

Chapter VIII

**PRACTICAL DIMENSIONS OF ECONOMIC CORRUPTION IN THE
PERIOD 1990-1998**

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1. METHODOLOGICAL INTRODUCTION

If entrepreneurship is defined as an activity of directing and managing resources aiming at the achievement of a certain result and/or (most often) profits, then the major problem of entrepreneurship is the choice of the mode and the degree of freedom of managing the given resources.

1.1. The implications of the public change

The general conditions of the choice are set by the initial institutional point of development – the fall of centralised planning and the state based on it. The obstacles for the emerging private sector and the ratio of state and entrepreneurship define the directions of their interaction. Thus, speaking about the practical dimensions of corruption and the economy, we need certain methodological notes to explain the way the phenomena are recognised. A basic element here is the expenditure on deals and making contracts. Private entrepreneurs, within the written and unwritten rules of the freedom of choice, aim at decreasing expenditures and hence increase their profit. The representatives of the state, acting under the same set of rules, also aim to maximise their effectiveness. Contrary to entrepreneurs, the representatives of the state are non-profit organisations financed partially through redistribution of the otherwise gathered means, mostly taxes and donations.

From an economic perspective, on one side stands the representatives of the state (the bureau[s], according to the theory adopted) and the supply of goods and services which in normal accounting standards are only counted as a share of the general expenditure of the government, the governmental services and the administrative salaries in the state-owned companies in the GNP. The entrepreneurs are willing to supply the same kind of goods and services, aiming not to take part in the redistribution, but in the concrete market share for these goods and services. To analyse corruption, it is fundamentally significant to believe that on the market both the buyer and the seller give less than they obtain. That is why it is commonly believed that non-market mechanisms of demand and supply of goods and services increase the expenditure on the ensuing deals.

The shortcoming in the rules, written or not, or their general illegitimacy, that is the lack of faith that these are not the best but will suffice, or the inapplicability of the written rules, direct the efforts of the entrepreneurs and the representatives of the state in one direction or another.

The social situation of change, of transition from one system of rules to another or simply the unstable economic conditions (e.g. inflation) is characterised by such disorientation of activities, of efforts for profit and increase of effectiveness. On the side of the state representatives we have a transition of public position into rent or, otherwise, hidden taxes. On

the pole of the entrepreneurs we have a shadow economy – this is the sphere of possible economic freedom chosen due to the high expenditure for observing formalities or otherwise “acting in daylight.” Corruption engulfs both sides of these relationships.

In a much narrower sense used recently by the World Bank, corruption is “abuse of office aiming at personal profit” appearing on the side of the official and his bureau. As an economic phenomenon, it is an erosion of relationships, the rules and the effectiveness of the production of goods or services for a given period of time or given amount of capital. On the level of a single act or chain of acts, the rent, that is the price for overcoming the bureau, might have a positive or a negative meaning, i.e. the deal in which the bureau is a mediator is either concluded or not. But as was mentioned above, the quality of the environment for this chain of actions is worsening due to the blocked mechanism of demand and supply of the best conditions and the least expenditure. The accumulated effect of net investments stops growth and diminishes welfare.

The economic description of these phenomena is fundamentally difficult. Due to its nature, a phenomenon emerging in the context of interaction between the efforts at profit and the efforts at rent, corruption is not an independent variable. It is a symptom of other problems. In a situation of a transition period, as is the situation in Bulgaria, the practical dimensions seem almost indescribable in their complexity. This is due to poor statistics regarding profits in the private sector as well as to the weaknesses in the functioning of the institutions involved in the execution of laws and contracts (courts, for example).

In order to throw some light on the reasons and the current dimensions of this phenomenon, the following will be explored in this chapter:

- the dimensions of economic freedom in Bulgaria for the last five years that we claim are decisive for the choice of behaviouristic strategies of both the administration and the business;
- the phenomenology of the permit-obsessed state;
- the reaction of the private sector, as found in the process of its capitalisation;
- the bureaucratic factor in privatisation and the “management of state interest in state-owned companies”.

2. FREEDOM OF CHOICE OF ECONOMIC BEHAVIOUR

The factors that diminish the freedom of choice might be considered factors directing the behaviour of the state representatives (the bureaus) towards corruption and those of the entrepreneurs towards informality and operation in the shadow economy. Below we give a description of these factors for Bulgaria with a short description of their role as a conditions for corruption.

2.1. (In)stability of the economy and currency

2.1.1. Inflation as a factor

Inflation is one of the major stimulæ for corruptive behaviour of both the entrepreneurs and the administration. Entrepreneurs are competing with the devaluation (the increase of supply) of money and try to avoid or shortcut the procedures for access to goods and services offered

by the state. Fixed income of state officials, usually lagging behind the rate of inflation, make them create additional (formal or informal) obstacles to the access to these services.

The money supply, monopolised by the state and the state bank, executed without clear institutional limits in the period of 1989-97, is a major factor in the transfer of savings in the Bulgarian economy through the mode of the so-called inflation tax. The average rate of growth of the money supply minus the potential real growth of the GNP for the last five years is 1333.08 % (nominal money supply) and minus 11.9% (real supply). The standard deviation of the annual rate of inflation for the last five years is 73.5% on a monthly basis. The dispersion of the monthly basis is 351.3% while that of the annual base is 444.9%.

