

### 3. STATE CAPTURE

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

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

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

#### Privatization of public institutions

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## Government for hire

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

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

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

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

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

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

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

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

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

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

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

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

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

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