Government Favouritism in Europe

The Anticorruption Report

Volume 3

Alina Mungiu-Pippidi (editor)

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written by
Muhittin Acar
Elizabeth Dávid-Barrett
Valentina Dimulescu
Mădălina Doroftei
Uğur Emek
Mihály Fazekas
Stefan Karaboev
Péter András Lukács
Roberto Martínez B. Kukutschka
Alina Mungiu-Pippidi
Munir Podumljak
Salvatore Sberna
Ruslan Stefanov
István János Tóth
Alberto Vannucci
Andrew Wilson
Todor Yalamov

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Authors

Muhittin Acar, PhD, is Professor of Public Administration in the Department of Political Science and Public Administration, Faculty of Economics and Administrative Sciences, Hacettepe University, Ankara, Turkey (acar42@yahoo.com)

Elizabeth Dávid-Barrett, PhD, is a lecturer in Politics at the University of Sussex, UK (E.David-Barrett@sussex.ac.uk)

Valentina Dimulescu is a researcher at the Romanian Academic Society and Managing Editor of the Romanian Journal of Political Science, Bucharest, Romania (valentina.dimulescu@sar.org.ro)

Mădălina Doroftei, PhD, is a post-doctoral researcher at the Romanian Academic Society and Assistant Lecturer at the Bucharest University of Economic Studies, Bucharest, Romania (madalina@sar.org.ro)

Uğur Emek, PhD, is an Associate Professor of Economics and a Senior Expert in the Ministry of Development, Ankara, Turkey. He is currently a visiting research fellow at Hacettepe University and teaches at Baskent University, Ankara, Turkey (uemek@baskent.edu.tr)

Mihály Fazekas, PhD, is a Post-Doctoral Researcher at the University of Cambridge, UK (mf436@cam.ac.uk)

Stefan Karaboev is an Analyst at the Economic Program of the Center for the Study of Democracy, Sofia, Bulgaria (stefan.karaboev@online.bg)

Péter András Lukács is an Analyst at the Corruption Research Center Budapest, Hungary (lukacs.peter.andras@gmail.com)

Roberto Martínez B. Kukutschka is a PhD Candidate and a Research Associate the Hertie School of Governance, Berlin, Germany (kukutschka@hertie-school.org).

Alina Mungiu-Pippidi, PhD, is Director of the European Research Centre for Anti-Corruption and State-Building at the Hertie School of Governance Berlin, Germany and author of the 2015 Cambridge University Press monograph '*A Quest for Good Governance. How Societies Develop Control of Corruption*'. (pippidi@hertie-school.org).

Munir Podumljak is the Executive Director of the Partnership for Social Development, Zagreb, Croatia (munirpodumljak@psd.hr)

Salvatore Sberna, PhD, is a Research Fellow at the European University Institute and coordinator of the APC Master's Program on Analysis, Prevention and Control of Organized Crime and Corruption, organized by the Department of Political and Social Science, University of Pisa, Italy (Salvatore.Sberna@eui.eu)

Ruslan Stefanov is Director of the Economic Program at the Center for the Study of Democracy, Sofia, Bulgaria (ruslan.stefanov@online.bg).

István János Tóth, PhD, is Co-director at the Corruption Research Center, Budapest, Hungary (tthstvnjns@gmail.com).

Alberto Vannucci, PhD, is Associate Professor of Political Science at the Department of Political Sciences at the University of Pisa and director of the Master Programme in "Analysis, prevention and fight against organized crime and corruption", organized by University of Pisa-Libera-Avviso Pubblico, Pisa, Italy (alberto.vannucci@unipi.it)

Andrew Wilson, PhD, is Professor in Ukrainian Studies at University College London, a Senior Policy Fellow at the European Council on Foreign Relations, London, UK and the author of '*The Ukrainians: Unexpected Nation*', New Haven and London: Yale University Press, (fourth edition 2015) (tjmsalw@ucl.ac.uk).

Todor Yalamov, PhD, is a Senior Analyst at the Economic Program of the Center for the Study of Democracy (Sofia, Bulgaria) and also Assistant Professor at the Department of Economics and Business Administration, Sofia University "St. Kliment Ohridsky", Bulgaria (todor.yalamov@online.bg)

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Abbreviations

ACR	Anticorruption Report
AKP	Adalet ve Kalkinma Partisi
ALB	Abnormally Low Bids
ANRMAP	National Authority for Regulating and Monitoring Public Procurement
ANTAC	Anti-corruption Action Centre
ANTICORRP	Anticorruption Policies Revisited: Global Trends and European Responses to the Challenge of Corruption
BCE	Corvinus University of Budapest
BDP	Barış ve Demokrasi Partisi (Peace and Democracy Party)
BGN	Bulgarian Lev
BOT	Build, Operate, and Transfer
CAE	Identification Data for Contracting Authority
CCI	Commission for Conflict of Interest
CHP	Cumhuriyet Halk Partisi (People's Republican Party)
CPO	Central Procurement Officer
CPV	Common Procurement Vocabulary
CSD	Center for the Study of Democracy
CVM	Cooperation and Verification Mechanism
DNA	Romanian National Anticorruption Agency
DPPS	Directorate for the Public Procurement System
EC	European Commission
EFSI	European Fund for Strategic Investments
EPPP	Electronic Public Procurement Platform
EU	European Union
EUI	European University Institute
FOI	Freedom of Information
GDP	Gross Domestic Product
GVA	Gross Value Added
HDZ	Croatian Democratic Union
HRK	The Croatian Kuna
IKS	Kosovar Stability Initiative
IMF	International Monetary Fund
LPP	Law on Public Procurement
MHP	Milliyetçi Hareket Partisi (National Movement Party)
MP	Member of Parliament
MSZP	The Hungarian Socialist Party
NABU	National Anticorruption Bureau
NAO	National Audit Office
NGO	Non-Governmental Organisation
NSI	National Statistical Institute
NSRF	National Strategic Reference Framework
NUTS	The Nomenclature of Territorial Units for Statistics
OC	Organised Crime
OCC	Organised Crime and Corruption
OP	Operational Programs
PFIA	Public Financial Inspection Agency

PPA	**Public Procurement Agency**
PPB	**Public Procurement Board**
PPP	**Public-Private Partnership**
PPL	**Public Procurement Law**
PPR	**Public Procurement Registry**
PSD	**Partnership for Social Development**
QOG	**Quality of Government Institute**
RPR	**Reanimation Package of Reforms**
SAO	**State Audit Office**
SAR	**Romanian Academic Society**
SCSPPP	**State Commission for Supervision of Public Procurement Procedure**
SEAP	**Electronic Public Procurement System**
SEEs	**State Economic Enterprises**
SICAP	**Romanian Electronic System for Public Procurement**
SME	**Small and Medium-sized Enterprises**
TCA	**Turkish Court of Accounts**
TED	**Tenders Electronic Daily**
TPC	**Turkish Penal Code**
TGNA	**Turkish Grand National Assembly**
TMAC	**Minister of Transport, Maritime Affairs, and Communications**
UNCAC	**The United Nations Convention against Corruption**
UNODC	**United Nations Office on Drugs and Crime**
USKOK	**Croatia's Office for the Prevention of Corruption and Organised Crime**
VAT	**Value Added Tax**