Annual inflation

1992	80
1993	64
1994	122
1995	33
1996	311
1997	405
1998 (through Sept.)	1

2.1.2. Implications

These figures lead to the well-known effects of tax evasion and the exchange of currency just before periods of hyperinflation. Deals in certain segments of the market are denominated or actually executed in foreign currencies, a practice that in the summer of 1996 to the winter of 1997 spread to the majority of deals in all segments. The Bulgarian lev lost its function as money, that is, it stopped being a means of exchange and a measure of the value of accumulation. To “restore” these functions, the national bank and the government introduced *additional limitations for payments and restored the guarantees on deposits* by blocking the system of payments and bankruptcy of banks. Even now prices of real estate and rent are estimated in US dollars, and those of cars and spare parts in Deutschemarks.

For the period July 1997-September 1998 (when Bulgaria joined article 18 of the IMF regulations) such deals were both illegal and in mass practice. Upon blocking the system of payment, deals were concluded in natural goods and, as we will see below, the special surveys show a broad range of such payments, including for services made by the state bureaus.

In the period 1991-97 the foreign currency rates were flexible and the national bank intervened on the market. Bulgarian citizens had the right to open accounts in foreign currency in local banks. For that period the national currency was convertible in the sense of article 14 of the IMF regulations. There was a prohibition on Bulgarian citizens opening bank accounts outside the country. The Bulgarian National Bank and the Ministry of Finance controlled capital transfers and issued permission for credits from foreign banks, as well as for the export of capital. There were also limitations on the export of foreign currency by private people without the permission of the national bank. The limit was USD 1000. One alleged form of payment

for services of the state administration is to help officials with foreign trips or the opening of bank accounts abroad.

The stability created by the introduction of the currency board enabled the country in 1998 to sign also article 8 of the IMF regulations for the convertibility of the capital accounts. The limitations on transfers of capital will be dropped by the end of 1998.

2.2. The market and state intervention

2.2.1. Analysis of basic markers

The general expenditure of the government for consumption (as a percentage of overall consumption) as follows:

year	1993	1994	1995	1996	1997
%	11.31	9.77	8.91	6.83	7.29

State-owned companies and investments as a share of the Gross Added Value (GAV):

year	1993	1994	1995	1996	1997	June'98
%	75.00	58.4	51.7	48.1	41.2	38.0

Share of the investment of private companies in the overall investment:

year	1993	1994	1995	1996	1997
%	22.76	39.04	44.45	38.53	44.40

In general, in 1996 and 1997 the investments in the private sector are lower than the respective percentage in the GNP and the share in the GAV. These facts can be considered symptoms of operating “in the shadows” or directing means for end consumption. But the more important thing is that the investments of the government in the state-owned companies (the difference by 100 per cent in the last table) does not meet the shares of these companies in the GAV. Hence, we suggest that there are hidden *quasi-fiscal transfers* and that there are incentives for their avoidance through not paying taxes, disinvestment and decapitalisation of the state companies.

Control over prices, contracts and profits for the period in question does not simply violate the freedom of business to determine on its own the prices of goods and services. As was explained above in the theoretical look at corruption, this factor makes the entrepreneurs and vendors seek ways of avoiding this control.

Currently minimal prices are fixed for the fuel, heating, electricity, and public transport, including the railways. In 1998 about 15.8% of the goods in the consumer’s basket had controlled prices. In all probability the prices of fuel and communal services will be liberalised by the end of 1998. For the previous years the percentage of controlled prices is as follows:

1991	14%
1992	13.4%

1993	16.5%
1994	18.9%
1995	49%
1996	52.4%

Apart from that the overall policy is still unclear: the Government Decree No 269 of July 1997 for regulating the prices (and profits, and practically the contracts as well) involving basic consumer goods is still in effect. It requires all deals of such goods to include end prices, that is to set a retail price for the end consumer the share of these goods is 2.78% of the GNP. At this volume, *entrepreneurs will seek ways to avoid control.*

The major mechanism of direct intervention in the economy is the execution of “the state’s rights of ownership”, but this is discussed in a different chapter.

2.2.2. Legal system and the right of ownership

Although the general legal grounds for corruption are described above, and special attention is given to privatisation below, at the risk of repeating something we need to discuss in brief the *general constitutional protection of the right of ownership.*

According to article 17 of the Constitution of Bulgaria, the right of private ownership is sacred and expropriation is prohibited. Using private property for public goals without proper compensation is prohibited. There is no risk of confiscation due to political activities. In the 1995-96 period the Constitutional Court overturned 35 acts affecting the right of private ownership (most of them connected with land).

After 1992, 87% of the nationalised urban real estate was restituted and about 30% of the agrarian lands were returned to their owners. Forests were restituted in 1998 without the necessary documentation and notarisation. The market of agrarian land has functioned since 1998 but is still undeveloped due to the small number of notary acts issued. The market for real estate is in a way limited by the taxes for transferring property (2.5% local tax and 1% legal fees). The tax for transfer of ownership of cars is 4%. Despite the absence of special surveys, we have a general conviction that taxes on the transfer of property give a reason to declare a lower price during the transfer. The lower declared prices in the notary acts mean that real estate and movable property are used as collateral for loans to a lesser degree.

