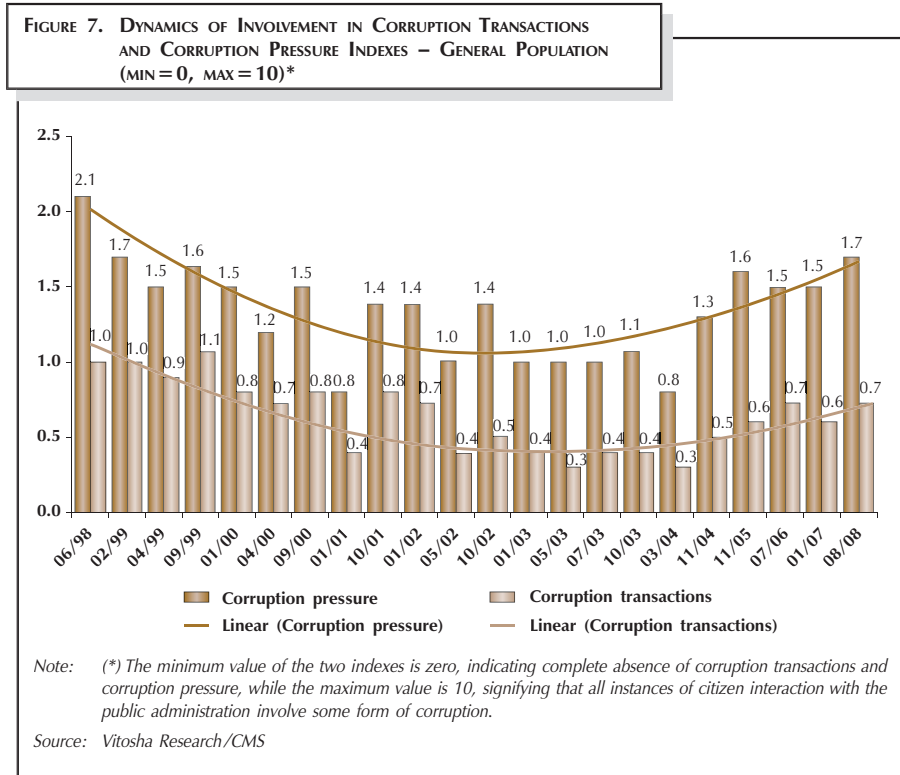
*Source: Corruption Monitoring System*

**These two corruption indexes do not reflect subjective opinions, assessments, or perceptions but self-reported involvement in real acts of corruption.** The corruption indexes reflect and measure the so-called administrative corruption occurring in the interaction of citizens and businesses with public sector employees and officials at the lower levels of the hierarchy. Information about political and institutional corruption is generally not obtained by representative surveys of the population and is obtained only to some degree by surveys of the business sector. Within CMS, the assessment of this type of corruption is based on qualitative methods and desk research.

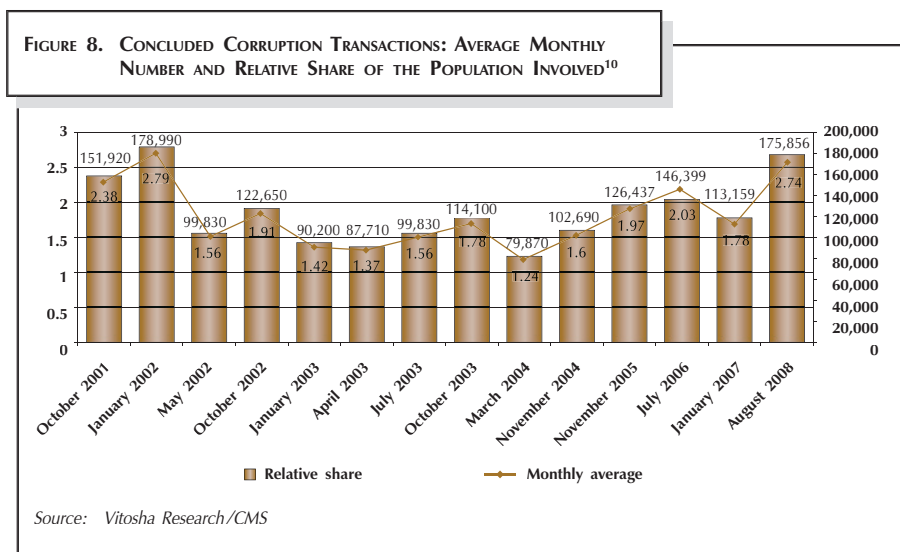
**The 1998-2008 period displays an initial downward trend in actual and potential corruption among the Bulgarian population followed by another upsurge over the past four years.**

After 2004 there appeared alarming indications of rising incidence of corruption transactions. In 2008 there was a slight increase in the values of the Involvement in Corruption Transactions and Corruption Pressure indexes concerning the general population.

<sup>9</sup> The term 'corruption transaction' refers to all instances of informal provision of money, gifts or favors by citizens or businesspersons, regardless of the sphere in which this occurs – legislative, judiciary, or executive branches of power, public services, business, or the third sector.



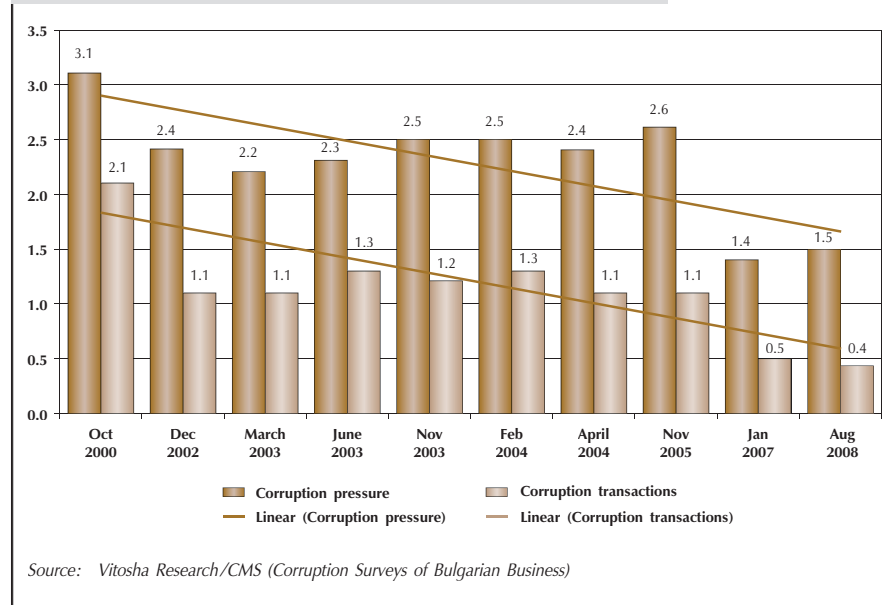
Whereas in 1998-1999 the average monthly number of self-reported cases of involvement in corruption transactions by adult Bulgarian citizens ranged between 180,000 to 200,000, in the period July 2003-March 2004 it was about 80,000 to 90,000. After 2004 the number of actually concluded corruption transactions reverted to the higher values characteristic of the earlier 2000-2001 period. **In 2008, the average monthly number of corruption transactions in which Bulgarian citizens were involved increased, reaching approximately 175,000.**



<sup>10</sup> Note: Calculations of the number of corruption transactions are based on the March 2001 population census according to which the population aged 18 and over numbered 6,417,869 and 1% of the sample accordingly represents 64,180 persons.

The reverse tendency is observed as regards actual and potential corruption levels in business. **The index of actual corruption in business dropped tangibly from 1.1 in November 2005 to 0.4 in August 2008, i.e. the level of corruption victimization fell almost threefold.** Corruption pressure by public and administrative officials on businesses has also been on the decline. The value of the corruption pressure index dropped from 2.6 (November 2005) to 1.5 (August 2008). As the corruption pressure on companies decreases ever fewer businesspersons say it is an established practice in their sector to make extra informal payments in the process of conducting business affairs/transactions.

FIGURE 9. DYNAMICS OF INVOLVEMENT IN CORRUPTION TRANSACTIONS AND CORRUPTION PRESSURE INDEXES – BUSINESS (MIN = 0, MAX = 10)



These data suggest that the business environment in Bulgaria is gradually improving and is beginning to operate in a more regular manner. The reasons for this may lie in the following recent developments:

- The reduced **fiscal burden** on businesses reduces covert business activity, the existence and proliferation of which generally involves the widespread use of corrupt practices;
- The change in the **customs regime** for foreign-trade operations involving EU member countries. Customs have long been regarded as a domain of pervasive corruption and limiting corrupt practices within this system has had a tangible effect on the general level of business corruption;
- Increased **foreign investment** and the establishment of major international corporations in the Bulgarian market in a number of sectors (banking and insurance, telecommunications, industrial production, retail, etc) that have accompanied Bulgaria's EU accession have led to the adoption by Bulgarian entrepreneurs

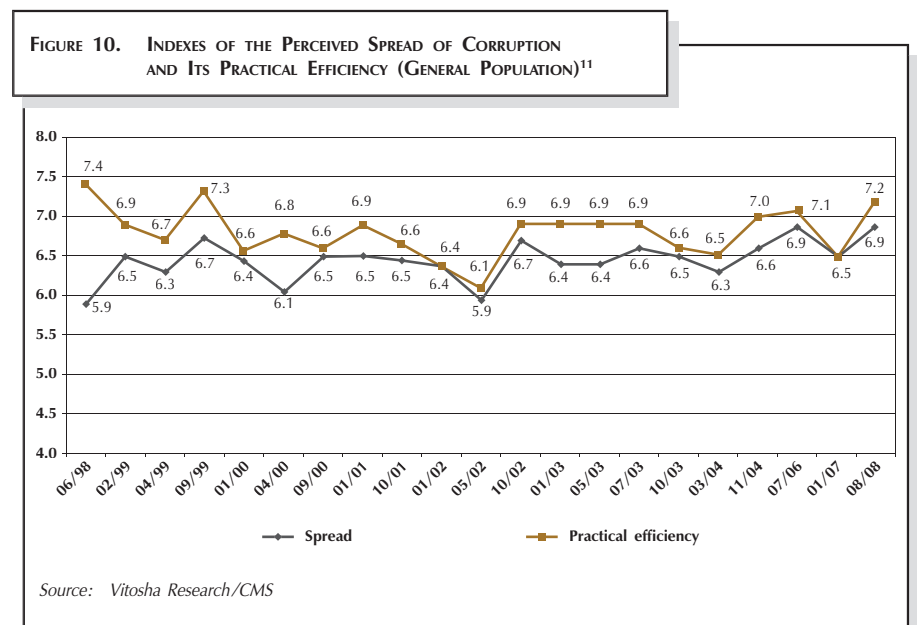
and managers of European good governance practices which help reduce the incidence of corruption in business;

- Efforts aimed at **internal self-regulation** in the various branches and sectors of the economy – the adoption of codes of ethics and business conduct rules aimed at limiting unfair competition – have gradually been driving out of the market discredited business entities using corrupt practices.

Further evidence of the normalization of the business environment is found in the ever greater consistency between data on people's subjective perceptions of the spread of corruption and data on the corrupt practices in which they are actually involved. Differences in corruption trends among the Bulgarian population and in the business sector are equally reflected in the divergent subjective assessments of the spread of corruption of citizens and business managers.

## 1.2. Subjective Assessments of the Spread of Corruption by Citizens and Business Representatives

The perceived spread of corruption in Bulgarian society from the point of view of the general public and the business community tends to change in line with the registered corruption victimization tendencies in the country in 2008. The subjective opinion of the Bulgarian population in the past four years is that corruption has been increasing.



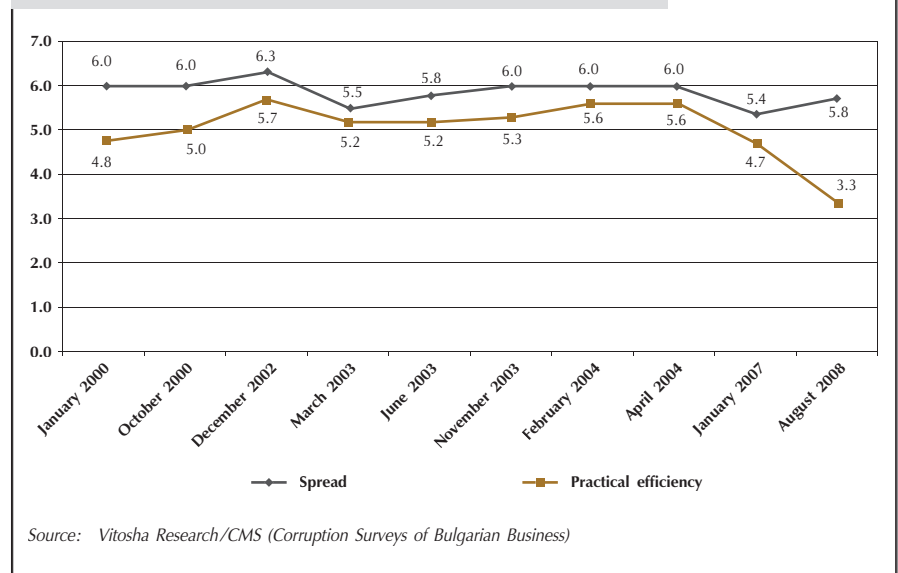
The proportion of citizens who perceive corrupt practices as an effective problem-solving tool has been increasing as well. Bulgarian businesspersons, on the other hand, tend to assess differently the spread

<sup>11</sup> **The Index of the Perceived Spread of Corruption** registers citizens' subjective assessments of the spread of corruption. The **Index of the Practical Efficiency of Corruption** reflects citizens' subjective opinions about the extent to which corruption is becoming an effective means of solving private problems.



of corruption in the economy. Over the past four years, the proportion of business managers who consider corruption an effective means of solving private business problems has been decreasing tangibly. This is one of the factors contributing to the registered decline in corrupt practices in the business sector.

**FIGURE 11. INDEXES OF THE PERCEIVED SPREAD OF CORRUPTION AND ITS PRACTICAL EFFICIENCY (BUSINESS)**



### 1.3. Values and Public Attitudes to Corruption

#### 1.3.1. Acceptability of Corruption

The Corruption Monitoring System incorporates two sets of indicators concerning corruption-related values and attitudes:

- Level of tolerance of various forms of corruption;
- Citizens' inclination to resort to corrupt practices to solve arising problems.

#### **Corruption Indexes of Public Attitudes to Corruption**

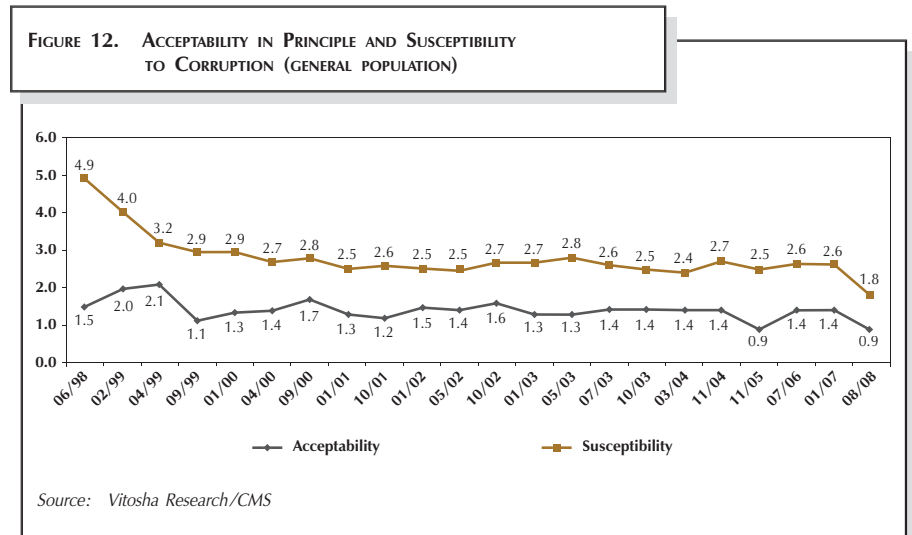
*Acceptability in Principle of Corruption* – measures the level of acceptability within the value system and tolerance of corruption occurring in different areas of the public sector.

*Susceptibility to Corruption* – assesses the inclination of citizens and businesspersons to resort to corrupt practices in addressing private problems.

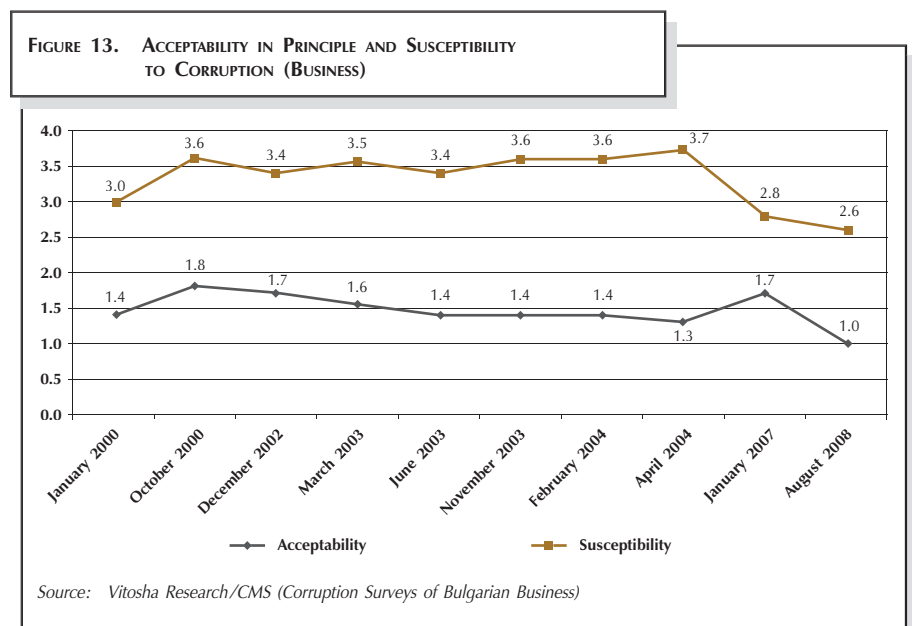
Source: Corruption Monitoring System



In the period covered by regular monitoring of these two corruption indexes, there has emerged a tendency towards growing moral rejection of corruption. Since 2001, the public's tolerance of corruption has remained essentially unchanged at a relatively low level. In 2008 there was a decrease both in Bulgarian citizens' tolerance of corruption and in their inclination to engage in corrupt practices. Citizens appear less likely to accept various forms of corruption as normal, which is a critical favorable precondition for the implementation of effective anti-corruption policies.



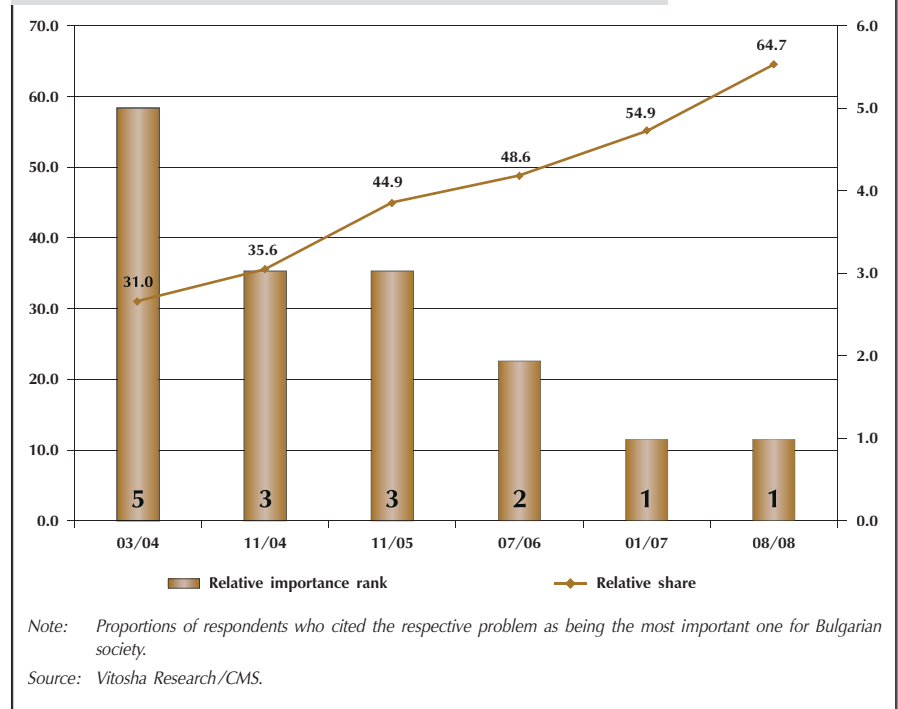
**Equally on the decline are business managers' tolerance of corruption and their inclination to engage in corruption transactions.** These indexes reached all-time low values for the entire duration of the monitoring. This fact provides further confirmation of the significant positive changes taking place in the business sector as regards curbing administrative corruption.



### 1.3.2. Social Significance of Corruption

The Bulgarian public still largely considers corruption to be a pervasive phenomenon at all levels of government and in all areas of public life. In the period since 1998 corruption has invariably been perceived as one of the most serious problems Bulgaria is facing. In the years between 2004 and 2008, as a result of the stable macroeconomic situation, high economic growth rates, and the government’s active social policies, the severity of problems such as poverty and unemployment diminished. **Yet the importance of corruption as a social problem grew ever more urgent and in 2008 it rose to the top of the country’s public agenda.**

FIGURE 14. RELATIVE IMPORTANCE OF CORRUPTION AS A SOCIAL PROBLEM (%)



The importance of corruption as a social problem is sometimes downplayed with the argument that subjective opinions are all too often at odds with the actual corruption situation. Yet the data gathered in the ten years of CMS implementation suggest that **public perceptions relatively closely match the actual achievements or failures of anti-corruption policies in the various sectors of society.** Thus, for instance, the improvements in terms of reducing unemployment and poverty in the country are in line with the perceived lower significance of these two negative phenomena. In 2008, the correlation between the actual dynamics of corrupt practices and their subjective perception found confirmation in the data on corruption-related attitudes and behaviors both of the population as a whole and of the business sector in particular.

#### 1.4. Spread of Corruption in Bulgaria in the International Context

The monitoring and measurement of corruption not only have a national, but also an international dimension. It is thus equally important to examine the relative corruption level in Bulgaria in comparison with other countries, including members of the European Union. International comparative studies facilitate the improved identification of problem areas with regard to corruption in individual countries, as well as the existing anti-corruption best practices.

Although corruption tends to be defined in different terms and its forms are constantly evolving, considerable experience has been gained in recent years in the implementation of international comparative surveys on corruption.

##### *International and National Corruption Surveys*

The **International Crime Victim Surveys** (ICVS), which have been conducted since the late 1980s, make it possible to assess acts of crime, including corruption, on the basis of their objective parameters rather than subjective perceptions (such as the Transparency International Corruption Perceptions Index). The first National Crime Survey (NCS) using this methodology was conducted in Bulgaria in July 2002<sup>12</sup>.

Based on the methodology of the international victimization surveys, the EU International Crime Survey<sup>13</sup> was conducted in 2005 making possible the assessment of the position of Bulgaria in terms of the spread of various criminal, including corrupt, practices.

Since 1995 Transparency International has been publishing its annual **Corruption Perceptions Index** (CPI) providing an international framework for comparing the rate of corruption as subjectively perceived by businesspersons, experts, risk analysts, and citizens.

The **World Bank** has been conducting **enterprise surveys** that assess countries' economic climate and obstacles to business development. These surveys also collect data on the incidence and rate of corrupt practices and their impact on the business environment<sup>14</sup>. These surveys have served as a basis for three World Bank reports on corruption in the countries in transition<sup>15</sup>.

<sup>12</sup> The survey was conducted by Vitosha Research on commission by Open Society Fund and UNICRI. In November 2004, December 2005, March-April 2007, and January-February 2008, the Center for the Study of Democracy and Vitosha Research conducted another four national crime surveys in the country.

<sup>13</sup> In 2007 it was conducted in Bulgaria, as well, by the Center for the Study of Democracy and Vitosha Research.

<sup>14</sup> Bulgaria was included in the 2001 *World Business Environment Survey (WBES)*, and in the three regional surveys of the countries in transition – *Business Environment and Enterprise Performance Survey (BEEPS)*, in 1999, 2002 and 2005.

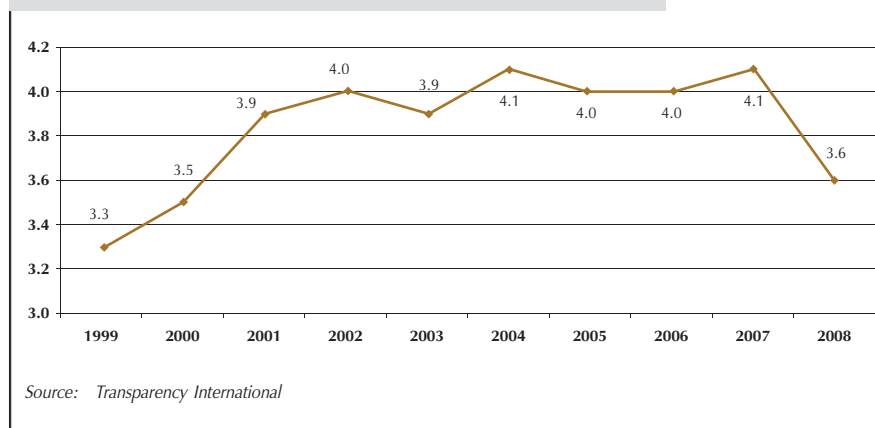
<sup>15</sup> *Anticorruption in Transition. A contribution to the Policy Debate*, The World Bank, 2000; *Anticorruption in Transition 2*, The World Bank, 2003; *Anticorruption in Transition 3. Who is Succeeding ... and Why*, The World Bank, 2006.