3. The Bulgarian Public Procurement Market: Corruption Risks and Dynamics in the Construction Sector[1]

RUSLAN STEFANOV, TODOR YALAMOV AND STEFAN KARABOEV

The Bulgarian public procurement market constituted 9% of national GDP on average between 2009 and 2013, making it a key public resource for allocation and an object of corruption pressure. Approximately a third of the total construction sector and half of the Top 40 companies' turnover in 2013 came from public procurement. Similar concentration is also evident on the supply side, with public works reaching above 50% of the value of all public procurement contracts the same year, implying an increase in corruption risks. The firm-level analysis of the public procurement contracts awarded to the Top 40 construction companies by turnover included in the paper, confirms the trend of concentration. Using public procurement data on Bulgaria from the EU's TED database we find that single bidding, the foremost corruption risk red flag in public procurement, is more prevalent in public procurement involving national than EU funds. In addition, linking the database of the Top 40 construction companies to the TED database, we discover that politically connected companies win a higher share of the single bidding public procurement contracts involving national funds than EU funds. The risk reduction effect of EU funds in single bidding contracts diminishes with the value of the contract. While the data does not conclusively uncover specific types of favouritism, it points to increased corruption risks, especially involving large-scale construction projects in infrastructure and energy.

Introduction

Bulgaria has been repeatedly defined as a high corruption risk country, in which the resources and opportunities for corruption are high, while deterrents and constraints remain low (Mungiu-Pippidi, et al. 2011, pp. 40-41). Its governance regime has been described as moving gradually from patrimonialism to open access order, with most of its features still in the competitive particularism stage (Mungiu-Pippidi, et al. 2014, p. 25). Hence, if the normative ideal of good governance is equated with open access order,[2] Bulgaria is still far from achieving good governance. Widespread bribery persists in the country (CSD, 2014), and the allocation of

[1] This is an abbreviated version of an earlier paper published as part of WP8 of the FP7 research project ANTICORRP. The original paper contains more detailed methodological and data parts, as well as legal framework analysis and is available online at: http://anticorrp.eu/publications/report-on-bulgaria/. The methodology for the data collection, and the data itself are available upon request. The authors would like to thank Professor Alina Mungiu-Pippidi and Dr. Ramin Dadasov, Hertie School of Governance, Dr. Mihaly Fazekas, University of Cambridge, and Mr. Munir Podumljak, Partnership for Social Development for the comments and suggestions offered to earlier versions of the paper.

[2] For a detailed discussion on how good governance relates to a taxonomy of governance regimes and to corruption and anti-corruption, please see Mungiu-Pippidi, et al. (2011), *Contextual Choices in Fighting Corruption: Lessons Learnt*, Hertie School of Governance and NORAD, Berlin, 2011.

public resources remains particularistic and unpredictable. EU membership, however, brought some transparency and accountability with it. As one of the main channels for transferring public resources to the private sector, studying the functioning of the public procurement market in Bulgaria and focusing on construction can provide important insights into the opportunities and constraints to corruption or favouritism in Bulgaria. We start by presenting the material stake or the available resources for distribution through public procurement. Then test what is the character of their allocation based on the single bidding red flag for corruption risks, using TED data for Bulgaria and a database of the Top 40 construction companies, specifically constructed for this paper. We conclude with some recommendations for public policy in Bulgaria and the EU.

1. Material Stake: the Bulgarian Public Procurement Market in Construction

1.1. General public procurement market

The term "public procurement market" is defined in this paper as the supply of goods, services and construction works[3] for the public sector and the utilities, for which the legislation prescribes specific procurement procedures. This definition excludes the supply of goods, services, and works below certain (minimum) threshold values[4], which according to Bulgarian law do not require such specific procedures. In this context, the public procurement market includes most of the current and investment consumption of the central and local government bodies, the legal entities they finance and/or manage ("conventional" contracting authorities), as well as the "sectoral" contracting authorities (energy, water supply, etc.)[5].

On average, public procurement made up 9% of Bulgaria's gross domestic product (GDP) from 2007 to 2013[6]. While small by EU standards, public procurement grew steadily from €1 billion in the early 2000s to a peak of just above €5 billion in 2009 before dropping to €3 billion in 2010 in the wake of the Eurozone economic crisis (see **Figure 1**). Both peak years of public procurement contracting since Bulgaria's EU accession – 2009 and 2013 coincided with parliamentary elections. In both years, the non-cyclical spike in public procurement came in the months just before the elections, clearly indicating the intent of incumbent governments to win voter support through the allocation of public funds. The rise in public procurement contracts in pre-election months has been documented also before EU accession, before the 2001 and 2005 parliamentary elections (CSD, 2006).

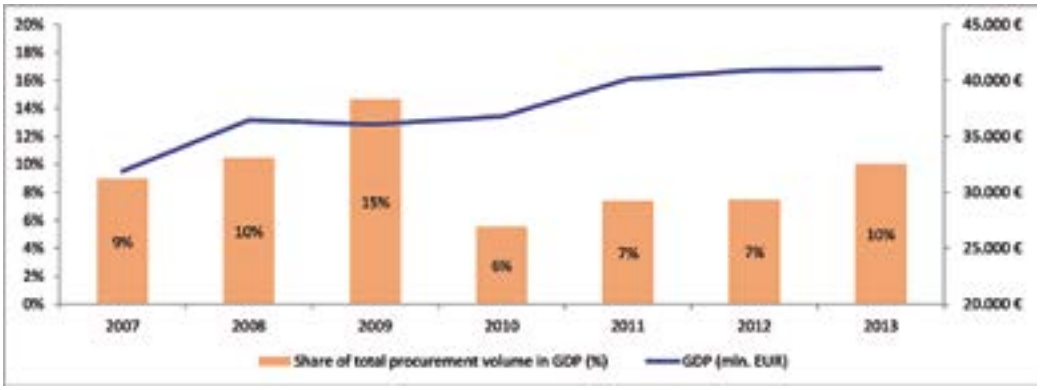
[3] There are different terms in the literature describing "construction works", such as "public works" or just "works". This paper uses the term "construction works" as this is the terminology used by the Bulgarian Public Procurement Agency. It is assumed that the construction sector has carried out the total value of the contracts classified by the PPA under "construction works".

[4] As of January 2015 the minimum thresholds, under which the application of the public procurement procedures prescribed by the *Law on Public Procurement* is not obligatory are: BGN 264,000 (app. € 142,254) for works and BGN 66,000 (app. € 35,564) for goods and services.

[5] The division between "conventional" and "sectoral" contracting authorities is used here as provided in the Bulgarian *Law on Public Procurement*.