Apart from that article 18 of the Constitution gives monopolist rights to the state over natural resources, the coastal area and the continental shelf, forests, natural and historical parks, radio frequencies and the geostationary orbit, roads, railroads, posts and communications, nuclear power, the military industry and so on, 21 spheres all in all. These do not include, though, such parts of the infrastructure as pipelines for gas, oil, and water. These rights, of course, are to be used for the benefit of citizens and the society. According to article 19 of the Constitution, the economy functions “on the basis of free economic initiative”, and “investments and economic activity” of local and foreign persons are “protected by the law”. According to article 21, though, agrarian land deserves “special protection by the state and the society” and obliges the owners to cultivate it. Article 22 prohibits foreigners from acquiring land. In general, that part of the Constitution contains many ambivalent statements and presupposes *ambivalent interpretation.* Such ambivalent interpretation is the basis of the domination of permit and

license regimes in different sectors and ignites the tendency for avoiding the regulations through private deals with state officials.

2.2.3. Obstacles to international trade (taxes on exports)

Fiscal income as a share of imports and exports:

year	1993	1994	1995	1996	1997
%	3.88	3.27	2.9	2.18	2.17

Fiscal income as a share of imports:

year	1993	1994	1995	1996	1997
%	6.92	6.39	5.64	4.27	4.36

Starting in 1991, the customs tariffs changed frequently (in 1991, 1992, 1993 and 1997), generally in compliance with the requirements of the Harmonised Customs Tariffs. The average duty was 11.4% in 1991, 15.4% in 1992, 17.5% in 1993 and 17.2% in 1995. The dispersion of duties is 176.9 and standard deviation is 13.3.

Average duties are higher than those in other East European countries are. The level of protection has not diminished since 1993. Duties vary from 0 to 110%, the highest dispersion being on consumer goods. Strongly protectionist duties have a heavy effect on prices, leading to ineffective distribution of resources. This does not raise the competitiveness of the Bulgarian economy, which for its part demands further protection. The customs regime, apart from being burdened by seasonal and complex duties, also includes special duties, licenses for export quotas, etc.

All this is a reason for vendors to seek ways to decrease or avoid the duty burden. The state aims at obstructing such tendency through border-crossing procedures. A survey of the Institute for Market Economy and the American University in Bulgaria in the autumn of 1996 shows that Bulgarian procedures for crossing borders are the most complicated, and Bulgarian customs officers, according the assessment of transport firms, the most corrupt in the Balkans. Sporadic observations show that the procedures for crossing borders have not become simpler and a glance at the papers of the Finance Ministry proves that simplification of the customs procedures has not taken place either.

3. THE PERMIT STATE: PHENOMENOLOGY AND ROLES; TAX-RELATED CORRUPTION

3.1. Roles and phenomena

3.1.1. The four factors

On a phenomenological level, corruption in state administration and its resistance might be explained by the complex action of four factors – the poor clerk, the permit-obsessed state, the aggressive entrepreneur and impunity.

In the beginning of the transition to a market economy, state organs were not able to exert control over the emerging small business. The new entrepreneurs did not observe sanitary, fire-

protection or other regulations. Tax control was not exerted, and a tax administration was not yet established.

Gradually the rules started to place the entrepreneur under the control of state institutions. According to the observation of Ivailo Hristov, a legal expert at Parliament, there are about 170 acts involving permits in effect now. As the acts and standards are not changed as quickly as the introduction of requirements for permission, state organs start to require the entrepreneurs to observe rules that were in effect for state companies in the planned economy era. These standards add to the new ones.

By “the aggressive entrepreneur” we mean, the willingness of small entrepreneurs to develop their business regardless of the existing legal limitations and regardless of whether they are really sensible, and their unwillingness to invest in efforts to meet state standards that are not directly profitable. A good example of that is the unwillingness of many entrepreneurs to observe regulations regarding sanitation and construction. Not ensuing from the hatred of the entrepreneur, the regulations suspecting that the entrepreneur will set fire to his neighbor, or poison customers, or sell an ugly building, are simply common sense and necessary, but requiring investments which are not directly profitable. For growth-oriented business owners, there are two general options:

- Meet the requirements at considerable cost;
- Partially meet the requirements or avoid them by bribing state officials to get the necessary certificate.

In such a case, the entrepreneur simply estimates the costs and chooses the cheaper option (usually the risks do not enter into the calculation).

The choice of the entrepreneur is not free, though – the state official must agree to take the bribe, and to state the amount of the bribe. Here comes the factor of the poor clerk. It is only logical that an average person cannot be expected to execute his duties, especially if he is a professional, if the following factors exist:

- Low salaries that don't pay for basic needs like food, electricity, heating;
- No hope for improvement in payments in the foreseeable future, regardless of promotions, changes in government, etc.;
- Poor working conditions and lack of necessary materials;
- Lack of respect from the society.

The state official faces the choice of accepting these conditions or accepting bribes that would lead to a more comfortable life, a sense of significance and a higher public status (the question remains what the values of the public are). The presence of the factor of “automatic corruption” should also be noted here. When a considerable part of the people in an institution are corrupt, they try to involve the rest of their peers in the business, because this guarantees their own security to a great extent. In this situation the choice is essentially pre-decided. But to have any choice at all, the clerk must have the power to secure for the entrepreneur the required service, that is, to have the power to decide. This constitutes the major factor in corruption – the permit-obsessed state.