In 2006, Bulgaria was included for the first time in the **ranking of the Institute for Management Development (IMD)**, Lausanne, assessing the competitiveness of the economies of 61 countries. It incorporates a component measuring the rate of corruption<sup>16</sup>. These surveys are conducted on an annual basis, including in Bulgaria.

All of these international comparative surveys help answering the question “Where does Bulgaria stand in terms of the rate of corruption with respect to the other European countries?”

The annual Transparency International Corruption Perceptions Index shows that in the period from 1998 to 2008, being initially a nation state with systematic corruption problems (CPI lower than 3), Bulgaria became a country with a moderate rate of corruption. However, although the index value increased till 2004, it remained largely unchanged until 2007, while a drop was registered in 2008.

FIGURE 15. CORRUPTION PERCEPTIONS INDEX FOR BULGARIA



These tendencies fall in line with the findings of national corruption surveys regarding worsening public perceptions of the rate of corruption over the past four years.

In comparative terms, the lowest values of the Corruption Perceptions Index in the countries of the European Union were registered in Bulgaria (3.6) and Romania (3.8). A decline in CPI values was also observed in other European countries – United Kingdom (from 8.4 in 2007 to 7.7 in 2008), Portugal (from 6.5 to 6.1), France (from 7.3 to 6.9), Italy (from 5.2 to 4.8). CPI values rose in Cyprus (from 5.3 in 2007 to 6.4 in 2008) and in Poland (from 4.2 to 4.6). Among the countries of Central and Eastern Europe, the highest index values were registered in Slovenia (6.7) and Estonia (6.6). Overall, the average index value for the EU has been on the decline and reached 6.48 in 2008.

<sup>16</sup> *IMD World Competitiveness Yearbook*, Lausanne, Switzerland, 2006, p. 377; 2007, p. 348; 2008, p. 357.

**TABLE 1. CORRUPTION PERCEPTIONS INDEX (CPI)  
FOR SOME EUROPEAN COUNTRIES**

| State           | 2008       | 2007       | 2006       | 2004       | 2002       | 2001       | 2000       | 1999       | 1998       |
|-----------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Denmark         | 9.3        | 9.4        | 9.5        | 9.5        | 9.5        | 9.5        | 9.8        | 10.0       | 10.0       |
| Sweden          | 9.3        | 9.3        | 9.2        | 9.2        | 9.3        | 9.0        | 9.4        | 9.4        | 9.5        |
| Finland         | 9.0        | 9.4        | 9.6        | 9.7        | 9.7        | 9.9        | 10.0       | 9.8        | 9.6        |
| Netherlands     | 8.9        | 9.0        | 8.7        | 8.7        | 9.0        | 8.8        | 8.9        | 9.0        | 9.0        |
| Czech Republic  | 5.2        | 5.2        | 4.8        | 4.2        | 3.7        | 3.9        | 4.3        | 4.6        | 4.8        |
| Hungary         | 5.1        | 5.3        | 5.2        | 4.8        | 4.9        | 5.3        | 5.2        | 5.2        | 5.0        |
| Italy           | 4.8        | 5.2        | 4.9        | 4.8        | 5.2        | 5.5        | 4.6        | 4.7        | 4.6        |
| Greece          | 4.7        | 4.6        | 4.4        | 4.3        | 4.2        | 4.2        | 4.9        | 4.9        | 4.9        |
| Poland          | 4.6        | 4.2        | 3.7        | 3.5        | 4.0        | 4.1        | 4.1        | 4.2        | 4.6        |
| Romania         | 3.8        | 3.7        | 3.1        | 2.9        | 2.6        | 2.8        | 2.9        | 3.3        | 3.0        |
| <b>Bulgaria</b> | <b>3.6</b> | <b>4.1</b> | <b>4.0</b> | <b>4.1</b> | <b>4.0</b> | <b>3.9</b> | <b>3.5</b> | <b>3.3</b> | <b>2.9</b> |

Note: The Corruption Perceptions Index measures the corruption level in a given country as perceived by businesspersons and risk analysts, and ranges from 10 (low corruption level) to 0 (extremely high corruption level).

Source: Transparency International

However, the values of the Transparency International Corruption Perceptions Index are based on data about subjective perceptions and assessments.

#### ***Methodological Limitations of the Transparency International Corruption Perceptions Index***

The Transparency International Corruption Perceptions Index suffers from several limitations in terms of its computation methodology and application:

**First**, it is largely based on subjective perceptions of the rate of corruption and can be influenced by a number of situational factors distorting the assessment of the actual corruption situation. These subjective opinions may be motivated by factors quite unrelated to the goal of verifying the objective parameters of corrupt practices.

**Second**, CPI focuses on the incidence of bribery and extortion mainly in business, leaving out a number of other notable corrupt practices (e.g. political corruption, clientelism, protection racketeering, nepotism, etc).

**Third**, as a rule TI does not use corruption surveys of its own but relies on independently conducted research and expert assessments. The requirement to use a minimum of three data sources prevents

a number of countries (for example in Africa, the Near and Middle East) from being included in CPI.

**Fourth,** certain basic indicators (e.g. the presence of single-party rule or the length of the government's term in office used by the International Country Risk Guide and incorporated in the CPI) are too remotely related to the rate of corruption in a given country.

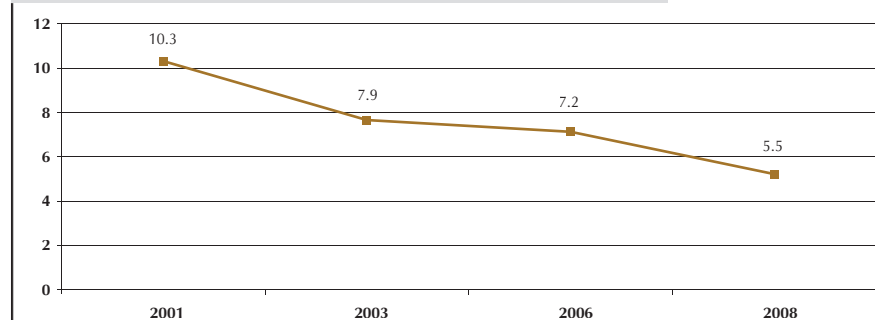
**Fifth,** CPI has been criticized for its one-sidedness as it focuses on bribe-takers while disregarding bribe-givers. In this sense, it appears to fail to fully take into account the binary nature of corrupt practices, and is thus skewed in favor of richer countries at the expense of poorer ones.

**Sixth,** CPI is not in a position to assess trends in the spread of corruption although it is often interpreted in this manner. In this sense, it can hardly serve as an indicator of the success of implemented anticorruption policies and reforms.

Source: Galtung. Fr. *Measuring the Immeasurable: Boundaries and Functions of (Macro) Corruption Indices (2006)* in: *Measuring corruption*. Ed. by Sampford. Ch. A. Shacklock. C. Connors. Fr. Galtung Ashgate Publishing Ltd. England.

A different tendency can be identified on the basis of information from the National Crime Surveys conducted in Bulgaria (NCS 2002-2008) concerning experience with corruption.

**FIGURE 16. SELF-REPORTED CASES OF INVOLVEMENT IN CORRUPTION TRANSACTIONS IN THE PAST YEAR (% OF RESPONDENTS)**



Note: The data concern the year preceding NCS (2002; 2004; 2007; 2008)

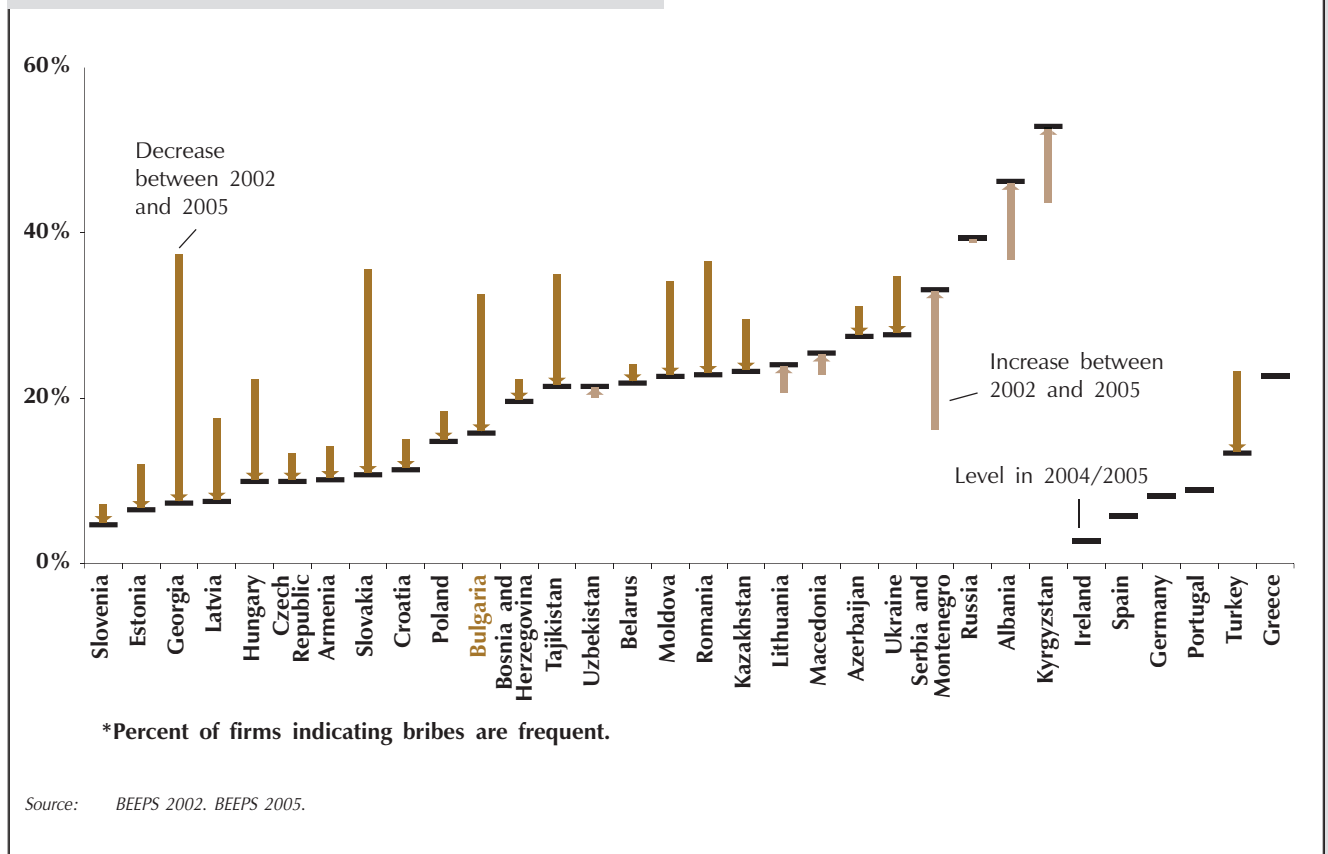
Source: Center for the Study of Democracy

Involvement in corruption reported by Bulgarian residents over a one-year period dropped from 10.9% in 2002 to 5.5 % in 2008.

Data from some international comparative surveys confirm the favorable tendencies towards declining levels of corruption in the business sector. The World Bank *Anticorruption in Transition 3* report (2006) presents

comparative data on the rate of corruption in the countries of Central and Eastern Europe from the Business Environment and Enterprise Performance Survey (BEEPS) conducted with the participation of nearly 10.000 companies.

FIGURE 17. FREQUENCY OF BRIBE-GIVING\* 2002 AND 2005.<sup>17</sup>



Bulgaria is among the countries where the greatest drops were registered in the number of cases when businesspersons pay bribes in connection with their activity. The frequency of **bribe-giving in the business sector in Bulgaria is lower than in countries such as Greece, Lithuania, Romania**, and is comparable to that in Poland, Turkey, and Portugal.

National and international corruption surveys conducted in this country generally register similar tendencies and obtain analogous results:

- Administrative corruption in business is on the decline. At the same time, administrative corruption among the population as well as political corruption are perceived as increasing;
- The corruption level in Bulgaria is assessed as exceeding the EU average;

<sup>17</sup> *Anticorruption in Transition 3: Who is Succeeding ... and Why*, The World Bank, Washington, 2006, p. 11.

- Public opinion about government efforts in countering corruption is still critical and the progress made is assessed as unsatisfactory.

Bulgaria's accession to the European Union has placed the assessment of the rate of corruption in a new context. The factors shaping corruption and its implications increasingly take on international dimensions and transcend the strictly national framework. National anticorruption initiatives and their impact are ever more dependent on concerted international efforts at curbing corruption. This calls for a new approach to its measurement and assessment based on uniform, all-European standards allowing for international comparisons. Diagnosing corruption and obtaining viable information about its dynamics are of key importance to the implementation of successful prevention and control policies. The next logical step would therefore be for the **European Union to develop its own methodology for the measurement and assessment of corruption**, as is the practice of the European Commission in other areas. The adoption of modern corruption diagnostic tools would significantly raise public trust in EU policy in this area and would help improve the EU's effectiveness in the implementation of international anticorruption standards<sup>18</sup>.

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<sup>18</sup> *The Future of Corruption Benchmarking in the EU*, Policy Brief No. 11, Center for the Study of Democracy, February 2007.



## 2. POLITICAL CORRUPTION

### 2.1. Dimensions of Political Corruption

Bulgaria has many of the features of a country affected by political corruption. Many national and international studies point out a high degree of illegitimate interconnectedness between the country's politics and economy<sup>19</sup>. Political corruption in the country takes multiple forms, but it is best exemplified by the following manifestations:

- **Lack of political morality and political responsibility:** necessary prerequisites to counteract political corruption;
- Purposeful **attempts to establish control over civil society organisations** – one of the most important elements of external political responsibility – by setting up quasi-NGOs and by co-opting existing ones in order to suppress criticism;
- **Tolerance of oligarchic organised crime**, which forestalls any progress in counteracting other types of organised crime;
- **Oligarchic control over the economy** and the use of public resources for the benefit of political parties or individuals.

#### *Elements of Political Corruption*

Political corruption is defined as the abuse of political power for private (personal or group) benefit, mainly in terms of material gains, status and wealth.

Political corruption affects political decision-makers, including politicians and high-level public officials, who are empowered to formulate state laws and determine the scope and content of rules and regulations. It can affect the following levels and positions:

- The executive branch: President, Prime Minister, ministers, members of and counselors of political cabinets, high public officials, including at domestic and foreign security services and the police;

<sup>19</sup> See the 2005, 2006, and 2007 Corruption Assessment Reports, Center for the Study of Democracy; the EC Cooperation and Verification Mechanism Reports on Bulgaria and Romania, 07, 2008; the EC Report on Bulgaria's EU-funds Management, 2008; the Corruption Perception Index 2008, Transparency International; etc.

- The legislative branch: Members of Parliament;
- The judiciary: members of the Supreme Judicial Council, heads of courts, prosecution offices and investigation services;
- Leaders of political parties (whether represented in Parliament or not);
- Local and regional government: mayors, regional governors, municipal counselors, etc.

Political corruption usually aims at:

- Public status and recognition;
- Personal enrichment (financially motivated corruption);
- Private and/or group benefits (for individuals, political parties, governments);
- Preservation and expansion of power.

Political corruption presupposes the violation of existing laws and established rules, but it could also spread via perfectly legitimate channels. Such is the case when national laws and rules leave loopholes or when legal provisions are circumvented, ignored or changed as is needed. Therefore, defining political corruption must necessarily take into account international standards as well.

Political corruption takes two basic forms. One entails the extraction of funds from the private sector and national resources. This form of political corruption occurs at the intersection of business and politics, where public and corporate funds are concentrated. The other form aims at the preservation and expansion of power (through favouritism and patronage). It is associated with the process of political decision-making and election campaigns.

Corrupt extraction and accumulation of funds could involve:

- Bribery, “commission fees” and fees levied on the private sector;
- The extraction of funds from the private sector by means of taxation policies or customs procedures;
- Fraud and economic crime;
- The creation of opportunities for rent-seeking by political means;

- The creation of market opportunities by political means with the goal of serving the interests of businesses owned by the political elite or by crony oligarchic circles;
- Extra-budgetary transfers and the manipulation of privatisation deals;
- The provision of funding to political parties by the state, the private sector and the constituents.

Corrupt methods of preserving power could involve:

- Oligarchic control over the economy: setting up and maintaining clientelist networks;
- The practice of buying political and majority support from “independent” or opposition parties and politicians;
- The practice of buying particular decisions of parliamentary, judicial, regulatory and/or supervisory bodies;
- Favoritism and patronage in the distribution of public resources;
- Electoral fraud and the practice of buying constituents and their votes,;
- The use of public funds for political campaigns;
- The practice of buying the media and the civil society.

Source: *Adapted from Political Corruption, Inge Amundsen, Christian Michelsen Institute, U4 Anti-Corruption Resource Centre*

## 2.2. Political Morality and Political Responsibility

Political morality and responsibility, or the lack thereof, are among the most important factors that could enhance or inhibit corrupt relations and interests. In official explanations to recent alleged corruption scandals, officials have insisted that despite the fact that a “certain degree” of moral unacceptability (i.e. contradicting the public interest) exists, the decisions made perfectly comply with existing legislation. This applies most frequently to cases of transactions concluded on behalf of public sector entities with private companies which are strikingly unfavourable for the state. Legal compliance is then used to claim that political morality has not been abused and, respectively, that there are no grounds to claim political responsibility (resignations) from high-level civil servants and/or cabinet members for making morally unacceptable decisions.

Such a situation clearly demonstrates the lack of will to counter corruption at the highest political level. In this respect, **an emerging key feature of political corruption** in the country, which is growing more and more visible, is the justification of **actions of officials with the provisions of existing legislation** in combination with the use of the latter to deliberately grant benefits to private sector entities closely related to those in power. Along with the constant changes in legislation, the firm **political will to favour certain private interests by ostensibly legal means**<sup>20</sup> is being demonstrated. The officials involved in such transactions reject or blatantly disregard public opinion and political discontent (including at the international level).

Political corruption is not merely related to violating legal and ethical norms. It includes cases when laws and regulatory rules are manipulated in favor of corrupt interests, i.e. when laws and regulations aimed at serving specific private interests are adopted and/or implemented. In recent years, this phenomenon has been labeled as “state capture”. The concept of “state capture” was coined by World Bank Institute experts, who tried to identify an integrated method of measuring the fusion of public and private domains. “State capture” refers to “the actions of individuals, groups, or firms both in the public and private sectors to influence the design of laws, regulations, decrees, and other government policy instruments to their own advantage as a result of the illicit and non-transparent provision of private benefits to public officials”<sup>21</sup>. “State capture” might be carried out by political agents within public institutions themselves, who could develop laws, regulations and policies in favour of private (corporate, political, criminal, community, etc.) interests.

In this situation, quite paradoxically, **the only barrier that could block corrupt interests is not the law, but political morality**, in both its internal and external dimension. This is because laws and regulations are applied selectively to the degree required by the political will stemming from political morality.

#### ***External and Internal Political Morality***

The existence of **internal political morality** allows for the restraining and/or dismissing of high-level public officials who deliberately disregard the public interest by the political parties responsible for their recruitment.

Internal political morality is nonexistent if its is considered acceptable high-level officials to be motivated by the interests of groups and individuals closely related to the respective political formation. This usually results in the emergence and reproduction

<sup>20</sup> A typical example in this respect was the regulation of duty-free trade through the Duty-Free Trade Law, proposed by the Ministry of Finance and adopted by Parliament on December 18, 2006.

<sup>21</sup> *Anticorruption in Transition: A Contribution to the Policy Debate*, The World Bank, Washington, 2000, p. XV

of clientele networks, crony circles, company loops, etc., which permeate all public spheres and exploit it for private/party benefit. The existence of such relations, where corrupt party interests dominate over those of the public, has been clearly documented in the transition years (including during the rule of the incumbent government) and blocks the implementation of effective anti-corruption policies. This situation both generates destructive horizontal and vertical governance dysfunctions and counters the application of existing anti-corruption instruments and policies. Conversely, this is a factor, which “necessitates” that laws are enforced/applied and interpreted from the perspective of current party interests.

**External political morality** exists when the social and political systems create the necessity for those in power to properly respond to public opinion and attitudes by adopting solutions to arising problems in favor of the public interest. External political morality could become a corrective factor, if there are effective possibilities for the opposition to impute political and legal responsibility when the public interest has been abused.

The established practice in the years since 1989 has been to rarely pursue or effectively impute political and criminal liability; this falls short of public expectations and blocks the operation of the external political morality factor as the public is growing increasingly incapable of identifying an appropriate embodiment of this morality (a party, a group, a civil organisation, etc.). The difficulty in finding an embodiment of external political morality is closely related to both **the actions of the political class**, and **the effectiveness of the judiciary**. The small number of convictions and the non-enforcement of criminal liability against high-level officials have had a negative impact on the public assessment of the resolve of political leaders to fight corruption. Public perceptions of slackening political will generate distrust. Publicly debated cases of political corruption are perceived as the top of the corruption iceberg. Low confidence in public institutions deteriorates public perceptions about the spread of corruption among politicians, high civil servants and members of the judiciary.

The evolution of Bulgarian society in 2008 has demonstrated that signs of internal and external political morality are very difficult to find, and, respectively that the political will that would eventually emerge as a result cannot therefore be regarded as a factor restraining corruption interests. Public expectations for a tangible reduction of political corruption have remained unfulfilled. This is why political corruption remains an element of the social environment, which considerably increases the risk of abuse of public funds with all the negative consequences this abuse would have on Bulgarian society and the country’s international image.

Introducing the concepts of internal and external political morality as the foundation of political will in the context of corruption analysis is

important, as their presence or absence is a factor, which considerably determines both the content of the legislation adopted and the degree to which laws are implemented by those in power. One of the most important keys to the efficiency of anti-corruption efforts is therefore the improvement of political process mechanisms in a way that would enhance internal and external political morality and respectively generate the political will necessary **to adopt and implement** laws promoting the public interest. This refers not only to electoral legislation, but also to the manner in which the parties in power and the opposition represent the interests of their constituencies. The effectiveness of mechanisms for seeking political responsibility in the periods between elections inside and between parties depends on the level of political morality, i.e. on the capability to subordinate specific political interests to the public interest. The absence of political morality results in parties ceasing to represent the public interest and re-focusing their priority to private (party or other) interests, thus ending up using power for their own objectives and needs.

### 2.3. Civil Society Capture

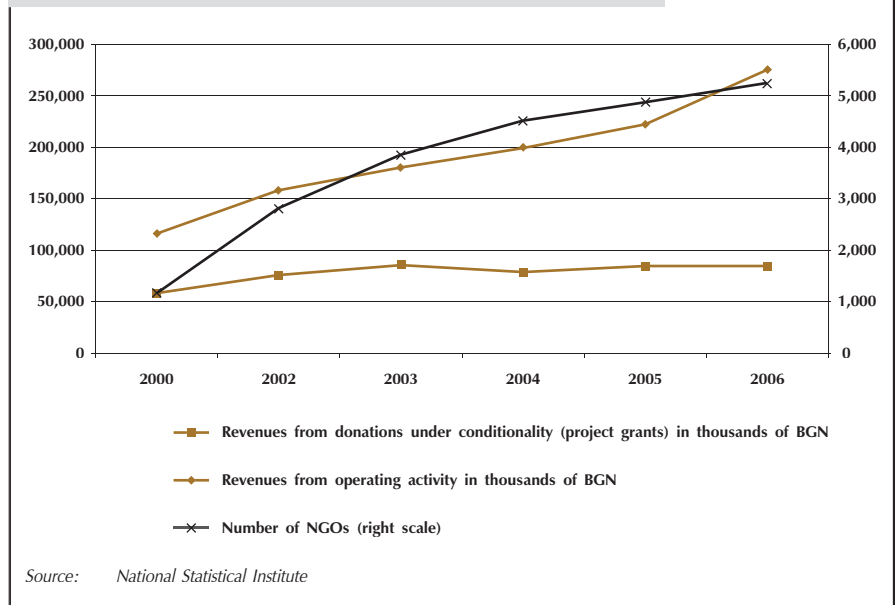
Non-government organisations (NGOs) are traditionally assessed, both according to victimisation surveys and people's perceptions, as the least corrupt when compared with other actors in the country's social and economic life. The increase in the proportion of citizens who believe that everyone or almost everyone in this sector is corrupt<sup>22</sup> from 18% to 32% of the population for the 2000–2007 period raises serious concerns. This suggests a serious disbalance in one of the most significant mechanisms of external political morality and is due to the following three sets of trends:

- over a period of eight years the **number of NGOs has increased five times**, which, however, is not an indicator of innovative social entrepreneurship, but of the fact that politicians and local authorities have perceived non-governmental organisations as **instruments for ostensibly legitimate extra income**, as tools for establishing political and personal circles of cronies, and a **safeguard against the loss of political power**. Slightly over 3/4 of MPs and the same proportion of ministers and heads of executive agencies, and over 90% of municipal mayors in Bulgaria are represented on NGO boards of directors<sup>23</sup>. Numerous other influential civil servants and members of political cabinets participate in NGOs operating in their respective fields of competence. Those NGOs offer paid training, receive state funding and exert policy influence. As a rule, these organisations have no websites or only publish scarce information about their activities, thus concealing their political ties.