[6] The authors have taken all due care to ensure that the provided data is comparable across years. No changes were detected in the reporting system or legislation, which might bias the comparability of the data over time. If not mentioned otherwise all PP data refers to values without VAT.

Figure 1. Share of the total public procurement volume to GDP in Bulgaria (2007- 2013)



Source: NPA, NSI, 2014

EU funds have been playing an increasingly important role in the public procurement market, providing for roughly a quarter of all public procurement announcements in 2013. This has added pressure on the Bulgarian authorities to spend funds at any cost before their eligibility period runs out, leading to spikes in EU funds' financed public procurement in the years 2009 and 2013. EU funds are disbursed at 7-year budget cycles (2007- 2013) under the so-called "n+2" rule, meaning that money has to be contracted at the latest by the year n (e.g. 2013) and invoiced by the year n+2 (e.g. 2015) or has to be returned to the EU budget. The European Commission's (EC) actions against Bulgaria have pointed out the continuing inability of the country to properly manage EU funds. In 2008, the EC forfeited €220 million from one national pre-accession programme, and froze EU funds earmarked for road infrastructure development in 2008 citing irregularities in the management of EU assistance programmes, and the lack of adequate systems of *ex-ante* and *ex-post* controls (Vachudova, 2009). The 2008 measures taken by the EC against Bulgaria were triggered by the uncovered conflicts of interest in the Road Infrastructure Fund, which had awarded tenders to companies controlled by relatives of its executive director at the time. The director was acquitted at first instance in April 2015, with the court ruling that the said contracts had not been signed by the head of the agency, but by its regional directors[7]. Problems seem to persist as the EC froze and subsequently unfroze EU funds for the country again in 2013- 2014[8].

After the first EU budget cycle for Bulgaria drew to an end in 2013, and financial penalties and corrections imposed by the European Commission started to increase, the government resorted to two practices which are likely to have increased corruption risks in this domain: covering withdrawn EU funds because of penalties and/or freezes with funds from the national budget, and over-contracting the available EU funds. In this manner the government wanted to guarantee that the whole amount of EU funds available to the country would be

[7] Bulgarian National Telvision. (30 April 2015) *Former Road Infrastructure Chief Acquitted in 'Big Brother And Brother' Case*. [WWW]. Available at: http://bnt.bg/en_news/former-road-infrastructure-chief-acquitted-in-big-brother-and-brother-case [Accessed July 1, 2015].

[8] Novinite.com. (4 December 2014), *EU Unfreezes Bulgaria's Blocked Funds for Regional Development*, [WWW]. Available at: http://www.novinite.com/articles/165213/EU+Unfreezes+Bulgaria%27s+Blocked+Funds+for+Regional+Development [Accesses 20 March 2015].

invoiced by 2015 even if some of the projects had delayed, not approved or altogether scraped by the EC (43rd National Assembly of the Republic of Bulgaria, 2014). This practice grants additional discretionary power to the government and the public administration as they get to decide, which projects (and respectively contracting authorities and contractors) receive national funds to compensate for the loss of EU subsidies, and which not.

The findings of the main control bodies of public procurement in Bulgaria – the Public Procurement Agency (PPA), the National Audit Office (NAO) and the Public Financial Inspection Agency (PFIA) – seem to confirm the existence of high risks of corruption in the procurement process given that the violations of the public procurement laws and procedures, according to PFIA, remain very high: In 2013 out of 2,333 checked contracts 918 were discovered to contain violations. The ex-ante control performed by the PPA on EU financed public procurement also showed a high number of violations. As of 2014 some 30% of the checked procedures were not fully compliant with the law. Progress reports under the Cooperation and Verification Mechanism (CVM)[9] (EC COM (2014) 36 final) of the EC underline that the ex-ante checks by the PPA are limited in scope, which raises questions as to their effectiveness. There are also doubts about the effective enforcement of rules and the application of sanctions.

Bulgaria has introduced an electronic database for all public procurement contracts in the country since 2006 to monitor and control the allocation of public funds. Although the register is constantly updated, the PPA refuses to make it public despite the fact that doing so involves only very low transaction costs. This, in turn, hinders the opportunities for better monitoring and policy advice. This decision also cases doubt on the adopted new legislative provisions for transparency from 2014, which establish two new platforms: an "E-Monitoring"[10] platform to collect, archive and ensure online access to awarding committee protocols, contracts and annexes, framework agreements, subcontracting documents, etc.; and an "E-Audit"[11] platform to allow physical persons and institutions to present, in a structured way, signals of deviation from the legal procedures established in the Bulgarian *Law on Public Procurement* (LPP) and in contract implementation (Markov M., Dimova E., Aleksandrov A., 2014).

At the same time the risks of corruption are exacerbated by the frequency and the high number of legislative changes introduced to the LPP citing EU legal approximation as the underlying reason. While the EU has enacted only two major changes in public procurement in the past decade, Bulgarian lawmakers have introduced a total of 27 sets of amendments to the public procurement law since 2005. The 2014 CVM report (EC COM(2014) 36 final) notes that in the area of public procurement, a complex and ever changing legislative framework has made it even more difficult to create a culture of objectivity and rigour. This confirms the observation that while EU accession apparently led to the creation of new legal constraints to corruption, its implementation remains problematic.

1.2. Key indicators of the Bulgarian construction sector

The share of the construction sector in the gross value added (GVA) of the Bulgarian economy averaged 7% in the 2007- 2013 period. Following the onset of the European economic

[9] The CVM was introduced by the EC for Bulgaria and Romania upon their accession to the EU for monitoring their progress in tackling corruption and organized crime, and on judicial reform to achieve EU justice an home affairs standards.

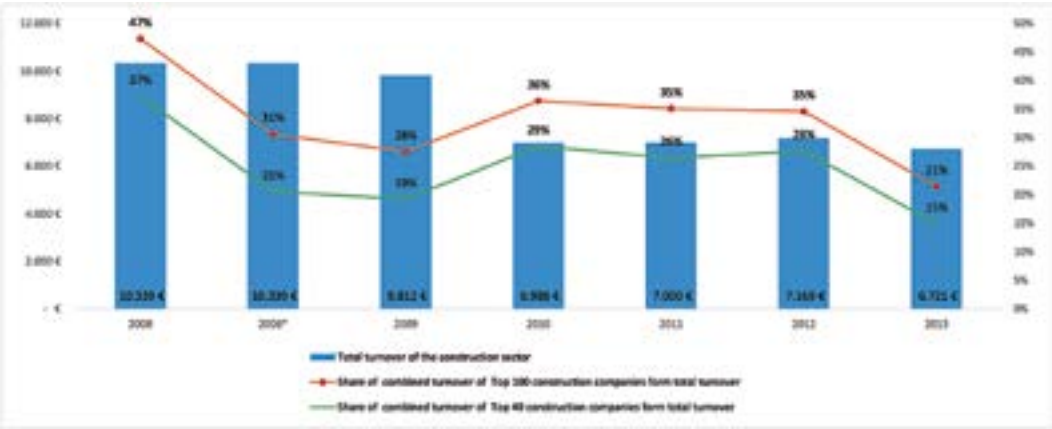
[10] Art. 126(a) LPP.