It is necessary for the state organs to have rules for the different economic activities, which should secure safety (of workers, society at large, the environment) and enable businesses to grow without considerable costs. As was explained, when expenditures are unreasonably high, the entrepreneur chooses to cut them and often doesn't pay them at all. To procure the observance of these requirements, the state representatives aim to exert preliminary, current and ensuing control over entrepreneurs.

In the beginning of the transition, priority was given to the current and ensuing control (mass inspections in the shops). Later preliminary control took on special significance, hence the growth of certifying regimes for all economic activities and licensing of certain businesses. The institutions entitled to give approval have clear and prescribed requirements, and there is nothing wrong with them at first glance, on the contrary they protect society from the undesirable events and effects. The problem is that the institutions are run by people empowered to decide whether entrepreneur X may or may not execute the activity planned by him. That is, the power of the state institutions comes from their right to judge and decide whether the requirements are met. It is clear that these people prefer this job to be done by the state alone, because there is no delegation of functions to non-state organs.

There should be noted some *specific features* of these requirements and standards. The requirements and standards are created by people having a very perfunctory idea of the nature of real economic activity and at the same time are not interested in the practical applicability of these requirements. This explains the excessiveness of the rules, their complexity to the point of ridiculousness and their vast numbers. Many are old enough to be unfeasible, as they don't relate to the current economic conditions. To meet them, one needs to make considerable expenses frequently amounting to the overall cost of the rest of the investments, given that starting capital is always very scarce.

3.1.2. The effect on small business

After the entrepreneur decides to embark on a certain kind of business, he will make it regardless of whether he meets the requirements or not, and sooner or later will have the document certifying that the standards have been met. The solution to this situation is to limit and simplify the rules to the extent that they are feasible

Starting a small business involves acquiring a number of certificates from at least three institutions, each of them with a number of rules of their own and procedures that often expect the approval of the others. The procedures are extremely clumsy and time-consuming, and a pile of documents are needed before they being. Another pile of papers is needed to prove the actual compliance with the multiple requirements. Professional assistance is frequently necessary to fill out these documents, resulting in a further waste of money and time. After starting the procedures, the entrepreneur must wait for the clerks to do their jobs, accumulating losses from inactivity the whole time. This is the moment the entrepreneur faces the worst part of the phenomenon of the permit-issuing state – after the institution processes the documents, a clerk comes and says “no way”.

The reasons for such a refusal might be a free interpretation of the legal acts on the part of the respective inspector, or just an “internal requirement” of the institution of which only the clerks are informed. The important thing is that the refusal has been handed down and the respective inspector cannot be avoided, even if his refusal is groundless. If the refusal is appealed to a higher power and permission is then obtained, the inspector, attempting to shore up power, will

be alert for the smallest infringement of the requirements and will shut the business at the first opportunity.

This is the moment when the state institution ceases and is replaced by the inspector. Contrary to the institution, which requires the observance of certain rules, the inspector might be persuaded to accept that certain rules have been observed and issue the necessary certificate. More often than not the clerks themselves hint at or directly state the ways to “persuade” them. Even if the entrepreneur strives to remain within lawful bounds, despite the expenses, and even if the business is in compliance with the requirements, it is practically impossible to obtain the certificate.

The small business owner usually has limited capital and is thus more affected by delays. This leads him to seek ways to speed-up the procedure through relatives and associates usually in one or two institutions, or through directly offering bribes.

It should be noted that a leading motive in bribery on the part of the entrepreneur is the saving of time. Objectively, the officials in the state institutions are not physically able to process all the information quickly. The administrative requirements are so numerous that every small entrepreneur besieges the respective institution for every shop he wants to start. The institutions are understaffed, under-equipped and the employees are weakly motivated to cope with so much work. The laws of the country impose duties on the institutions without providing the necessary resources for their execution. Furthermore, increasing the number of employees and the budget to a point where the requirements could be met would be both prohibitively expensive and unwieldy.

The curious thing in this case is that because every entrepreneur offers bribes or has connections, or both, no one is safe, because the official system is being violated. The effect is that a great part of the entrepreneurs operate most of the time illegally or semi-legally. They offer bribes to state officials in order to issue a permit to their business as is, or to speed up the procedure or both. As was already described, there is no speeding-up of the procedure. The avoiding of the requirements through bribery is also meaningless. Most of the entrepreneurs do not include the risk when calculating the price of the service. Excluding the impropriety that will be found if an investigation takes place, the most significant risk is the replacement of the bribed clerk. The new clerk usually finds an irregularity that needs to be mended, and behold, the chance to offer another bribe comes up.

Entrepreneurs are compelled to offer bribes, because otherwise they run the risk of their applications “disappearing” for a certain period of time. The bribe does not even grant a privilege – it simply brings them to the “common” level. In this way corruption in the administration acquires the characteristics of a *tax*, based on the administrative power of clerks as initiated by a legal framework.

All of this shows that the very policy of licensing and certifying economic activities by different institutions acting on a highly complicated, outdated and simply unfeasible legal basis breeds corruption among state officials and lowers the effectiveness of business, as well as creating business relationships of an Oriental type at the same time.