<sup>22</sup> Source: *Corruption Monitoring System* and Vitosha Research, 2000–2006.

<sup>23</sup> The data is based on a survey on NGO board participation in the Ciela legal information system from the July-December 2008 period.

FIGURE 18. NGO DYNAMICS AND THEIR REVENUES (2000-2006)



- **NGOs' total turnover** of for this period **increased two and a half times**, despite the fact that that the share of grants (project funding subject to competitive bidding) shrank from 50% to 34% of total turnover between 2000 and 2006. **NGOs' share of business activity** increased over seven times in absolute terms, and its relative share rose from 9% to 28% in the total revenues. This indicates that the nature of **NGO activities is changing**, approximating regular business ones, while at the same time it is subject to less regulatory supervision. Few NGOs are audited by internationally recognized firms or have split their business and non-profit functions by forming separate legal entities. Although **corporate philanthropy has developed considerably in recent years**, mainly in favour of supporting disadvantaged children or for covering expensive medical treatment abroad for various categories of patients, there is an ongoing risk of financing political parties through NGOs. This is another factor contributing to the growth of NGOs.
- With the gradual phasing out, since Bulgaria's accession to the EU, of bi-lateral and international donor programs sponsored by foreign governments and international organisations, the **Bulgarian government has come to play a crucial role in NGO funding**. EU and public funds distributed by the government and intended for NGOs in 2008 constitute almost 40% of the total project funding for 2006. Compare to the end of the 1990s, when the core project funding for NGOs came solely from foreign sources and was considerable: it equaled about 10% of all foreign financial inflows to the country. All weaknesses and **corruption risks related to strategic target-setting and public procurement are thus transferred to the NGO sector**. The state's administrative capacity to maintain market-based competition for NGO funding is very low. The absence of any priorities in providing public funding to NGOs



or the provision of large amounts of funding to newly or ad-hoc established NGOs, as well as attempts at project micro-management by the public administration, are indicative of this trend.

Clientelism and corruption in this area came to be broadly publicized in 2005, when the Bulgarian chapter of Transparency International pressed charges against officials from the Delegation of the European Commission in Bulgaria and the Ministry of Finance for manipulating the assessment of project proposals under the PHARE-Democracy Programme. Suspicions of corruption have not yet been allayed<sup>24</sup>, whereas the European Commission continues to direct a large proportion of NGO-intended funding primarily via the government, which additionally enhances corruption risks.

Thus, using a variety of mechanisms, politicians and government officials have de facto established a **large circle of their own NGOs** which have no national, local or competitive experience, but nevertheless enjoy generous support and funding despite flagrant conflicts of interests.

This period also saw a considerable **penetration of the civil sector by organised crime**, mainly at the local level, through various types of NGOs – such as some focusing on ethnic issues, antiquities or dealing with European affairs and consultancy work. Another identified risk is **the proliferation of NGOs maintaining close ties to Russian oligarchs** and the non-transparent funding of certain NGOs operating close to the local authorities in the interest of these oligarchs.

Although this sector's turnover for 2007 and 2008 is estimated at just 350-400 million BGN per year – which equals the latest capital increase of the Bulgarian Energy Holding in December 2008 or the turnover of the Toplofikatsiya-Sofia heat distribution company, these trends may in the long run endanger the proper functioning of civil society and may have a lasting negative impact on democracy and the market economy in the country. Thereby, huge responsibility is borne by the government, by the country's compliance enforcement system, by legitimate civil society organisations, as well as by the European Commission.

To contain these threats, the Ministry of Justice proposed a radical **ban on high-level officials participating in the management of not-for-profit legal entities**. It further obliged a broad category of public officials to declare conflicts of interests in relation to such entities, pursuant to the newly adopted *Law on the Prevention and Detection of Conflicts of Interests*.

Experts estimate that the ban on participation in NGO management boards affects some 550 to 750 persons, although the time between the adoption and the coming into force of the law on 1 January 2009 has been too short to respond by convening general board meetings and submitting resignations, or reconsidering the relevant resolutions, so that

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<sup>24</sup> *Anti-Corruption Reforms in Bulgaria: Key Results and Risks*, Center for the Study of Democracy, Sofia, 2007, page 63-64.



not natural persons, but the institutions they represent (municipalities, mayoralties, regional governments, ministries, state and executive agencies and certain other authorities) would sit on NGO management boards. Only a few individuals have declared their intention to promptly resign from the NGO management boards on which they sit, whereas many others may not even be aware of the requirement. It is of crucial importance for the Council of Ministers to effectively enforce the withdrawal from management boards of at least cabinet members and their appointees, and to ensure that non-compliance is met with administrative sanctions. If this does not occur (well before the elections in 2009), the impression will be created that the law has been adopted solely for the purpose of reporting the “achievement” to the EC, and that cabinet members are thus allowed, once their term expires, to effectively stay with the NGOs which they established while in office.

Such quasi-civil organisations are more accurately referred to as QUANGOs (Quasi NGO) or GONGOs (government NGO). Such organisations are typically registered by high-level public officials who, while still in office, use their status to divert resources to the NGOs in question and profile them so that upon exiting power they could manage to arrange for a haven for themselves. During their term of office, such officials might imitate the functioning of civil society and allocate funds to NGOs.

It is a widespread practice in Bulgaria to register similar NGOs at the address of the official institution where their heads are employed, and then to switch the registration to a different address once the respective NGO's first project is awarded. An important detail in this respect is that officials in such institutions, during their working hours and as a part of their official duties, work towards the development of such NGOs – they receive training, write projects and most probably implement them before being transferred to the NGO itself, on a higher salary.

Mayors of almost all municipalities in Bulgaria participate in NGOs. Reelection to serve a second term of office is correlated with participation in a large number of NGOs. Naturally, the most widespread associations are those between municipalities or mayors and sports clubs, leaving no doubts as to the nature of the organisation. The former practice is actually related to the mayors' term of office, while the latter usually depends on local peculiarities.

#### ***Local Government Quasi-civil Associations Receiving Public Funding<sup>25</sup>***

The Kamchiyski Bryag Foundation (Avren), the Centre for Economic and Social Analyses and Strategies (Kardzhali) and the Ecological Stock-Breeding Association (the village of Tsenovo, Rousse Region)

<sup>25</sup> Some twenty similar examples (out of a total of 130 organisations funded under OPAC) have been described in articles in the *Capital Weekly* (as well as in internet forum comments on those articles)

were registered at the addresses of the respective municipalities. The three entities are beneficiaries under OPAC in the field of civil society development. The mayor of Avren participates in the management of the first organisation, and the second one used to be managed by the current mayor while he was deputy regional governor of Kardzhali. Currently it is managed by officials at the regional and municipal administration and a municipal councillor. The third NGO is more of an association of mayors or municipalities as the mayors of the Dolna Studena, Karamanovo, and Novograd villages sit on its board. It was registered only a few days before the deadline for submitting documents under the programme.

On average, mayors participate in four NGO management boards (whereas the average Cabinet member sits on three ), with the maximum number of NGOs associated with a single mayor being eleven. Quite often mayors preside over more than one organisation, with the number sometimes reaching up to five or six. However, such involvement is rarely institutionalized by a resolution of the respective municipal council or publicly announced on the website of the municipality in question (the Kardzhali municipality is a good practice in point). The municipalities themselves are not sufficiently frequently represented on management boards of organisations; neither are mayors acting as their representatives. The Srednogorie Med (Srednogorie Copper) Industrial Cluster could serve as an example of good practice, as it is managed by the municipalities themselves (Panagyurishte and Pirdop), and not by the mayors in their individual capacity. This should be the preferred approach in all cases where public institutions are associated with or become members of a particular public-private partnership.

Organisations with little or no previous institutional experience, yet with high level public officials as members of their management boards not only receive grants (as mentioned above), but **take part in the elaboration of state policies under the guise of being independent civil associations**, and provide training to civil servants. An example in this respect is the Adaptation to Electronic Government Association, which just a few months after its registration became a member – one of five other members beside the government itself – of the Information Society Co-ordination Council, whose secretary sits on its management board. The association's project was listed as qualified under OPAC's first call for proposals intended for civil society organisations, though it never received funding due to the depletion of funds. According to media publications, it provides training, assists in the opening of laboratories, etc. An interesting detail about this prominent organisation is that, more than three years after it was established, it still has no website, and is managed by individuals who launched the first e-government portal (while minister Kalchev was still in office), and recently designed the national IT portal and carried out numerous other projects financed by the State Agency for Information Technologies and Communications (SAITC).

SAITC itself has become overblown with dozens of quasi-NGOs perceived as instruments of state policy, registered at the same address and/or managed by individuals from within the ranks of SAITC or with close ties to the organisation. The risks for good governance stem from **the practical absence of control over the activity of these non-profit legal entities on the part of regulatory bodies** (such as the Agency for State Financial Inspection or the National Audit Office). Neither are these entities subject to parliamentary control. They act in an environment of low transparency, especially as regards financial reporting since the *Law on Access to Public Information* does not apply to them. An additional risk is associated with the amount of BGN 15 million in expenditures during the last four or five years for management (in fact this constitutes a business transaction per se). The funds were provided to the UNDP by the government with no tender submission required, which constituted direct state intervention in the vanishing market for Internet clubs and in the market for training public administration officials. The VAT saved on these projects and the transfer of prestige from the UNDP to the state hardly suffice to offset the negative effects of the unstable network of tele-centres, under high risk of collapse<sup>26</sup> upon any significant decline in or reversal of funding.

This unhealthy environment for the operation of civil society organisations stimulates **a special type of entrepreneurship**. On the one hand, reference has already been made to people already in power, who often establish NGOs, and on the other, to the serial (crony or family-based) entrepreneurship involving the setting up of NGOs by people formally outside power, who are nevertheless involved in local party structures (party operatives, sponsors, candidate mayors and municipal counselors).

Ensuring the incompatibility of holding high level public office and participating in NGO management boards as well as subjecting non-profit legal entities to the obligation to declare conflicts of interests are certainly a step in the right direction. It is to be expected, however, that **attempts will be made to obstruct the application of the law and that pressure will be applied to change it before the elections**. At the same time, however, the law presents the General Inspectorate under the Council of Ministers, the Parliament and the judiciary with the opportunity to demonstrate the clear political will and capacity to deal with the issues of conflict of interests before their term of office ends.

Numerous other amendments to legislation and changes in the regulatory framework need to be adopted however in order to strengthen control mechanisms as well as mechanisms for determining political responsibility. Some **possible ways of reducing corruption risks as well as improving the operational environment of civil society organisations** include:

- Developing an overall long-term state strategy to govern the work of the state with NGOs, indicating priority areas and forms of funding and

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<sup>26</sup> A large proportion of these tele-centres were effectively closed down in the period prior to the 2005 elections due to the lack of funding; they then had to be reconstituted as their former staff had already sought other jobs.

partnership. The strategy has to provide for transparent instruments for outsourcing to and ex post control by existing organisations with good capacity, instead of setting up new organisations;

- Barring organisations which are newly registered or do not have the minimum experience required under the priorities set forth in the respective operational program from benefiting from substantial public financing. It should be possible, however, to elaborate special programs for social entrepreneurship aimed at particular target groups, in order to offset the underdeveloped civil society structures in certain localities or among certain ethnic or age groups;
- Introducing more stringent transparency requirements as regards the activities, key teams involved, and financial reporting, including the need to publish financial audits on organisation websites, for those NGOs receiving public financing from the state budget or from EU structural funds;
- Improving considerably the capacity of the Ministry of Justice to maintain the Register of non-profit legal entities acting in the public interest and introducing a national electronic Register of Non-Profit Legal Entities similarly to the National Commercial Register. Currently, the Register is quite incomplete, with numerous errors, infrequent updates and frequently nonoperational functions (e.g. organisational reports reviews);
- Developing a methodology for the risk assessment of non-profit legal entities to serve the National Audit Office, the Agency for State Financial Inspection (ASFI)<sup>27</sup> and other regulatory bodies. The range of the non-profit legal entities to be inspected by the National Audit Office, in addition to including organisations receiving direct budget subsidies, may be widened to include entities that have been “institutionalised” by means of resolutions of municipalities, ministries or state agencies; entities directly under the control of the authorities, receiving direct or indirect funding from first- and second-level budget spending units or EU funds. The National Revenue Agency and the ASFI could also carry out joint inspections of non-profit legal entities, which simultaneously conduct business activities and receive funding from European projects, in order to prevent the duplication of funding for the same activity.

***Good Anticorruption Practices: the Law on the Prevention and Detection of Conflict of Interests***

Having in place rules preventing conflict of interests situations as regards high-level officials is a strong factor for the effective countering of corruption, including among high-level officials and

<sup>27</sup> In 2007 ASFI performed five NGO audits of a total of 525 inspections. However, its future audits need to include more quasi-NGOs.

politicians. Over the course of many years, in their evaluation of corruption and anticorruption reforms, experts from the Center for the Study of Democracy have repeatedly suggested that it is necessary to adopt a uniform legislative and regulatory framework dealing with conflict of interests prevention and incompatibilities of holding certain positions as well as that the provisions of certain special laws should be harmonised. On 16 October 2008, the Parliament adopted *the Law on the Prevention and Detection of Conflict of Interests*, to be enforced as of 1 January 2009. The law, which was drafted by the Ministry of Justice, is a needed instrument in the more effective counteraction of corruption. Based on modern European standards, it basically establishes a uniform legal framework on sensitive issues both as far as the state and the general public are concerned. From a political perspective, the adoption of the Law is a positive signal indicating Bulgaria's emerging political will and preparedness to undertake serious measures to curb corruption and to introduce long-overdue rules for dealing with conflict of interests. Some of the rules spelled out in the law relate to restrictions on holding public office, declaring professional incompatibility and private interests, actions to prevent conflicts of interest, restrictions following discharge from public office, restrictions on and bans from participation in public procurement procedures for the allocation of EU funds, the detection of conflicts of interest and the consequences thereof, whistle-blower protection, etc.

The scope of the law is quite broad: it is to be applied within all three branches of power, including central and local government structures. Because the different branches and levels of government have their specificities, however, it is necessary to define further and in greater detail the rules applying for each of them.

The general principles and rules for preventing conflicts of interest, establishing control mechanisms, as well as for determining the consequences of in cases of actual conflicts of interest, which the law outlines, are to be **further elaborated in special laws and the respective government regulations**, in view of the specific nature of each branch of power and the institutions and persons falling within the scope of the Law.

To meet the high expectations with respect to this Law, some of its obvious shortcomings need to be promptly addressed. Among those we could cite to the following:

- The general regulations in Article 5 on the restrictions on holding public office and the reference to "the Constitution or a special law" regarding positions and activities incompatible with public service, which is a retreat from earlier drafts of the same law containing express and detailed restrictions on holding public office;

- Article 19 of the Law provides relatively detailed rules on the discharge from duties of individuals holding public office; there are nevertheless gaps with respect to the various bodies responsible for initiating such discharges, as well as the applicable procedures;
- The exemption from the scope of these restrictions, following discharge from public duty, of a number of individuals holding public office, including Members of Parliament, the Chief Inspector and inspectors at the Supreme Judicial Council Inspectorate, judges, prosecutors and investigators. Given the enormous significance of these restrictions and the great number of well-known cases of conflict of interests among these officials, this is a cause of great concern;
- The application of this important law would supposedly overcome the weaknesses of the *Public Disclosure of Senior Public Officials' Property Law* identified in the process of its application and analyzed in previous Corruption Assessment Reports. For the law to become effective in practice, though, it is necessary for the leading institutions in each of the three branches of power to adopt specific rules and procedures to ensure that the principles governing the exercise of official duties, internal control on the possible restrictions for holding public office and the incompatibilities in the course of service, etc. can be implemented in reality.

## 2.4. Organised Crime and Political Corruption

Two years after Bulgaria's accession to the European Union, and at the outset of a serious economic crisis, the issue of organised crime and related issue of corruption are invariably subjects of public debate and are on the country's top political agenda. Assessing risks for Bulgaria in this area, while taking into account its relations with the European Union, requires an understanding of the structures and the current state of play of Bulgarian organised crime since organised crime is the major source of political corruption and a destructive factor for the internal and external political morality in the country.

There are three broad types of discernible criminal structures with different historical backgrounds, dynamics and dispositions towards the use of political corruption for facilitating their activities:

- **Violent entrepreneurs** (violent entrepreneurship groups) are the most clearly distinguishable segment of organised crime. **Violent entrepreneurship groups** are the Bulgarian version of the model known as the "**entrepreneurship of violence**". The political and economic stabilisation in 1997 put an end to the so called "golden age" in the entrepreneurship of violence. The process



of adaptation that followed led to the development of various corruption techniques and clientelist relations;

- **Deviant entrepreneurs** secure for themselves a **competitive advantage in the market by means of criminal structures**. Unlike ordinary companies, organised criminals of this kind obtain their market advantage via the nonpayment of duties, taxes, and charges as well as through criminal or illegal transactions. Historically, this type of organised crime emerged before violent entrepreneurs and oligarchs did. Deviant entrepreneurs were the first to apply large-scale corruption techniques with respect to civil servants, such as customs officers, police officers, tax officers, etc. Bribes allow them not only to freely operate in violation of the law, but also ensure that the work of competitors is also obstructed (e.g. when customs officers confiscate competitors' commodities, when extra or targeted tax audits are performed, etc.);
- **Political investors or oligarchs** represent the currently most influential kind of organised crime in Bulgaria which is most often associated with political corruption.

The term "oligarch" (oligarchs), by analogy with Russia and Ukraine, began to be used in Bulgaria in reference to the leaders of some of the biggest business groups. The introduction of this concept is designed to demonstrate the qualitatively different pattern of organised criminal behaviour of oligarchic structures as compared to the patterns associated with violent entrepreneurs. The use of the term "oligarch" is subject to considerable restrictions in the Bulgarian context. **Unlike countries like Russia, where the state directly shields the domestic market from foreign companies and ensures the monopoly or oligopoly status** of Russian companies, such efforts in Bulgaria are much more constrained. As a result, opportunities for Bulgarian oligarchs are much narrower due to the well established presence of international companies, especially after the country's accession to the EU. Very often, even after succeeding in acquiring control over some internal markets, Bulgarian oligarchic companies eventually resort to selling their business to foreign corporations or shrink in market share until finally becoming marginalized. However, there are certain sectors in the economy, highly dependent on municipal legislation and heavily dependent on state policies, which remain impenetrable to foreign investors without a suitable local partner. During the past several years such relationships could be observed in the granting of concessions over airports and seaports, in the establishment of law firms, etc.

Meanwhile, the concept of oligarchy seems to provide a suitable description of dozens of business structures in Bulgaria, which emerged along with violent entrepreneurs and managed to gain access to local and national resources by exerting influence over political elites, rather than by using violence. With entrepreneurs "selling" protection, the dynamics involved are bottom-up in nature, i.e. they use violence to appropriate the tangible assets they need and thus extort financial resources from small and medium-sized businesses. **Oligarchs**, on the

other hand, **tend to develop in a top-down fashion**: they gradually seize control of the state by controlling key political figures in the executive, the legislature and the judiciary, or by gaining control over the leadership of political parties,<sup>28</sup> or by assuming leadership positions in state-owned and mixed companies.

In the current environment in Bulgaria, the oligarchic model is a good explanation for the concentration of state economic resources in a handful of large entrepreneurs, who, by using politicians and political parties at the national level, continue to successfully redistribute resources for their own private benefit and to the disadvantage of the public interest. Control over public resources for the benefit of a small group of entrepreneurs is especially striking to observe at the **local level**. Local oligarchs can easily be recognized from among the population of any small, medium or medium-to-large town. Groups of two to six individuals (or families) have often succeeded in taking control not only over local government in the region, but also over representatives of the institutions of central government, such as the police, tax authorities, construction services, as well as local courts and prosecution offices.

Nowadays, Bulgaria's oligarchic structures are the **biggest "political investors"**. The establishment of a democratic political system was followed by a prolonged initial period of political instability: eight governments changed places over the course of seven years (without taking into account the two interim governments). Therefore, until 1997 political formations had an exceptionally short temporal horizon and thus were easily susceptible to the offers of "political investors". In addition to becoming established at the highest levels of power like the government and the top structures of the ruling political forces, the oligarchic model has worked its way elsewhere by exercising influence over Members of Parliament, civil servants, and members of the judiciary. This symbiosis has subsequently allowed oligarchs to establish control over state-owned enterprises, to receive unlimited financing from banks, to import and export commodities without being subject to customs controls, to evade tax audits, to have all their disputes in court "favourably" resolved, to benefit from special treatment in laws, etc.

The above approach typically involves employing well-qualified civil servants – such as heads of ministry departments, directors of state-owned enterprises who, due the unstable political climate of the 90's, would often find themselves unemployed – in the companies controlled by the oligarch in question. The model entails a two-way process, as in the end **oligarchs become a recruitment factor for the high-level administration**. Assuming control over key positions in public institutions and state-owned enterprises is of strategic importance. Unlike politicians, who only exercise influence over a limited time span, civil servants or directors could be around significantly longer. As a consequence, a symbiotic model comes into being, where it is not clear where state ownership ends and where private ownership begins. Recently, oligarchs have also resorted more and more frequently to the use of offshore companies.

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<sup>28</sup> In rare, yet recently widely publicised cases, this has even involved oligarchs assuming leadership positions in some parties.



By origin, the leaders of oligarchic organisations are most often former agents of the “State Security” secret services, or representatives of the former communist elite of *functionaries* (nomenklatura), or former heads of foreign trade missions (also largely associated with the secret services). Later, they were joined by successful deviant entrepreneurs, and having survived through a series of political and economic crises, these structures were transformed into today’s oligarchic groups, which use their position to drain money from public and private banks, to conclude illegal privatization deals, thereby appropriating the assets of other oligarchic, violent, deviant and ordinary entrepreneurs.

TABLE 2. SOURCES, METHODS AND STAGES IN THE DEVELOPMENT OF ORGANISED CRIME IN BULGARIA

|                | <b>Violent entrepreneurs (entrepreneurs selling violence and protection, violent entrepreneurship groups)</b>  | <b>Deviant entrepreneurs</b>  | <b>“Political investors” (Oligarchs)</b>  |
|----------------|--|---|---|
| <b>Origins</b> | <ol style="list-style-type: none"> <li>1. Former athletes practicing wrestling, boxing and martial arts</li> <li>2. Former Ministry of the Interior officials</li> <li>3. Ex-convicts</li> </ol> | <ol style="list-style-type: none"> <li>1. Representatives of the “free market professions” during socialism, who had no educational background: taxi drivers, bartenders, warehouse keepers, waiters, etc.</li> <li>2. Representatives of certain occupational groups, such as export traders, accountants, and lawyers, as well as students majoring in the respective fields</li> <li>3. Former convicts</li> </ol> | <ol style="list-style-type: none"> <li>1. Former heads of enterprises</li> <li>2. Former Communist Party Functionaries</li> <li>3. Former Secret Service Officials</li> </ol>   |
| <b>Methods</b> | Use and sale of violence through large groups.   | Use of networks to carry out criminal and semi-criminal operations, mainly relating to the import and smuggling of goods and to the leasing or purchasing of state or municipal property; obtaining bank loans (the so-called group of credit millionaires), etc.   | Redistribution of national wealth utilizing newly established political elites; establishment of holding companies composed of multiple businesses; domination of financial institutions and capture of public financial institutions (including the Central Bank) and the media. |

CONTINUATION OF TABLE 2.

|  | <b>Violent entrepreneurs (entrepreneurs selling violence and protection, violent entrepreneurship groups)</b>   | <b>Deviant entrepreneurs</b>   | <b>“Political investors” (Oligarchs)</b>   |
|--|---|--|--|
| <b>Co-operation between the three groups</b> | Use of oligarchs to solve problems with law-enforcement and the judiciary; use of high-risk entrepreneurs as advisers, confidants and channels of profits and investment.   | Use of violent entrepreneurship groups to gain market share or in case of problems with competitors and partners; partnerships between oligarchs to ensure access to markets, protection and assistance against the state.   | Arbitrary use of violence against small businesses by (including the destruction of property and murders); using high-risk entrepreneurs (including through funding) for shady operations.   |
| <b>Markets</b>                               | <ul style="list-style-type: none"> <li>• Protection for shops, restaurants, company offices</li> <li>• Debt collection, violence, intermediation in disputes (arbitration between business structures)</li> <li>• Smuggling to/from Yugoslavia</li> <li>• Smuggling of excise goods – alcohol, cigarettes, gasoline</li> <li>• Burglary and theft, trafficking and trade in vehicles</li> <li>• Production of CDs, considerable investments in advanced technology</li> <li>• After the end of the embargo on Yugoslavia, attempts to make up for the loss of proceeds by controlling the most lucrative markets for smuggled goods (including drugs).</li> </ul> | <ul style="list-style-type: none"> <li>• Benefits from illegal entry into all possible markets: in commodities in short supply like basic foodstuffs, such as sunflower, oil and sugar, during the first months of the crisis (in the spring of 1990)</li> <li>• Import of second-hand cars and spare parts, as well as fraudulent vehicle registrations</li> <li>• Trading in real estate and speculative purchases, e.g. the purchase of municipal and state-owned housing facilities, sometimes even forcing the eviction of current tenants</li> <li>• Foreign currency exchange (including speculative transactions)</li> <li>• Involvement in black markets, including for prostitution and drugs</li> </ul> | <p>Capture of key markets through:</p> <ul style="list-style-type: none"> <li>• Establishing financial companies – financial houses, banks, etc.</li> <li>• Controlling entry and exit points</li> <li>• Establishing, capturing and controlling mass media</li> <li>• Gaining large market share of retail markets (establishing cartels)</li> <li>• Partnering with risk entrepreneurs and establishing holding companies operating in multiple markets</li> <li>• Creating strategic alliances with large multinational companies</li> <li>• Using connections to high-ranking administrative and political officials for tapping EU funds</li> </ul> |

By the time the country's political crisis had subsided and economic stabilisation had begun at the end of the 1990s, the currently existing structures of organised crime had started emerging. **The restructuring of organised criminal activity has been facilitated by the predisposition of all branches of power to compromise with the various types of organised crime.** While in the case of deviant entrepreneurs this was a somewhat logical step, due to the fact that the general public perceived them as representatives of the private sector, which had to adapt to the crisis environment, the direct and indirect arrangements with oligarch entrepreneurs and violent entrepreneurship groups entailed long-lasting negative consequences which can still be observed nowadays. By entering into such arrangements, the state agreed to legalize the existing economic structures on the condition that they terminate their criminal activity. In fact, oligarchic structures and violent entrepreneurship groups<sup>29</sup> were presented with the opportunity to carry on with most of their business activities undisturbed by the tax and police authorities or by the judiciary. Moreover, this has given a chance to organised criminal entrepreneurs to take part in the redistribution of the national wealth consecutively through privatisation, public procurement, concessions and the absorption of EU (including pre-accession) funds.