[11] Art. 126(b) LPP.

crisis, its turnover has slumped by more than 30%, compared to its peak in 2008, reducing the share of the sector in total GVA to 5% in 2013.[12] This has increased the dependence of construction companies, in particular larger ones, on public procurement contracts. By 2013 the number of active enterprises in the construction sector decreased by a fifth from when compared to its maximum level achieved in 2009.

Between 2008 and 2013, the top 100 construction companies[13] in Bulgaria concentrated on average 31% of the total turnover of the sector (see Figure 2). Less than 1% of the construction companies in the country have a combined average turnover of EUR 2.5 billion. The firm level analysis, based on a sample of the Top 40 construction companies (see Section 3.2.2. below), shows that they controlled 15% of the total turnover of the sector in 2013. While this does not seem like a high concentration rate, it certainly implies that there are not many construction companies in Bulgaria that can handle larger public procurement contracts.

Figure 2. Share of the Top 100 and Top 40 construction companies by turnover in the total turnover of the construction sector (2008 - 2013)



Note: In 2012 the Bulgarian government repealed the regulation on so called small public procurement (under certain threshold), which led to the inclusion of such contracts in the Public Procurement Registry, which diluted nominally the concentration of the sector.

Source: Eurostat, APIS, 2014; CSD calculations.

1.3. Public procurement trends in the Bulgarian construction sector

Both the number and value of public procurement contracts for construction works registered a significant increase between 2010 and 2013. Their numbers rose from 1,269 in 2010 to 2,561 in 2013. The respective increase in the total value was from €728 million to €2,105 million. The very low volume of public procurement of construction works in 2010 is attributable to the aftermath of the economic recession in Bulgaria and the subsequent tightening of fiscal policy. In 2011 and 2012 there has been a significant rise in the public procurement contracts in the construction sector. This increase is related to the rush for absorption of EU funds – for which 2013 was the last year before decommissioning them – and to higher pre-

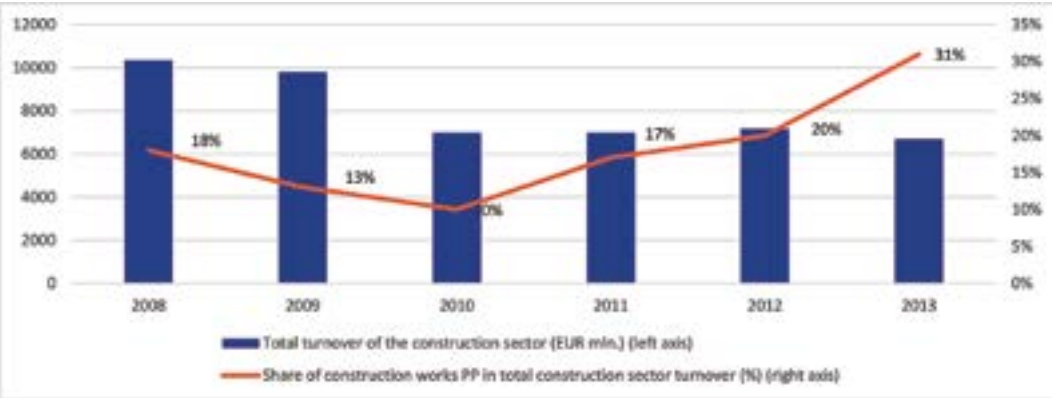
[12] Based on PPA and NSI data for the period 2007-2013.

[13] According to the National Classification of Economic Activities.

election spending and a fiscal loosening by the newly elected majority, following the parliamentary elections of May 2013.

In the 2010-2013 period, there was a clear trend of concentration of public procurement contracts in construction works vis-à-vis the supply of goods and services, and of larger value construction contracts. While in terms of numbers the share of the construction works contracts has remained relatively stable, their value as a share of total public procurement contracts has increased steadily to over 50% in 2013. This rising concentration of public procurement in construction works has been attributed entirely to the rise of large-scale construction projects[14]: construction works with values above €1.1 million have risen to 43% of the total public procurement value in Bulgaria. During this same period, the concentration of public procurement on the supply side coincided with an increase in the importance of public procurement for the construction sector or a concentration on the demand side too. In 2013 the total public procurement value for construction works reached 31% of the total construction sector turnover, transforming the public administration into the largest single customer of the industry (see Figure 3). The leverage power of the public administration over the resources available to construction companies increased substantially, which in the absence of higher deterrence to corruption, implied rising risks of corruption and/or favouritism.

Figure 3. Share of construction works public procurement in total construction sector turnover (2008 - 2013)



Source: PPA, 2014; CSD calculations

2. Detecting Corruption Risks in Public Procurement in Construction

So far the analyses of corruption risks in public procurement in Bulgaria have been primarily based on two traditional economic models: (a) the principal-agent model; and (b) the classical individual behavioural model, using case studies. These traditional models regard corruption as an individual trait, and as a deviation from the norm, which is typical for well-established western democracies. The classical models assume difference between the procurer, the winning company, and the controlling/law enforcement system. They are less helpful in

[14] The PPA uses the following thresholds for classifying the size of public procurement contracts in goods, services, and construction works in Bulgaria: EUR 0 - EUR 102,258; EUR 102,258 - EUR 1.1 mln.; above EUR 1.1 mln. The latter are considered large contracts and undergo a specific pre-screening by the PPA.

guiding anti-corruption reform policies in captured states and societies, in which corruption is still so widely spread that individuals believe it is the norm, which is the case in most new EU member-states, (Mungiu-Pippidi, 2011). Hence, governance-based models seem more appropriate for detecting corruption risks in Bulgaria as they view this phenomenon as stemming from a set of institutional characteristics, which either provide resources/opportunities for corruption or deterrents/constraints to control it (Mungiu-Pippidi, 2013). A paramount characteristic is the political embeddedness of certain firms, which are endogenous to the setting and implementation of the rules of the game, including the full procurement life cycle (from needs assessment and feasibility studies, to the drafting of ToRs, and to subsequent control). This is primarily due to the dysfunctional control, judicial and political systems, which do not prevent, disclose and prosecute shadowed conflict of interests. Studies suggest that the odds for a (politically) networked firm to influence laws are five times higher than a firm, which is not, and similarly wins more public contracts than the not connected (Yalamov, 2012). Grødeland (2006, 2007) reaches similar conclusions based on content analysis of in-depth interviews of elite groups in Bulgaria, Romania, Slovenia and the Czech Republic.

With its EU membership Bulgaria has shown its willingness to embark on a course towards open access order (or a good governance model), which EU funds and peer pressure from other EU members are supposed to help bring along faster. However, the majority of international and national assessments concur that Bulgaria's distribution of resources remains particularistic, with citizens perceiving corruption as the norm, which has impacted the very mechanisms meant to curtail it, such as the EU funds (Stoyanov, Stefanov, and Velcheva, 2014).

