

Bulgaria and EU Fraud: A Case of Better Late Than Never?

Brendan Quirke¹ & Alan Doig²

Abstract

Bulgaria joined the European Union along with its neighbour Romania in January 2007. Before she joined there were widespread concerns about rampant corruption and the power of organised criminal networks. The transition from communism to capitalism and democracy has proved problematic with many examples of corrupt behaviour both in the privatisation process and in other areas of economic life and society. Bulgaria has received a massive amount of financial aid, yet in some ways she was ill-prepared for membership and the management of such large sums of money. There have been delays in the establishment of the AFCOS (Anti-Fraud Coordinating Service³) structure that all candidate states have to have in place before accession and the position of AFCOS has been affected by in-fighting over its position in the bureaucracy. Serious reservations were expressed by the European Commission in 2008 regarding the management of EU funds and the level of fraud and corruption. Yet there are examples of good co-operation between AFCOS and OLAF and Bulgaria is trying to put her house in some kind of order. Whether she will be successful, remains to be seen?

¹ Senior Lecturer in Accounting & Finance, Liverpool John Moores University, UK

² Visiting Professor in Public Service Management, Liverpool John Moores University, UK

³ Responsible for coordinating the legal, administrative and operational aspects necessary for protecting EU financial interest in a specific country.

Introduction

In 2008 and 2009, the European Commission published highly-critical reports on the progress Romania and Bulgaria had made to address corruption. The reports on Bulgaria acknowledged progress but stated that ‘these steps are confined to the technical level and have limited impact. While increased overall awareness and these individual initiatives are to be welcomed, they are not adequately backed up by a broad political consensus or a convincing strategy to make the fight against organised crime and corruption the top priority for Bulgaria’.⁴

The purpose of this chapter is to consider the experience of Bulgaria in working to establish and strengthen anti-EU fraud structures and measures, the problems she has encountered and how she sought to overcome them as well as any wider lessons that can be drawn for prospective entrants to this club called the EU. Perhaps it is not exclusive as it once was, but is still courted by a number of countries which are desperate to join such as Croatia, Serbia, Bosnia, Turkey, Macedonia and so on.

The methodology employed was a review of secondary materials such as European Union reports, academic articles and semi-structured interviews with four Bulgarian government officials as well as one official from OLAF – the European anti-fraud office. The interviews lasted eight hours in total and were not tape recorded.

The Developmental Context

Bulgaria joined the European Union in January 2007 along with its neighbour Romania. Like many of the countries which joined when the big expansion of the EU occurred in 2004, it had made a rapid transformation from what was widely regarded as a particularly oppressive

⁴ Commission Of The European Communities. (2009). *Report From The Commission To The European Parliament And The Council On Progress In Bulgaria Under The Co-Operation And Verification Mechanism*. Com(2009) 402 Final. Luxembourg. pp6-7.

communist dictatorship presided over by Todor Zhikov to a democratic market economy within a very short period of time.

On the other hand, there were a number of emerging fault-lines, identifiable from the move from one to the other, with the imperative to replace the planned economy with the discipline of the market not been matched sufficiently quickly by the checks and balances of a comprehensive legal and regulatory system. This immediate institutional vacuum has been successfully filled by organised crime (with some 17,000 employees of the Ministry of the Interior forced to resign and using their past contacts and access to classified economic intelligence, thus creating opportunities as security and business consultants and as protection racketeers, and members of the former party elite who clearly used the reform programme to capitalise on the privatisation process through sweetheart deals with private contractors and also through fraudulent import-export schemes creating smuggling networks, primarily for cigarettes⁵).

Much of the fault lies with the EU itself. While it has been described as a club and just as with any club there are rules that members have to abide by, and it might be reasonable to assume that new members also want to create a favourable impression and make a positive contribution, the hurried accession process allowed both sides to fail to take full stock of continuing problems. Certainly, and unlike the process with the Baltic states, the Bulgaria accession process was more driven by the EC's own imperatives than the readiness of the countries involved. The process also appeared to be predicated on assumptions that membership would initiate the reform processes and that the pre-and post-accession initiatives it funded would be tailored to meet the existing conditions and thus secure the necessary legislative and institutional changes. This requires support from existing members

⁵ Drawn from Watt, D. (1998). *Country Visit Report 7: Bulgaria*. Liverpool: Liverpool JM University Corruption Project Research Study (unpublished).

and the senior members of the club. The paper will attempt to consider the kind of support Bulgaria received in the time leading up to accession and since she acceded.

Since accession, Bulgaria has been subjected to many scare stories in the press and media and beyond about the level of corruption in the country and whether this would lead to a widespread misuse of EU funds and officials of newly arrived member states have not been too complimentary about the country and its efforts to build up effective anti-fraud structures - “anti-fraud structures look okay on paper, but the reality will be somewhat different”⁶. OLAF too, has acknowledged difficulties in the relationship with Bulgaria in the first year of membership⁷

One consequence is that fraud and corruption take on a different complexion than in many other countries, and especially about the power of organised criminal gangs and their links to politicians and law enforcement. This complexion is reflected in the various international indicators where, although Bulgaria scores relatively low on the Transparency International’s Perceptions of Corruption Index (CPI) but is ranked as ‘strong’ in terms of anti-corruption by Global Integrity’s International Index (Bulgaria has a score of 87) and appears to be more effective at controlling corruption than many of its neighbours (the World Bank Institute places Bulgaria ahead of Romania, Serbia, Albania, etc). On the other hand, media reports very much reflect the GRECO reviews which, while arguing that Bulgaria has taken ‘adequate’ steps to address corruption in ministries, remains concerned at the lack of progress to address money-laundering, proceeds of crime and the other issues that surround corruption, organised crime, and so on.

Thus, while Bulgaria has done everything asked of it by the European Union in terms of adopting international anti-corruption protocols and in terms of strengthening its anti-

⁶ Interview with Maltese officials 2007

⁷ Interview with OLAF official 2007

corruption and repressive institutions, the question remains to be asked: is Bulgaria being asked to reach – and reach quickly - a standard that few of the established member states reach, or which took them many years and a significant investment to achieve? Is this a case of stable doors slamming as consequence of a hasty accession process or is it a case of political necessity with the desire and even need to reassure domestic audiences in Western Europe that a tough line is being taken with so-called “corrupt” member countries in relation to EU funds?