The characteristics of organised crime in Bulgaria determine the particular corruption instruments and techniques that organised crime groups employ. Organised crime groups most often employ **political corruption** in order to ensure freedom from inspections or regulatory oversight for their business operations in exchange for a "political contributions" to parties or individual political actors. These contributions are usually accomplished through legitimate companies and reliable intermediaries. The return on this "investment" takes the form of appointing to key positions preliminarily agreed individuals designated by the "investor". Even where there are no special appointees involved, the existing administration is quickly "reoriented", thus trying to avoid the risk of dismissal on political grounds. Several cases containing elements of **"political investment"** and involving organised crime groups became widely publicized over the past year:

- The first case involved a well-known businessman with investments in the energy, tourism, and retail sectors, who supported one of the incumbent government coalition parties and was the founder of a new political formation with aspirations to make it into the next Parliament, against whom the Prosecution Office pressed charges over involvement in large-scale VAT fraud. Sources from the MoI and the Customs Agency made it clear that this individual was one of the biggest actors in customs fraud, fraudulent privatisation deals, etc.
- The second case involved two businessmen supporting the ruling coalition, who were awarded an EU-funded project. Later on a complex criminal organisation was detected involving participants from Germany and Switzerland. The discovery was made in the

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<sup>29</sup> Mostly related to "credit millionaires", the banks, which went bankrupt, and the liquidated state enterprises.

course of an investigation by the Customs Agency and the Chief Directorate for Combating Organised Crime, and was forwarded to the authorities in Germany.

The **use of violence** is one of the most important features of the relationship between corruption and organized crime. While violence was the primary method used to seize and defend/preserve positions in society and the economy, with the advance of social stabilization it led to increased risk and was gradually replaced by corruption transactions. From the end of the 1990's a trend of **gradual decrease of the number of mass violence acts** (beatings, car bomb explosions, arson and the destruction of property) has been observed. Violent entrepreneurs started downsizing and even closing down their specialized violence forces (specialized brigades). Some of the members of these units were given the opportunity to work for their former bosses in the gray sector (tax and customs fraud), but without the need to resort to violent methods. Within purely criminal markets (car theft, prostitution, drug trade, collection of debts), where the use of violence is inevitable, efforts have been made to substantially reduce its scale.

The use of violence attracts public attention and is fairly costly to conceal. In order to preserve their status and position, organized crime groups started using **corruption instruments** with increasing intensity. New techniques like weekly (monthly, annual) payments, the employment of "loyal" officers in the police, investigation service and the prosecution emerged. As a result, public institutions gradually became involved in serving the private interests of a certain organized crime group while countering competing organized crime groups.

#### ***Corruption in the Security Sector***

- Young professionals are placed in relevant security sector jobs, or special service officials and volunteers are hired to provide early information for a fixed monthly remuneration.
- Security officials maintain contacts with crime bosses for the supposed purpose of using them as informers. In reality, such relations (particularly with NSS and NSCOC officers) grant criminals the latitude to sustain their shady activities.
- Some security officials investigate sources and channels of leakage among corrupt inferiors linked with smugglers only in order to capture a share of the gains or to prevent such officers from further revealing discrediting facts.
- Election-time fundraising from criminal sources in exchange for "immunity" from investigations is particularly common.
- Certain private companies provide information to the special services, which, in exchange, help them monopolize the respective business sectors.

- Leading security sector positions are occupied by inexperienced political and economic appointees. As a rule, reshuffling at the highest levels is followed by staff and organizational restructuring involving expert officers and key unit directors. Often professionals of undisputed expertise are dismissed to prevent them from interfering in the threefold relationship between the security sector, political corruption and organized crime.
- The unofficial privatization of official information has become a profitable business for individual security officials. Information leaks to the media, on the other hand, are a means to sustain smear campaigns directed by corrupt officials in certain parties or by corporate interests. The public is often unaware that abuse of such information by those who hold it turns into racketeering of political and other public figures.

Source: *Partners in Crime. The Risks of Symbiosis between the Security Sector and Organized Crime in Southeast Europe*, CSD, 2004, p. 39

As organized crime groups block each other through their access to public institutions and cannot use violence to seize and control new territories or markets, a new phenomenon has emerged as a “problem-solving tool” – **contract killings**. This type of focused violence is associated mainly with representatives of the former violent entrepreneur groups, but some oligarchs and deviant entrepreneurs also use it because of the lack of effective investigation and the consequent atmosphere of impunity. Recently revealed facts demonstrate that many contract killings have a dominant economic motive: namely, the elimination of the competition. However, this economic competition tool attracts strong public and media attention, while the low rate of detection of contract killings and the high rate of homicide detection raises the question of whether this is due to low police and investigative capacity or is rather a result of **corruption/clientelist pressures on law enforcement authorities**.

There are almost no successful investigations of the more than two hundred contract killings committed over the past ten years. This situation has not changed since the country became member of the EU. Most often the police and the investigators have sufficient information, but the investigation is being blocked, dismissed, or has led to no concrete results. Two scenarios are most common in this respect.

In the first scenario, **the investigation “crashes” at the primary level** due to a deliberately produced problem that disrupts the proper coordination along the police investigator – investigator (magistrate) – prosecutor procedural chain of the case in question. The methods employed to disrupt the normal course of investigations could range from a direct or indirect order from a higher level to the use of different tricks like deliberate negligence in commissioning expert analyses or summoning of witnesses, employing inexperienced investigators, staff reshufflings of “too active” officers, etc.

The second scenario involves exerting **political interference** motivated by the fact that the investigation could harm long-term “political investors”, their political appointees, relatives, etc. In addition to cases of political interference in the work of the judiciary that have become publicly known, there are cases for which the information that has been provided by law enforcement authorities of other countries has not been used, because it has been blocked at the political level. One of the cases of political interference, which became publicly known because of an internal controversy at a high level in the Ministry of Interior, was the meeting between the Minister of Interior and the Galevi brothers (considered criminal bosses of Dupnitsa). One of the explanations publicized in the media was that the main reason for the meeting was an alleged attempt to stop the expected new wave of contract killings in the period immediately preceding the country’s EU accession.

## 2.5. The Economy and Political Corruption

Bulgaria’s accession to the EU has created numerous opportunities for the faster and more sustainable development of the Bulgarian economy, but at the same time has intensified the risk of a **short-term aggravation of institutional deficits and associated corruption**<sup>30</sup>. Inspections on the administration of EU funds in Bulgaria carried out by the specialized units of the European Commission have revealed a lack of administrative capacity, numerous violations of rules and procedures, a lack of control mechanisms and sanctions for violations, as well as evidence of political interference in the evaluation of project proposals and the approval of expenditures. These institutional shortcomings may have a strong negative effect on Bulgaria’s development as the global economic crisis deepens and as the **national budget and EU funds remain the only source of fresh funding in 2009**.

In the context of global recession and high levels of corruption in the Bulgarian economy, there is an imminent threat that a substantial part of the investments made over the last few years may deliver no benefits and may result in a faster and deeper contraction of economic activity, thus exacerbating the effects of the economic crisis in Bulgaria. That is why the Bulgarian government must undertake immediate and decisive actions to curb political corruption and strengthen governance mechanisms with respect to key corruption risk areas, which create favourable conditions for informal and illicit cash-flows in the economy. Namely, the government needs to:

- improve the transparency and efficiency public and EU funds management;
- apply European best practices in the management of public procurement, concessions and public-private partnerships;
- terminate the non-market management of state property involving exchanges of state-owned lands, forests and other assets;

<sup>30</sup> *Anti-Corruption Reforms in Bulgaria: Key Results and Risks*, Center for the Study of Democracy, Sofia, 2007.



- restrict the shadow economy by improving the rule of law and the effectiveness of regulatory bodies and control mechanisms.

Intensified pressure on the part of the EU for better governance practices and the continuing efforts of the anticorruption community in Bulgaria have led to successful **inroads into entrenched corrupt oligarchic relationships, such as the closing down of duty-free outlets along Bulgaria's land borders** in 2008<sup>31</sup>. Cases of high-level corruption demonstrating its pervasive nature were publicly disclosed, such as the concentration of considerable shares of the energy sector in business structures of unclear ownership, the capture by private interests of the Service for Combating Organised Crime (for example, by producers of high excise goods), conflicts of interests and grievous misuses of power in the management of the road infrastructure, non-market substitutions of state-owned lands and forests, concessions and public procurement.

The most striking manifestation of this process was **the capture of local power** in 2007 and 2008 in small, tourist resort municipalities by means of a growing number of business coalitions, including via buying votes, as well as by means of oligarchs taking control of locally established political parties. Conditions are there for political corruption to go full circle, whereby power is used to extract personal benefits while the wealth thus accumulated is in turn used to preserve political power. The vicious cycle of political corruption will be complete when wealth becomes the goal of power, while power becomes the goal of wealth. Each of the numerous rotations of this cycle risks the **criminalisation of the state**. Brought to its extremes, this tendency would translate into the cartelisation of the economy, the loss of the efficiency of markets as well as of the effectiveness of state control mechanisms, which would dampen the entrepreneurial spirit of the nation.

The economic crisis, which is expected to hit rock bottom in Bulgaria in 2009, will be both a test and an opportunity for anticorruption reforms in the country. If corruption has played a predominant role in the accumulation and investment of capital during the years of growth, the recession might turn out to be deeper and might last longer than expected. The crisis provides an opportunity for reforming the sectors plagued by serious corruption problems which have negative repercussions for the overall economy, such as security provision, healthcare and education.

The manner in which **public funds are used in this election year** will determine the success or failure of the government's anticorruption policy. If funds are targeted to reform the most underdeveloped budget-funded sectors and increase their added value, this will be a sign of success. Should they be used instead to satisfy the growing demands of oligarchic business structures as well as to buy political influence among voters, this will exacerbate the problems of political corruption and could lead to Bulgaria's isolation in the European Union.

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<sup>31</sup> *Effective Policies Targeting the Corruption – Organized Crime Nexus in Bulgaria: Closing Down Duty-Free Outlets*, Policy Brief No 13, Center for the Study of Democracy, December 2007





### III. CORRUPTION AND THE ECONOMIC PROCESS

Taking into account the importance of the pecuniary motive for the existence of political corruption, this part of the report looks into the main sources of hidden or illegitimate income for the business sector and into the channels for corrupt political influence on the economy in Bulgaria:

- The size and scope of the **hidden economy** provide cover for large grey and black financial flows from the business sector into politics, which in turn influence the operation of the official economy;
- **Public procurement**, including the absorption of EU funds, concessions and other forms of public-private partnership, are misused by corrupt officials for the purposes of personal enrichment, returning favours, and preserving political power or party financing;
- **Land and forest swaps** have in recent years become the main instrument for favoring politically connected businesses. “Zamenki”, as the swaps have become notorious in Bulgaria, have replaced privatization as the main instrument for redistributing national wealth.

#### 3.1. Level and Dynamics of the Hidden Economy in Bulgaria. The Hidden Economy Index

The focus on the narrow aspects of judicial reform and the fight against corruption and organized crime risks losing sight of a very important underlying issue that sheds extra light on their sources and mechanisms: namely, the size and dynamics of the hidden economy in Bulgaria. There is an increasing body of studies showing that corruption and the hidden economy are closely linked. Recent research has demonstrated that in lower income countries such as Bulgaria corruption and the hidden economy seem to complement each other.<sup>32</sup> Reducing incentives and opportunities to conceal incomes and revenues lowers the available resources for corruption, which in turn puts additional pressure on non-compliant players to come out in the open. Research on the links between hidden economic activity and corruption conducted since 1998 by the Center for the Study of Democracy in its annual **Corruption Assessment Reports**

<sup>32</sup> Dreher, A., F. Schneider, *Corruption and the Shadow Economy: an Empirical Analysis*, Center for Research in Economics, Management and the Arts, Basel, 2006.

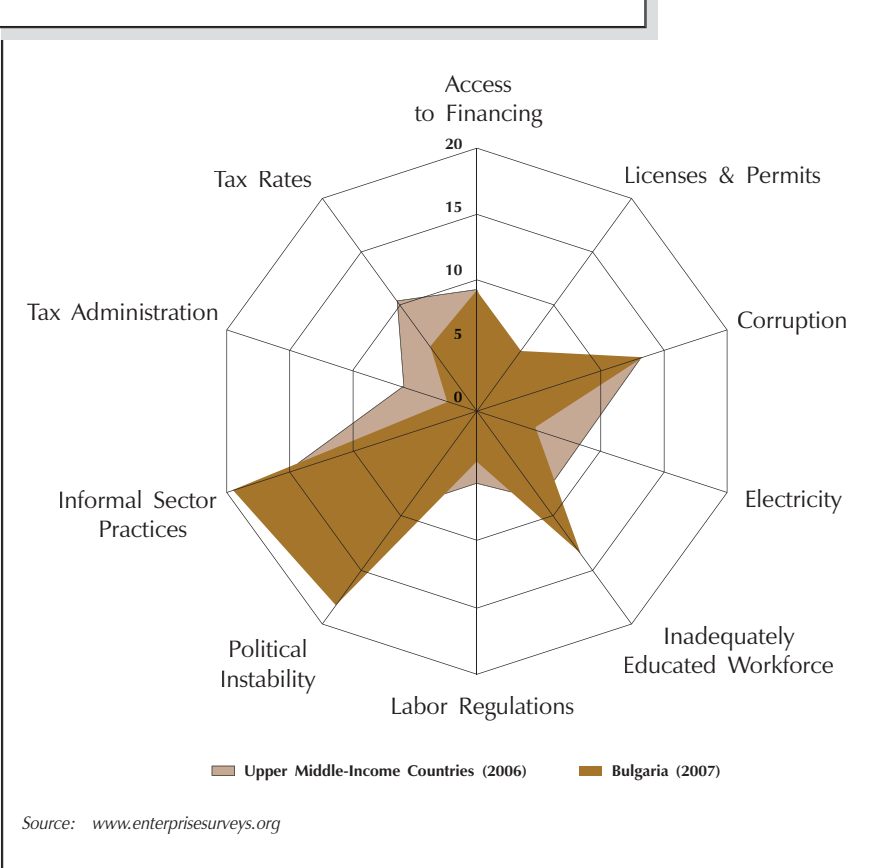
has demonstrated that corruption has been the main tool for corrupt businesses to stay off the record books and to generate government protected monopolies and undue rents.<sup>33</sup>

### 3.1.1. Level and Dynamics of the Hidden Economy in Bulgaria

Although the hidden economy<sup>34</sup> is notoriously difficult to measure and understand, it is easily identifiable by businesses when they face partners and/or competitors who operate outside the law by evading taxes, social security and health contributions, hiding actual employment, circumventing product quality, safety or environment regulations, infringing copyrights, etc. According to the latest Enterprise Survey of Bulgarian firms performed by the World Bank in 2007, informal sector practices topped the list of constraints to company investment in Bulgaria.

Hidden or unregistered payments represent such a large share of the value-added chain in all sectors of the Bulgarian economy that there is hardly a company in the country which has not either made or received them. **Unfair competition**, which is how firms perceive the hidden economy and corrupt practices, has topped firms' concerns in Bulgaria in the last ten years (according to CSD data from its *Corruption Monitoring System*). Companies understand and identify the hidden economy and its negative impact on their competitive positions much more easily than corruption, which they view as an instrument for preserving unfair competitive advantages.<sup>35</sup>

FIGURE 19. TOP TEN CONSTRAINTS TO FIRM INVESTMENT IN BULGARIA



<sup>33</sup> Each Corruption Assessment Report from 1999 to 2007 contains a separate section on the grey economy ([www.csd.bg](http://www.csd.bg)).

<sup>34</sup> The Center for the Study of Democracy has adopted the term “hidden economy” to qualify all activities that, for some reason, remain beyond the reach of national statistics and regulations. These are either legal activities which are under or misreported to government agencies or which are performed by unregistered firms, or fully illegal activities. “Hidden economy” is a term used alternatively to “informal”, “unregistered”, “shadow” or “unreported economy” and comprises both grey (legal) and black (illegal) activities. Although the present analysis does not cover the so-called “subsistence economy”, the latter is also usually represented as part of the hidden economy.

<sup>35</sup> Interviews with international and local investors conducted by the Center for the Study of Democracy in 2008.

Notwithstanding differences in concepts and methodology, estimates of the size of the hidden economy in Bulgaria since 1990 have ranged from 16% to 38% of GDP,<sup>36</sup> which has consistently ranked the country among the worst performing new EU Member States with respect to the share of hidden economic activities. According to various estimates, the size of the hidden economy in Bulgaria in 2007 and 2008 ranged between 20 and 35 per cent of GDP, with some sectors, such as construction and real estate, reporting less than 50% of the actual value of transactions.<sup>37</sup> According to business surveys of the *Corruption Monitoring System* of the Center for the Study of Democracy, the share of **hidden economic activity across all sectors of the economy averaged 14.1% in 2008**, marking a decline of over 50% compared to 2002 when 29% went unreported. As these data were obtained through a sample survey, in which respondents tend to underreport the actual size of the problem, they should be interpreted as the lower bound when it comes to the actual size of the hidden economy in Bulgaria. According to these data, the total value of **the hidden economy in Bulgaria has levelled off at about 10 billion levs over the past two to three years**. One should keep in mind that the hidden financial flows (turnover) that such grey economic activities generate are much larger. While the National Statistical Institute provides for imputations of the hidden economy in the system of national accounts and the numbers on the size of the hidden economy should always be interpreted with great caution when making conclusions about policy actions, they send a clear signal to policy makers that the hidden economy constitutes a considerable challenge to Bulgaria's economic development. Most affected are the labor intensive sectors of the economy: construction, textiles, tourism, agriculture and services (e.g. repairs, private education, healthcare, transport, etc.). There are also considerable pockets of hidden economic activity in manufacturing, in particular in industries producing excise duty goods (e.g. alcohol, cigarettes and fuels).

### 3.1.2. Dynamics of the Hidden Economy Index

In response to rising business concerns and policy actions to reduce the levels and scope of the hidden economy in Bulgaria, in 2002 the Center for the Study of Democracy and Vitosha Research designed the **Hidden Economy Index**. The index aims to track the dynamics of the hidden economy in Bulgaria and its main components – informal labor and concealed turnover or taxes – as well as perceptions on its size through annual surveys of the Bulgarian business and the population.<sup>38</sup>

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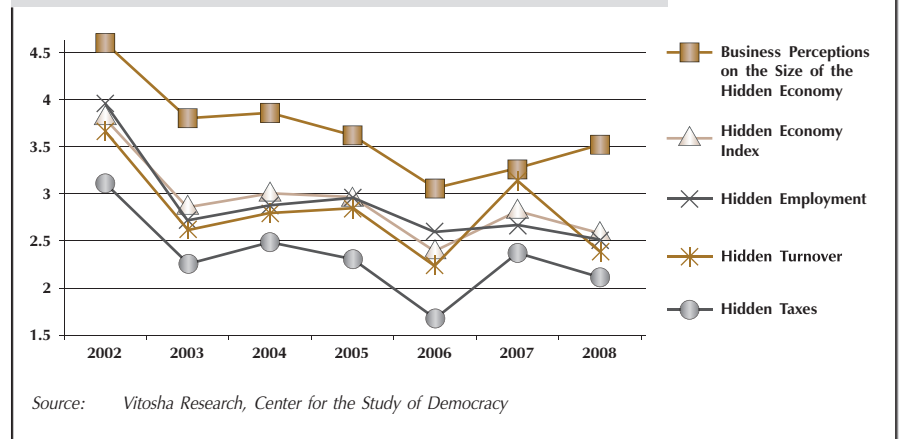
<sup>36</sup> *The Informal Economy in the EU Accession Countries: Size, Scope, Trends and Challenges in the Process of EU Enlargement*, Center for the Study of Democracy, 2003; *The Hidden Economy in Bulgaria*, Center for the Study of Democracy, 2004 (in Bulgarian); Feige, E., I. Urban, *Measuring Underground (Unobserved, Non-Observed, Unrecorded) Economies in Transition Countries: Can we Trust GDP?*, MPRA, University of Munich, 2007; Schneider, F., *Shadow Economies and Corruption All Over the World: What Do We Really Know*, Institute for the Study of Labor (IZA), Bonn, 2006.

<sup>37</sup> *Anti-Corruption Reforms in Bulgaria: Key Results and Risks*, Center for the Study of Democracy, 2007, interviews with managers of international and local companies.

<sup>38</sup> *The Informal Economy in the EU Accession Countries*, Center for the Study of Democracy, 2003. The index was developed by an expert group comprising experts from the National Statistical Institute, the Bulgarian National Bank, the National Social Security Institute, the National Revenue Agency and the University for National and World Economy.

It is important to note that the index does not measure the size of the hidden economy but its dynamics, providing important feedback to policy makers and the business community on the effectiveness of measures undertaken to curb the hidden economy and related corruption.

FIGURE 20. THE HIDDEN ECONOMY INDEX AND ITS COMPONENTS (2002–2008)

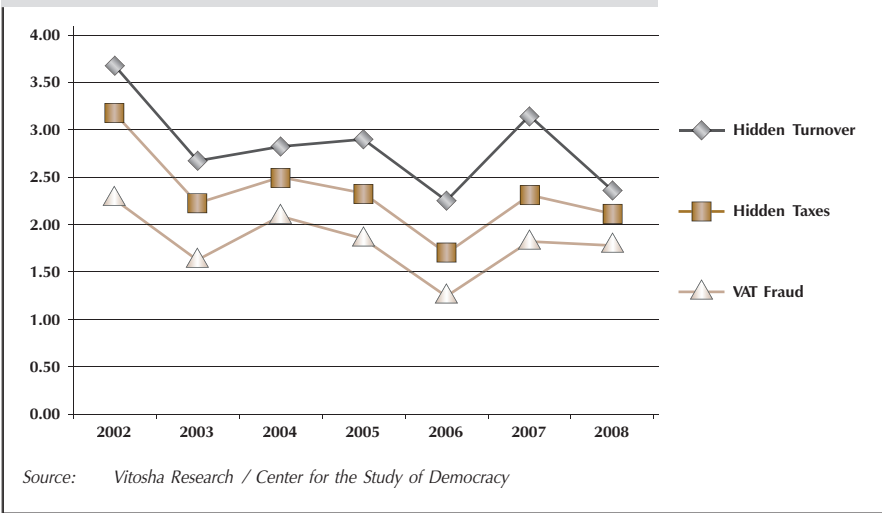


The Hidden Economy Index registered a **moderate decline** in 2008. In comparison, the index was 40% higher in 2002 when it was first estimated. The decline is due to the shrinking of the hidden economy in all its dimensions: tax evasion, hidden turnover and informal employment. However, business perceptions regarding the size of the hidden economy in Bulgaria have kept on rising since 2006. This discrepancy between the actual dynamics and business perceptions could be attributed to a set of factors, the most important of which are:

- **rising institutional distrust and growing political instability** in the country in the run-up to the next general parliamentary elections (to be held in the summer of 2009);
- **intensifying external competition** after Bulgaria's EU accession, coupled with **ineffective and stalling absorption of EU funds** earmarked to modernise the Bulgarian economy and support micro, small and medium enterprises;
- growing concerns about the impending world economic crisis, which is expected to increase Bulgarian companies' overall vulnerability, as well as concerns about **inadequate leadership** on the part of Bulgarian policy makers in initiating measures to moderate the adverse effects of the crisis on the economy.

