

POLSCI FOCUS

Administrative and Political Corruption in Bulgaria: Status and Dynamics (1998-2006)

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Abstract:

Corruption, particularly in the high echelons of power, is one of the most serious problems faced by Bulgaria on the eve of its accession to the European Union. The problem has remained on the monitoring agenda for Bulgaria and extensively commented by the EC in its monitoring and evaluation reports in the last 2-3 years. In a period of three years subsequent to EU membership the government and the European Commission will report on the progress in countering administrative and political corruption in the country.

Keywords:

Bulgaria, European Union, administrative corruption, political corruption, countering corruption, EU monitoring agenda, CMS

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It is always difficult to say how much (or how little) corrupt the administration of a country is unless a proper operational definition of corruption is used. There are two ways of dealing with the more general approach towards corruption. First, the denial-of-everything approach which claims that corruption is too complex, too vague and too difficult to define and eventually measure and/or analyze. Many reports and analyses of corruption adopting this approach usually begin with the notion that corruption is a complex social phenomenon that is practically immeasurable and difficult to define. In addition corruption (as most social phenomena) is system dependent, i.e. its forms and involvement in different societies varies. Respectively, perceptions of corruption in different countries and governments differ substantially. Most often this approach is politically biased and is used to reject findings on corruption at all levels. The rationale is that one cannot measure something that could not be defined.

Secondly, the positivist approach, which includes the attempt to compose and decompose corruption to its different forms and mechanisms and to construct a system of measures which aim to account for the levels of corruption in societies, social sectors, or among different population groups. The logic of this approach is that the function of science is to measure the immeasurable, i.e. to step by step create preconditions (theory) that would make it possible to asymptotically get closer to the true understanding of a given phenomenon.

In Bulgaria, a well-known and systematic approach to analyze and counteract corruption has been adopted by Coalition 2000¹. One of the instruments used by Coalition 2000 has been its Corruption Monitoring System (CMS)². The basic methodological assumptions and concepts on which the CMS is based are:

Administrative corruption. This concept refers to the corruption transactions in which lower and middle level officials receive kickbacks (money, gifts, favors) from citizens either to provide a better service or to violate existing rules and laws. This type of corruption has been found to be characteristic for all post-socialist countries and is manifested in forms and sectors that seem fairly unlikely for developed countries. The main systemic reason for the existence of this type of corruption is the character of transition processes in these countries. More specifically this is the dynamically shifting balance between the public and the private spheres within a short period of time. Administrative corruption seems to be the negative byproduct of systemic adjustment to the new public-private balance in society.

Political corruption. This concept refers to corruption

of high level officials in the executive, the legislative and the judiciary. In principle corruption transactions of this type involve manipulation of substantial resources and more complicated corruption schemes (including political party financing).

Perception based measures. Perception based measures of corruption include accounts for the perceived spread of corruption in different social sectors (also institutions, professional groups, etc.). CMS research findings and other international research has shown that perception based measures reflect attitudes of different target groups towards corruption are not precise estimates of the actual level of corruption. In this respect perception based measures are dependent on situational factors and are strongly politically biased. However they proved a fair account of public tolerance or intolerance of corruption practices in society.

Experience based measures. Experience based measures account for incidences of personal experience with corruption transactions. These measures are based on anonymously provided reports. The same approach is used in crime victimization research and experience accumulated since the 1960-ies has proved that obtained results are fairly accurate. The CMS includes both perception and experience-based indicators. Collecting of information started in mid 1998 and the last monitoring survey was conducted in November 2005. The main target groups addressed in CMS surveys are 1) general population (18+); 2) business sector representatives (managers of small, medium and large companies). CMS monitoring surveys address mainly administrative corruption. While this is the most widespread form of corruption observed in Bulgaria, another important form of corruption - political corruption - remains out of the scope of the CMS. However, many aspects of political corruption have also been analyzed.

Corruption: Issues of Contemporary Social History

The forms and mechanisms of political and administrative corruption in Bulgaria are essentially something new for the country. They emerged in the beginning of the 1990-ies are closely linked to the specific driving forces of political and economic transformations. In the period 1990-2005 the structure of property in the country changed dramatically. The ratio between state v/s private property of industrial assets changed from 96:4 (1989) to 20:80 (2005). In the context of an evolving legal system, the transformation of property did not always follow the legitimate rules. Political power and influence have been decisive in the first years of the privatization of the state. At later stages mechanisms have become more

¹ Coalition 2000 is a coalition of NGOs aimed and countering corruption in Bulgarian society [www.anticorruption.bg].

² The first description of CMS methodology, as well as the first results of its implementation, were published in CLEAN FUTURE. Anti-Corruption Action Plan. Monitoring. Corruption Assessment Indexes., 1998.

sophisticated and this has led to the involvement of various levels of the administration into the process of privatization of the state.

The mechanism that has “facilitated” privatization and the establishment of the new property structure in the country has often been corruption. Now that privatization is practically completed, corruption mechanisms that have been used to control privatization are being utilized to gain comparative advantages in the functioning of the new structure of the economy under the new rules (market economy). Corruption mechanisms are targeted to “benefit” from resources in several principle areas:

1. Violation of rules with imposed payments in favor of the state. Such rules are – taxes, VAT, customs fees, social benefit payments, excise payments, etc. These are contributions to the budget enforced by the state; their violation through corruption brings substantial advantages to social actors.

2. Control over public procurement spending. This type of corruption transactions very often combine administrative and political corruption and substantially modify specific markets.

3. Control over spending of EU funds. This corruption area is relatively new and its importance is most likely going to increase, as the amount of funds will substantially grow after the EU membership of the country.

4. Control of law enforcement mechanisms. This type of control through corruption has proved to be important for the perpetuation of more complicated corruption schemes (involving various actors and operating for a longer period of time). The intensification of government anticorruption policies and practical measures in 2006 has shown that a disturbing number of high level law enforcement officials have been involved in corruption schemes ensuring protection for violations of the law.

5. Political party financing. Party funding is the crucial intersection of different corruption schemes, which ensures political lobbying. One of the basic preconditions for that (except economic interest of the political class) is the under-funding of parties by the budget. Financial needs, especially in election years, do normally exceed state subsidies. According to expert estimates the latter account for 10-20% of actual party spending.

6. Protection of “black businesses” (organized crime activities). For many reasons organized crime has been one of the elements of transition. At the very early stages of transition criminal groups have (through

corruption) managed to create relationships with institutions important for their sphere of activity.

These principle fields of corruption transactions generate both administrative and political corruption. Depending on the specific corruption transaction one or more levels of the administration and forms of corruption could be involved.

For example large-scale customs fraud (cigarette smuggling) for a longer period of time necessarily involves officials from the customs administration, tax administration, border police, investigation and prosecution officials, “private law enforcement”, and political protection combined with party financing. Lower level customs officials get paid to close their eyes when necessary, their superiors get paid to tolerate the violation of agency rules and higher-level politicians get paid (personally and/or their parties) to tolerate the existence of such a situation. Law enforcement officials get paid not to act, if something goes wrong in smuggling operations and bank or financial institutions get paid to process the revenues³. Evidence that accounts for the existence of cigarette smuggling is relatively easy to find. It is just necessary to compare consumer spending of imported cigarettes (market research information) with aggregate customs information about official (legitimate) import. For specific periods of time the share of legitimately imported cigarettes on the Bulgarian market has been down to 15-20%.

The above example and issues elaborated make it possible to deduce several important assumptions about corruption assessment:

1. Administrative and political corruption are closely linked. It is practically not possible to observe high levels of administrative corruption without assuming that the higher political levels are not involved. If administrative corruption levels are high and political corruption level are low, this would mean that the higher levels of the administration do not have any control over their officials.

2. The existence and evolution of corruption over a longer period of time links different political parties and get to one and the same corruption scheme. In this way parties practically block each other in any attempt to counter corruption (more than one political actor is involved). The longer a given corruption scheme operates the greater is the risk for a domino effect when attempting to stop it. This is why there practically are no high level officials charged with corruption in the country despite the fact, that all parties accuse each other of corruption.

³ Corruption schemes of similar type might be organized and initiated from top to bottom (by higher level officials) or from bottom to top (initiated by lower officials).