We use two firm-level data-bases to map the frequency of occurrence of the most important red flag capturing the probability of government favouritism occurring in public procurement (particularistic distribution of resources) – single bidding (Fazekas, Toth, & King, 2013). We identify the companies in the two databases, which are likely to be politically connected through media content analysis and expert interviews. Then, we test how politically connected companies fair in single bidding procedures vis-à-vis non-connected ones in EU and nationally financed public procurement to detect corruption risks.

2.1. Data and methodological note

The firm-level analysis presented in this paper is based on two datasets – first, a database with 4928 procurement contracts between 2009 and 2014 from the TED structured dataset (TED, 2008-2014) and second, a manually constructed database using a sample of the Top 40 construction companies, ranked according to their total turnover for the period of 2008-2013[15].

The TED based dataset includes records with primary or additional CPV codes 44, 45 and 71[16], and was further cleaned to allow higher reliability and validity of data for subsequent hypothesis testing. Identification data for contracting authority (CAE) and winning entity include name, national identification number, and address. The recoding lead to a reduction of the 475 different contracting authorities, available in the original database, down to 300 organizationally independent contracting authorities, as for example some organisations were

[15] Despite repeated requests under the Access to Public Information Act and the sending of several official letters for obtaining specific indicators for all public procurement contracts in the construction sector, the Bulgarian Public Procurement Agency (PPA) has not responded, and has effectively refused to provide the requested information.

[16] These three CPV codes relate most closely to construction. They have been used also in other ANTICORRP analyses, see Fazekas, M., Toth, 2014.

present with more than one branch. Similarly, in terms of winning entities in the original database there were 3573 unique names, which were reduced to 2321 unique entities[17].

The Top 40 database includes information on the number of public procurement contracts for construction works, awarded to the selected companies, based on CPV codes 44, 45 and 71. The data was manually extracted from the Public Procurement Registry based on the companies' national identification number. For a more comprehensive analysis firm level data encompasses the construction procurement contracts for public works awarded to third companies (hereafter referred to as linked companies), in which the selected sample of Top 40 firms have equity ownership. The value of each public procurement contract, awarded to a linked company is recalculated depending on the percentage of ownership of the respective primary company included in the sample. Other (softer) types of dependency between Top 40 construction companies and third parties (e.g. participation in the board of directors or similar governance structures) are not considered.

The variable for political connectedness was constructed on the basis of screening of the Top 7 and Top 40 companies, and the top 40 most-frequent contractors in the TED database by a) media content analysis and b) a panel of experts in corruption, state capture and construction. We consider a company to be connected not just when there were media articles on this, but when there were solid family, corporate or party ties between the owners of the company and mayors, ministers or the respective municipal council chairs according to long-term media reports originating from competing media outlets, and/or when more than two experts agreed on that. The process resulted in a total of 35 companies (including linked through capital control) that are direct contractors in public procurement in the TED database and 126 consortiums between some of those 35 companies and others[18]. The variable is named POLITIC coded with 1 if connected and 0 if not (see section 3.2.1. below). The way the variable is constructed implies that it measures only the strongest connectivity, without accounting for smaller, locally or more loosely connected companies.

2.2. Economic dependencies and corruption risks in the Bulgarian construction sector: firm level analysis of public procurement

2.2.1. Single bidding as an indicator of corruption risks

Public procurement with single bidding is a serious red-flag for corruption due to at least two factors: a) entry barriers – contracting authorities may have designed such tender specifications especially for a specific company or a combination of companies (which is more often the case) – and b) political embeddedness, i.e. tacit knowledge and relationships that allow politically connected firms to bid in tenders with difficult or impossible requirements that will later be amended or ignored through low implementation controls. Large sized contracts usually facilitate single bidding, as larger bids might have explicitly high thresholds that can be met only by a reduced number of companies, usually the biggest ones. Thus, once you are "in" the market of public procurement, you have privileges against the others. We will look for the effect on single bidding of European funding (contracts with EU funding) and of political embeddedness.

[17] We consider the 2321 entries as relatively independent centers. But some 41% of them were consortiums of more than one company, which sometimes have different capital control relationships to the individual winners elsewhere in the database. The next step and case for further research would be to decompose the winners to ultimate beneficial owners and their decision making power.

[18] The list could be obtained by the authors for academic purposes only.

We tested altogether eleven models of competitive versus single bidding using the TED database: one on the whole database, four per quartile of size of contracts, one only with national contracts (all reported in Table 1) and four more to compare the odds for single bidding over time (2009-2011 and 2012-2014) and by funding source (all contracts and only national), and one to account for the effect of the contract size directly. Single-bidding in construction gradually decreased over time from 27% in 2009 to 17% in 2014.

In the main model (Model 0) our two independent variables, EU funding and political connections (which are not correlated to one another) show a statistically significantly impact (p=0.000) on our dependent variable, i.e. competitive bidding (coded 1 for competitive bids and 0 for single bidding). The positive coefficient for EU funding means that this variable fosters competition, while the negative coefficient for political connection means that its existence reduces competition. If only nationally funded contracts are considered, the political connectedness increases the odds of single bidding (Model 5).

Models 1-4 divide the contracts included in the database into quartiles according to their size and show that although the size of the contract (especially if in the top quartile) contributes to single bidding, and is statistically significant (p=0.006), the correlation, albeit weak, (r=0.043) between the number of offers provided and the size of contracts and the existence of EU funding counteracts this relationship. The average public procurement contract with EU funding is 3.6 times bigger than the average nationally funded contract. The positive impact of EU funding could be seen in Model 1, where the odds for competition are highest among all models and even political connections are not statistically linked to single bidding. This is most probably possible because of the close EU monitoring of larger EU projects. As the size of the projects goes down, the monitoring is weaker and political influence increases (in Model 4 it is the only statistically significant variable).

Table 1. Binary logistical models explaining single bidding

Dependent variable: Single bidding												
	Model 0 All contracts		Model 1 Top quartile		Model 2 Second quartile		Model 3 Third quartile		Model 4 Lowest quartile		National funding	
Independent variables	B sig	EXP (B)	B sig	EXP (B)	B Sig	EXP (B)	B sig	EXP (B)	B sig	EXP (B)	B sig	EXP (B)
EU funding	0.746 (0.000)	2.108	1.317 (0.000)	3.732	0.607 (0.002)	1.835	0.681 (0.004)	1.975	-0.160 (0.496)	0.852		
Political connection	-0.80 (0.000)	0.449	0.250 (0.245)	1.284	-0.907 (0.000)	0.404	-1.919 (0.000)	0.147	-1.493 (0.000)	0.225	-1.001 (0.000)	0.368
Constant	1.544 (0.000)	4.681	0.807 (0.000)	2.241	1.731 (0.000)	5.647	1.828	6.223	1.863 (0.000)	6.441	1.577 (0.000)	4.841
Observations	4876		1006		1006		1010		1013		3345	
Pseudo R^2 Cox and Snell Nagelkerke	0.024 0.041		0.063 0.100		0.024 0.045		0.064 0.112		0.030 0.052		0.020 0.032	

*Notes: Unstandardized and exponential coefficients provided, standard error in parenthesis. *** p<0.01, ** p<0.05, * p<0.10. The observations in models 1 to 4 do not sum up to total observations in model 0 due to missing information on size of contracts in some cases.*
Source: Authors' calculations based on TED, 2015 extraction.