The decline in the index values was to be expected, given the expansion of bank credits over the past two years, the cuts in direct corporate and personal income tax rates, and the improved functioning of two important regulatory control agencies: the National Revenue Agency (NRA), which monitors hidden turnover, and the General Labor Inspectorate (GLI), which monitors hidden labor. In 2008, compliance enforcement bodies conducted their **first horizontally coordinated audits** on grey markets with identified

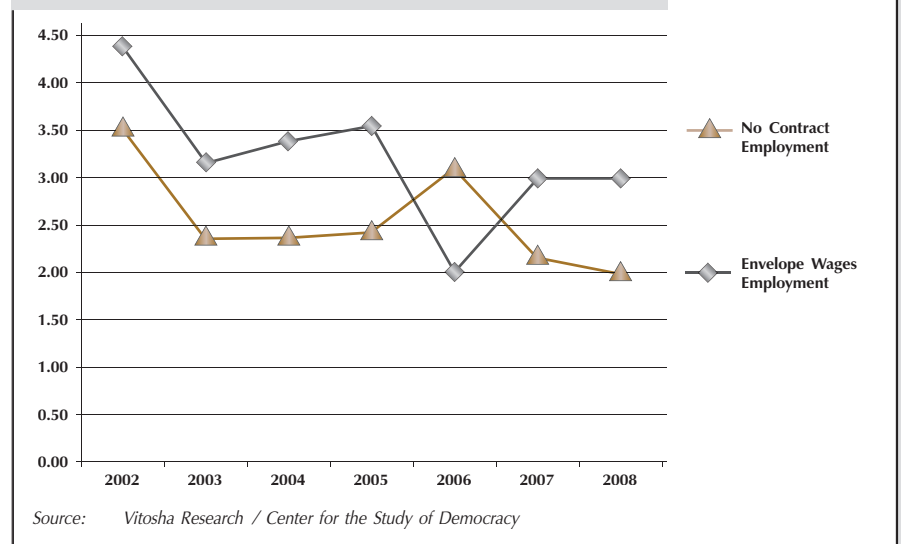
FIGURE 21. DYNAMICS OF THE COMPONENTS OF HIDDEN TURNOVER OF THE HIDDEN ECONOMY INDEX (2002–2008)



high corruption and crime risks, such as the trade in used cars. Still, some **areas of heightened risk** of hidden economy remain largely unchanged, such as “envelope wages” employment (i.e. the payment of higher actual wages than those reported in official employment contracts), **VAT and excise duty fraud**. The hidden economy index shows that **the introduction of proportional personal income tax in 2008 has not resulted in the expected substantial shrinking of the hidden economy**, although it has led to a certain improvement. To further reduce

the size of the hidden economy and its manifestations in Bulgaria, as well as related corrupt practices, the Bulgarian authorities should focus their efforts on strengthening law enforcement and control mechanisms paralleled by continuous improvement in the quality of public services provided by the state administration.

FIGURE 22. THE HIDDEN ECONOMY INDEX — DYNAMICS OF THE HIDDEN LABOR COMPONENTS

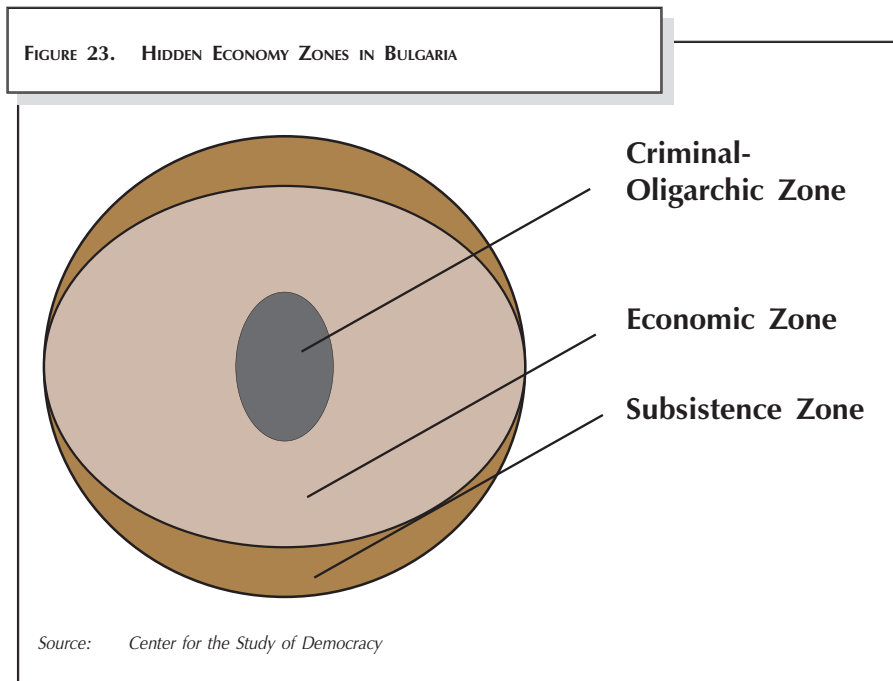


Despite the overall positive trend towards the reduction of the hidden economy in Bulgaria over the past couple of years, informal economic activity remains a major drag on the country’s competitiveness and growth. In 2008, over 1.5 million Bulgarian residents in the 15-64 age group still remained outside the labor force: a tremendous **waste of human capital** for the country with the lowest GDP per capita in the European Union. If these people could be intergated into the official work force, **they would add over 5.5 billion euro to the country’s GDP**, assuming they were employed and produced output equal to the

annual per capita GDP for 2007. With 14% of employees reporting they had received envelope wages – a figure three times above the average level in the EU – Bulgaria ranks third highest in this respect.<sup>39</sup>

### 3.1.3. The Hidden Economy Zones in Bulgaria

CSD research over the past ten years has shown that the hidden economy in Bulgaria can be conceptually subdivided into three major zones,<sup>40</sup> which are driven by different motivations and mechanisms requiring different sets of policy responses:



The **criminal-oligarchic zone** (loops of companies) forms the nucleus of the hidden economy in the country. It comprises politically connected companies controlling the financial and commercial flows generated by and for the benefit of oligarchic economic circles, while sometimes even engaging in illegal activities, such as prostitution, drug dealing, theft, etc. This is the domain of actors such as some of the figures involved in the “key cases” monitored by the European Commission in its assessment of the country’s progress in countering corruption and organised crime: cases in which Bulgarian courts have

failed to issue verdicts for the past two years. The oligarchy-centered hidden economy **engenders political corruption**, extending its influence from the economy to the judiciary.

The creation of **parallel power networks** has enhanced the tendency for the administrative apparatus to be partially replaced or sidestepped by appointments in the political cabinets of the executive branch in Bulgaria.<sup>41</sup> Political cabinet advisers at various ministries and agencies sit on state enterprise boards, having an essential, even definitive role in policy making despite their usually low public profiles. The replacement of public administration functions with structures and networks of politically, economically or personally loyal individuals and/or organizations, which are not regulated by the Constitution or other state laws, has led to

<sup>39</sup> *Undeclared Work in the European Union, Special Eurobarometer*, European Commission, October 2007.

<sup>40</sup> *The Informal Economy in the EU Accession Countries: Size, Scope, Trends and Challenges in the Process of EU Enlargement*, Center for the Study of Democracy, 2003; *Organized Crime in Bulgaria: Markets and Trends*, Center for the Study of Democracy, 2007.

<sup>41</sup> *Anti-Corruption Reforms in Bulgaria: Key Results and Risks*, Center for the Study of Democracy, 2007.



the **creation of oligarchies, clans and elite cartels**,<sup>42</sup> as well as to the **involvement of the administration in political corruption**. The most visible manifestation of this trend in Bulgaria is the Political Council of the ruling three-party coalition which does not have any democratic legitimacy (one of its members does not even hold an elective office), yet in effect has replaced the Council of Ministers in the decision-making process with respect to some of the most important matters of government policy. Such trends make it more difficult to reduce the impact of the hidden economy and administrative corruption in the country. The major channels of political corruption supporting the criminal-oligarchic zone of the hidden economy in Bulgaria are: **the management of state-owned and municipal land and property, concessions, as well as public procurement, including the administration of EU funds**.

The **economic zone** comprises the bulk of the hidden economy. It is the result of inconsistencies between economic realities and formal state regulations. It could be caused either by high burdensome regulatory and/or tax policies, or by the habitual failure of private companies to comply with existing rules. This zone, as portrayed by the *Hidden Economy Index*, has shrunk to the greatest extent in recent years. This is due to a number of factors, among which are the improving business and financial environment, the improved functioning of some of the compliance enforcement and regulatory agencies, the introduction of European standards and rules in a number of economic spheres and the opening up of EU markets to Bulgarian enterprises. Businesses in the country have benefited in particular from the removal of customs controls for inter-community trade, which has helped reduce corruption victimization levels<sup>43</sup> and curb the scale of unreported income among Bulgarian exporters.<sup>44</sup> Still, the business environment in Bulgaria has some essential flaws, which allow the administration to extract illicit payments from larger companies and push smaller companies into the hidden economy.

The World Bank's *Doing Business 2009* report ranks Bulgaria fifth among the new member states with respect to the ease of doing business in the country. The country compares worst to its 2008 positions in the "ease of obtaining construction permits" category, as the state administration tries to carve out its share of profits from such fast developing sectors as construction works and real estate. On the other hand, Bulgaria has improved its ranking the most in the "starting a new business" category, as commercial company registration was finally pulled out of the court system and a long-overdue centralized commercial registry commenced operations in 2008.

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<sup>42</sup> The corruption of *elite cartels* is practiced and supported by the maintenance of networks of political, economic, military, bureaucratic, or ethnic and community elites, depending on the specific culture of the country. Unlike cartels, in the case of *oligarchs* and *clans* power and the corrupt access to it are dominated by government officials or enterprising businessmen who are powerful personalities mastering many followers. According to expert studies, Bulgaria and Romania are in the group of countries characterized by corruption of *oligarchs and clans*. Poland and Hungary are in the group of countries with corruption of *elite cartels*. See Johnston, Michael, *Syndromes of Corruption: Wealth, Power and Democracy*, Cambridge University Press, 2005.

<sup>43</sup> See Figure 9 in the present report.

<sup>44</sup> According to data from the World Bank project Doing Business ([www.enterprisesurveys.org](http://www.enterprisesurveys.org)).

TABLE 3. EASE OF DOING BUSINESS IN BULGARIA (2008 – 2009)

| Ease of...                        | Doing Business 2009 rank | Doing Business 2008 rank | Change in rank |
|-----------------------------------|--------------------------|--------------------------|----------------|
| <b>Doing Business</b>             | <b>45</b>                | <b>44</b>                | <b>- 1</b>     |
| Starting a Business               | 81                       | 103                      | + 22           |
| Dealing with Construction Permits | 117                      | 98                       | - 19           |
| Employing Workers                 | 60                       | 62                       | + 2            |
| Registering Property              | 59                       | 55                       | - 4            |
| Getting Credit                    | 5                        | 5                        | 0              |
| Protecting Investors              | 38                       | 33                       | - 5            |
| Paying Taxes                      | 94                       | 93                       | - 1            |
| Trading across Borders            | 102                      | 94                       | - 8            |
| Enforcing Contracts               | 86                       | 93                       | + 7            |
| Closing a Business                | 75                       | 75                       | 0              |

Note: The country's Doing Business 2008 ranking has been recalculated to reflect changes in methodology and the addition of three new countries.

Source: Doing Business 2009 Database.

The **subsistence motivated** hidden economy is concentrated among the most poverty stricken and socially and/or geographically isolated communities in Bulgaria. Despite declining levels, the subsistence economy remains an important source of consumption and even of some employment and income. One fifth of Bulgarian households still rely on subsistence economic activities, though the share is much larger in smaller towns/villages as well as with some traditional goods like home-distilled spirits). Its still substantial share of the Bulgarian economy is indicative of the weak penetration of market mechanisms in some parts of the economy, and of the low purchasing power of a large proportion of Bulgarian households.

The structure of both the official and the hidden parts of the Bulgarian economy signifies the existence of a high risk of using concealed income to bribe public officials and exert influence by pushing for legislation that serves the interests of particular companies, political parties or social groups (state capture). According to the Transparency International 2008 Bribe Payers Index, the sectors most likely to engage in bribery and state capture practices are precisely those displaying the fastest rates of growth in the Bulgarian economy in recent years: public works/construction contracts, real estate and property development, oil and gas, heavy manufacturing and mining. They are closely followed by pharmaceutical and medical care, utilities, power generation and transmission. Data from the *Corruption Monitoring System* (CMS) of the Center for the Study of Democracy points to a downward trend



in corrupt pressure and practices among Bulgarian business over the past two years. At the same time, government spending on the high corruption risk sectors mentioned above is continuously rising. This suggests that the corruption potential of those sectors might have been transformed into legal corruption and/or **state capture**. The characteristics of most infrastructure concession contracts and privatisation deals in the Bulgarian energy sector in the last few years support this conclusion, as they have lacked transparency and have involved a limited number of participants, with the winners being easily identifiable well beforehand.

#### 3.1.4. Expected Dynamics and Policies to Tackle the Hidden Economy

As the local economic conditions deteriorate due to the global economic recession, it could be expected that **pressures to expand the hidden economy and related corruption will increase** in all of its three zones:

**Subsistence zone** – the poorest, marginalized parts of society will increasingly resort to subsistence economic activities. Some urban households which have discontinued this practice in the past two years might return to it on finding that their incomes have declined;

**Economic zone** – pressures will grow on corporate and household incomes, and in particular on those with high levels of indebtedness. The economic crunch will hit disproportionately hard micro and small enterprises, which operate closer to the hidden economy. The construction industry will be most seriously affected, as domestic consumption shrinks and downward pressures on the value of assets used as collateral for obtaining bank loans intensify. The crisis will undermine public compliance and control mechanisms on account of several factors, most notably: (a) rising insecurities among the public administration officials as general parliamentary elections approach, (b) anticipated cuts in funding for state budget financed entities as a result of shrinking general budget revenues and mounting claims for higher salaries, and (c) an increase in the number of entities along value added chains opting to operate within the hidden economy.

**Criminal-oligarchic zone** – slowing economic activity will make companies increasingly dependent on the public sector and on the decisions of the state administration, such as regarding the assignment of public procurement contracts and concessions. This will whet corrupt appetites for redistributing public resources through political connections. Due to the freezing of EU funds for the country local infrastructure construction companies received fewer orders than expected over the past year. Yet they had invested in raising their capital in preparation for EU funds absorption and it can be reasonably expected that they will try to land more contracts using their political connections. As the crisis aggravates in 2009, demands for state support from all industries will intensify, as will tendencies to resort to fraud and attempts to bypass the law. Depending on how long the crisis lasts and how severe

it turns out to be, growing unemployment will to varying degrees boost labor supply in the hidden and criminal economy, rather than in official jobs.

In order to curtail the extent of the hidden economic activity and related corruption, Bulgaria will have to strive for good overall governance, as well as make improvements in a number of specific areas, utilizing European and international best practices. The Bulgarian authorities should invest most heavily efforts in those aspects of good governance<sup>45</sup> in which the country has lagged most considerably behind its European peers over the last decade:

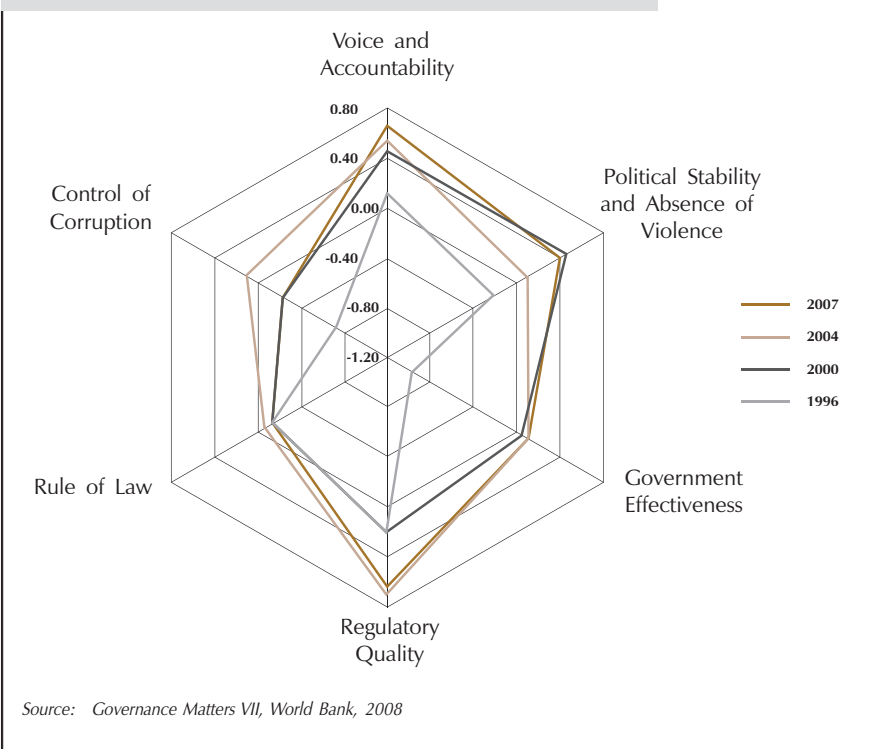
- Guaranteeing **the rule of law** – the sense of de facto impunity in Bulgarian society is pervasive, particularly with regard to corruption and organized crime related to powerful economic groups or individuals closely linked to incumbent politicians. The most important test in this respect will be the severing of illegitimate links between

politicians, high-ranking security officials and grey businesses, i.e. **the dismantling of so-called loops of companies**, in particular in industries with high levels of state control or participation, such as energy, the production of and trade in excise goods, concessions and the construction of infrastructure, swaps or the outsourcing of public property and its management in the defense sector or at the local level;

- Strengthening the **control of corruption** through reinforcing state anticorruption institutions;

- Boosting **government effectiveness** through designing well-defined policies, based on clear targets and performance indicators, and budget spending linking to those targets.

FIGURE 24. DYNAMICS OF THE ELEMENTS OF GOOD GOVERNANCE IN BULGARIA (1996–2007)



The diverse structure and complexity of the hidden economy require an **integrated policy response**, targeting its root causes by taking into account the state and trends of the business environment and the hidden economy zones in Bulgaria. While there is no universal blueprint

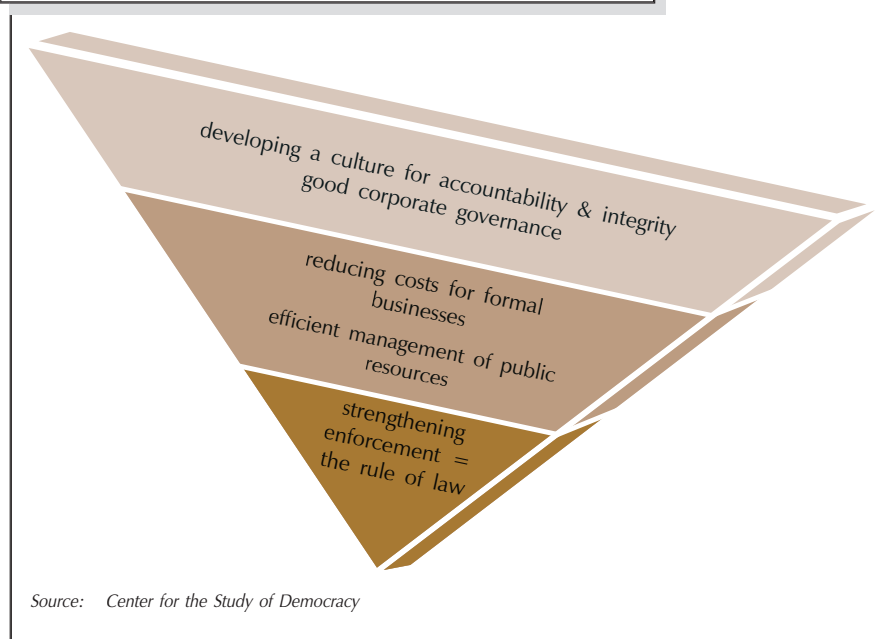
<sup>45</sup> The analysis in this part of the report draws upon the World Bank's Good Governance project, but its implications are supported by a much larger number of national and international studies, such as the Center for the Study of Democracy's annual Corruption Assessment Reports, the Heritage Foundation's Index of Economic Freedom, and the reports of Transparency International, Freedom House, the Bertelsmann Foundation, etc.

for tackling hidden economic activity, the *policy pyramid* presented here provides a guide for designing comprehensive and actionable strategies to curb hidden economy in its three zones. In order of their urgency and importance these policies should be:

- strengthening the rule of law and enhancing the accountability and transparency of state authorities and institutions;
- improving the conditions for doing business and the quality of public services, as well as raising the effectiveness of public resource management, e.g. in public procurement, property swaps, etc.;
- reinforcing the culture of accountability and good corporate governance among businesses and its associations.

Accomplishing results under these three policy areas would require the joint efforts and commitment of the public and the private sectors.

FIGURE 25. THE HIDDEN ECONOMY POLICY PYRAMID



The debates over the closure of **duty-free operators** along Bulgaria's land borders revealed how deeply entrenched clientelist-type relations between powerful, legally secured monopolies and high-ranking incumbents have become.<sup>46</sup> Even after the adoption of the Council of Ministers decision in February 2008 to close down duty-free operations, various MPs from almost all Parliament-represented political parties did their best to thwart the decision of the government and their parties' leaders. Two years earlier – in late 2006 – these same MPs had voted into existence the *Law on Duty-Free Trade*. In effect this law secured the monopoly over duty-free outlets along the

national land borders for the then operators. It failed to introduce any restrictions on their sales of excise goods per traveler, which left the door wide open for fraud and corruption.<sup>47</sup> There are numerous similar cases of forfeiting the public for the benefit of private interests in the executive and legislative branches as well, but this specific example demonstrated very clearly how difficult it would be to break the bonds of political corruption in Bulgaria. The Bulgarian authorities did not follow up on their

<sup>46</sup> *Effective Policies Targeting the Corruption–Organized Crime Nexus in Bulgaria: Closing Down Duty-Free Outlets*, Policy Brief No 13, Center for the Study of Democracy, December 2007.

<sup>47</sup> *Levelling the Playing Field in Bulgaria: How Public and Private Institutions Can Partner for Effective Policies Targeting Grey Economy and Corruption*, Policy Brief No 15, Center for the Study of Democracy, May 2008.

decision to close down duty-free outlets with efforts to further investigate, expose and bring to justice suspected crime and corruption in duty-free trade. Such failures to penalise misappropriations are a sign of the **insufficient resolve in and consistency of anticorruption efforts.**

Meeting these challenges requires a long-term approach, which should focus on **strengthening the administrative capacity of law enforcement and compliance enforcement and regulatory bodies.** Once the country's accession to the European Union and the transposition of Community law into national legislation have become facts, it is time to shift efforts from institution towards capacity building, with fewer legislative changes outside new EU regulations. Current policies targeting the hidden economy focus on intensifying compliance control mechanisms in a campaign-like manner.<sup>48</sup> They lead to temporary compliance at best, and higher administrative burden on official businesses at worse. For example, one of the most active control agencies in the country, namely the General Labor Inspectorate, carried out 33,031 inspections in 2007, which resulted in 4,920,000 Bulgarian leva in fines collected (i.e. roughly 149 leva per inspection). The National Construction Control Directorate received 75,052 tips from citizens and legal entities and carried out 9,919 construction inspections in 2007 but collected only 1,258,999 leva from imposed fines (i.e. 127 leva on average per construction inspection). Some agencies, such as the National Veterinary Medical Service, do not even put up annual reports on their web-sites.

**The profile of Bulgaria's control agencies<sup>49</sup> exhibits an unbalanced approach towards risk** – they tend to focus their inspections too much on micro enterprises and/or smaller value contracts and to impose penalties, which are regressive in character (much lower in value than the financial interest at stake). This increases the regulatory burden on the economy, **tolerates large-scale non-compliance** and encourages the spread of financially motivated hidden economic activity and administrative corruption. These observations alone are enough to demonstrate the urgent need to beef up national compliance enforcement agencies<sup>50</sup> through:

- enhancing transparency – every control agency should make its annual reports available online. The reports should contain at least simple indicators of efficiency and impact (e.g. revenue per inspection) and action plans for expanding them further into elaborate **performance assessment systems;**

<sup>48</sup> *Anti-Corruption Reforms in Bulgaria* (Center for the Study of Democracy, 2004) revealed that in the Bulgarian government's campaign to reduce the share of the hidden economy in the country in 2003 the collected fines from targeted financial inspections of tobacco and alcohol producers amounted to 2.52 leva per inspection.