3.1.3. Empirical evidence

First is a survey of the Institute for Political Surveys made in April-May 1996, reflecting the situation at that moment. Presented here are some results that we suppose would be similar if

the survey were made today. The survey demonstrates how the *foul economic environment* creates expenses for running a business that rationally stimulate informal economic activities and to what extent the corruptive behavior of private entrepreneurs is spread.

The definitions of small, mid-size and large business was derived through empirical methods. Significantly for the surveyed data, the definitions are: small – up to 3 million (45.9% of the interviewees); large – (3.4% of the interviewees). The mid-size business are in between.

In the same way the definitions of high and low expenditures (both official, rent, salaries, as well as unofficial, like commissions given by hand, bribes for decrease of duties, other payments in cash, etc.), were derived through a simple arithmetic principle, usually “over half” of something or “less than half”. The expenditures were divided into categories of official, unofficial, expenses of time and expenses of money.

Private businesses are either a personal liability business or a family business. The long-term assets of small companies are comprised of personal or family resources. 82.4% of the interviewed said they started using personal savings, family property or aid from a relative or friend. The structure of loans is very interesting. Upon starting a business 62% claimed they did not take a credit or indirect funding. Of the other 38%, only 17% took credits from private banks. Some 41.5% were funded by relatives. Probably this group includes inter-company credits.

The registration of a company can take a bit over three weeks, though most (50%) said they were registered in ten days. The process takes longer when the company applies for a certificate for a specific activity, with procedures taking as long as three and a half months, but about half of the companies managed to register in the same amount of time as it took for other registrations. An interesting point here is that when a “fixer” is used for the registration (a lawyer, etc.), expenses increase both in time and money.

One-fifth of the interviewees were importers. Over 60% claimed they always paid duties and taxes, and the rest admit they managed to decrease the taxes to a considerable extent. Nearly 20% of those importing goods and resources admit that they decreased their duties through the aid of an official or a mediator. In about 43% of the cases, between 70% and 100% of the payments are made in cash.

Here are the answers to the question “What percentage of the payments of the company are made in cash?”

up to 10% – 18.1%	up to 60% – 3.8%
20% – 6.7%	70% – 3.8%
30% – 7.6%	80% – 4.8%
40% – 8.6%	90% – 9.5%
50% – 12.4%	100% – 24.8%

It is quite paradoxical that 20% of the interviewed said that their companies have no bank accounts. It is important to note that this answer was obtained before the conditions of a rapid devaluation of the national currency and before First Private Bank and Mineral Bank were put under a special control regime, that is at a time when there was supposedly no distrust of banks

and non-cash methods were supposed to be a more reliable means of payment, or perhaps private business was able to predict the coming events and readily turned to cash transaction.

The answer to the question “Does your company practice double accounting?” is quite meaningful. One-fourth of the companies admit they keep two books. According to about 60 % of those that admitted it, the double accounting is to a result of the cash payments.

The terms for concluding a contract, according to the survey, is about 14 days. 78.8% of the interviewed said they paid “commissions” for the legal registration of a contract. 65% of the business owners said they never had a contract violated. The ineffective laws for protection of business relations in Bulgaria means that 10% said that they use other companies’ services for protection of their rights. 65.7% said that they insure their company property and 37% have expenses for additional protection, apart from insurance. The only explanation as to why these outlays are taken care of is the threat to the very existence of the business. And if this is the normal everyday condition for 35% of the private businesses in Bulgaria, the burden of expenses is severe: for the companies using protection (apart from insurance) the overall expenses in cash are claimed to be “high” in 73% of the cases, and unofficial expenses are present in 83 per cent of the cases.

The high unofficial (unregistered) expenses are fundamental for Bulgarian companies. They stem from higher general expenditure for subcontractors and last but not least much time-consuming work. Results show that high expenditures for the companies and the disorganisation of the market (the time-consuming conditions and the expensive mediators’ services) explain the tendency to register economic activity.

The higher expenses for mediators obviously leads to higher overall expenditure. If the mediators’ services are effective for the companies, there should be observed an inverse correlation between these expenses and the time-expense. But there is no significant correlation. In this sense, the mediation is a burden on the management of a business rather than a rationalisation.

Similar is the logic of the inverse correlation between the time expenses and cash expenses: more transactions in cash should save time. But this is not a statistically significant criterion for Bulgarian companies – having more expenses in cash does not necessarily lead to a lowering of the expenditure of time. The necessity for a license of course increases the spending of money. These formalities are also a factor in the higher unofficial expenses and the expenses for mediators, most of that kind of business being taxed and thus higher in price.