In the 2012- 2014 model of competitive bidding the contribution of EU funds to competition measured by the exponential coefficient increased by 55% from 1.574 in the 2009-2011 model to 2.44. Simultaneously, the role of political connectedness decreased by 31%. This seems to be entirely due to the higher control over European funds management procedures (including limiting the practice of eliminating competition through administrative tricks leading to single bid opening), which share has increased in overall public procurement. If we consider only the nationally funded projects, then the single bidding situation with political connectedness deteriorated by 32% in the last three years compared to the first period, signifying increasing corruption risks.

Competition in bidding can be analysed from two more perspectives – one is that of companies, which engage in single bidding, and the second is that of contracting authorities, which procure through single bids. Slightly above a fifth of all winning entities have been engaged at least once in a single bidding tender. Out of them a privileged share of 59% have been winning only single-bidding tenders, and 76% have won more than half of their bids as single-bidders. Single bidders are domestic firms or consortiums dominated by domestic firms (with the notable exception in the field of energy where foreign companies dominate); they are linked to one contracting authority – 66% of single bidders work with only one CAE; and on average they get 85% from their total procurement turnover from a single CAE.

Common sense has it that corruption risks increase with lower competition or with lower diversification of procurement contracts to different contractors. While, there might be highly specialized tenders, which legitimately call for limited competition, it is unlikely that contracting authorities will always run such specialised construction procurement, in particular as the market deepens and CAEs experience grows. Hence, we built the Herfindahl-Hirsch index of concentration for CAEs based on relative shares of contractors. And there is a statistically higher average concentration for CAEs weighted through the contracts for single-bidding (index=0.32) compared to two or more bids (index=0.24), with level of significance p=0.000. Pearson correlation between the number of offers per contract and the associated concentration of CAE is low (r=-0.134), but significant (p=0.000), and suggests, as expected, that the higher the competition (at the stage of offers), the lower the concentration (at the stage of implementation). Other things being equal lower concentration should mean lower prices. This result suggests that reducing single bidding is a valuable policy option, which could lead to competition and public funds savings. The TED database does not contain information on how many bidders were found non-eligible due to the bidding requirements, hence competitive procurement bids (seen at the time of submission of offers) might turn out to be single bids (at the end) due to administrative issues and subject to discretion of the procurement committee. Although policy-makers could not artificially create more competition they are advised to limit administrative discretionary power to reject bidders the right to propose offers.

At the same time, correlation analysis on the side of contractors suggests that the higher the frequency of single bidding, the higher the number of awards per company (r=0.998, p=0.000, R^2=0.996). This implies very high efficiency of single-bidders. Many CAEs are highly dependent on one contractor – 28% of all CAEs had a single procurement partner in construction during 2009-2014, and 70% had a single contractor responsible for more than 50% of the spending on construction by the respective CAE. Such CAEs would be considered as "captured" (Doroftei & Dimulescu, 2015). We tested this model for captured agencies, using two measures of capture: first is a dichotomous divide between those contracting entities, which have a single contractor that received more than 50% of all procure-

ment funds ("captured") and all others ("uncaptured"); and second, a continuous measure of the concentration index for CAE. Table 2 shows the two models using the different capture measurements. The first uses binary logistic regression with dependent variable being the dichotomous variable used by Doroftei and Dimulescu (2015) and the second using linear regression. The data suggests that political connectedness is not significant and does not explain the "capturing" of the agency, while it does contribute to the concentration index. It seems that the rationale why this is so could lie in the specifics of the CAEs and suggests that the threshold of 50% for one company is too broad (70% of contractors labelled as captured) but also because capturing in Bulgaria often follows a different (more coalitional) pattern compared to Romania. We tested if specialised winners (measured through the concentration index based on shares of contracts with different contracting authorities) would tend to work with captured contracting authorities. The test was negative. This also confirms the coalitional capture model where politically connected firms would join forces with each other and sometimes with non-connected firms to obtain procurement contracts from highly concentrated contracting authorities (41% of all contracts are with consortiums).

Table 2. Analysis of diversification of CAE partners in procurement

Dependent variable	Agency capture (binary logistic)		Concentration of CAE (linear regression)		
Independent variables	B sig	EXP (B)	B sig	STAND (B)	T
Single bidding	-0.586 (0.000)	0.556	-0.078 (0.000)	-0.114	-7.961
Political connection	0.185 (0.065)	1.203	0.036 (0.002)	0.045	3.154
Concentration of winner	-0.140 (0.167)	0.869	0.13 (0.243)	0.17	1.168
Constant	0.056 (0.753)	1.058	0.383 (0.000)	2.241	18.331
Pseudo R^2 Cox and Snell Nagelkerke	0.011 0.017		R =0.129 R^2=0.17 Adjusted R^2=0.16 ANOVA F=27.436		

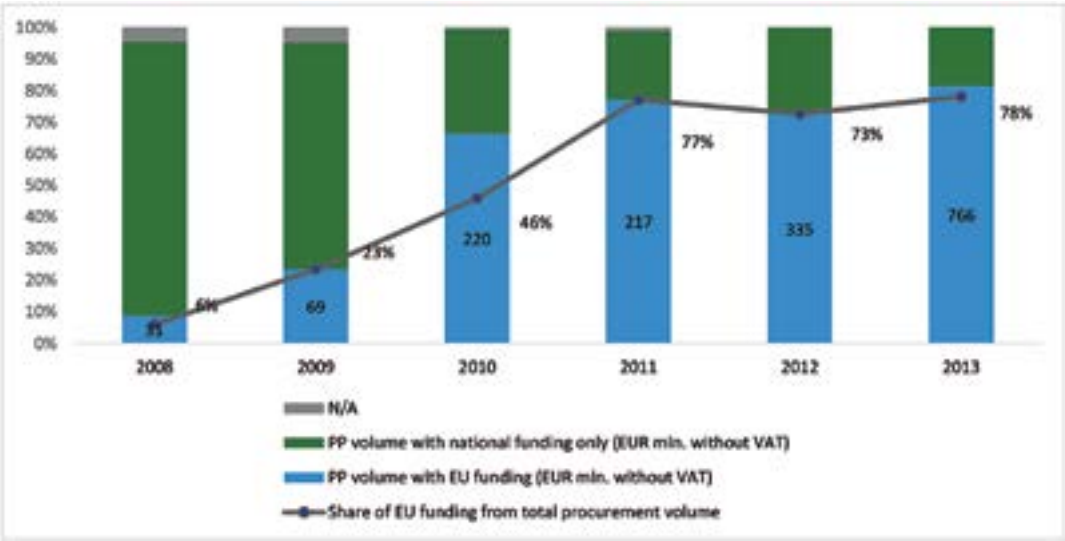
Source: Authors' calculations based on TED, 2015 extraction.