<sup>49</sup> Agencies listed in the text are randomly chosen to exemplify characteristics that apply to all public control and compliance bodies: the Public Financial Control Agency, the former Financial Intelligence Agency, Regional Inspections for the Protection and Control of Public Health, the Bulgarian Privatization Agency, the Inspectorate General at the Council of Ministers, etc.

<sup>50</sup> For a detailed analysis of measures to increase the administrative capacity of control agencies on the example of the tax administration, see Pashev, K., *Corruption and Tax Compliance: Challenges to Tax Policy and Administration*, Center for the Study of Democracy, 2005. A number of the measures proposed in the report have already been adopted by the National Revenue Agency.

- improving financial incentives and human resource management, including via recruitment, performance appraisal and pay bonuses, career development and training. While base salaries should depend on education and experience, **pay bonuses and promotion** should be tied to personal performance and integrity;
- streamlining operational processes, including through the introduction of **effective information technology systems to manage document flows** and to pinpoint weaknesses in the operational setup. In particular, agencies should introduce audit and inspections targeting, as well as performance and reporting methods based on state-of-the-art risk assessment and monitoring systems, including reports on the individual performance of agency staff. For instance, according to the 2007 Annual Report of the Financial Intelligence Agency, notaries in Bulgaria filed only two reports on suspicious transactions under the *Law on the Measures against Money Laundering*, which against the backdrop of the substantial hidden economy in construction and real estate should be enough to prompt closer scrutiny from the authorities;
- revising the penalty **structure** to limit discretion on the part of the administration and to take account of the financial interests involved. Currently, most penalties imposed by the control and compliance enforcement agencies in the country are dwarfed by the potential financial gains for large-scale offenders;
- improving anti-corruption enforcement by developing **corruption risk-assessment systems** based on inspection officers' personal wealth declarations and their control and audit effectiveness. Particular attention should be paid to public administration units exposed to high corruption risks, such as public procurement and concessions units, VAT fraud units, EU funds audit units, excise duty control units, etc.;
- identifying and consulting businesses with proven integrity, based on recommendations from NGOs focused on good governance efforts, European business associations, and publicly available integrity rankings of reputable international media.

As public financial resources are inherently limited, **focusing the public compliance and control system on a well-defined set of hidden economy risks** is the only way to guarantee improvements in law enforcement. For example, over the next eighteen months control bodies might want to focus their attention on **public procurement** (concessions, public-private partnerships, EU funds) in the energy and infrastructure sectors. These are some of the fastest growing sectors of the Bulgarian economy carrying substantial hidden economy risks and involving multiple contracts with the public sector. Increasing horizontal accountability in the compliance enforcement and control system, i.e. joint work and performance competition between control agencies, is a cornerstone for improving the rule of law in Bulgaria.



The **second priority** in the hidden economy policy pyramid is centered on the introduction of **improved mechanisms of public resource management**<sup>51</sup> to promote fair competition. Concessions, public procurement (including EU funds administration), the outsourcing of public services, privatisation, and land and forest swaps are areas with very high corruption risks and are recognised as frequently used channels for creating and sustaining politically connected “loops of companies”. Ensuring fair access and free competition in public contracting is key to reducing possibilities for the diversion of public funds into the criminal-oligarchic zone of the hidden economy:<sup>52</sup>

- The government’s responsibility in ensuring competitive bidding in public procurement should not end with the publication of the tender announcement. Public contractors should be more actively involved in sourcing tenderers, especially in cases of bigger projects involving substantial public resources. There have been many examples of tenders being won by single bidders in Bulgaria’s public procurement practice;
- The government should strive to ensure legal clarity and stability in the area of public contracting, making certain that there is enough administrative capacity to manage and control complex public-private relations under existing regulations before introducing new instruments and legislation in the area. The recently proposed amendments to the *Law on Concessions* and the *Law on the Management of the Black Sea Coast* are a clear example of legislation-induced higher risk of hidden economic activity. The amendments increased administrative discretion to end and/or prolong concession agreements, expanded the scope of the law, allowed the granting of concessions to public-private companies (not yet legally regulated) without competitive tendering, and proposed to scrape pre-concession feasibility studies in some cases. The amendments were not required by EU regulations; they further challenge the already poor administrative capacity in this area and clearly increase the risk of public funds diversion into the hidden economy.

The third set of policy measures that need to be employed in Bulgaria to curtail the hidden economy relates to the promotion of **business integrity and responsible corporate culture**. This is the area that requires the most active involvement of Bulgarian business and professional associations. Professional associations in Bulgaria continue to be passive when it comes to enacting policies and rules of member conduct, in particular relating to good corporate governance practices. Some of the key professional associations in the country, such as those of doctors, lawyers, notaries, etc., suffer from most of the flaws identified by the World Bank for the external auditors and accountants professions, such as

<sup>51</sup> The problems of public procurement, concession, EU fund and swap deal management are examined in detail further in the report.

<sup>52</sup> For a detailed discussion on the deficiencies and possible reform actions in the area of public contracts, see *Corruption in Public Procurement: Risks and Reform Policies*, Center for the Study of Democracy, 2007.

excessive fragmentation with multiple associations, the absence of internal professional quality assurance processes, and the lack of investigation and disciplinary measures against non-compliant members.<sup>53</sup> One important tool for associations to put pressure on businesses engaged in corrupt or illicit practices is the adoption and implementation of **business integrity codes**, which can be used to publicly rank companies on the basis of their integrity performance.

Some of the worst comparative rankings and declines in Bulgarian competitiveness in 2008 can be attributed to the quality of **business management and ethical practices implemented at Bulgarian companies**.<sup>54</sup> Bulgarian public companies in particular seem to have serious issues with respect to transparency and accountability due to their typically **high ownership concentration**. Some **130 to 150 local investors** control the assets of Bulgarian public companies, with the average share owned by the largest shareholder amounting to a little over 60%.<sup>55</sup> In this respect, the Financial Supervision Commission should enforce stricter observance of the recently adopted National Corporate Governance Code, in particular concerning the largest stock issuers, holding companies and companies listed in the unofficial segment of the Bulgarian Stock Exchange. Good practices of minority institutional investors holding majority shareholders accountable, instances of which were first observed in 2008, should be developed further.

### 3.2. Public Resource Management: Mechanisms of Political Corruption and Anticorruption

As pointed out in the last CSD Corruption Assessment Report,<sup>56</sup> EU accession provided Bulgaria with exceptional opportunities for development and increased prosperity by means of two main tools: (i) the right of entry of Bulgarian enterprises into the EU's internal market and (ii) access to EU funds for the modernisation of the public administration and the economy. Two years after Bulgaria's EU membership became a reality, the first tool seems to work properly, whereas the second one is blocked due to the lack of will and the incapacity of the Bulgarian authorities to effectively manage and control EU funds spending.

The loss of EU funds for Bulgaria in 2008 is symptomatic of a much larger-scale problems, such as poor overall governance, inefficiency and political corruption in the management of public resources at the local and national level. The first two years of EU membership highlighted several areas and mechanisms fraught with high risks of political corruption, which demand immediate anticorruption efforts and solutions:

- **Public spending** should be more effective and based on long-term policies containing clear performance indicators of success.

<sup>53</sup> *Report on the Observance of Standards and Codes, Accounting and Auditing, Bulgaria*, World Bank, 2008.

<sup>54</sup> *IMD Competitiveness Yearbook 2008*.

<sup>55</sup> *Report on the Observance of Standards and Codes, Corporate governance country assessment, Bulgaria*, World Bank, June 2008.

<sup>56</sup> *Anti-Corruption Reforms in Bulgaria: Key Results and Risks*, Center for the Study of Democracy, 2007.

Currently, the Bulgarian government's budget expenditures are the least effective in the EU;

- **The public regulatory compliance control and audit system** should be reinforced to ensure the more effective assignment and monitoring of public procurement, concessions and public-private partnership contracts. The current system of EU funds management should be restructured to accommodate greater competition and horizontal accountability among the different operational programs and implementation agencies;
- **Conflicts of interests** in the management of national and EU financial resources should be effectively prosecuted and curtailed;
- Non-market-based **swaps of public land and forest** should be banned. They have become the current equivalent to the shady privatization deals of the recent past, as well as a tool for rewarding loyal oligarchs and a means to redistribute national wealth.

The de facto impunity of political corruption in the country and the lack of capacity of the Bulgarian government to put together and implement transparent economic policies create the real threat that **the benefits offered by the country's EU membership will be captured by a few politically connected oligarchic elites** and Bulgaria's economic development will fall further behind the rest of the EU Member States. No doubt, the most crucial first step in this direction would be "to dismantle at least one loop of companies and to hold the politicians and senior government officials involved in its establishment and functioning criminally liable."<sup>57</sup> The German court system twice proved in 2008 that given adequate will and criminal justice capacity, Bulgarian criminals and their accomplices can be brought to justice and effectively sentenced.

Bulgaria should make better use of cooperation opportunities within the EU (with both individual Member States and the European Commission) to attain more convincing **results in countering political corruption and organised crime**. Otherwise, the worsening global economic recession, coupled with declining public trust in national institutions, could prove disastrous for the country's economy and have long-term negative repercussions on its development.

### 3.2.1. Public Policies and State Budget Management

The key factors creating or, on the contrary, preventing a corruption-prone environment are related to the overall quality of governance in the country: in other words, the presence and time horizons of policies and rules which are binding for all, and the way those affect the local business climate. Frequent, unexpected and opaque changes

<sup>57</sup> *On the Eve of EU Accession: Anti-Corruption Reforms in Bulgaria*, Center for the Study of Democracy, 2006, p. 23.



in policies and laws restrict mechanisms of effective democratic control on the part of the government, undermine trust in public institutions, and can easily be misused to the benefit of corporate interests and corrupt political actors.

One **good governance practice** in public resource management that the Bulgarian government has introduced in recent years has been to deliver progress reports on the accomplishment of its political program goals. The government presented such reports in 2006 and 2007, while in 2008 only several ministries have published progress reports varying in depth, detail and methodology. Though positive, such efforts confirm the existence of governance inconsistencies and fragmentation within the executive, signalling the lack of capacity to formulate and accomplish forward-looking and sound economic policies.

Since it attained EU membership, Bulgaria has had to comply with the European Commission's requirements and prioritise national strategies and policies accordingly, in particular those related to EU funds management. Yet the overall **legal framework for developing and implementing public policies remains highly fragmented**. The government's economic policies still remain fairly unpredictable, creating an atmosphere of institutional instability and uncertainty for private sector planning, and providing incentives for oligarchic interests to use political corruption to bend the rules to suit their own private interests. Several examples expressly support this conclusion:

- The voting of the core laws related to the state budget continue to be postponed until the latest possible parliamentary sessions each year. This makes it possible for MPs representing private interests to deliberately create loopholes to the benefit of their business "masters";
- Bulgaria's preliminary strategy for early membership in the European Monetary Union (EMU) in 2009, announced in the *Report on the 2007 State Budget Law*, had already silently been abandoned by late 2007. The government provided no explanation as to what was the real rationale for prematurely raising excise duty rates, which has a high corruption risk potential, if it had no intention of meeting its EMU membership target. This silent repudiation of the EMU strategy was followed by significant changes in the government's economic policies towards considerable easing of inflation checks, such as (i) higher budget expenditures than those planned in the budget, (ii) the renegotiation of natural gas prices from fixed to variable at a point in time when it was clear that such a step would raise energy costs for the economy, (iii) the introduction of a proportional personal income tax, which added additional liquidity and demand pressures to an overheating economy, etc. As a result, toward mid-2008 the annual year-on-year inflation rate in Bulgaria was the highest among EU member states, colliding with the international trend of downward pressures on prices due to the global economic recession;

- The adoption of a proportional personal income tax scale (flat tax) without a non-taxable minimum threshold, despite the government's publicly declared commitment to adhering to the principles of progressive taxation. Although the introduction of the flat tax was generally hailed by businesses and commentators as a positive decision, it came as an unexpected step in the context of official statements and commitments to the contrary on the part of the government, raising doubts about its real motivations.

***Examples of Abrupt Changes in Key Economic Policies:  
Membership in the Eurozone and the Introduction  
of Proportional Personal Income Tax***

***Eurozone Membership: Delayed Indefinitely***

“[Bulgaria’s goal is] Joining the Exchange Rate Mechanism II at the earliest possible date after the date of official accession of Bulgaria to the EU”

*(Convergence Programme 2006 – 2009 of the Republic of Bulgaria)*

“The significant slackening of the fiscal position in this period will give internal demand an excessive stimulus and exert inflation pressure at a moment when the country will have to meet the Maastricht inflation criterion in order to apply for Eurozone membership at the beginning of 2009. [...] In order to decrease inflation pressures in 2008 and meet the criterion for price stability in ERM II with greater ease, the government decided to introduce the excise duty rates on tobacco products initially projected for 2008 as early as in 2006. This resulted in a sharp rise in inflation at the beginning of the year.”

*(Report on the 2007 State Budget Law)*

***Proportional Personal Income Tax Without Non-Taxable Threshold:  
Adopted With A Decision Of The Political Council Of The Three-Party  
Coalition, July 2007***

“Preservation of progressive taxation, non-increase in current personal income tax rates and reduction of their number.”

*(Political Priorities of the Government of European Integration, Economic Growth and Social Responsibility, 21 September 2005)*

“We will maintain progressive taxation of personal incomes. As a priority, as early as 2006 we will seek opportunities to cut tax rates for low and medium income brackets. Progressive taxation creates conditions for a lower tax burden on the middle class as the economy’s backbone, and is also key to a socially responsible

approach to society's lowest-income groups.”

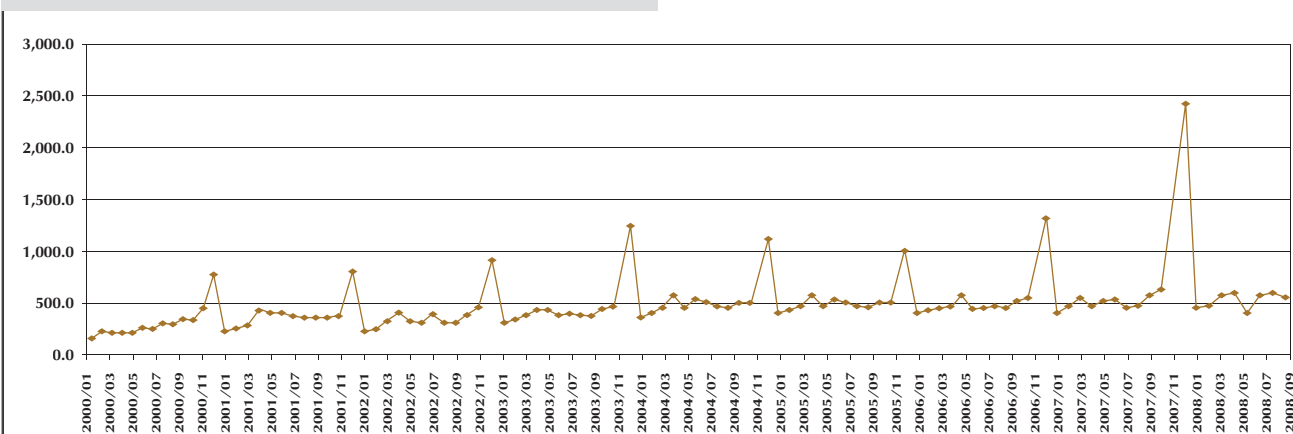
*(Programme of the Government of European Integration, Economic Growth and Social Responsibility)*

“Maintaining progressive taxation of personal incomes. The 2006 amendments to the *Law on Personal Income Tax* introduced a four-tier tax scale on the incomes of individuals. The tax burden for all income groups was decreased, most significantly for low-income groups and recipients of medium-high salaries. In 2007, the policy to reduce the personal income tax burden continued, the greatest reduction being for the income bracket of 300-400 Bulgarian lev.”

*(Report of the Government of European Integration, Economic Growth and Social Responsibility, August 2005 – August 2007)*

The absence of detailed and sustainable long-term public policies in Bulgaria creates favourable conditions for government members and representatives of the public administration to distribute public resources within short time spans and in violation of, or just formally in compliance with, the legal procedures regulating public expenditures. The lack of clear public policy priorities stands out the most when budget surpluses of above BGN 1-2 billion come to be “distributed” by the government within 1-3 months at the end of the year. This practice has a further **negative effect on the transparency and effectiveness of public expenditures**, as it allows government bodies to “ earmark” projects for which resources will be spent in an opaque manner at the end of the year. In 2007, the amount of budget surplus spending at the end of the year doubled compared to previous periods. This was due to the additional BGN 1.4 billion (2.4% of GDP) in excess of planned budget revenues. The situation in 2008 is similar, although the actual amount spent at the end of the year will probably prove smaller once the final figures become publicly available, due to the negative effects of the international economic crisis.

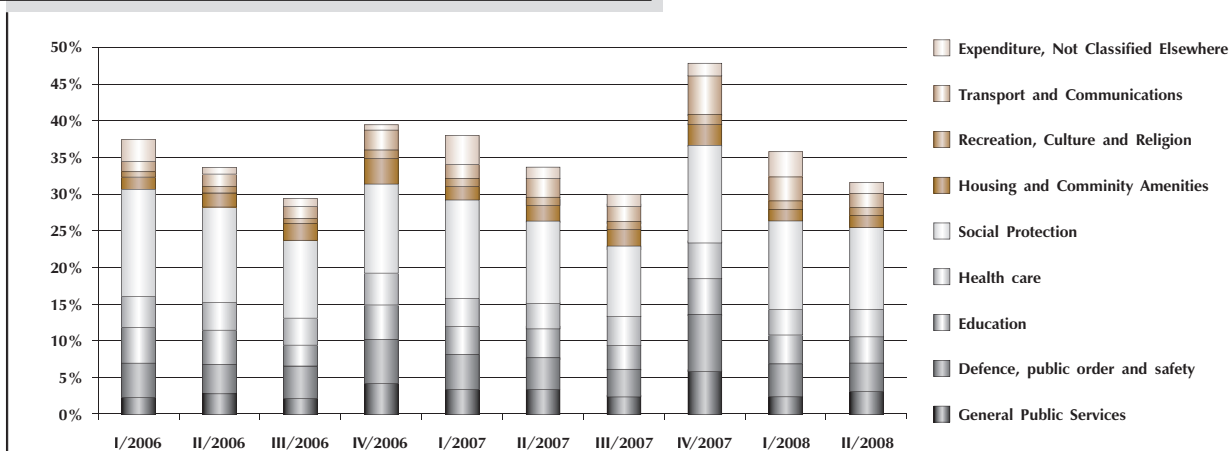
FIGURE 26. TOTAL MONTHLY BUDGET EXPENDITURES EXCLUDING INTEREST (01.2000–10.2008) (BGN MLN)



Source: Ministry of Finance and CSD estimates.

Budget surplus expenditures have not followed set policy priorities, and have not been transparent or accountable either. This raises reasonable doubts among the general public that surplus expenditures are used in a corrupt manner for channeling funds to politically connected companies. Budget surplus resources were mainly spent on general public services, but no **public information is available about related rules of procedure or the efficiency of these expenditures.** At the end of 2007, surplus spending grew most significantly in the defense, public order and safety sector, in general public services (which include departmental expenses of executive and legislative bodies) and in transport and communications: all of these being areas highly susceptible to political corruption.

FIGURE 27. QUARTERLY BUDGET EXPENDITURES BY ECONOMIC ACTIVITY AS A SHARE OF GDP (%)



Source: Ministry of Finance and CSD estimates

The bulk of state budget funds for transport and communications were spent on infrastructure: the area in which the greatest irregularities in EU funds management have been brought to light. Assuming there is no difference in the quality of management practices of EU and national budget funds, tender manipulation and the favouring of politically connected companies is most probably even more pronounced and pervasive in budget surplus spending. The very mechanism of budget surplus spending, which requires that funds be absorbed by the end of the budget year, predetermines that both the contracting authority and contractor firms will only formally apply the provisions of the *Law on Public Procurement*. Thus, companies are driven by the wrong incentives, leading to an increase in moral hazard, i.e. less competitive yet politically better-connected firms stand a better chance to receive public funds and to the detriment of their competitors.

Another major beneficiary of budget surplus funds at year's end are municipalities. Again, the government does not publish information or guidelines on how these extra resources are allocated and spent. In 2007, the extra money allotted to municipalities amounted to 21% of those initially projected in the annual state budget. The share of municipal spending in the consolidated state budget has been growing,

yet accountability and local public procurement practices have remained weak. For instance, the only available data by municipality about state budget surplus resources allocated to the local level is contained in the projected expenditures from the *Law on the State Budget*. No information is available on the amounts actually spent by municipalities.

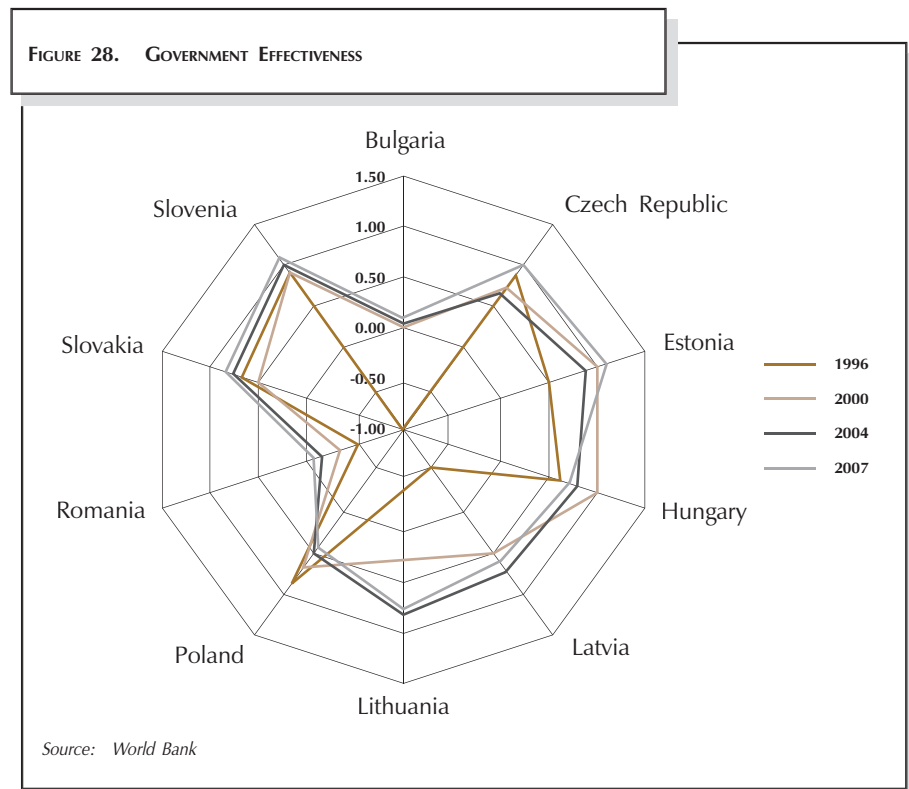
Transparency is insufficient also **with respect to subsidies provided to partially or fully state-owned companies**. Among them are the Bulgarian State Railways, the National Railways Infrastructure Company, the Kremikovtsi steel mill, Bulgartabac, Bulgarian Post, the Bulgarian Energy Holding with its constituent enterprises, etc. According to the budget plan the state subsidies granted to non-financial enterprises reached BGN 395 million in 2007 and 460 million in 2008. There is, however, no information on how these funds were actually spent. In addition, in late 2008 the Council of Ministers granted another BGN 400 million in order to raise the capital of the Bulgarian Energy Holding without any clarifications as to the purposes for which this amount was to be spent. As audits of municipal companies in Sofia in 2007 and 2008 have demonstrated, the risk of misappropriation of public resources goes up if they are provided to public and/or municipal companies through nontransparent procedures.

According to World Bank data on government effectiveness, which assess the quality of state governance, Bulgaria has made considerable progress in the last ten years, but is still next-to-last among the new EU Member States. European Commission research into the quality of public finances concluded that **Bulgaria ranked at the bottom of the EU with regard to the composition, efficiency and effectiveness of budget expenditures as well as with regard to fiscal management**.<sup>58</sup> Recommendations of the International Monetary Fund and the World Bank in this respect in some of their earlier reports are still valid; namely, it is necessary to:<sup>59</sup>

- Rationalise and improve the long-term efficiency of capital expenditures, sound and transparent criteria must be in place to define technical, economic, financial, environmental, and social requirements towards publicly financed projects. It is necessary to develop guidelines for planning and evaluating public investments that will improve transparency in the selection of capital expenditure projects.
- Strengthen the still weak system of ex-post evaluation of the fiscal program and seek feedback from civil society – virtually non-existent at present – on the quality of service and appropriateness of priorities. Budget monitoring focuses on fiscal targets in order to maintain macroeconomic stability, and little attention is paid to assessing the budget programs' effectiveness.