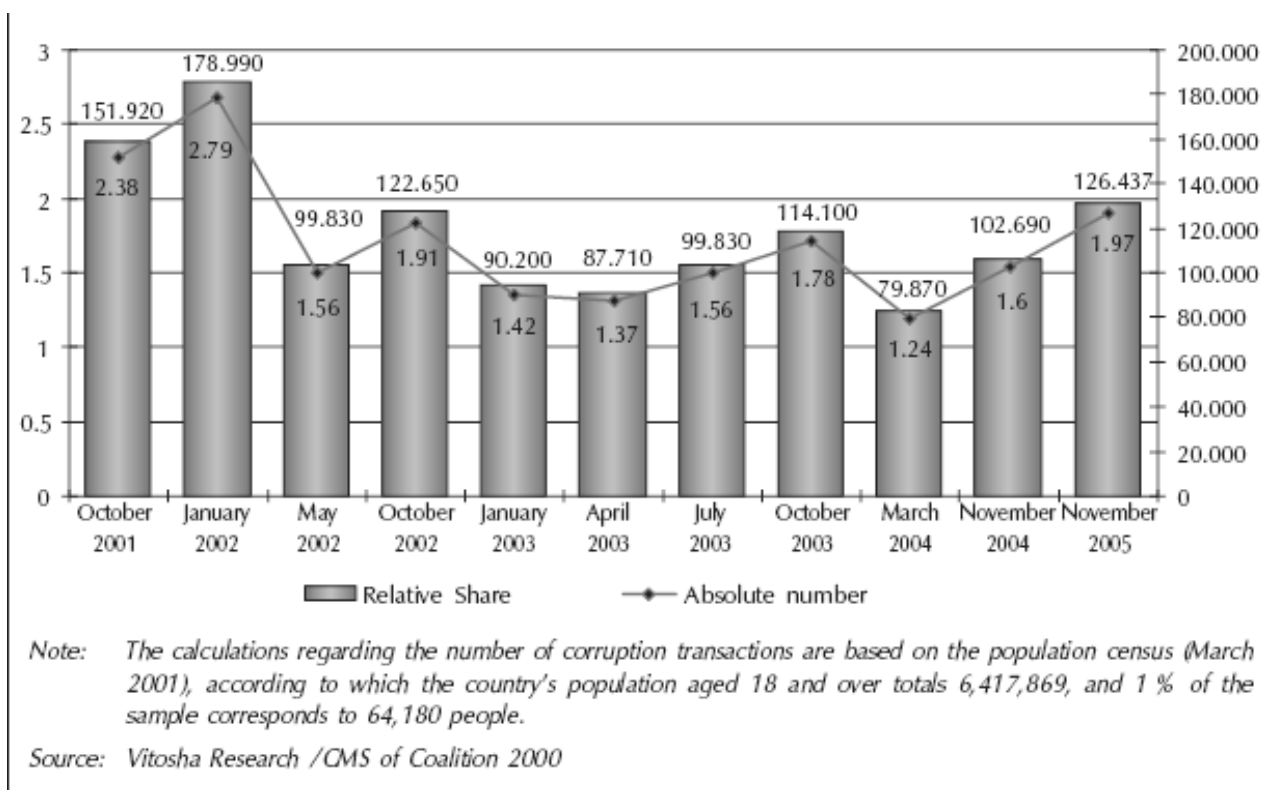
Level of Administrative Corruption

The period between mid April 2004 and the end of November 2005 was marked by an increase of the level of administrative corruption. This increase goes parallel to the increase of the number of corruption pressure cases (public sector employees exert pressure on citizens in order to engage them in corruption transactions). In 1998-1999, the average monthly frequency of self-reported involvement in corruption transactions was fairly high; it ranged between 180,000-200,000 cases a month. In the period July 2003-March 2004 it reached its lowest

level, dropping to 80,000-90,000 transactions per month (Chart 1). The lowest frequency of cases of corruption pressure by public officials was registered in March 2004.

In 2005, however, the pressure and the number of concluded corruption transactions reverted to the higher average values characteristic of the 1999-2001 period. Compared to March 2004, the number of corruption transactions has increased from about 80,000 per month to about 130,000 per month. Whether this will prove to be a lasting negative tendency or a short-term fluctuation resulting from temporary factors (for instance, the recurrent increase in

Chart 1. Average monthly number and relative share of concluded corruption transactions



corruption by the end of each electoral cycle) remains unclear.

The level of administrative corruption shows the number of corruption transactions which citizens admit to have been involved in over a certain period of time. Corruption transactions, which for the most part constitute criminal acts, are commonly referred to as corruption victimization. The possibility of using sampling methods to gauge crime levels (in particular, the number of administrative corruption transactions) is based on the assumption that the incidence of such phenomena is sufficiently high; this allows a random sample to identify an adequate number of victims who can be subject to statistical analysis. Such a method however is not applicable to political corrup-

tion which cannot be studied with statistical research methods and instruments. The existence of political corruption is deduced largely based on indirect evidence: 1) high rates of administrative corruption usually exist, if they are implicitly or explicitly tolerated by the higher ranks of government; 2) the state of a number of socio-political and economic processes in the country (grey economy, organized crime, customs violations, VAT fraud schemes, drug traffic, controversial privatization transactions, political party financing, etc.) is impossible without the involvement of representatives of the senior state officials (legislature, the executive, and the judiciary); 3) statements by numerous politicians and magistrates openly refer to a multitude of corruption transactions.

Table 1. Indicators and indexes measuring the level of administrative corruption

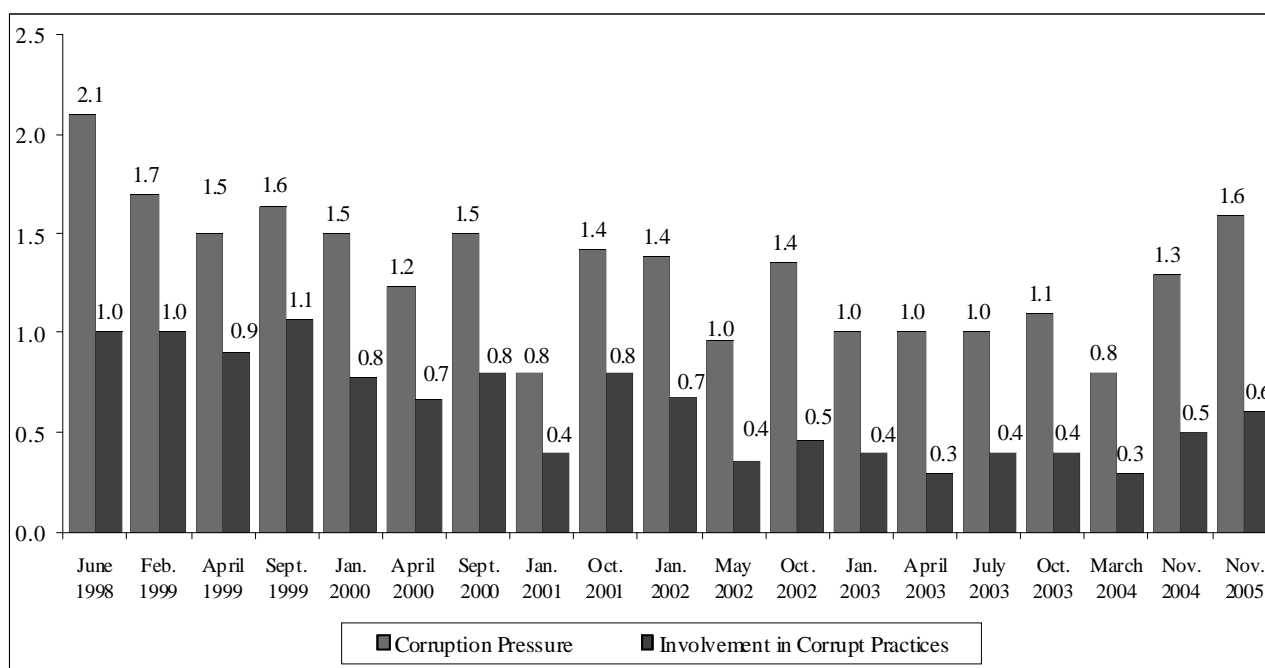
	<i>Indicators</i>	<i>Indexes</i>
Corruption victimization	Potential corruption	Corruption pressure
	Actual corruption	Corruption transactions

CMS methodology differentiates between actual and potential corruption. Each corruption transaction goes through at least two stages. First, negotiating the conditions (potential corruption) and second, conducting the transaction (actual corruption). Measuring the incidence rates in both stages of the corruption transactions is essential since even the presence of the first stage (offering/soliciting a bribe or other type of unlawful gain) constitutes a violation

of the law. The indexes measuring the dynamics of potential and real corruption victimization are, respectively, "corruption transactions" and "corruption pressure". The corruption transactions index accounts for the frequency of self-reported cases when citizens and business organizations provided money, gifts, or favors in order to have a problem solved. The index reflects the level of actual corruption based on a period of one month. The corruption pressure index records the frequency of cases when citizens and businesses were asked for money, gifts or favors in order to have a problem of theirs solved. It reflects the level of potential corruption.

There was the gradual decline in both actual and potential corruption in the period 1998-2004 (Chart 2). Over the past year and a half, however, alarming indications of increased numbers of corruption transactions have been identified.

Chart 2. Index dynamics of corruption transactions and corruption pressure



Notes: The two indexes register actual and potential corruption, respectively. Their minimum value is 0 when no corruption transactions at all have been concluded and 10, if all citizen interactions with the administration involve a corruption element.
Source: Vitosha Research/CMS

The levels of corruption victimization and corruption pressure are unevenly distributed among the various occupational groups. Some of them are characterized by a stable downward trend; others, by a rise; and still others show little change (Table 2). For some occupational groups (e.g. university teachers, customs officers, local government representatives), substantial fluctuations have been identified depending on the time of the survey. On the whole, corrup-

tion pressure has been on the decline in the judicial system over the past year. It has dropped for the magistrates (judges, prosecutors, investigators) and for the judiciary's administrative staff. The change is due mainly to the reforms (even if only partial) in the judiciary and to internal anti-corruption measures. However, the prevailing opinion of citizens that corruption in the judiciary is unacceptably high has not changed (Table 2).

Table 2. Corruption pressure by occupational groups* (%)

	October 2002	October 2003	October 2004	October 2005
Police officers	22.3	13.9	22.2	27.7
Doctors	20.3	16.6	22.5	26.2
Customs officers	19.4	15.3	13.8	22.1
Lawyers	26.5	13.8	16.5	22.0
University teachers	11.9	16.6	12.6	15.3
University employees	5.6	9.0	9.0	10.1
Municipal officials	10.9	6.4	10.3	9.5
Ministry officials	5.6	8.2	6.3	8.2
Tax officials	4.2	5.9	5.1	8.1
Mayors and municipal councilors	5.3	3.3	6.6	6.5
Teachers	7.4	5.6	6.2	6.0
Judges	16.6	8.5	5.8	3.4
Politicians and political party leaders	7.1	4.1	5.0	2.5
NGO representatives	5.0	1.4	1.3	1.5
Investigators	8.3	9.6	5.0	1.3
Prosecutors	12.3	4.2	5.1	1.2

Note: (*) Proportion of those who have interacted with the respective group in the past year and have been asked for money, gifts, or favors.