As Quirke (2009) observes, it would not be feasible, nor would it be sensible or appropriate to study the phenomenon of the misuse of EU funds in isolation. For a more comprehensive understanding, one has to consider the broader political, social, economic, historical and cultural context within which it operates (Scheinost, 2006). These influences have coloured and affected Bulgaria and its journey and progress from a hard-line communist country to a democratic member of the European Union.

The country still appears to have retained its enthusiasm for membership of the European Union, if public opinion surveys are anything to go by. In 2010, a survey by Eurobarometer quoted in a Europa Press Release noted that 61% of Bulgarians favoured Bulgaria’s membership of the EU⁸. Admittedly, there has been a decline from the 71% of people who favoured membership in 2005⁹ (although this was before Bulgaria had joined the EU when expectations were probably very high), but both surveys indicated a higher level of support for EU membership than the 1998 survey quoted in a European Parliament Briefing document when it stood at 57%.¹⁰ Anecdotal evidence gathered from the citizens of Sofia

⁸ www.europa.eu/Eurobarometer - EU Citizens favour stronger economic governance, Spring 2010 accessed on October 9th, 2010

⁹ www.eurarchiv.eu – Bulgaria to hold referendum on EU membership, 7th January 2005, accessed on October 9th, 2010

¹⁰ European Parliament Briefing No.41 – Public Opinion on Enlargement in the EU Member States and Applicant Countries, 1998

who included waitresses, waiters and taxi drivers by the author, appears to indicate that there is a wide degree of support from individuals who are by no means members of the political and economic elites¹¹. There are believed to be great benefits for the country both economically and politically by being members of the EU. There is a widespread belief that membership will enhance the country's economy, its infrastructure will improve due to help from the EU's structural funds and Bulgaria's influence in the world will be enhanced by being a member of a grouping which is a global player in international affairs. As Quirke (2008) observes, this support for EU membership can be compared with the experience of the Czech Republic where the initial enthusiasm for EU membership soon wore off and was replaced by a more Euro-sceptic attitude towards Brussels.

Quirke (2008) has observed before that, in seeking to understand any form of economic crime such as EU fraud, it is essential to understand the norms and mores that operate within a given society. As Krastev (2002) outlines, corruption in Bulgaria is not a new phenomenon. He explains how Bulgaria's political history over the last one hundred years or so demonstrates that there have been many attempts to pursue anti-corruption policies, but these have invariably led to more state regulation and these have in his view been anti-market and anti-liberal. He quotes the example of the Zveno political circle which was a political organisation that established a dictatorial regime in Bulgaria in 1934-35. This regime attempted to respond to widespread public disgust and disillusionment with a political and economic environment which was described by the press of the time as: 'totally corrupt'. It implemented a crackdown that was based on total state interference in public and political life. Krastev (2002) believes that this demonstrates that the tradition in Bulgaria is to fight corruption with more state regulation and more administration.

¹¹ Interviews with Bulgarian citizens 2010

Under the Communist regime of Todor Zhivkov from 1954 to 1989, nepotism was widely practised. He promoted his daughter to a senior position in the Communist Party and membership of the politburo, his son also rose to a senior position in the Party, his son-in-law became head of the State airline and Chairman of the Olympic Committee. Party members received access to luxury goods through the state shop Corecon as well as holidays on the Black Sea and privileged accommodation. For those who were not members of the political elite or did not have strong connections to it, the harshness and privations of daily life meant having to engage in the bribery of state officials in order to get a better apartment or better job or to get your children into a better school. Giatzidis (2004) comments that corruption under the communist regime concentrated mainly at the individual level, being the result of the individual citizen's dependence on officials. The rigidity of the communist system and the functioning of state bureaucracy gave officials the opportunity to exploit their position for private gain. According to a 1991 national survey quoted by Chavdarova (2001), the giving and taking of bribes was spread among 30% of the population under the Communist regime. Chavdarova (2001, p.11) believes that bribery was fostered mainly by: *'omnipresent deficits, nepotism and the privileges enjoyed by virtue of party membership. Corruption was an outgrowth of the individual citizen's dependence on officials and offices'*.

Barnes (2007) considers that the Bulgarian Communist Party and its leader Todor Zhivkov were unashamedly opposed to Mikhail Gorbachev's reforms in the Soviet Union in the late 1980's. This opposition was a cause of the fall of his regime and the decision to rename the Communist Party as the Bulgarian Socialist Party. Barnes (2007) points out that behind the appearance of inertia, changes had been underway for several years that would undermine any post-Communist Bulgarian government's ability to shape the political economy. These changes also sowed the seeds for the "smash and grab" capitalism of the post communist transition in the 1990's. Barnes (2007) explains how the growth of an economic

conglomerate – ‘Multigrup’ was aided by its patron Andrei Lukanov who served in the foreign trade ministry in the Zhivkov era. Lukanov helped prepare Bulgaria’s regulations governing economic liberalisation in the late 1980’s and these rules had sufficient loopholes for Multigrup to exploit and amass great wealth through: ‘arbitrage, smuggling and money laundering’ (Barnes 2007, p.76).

At the same time from a position of a command economy which was totally controlled by the state, state control of the banking sector also began to weaken and in Barnes (2007) view this enabled well connected actors to siphon resources from the state. From a position of a single bank controlling the regulation of the money supply and acting as a creditor for industrial and commercial enterprises, the banking sector became a collection of poorly monitored banks which were owned by former ministries which often had 80% of their assets tied up in one firm and could “blackmail” the central bank for refinancing aid, since they could claim that allowing them to fail would cause irreparable damage to an entire sector of a local economy (Barnes, 2007). So as communism started to fade and fail there were emerging conglomerates developing methods to transfer state assets to their own control. Elites had a nose for a good business opportunity in order to prepare themselves for the free for all of the post communist era.