<sup>58</sup> *The Quality of Public Finances, Findings of the Economic Policy Committee Working Group (2004-2007)*, Occasional Papers 37, March 2008, DG Economic and Financial Affairs, European Commission.

<sup>59</sup> *Report No. 27576-BUL Bulgaria Country Financial Accountability Assessment*, September 2003; Report on the Observance of Standards and Codes (ROSC), 2000, Bulgaria.



### 3.2.2. EU Funds Management

As noted in the preceding Corruption Assessment Report,<sup>60</sup> public procurement, concessions and land and forest swaps are the **preferred instruments of corrupt interaction between politics and business** in Bulgaria. They are the main routes for channeling public funds into the private sector, which makes them particularly attractive for corruption and fraud purposes. In 2008, the public procurement market continued to soar, concession deals expanded, while land and forest swaps became a channel for diverting public assets into private hands similar in corruption impact to privatisation. Some sectors, such as **road infrastructure and energy**, in which profits and revenues are very much subject to political and administrative discretion, have become particularly vulnerable to political corruption. The numerous **law violations, conflicts of interests, and cases of corruption** within the operations of the former **Republican Road Infrastructure Fund (RRIF)**, exposed by the media in 2008, corroborated a fact long proven by the competent regulatory bodies, such as the National Audit Office and the Public Financial Inspection Agency (PFIA): namely, violations of and non-compliance with the regulations of the *Law on Public Procurement* by central and local public authorities are of unacceptable magnitude. The numerous irregularities in the management of the PHARE and SAPARD pre-accession funds exposed by European Commission units, coupled with the **lack of adequate systems of ex-ante (preliminary) and ex-post (follow-up) controls**, and the tenuous response of the Bulgarian government to those findings, led to the forfeiture of **€220 million from the national PHARE**

<sup>60</sup> *Anti-Corruption Reforms in Bulgaria: Key Results and Risks*, Center for the Study of Democracy, 2007.



**programme**, as well as to the freezing of EU funds earmarked for road infrastructure development until further approval by the European Commission.

Nevertheless, in response to the harsh domestic and external criticisms leveled against it since mid-2008, the Bulgarian government has undertaken a series of steps to improve EU funds management and provide adequate controls over their spending:

- A new position of deputy prime-minister was instituted to improve the planning, development, management, monitoring and controls of the EU pre-accession programmes, the transitional financial instrument, the Schengen instrument and the operational programs, co-funded by the Structural Funds, the Cohesion Fund, the European Agricultural Fund for Rural Development, the European Agricultural Guarantee Fund and the European Fisheries Fund<sup>61</sup>;
- The Republican Road Infrastructure Fund was transformed and renamed into the Road Infrastructure National Agency; its former executive director is under ongoing investigation, while two former fund officials have already been sentenced for bribery;
- The management and staff of two of the agencies most severely criticised by the EU – the Agriculture Fund and the Central Finance and Contracting Unit – have been replaced;
- The *Law on Public Procurement* was amended in order to facilitate its proper overall enforcement as well as to provide for the establishment of an effective preliminary control system on public procurement;
- The *Law on the Prevention and Detection of Conflict of Interests* was adopted, aiming to restrict corrupt interactions between contracting authorities and contractors, as well as to aid the prosecution and prevention of corrupt relations.

However, **no sanctions have been imposed on the highest ranking public officials and politicians** responsible for the financial losses sustained by Bulgaria in the forfeiture of EU funds. Meanwhile, two of the newly appointed top officials at the state bodies affected by the losses – the Agriculture Fund and the Road Infrastructure National Agency – resigned their positions within just three months of their appointments. The next step in the fight against corruption in EU funds management that the Bulgarian public expects is that it will result in the imposition of **effective sentences at the highest administrative and political level**. It is highly unlikely that the violations of international standards about conflict of interests in the administration of amounts in excess of 120 million leva at the RRIF could have occurred without the knowledge of or protection from higher-ranking political figures. Even if one were to assume that there was no such protection, the existence

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<sup>61</sup> Council of Ministers Decree No. 104 of 17.05.2008.



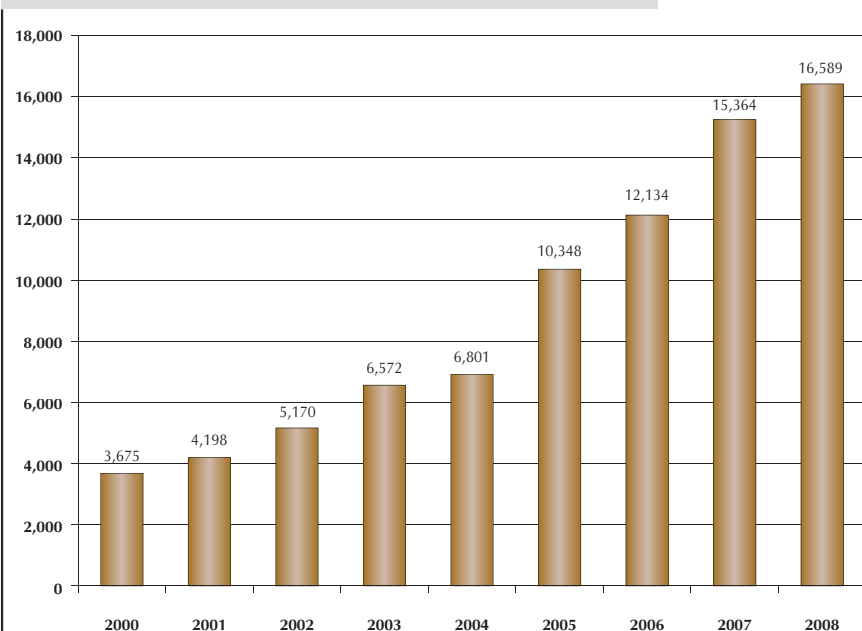
of such grave conflicts of interests would signal a **dangerous lack of administrative capacity and political responsibility in the spending of public funds**. This is particularly alarming given the growing need and pressures for increased public spending during the impending economic recession. If Bulgaria failed to convincingly demonstrate its political will and ability to implement international standards of transparent, accountable and efficient spending of public funds, it would face some very real **threats**. Its economy and population might suffer the full effects of the crisis despite the public funds surpluses accumulated over the last ten years of sustained growth. Moreover, the **oligarchic-criminal loops of companies might become consolidated and gain further ground in the economy** if they established full control of the public spending earmarked for cushioning the adverse effects of the economic crisis.

### 3.2.3. The Public Procurement Market: Growing Risks of Political Corruption

As expected, the registered public procurement market grew both in absolute terms and as a share of GDP, reaching BGN 6.3 billion, or 9.5% of GDP, in November of 2008. The total public procurement market exceeds the registered one by about 20-25%. It includes contracts that are not subject to registration (e.g. for national security reasons), as well as contracts that simply failed to become duly registered for various reasons (lack of knowledge, loss of data, etc.). In addition, the total public procurement market includes contracts that were concluded without an official tendering procedure despite legal obligations to hold one.<sup>62</sup> Over the past four years, **the public procurement market as measured by concluded contracts has doubled both in value and in number**. At the end of 2008, the number of public procurement contracts reached 16,589.

**Over the last couple of years, the risk of corruption and fraud in public procurement has increased significantly** due to a number of factors, including the lack of administrative capacity for public procurement at central and local levels, numerous legislative amendments and the restructuring of important public

FIGURE 29. DYNAMICS OF THE NUMBER OF PUBLIC PROCUREMENT CONTRACTS



Note: Data for 2008 as of 30.09. Data for the period 2000-2005 may differ from other official data due to the inclusion in the register of newly awarded contracts after the receipt of the data.

Source: Public Procurement Agency and CSD estimates

<sup>62</sup> *Corruption in Public Procurement: Risks and Reform Policies*, Center for the Study of Democracy, Sofia, 2007.

procurement control agencies, and the ongoing bad practice of “surges” in public procurement contracts at the end of each year as a result of budget surplus spending. Meanwhile, the value structure of public procurement contracts changed, registering **an increase in the share of services: a sector** which by default is difficult to quantify and control. It is precisely in this sector (of the PHARE program) that Bulgaria lost EU funding due to irregularities in implementing, reporting and controlling tendering procedures. The value of the **public works sector** is expected to **grow further at an annual average rate of 30%** in the next few years, albeit it registered a lower rate of growth in 2008 due to the freezing of ISPA and the Cohesion Fund financing and the delayed restructuring of the Road Infrastructure National Agency. Its growth will be propelled by efforts to quickly overcome gaps in Bulgaria’s road, communication and environmental infrastructure to meet competitiveness requirements for an economy within the EU’s internal market. Such growth is linked to **two corruption risks**. First, national infrastructure firms are wholly dependent on national public funds for revenues and growth. In order to fulfill their strategies for growth and regional market expansion, they will be motivated to apply corruption pressures on the administration in order to secure public procurement contracts. The public administration will in turn have a powerful tool to influence profits in the private infrastructure construction sector, which will provide it with additional leverage to extract illicit payments. Second, the lack or inefficiency of administrative control over the implementation of mushrooming infrastructure projects will allow companies to more easily lower quality standards, thus both saving money and creating artificial demand for their future services, as badly built infrastructure deteriorates at faster rates. Savings stashed through lowering infrastructure quality could later be used to ensure support from the public administration by means of bribes for further projects of the same company. The country might in this manner drag itself into an **infrastructure trap**, maintaining high infrastructure expenditures as a share of GDP, yet continuously lagging behind average European levels in terms of both quality and quantity.

**TABLE 4. TOTAL VALUE OF PUBLIC PROCUREMENT CONTRACTS BY SUBJECT AND YEAR (MILLION LEVS AND SHARE OF GDP)**

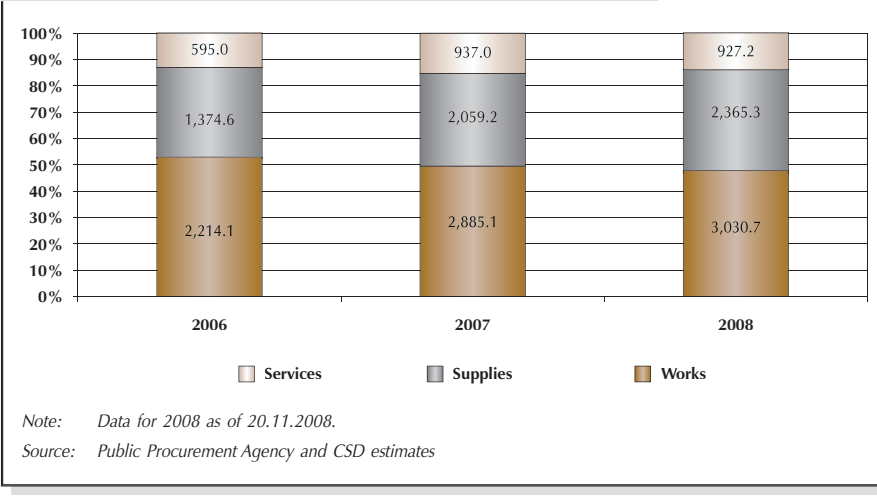
| Subject             | 2006 <sup>63</sup> | 2007          | 2008*        |
|---------------------|--------------------|---------------|--------------|
| Works               | 2,214.1            | 2,885.1       | 3,030.7      |
| Supplies            | 1,374.6            | 2,059.2       | 2,365.3      |
| Services            | 595.0              | 937.0         | 927.2        |
| Design              | 0.6                | 0.1           | 2.1          |
| Total               | 4,184.2            | 5,881.4       | 6,325.2      |
| <b>Share of GDP</b> | <b>8.48%</b>       | <b>10.41%</b> | <b>9.53%</b> |

Note: (\*) Data as of 20.11.2008. The projected GDP for 2008 according to the Report on the 2009 State Budget is BGN 66.4 billion.

Source: Public Procurement Agency and CSD estimates

<sup>63</sup> From this point on in the report, public procurement data on 2006 do not include the contract for the construction of the Belene Nuclear Power Plant (NPP), unless this is expressly mentioned. Its initial worth is BGN 7.8 billion.

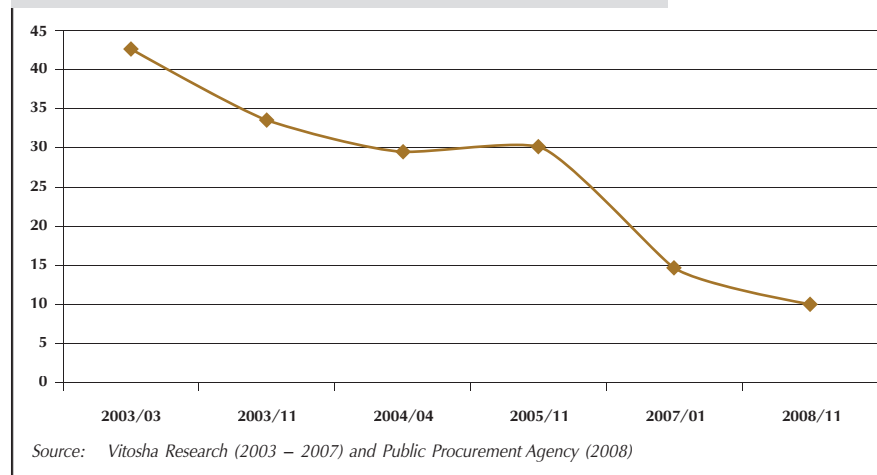
**FIGURE 30. STRUCTURE OF THE VALUE OF PUBLIC PROCUREMENT CONTRACTS BY SUBJECT**



The growing concentration – both as far as contracting authorities and bidders are concerned – of the large and very dynamic market of public procurement in Bulgaria creates ample opportunities for excessive profits and non-market-based rents. This ever-greater concentration provides fertile ground for the formation of durable clientelist networks. On the one hand, the share of the companies which have participated in public procurement tenders continues to decline, having dropped from over 40% in 2003 to below 10% in 2008.

On the other hand, in the last three years the 25 largest contracting authorities in the country have commanded more than 45% of the total value of the public procurement market.<sup>64</sup> In some sectors of the economy, public procurement accounts for a sizable portion of firms' revenues, creating additional risks of corruption pressures. Examples are the markets in pharmaceuticals, fuels and oil products, professional and business services, office and computer equipment, as well as motor vehicles. The shrinking in the number of public procurement bidders down to 10% of companies is due in part to some positive factors, such as the expansion of market opportunities beyond the public sector, but it could also be attributed to the trend for many companies to forego participation in bidding procedures, as they are convinced these are restricted by administrative means to a few pre-selected bidders. The high concentration of the public procurement market both on the contracting authorities' and the contractors' side promotes the establishment of lasting bribery schemes and corrupt relations, such as the ones uncovered at the Republican Road Infrastructure Fund.

**FIGURE 31. SHARE OF COMPANIES TAKING PART IN PUBLIC PROCUREMENT PROCEDURES**



<sup>64</sup> According to data of the Public Procurement Agency.

TABLE 5. TOP 10 SECTORS BY TOTAL VALUE OF PUBLIC PROCUREMENT CONTRACTS (IN BGN, NET OF VAT)

| No  | Sector                                    | 2006        | 2007        | By<br>15.09.2008 |
|-----|---|-------------|-------------|------------------|
| 1.  | Chemical industry (pharmaceuticals)       | 272,217,910 | 272,377,979 | 239,575,851      |
| 2.  | Oil products and fuels                    | 241,991,022 | 466,728,589 | 385,310,478      |
| 3.  | Medical and other instruments and devices | 215,421,147 | 244,214,670 | 286,991,598      |
| 4.  | Machinery and equipment                   | 166,866,689 | 118,538,190 | 118,763,978      |
| 5.  | Professional and business services        | 127,985,598 | 212,360,723 | 176,897,116      |
| 6.  | Repair and maintenance Works              | 125,165,946 | 146,579,506 | 150,753,700      |
| 7.  | Semi-finished products                    | 113,915,228 | 116,841,919 | 97,258,687       |
| 8.  | Office and computer equipment             | 94,157,529  | 66,211,645  | 31,890,976       |
| 9.  | Electrical machines and equipment         | 79,912,709  | 74,214,454  | 62,753,384       |
| 10. | Motor vehicles                            | 67,944,508  | 111,938,131 | 78,737,413       |

Source: Public Procurement Agency and CSD estimates

The trend towards further concentration of the public procurement market, together with the detected cases of bribery, testify to persistent pressures for increases in average bribe amounts in public procurement as compared to the level last estimated by the *Corruption Monitoring System* in 2005: namely, 7.5% of contract values. This conclusion is also corroborated by the prevailing high violation rate of public procurement regulations detected by the PFIA and the National Audit Office (NAO). In 2007 the share of violations established by PFIA within all registered public procurement contracts (6.4% in terms of value and 10.7% in terms of number) remained relatively high against the backdrop of the introduction of fewer in number but more targeted audits (i.e. PFIA only conducts checks when alerted about irregularities detected by other agencies). A better estimate of the actual number of public procurement procedures in violation of regulations, and in particular involving corruption, is provided by business perceptions. According to *Corruption Monitoring System*

data, Bulgarian companies claim that between 27 and 35% of tender procedures in their respective industry have been discredited. Therefore, optimistic estimates the cost of organised public procurement corruption in terms of **fiscal and public welfare loss range between 25 – 30%**<sup>65</sup> of the size of the public procurement market. This suggests that total annual losses due to public procurement misappropriations for the 2007–2008 period have amounted to **1.5-1.6 billion levs**. These losses are calculated under the assumption that bribe takers and bribe givers divide rents equally. In the case of politically motivated corruption, losses could reach 30-50% of the awarded contract's value.

<sup>65</sup> For a description of the methodology and steps to estimate losses see *Corruption in Public Procurement: Risks and Reform Policies*, Center for the Study of Democracy, Sofia, 2007.

TABLE 6. RESULTS OF THE INTERNAL INSPECTION OF PUBLIC PROCUREMENT CONTRACTS

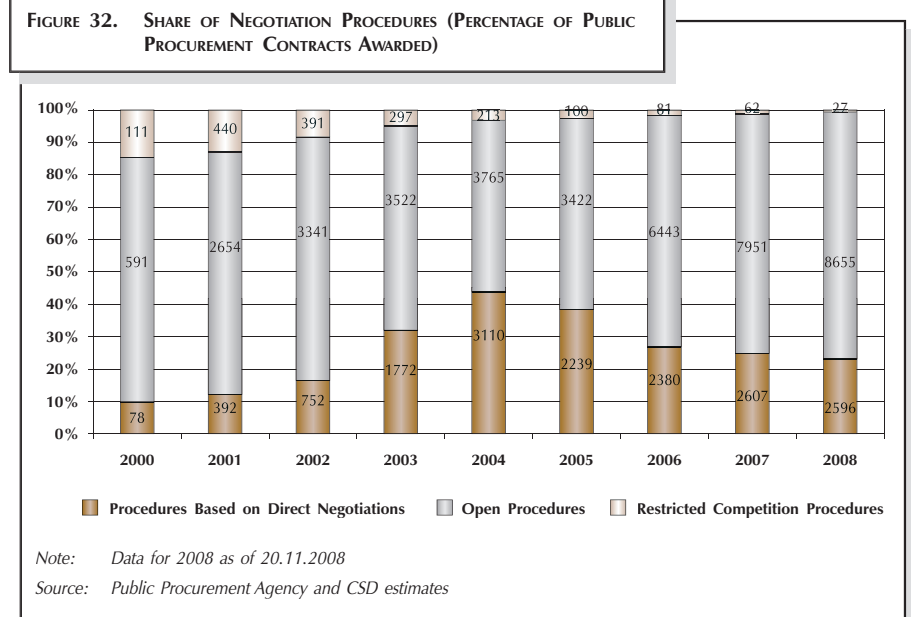
|  | 2005   |          | 2006   |          | 2007   |          |
|--|--------|----------|--------|----------|--------|----------|
|  | Number | Mln levs | Number | Mln levs | Number | Mln levs |
| Registered procedures (1)                    | 10,583 | 3,296    | 12,134 | 4,184    | 15,364 | 5,881    |
| Inspected (2)                                | 6,399  | 1,200    | 2,130  | 286      | 1,529  | 1,032    |
| Violated procedures                          | 1,609  | 567.0    | 322    | 44       | 776    | 601      |
| Violations established                       | 2,551  | 567.0    | 607    | 44       | 1,548  | 601      |
| Failures to conduct procedures               | 641    | 98.5     | 110    | 16       | 202    | 30       |
| Total violations and failures (3)            | 2,250  | 665.5    | 432    | 60       | 978    | 631      |
| Share of inspected procedures (2/1)          | 60.46% | 36.41%   | 17.55% | 6.84%    | 9.95%  | 17.55%   |
| Violations/inspected procedures ratio (3/2)  | 35.16% | 55.46%   | 20.28% | 20.98%   | 63.96% | 61.14%   |
| Violations/registered procedures ratio (3/1) | 21.26% | 20.19%   | 3.56%  | 1.43%    | 6.37%  | 10.73%   |

Source: Annual reports of the Public Financial Inspection Agency

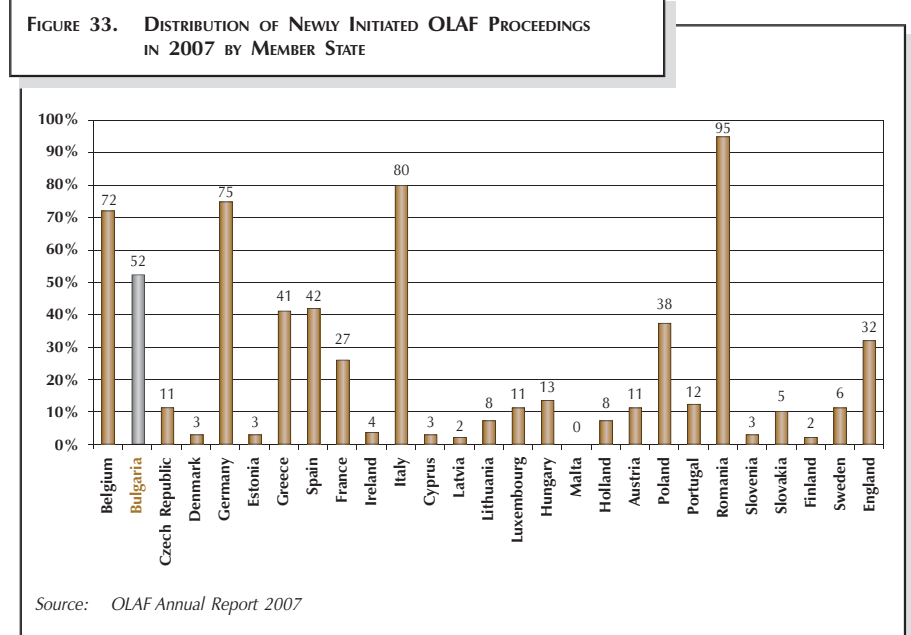
Violations in public procurement procedures are so numerous that **the business and the general public persistently hold the belief that bids cannot be won without resorting to bribery or political protection.** In turn, such beliefs undermine the quality of participating bidders, which forces contracting authorities to search for ways to attract quality candidates for legitimate procedures by artificially lowering administrative requirements for participation. Thus, a vicious circle of noncompliance with the law comes into being, which makes all procedures vulnerable upon auditing. Historical deficiencies in efficient and consistent law enforcement in general and in public procurement contracting in particular, should be tackled decisively in order to start rebuilding the public's trust in public services and institutions.

#### 3.2.4. Anticorruption in Public Procurement and EU Funds Management

Notwithstanding the setbacks in anticorruption policy, some of the positive actions outlined above may be behind the **positive trend of increases in the share of open public procurement procedures** throughout 2008. Although abuses are possible in open procedures as well, auditing and control mechanisms are easier to implement as well. Indeed, the rising share of open procedures in the total number of contracts is a prerequisite for curbing political corruption in public procurement.



The implementation on the part of OLAF of active control mechanisms with regard to EU funds spending in Bulgaria should also be considered a positive development in the fight against corruption. In 2007, OLAF initiated fifty-two fraud investigations in the country: the largest number per capita out of all EU Member States. This implies that Bulgarian control agencies have lacked the requisite skills and capacity and that the share of fraudulent transactions involving EU funds in Bulgaria is high. However, it is likely that such stricter monitoring by OLAF will also have some positive effects such as the **transfer of good auditing practices to Bulgarian agencies and the reinforcement of the rule of law in public procurement.**



### *European Commission's Findings on Problems with PHARE Implementation*

- Problems with the interpretation and consistent application of the Law on Public Procurement provisions in Implementing Agencies, affecting amendments to contracts, evaluation committee proceedings, and cancellations of tenders. Excessively formal manner of the law's application, undermining key principles of sound financial management, such as the equal treatment of applicants, transparency or value for money.
- Inadequate staffing of Evaluation Committees: members without adequate technical expertise and no external independent evaluators involved.
- Filing and archiving problems: loss/absence of key documents leading to risks of the lack of audit trails. Unclear or incomplete tender evaluation reports and missing internal approvals and/or comments.
- Unaccounted for and excessive delays in procurements, including documents withheld from EC ex-ante control before EDIS accreditation without justification.
- Intentionally restrictive technical specifications for IT equipment, limiting competition and undermining the "value for money" principle.
- Insufficient follow up on suspicions of conflict of interest, irregularities or fraud.
- Weaknesses in the supervision of construction projects, including high risks of subcontracting and the completion of projects not in line with contract provisions.
- Indications of contract completions beyond contracting deadlines and excessive delays in commencing the execution of contracts.
- Indications of overlap between and within programmes (e.g. SAPARD/ Structural Funds vis-à-vis PHARE).