2.2.2. The Top 40 construction companies: analysis of performance and corruption risks

Concentration of public procurement is also visible at below sector levels. The top 40 procurement winners from TED database account for 62% of the total procurement volume in construction. Four companies account for 23% of all TED records and the list of top 40 companies compiled by the authors controlled 23% of the total value of the public procurement market in Bulgaria, which was more than double their share compared to 2008, the last year before the European economic crisis. After the crisis began, EU funding replaced national funding in large-scale public procurement of construction works (see Figure 4), which, according to the single bidding analysis of the TED database presented above, would have been expected to reduce the risks of corruption. However, other things being equal, with the rise of

the EU funding share in their turnover, one can expect incumbent companies to become more accustomed to the rules governing EU funding and gaining the confidence to try and find ways of capturing EU funds in similar ways as they did with the national ones.

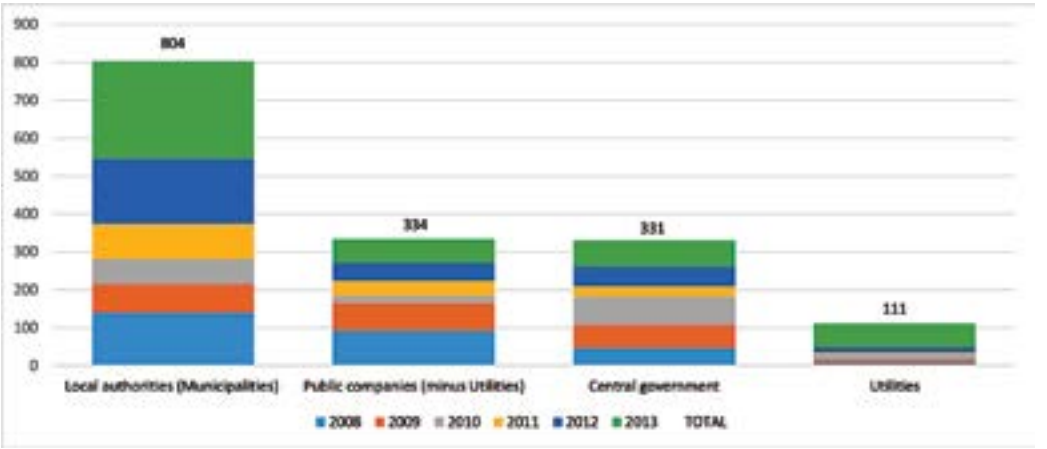
Figure 4. Weight of the EU funding in the public procurement market value of the top 40 construction companies*



*Source: PPA, CSD calculations; * excluding duplicates, i.e. large scale public procurement contracts, in which two companies from the selected sample took part.*

There are also other emerging governance problems likely to dim the better performance of EU funds in terms of less corruption risks than national funds. In the period of 2011-2013 the share of municipalities among the contracting authorities with EU funds increased steadily (see Figure 5). Bearing in mind that most Bulgarian municipalities depend on the central budget for financing their operations, they are unlikely to be able to cover for any financial corrections imposed by the EC or national authorities on their EU projects. There have already been cases reported in the media that financial corrections on EU funded projects imposed by the EC and/or delays in reimbursement of funds have led to the deterioration of the financial viability, and have even triggered insolvency procedures, of smaller municipalities. This is turn has made them even more dependent on central budget subsidies to keep their functions going.

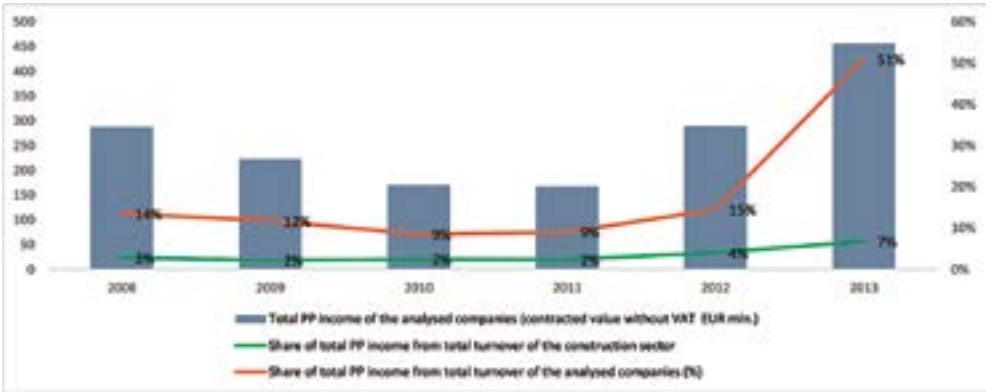
Figure 5. Type of contracting authorities, which have awarded public procurement contracts to the top 40 construction companies (EUR mln. without VAT)



Source: PPA, CSD calculations.

The Top 40 construction companies have grown increasingly dependent on public procurement for their turnover in the period of 2008-2013 (see Figure 6). This implies an increase in their motivation to apply pressure on the public administration to secure such contracts. The stagnation in the private construction market has, on the other hand, empowered the public administration to influence the profits of the construction companies, which has in turn provided it with additional leverage to extract corrupt payments. Extracting rents from this concentration can take very different forms. For example, provided the overall inefficiency of administrative control over the implementation of mushrooming infrastructure projects in Bulgaria, companies can more easily lower quality standards, thus both saving money and creating artificial demand for their services in the future, as badly built infrastructure deteriorates at faster rates. The country might in this manner drag itself into an infrastructure trap, maintaining high infrastructure expenditures as a share of GDP, yet continuously lagging behind average European levels in terms of both quality and quantity (CSD, 2009).