From the commentary provided by both Barnes (2007) and Chavdarova (2001), one can see that although corruption did not start with Bulgaria’s transition from a communist to a democratic state, the change to a democratic system did create new opportunities for corruption. Ghitescu’s (2006: 44) observations about Romania could equally apply to Bulgaria after the Communist Part was pushed from power: *“it did not take long until a number of people identified the lack of legal regulations in certain areas – such as banking, commerce, foreign trade and so on – and started to exploit this vacuum for their own benefit”*. An environment in Bulgaria was created which was similar to its neighbour

Romania, where as Henshaw (2006) observes that institutionalised theft became the norm rather than the exception.

An area that was heavily exploited for the purposes of corruption after the transition to democracy was the privatisation of state-owned enterprises. Privatisation was regarded as essential to transform the country from a communist centralised command economy to a market economy. As Gheorge (2005) comments, there are standard and non-standard means of privatisation: the standard means used in Eastern Europe were: public auction, public tender and direct sell. The non-standard means are employed in general mass privatisation schemes like the voucher scheme employed in the Czech Republic or the manager employee buyout scheme applied to some extent in Romania.

In Bulgaria in the early 1990s, there was no consensus about which model of privatisation should be applied. The former communist party which had rebranded itself into the Bulgarian Socialist Party (BSP) was openly against large scale privatisation. As Bojicic-Dzelilovic & Bojkov (2005) observe, the BSP favoured attempting to recover as much as possible from every state enterprise before selling it and preferred selling to Bulgarian citizens and employees rather than outright to foreign buyers. In such circumstances, the emergence of economic counterparts of the state was encouraged by the state itself – manager-employee associations, banks operating with money borrowed from the state and giving them to favoured state-owned enterprises, joint venture enterprises involving an investing partner, holdings composed of state-owned enterprises. In such conditions, as Bojicic-Dzelilovic & Bojkov (2005) comment, the creation of informal networks with influence over the process had to have the approval of at least part of the governing elite and strategically placed individuals with access to power or to those in power where able to interact and transact with large state-owned companies and commercial banks and exclude other strata of society. There is a tradition in South East Europe of a system of networks which are based on

personal relationships and the communist state acknowledged the existence of such networks, was never challenged by them and did not discourage them as they had a positive function of creating a safety net for people – they helped them gain better and faster access to health services, scarce goods and preferred employment. Such informal networks played a great part in the transfer of state assets to private ownership.

The other main party the Union of Democratic Forces (UDF) was concerned to gain control over the privatisation process and with draw it from its political opponent. As Bojicic-Dzelilovic & Bojkov (2005) comment, the UDF favoured restitution to previous owners and sale to foreign investors. However, once they gained power in 1992, they adopted the Privatisation Act and then began to adopt the same mechanisms as their opponents such as manager and employee buy outs (MEBO) – once a critical number of friendly managers were appointed and this helped to speed up the privatisation process – informal networks in evidence again.

With political power changing hands in the 1990s between the BSP and UDF and alternate methods of privatisation from mass voucher operated by the BSP to MEBO's favoured by the UDF were implemented, there were widespread allegations of corruption. Economic groups or "networks" like Multigrup – mentioned above, which grew to prominence in the dying days of communism, which had the advantage of its patron, Lukanov, sitting in the prime minister's seat, who in the view of Barnes (2007), pursued policies which weakened the state's ability to uncover and punish economic crimes. As Ganev (2001) outlines, he hindered the investigation of crimes such as embezzlement in state owned organisations and also allowed several ministries such as Economics, Internal Affairs, Defence and Transport to sell off state assets such as oil and metal reserves, trucks and property. Barnes (2007) observes that even after Lukanov was removed from the premiership, Multigrup's directors continued

to build on the ties they had developed in the Zhivkov era and moved without hindrance between commercial boardrooms and policy offices.

Other economic networks such as Orion which had close connections to the then Prime Minister Zhan Videnov in the mid 1990's sought to gain control of a number of banks in the de-regulated banking sector to help facilitate its programme to acquire state assets. Orion fared well under the Videnov regime. Barnes (2007) observes how when the civil courts declared invalid the registration of one of Orion's banks, the government amended the law on banks to enable it to keep operating. Interior Ministry documents showed that Orion firms channelled loans out of state banks and failed to repay them, no action was taken by the government to force repayment. This favoured treatment of economic networks was also aided by a weak regulatory structure. The Privatisation Agency which had been established by the Privatisation Act of 1992 did not have the independence, power or will to effectively regulate the privatisation process. It quickly developed in the view of Bojicic-Dzelilovic & Bojkov (2005) an inborn state of denial against any blame for misconduct. Its regulatory role was also hampered by the degree of fragmentation which existed, as it was not the only privatising body. Below a certain asset value threshold, the principal ministries (who effectively owned the enterprises) were also responsible for implementing privatisation deals. Relevant Ministers were the only ones in charge of administering and approving deals. In theory they were responsible to Parliament and the relevant Parliamentary Committee, but it is reasonable to ask the question: how effective was this, given there was no specific privatisation committee (Bojicic-Dzelilovic & Bojkov, 2005). A route for influential buyers connected to networks which politicians were close to or perhaps even part of, enabled them to determine which body would privatise the enterprise they were bidding for.

There was therefore a situation of no consistent policy on privatisation, it varied from mass voucher to management and employee buyout, the pervasive influence of powerful economic

networks with access to and indeed membership by political elites and the competition between such networks. The situation was made worse by a weak regulatory structure hampered by fragmentation and the ability of government ministers to privatise parts of the state asset portfolio without any political or democratic oversight. Also, there was a consequent climate of allegations of corruption in the privatisation process with officials and politicians accused of being offered bribes to favour certain economic actors and networks or indeed having economic or financial interests which depended and could well prosper with the success of such favoured bidders (Chadarova, 2001).

Given that privatisation was occurring during a period when Bulgaria was ranked quite poorly in terms of perceptions of corruption by Transparency International in the 1990's scoring below 4.0 in the PCI and networks were exploiting connections and/or using bribery to gain control of large blocks of shares in the newly privatised state industries, then inevitably the stench of corruption and malpractice hung over the whole process.