Source: Vitosha Research/CMS

When assessing the corruption pressure exerted by magistrates, it is important to take into account the role of attorneys-at-law as intermediaries between their clients and the institutions of the judiciary. Data indicate that potential corruption levels for this group are high and decrease slowly. This is due to the fact that a number of attorneys-at-law act as corruption mediators under pressure from the magistrates or on the initiative of their clients. There is also reason to assume that, in some cases, attorneys-at-law take advantage of being better informed than their clients to secure immediate gains for themselves. In terms of the public visibility of judiciary corruption the focus tends to shift towards attorneys-at-law, rather than towards magistrates. It is however difficult to separate the actual amount of corruption pressure exerted by the magistrates and the judiciary's administrative staff through attorneys-at-law from pressure initiated by attorneys-at-law themselves. Often the judiciary also comes under political pressure. Regardless of how successful such attempts are, it is a process that generates speculations, undermines the independence of the judiciary, and adversely affects public trust.

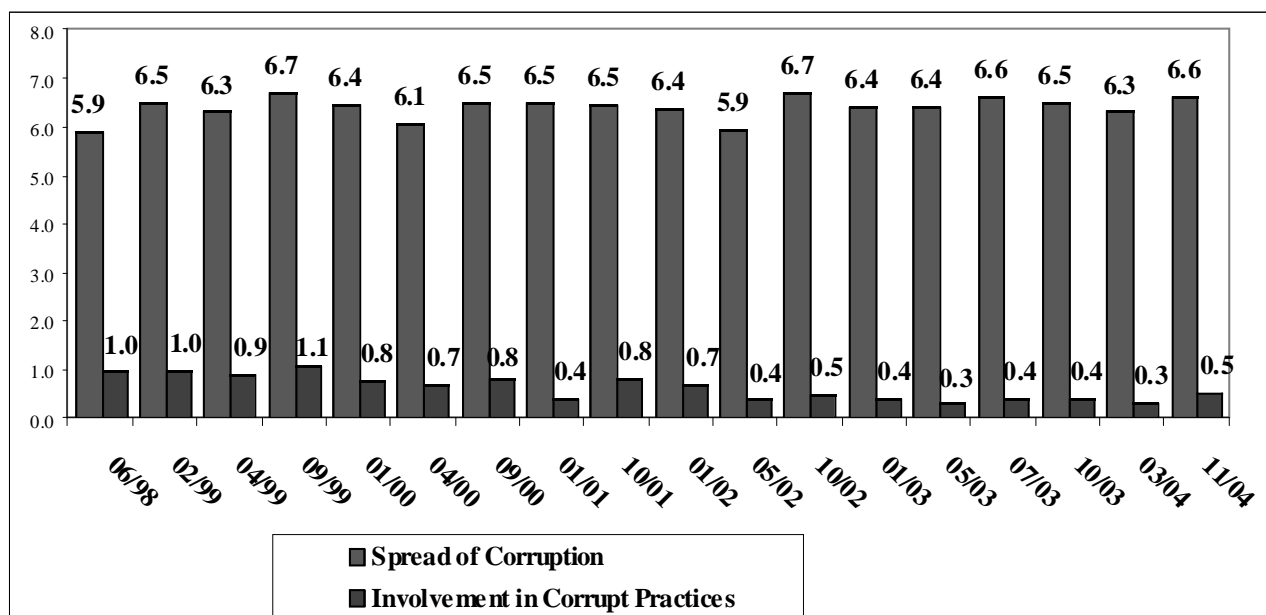
In the 2004-2005, police officers and doctors have topped the administrative corruption pressure

ranking (Table 2). The fact that potential corruption for both groups is on the rise is alarming. Increased corruption pressure has also been registered for ministry officials, tax administration officials, university teachers and employees.

Perceptions of the Spread of Corruption

Regardless of the fact that the overall level of corruption victimization in 2005 dropped nearly by half compared to 1998, public perceptions of the level of corruption in society practically have not improved (Chart 3).

Chart 3. Level of corruption victimization and assessments of the spread of corruption



Source: Vitosha Research/CMS

The data since 1998 shows that perceived spread of corruption by far exceeds the level of actual corruption victimization. This means that the subjective perceptions reflect people's moral assessment of the observed levels of corruption, showing whether observed corruption levels are perceived as too high or normal; i.e. perceptions are a qualitative assessment of the social and moral acceptability of the corruption situation in the country and not a measure of the number of corruption transactions.

When citizens believe they live in a highly corrupt environment where corruption not only remains unpunished, but is also perceived as an effective means of solving problems, their own inclination to engage in corrupt practices increases. In Bulgaria, the predominant public perception is that corruption is widespread in all spheres of public life, at all levels of state governance, and among the various occupational groups (Table 3).

Perceptions of the spread of corruption among different occupational groups differ substantially from the data about actual acts of corruption and corruption pressure exerted. For instance, despite the registered drop in corruption pressure exerted by magistrates and judiciary administrative staff this fails to find confirmation in citizens' subjective perceptions of the spread of corruption in those groups. Politicians, MPs, ministers, and tax officials are perceived to be far more corrupt than data on corruption transactions and direct corruption pressure they exert actually show. In terms of perceptions, the stable negative attitudes about these groups tend to intensify - perceptions of the spread of corruption marked a

slight increase in late 2005.

The possible reasons for the divergence between registered levels of corruption victimization and the predominant negative public perceptions of the spread of corruption may be sought in several directions:

Firstly, as already noted, the data on real corruption and citizens' subjective assessments refer to different social phenomena. Perceptions of the spread of corruption are strongly influenced by moral, ideological, and political factors. They rather reflect citizens' trust in the institutions of the state and citizens' overall assessments of the effectiveness of governance. Low levels of confidence in state institutions make citizens' perceptions of the corruption situation more negative.

Secondly, the public exposure of corruption scandals without any tangible results (consequences) affects adversely public perceptions of the will of the government to counteract corruption. The lack of political will does not influence corruption victimization but has direct impact on the growing public mistrust in high-rank state officials and politicians. That is why, even while the corrupt practices registered among MPs, members of government, top state officials, and political leaders are relatively few, the population's perceptions of the spread of corruption in the high ranks of state power and among the representatives of the political class are disturbingly unfavorable.

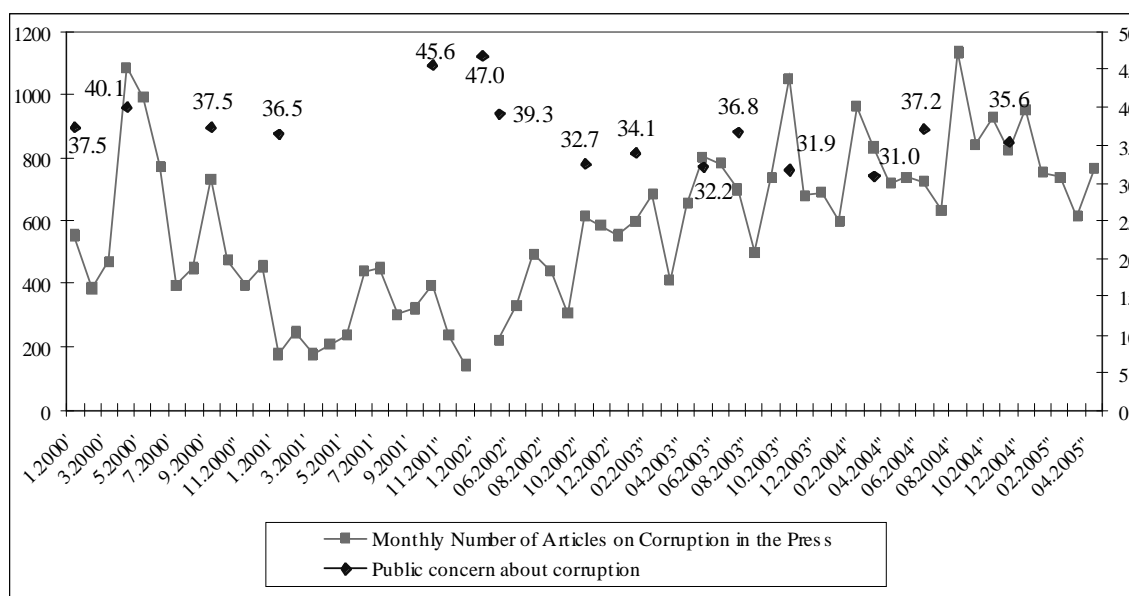
Thirdly, the ranking of corruption among public concerns is not influenced by the intensity of media exposure (number of corruption-related publi-

Table 3. Perceptions of the spread of corruption among occupational groups* (%)

Relative share of those who answered "Nearly all, or most, are involved in corruption"				
	October 2002	October 2003	November 2004	November 2005
Customs officers	79.2	74.5	70.3	71.8
Judges	63.0	57.3	56.1	59.3
Prosecutors	63.0	55.7	55.3	57.1
Police officers	59.6	59.2	58.8	56.1
Lawyers	62.3	55.8	54.9	54.7
Doctors	54.9	52.9	55.4	54.5
Tax officials	58.0	49.3	49.9	53.5
MPs	56.2	54.5	50.7	53.4
Politicians and political party leaders	54.0	47.6	50.5	51.6
Ministers	50.8	52.6	45.4	51.1
Investigators	57.5	49.2	51.7	50.5
Mayors and municipal councilors	48.3	43.4	47.0	47.5
Ministry officials	48.3	40.1	42.6	44.4
Municipal officials	49.1	36.5	44.3	43.4
University teachers	33.4	36.5	33.1	29.9
NGO representatives	21.4	22.3	23.7	26.6
Teachers	13.9	11.0	14.0	14.4

Source: Vitosha Research/CMS

Chart 4. Intensity of media coverage of corruption and public concern about corruption