Other interesting findings were:

- Similar to the case of obtaining a loan, direct funding increases the overall expenditure, but does not decrease the expenses of time and supposes the use of a mediator;
- The inherent expenses on credits increase the high expenditure in cash, but do not, again, decrease the expenses in time. The mechanisms of obtaining credits are the reason for the high expenses for using mediators;
- Using bank transfers for payment decreases the expenses in time and the unofficial expenses, but increases the overall expenditures; cash payments are more effective for the companies, especially in the conditions of 1996;

- Companies with high cash turnover have lower overall expenditures;
- Companies paying higher taxes have higher overall expenditure, but are compelled to spend more unofficially; the tax tariffs are ineffective;
- Industrial entrepreneurs have higher levels in all groups of expenditures;
- Expenses for mediators and the overall unofficial expenses in production are higher than those are in trade and services. Increasing the number of employees decreases the expenses in time and those for a mediator, but increases the unofficial and cash expenses;
- Owners managing their companies alone prefer to make higher expenditures in cash rather than reduce expenditures of time. Managers apparently feel they have more time than money. Managers of companies with foreign ownership have the lowest expenses in time and lowest expenses in money and mediators;
- A company's internal job differentiation is poor. In most of the cases there is no clear border between business and family;
- Companies with young managers have comparatively higher expenses, most of them unofficial;
- Companies in Sofia have lower expenses in time and considerably higher expenses for mediators and unregistered expenses.

3.1.4. On taxes and corruption

It is only logical to suppose that entrepreneurs will choose the cheapest possible option for paying taxes. The price of the options includes (often only intuitively) the risk of violations of the law being discovered.

At the existing rates for VAT and the subtaxes, it is more often calculated to be cheaper to violate the regime, in an amount huge enough to be financially worthwhile and small enough for the inspectors to be able to "close their eyes". The existing practice is to pay 50-70% of the due, and in case of a check, a bribe for the inspector in the amount of about 10% of the due tax, keeping in mind the latter's low salary. This is normal behaviour for an entrepreneur and no one should be surprised by it. Every store owner is capable of paying a bribe in case of inspection that will still result in a net saving of money. Tax inspectors, underpaid and overworked, are beset with attractive offers that would allow them to buy, say, a pair of shoes for their child. A significant point here is that the tax administration is last on the table of salaries of the state administration, and funding for social aid and promotions is, by rule, distributed among the senior staff only.

It is worth noting that with the introduction of the new taxation laws in 1998, common employees are swamped with questions from taxpayers regarding the Act on Local Taxes, and its effect on the income taxes of physical bodies and the Act for Corporative Taxes. At the same time, the Ministry of Finance, the Tax Administration Chief Office (TACO) and the regional offices (TARO) seem to want to humiliate others. For example, the Sofia TARO refuses to answer requests of the tax administration on the interpretation and application of the laws. At the same time, the tax administration is not officially entitled to interpret the laws. As

a consequence, tax inspectors or heads of offices interpret the laws by way of expedience and a common practice for all cities or even within the same city does not exist.

A good example is the case of the Constitutional Court overturning articles from the act on income taxes of physical bodies concerning the so-called patent tax. As a consequence the patent tax was undefined for most of activities, but the terms for its payment was in effect. Most of the tax administrations adopted the practice of gathering any amount from the taxpayers, in order to follow the general plan, and usually the amount was set by the taxpayer, but not less than BGL 20 000. Of course, this was *illegal*, because under the act for state taxes and fees, taxes are payable only when the amount is defined. In addition, the same employees were threatened with dismissal and compelled to work extra hours due to the unreasonable terms for gathering local taxes set by the Ministry of Finance. Such cases demoralise and disorganise the common tax inspectors, because they have to explain all the mess to taxpayers. Thus, they can hardly be expected to be loyal to the state, especially when they are underpaid.

Such case, though, shows the taxpayers that the people in the tax administration are confused. Their working conditions are poor (about 8 people are confined in a space of 20 square metres with one PC 286 with no hard drive) and the amount of their salaries is no secret. Thus, it is not difficult to conclude that most of the employees are motivated to take a bribe because they do not feel that they play an important role in the state, and that they have been placed by accident in a job that no one wants to take.

It might be considered that many officials would refuse to take a bribe if they were scared by the possibility of prosecution. Under the existing Penalty Code, the category of “bribery” is difficult to prove and the case needs cooperation from one of the two participants. This could happen if the state administrator demands a bribe and the entrepreneur signals to the police before handing the money over. There are such cases, but they usually happen when the amount demanded is considered too high. In any case, the usual practice is for the officials not to demand the bribe outright, but to use key words to prompt the entrepreneur, or just to take what is offered. In such a case, there is no chance for proving the crime due to the fact that after a fiscal check of a company, the inspectors themselves are never checked.

We would suppose that *a decrease in taxes* would decrease to a certain extent corruption, because it would change the balance between the taxes paid and the price of a bribe of an employee. But this would not lead to a considerable decrease of the use of such practices. Entrepreneurs will continue to pay only part of the taxes and inspectors will still be corrupted. The situation will change only if there is a significant change in one of the two major factors:

- The payment of tax inspectors – the funding for stimulation the tax administration should be decentralised on the level of taxation offices and the individual inspectors should have incentives to personally discover violations;
- The punishment – TACO should selectively double-check companies to confirm conclusions made by previous checks.

4. “THE STATE INTEREST IN STATE-OWNED COMPANIES” AND PRIVATISATION

4.1. The function of the administrative regulations

Of significance in the management of state property is the administrative regulations. The idea of the reform of the state administration, eminent since the beginning of the transition period, is based on French traditions. All positions are assigned by the Government, and there are no clear rules for assigning and firing of employees. In this way the rules of competition for state posts and managers of state-owned companies were not distinct for the entire period 1991-98. The state was judging which monopolies were “good” or “bad”; in 1998 the preservation of the monopolist status quo seems the only chance for the oil refinery Neftochim to be privatised, or for getting the best price for the Bulgarian Telecommunications Company.