All these incidences of corrupt behaviour together with the numerous incidents of low grade corruption involving ordinary citizens and officialdom have had unfortunate consequences for Bulgaria's reputation abroad. Engelbrekt (2007) cites a study by Price Waterhouse Cooper that suggests that in 2005, as many as 39% of all large foreign companies operating in Bulgaria reported instances of bribery and corruption, a figure that is amongst the highest in Central and Eastern Europe. The EU had every reason to be worried about bringing Bulgaria into the organisation and giving such corrupt actors within the country an opportunity to get their snouts in the EU trough of funds and whether the entry of such a corrupt state could prove to be a cancer which would spread secondary tumours of corruption to other parts of the EU body politic. Surely, the prospect of a honey pot of billions of EU funds would prove to be very attractive to the nexus of fraudsters, organised criminals and corrupt officials.

The influence of prospective EU membership on the fight against corruption

Bulgaria formally applied for EU membership in 1995 and there was widespread public support – over 70% for this policy. With such high support for EU membership, accession became the number one foreign policy objective and a policy priority of supreme importance. This therefore gave the EU an opportunity to pressurise the Bulgarian government to try to tackle the problem of corruption and to take effective measures against it in both the legal and administrative spheres. The influence and pressure of popular sentiment and desire for EU membership gave added force to the demands of the EU and “encouraged” politicians indirectly, to try to implement anti-corruption strategies and policies because they were keen to receive favourable reports from Brussels. It did however, take time for the politicians to seriously tackle the issue of corruption, because the EU did not exert enough pressure on this issue in the early negotiations on accession.

As Quirke (2008) observes, as with Romania so with Bulgaria, this situation changed with the European Commission’s Agenda 2000 Report which called for yearly monitoring reports on candidate countries and gave significant importance to the issue of anti-corruption measures. Given that Bulgaria up to 2002, had not devoted sufficient attention to this issue, the EU’s Strategic Report of that year recommended ten candidate members for admission, Bulgaria was not one of them and the date for its admission was postponed. The “carrot” of EU membership was now going to be replaced by the “stick” which suggested that unless important changes were made, there would be no successful conclusion to the negotiations.

This hardnosed approach appeared to have the desired effect, there were significant changes to anti-corruption legislation. Bulgaria ratified the Council of Europe’s Criminal Law Convention on Corruption and in February 2005 amended the National Strategy for

Combating Corruption to include a number of measures designed to combat high level corruption. At the same time, Bulgaria instituted amendments to the criminal code to bring it in line with the Convention on the Protection of the European Community's Financial Interests.¹² As Noutcheva & Bechev (2008) note, Bulgaria - unlike Romania - did not undertake major institutional changes, such as establishing and strengthening a National Anti-Corruption Agency, but concentrated as discussed above on strengthening legislation.

The only specialised bodies it created, as Noutcheva & Bechev (2008) identify, were an inter-ministerial committee (headed by the Interior Minister to coordinate action and a commission within the Supreme Judicial Council monitoring the judiciary. These efforts resulted in more favourable comments in the EU's Monitoring reports for 2004, 2005 and 2006 which concluded that anti-corruption legislation was well-balanced and in line more or less, with the relevant EU acquis. Although as Noutcheva & Bechev (2008) note, a lot still needed to be done particularly with regard to judicial corruption, it appeared that the Bulgarian government had made some progress in seeking to tackle and reduce corruption.

There was concern on the part of officials of the EU's Anti-Fraud Office, OLAF, about the general situation in Bulgaria. Given that corruption and other forms of economic crime appeared to be well embedded in Bulgarian society, the availability of significant EU funds would be likely to prove attractive to economic criminals and corrupt officials, despite some naïve views among Bulgarian as to whether even traditional organised criminals could be bothered dealing with the red tape and bureaucracy of the EU in order to get their hands on its funds¹³. On the other hand, as Spencer (2007) and Van Duyne (2003) have noted, organisations can be loose and local and consist of criminal entrepreneurs on the lookout for opportunities, and it is likely that there would be chances for locally based fraudsters to make

¹² www.europa.eu/legislation_summaries/enlargement2004and_2007_enlargement/bulgariae22101.en.htm

¹³ Interview with Bulgarian Officials 2010

mischief. In order to counter this type of threat a system of financial aid and technical support was offered to candidate countries like Bulgaria as part of the preparations for the enlargement yet again of the European Union.

Impact of the expansion of the EU on the fight against fraud

Prior to the expansion of the EU in 2004, fraud was already a major issue among existing members and the EU. Academic commentators such as Tutt (1989), Sherlock and Harding (1991), Passas & Nelkin (1993), Sieber (1998), Quirke (1999, 2000 & 2006) have all highlighted the issue and problem of fraud. When there were just fifteen member states, the fight against fraud was dogged by the fragmented response from a multiplicity of member state agencies operating within fifteen separate legal systems, all of which defined, investigated and reported it differently. The true extent of fraud against the European budget has never been quantified. Indeed, given that fraudsters like to keep their activities secret, this is not surprising. Estimates have ranged from 2% to 10% and above (Ruimschotel 1994). Now that EU membership has increased to twenty seven member states and with the likelihood of a further enlargement with Croatia and Iceland waiting in the wings, this problem of fragmentation can only be exacerbated. An indication of the problems having to be faced is that there are now twelve new legal systems for Community institutions to cope with – this is hardly likely to improve the existing situation. Fraudsters exploit differences in legal systems and procedures, they operate in “real time”; they do not have to comply with legal protocols and agreements.

There have been attractive sums of money for fraudsters to consider focussing their activities upon. In the pre-accession period, Bulgaria received about 1.6 billion euros in pre-accession aid and between 2007 and 2013 she is due to receive over eight billion euros of non-reimbursable Community assistance (Center for the Study of Democracy, 2007). In order to

minimise the risk of fraud, the European Anti-Fraud Office (OLAF), which administratively is part of the European Commission, made checks and investigations in the candidate states, including Bulgaria, and sought to ensure good co-operation between itself and the administrations of the new member states (Murawska, 2004). The role of OLAF is to protect the finances of the European Union and to support and liaise with national investigative bodies, particularly where investigations have a cross-border dimension (Illett, 2004).