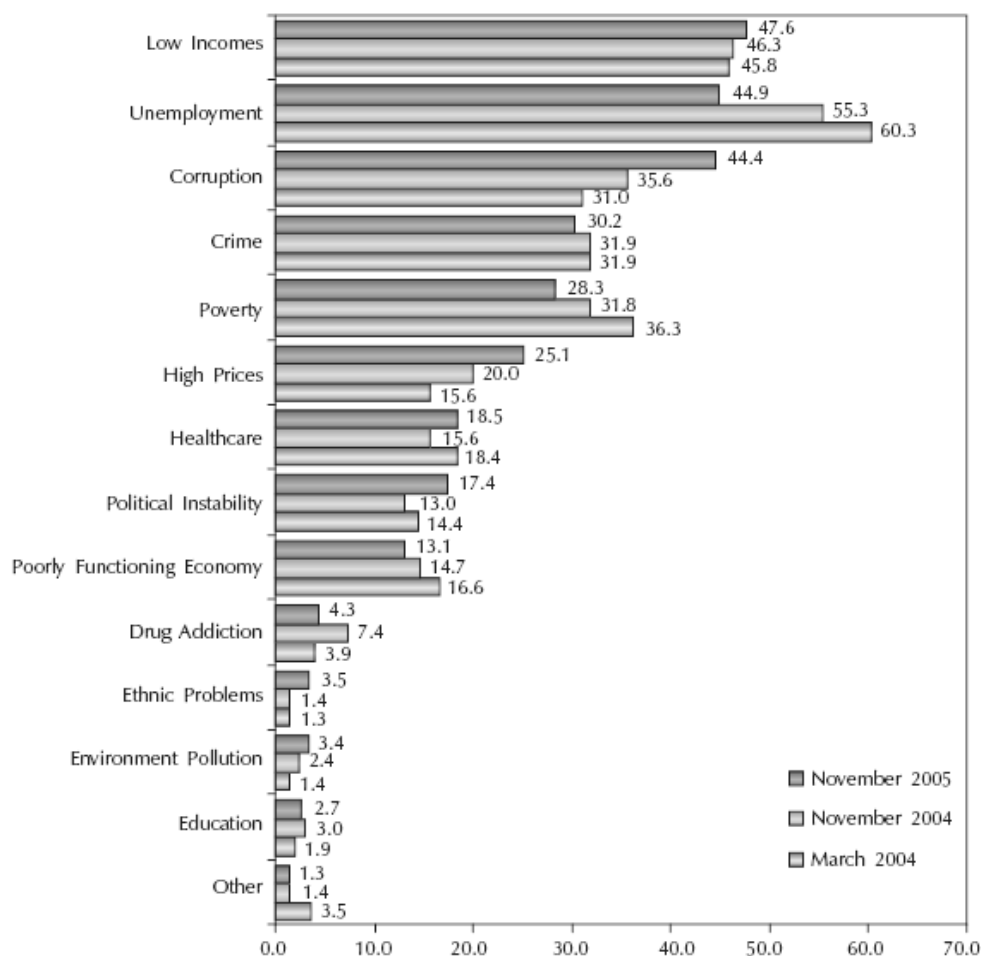
Source: Vitosha Research/ CMS

cations in the media). More intensive media coverage of corruption neither increases its perceived spread nor heightens concerns about corruption (Chart 4). The dynamics of this indicator is rather associated with changes in society's political agenda as set by the political class. Corruption tends to be high on people's minds not when the level of corruption victimization is high, but when public expectations about resolving of this problem are high.

Public Values and Attitudes to Corruption

In the period since 1998, corruption has persistently been perceived as one of the most serious problems of Bulgaria. It is always among the top five social problems, usually taking up the fourth or fifth position. In 2004-2005, it rose making it the third most important problem. The overriding concerns of the Bulgarian population were low incomes (first place) and unemployment (second place).

Chart 5. Ranking of corruption among public concerns (%)



Note: The chart presents the ranking (relative shares) of the three major problems faced by Bulgarian society.

Source: Vitosha Research/CMS

The dynamics of these rankings clearly shows that Bulgarian society considers corruption one of the most important elements of the country's political agenda. Expectations related to the countering of corruption tend to rise in the periods of transition from one government to another. A new government usually heightens the priority of the problem and raises the performance standards for the political class.

Overall, the data covering the 1998-2005 period suggest that public expectations remain unmet. Set against the rising expectations for good governance, realities have been rather disappointing. The discontent stems from the actual status of the problem (the level of corruption victimization) and from the performance of the political class and the administration. In this sense, there is reason to believe that the public

considers the tendency towards decline of the level of corruption victimization as not radical enough and the government policies as failing to meet public expectations and standards. In addition, these actions are not considered effective enough.

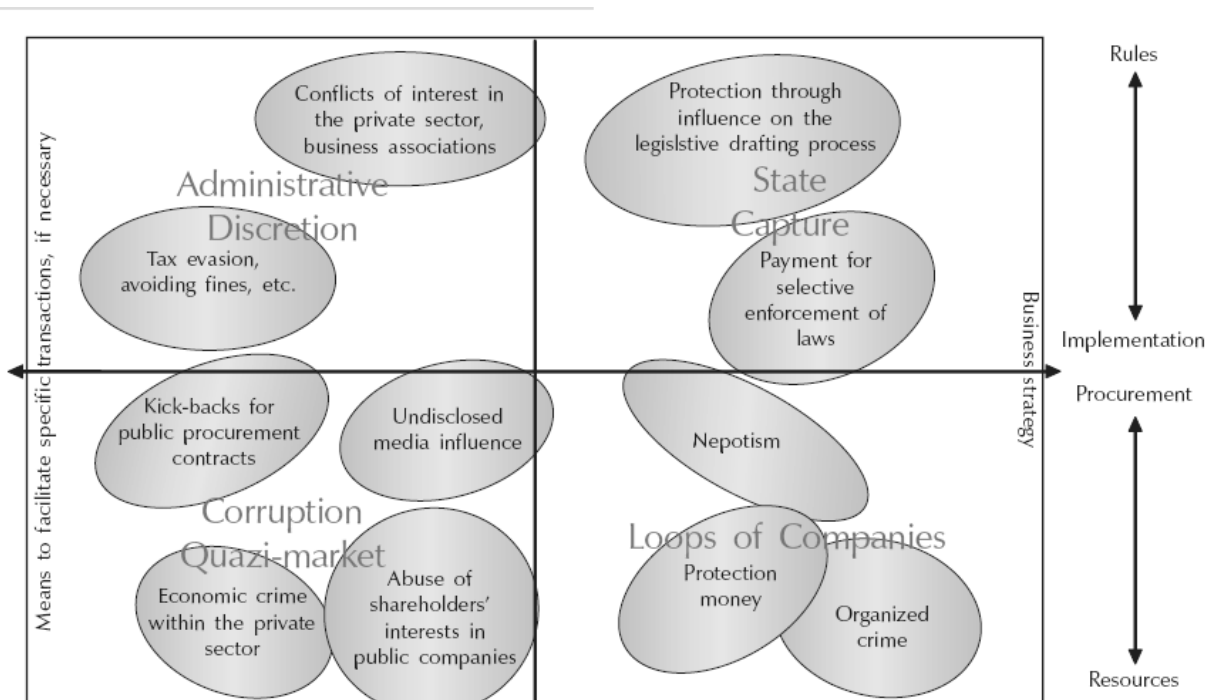
The significance of subjective perceptions of corruption is often downplayed with the argument that they do not provide an accurate view of the level of corruption. While this is essentially true, it is also true that public perceptions relatively closely follow the actual achievements and failures in various sectors of society. Thus, for instance, the actual progress in countering unemployment and poverty runs parallel to the decline in their perceived social importance. The dynamics of the corresponding indicator concerning corruption, however, follows clearly the dynamics of political will to deal with the problem: the rank of corruption among major concerns is high in the periods before and after the coming into office of a new government and tends to decline when its actions fall short of public expectations. In this sense, to Bulgarian society, late 2005 was a period of heightened expectations with respect to countering corruption – both in terms of the presence of political will and its effective practical realization in the policies of the administration.

Main Areas of Political Corruption

The involvement of the government in the economy generates a number of points of potential conflicts of public and private interests in the business sphere. The legal and institutional deficits in the beginning of the transition, coupled with the lack of traditions for openness and transparency and the unstable situation in Southeastern Europe, created broad opportunities for corruption in Bulgaria. Conversely, the progress of the country in the EU accession process and the related legal and administrative harmonization restrict and narrow the available channels for corruption and crime.

As the delivery of administrative services gradually improves and the income level of Bulgarian citizens grows, administrative corruption in the business sphere connected with regulatory inefficiency tends to decrease. However, opportunities for political corruption related to the economy remain. The main forms/areas of political corruption in this respect are: rings of companies and state capture, procurement contracts, VAT fraud.

Chart 6. Forms of corruption



Source: Center for the Study of Democracy

Political Corruption: Rings (Loops) of Companies and State Capture

The informal political and economic networks which evolved over the years in Bulgaria (commonly referred to as “friendly circles” and/or “rings of companies”) and the existing criminal networks and capital will seek to continue their economic and/or political monopoly under the new conditions of EU membership. This is particularly relevant to the sphere of political corruption. In the beginning of Bulgaria’s transition, political and economic corruption networks had numerous opportunities to redistribute national wealth, by siphoning state-owned enterprises and banks, bogus privatization, tapping into smuggling channels, etc. As these channels are gradually drying off, the efforts of these networks currently refocus on control over public procurement, concessions, EU funds, VAT fraud and appointments to the executive and the judiciary intended to facilitate corruption schemes and to ensure their impunity from prosecution.