The cabinet established state committees and agencies already controlling the industrial and commercial sectors. These activities did not raise the expenses of the cabinet at the moment; most of the members of the committees belong to the administration itself and do not get much from their participation in them. But there is a danger in accumulating the critical mass of controlling bodies that their members will seek opportunities for increasing their incomes, which will raise the expenses of entrepreneurs. At the same time, it should be made clear that due to different reasons over the years, entrepreneurs agreed that the state should have that role, or at least do not express strong resistance to it. There are at least three reasons:

- Lack of self-confidence on the part of entrepreneurs to take on the functions of self-regulation of the market;
- The conviction of the entrepreneurs that “our people will do it”;
- A common lack of political trust in the capabilities of the entrepreneurs, and the political establishment’s view that they are a class of outlaw nouveaux riches that is to be heavily taxed.

The management of state-owned companies is regulated by the Labour Code and a special sublaw regime stipulated in the instructions for exerting the rights of ownership of the state in companies, adopted in decree No. 7 of the Council of Ministers from Jan. 25, 1994 and amended several times. Decree No 7 replaced the old decree of Jan. 1992. The major goal of this decree is to stipulate the applications of the regime of management under the Labour Code regarding the management of personal liability companies with state participation.

According to article 2 of the decree, the right of ownership of the state in personal liability companies is exerted by the Council of Ministers, and according article 10, item 1, the government delegates these rights to a minister, a committee, chair of the committee or a director of an institution according to their qualifications.

Hence, the powers of general assemblies shareholders in both cases are executed by the respective field minister, chair of the committee or director of an institution who issues orders of a legal nature. The rest of the governing bodies are the same – manager(s) for the personal liability companies and a board of directors in a one-level system of management, or a control council at if a two-level system is chosen. The managerial structure of personal liability commercial companies with state shares is not different in principle from the managerial structure of the “common” capital companies, because the legal framework is one and the same.

In case the owner is the state represented by the respected field minister/chair of a committee/director of an institution the *problem is poised more sharply than ever*. That is why the spirit of the decree is directed towards limiting the rights of the manager of the personal liability companies (respectively the councils of the joint ventures) by enlarging the powers of

the general assemblies implemented unilaterally by the minister/chair/director. The replacement of the managerial powers by the general assembly is apparent only in the joint ventures.

The core of the phenomenon is the acquiring of the rights on state property. The rules are set in articles 10 and 11 of decree No 7 and stipulate that for the state companies, the right of ownership is delegated to the field ministries or committees (those of industry, trade, agriculture, energy, post and telecommunications, etc.) and the Council of Ministers (in the case of the military industry). Actually the Premier and his Council of Ministers (due to the already established tradition of the party leader being elected Premier) are the single owners of first degree due to their controlling functions over the field ministries. The field ministries, on their part, assign the managers and the members of the boards of directors in the state companies.

These assignments are ambivalent in effect. On the one hand, they aim at order in the state sector. On the other hand, the government considers them a privilege and uses them as a reward for political support. Assignments of the last few years were rewards for political merits and loyalty. Because there do not exist updated norms for funding the political campaigns or lobbying, the temptation to aid them by state funds (or control over these funds) will continue to exist, unless the appropriate laws are created. For the moment, the intentions of the government to solve these problems are only in the sphere of wishes and good intentions.

Members of the central administration do not have the right to take part in more than two governing bodies of companies, while MPs suffer no such limitation. There are no requirements for competition, there is no set procedures for the assignment of managerial teams or using joint capital in investment projects with the participation of the state. Such schemes are not prohibited, but no practice exists. The field ministers are afraid of being accused of neglecting their duties to protect the interests of the society in state companies.

Decree No 7 also requires the managers and ministers to close down companies when debts exceed 50% of the assets. This requirement was never applied by the socialist government. According to a survey of the decision-making process in state-owned companies made by the IPS in 1997, there were no decisions taken for improving the performance of the company through incentives for the managers and/or members of the managerial bodies. As yet the administration still has not stated any intention of getting rid of the decree or amending it and introducing an element of a risk in the management of state-owned companies.

4.2. Control over privatisation as a resource

4.2.1. Opportunities for corruption

Regarding cash privatisation, the *choice of a strategic investor* is still a very complicated procedure. The cabinet launched the idea of speeding-up the sales of the “jewels of the crown” – leading investment banks and consulting companies were invited to prepare for the purchases of these companies.

Under the scheme of *public offering* of majority packets of shares of the biggest companies, there are insignificant opportunities for corruption, at least theoretically. If the details of some purchases are examined, we will find that the lack of corruption is only in theory. Elcable and Chimmach were sold on the stock market through public offering. The first company was sold over the course of months with considerable ups and downs in the price; the second company

was privatised in a few consecutive sessions of the second market. The reason for the different lengths of time is not so much the differing amounts of capitalisation, but in the lack of transparency regarding Elcable.

The present legal framework and especially the *stock market* do not allow for transparency and free competitive market. The very shallowness of the market provides for manipulations by a single person with limited means. This way of privatisation can breed corruption on another level. The state chose for mediators in these deals brokers – private investment brokers – the choice of which was not made on a competitive basis.