Efforts of Bulgaria to prepare for accession

Bulgaria was obliged to comply its legal system with the *acquis communautaire*, under the first pillar of the European Union, as part of its preparations for accession, and it made efforts to adopt the *acquis communautaire* (body of laws) in the protection of the Communities financial interests and the candidate countries were required to: *'create an efficient anti-fraud protection system with respect to funds provided in the framework of the Accession Partnership such as the programmes PHARE, ISPA, or SAPARD'* (Murawska, 2004: 3).

As Murawska (2004) further comments, the Community measures about protection of the Community's finances are fairly modest. These consist of three EC Regulations:

- Council Regulation (EC, Euratom) No. 2988/95 of 18 December 1995 on the protection of the European Communities financial interests
- Council Regulation (EC, Euratom) No. 2185/96 of 11 November 1996 concerning on the spot checks and inspections carried out by the Commission in order to protect the European Communities financial interests against fraud and other irregularities

- Regulation (EC) No. 1073/99 of the European Parliament and of the Council of 25 May 1999, concerning investigations conducted by the European Fraud Prevention Office (OLAF)¹⁴.

The Bulgarian government was also expected to incorporate into its legal system the Convention on the Protection of the European Communities Financial Interests (the PFI Convention) together with its associated protocols. The convention, as Fenyk (2007) details, requires that member states shall incorporate frauds against the European Communities financial interests into their criminal code and should take the necessary steps to ensure that fraudulent behaviour and conduct is punishable by criminal penalties that are effective and reasonable and also that heads of businesses and other senior executives and other senior executives that have the power to take decisions or exercise control: *“to be declared criminally liable in accordance with the principles defined by national law in cases of fraud affecting the European Community’s financial interests...”* (Fenyk, 2007: 2).

The First Protocol to the PFI Convention requires that definitions on what is termed corruption, both active and passive (Articles 2-3) be assimilated into the criminal code and the Second Protocol to the PFI Convention requires national law to provide that legal persons can be held liable in cases of fraud or active corruption and money laundering that damages or is likely to damage the European Community’s financial interests (Fenyk, 2007).

Bulgaria’s National Strategy against Fraud affecting the European Community’s Financial Interests which was adopted in 2005 stresses the importance of harmonising Bulgarian legislation with European regulations in the area of protecting EU financial interests and efforts have been made to amend legislation such as the Financial Management and Control in the Public Sector Act which includes definitions of fraud and irregularities which accord

¹⁴ OJL 136 31/05/1999:1-7

fully with the Convention on Protection of the European Communities' Financial Interests and the *acquis*.

However, the efforts to amend the criminal code to incorporate aspects of the Convention such as Article 3 which deals with the criminal liability of heads of business has not yet been completely implemented and proposals to reform part of the Criminal Procedure Code to allow OLAF reports to be submitted in pre-trial proceedings and for OLAF reports and related documents to be admissible as evidence were only contained in a draft law submitted to parliament in November 2009, nearly three years after Bulgaria acceded.¹⁵ This is unacceptable. Bulgaria may have indeed ratified the Convention on the Protection of the EU's financial interests, but this is not just a "box ticking" exercise. What really matters is how the provisions of the Convention are implemented. In order to have a level playing field across the EU, it is imperative that all member states not just ratify, and indeed some like the Czech Republic, have not even achieved that yet (Quirke, 2008), but also fully implement the convention. Ratification and implementation are important steps towards reducing the fragmentary nature of the legal approaches to fighting fraud against the EU. Given that such serious concerns had been expressed about the general level of corruption, economic crime and indeed the power and influence of organised criminal networks and the demands made by the EU for Bulgaria to "clean up its act", it is very surprising that implementation of the Convention was not made a pre-condition for entry. This is yet another example of a self-inflicted wound and once more, the EU needs to learn a lesson from this experience and not repeat it in further enlargements.

Establishment of the AFCOS Structure

¹⁵ Interview with Bulgarian Officials 2010

In order to ensure effective co-operation between OLAF and the national administrations in the candidate countries as well as seeking to have in place organisational arrangements which would be capable of preventing and detecting frauds and irregularities, OLAF supported the creation of independent anti-fraud structures at a national level in the then candidate countries (see Murawska [2004]). The rationale behind the decision to create such structures was to ensure effective co-ordination between legislative and administrative measures dealing with EU fraud policy (Murawska, 2004). It is interesting to note that established member states in Western Europe have no such AFCOS structures – “where are the British, French and German AFCOS?”¹⁶ It does appear, to new countries, that the EU is asking new members to meet requirements that existing members do not have to meet, an appearance that suggest to them dual, if not double, standards¹⁷.

OLAF has provided training and support to anti-fraud bodies and officials in candidate states and although some national officials regarded such support as not being sufficient¹⁸ and some as fairly minimal¹⁹, the Bulgarians seem to be fairly satisfied with the support and training they have received²⁰. A country like Bulgaria which is one of the poorest in the EU, with a nascent anti-fraud service with officials who did not have the experience of dealing with the complexities of EU policy regimes, with a bureaucracy which did not have the capacity to absorb billions of euros of EU funds (Center for the Study of Democracy, 2007) as well as perhaps not having the experience of investigating transnational frauds, obviously were in need of support and nurturing.

In the case of Bulgaria, in 2002, unlike its neighbour Romania which had established an AFCOS structure (Quirke, 2009), no designated AFCOS body had been established. The anti-

¹⁶ Interview with Bulgarian Officials 2010

¹⁷ Interview with Bulgarian Officials 2010

¹⁸ Interview with Czech Officials 2006

¹⁹ Interview with Maltese Officials 2007

²⁰ Interview with Bulgarian Officials 2010

fraud co-ordination structure – the Council Co-ordinating the fight against the infringements affecting the financial interests of the European Communities (the Council) - was set up by a Council of Ministers Decree No. 18 of 4th February 2003²¹. The objectives behind establishing such a structure were to co-ordinate and combine the efforts of the competent authorities, including the bodies of the independent judiciary, rather than duplicating their activities²². The Council was entrusted with the following functions: to propose to the Council of Ministers draft anti-fraud legislation, to develop strategies to combat infringements affecting the financial interests of the European Communities, and respective action plans to implement the strategies, to report annually on its activity to the Council of Ministers and to discuss issues related to the fight against fraud and irregularities and to interact as appropriate with the judicial authorities²³. The Council was chaired by the Minister of the Interior.