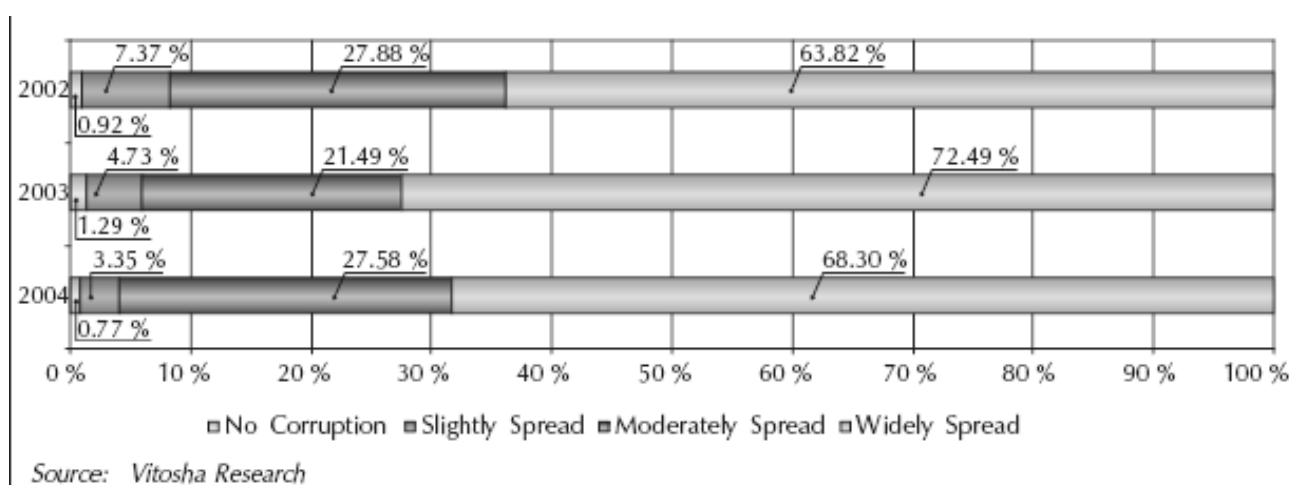
Politically favored companies and organizations in Bulgaria are typically financed through public procurement contracts and lease agreements. In return, they reward their patrons through direct or indirect financing of party activities, hiring of party functionaries or their associates, payment of scholarships for overseas studies to children of senior party leaders, etc. The fact that on the eve of the 2005 parliamentary elections the leader of one of the governing political parties admitted that such practices are commonplace corroborated the multitude of journalist investigations and NGO analyses of their existence

and reinforced the Bulgarian public’s conviction that political corruption and impunity were rampant. However, it is difficult to make an accurate assessment of the operations of the rings of companies in the absence of judicial prosecution and punishment of their actions; moreover, the transfer of resources between the public and private sector within such rings is typically carried out through perfectly legitimate channels.

According to expert assessments (based on available data on parties’ election campaign spending, survey research and official statistics) the rent (i.e. the resources deviated from the public procurement process by all parties’ rings of companies), ranges between 320 million and 370 million Bulgarian leva⁴ in 2005. The total direct rent is much greater, taking into account also other possible payment channels such as concession agreements. Considerably larger, much more negative and difficult to calculate are the indirect effects on the Bulgarian economy of the existence of the clientele companies – unfair competition, disheartening of entrepreneurship, brain-drain of the best and brightest young people, low corporate citizenship standards, etc.

The phase of the political cycle in Bulgaria and the nature of the government majority determine the time and amount of rent received and the number of rings of companies in operation. For instance, the 2003 local elections were accompanied by a substantial increase of the number of companies which believed that corruption in party financing was widely spread. That growth was likely to be partially generated by the real pressure exerted on businesses by newly emerged local political interests.

Chart 7. Spread of corruption in the financing of election campaigns

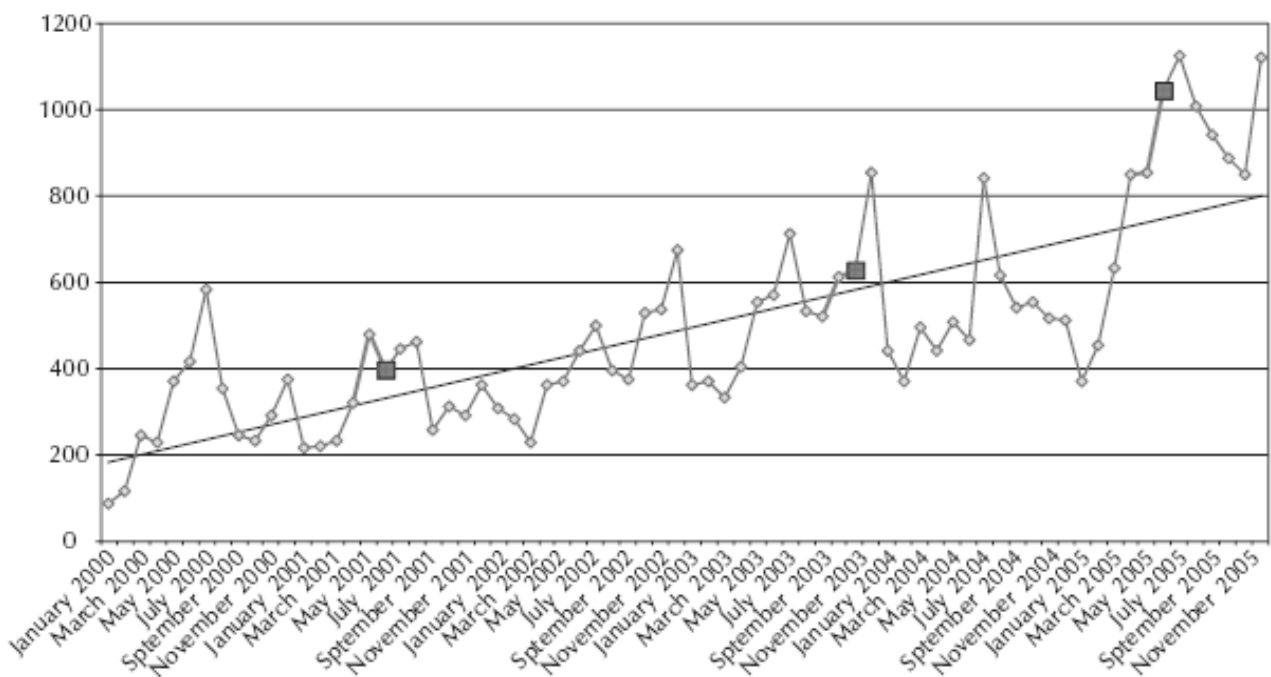


⁴ 164 mln and 190 mln respectively.

The linkage between the political cycle and the distribution of rents among the party rings of companies is confirmed also by the statistically significant correlation between the peaks in awarding public procurement contracts and elections in Bulgaria in 2001, 2003 and 2005. It was particularly pronounced in 2005 when the number of public procurement contracts signed by state institutions rose disproportionately high on a year-to-year basis without any specific underlying reasons. The ostentatious government discretion in the allocation of a part of the substantial

budget surplus accumulated in 2004 and 2005 without prior endorsement of the Bulgarian Parliament and in violation of the existing fiscal policy agreements with the International Monetary Fund creates a favorable environment for the nourishment of party rings of companies. Examples to this effect are the establishment of the state-owned Public Investment Projects company, the election raffles intended to boost voter participation, the non-transparent functioning of the Agricultural Fund and the Tobacco Fund, the national grain reserve, etc.

Chart 8. Dynamics of public procurement contracts and elections in Bulgaria



Source: Public Procurement Agency

Whereas the formation of rings of companies is seen primarily as a strategy of politicians, the second manifestation of political corruption - state capture - is a strategy of the business. Generally, it takes three forms:

First, lobbying for the adoption of laws and enforcement of specific regulations to the benefit of certain market players, in which neither lobbyists nor Members of Parliament disclose their interests;

Second, leaving deliberate loopholes in the legislation to benefit certain businesses whose lobbyists have taken part in the legislative drafting process; and

Third, "purchase" of selective application of certain laws to the detriment of competitors. The third type (although almost invariably complemented

with the first two types) is often characteristic of the strategies of organized crime and is particularly difficult to counter.

Examples of such practices can be found in many grey sectors of the Bulgarian economy like the import of and trade in excise goods (oil products, cigarettes, etc.), the trade in antiques, gambling, etc. They are also employed by organized crime to gain political protection for continuing its illicit operations. In this sense, the rings of companies create opportunities for legitimization of criminal business activities and for "cleansing" of the public image of persons associated with corruption and crime. These are some of the services, which politicians provide in return for the financing they get. In fact, criminal business can-

not thrive in Bulgaria without political protection and organizational and technical support coming from legitimate business structures and public administration officials. Thus racketeering groups, which sprung to life in the beginning of Bulgarian transition, have gradually merged or transformed into political and economic networks.

Both experts and politicians have repeatedly stated that duty-free shops at the land border crossing points of Bulgaria are an effective tax evasion instrument, which is a key component of the smuggling channels for oil products, cigarettes and alcohol worth hundreds of millions of *leva* annually. Nevertheless, practical measures for shutting them down have always been blocked by top politicians, Members of Parliament, and senior government officials. As part of the government package of measures to reduce hidden economy and corruption, the Council of Ministers approved an amendment to the Law on Excise Goods in July 2003 whereby 44 duty-free shops at the land borders of Bulgaria were scheduled for closure. However, after the Movement for Rights and Freedoms party blocked the amendments in the Bulgarian Parliament, the Minister of Finance was compelled to issue an order to renew the licenses of 14 companies.

