

Transitions to Democracy or Transitions to Organized Crime?
A Comparison of Bulgaria and Latvia

By
Daniela Ivanova
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Introduction

For Europe the first decade of the 21st century meant a reunification of sorts: ten former Communist states from Eastern and Central Europe joined the club of the rich democratic Western European states, the EU. The decision to extend the world's most successful project of regional integration to include the former totalitarian regimes of the East was not easy: what if they are different, what if they are not democratic enough?

This question has been raised and tackled multiple times by scholars of Europe, Communism and the transition to democracy and the market. The first accounts embraced the classic dichotomy of state and market and focused on the actions of neo-liberal reformers. Transitioning was seen as playing with a doctor set, hence the lingo “shock therapy.” Later accounts noticed the diversity of outcomes and looked for the roots of the problem in a more complex interaction of the state, the market and society. The idea of a Communist legacy in politics, administration, economy and even human relations began to be debated. Multiple other factors determine to what extent this legacy slows down and distorts reform.

Although omnipresent in national and local media and at dinner table conversations in Eastern and Central Europe, a missing element in Transition scholarship was the mafia. In Western scholarship of the region it was relegated to the realm of conspiracy theories. A closer look at news headlines in the 1990s and 2000s, however, betrays a scope and intensity of the problem that is not to be overlooked. In Eastern Europe the mafia is not conventional, it is a criminal alliance of politicians, oligarchs and groups of violence-wielders for the draining of formerly state-owned assets. Not without apprehension, this thesis aims at borrowing the so-defined organized crime from the field of criminology and plugging it into the Transition equation. It then goes on to insert this

revised Transition variable into the European integration formula and recalculate: is Eastern Europe democratic? The results will be surprising.

Even though this is a mammoth argument, the limited scope of this work called for a narrowing down of the study material. From all new member states of Eastern Europe, the focus of this work became the two worse performers according to the rating of *state capture* in the World Bank's Business Environment and Enterprise Performance Survey (BEEPS). The BEEPS *State capture* or the degree of influence of the private sector in the state's decision and rule making is the closest any numerical ranking that exists in official fora comes to rating Eastern Europe's mafias. Hence, this thesis compares the Transition records of an unprecedented pair: Latvia, formerly a subordinate entity within the Soviet Union, and Bulgaria – a former independent People's Republic.

The thesis consists of a theoretical first chapter that lays out the main Transition, organized crime and corruption models and sets the tone for the actual case studies. Chapters 2 and 4 are also theoretical with a more defined chronological focus on how to read the developments in Bulgaria and Latvia in the 1990s and the 2000s respectively and their significance to organized crime. Chapters 3 and 5 are more detailed historical accounts of how organized crime factored into democratization and marketization and later into the European integration of the two states.

Chapter 1 looks at organized crime from the point of view of different disciplines: as a sociological phenomenon in criminology and as an economic phenomenon in Diego Gambetta's political economic model of the Sicilian mafia. It then tackles theories of the Transition state and examines notions of statehood as defined by the state-market-society trichotomy. The basis of this theoretical experiment is Max Weber's definition of the state as the monopoly over the legitimate use of violence in a given territory as juxtaposed with

Gabmetta's definition of the mafia as organized violence used to protect property and enforce contracts in a given territory. The chapter continues with a theoretical discussion of corruption and its relation to organized crime and ends with several scenarios for the future based on models of economic and political criminalization in Russia.

Chapter 2 first draws on a seminal work on the Bulgarian Transition period "Preying on the State" in order to challenge the state-market-society trichotomy in post-Communism scholarship. The chapter advances a radical theory of the "criminal state" or a state run by doppelgänger elites comprising former nomenklatura members and current oligarchs, who profess democratic values while colluding with criminal elements in order to drain the public domain of its assets. Theories of organized crime as social transformation, partial reform, public and private spheres, weak states and Communist legacy are discussed and evaluated in the context of the Transition to democracy. Western in their conception, they are all qualified by two major Transition peculiarities conducive to corruption and organized crime: all state assets have already been extracted and stored in the loosely monitored public domain; and the ongoing process of legislative reform gives a chance for the legalization and even institutionalization of criminal practices.