Sigma, the consulting arm of the OECD in Paris, was commissioned by the European Commission to undertake an assessment of the anti-fraud structure in Bulgaria and it reported in 2004. The objectives of Sigma's assessment in Bulgaria were to: 'evaluate the operational and administrative capacities of AFCOS and its partner institutions in the protection of the European Community's financial interests and, where needed, to put forward proposals and recommendations for strengthening these capacities' (Sigma, 2004:7). Sigma's evaluation of the operational and administrative capacities of AFCOS and its partner institutions was made on the basis of an AFCOS' basic functions: co-ordination, co-operation and communication (the 3 C's) which signify the ability:

²¹ Interview with Bulgarian Officials 2010

²² Interview with Bulgarian Officials 2010

²³ Interview with Bulgarian Officials 2010

- to co-ordinate, within Bulgaria, all legislative, administrative and operational obligations and activities related to the protection of the Community's financial interests;
- to co-operate with OLAF and its partner institutions whenever OLAF requires investigative assistance or, on the other hand, whenever OLAF assistance is required;
- to communicate with OLAF and its partner institutions with regard to mandatory reporting and information exchange. (Sigma, 2004)

The main findings of the Sigma report were as follows:

- In 2002, no AFCOS existed in Bulgaria. Valuable time had already been lost as AFCOS was only established in 2003. There needed to be an urgent recruitment drive with regards to staff and AFCOS needed to be firmly embedded with respect to its legal position and also with respect to its interaction with relevant investigative bodies in Bulgaria and with OLAF
- The Council had not carried out a risk analysis and had not developed a national anti-fraud strategy. A strategy for fighting fraud would be useful in harmonising the various efforts undertaken by different ministries and bodies to protect both national and international financial interests, including the EU budget and own resources. Such a strategy would have signalled Bulgaria's willingness to take action in this respect.
- The Council had not forwarded reporting guidelines on irregularities to partner institutions, accompanied by additional guidance and/or training.
- Knowledge of European regulations and rules was insufficient and partner institutions had asked, without exception, for additional training
- The training function and help-desk function was underdeveloped or even non-existent

- The Anti-Fraud Information System (AFIS) was not yet operational and no terminals were linked to the National Customs Agency, which had a gateway link to OLAF.

A major problem with the Council was that it was not a body that could take care of daily operations. Sigma acknowledged that it had a useful role in directing and controlling operations, but in 2003, it only met three times and there was a need, therefore, for an active support unit to drive forward the implementation of anti-fraud policy. There was a need for an active secretariat staffed by people with technical expertise and language skills who could provide the link between national institutions and OLAF and also act as a help desk in order to bridge the gap between national institutions and OLAF (Sigma, 2004). OLAF had already made the point that unless the Council had such a secretariat, it could not act as an AFCOS.

In summary, the genesis of the AFCOS regime in Bulgaria was beset by problems. It was not established when it should have been in 2002, and when a body had been constructed, it had too many problems – lack of resources, lack of administrative capacity, lack of will - to meet the requirements and strictures of OLAF and the demands of the fight against fraud. This was not a promising start, requiring a quick response in anticipation of EU membership.

Response of the Bulgarian authorities

In order to respond effectively to the weaknesses and issues identified by the Sigma assessment (2004), the Bulgarian authorities adopted and implemented a national anti-fraud strategy against fraud affecting the financial interests of the European Communities. The strategic aims set by the Bulgarian government were as follows:

- *‘To ensure the efficient prevention and fight against fraud, misuse, inefficient management or utilisation of EU funds;*

- *To detect and suppress fraud, misuse, ineffective management or utilisation of financial assets and property belonging to the European Union or provided to the Bulgarian state...*
- *To develop a common approach towards the prevention and fight against corruption within the state institutions ... to achieve as an ultimate goal, high level protection of the EC's financial interests'* (Strategy against fraud affecting the European Communities' Financial Interests, 2007: 2)

The provisions of the Convention on the Protection of the European Communities' financial were transposed into Bulgarian law with, however, some delay and omissions as identified above.

In order to meet the demands of OLAF for a properly resourced AFCOS structure, a Central Co-ordination Unit was established within the Ministry of the Interior, yet this was only in 2006²⁴ – two years after the Sigma Report (2004) was published and evidence of yet another delay and lost time. In the first two years of its existence, there were ten officials working in the Central Co-ordination Unit (now been increased to twelve since 2008²⁵). The Central Co-ordination Unit is now known as the AFCOS Directorate and it is composed of three departments: Operational Co-operation, Administrative Control and Irregularities Reporting.²⁶ The Directorate is the contact point for OLAF and the respective competent bodies in the field of the protection of the financial interests of the European Union, it should ensure operational co-ordination between OLAF and the competent agencies and bodies which are members of the AFCOS network in terms of carrying out investigations in Bulgaria, maintains a database with information about suspected irregularities and frauds, communicates alerts about suspected irregularities to relevant organisations and bodies in the

²⁴ Interview with Bulgarian Officials 2010

²⁵ Interview with Bulgarian Officials 2010

²⁶ Interview with Bulgarian Officials 2010

AFCOS network and communicates irregularity reports on a quarterly basis to OLAF (Strategy against fraud affecting the European Communities Financial Interests, 2007).

Yet, despite this, in Customs cases, the Customs Agency can be contacted directly by OLAF without going through the AFCOS Directorate. This does undermine the position of AFCOS at least in this respect and this situation has been observed before in other member states.²⁷ AFCOS officials believe that the setting up and strengthening of the AFCOS network was primarily due to the efforts of the late Dr Bruener, the former Director of OLAF, who made five visits together with his officials to Sofia, between 2004 and 2006²⁸. Whilst not wishing to diminish these efforts, it is not surprising that such close attention was shown to Bulgaria by senior OLAF officials, given the widely expressed concerns about corruption, weak administrative structures and the power and influence of organised criminal gangs.