Another widely spread practice in Bulgaria, which is closely related to political corruption and state capture is the "migrations" of senior administrative and political appointees (ministers, deputy ministers, chairs of independent regulatory committees, etc.) to businesses in the private sector directly or immediately after they have taken important decisions concerning the development of these companies. This prac-

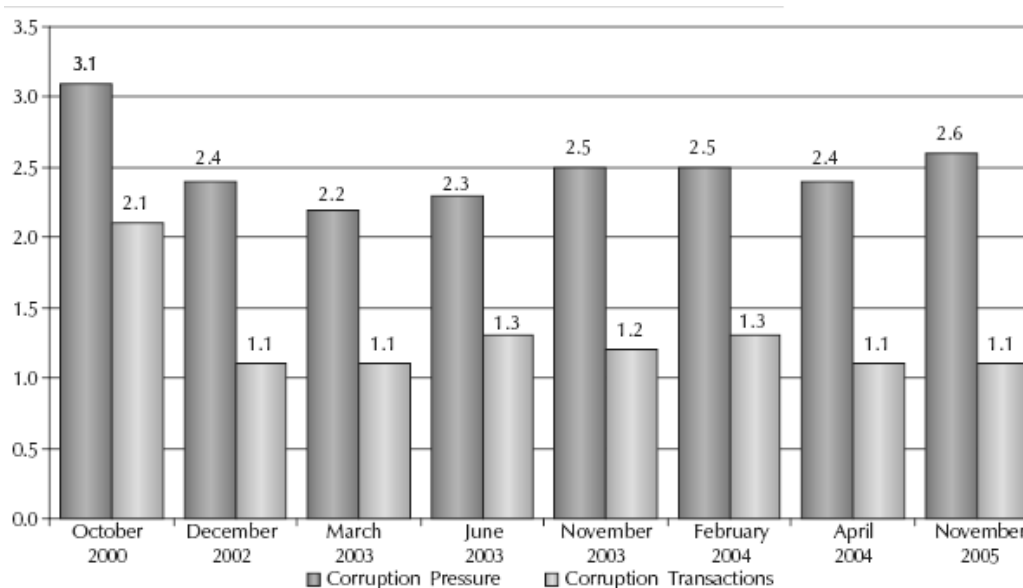
tice is most common in telecommunications, the energy and defense sectors in Bulgaria. In advanced democracies, such practices invariably attract the attention of the prosecution and the conflict of interests is strictly regulated in the legislation.

It is extremely difficult to counter political corruption because it requires active measures to be undertaken precisely by representatives of those political elites which benefit from it. EU membership and the related pressure for political and economic reforms make it easier to move against political corruption. Undoubtedly, the most important first step in this direction should be to unveil at least one "ring of companies" and to hold the politicians and senior government officials involved in its establishment and functioning criminally liable. This would be almost impossible at present because the methods used to redistribute resources and influence from the public to the private sector within the rings are legal.

Administrative Corruption in the Economy

Political corruption nourishes the development of administrative corruption in the economy, especially where their channels coincide, for instance, in public procurement and the administering of tax revenues. The spread of corruption in the economy continues to be a major problem of the business and investment environment in Bulgaria. As a whole, actual corruption and corruption pressure experienced by the business are twice higher than the one experienced by the public and they have been sustained for the last five years.

Chart 9. Dynamics of the indexes of corruption in the business sector (October 2000 – November 2005)⁵



Source: CMS, Vitosha Research

⁵ The 2005 corruption transactions index has been drawn up by preserving one of the aggregate data inputs from the survey conducted in April 2004.

There are some positive signs of a reduction of the share of businesses paying bribes in comparison to 2004. This is most tangible in the avoidance of customs duties and in the private sector and, more specifically, the access to financing. However, the growing share of bribes associated with the issuance (or renewal) of permits and licenses is alarming. A deeper analysis shows that these are predominantly

cases of companies in the construction sector and the overall process of obtaining (or being refused) permits pending the completion of construction works. In the public procurement sphere the level of corruption practices has remained flat but this has been accompanied by a negative trend of a concentration of bidding companies, i.e. only companies that enjoy certain level of political support bid for public tenders.

Table 4. Changes in the share of companies which paid bribes

Area	Change (2005 compared to 2004)
To obtain permits	▲
To avoid fines/penalties	▼
To reduce tax/customs duties	▼▼
To win public procurement contracts	≈
In the private sector	▼▼
In relations with the judiciary	▼
Total number of companies which have paid bribes	▼

Note: ▲ increase, ≈ - no change, ▼ average decline, ▼▼ more substantial decline than the average

Source: Vitosha Research

What brings all these types of corruption together is the unpunished violation of rules or the preferential treatment, i.e. the obtaining of illegal or undue benefit in the administrative services and the enforcement of the legislation by the public administration. The objective is to gain time or money or to avoid losses, while the reasons lie in the poor rules and excessive regulation, the corporate aspirations for profiteering, or the quality of competition.

Public Procurement and Corruption

As the process of harmonization of the Bulgarian legislation with the *acquis communautaire* is progressing, some substantial corruption channels of the past like smuggling and privatization have been discontinued while there is increasing corruption pressure and risks in other areas such as public procurement and concessions. The use of the latter for political pay-backs makes them highly vulnerable to administrative corruption, too. This is confirmed also by the latest report on the economies in transition of the European Bank for Reconstruction and Development which pointed out that corruption payments for awarding public procurement contracts were the only type of corruption in the business sphere in Bulgaria which worsened in 2005 in comparison to 2002⁶. In fact, Bulgaria is the only South-eastern European country which reports deterioration in comparison to the previous survey.

The public procurement market has grown substantially over the last five years both in terms of number of contracts and total value of contracts. Experts estimate public procurement contracts at 1.5

billion leva in 2003 (19.6 % of the consolidated state budget) and double that amount and number of contracts in 2005, at 3.3 billion leva (31.3 % of the consolidated state budget). Since 2003, the public procurement tenders are won by a decreasing number of companies. On the one hand, this is a natural consequence of market specialization of certain companies in working with the central and local administration. On the other, companies do not consider bidding for public procurement contracts if they do not have any form of political protection beforehand.

Thus, the share of companies paying bribes to win a public procurement contract decreased from 54 % in 2003 to 35 % in 2005. However, their level remained alarmingly high and even increased slightly in 2005. Corruption in public procurement might be defined as a quasi-market, on which the quasi-price (the kickback) goes to political entrepreneurs from the central and local government administration. Although real competition might exist on such markets and the contract might be awarded to the most efficient bidder, the losses to the budget and the illegal benefit remain. The quasi-price in administrative corruption in public procurement in Bulgaria accounted for an average of 7 % of the total value of the contract in 2005, i.e. some 55 million leva worth of public resources were siphoned to private benefit in 2005. This amount does not include the far more excessive losses of market efficiency and the potential risks of poor procurement performance (e.g. the quality of construction works and the risks in the case of an earthquake, the quality of infrastructure, etc.).

⁶ Transition Report 2005, Business in Transition, European Bank for Reconstruction and Development. The EBRD data are based on Business Environment and Enterprise Performance Surveys of 2002 and 2005.

Chart 10. Public procurement contracts and tenders

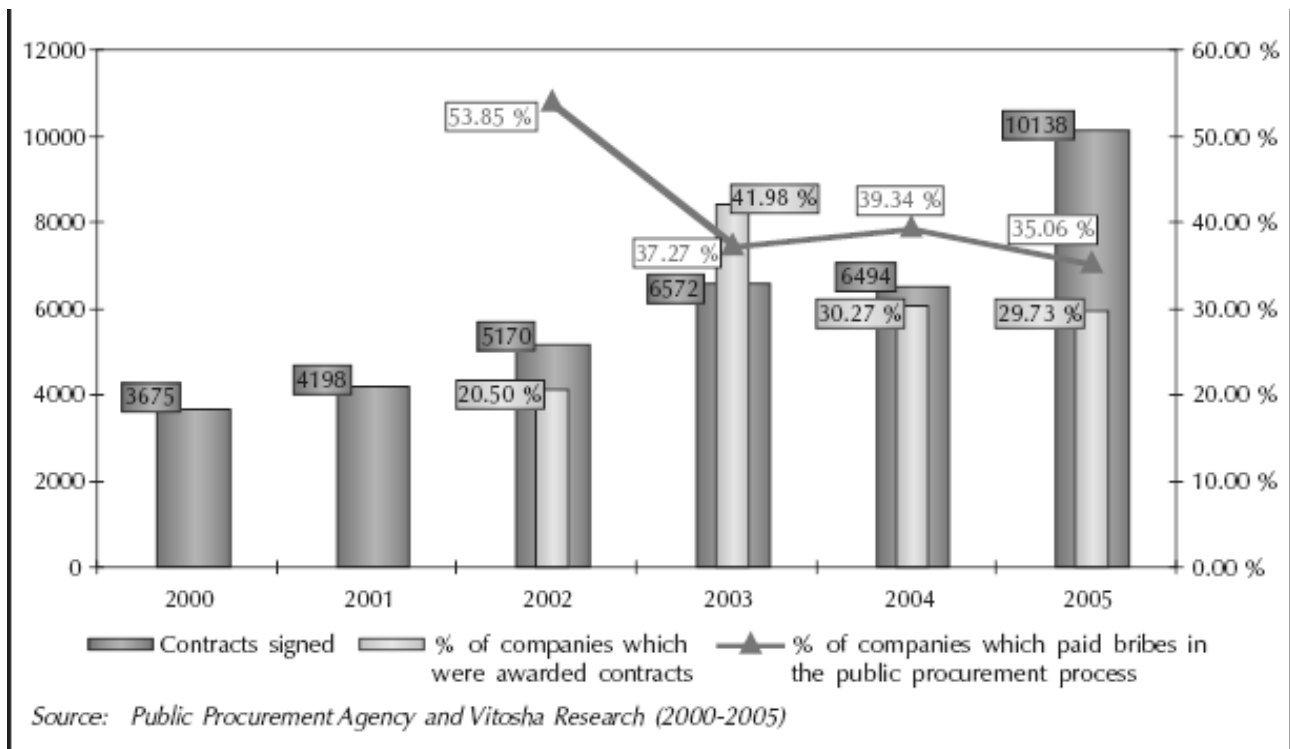
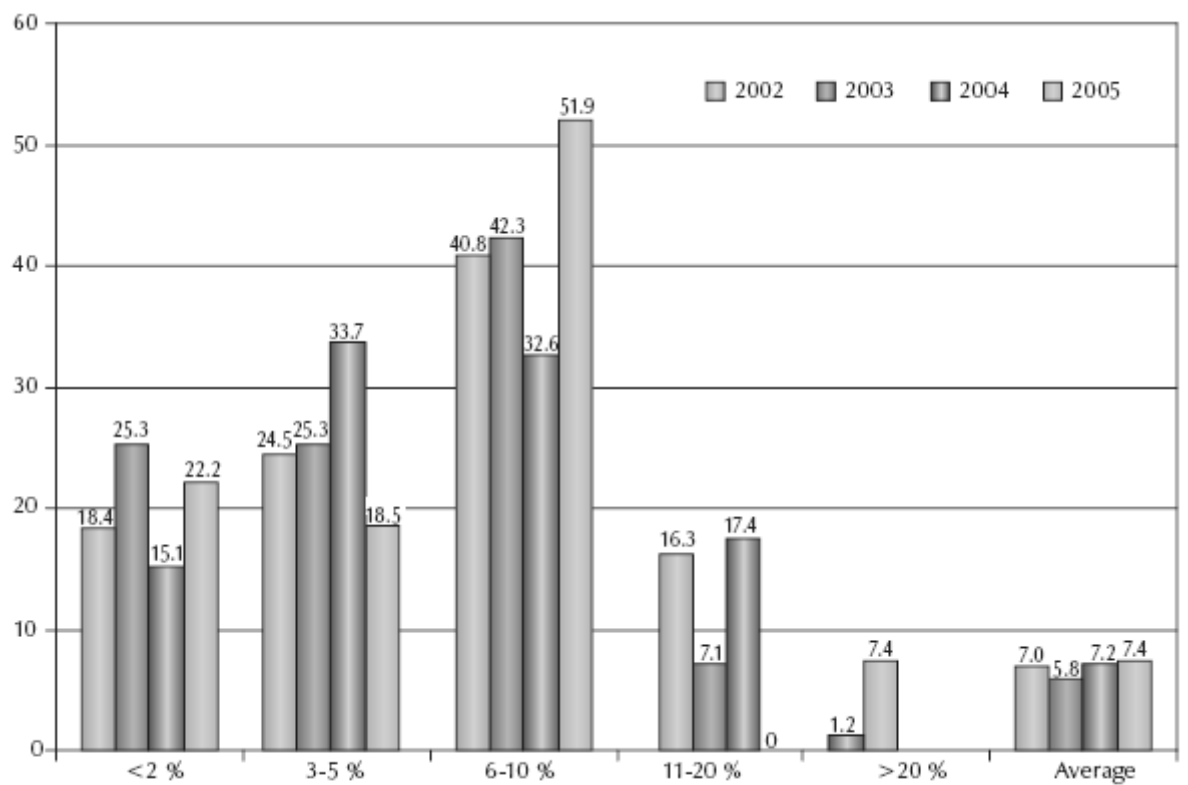