Selling firms to *Management-Employee Buy-out companies* created with the sole aim of participation in the announced tenders undoubtedly has economic advantages. Unfortunately, though, this mode of privatisation usually involves a closed circle of “shadowy” relationships and processes. The reasons are, on the one hand, in the nature of the competitive principle as a privatisation scheme and, on the other hand, the concrete conditions of MEBO privatisation being fertile ground for the development of corruption. The considerably profitable provisions in such contracts often attract several candidate-buyers of MEBO type and then the choice of the state loses the last features of transparency.

5. CONCLUSIONS AND RECOMMENDATIONS FOR IMPLEMENTING THE ECONOMIC REGULATIONS AND MECHANISMS

5.1. How to perceive corruption

There exists an opinion that corruption in Bulgaria is based on a traditional system of values. Such an understanding is connected to the *traditionally bad image of the state* in the national system of values. From an historical point of view, the state has always been hostile to the individual. Some 120 years ago, the newly established statehood was supposed to unite and enrich the nation. Several governments tried one after the other to do their best, but did not manage to fulfill the hopes of raising the nation to life. In the 1890s of the last century, the law for protection of national industry was considered the key instrument for enriching the citizens. Under this law, the government was obliged to support local industries and use quotas for its encouragement. The application of this law had partial success regarding the modernisation of economy. The more significant, though not acknowledged result from the law was the conviction established in the business circles that the government should support it, and the tendency to lobby for preferences which makes connections a means of funding. History proves that such attitudes brought economic problems to the country even in the 1920s and 30s.

The redistributive philosophy of the authorities might be synthesised in a sentence – “the more we control, the more there will be for redistribution”. Both the years of communism and the ineffectiveness of the socialist governments in the last few years showed that the state works against rather than in support of the individual. In the structure of a national value system, the public interest is always abstract and impersonalised. This abstractness and impersonalisation together with the delay in privatisation, the historical and cultural roots and other attitudes encourages the major part of the population (over 80% according to a poll conducted in Jan. 1998 by MBMD and Vitoshka Research) to either engage in or tolerate corruption.

5.2. Preliminary conditions for success

Whatever the roots, the phenomenon of corruption should be dealt rationally with: the *systematic means* of corruption in Bulgaria and the other countries are in the exertion of state control over the individuals' activities and also in the practices and procedures of state control. Such an interpretation might be viewed both pessimistically and optimistically. Pessimistically because corruption is already part of the newly-built system of social relationships. And optimistically because the problem might be solved, if the conditions breeding it are eliminated.

In a sense, people are not bound to the historical conditions forming their attitudes and hopes. The first condition for counteracting corruption, though, is realising these conditions and the fact that discussions of the issue are meaningful as a basis for future actions.

For the future actions we are to take into account that it is within the range of influence of people and the institutions established by them that hides the key to changing what they consciously build. In this chain of thinking, a counteraction to corruption would be successful only through a change in the written regulations that evoke it. As for the unspoken regulations – historically-bound attitudes and habits – we should take into account the fact that they will change in time, with the change in education and experience, which is not to be controlled.

As a whole, corruption in the economic development of the country at the end of the 20th century is a *systemic phenomenon*. It is a consequence of several factors and itself has turned into an institution defining further the prospects for the economy. Among the factors spurring the institutionalisation of corruption are the following:

- Lack of a professional and market-oriented transparent administration, the use of populist political strategies by the ruling politicians and habits from the planned economy era;
- Lack of a clear agenda and vision for economic development and reforms, lack of public consensus on even a minimum number of values for rational economic policy;
- Economic instability and high inflation for seven years, together with periods of hyperinflation when the incentives for abuse of office and violation of the written laws are a means of survival;
- Lack of good economic statistics and research on the informal economy and corruption.

All in all, the years of experience with a currency board show that the fixed rates help diminish petty acts of corruption, establishing control over prices, trade, etc. The regime of the currency board created both conditions for transparency and conditions for the establishment of a competitive market economy led by development of the private sector. Such a platform has been signed by the cabinet and supported by the loans granted by the IMF and the World Bank.

Again in the case of transparency, as in the case of the platform itself, the problem is that for the moment there are not enough clues to tell if this policy is an innate conviction of the government, a criterion for assessment of the administration and a policy that can be supported by the entrepreneurs.

It is significant to note that entrepreneurial freedom is limited by administrative procedures suppressing the growth of salaries that are paid by the state. The rigid system of the currency

board suggests *liberation* of all the rest of spheres of social economic life, except the currency rates. For the moment, judging from the regulations that have been enacted and certain statements of Prime Minister Ivan Kostov, the cabinet believes that limiting economic freedom is a condition for fighting corruption. In general, there is no survey that would prove such a hypothesis. The fight with corruption is connected with limiting the freedom in one single aspect – institutional control in the implementation of contracts and protection of private property (that is, preventing the acquisition of property through violation and power, deceit or theft.) If the cabinet aims at diminishing corruption and increasing the strength of the economy, it should sharply curtail regulations and the number of institutions empowered and obliged to permit, license or certify. For the achievement of this the government should decide at its sole discretion what kind of state and what scope it desires, including the range of intervention in the economy.