These efforts were also supported by the decision to base an OLAF official in Sofia in order to be a source of on the spot support and advice. This official stayed in Sofia from 2004 until 2008, but was then recalled²⁹. This was premature and indeed a mistake. The early years of membership of the EU are a time of transition and challenge. There is inevitably a steep learning curve for national officials and to have an experienced OLAF official in such close proximity was a very valuable resource. The same decision was taken with respect to the OLAF official based in Bucharest (Quirke, 2009) and this is not helpful when a nascent anti-fraud service is in need of support and nurturing. OLAF should take this into account in future enlargements.

As has been identified in previous studies in Romania (Quirke, 2009) and the Czech Republic (Quirke, 2008) Bulgaria had a number of different agencies/bodies which have a role in the

²⁷ Interview with Maltese Officials 2007

²⁸ Interview with Bulgarian Officials 2010

²⁹ Interview with Bulgarian Officials 2010

reporting, investigation and prosecution of fraud cases. There are directorates from the Ministry of the Interior such as the Combating Organised Crime Unit, the Border Police and a very powerful new agency SANS – the State Agency for National Security which has responsibility for investigating economic crime as well as other national security duties. There is also Department VIII of the Supreme Prosecution Authority of Cassation which oversees all cases regarding abuse of EU funds. From the Ministry of Finance there is the Customs Agency; the Financial Intelligence Agency, the Public Financial Inspection Agency, the Audit of European Funds Directorate, the Management of European Funds Directorate. There is also the Ministry of Agriculture, Regional Development, Transport and so on. Some of these bodies such as the Police units from the Interior Ministry and Customs are investigative bodies, whilst others manage funds such as CAP and structural and cohesion funds and have their own units (internal audit and inspection) for carrying out investigations of irregularities.

From this brief overview, it is clear that there are many agencies involved in detecting/investigating EU frauds and irregularities in Bulgaria. It is possible to identify two sub-groups in these arrangements. In one which could be called criminal investigation groups, there are well established arrangements for contact and co-ordination between the Ministry of the Interior police directorates dealing with organised crime and the protection of the borders and Customs, SANS and the Supreme Prosecution Authority of Cassation. In the other sub-group, there are organisations which tend to undertake non-criminal investigations such as the Audit of European Funds Directorate and internal audit units of the Agriculture Ministry etc and these have no or very little experience of liaising with criminal investigative bodies. Just as Quirke (2008 & 2009) identified in the cases of the Czech Republic and Romania, here in Bulgaria, there is the potential for confusion, inefficiencies, duplication and misunderstanding.

Another difficulty has been the fact that the position of AFCOS has been the subject of both uncertainty and political infighting. In 2008 after the elections, a political decision was taken to create a Deputy Prime Minister post in charge of EU funds and AFCOS was moved away from the Ministry of the Interior to become part of the administration of the Council of Ministers.³⁰ Yet in 2009, after new elections, the decision was taken to switch AFCOS back to the Interior Ministry. Such instability is not good for an organisation in its formative years, when it needs stability in order to become embedded in the anti-fraud process and to become accepted. This instability was damaging to staff morale³¹ and to say the least was highly unfortunate. All this was happening at a time when Bulgaria and its management of EU funds and attitudes to fraud and irregularity with respect to them were under severe scrutiny.

Difficulties and problems with the management of EU funds

In 2008, the European Commission published a damning report on the management of EU funds in Bulgaria. The Commission was very concerned that administrative capacity was weak and that there had been serious allegations of irregularities as well as suspicions of fraud and conflicts of interest in the award of contracts. This led to a temporary suspension of pre-accession funds and the freezing of payments under various other financial instruments. There were many areas of concern but those relating to the PHARE and Transition Facility programmes which supported Bulgaria to complete institutional reforms and to prepare for the absorption of much larger amounts of assistance under the Structural Funds are worth noting.

The total amount allocated under PHARE and Transition Facility programmes was around 650 million euros (European Commission, 2008). Monitoring and audit work had shown that there were serious weaknesses in the management and control systems and there were a

³⁰ Interview with Bulgarian Officials 2010

³¹ Interview with Bulgarian Officials 2010

number of irregularities, suspected fraud cases and conflicts of interest between the programme administration and contractors. Two of the implementing agencies - the Central Financing and Contracting Unit (CFCU) and the Implementing Agency at the Ministry of Regional Development and Public Work (MRDPW) had their right to manage aid withdrawn. Also, at the SAPARD agency which would oversee the implementation of 445 million euros of funding to modernise agriculture and the countryside, there were a number of serious problems. Firstly, there were OLAF investigations relating to projects worth 26 million euros regarding fraud and corruption. Secondly, the former executive director of the SAPARD Agency was accused of the wrongful approval of projects and criminal proceedings had been initiated against him. Thirdly, 105 million euros had still to be paid to beneficiaries and there were serious control weaknesses in the investment aid system. OLAF commented about there being a lack of haste in the investigation of the SAPARD irregularities (European Commission, 2008). There were also concerns expressed by OLAF about breaches in confidentiality, improper transmission and leaks of sensitive information, possibly involving organised crime (this has been strongly disputed by Bulgarian officials – they say one such major leak involved journalists and not organised criminals – but there was still a leak³²).

The report caused immense damage to Bulgaria's reputation and as Gawthorpe (2010) observes, it severely damaged confidence in Bulgaria's capacity to function as a full member of the EU. Owing to the pressure she was under, Bulgaria did attempt to respond quickly to these concerns to try to strengthen administrative capacity, control systems and to guard against potential conflicts of interest. The Commission recognised in its 2010 Report on Progress in Bulgaria under the Co-operation and Verification Mechanism, that progress had been made but Bulgaria still needed to substantially strengthen its capacity to correctly manage EU funding and that OLAF was concerned about leaks of confidential information as

³² Interview with Bulgarian Officials 2010

well as the slow progress of cases through the Bulgarian legal system (European Commission, 2010). There is obviously much work that needs to be done. However, to be fair to Bulgaria, she is one of the poorest countries in Europe, it was inevitable therefore that she would find it difficult to absorb hundreds of millions of euros of pre-accession aid. She did not have sufficient administrative or bureaucratic capacity, therefore in the absence of such a legitimate and administrative network, it was inevitable that informal networks which have long existed in this part of Europe would become involved. The Bulgarian bureaucracy had not been prepared to handle such vast amounts of funds and the authorities in Brussels as well as more established member states should bear some of the responsibility for a failure to tackle such a crucial structural weakness.