Chart 11. Portion of the tender worth paid for getting procurement contracts



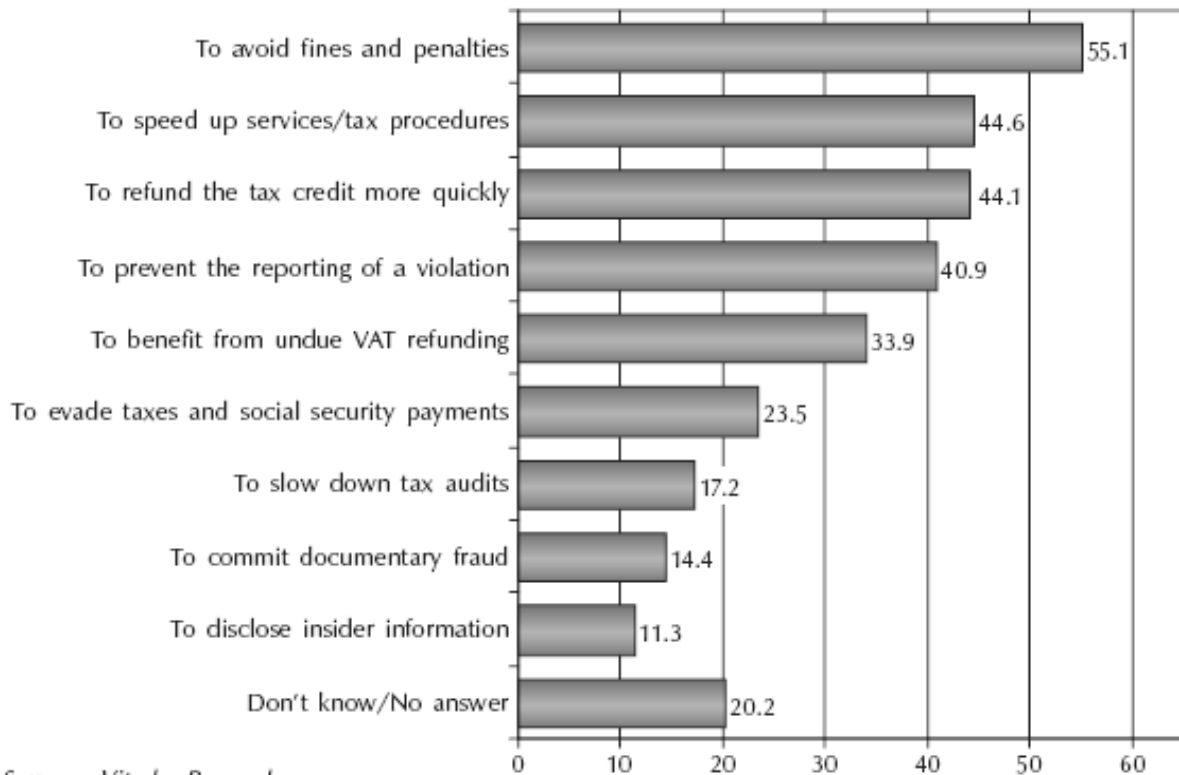
Source: Vitosha Research

Corruption risks in the public procurement process in Bulgaria exist throughout its life cycle – from the stage of the call for tenders (e.g. artificial fragmentation of public procurement tender into several smaller bits to allow the application of less transparent procedures under the Law on Public Procurement (LPA) through the preparation of the tender documentation (terms of reference, technical specifications, documents required, etc.) and the functioning of evaluation committees (e.g. appointment of preferred appraisers, information leaks, etc.) to actual contract changes in the implementation phase, re-negotiating elements, which were significant in winning the bid.

Tax and Administrative Services to Businesses and Corruption

More often than not, corruption related to administrative services and the enforcement of regulations is the result of administrative pressure. However, corrupt transactions based on the mutual benefit of the parties involved are also still common. In the latter cases, it is the competition, the budget or consumers that suffer rather than the specific company involved in bribery which usually gets in profits much more than it pays in bribes. Quite indicative in this respect are corruption practices in the revenue administration. The typical reasons for bribing tax officers are to avoid penalties and to evade taxes.

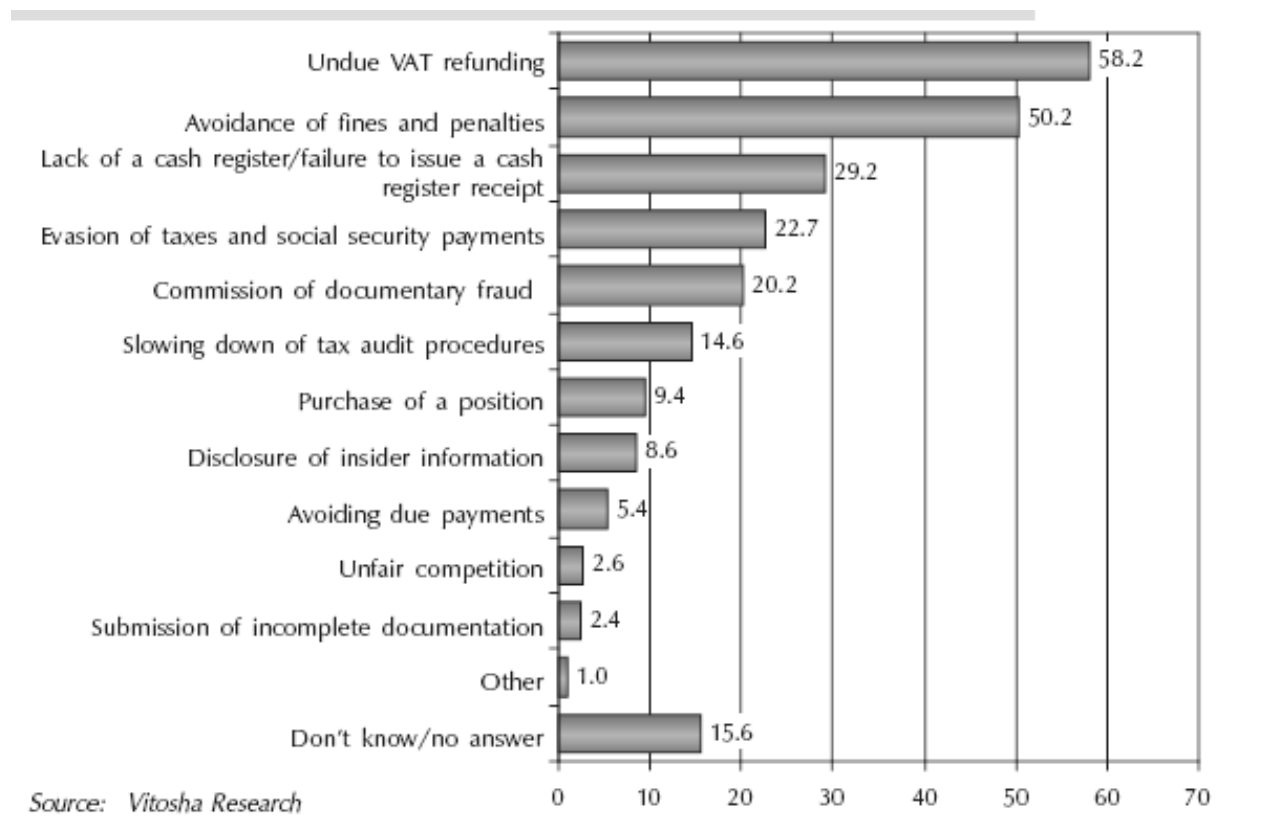
Chart 12. Reasons for corruption payments to the revenue administration (% of companies who gave the respective answer)



Source: Vitosha Research

The list of cases where tax fraud was made possible through a bribe includes mostly VAT fraud, avoidance of penalties, failure to register turnover, evasion of taxes and social security payments. Corruption is most widely spread in the Audit and Operational Control functional units of the revenue administration.