Chapter 3 is a tour of the major economic reforms in the Transition period of the 1990s and their hijacking by politicians, oligarchs and groups of violence-wielders – the mafia. The process of privatization of the state's property and activities enabled organized crime to thrive in areas such as banking, industry, transport, public procurement, real estate, retail, and even international business. The key is found to be a Communist social legacy of informal links crisscrossing society in and out of the newly defined public and private sphere. The chapter also advances an evolutionary hypothesis for Eastern European organized crime: the *state domain runs out hypothesis*. The end of an initial violent

redistributive phase ends in the mid-1990s for Latvia and the late 1990s for Bulgaria with a separation into oligarch business and conventional organized crime activities. The chapter ends with a discussion of the stability of the oligarch model.

Chapter 4 builds upon the narrative of privatization and the evolution of private protection in Eastern Europe and introduces more factors for the existence of organized crime: the proximity of armed conflict and trade embargos; the role of ethnic minorities for international criminal networks and domestic organized crime; “bad” social capital inherited from Communism; rotation of the ruling elites; and EU accession. The second half of the chapter is devoted to accession theory as formulated by Milada Vachudova and the attempt to define Latvian Transition democracy along Vahudova’s criteria for liberal and illiberal democracies. An attempt is then made to connect Bulgaria’s illiberal and Latvia’s ambiguous liberal identity to manifestations of the mafia in the two states. Geoffrey Pridham’s post-accession theory of backsliding is then used in order to trace organized crime’s lasting institutional impact.

Chapter 5 reiterates the last point made in Chapter 4 and develops an institution-by-institution analysis of the impact of the mafia on democratic institutions built in the 1990s and on the harmonization between domestic and European law, which is part of EU integration. The NGO sector, customs, private property rights, party financing and conflict of interest laws, local government and public procurement with EU funding are scrutinized in turn with the aim of discerning the role of organized crime in them. The chapter ends with a methodological argument about the applicability of comparisons between Bulgaria and Latvia and generates a performance curve argument for Eastern European EU member states.

Chapter 1

A theoretical framework for Organized Crime in Transition Societies

My purpose in this chapter is to examine existing theories of organized crime from the realm of sociology and criminology, together with theories of the Transition from command economy and authoritarianism to market economy and democracy from the fields of government and political economy, and devise a coherent theory about organized crime in Post-Communist transitions.

Organized crime and Transition issues have so far been treated by different disciplines and rarely viewed and examined together. However, if one looks at the approaches to the two phenomena, just as organized crime is defined in terms of the free market and the democratic state, so is the post-Communist Transition seen as a period of unleashing free market forces and democratic state building. Before I launch into a discussion of the available theoretical definitions on both counts, I will suggest that there are also enough empirical grounds to see organized crime and the dynamics of transitioning in Post-Communist states as intertwined, interdependent, and endemic to the said group of states. Therefore, a new interdisciplinary framework is necessary to illuminate the reasons for the prevalence and systemic qualities of organized crime during periods of Transition from socialism to market capitalism and democracy.

Organized crime as a sociological phenomenon: crime that is organized

From a sociological perspective organized crime is interesting because of its structure. In a 1985 study of American organized crime Howard Abadinsky describes the

phenomenon in the following terms: non-ideological, hierarchical, limited or exclusive in membership, perpetual, functioning through division of labour, monopolistic, obeying its own rules and regulations.¹ This definition does not suggest much for the purpose of this study, but a discussion of the causes and effects of organized crime and whether they are to be found in the framework of the state and the market will on the other hand have important implications for the Transition case.

This fact has not been widely recognized, however. In *Rotten States* Leslie Holmes considers it a more important task to theoretically divorce organized crime from corruption in the post-Soviet world by consigning it to criminology: it is perpetrated by a group but not of officials; coordinated; targeted on a particular type of criminal activity such as drug dealing, prostitution, gambling, arms smuggling; illegal, at least in part; usually involving violence, actual or threatened.² Although this settles a possible misunderstanding of what it is about states that can be “rotten” from the point of view of political science, namely corruption, the very existence of a context, be it informal, where organized crime and corruption are perceived as intertwined, suggests that they should be studied together.