Co-operation with OLAF

Despite the difficulties discussed above and the concerns expressed by OLAF, the Bulgarian AFCOS officials believe that there is a very good and co-operative relationship³³. They cite the investigations into the SAPARD frauds and irregularities, which although damaging to Bulgaria's reputation did illustrate the close co-operation that exists between AFCOS and OLAF. One of the frauds investigated concerned a scam involving fifty Bulgarian enterprises defrauding SAPARD of £4 million involving grants to replace old meat processing equipment. Old East German built meat processors were shipped from Germany and bought as "new" for 24 times the original price. From a distance the machines which had been painted white looked very new, up close and investigators having scraped some of the paint away – the unmistakable mark of quality – "Made in the GDR" was revealed.³⁴. The investigations and co-operation were greatly facilitated by OLAF in the opinion of Bulgarian

³³ Interview with Bulgarian Officials 2010

³⁴ Interview with Bulgarian Officials 2010

officials – “They put is in touch with the right people in Germany”³⁵. OLAF agents were able to ascertain that invoices had been overpriced for purchases by SAPARD for meat processing plants in Bulgaria (European Commission, 2010). The former head of the State Agriculture Fund, Assen Droumov, and a political associate and a businessman and fundraiser of the Socialist Party with ties to then Prime Minister Stanishev were indicted for fraud and received substantial prison sentences in 2010³⁶.

In the area of cigarette smuggling and counterfeiting and the avoidance of duty, there has also been good level of co-operation between AFCOS and OLAF. In 2008, OLAF requested assistance from the Bulgarian authorities with respect to contraband Chinese cigarettes – Jin Ling – which had been found in several EU member states. There was suspected involvement of Bulgarian companies in the counterfeiting and smuggling of these contraband cigarettes and there was co-operation between OLAF officials, the AFCOS Directorate, Customs Agency and the Border Police. Customs offences and illegal production of cigarettes were discovered and the Bulgarian authorities received a commendation from OLAF for their co-operation in this case³⁷. Despite the difficulties and problems that have been discovered and pointed out above, on the ground, there are instances of effective and valuable co-operation. AFCOS officials do stress that when they require assistance from other member state agencies, they always approach them through OLAF as they know that they will be put in touch with the most appropriate people and they greatly value this³⁸.

Wider lessons to be drawn from the Bulgarian Experience

There are a number of lessons that can be drawn:

³⁵ Interview with Bulgarian Officials 2010

³⁶ Interview with Bulgarian Officials 2010

³⁷ Interview with Bulgarian Officials 2010

³⁸ Interview with Bulgarian Officials 2010

- The speed of accession and the preparedness of Bulgaria, its uneven post-communist development and the potential for fraud and corruption from a number of groups, and the absence of a functioning control environment, should have been addressed by the EU in advance of accession;
- The issue of fragmentation needs to be addressed. There is a multiplicity of agencies involved in the investigative process, some of which investigate on a criminal investigative basis and some which investigate on an administrative basis. There is the potential for misunderstandings and duplication of effort and a lack of efficiency in the investigative process. A more streamlined anti-fraud structure may well prove easier to manage and lead to a more productive and cohesive investigatory regime
- The AFCOS structure needs to be pro-active in analysing its skill gaps and deficiencies and seeking help in tackling them. Brussels too should take a more active part in terms of offering additional training in the period leading up to accession.
- The issue of bureaucratic and administrative capacity needs to be addressed. It is neither fair nor sensible to expect a poor country like Bulgaria to be able to absorb billions of euros of aid without a major programme to strengthen administrative capacity and expertise **before** such aid is disbursed. Being critical after the event is not good enough – this situation should have been foreseen.
- The reporting requirements to all partner institutions should be clearly disseminated and explained. The co-operation of OLAF would be very useful in this respect.
- AFCOS is meant to be the sole contact point with OLAF. This should not be circumvented by separate communication to the Customs Agency with the AFCOS Directorate informed after the fact. This undermines one of the main reasons for setting up the AFCOS system.

- AFCOS should not be the subject of political in-fighting regarding its position and placement. This happened in Bulgaria when it was transferred from the Interior Ministry to the Council of Ministers and back again within a twelve month period. Such instability is not conducive to successfully embedding such a nascent anti-fraud service, is disruptive and bad for staff morale.
- OLAF officials should be based in candidate states and should stay there for some time after accession, in order to be a ready source of advice and support and to give national officials experience of working with a transnational organisation. To withdraw such officials a year or so after accession is far too soon.

Conclusions

Bulgaria has had a rocky path to accession and since accession. There have been serious concerns expressed about her ability to adequately manage EU funds and to also to effectively fight fraud and corruption. She has made genuine attempts to create and install an effective anti-fraud structure but, given the high levels of fraud and corruption in the country, EU funds will be vulnerable from corrupt officials and the activities of organised criminals. Not all the blame for this situation can be laid at the door of Bulgaria. She was not adequately prepared for accession and there had been a failure to adequately strengthen administrative capacity. There are examples of effective co-operation with OLAF and there is a genuine appreciation on the part of AFCOS officials for the help and support which OLAF has offered to Bulgaria over the years. The question will remain: was and is Bulgaria being asked to reach – and reach quickly - a standard that few of the established member states reach, or which took them many years and a significant investment to achieve? Is this a case of stable doors slamming as consequence of a hasty accession process or is it a case of political necessity with the desire and even need to reassure domestic audiences in Western Europe that a tough line is being taken with so-called “corrupt” member countries in relation

to EU funds? And how long will the EU support Bulgaria until and when both the standard and the reassurance is achieved?

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