Chart 13. Tax violations and fraud for which typically bribes are paid (% of companies which gave that answer)



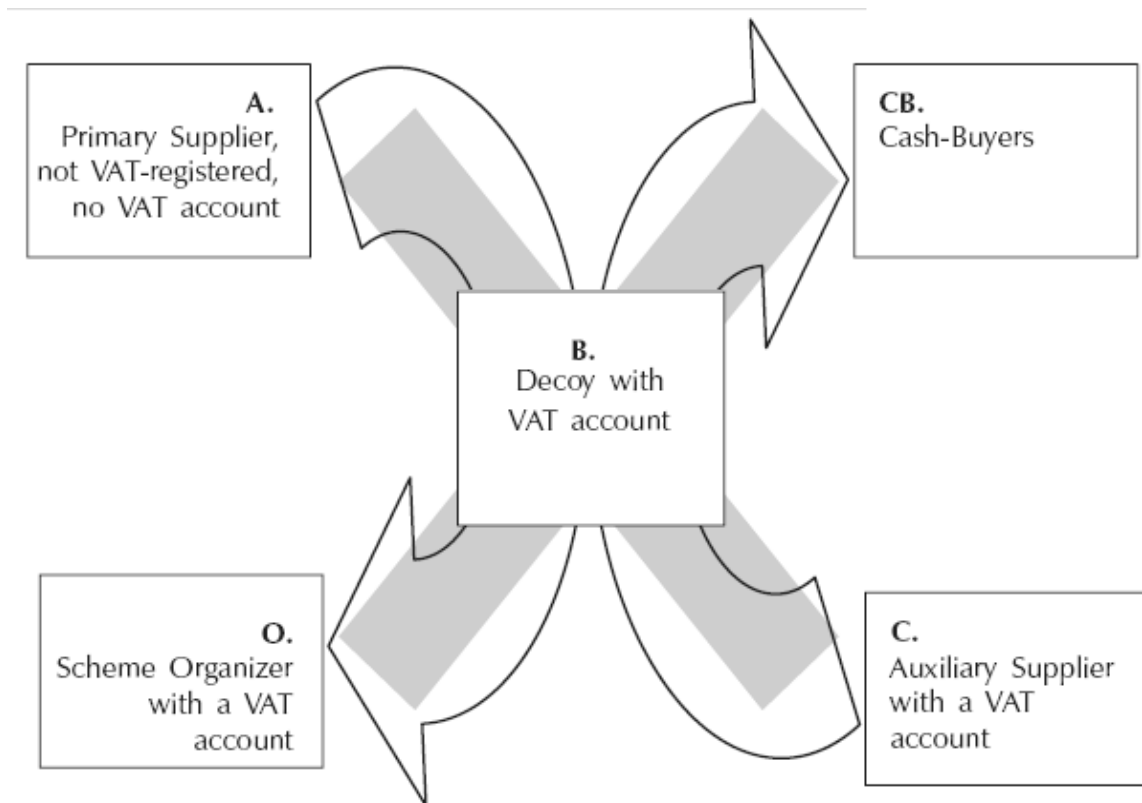
Bulgarian businesses not only suffer from unfair competition because of political corruption but also sustain considerable losses due to widespread corruption in administrative services and control in the business sphere. This is still a serious obstacle to market competition based on equality and clear and predictable business rules.

VAT fraud and related corruption will be some of the greatest challenges which the revenue administration in Bulgaria faces after EU accession.

The 'missing/insolvent trader' schemes⁷ and especially their cross-border version (carousel schemes) represent a serious problem in all European countries. The efforts to combat them are focused primarily on the optimal application of the joint liability principle and the close operational interaction between the tax administrations of the Member States in order to trace out the flows of goods and cash in the absence of customs checks within the European Union.

⁷ In its various modifications, this type of fraud relies on a chain of fictitious transactions which concentrate a large portion of the VAT liability in a phantom undertaking, thus making it uncollectible.

Chart 14. X-shaped VAT account fraud scheme in Bulgaria



Source: Center for the Study of Democracy

Bulgarian tax practice is characterized by an attempt to reduce VAT fraud through a specific solution introduced as an alternative to the joint liability principle - the VAT account. The VAT account, however, could not provide reliable protection against VAT fraud because it may be siphoned out rather easily without any credible threat of penalties. Thus, the VAT account arrangement increased the costs of compliant businesses, failing to restrict substantially the opportunities for VAT fraud from undue tax credit. For all practical purposes, it rather relieves fraudsters from the burden of the joint liability principle. Therefore the experience with the VAT account should be reviewed critically. If the cost and benefit analysis confirms that it generates more costs for compliant businesses than barriers to VAT fraud, this practice should be abandoned. Instead, more fair versions of the joint liability principle should be sought. More specifically, the opportunities to restrict VAT fraud could be identified along three main lines:

Restriction of the opportunities for registration or transfer of companies to fictitious or phantom owners;

Restriction of the opportunities for increased refundable tax credit through registration of transactions at prices deviating from market levels;

Restriction of the opportunities for the person receiving the tax credit to avoid liability.

Equally important is the introduction of criminal liability for VAT fraud. At present, the Bulgarian Criminal Code does not treat VAT schemes as a special type of tax or financial offence. In terms of its mechanisms and scale, it comes closer to the forms of organized crime rather than to conventional tax evasion. The pumping out of VAT, especially in big amounts, needs the involvement of organized criminal groups with the participation of senior tax officials. The small number of effectively convicted persons compared to the size of VAT fraud is indicative that these schemes often use political protection.

Conclusions

The analysis of anti-corruption efforts in Bulgaria in 2005 and 2006 leads to some conclusions about anti-corruption policies seen in the context the country's EU integration:

1. The potential of the "soft" measures against corruption is being exhausted (awareness campaigns, training public sector employees, codes of ethics, etc). These are appropriate and indispensable

for success in the early stages of an anti-corruption drive. Currently, there is a need for more effective and consistent political and institutional mechanisms to curb corruption. These should be complemented by a national system for monitoring and assessment covering not only the legislative and institutional measures adopted, but also the results achieved.

2. Reforms have thus far affected mostly administrative graft but not large-scale, political corruption. A particular challenge to anti-corruption policy in Bulgaria is posed by the institutionalization of political-cum-business networks which came to be popularly known as “friendly circles” or “loops of companies”. Their public flaunting by leaders of governing political parties further erode the already low public confidence in democratic institutions. The “circles” monopolize important markets in the Bulgarian economy and the opportunities arising from the country’s accession to the EU. With the advancement of the accession process, political corruption gradually shifts from privatization and illegal trafficking to the spheres of concessions, public procurement, and the use of EU funds. The economic cost of political corruption, i.e. misused public funds, is far greater than in the early stages of the transition although its relative proportion in the economy has been declining. Yet, the political and institutional checks against this type of corruption remain inadequate. Further, the institutionalization of political corruption makes it easier for criminal interests to capture state institutions thus allowing organized crime to enter the legal economy of Bulgaria and the EU with impunity.

3. An alarming trend over the past year has been the effort by government institutions to mask reluctance and incapability for coherent action against political corruption behind “high-visibility” operations. Such an approach risks, however, damaging the reputation of innocent people and organizations at the expense of continuing impunity of corruption. It does not allow the consistent and proper use of the enforcement and preventive potential of penal policy. The election of the new prosecutor general provides an opportunity for urgently needed reform in one of the weakest links in the enforcement of criminal justice – the prosecution. Reinforcing accountability, impartiality, and professionalism, as well as the will and resolve of prosecutors are indispensable for a breakthrough in the fight against corruption and crime. These developments would open up the way for further reforms in the remaining bodies of the judiciary and law-enforcement agencies and in the longer term, for greater transparency of the political process in general.

4. Bulgaria’s accession to the European Union will unquestionably step up the process of curbing corruption, the grey economy, and organized crime in the country, but it cannot be expected to automatically do away with the internal factors that bring them about. At the same time, membership in the fairly complex political and institutional structures

and procedures of the EU will bring the country up against new challenges.

5. The internal risks have already been identified by Bulgarian society and by European partners: political corruption and organized crime, and the impunity from criminal prosecution of the members of the corrupt political-cum-business networks. The influence of some external factors should, however, not be ignored as they are of key importance if the country is to make the most of the benefits associated with EU membership. Some of these factors include:

on-going reforms of the institutional dynamics of the EU and in particular, overcoming the constitutional crisis;

the absence of a comprehensive European anti-corruption policy;

the lack of tradition of collaboration of the European Commission with civil society in the member countries on developing and monitoring the policies aimed at improving democratic governance, enhancing transparency, and reducing corruption.

6. The European Union still does not have a comprehensive anti-corruption policy. Moreover, in its ambition to curb corruption the European Commission has adopted complicated bureaucratic procedures whose negative effect is commensurate with that of corruption. Priority is often given to “input” indicators (regulations, procedures, etc) rather than “output” indicators (actual impact), as done by a number of international financial institutions. An important element of the formulation and development of a co

sistent anti-corruption policy within United Europe, as well as domestically, is the active involvement of civil society and business, which have an equal stake in the adoption of clear-cut and transparent rules in the process of forging the new European identity of the countries in transition. These sectors need to play a stronger role in the implementation of modern standards of transparency and visibility, which include effective civic control over the public sector, and specifically, over the government agencies in charge of European funds’ distribution. The near future will show to what extent the European Union has the vision and political will to genuinely involve civil society in addressing these anti-corruption tasks.