Source: *EDIS Ex-Post Transaction Review of Phare Projects in Bulgaria, DG Enlargement unit D2, 23.09.2008 – 08.10.2008*

Positive changes have been made in the ways national public procurement control agencies operate. The efforts of the **National Audit Office with respect to identified corruption risks** in public procurement are adequate. In 2008, the office focused on monitoring political parties, audit and control systems at public institutions, municipal finance,



EU funded programs, etc. Its audit reports and conclusions are still not followed up by appropriate sanctions of detected irregularities, as **horizontal accountability and integration with other control and compliance enforcement institutions remain weak**. Nevertheless, in 2007 the National Revenue Agency for the first time made publicly available information about its inspections following tips by the National Audit Office concerning discrepancies in the income statements of around two hundred individuals, as stipulated by the *Law on the Declaration of Property Belonging to Persons Occupying Senior Public Positions*. The National Audit Office should however step up efforts at horizontal cooperation with other control and compliance enforcement agencies.

In the year preceding Bulgaria's accession to the EU (i.e. in 2006), the operations of the **Public Financial Inspection Agency** were constrained by major legislative amendments and internal organisational reforms. Due to the decentralisation of the agency's operations, there was a sixfold reduction in staff to a total of only 192 in 2007, and respective declines by 75% in public procurement inspections performed by the agency. However, PFIA's restructuring has already produced the following positive results, in keeping with recommendations offered in the preceding Corruption Assessment Report:

- **More effective targeting of inspections:** the agency has detected violations in over 60% (in terms of number and value) of inspected public procurement procedures;
- **Improved risk profiling in inspections:** in 2007, the agency inspected 10% of registered public procurement procedures worth 18% of the value of the registered market; it seems that the focus of public procurement inspections has shifted from checking greater numbers of contracts to examining more limited numbers of higher-value ones.

PFIA's inspections could still be much better targeted and performed. Inspection targeting could be based on the statistics, in terms of value and numbers, concerning the contracts registered under the *Law on Public Procurement (LPP)* and under the *Regulation on Awarding Small-Scale Public Procurement (RASSPP)*. Over the last three years, the contracts concluded under the LPP have constituted 20% of the total number and 80% of the total value of all registered public procurement contracts. As could be surmised from the 80/20 rule (also referred to as the Pareto principle), for contracts under RASSPP the ratio is reversed, as they have constituted 80% of the total number and 20% of the total value. In view of the need for improved risk profiling outlined above, it would therefore be advisable that **80% of the total of PFIA public procurement inspections be targeted at LPP contracts, while the remaining 20% be focused on RASSPP contracts**. Public financial inspections still seem to be largely focused on petty violations followed by inconsequential penalties, which might look deceptively impressive in annual report statistics but otherwise have weak deterrence effects. As with the other state control agencies mentioned above, PFIA's fiscal and preventive effectiveness is modest: violations are still committed en masse. This

suggests that **horizontal interactions between control agencies should be intensified and task forces comprising their representatives as well as representatives of the Ministry of Interior agencies, the Investigation Service and the Prosecution Office, should be formed for the purpose of solving high-profile cases.** PFIA also needs to have greater independence from political interference, while inspectors should be provided with sufficient opportunities to improve their professional skills. Trimming unproductive staff is a good precondition for achieving this. Had such measures been introduced earlier, they would have rendered it more likely that the three PFIA inspections at the Republican Road Infrastructure Fund conducted in late 2007 would have led to the detection of the significant irregularities of which the Bulgarian public only learned in 2008.

TABLE 7. STRUCTURE OF AWARDED CONTRACTS UNDER LPP AND RASSPP BY VALUE AND NUMBER

| Year   | 2006  |        | 2007  |        | 2008  |        |
|--------|-------|--------|-------|--------|-------|--------|
|        | Value | Number | Value | Number | Value | Number |
| LPP    | 81%   | 19%    | 79%   | 19%    | 80%   | 20%    |
| RASSPP | 19%   | 81%    | 21%   | 81%    | 20%   | 80%    |

Note: Data for 2008 as of 20.11.2008

Source: Public Procurement Agency and CSD estimates

In 2008, the *Law on Public Procurement* was amended in line with many of the recommendations made by the Center for the Study of Democracy<sup>66</sup> in the past. The amendments will improve the management and control mechanisms and will enhance the transparency of the process. Namely, the amendments have:

- **Provided for preliminary controls over large-scale public procurement** with values above the so-called “European thresholds”, which bear the most substantial risk of abuse and damages to Bulgaria’s financial interests. A new unit will be set up at the Public Procurement Agency (PPA) to monitor a minimum of 10% of the procedures published in the EU Official Journal. PPA’s executive director will have the powers to monitor whether the decisions to announce public procurement tenders published in the Public Procurement Register comply with the legal requirements;
- **Introduced further barriers to unwarranted changes to already awarded public procurement contracts**, which is a major medium of corruption as well as an impediment to business. According to the amendments, only contracts with a duration of over 12 months

<sup>66</sup> *Anti-Corruption Reforms in Bulgaria: Key Results and Risk*, Center for the Study of Democracy, 2007; *Corruption in Public Procurement: Risks and Reform Policies*, Center for the Study of Democracy, 2007.

and relating to activities the prices of which are subject to state regulation can be renegotiated;

- **Set higher national thresholds for the obligatory LPP implementation**, which will help focus auditing and inspection efforts of individual control agencies on larger-scale contracts;
- **Removed opportunities to charge unduly high fees for tender documentation**, setting fee limits equal to the cost of photocopying relevant sets of documents;
- **Expanded the number and membership scope of Evaluation Committees**, allowing in NGO representatives and detailing their functions. **Provisions have been introduced to make price offers harder to manipulate**, when the selection criterion of “economically most advantageous offer” applies, by allowing bidder representatives to attend the opening of price offers and making it mandatory to announce rankings by technical criteria in advance;
- **Improved and facilitated companies’ access to the public procurement market**, as bidders are no longer obliged to make repetitive declarations regarding circumstances already declared in the Commercial Register;
- **Provided for the improved status of and pay bonus opportunities at the Public Procurement Agency**, so that it is on a par with the rest of the auditing and public procurement control agencies, such as the Commission for the Protection of Competition, PFIA and the National Audit Office. The amendments have also expanded the powers of PPA’s executive director to assign inspections following tips regarding irregularities in public procurement.

Despite these positive LPP amendments, **provisions which could lead to reduced transparency in public procurement have also been squeezed by**. For instance, following the amendments, **it might not be possible to obtain direct access to Public Procurement Register (PPR) data/information according to preliminarily specified criteria**, with inquiries instead being redirected to PPA’s web site and the data available on it. The PPR is one of the main tools for providing adequate management analyses and public procurement market controls, so it should remain open to provide to all users the maximum possible information its design allows. Its web-based version limits the options for analysis and for obtaining aggregate data. PPA should seek to increase the financial resources allocated to securing wider public access to the register and to improving the agency’s annual reports. PPA should also aim to **maintain the register as complete and comprehensive as possible**. As of late 2008, 2,296 of the procedures input into the register had not been updated for over nine months.

TABLE 8. THRESHOLDS IN PUBLIC PROCUREMENT PROCEDURES  
(IN LEVS, NET OF VAT)

| Type of procurement | Under LPP      | Under RASSPP        | No formal procedure required |                |
|---------------------|----------------|---------------------|------------------------------|----------------|
|                     |                |                     | With 3 bids                  | Without 3 bids |
| Works               | Over 2,150,000 | 100,000 – 2,150,000 | 45,000 – 100,000             | Below 45,000   |
| Supplies            | Over 180,000   | 30,000 – 180,000    | 15,000 – 30,000              | Below 15,000   |
| Services            | Over 110,000   | 30,000 – 110,000    | 15,000 – 30,000              | Below 15,000   |
| Design              | Over 110,000   | 10,000 – 110,000    |                              |                |

Source: Law on Public Procurement and Regulation on Awarding Small-Scale Public Procurement

It should be noted that although the 2008 legislative amendments have created a better management and controls environment in public procurement in Bulgaria, such provisions could not replace the need to **establish and disseminate administrative best practices in tendering, contracting, implementing and controlling public procurement procedures**. This is why it is crucial to enhance the horizontal accountability of public procurement contracting authorities and control bodies. For the purposes of EU funds administration, this role belongs to the Deputy Prime-Minister for EU funds management. In the more general cases of national funds procurement, it is necessary that the Public Procurement Agency be given greater powers in this respects. It is feasible to achieve better horizontal accountability in public procurement via either: (i) centralizing public procurement contracting or (ii) strengthening the **PPA's coordinative and interpretative roles**. As decentralised management has proven more successful in market and democratic terms, it might be advisable that at this stage of the development of Bulgaria's public procurement market reinforcing the PPA's preliminary control functions is the preferable option. This could be achieved through rendering PPA decisions on procedures' compliance with the law and to best practice binding for the contracting authorities.

Although the 2008 regulatory amendments have been rather substantial, still a number of important anticorruption issues remain to be addressed:

- As the public administration gains experience in the contracting and controlling of public procurement, it should also learn to recognise and observe the **value for money** principle. Often, participation in public procurement is restricted by the overly formal enforcement of legal provisions without giving due consideration to economic efficiency issues, i.e. without ensuring that gains from public procurement exceed the procedure costs and that more than one competent contractor is available to select. Moreover, issues of value for money should play as prominent a role as those of legality when it comes to controlling public procurement decisions at central and local levels;

- More **guarantees and control mechanisms over irregularities at the implementation stage** must be sought. Very often in public procurement there is substantial risk that the contractor will deviate from contractual provisions during the implementation phase, which is not subject to adequate quality control and monitoring by the public administration;
- Although **penalties for infringement of LPP provisions** were significantly increased, they **remain regressive**, i.e. they encourage large-scale non-compliance since proportional penalty burdens decrease with increases in the misappropriated amounts or financial damages resulting from the violation. This could be resolved by the imposition of penalty amounts as a percentage of the contract value in question and the introduction of much higher penalty ceilings, similarly to the regulations applying to determining the required collateral for the purpose appealing public procurement procedures.

In their present form, the LPP and RASSPP have narrowed the loopholes allowing for their corrupt circumvention. This **has restricted opportunities for practicing familiar forms of corruption from the recent past**. The reinforcement of this tendency **calls for the further development of effective public procurement policies** along several lines: the introduction of rules for ethical conduct in public procurement; the development of strategies (policies) and corporate public procurement plans in each administrative unit operating as a contracting authority; and strengthening of the administrative capacity to implement international projects with partially or predominantly external financing in order to ensure the successful absorption of EU funds. It is necessary to create mechanisms for feedback and the dissemination of public procurement best practices in terms of EU and national funds management. In this respect, it is not advisable to differentiate between EU and national budget funds, although this seems to be the direction taken so far in an attempt to quickly address European Commission criticisms concerning EU funds management. It would be useful to **apply the rules valid to EU funds management directly to the administration of national financial resources as well**.

### 3.2.5. Concessions and Public Private Partnerships

Good governance principles require that the applicability and scope of the various instruments for the management of public budget resources and of public property be clearly defined and based on detailed written instructions. Bulgaria **has not yet designed a comprehensive policy on public-private partnership** in all its forms, such as public procurement, where implementation and funding risks are borne entirely by the public sector; or concessions and a variety of contracts for building/operating/management/ transfer where risk and funding are shared by public and private sector; or privatisation where risk and funding are fully shifted into private hands. The varying degrees of risk-sharing and co-funding between the private and the public sector in the various forms of public-private partnership require different approaches in their legal regulation,

use and oversight, so corruption risks ensuing from their application are reduced. Although in 2008 the government introduced new forms of public-private partnership through amendments to the *Law on Concessions*, the responsibilities for concession planning, implementation and controls are so scattered across institutions that **serious preconditions for large-scale corruption, embezzlements and neglect** emerge. The vaguely formulated or non-existent public body guidelines on the use of the various instruments of public-private partnership pose further problems. The most flagrant violation with potentially very serious fiscal and social consequences is the **use of a public procurement procedure for the construction of the Belene Nuclear Power Plant (NPP)**. As a rule, public procurement is a public-private partnership instrument used for shorter-term or repetitive projects, the value of which is easily identifiable. Not only will the state budget bear the full burden of risks and funding for the NPP contract, but also the use of public procurement in this case provides convenient legal cover for the discretionary spending of considerable amounts of public funds: the contractor will dispose of 7.8 mln Bulgarian leva, which is comparable in value to the total public procurement market in Bulgaria.

The history of concessions in Bulgaria has shown that they involve serious corruption risks. Through the latest amendments of the *Law on Concessions* in 2008, the Bulgarian government enabled (even newly formed) public-private companies to be automatically granted concessions for a period of thirty-five years. This provision greatly **raises the risk of concession abuses and their use to create or sustain oligarchic interests**. Data from the National Concession Register reveal that concessions are increasingly used as an instrument of interaction between the public and the private sector in Bulgaria. The national and local authorities granted fifty-five concessions in 2008. In contrast to public procurement, however, the granting and the implementation of concessions are subject to laxer controls. Taking into account the much longer duration of implementing a concession in comparison to a public procurement contract, the former demands: (i) much more thorough preparation and follow up oversight, (ii) the establishment of partner relations between the state and the business; and (iii) the creation of a more comprehensive anticorruption system to counteract the likely durable corruption relations.

### 3.2.6. Outstanding Areas of High Corruption Risk: Land and Forest Swaps

In view of the real estate boom in Bulgaria's largest cities and resorts in recent years, **state-owned and municipal land, forest and real estate property have become the public resources in highest demand and most exposed to corruption pressures on the part of the private sector**. Investor pressures for the acquisition of state-owned and municipal lands are unlikely to decrease in the future. Experience from previous EU enlargements has demonstrated that corrupt deals involving land acquisition and the construction of and trade in real estate in the new member states can have strong negative consequences for their economic development and lead to a snowball effect on the number and value of bribes offered.



Swaps of state and municipally owned property constitute a **major form of high-level corruption and abuse of public office in Bulgaria which became emblematic in 2008**. These practices contravene market principles and transparency requirements alike. Political power has thereby become a tool for extracting financial gains and benefits for privileged companies, high-ranking public officials and politicians. These swaps are of substantial value, cause great losses to the state budget, and can be defined as the most conspicuous and intolerable form of **political corruption in Bulgaria in 2008**.

The deficiencies in regulations concerning the swapping of private for state-owned or municipal property provide opportunities for the public administration to apply the law arbitrarily in favour of specific persons or businesses. The legal provisions regulating swap deals are overly general and **predominantly permit based, i.e. swaps cannot be refused once the lax legal requirements are met**. Thus, even though most swaps are economically disadvantageous to the state, they do not breach legal requirements as the law does not require officials to consider the economic rationales of the deals concluded. Additionally, **a lot of the legal details concerning swaps are contained in secondary legislation**, such as municipal council ordinances. In this manner, the very design of the rules governing such deals is susceptible to corrupt influences. For example, some municipal councils have issued regulations stipulating that properties can be sold through direct negotiations between the mayor and potential buyers.

The law vests certain high-ranking officials (mayors, ministers, district governors) with substantial powers, whereas the legislation contains **no guarantees of the transparency of the deals or of the adequate evaluation of swapped properties**. The prices of swapped properties usually greatly differ from market values. As a rule, the authorities do not provide any explanations regarding the reasons swaps are concluded, regarding the way properties to be swapped are chosen, regarding the procedures for selecting private counterparts, etc. **The principles of openness and transparency, free and fair competition, and equal treatment of participants in property swap transactions are not adhered to; there is no legal requirement to that end**. As confirmed by hundreds of media reports on property swaps detrimental to the public interest, this problem has become pervasive. The Bulgarian authorities continue to conclude such deals in the face of repeated declarations by government and parliament officials that the practice should and will be terminated or better regulated. What is more, since some ministers and MPs announced it was likely that property swaps would be stopped or a moratorium imposed on them, the demand for such deals has increased.

#### ***Legal Basis for State and Municipal Property Swaps***

The *Law on State Property* and its Implementation Regulation are the basic legal instruments governing the management, disposition and control over state-owned real estate, including properties assigned



to be managed by district governors. District governors and the Minister of Regional Development and Public Works have the authority to approve swap deals.

The *Law on the Ownership and Use of Agricultural Lands* (art. 24, par.1) provides the Minister of Agriculture and Foods with the authority to swap lands from the State Land Fund with private lands, upon demand by physical and/or legal persons. The single legal requirement is that the private lands on offer be equal in quality and quantity to the public lands exchanged in return. Provisions for these ministerial powers are made in art. 36 of the Law's Implementation Regulation.

The *Law on Forests* (art. 156) states: "Swaps of forests and lands from the forest fund, which are private state property, with forests and lands, which are property of physical and legal persons or municipalities, is performed upon order of the Chairman of the State Forestry Agency.

The *Law on Municipal Property* (LMP) regulates the disposition of municipally owned properties through purchase, barter, partition, and instituting restricted property rights with or without compensation. The law sets forth the general provisions on municipal property, while the local government bodies (i.e. municipal councils) have the discretion, through ordinances they adopt in compliance with the LMP, to regulate the management and disposition of municipal property.

All **swap deals** follow a similar **pattern**:

- First, state-owned land in or in the vicinity of high-value resort areas is swapped for private plots in less attractive or lower-priced parts of the country;
- Second, the private individuals or companies engaging in swap deals are closely related to the political elite (whether local or national). The practice of swaps has survived through several successive individual and institutional reshuffles at the public bodies responsible for controlling such deals;
- Third, after the swap deal is completed, local municipal councils intervene to change, if necessary, the land's purpose of use and thus increase its value several times.

Swap deals are thus based on the current value of the lands/forests in question, not taking into account any potential future increase in their value in case their purpose of use is changed. While the potential value of swapped private forests is not likely to grow, that of the public properties acquired usually is. Public authorities overlook the net present values of swapped public properties and consider only their accounting

values. **Swap decisions are thus not based on economic logic.** They are officially presented as serving the needs of agricultural land consolidation, or as contributing to the state forest fund, **in disregard of any wider public interests.** Although toward the end of 2008 forest swaps started to be publicly announced, **the private beneficiaries of the deals remained anonymous.** There is no public information available on the total number of swaps concluded, as Bulgaria has no public property register, let alone a separate property swaps register.

There are **three major channels for property swaps** at national level, involving lands, forests, and military property. The first two types of deals are managed by the **Ministry of Agriculture and Foods** and the **State Forestry Agency (SFA)** respectively. The agency was established specifically for the purpose of improving the administration of forest swaps, and is directly accountable to the Prime Minister. The third type of deals are handled by the **Ministry of Defense.** At local level, swaps of municipal property are administered by **municipal authorities.**

As land prices range between 4 and 1,000 Bulgarian leva per square metre depending on location, there are plentiful opportunities to benefit legally from such transactions. For example, **the re-sale of the 1,450 hectares of forests swapped in 2008 with an assumed profit margin (i.e. the difference between the buying and selling price) of 100 leva would result in revenues of 1.45 billion leva.** In most cases though, profit margins in the re-sale of swapped forests are much wider, as forests are typically acquired in order to be included in larger investment projects. The overall amount of foregone income from swap deals is most probably much larger, as value estimates of agricultural lands or municipal and military properties have not been taken into account. Thus, the actual losses incurred by the state are at least twice as high as the 1.5 billion leva mentioned above.

In spite of parliamentary debates over the need to place a moratorium on or ban swaps of state-owned and municipal properties throughout the second half of 2008, no decision to act on this issue had been taken by the end of the year. The lack of resolve to deal with the issue on the part of the Bulgarian government suggests that this represents yet another **example of state-capture by private oligarchic interests,** which forces the authorities to abandon an important instrument for stimulating the development of the country's economy. There is a pressing need to **introduce a moratorium on swaps and adopt new and modernized policies on the conclusion of similar deals** based on economic efficiency considerations. Compared to the huge importance of the public interest involved, the means needed to act on removing negative effects of swaps are only very modest.



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## PUBLIC-PRIVATE PARTNERSHIP TO OVERCOME THE INSTITUTIONAL DEFICITS IN COUNTERACTING CORRUPTION AND ORGANIZED CRIME

When Bulgaria became a Member of the European Union two years ago, the Bulgarian authorities hardly expected radical changes in the criteria for the assessment of their anticorruption policies and practices, particularly concerning the management of EU funds. In 2008, both the Government and the general public realized that two critical changes had since occurred: the European Union has now come to regard Bulgaria as a full-fledged Member with all of the ensuing obligations and criteria to be fulfilled, while Bulgarian citizens see EU anticorruption procedures and sanctions as an objective assessment largely matching the prevalent skepticism about the actual motivations of the government and the administration behind failures to implement effective anticorruption measures.

The analysis of corrupt practices in this country, as well as of the anticorruption policies and measures implemented so far, points to **two fundamental deficits**: namely, of political will and of administrative capacity.

Prior experience demonstrates that **political will** is not to be confused with empty declarations, nor should it be limited to the formulation of anticorruption strategies or even the formal creation of anticorruption institutions and mechanisms. “Political will” is a complex concept which, however, does have clear and practical implications in public life. According to research supported by the US Agency for International Development, it involves:

- Undertaking **new initiatives aimed to curb corruption** with a clearly defined decision-making center. The Bulgarian authorities have to meet public expectations and implement real and radical anticorruption measures. At the very least, the already adopted and much publicized anticorruption measures and instruments need to be consistently and effectively implemented. This is of particular relevance to the executive and the judiciary. The political will for radical anticorruption reforms needs to be clearly associated with a public figure at the highest level (the Prime Minister, for example). So far, the responsibility for implementing and updating anticorruption measures has been relegated to collective bodies lacking the required leadership for undertaking decisive initiatives;
- Adequate **diagnostic tools to establish the underlying reasons for corrupt practices**. The Bulgarian Government has yet to

implement the *System of Indicators for the Assessment of Progress in the Implementation of the Strategy for Transparent Governance and Prevention and Counteraction of Corruption for the period 2006-2008*. The *Corruption Monitoring System* that the Center for the Study of Democracy has been implementing for the last ten years needs to be put to use, in accordance with the decision<sup>67</sup> of the government anti-corruption commission, not only for the assessment of strategic documents but also of all areas of high corruption risk and public concern, such as healthcare, education, public procurement, swaps of land and forest, etc.;

- **Mobilizing the public** in support of anticorruption reforms. The level of public trust in state institutions and in the specialized anticorruption bodies in particular is extremely low. Such a low-trust environment calls for enlisting public support for specific new anticorruption initiatives enjoying highest-level political backing. Examples of such endeavors include the activities of the Deputy Prime Minister in charge of EU funds management, the establishment of the joint ad hoc teams at the Prosecutor's Office working on specific criminal investigations, etc.;
- **Enforcing real and adequate sanctions** in the process of reform implementation. The only way to restore public trust in government anticorruption policy is to enforce effective sanctions against corruption crimes, particularly as regards political corruption and organized crime;
- **Achieving consistency in anticorruption endeavors.** One of the most notable shortcomings of the anticorruption efforts of the authorities in the country has been their sporadic nature. Anticorruption measures are typically stepped up under conditions of internal and external pressures. If pressures subside, anticorruption efforts slacken as well. Thus, for instance, the efforts of the Bulgarian authorities in counteracting corruption and organized crime have slackened since the country's EU accession.

The second conclusion is that not everything boils down to political will, since even the best intentions can be ruined by the lack of **administrative capacity**. In this respect, it is necessary to adopt more resolutely European transparency, civic control and accountability practices, which are already among the criteria for the country's progress in implementing EU rules. The efforts to date to bring the administration in line with European standards have come up against determined resistance originating from traditional structures and methods aiming to subject public interests to the private agendas and commitments of certain public officials. Naturally, even here the problem is not just the existence of corrupt practices, but the shortage of well-trained staff, lack of experience in working with European institutions, etc. This therefore calls for radical improvements in the institutional environment

<sup>67</sup> Decision No 3/10 May 2006 of the Commission for the Prevention and Counteraction of Corruption with the Council of Ministers of the Republic of Bulgaria.

in Bulgaria, which would involve programs and investments far more ambitious in scope, which could, in the mid-term, make up for the existing administrative deficit.

These two structural deficits of the Bulgarian political system require a **new level of interaction, partnership and involvement of civic organizations at all stages of the implementation of anticorruption reforms**. It is imperative to make full use of the **“triangular mechanism”**<sup>68</sup> in place in some sectors, which can unite the efforts to uphold transparency and integrity on the part of civil society, international partners, and reformist-minded government and administration officials. The process of making up for the deficits in question could indeed be greatly facilitated and speeded up by drawing on the skills and infrastructure of Bulgaria’s international partners and of Bulgarian civil society.

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<sup>68</sup> See *Democracy that Delivers: Unlocking the Potential of Transition*, Center for the Study of Democracy and USAID, Sofia, 2008, p. 18.