Figure 6. Share of public procurement revenue from construction works in the total turnover of the top 40 construction companies (2008- 2013)

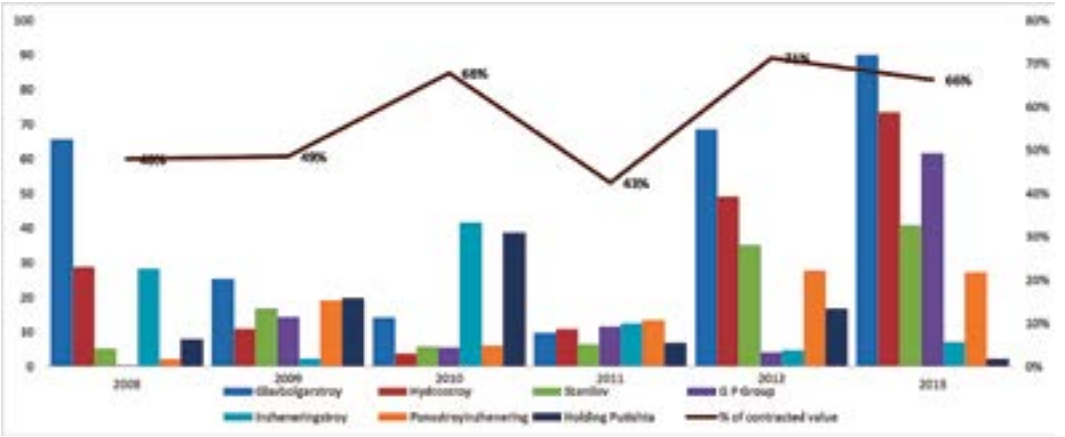


Source, PPR, Commercial registry, CSD calculations

The analysis of the data demonstrates that the Top 7 construction companies in terms of awarded public contracts commanded more than two-thirds of the public procurement contracts for construction awarded to the Top 40 companies. The top seven companies move significantly above the average Top 40 sample values, both in terms of number of contracts awarded and, especially, with regard to overall contracted value (see Figure 7).

The data from the Top 40 revealed slightly lowered average ratio between forecasted and contracted prices. This coupled with the limited number of restricted tenders and the competitive number of offers (5 on average) indicate higher levels of competition among companies for winning public procurement contracts, which is also associated with higher leverage on the side of the public administration, as its monopsony power rises. Hence, other things being equal, the opportunities for rent seeking have increased on the part of the administration, while they have decreased on the part of the participating companies, potentially producing a better overall outcome for society compared to the situation prior to the economic crisis.

Figure 7. Public procurement revenue from construction works of the top 7 construction companies (EUR mln. left axis) and their share in top 40 construction companies' public procurement revenue (right axis) (2008 - 2013)



Source: PPR, Commercial registry, CSD calculations

The Top 7 construction companies have seen relatively stable performance vis-à-vis government changes. However, market concentration has been visible even there with three of the Top 7 (Hydrostroy, GP Group, and Stanilov in this order) being the biggest gainers in the 2010- 2013 political period (right of centre minority government) compared to the 2008- 2009 period (centre-left coalition government). While the conclusions might deserve reasonable doubt based on various issues with available data, cases of big road and energy infrastructure development projects have demonstrated that political patronage continues to play a major role in winning larger public procurement contracts and contracts funded by the national budget in Bulgaria (CSD, 2012).

We have further analysed the political connectedness of the Top 7 Bulgarian construction sector companies for the period 2008-2013, ranked by total value of public procurement revenue, via content analysis of electronic media articles. While the resulting data set was not sufficient to perform a comprehensive statistical analysis, some noteworthy patterns of political con-

nectedness related to corruption risks have emerged. It seems that the largest infrastructure companies in Bulgaria are likely to try to have good connections to all ruling parties at any given government. This is related to constant "revolving door" practices, with former managers of state-owned construction companies becoming owners after privatisation, then moving into the public sector, only to return to the private sector, depending on the position of their party patrons. One of the more prominent cases in the media is that of Hydrostroy-Varna. During the socialist-led coalition government of 2005-2009 the company`s director served as a senior advisor to the Minister of Regional Development. The firm`s director used to be in charge of the road administration during the term of the previous centrist government of 2001-2005 and managed one of the biggest public construction companies in the Notheast Bulgaria (Inzhstroyinzhenering) before its privatization in 1999. With the shift of political power in 2009 towards a right of centre government the said director appointed a member of the new ruling party and of the Varna Municipal Council as CEO of the company.

CONCLUSION AND RECOMMENDATIONS

Public procurement in Bulgaria remains trapped in the wider governance problems of the country, which still display the main features of a particularistic regime. Declining private sector opportunities in the wake of the Eurozone crisis in 2009 and the rising pressure on the Bulgarian authorities to deliver full EU funds absorption by the end of the EU funding cycle in 2013 have led to concentration of public procurement resources and market leverage in the public administration. Construction works have continuously increased their share in total public procurement of the country, and their importance for construction companies' turnover further contributing to higher corruption risks. The main counterbalancing trend has been associated with the steady rise in EU financing in the procurement of construction works, associated with more and better controls. The implementation of the Bulgarian legal public procurement framework remains haphazard and riddled with corruption risks, and changes in the legislation remain frequent. Limitations exist in terms of capacity and effectiveness of the controlling authorities of the procurement system. Detected violations are also high, hinting at the lack of proper preventive capacity.

The firm level analysis of public procurement contracts from the TED database using single bidding as a proxy for corruption risk has shown that EU funds contribute to higher competition and national funds tend to increase the negative impact of political connectedness of the construction companies. This effect of the EU funds recedes as the tenders' size decreases. In-depth analysis of contracts to the Top 40 construction sector companies introduced in this paper confirms the trend of concentration of the public procurement contracts to the Top 7 companies. The data does not confidently project specific type of favouritism (i.e. conflict of interests, endogenous lobbying, etc.) but suggests that some companies' performance in securing public contracts is more linked the government in office than to performance.

The public procurement process cannot be decoupled from the overall progress in transition from particularistic to an open access or good governance regime in Bulgaria. First and foremost, the country needs to tackle its endemic lack of trust of citizens in public institutions through strengthened law enforcement in particular as concerns higher level, political corruption. Simultaneously, the government of the country and its European partners can work to reduce the opportunities and increase constraints to corruption in public procurement in the construction/infrastructure sector through adopting several groups of tools:

1. Discontinue the practice of awarding single public procurement contracts worth more than a certain threshold, which is aligned with the current management capacity of contracting authorities; a reasonable approach would be to limit single tender procedures to 5% of the average annual total public procurement market value for the past three years. Investigate long-standing single bidding practices of certain contracting authorities;

2. Optimize the legal framework towards increased transparency and competition in public procurement trough the more aggressive introduction of e-tools;

3. Enhance the effectiveness of legal remedy and control mechanisms, as well as more active prevention of market concentration;

4. Strengthen the administrative capacity and more stringent requirements to the professional ethics of the responsible officials in the contracting authorities;

5. Increase the effectiveness of criminal prosecution, in particular in cases involving larger public financial resources;

6. Introduce effective control over the property and income affidavits submitted by senior officials but also over conflicts of interest, which might hint at more subtle forms of corruption such as favouritism;

7. Optimize the legal framework regulating the financing of political parties and election campaigns, including independent candidates and lobbying to include non-monetary contributions such as employment, hidden subsidies, etc.

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The fundamental purpose of ANTICORRP is to investigate and explain the factors that promote or hinder the development of effective anti-corruption policies and impartial government institutions. A central issue is how policy responses can be tailored to deal effectively with various forms of corruption. Through this approach ANTICORRP seeks to advance the knowledge on how corruption can be curbed in Europe and elsewhere. Special emphasis is laid on the agency of different state and non-state actors to contribute to building good governance.

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