Conventional theories of the causes of organized crime suffer from an equal amount of generality. The sociological theory of deviance assumes a repressive normative society which causes individuals to depart from it and is quickly proved irrelevant in a Transition society where all norms and values have been undermined.³

¹ Howard Abadinsky, *Organized Crime* (Chicago: Nelson-Hall), 1985, 5

² Leslie Holmes, *Rotten States?* (Duke University Press), 2006, 26

³ Vadim Volkov, *Violent Entrepreneurs* (Cornell University Press), 2002, 17

Similarly, the well-developed theory of anomie of the middle of the 20th Century runs into explanatory deficiencies. In the words of Robert K. Merton anomie occurs “when the cultural structure unduly exalts the end, and the social organization unduly limits possible recourse to approved means.”⁴ There are five modes for individual adaptation to inequality of opportunity: conformity, ritualism, rebellion, retreatism, and innovation, the last including organized crime.⁵ The theory originates with American society, but even there the psychological premise has been contested: Peter Lubisha puts forward a rational choice argument where “only suckers work,” to explain the resort to organized crime.⁶ Neither approach seems to fully account for the choice of organized crime over simply crime unless one assumes that the former represents a form of socialization that counteracts anomie. The missing ingredient in sociological explanations like these has to come from other disciplines.

In advancing a theory about the effects of different kinds of organized crime on state institutions in the Transition period Vadim Volkov makes a key objection: the theory of anomie implies that all forms of organized crime are equally dysfunctional and disruptive.⁷ Volkov’s objection comes from the field of political science and instead of focusing on society it looks at the state and the market to test the plausibility of what constituted, until a decade ago, mainstream thinking about organized crime. If simply a sociological phenomenon, then why do some forms of organized crime, in particular those found in post-Communist Transition countries, pervade the state and the market to the point of a failure of governance?

⁴ Abadinsky, *Organized Crime*, 69

⁵ Abadinsky, *Organized Crime*, 69

⁶ Abadinsky, *Organized Crime*, 76

⁷ Volkov, *Violent Entrepreneurs*, 17

Organized crime as historically and culturally inherited from Communism

Another set of explanations looks at crime in the Communist period and finds continuity in its nature and patterns of operation in the Transition period. In the work of Stephen Handelman “Comrade Criminal: Russia’s New Mafiya” the Red Mafia denotes the criminal alliance between corrupt Communist Party officials and underground dealers in the Brezhnev period. In a discussion of the criminal networks which were spawned off the GULAG, condoned by the prison authorities, and spread across the Soviet Union, Vadim Volkov asserts that “generally the more strong and oppressive the state regime became, the more organized and powerful the underworld was.”⁸ The organizational element runs parallel to party and state security structures – it constitutes the informal networks that outlasted the fall of Communism and exist even today. Although globalization has broadened the possible range of criminal activities the faces and connections between them, and their organized criminal enterprises, namely smuggling of goods and currency speculation, are elements of continuity . In Volkov’s paraphrase of the historical legacy argument, “the mafia is Communism unwilling to die.”⁹

What this neat analysis misses is the fact that the Communist state was overhauled together with the necessity for a grey sector to make up for the inefficiencies of central production and distribution. Even if informal networks endured, their functions, *raison d’être*, and the allegiance of their members was in various ways altered and subsumed in the process of the “withering away” of the state that accompanied neo-liberal reforms, the advance of the market, and democratic pluralism.

Organized crime as an economic phenomenon

⁸ Volkov, *Violent Entrepreneurs*, 55

⁹ Volkov, *Violent Entrepreneurs* , 17

Recent studies of organized crime have made more progress in the direction of contextualizing organized crime within a world of missing or underperforming institutions. Scholars of Russia and the East European states have endorsed Diego Gambetta's economic model of the Sicilian mafia. It has two simple premises: since the state does not provide a service, the market inevitably will; and a demand for protection creates a supply of protection. This is a model where weak states produce organized crime – a model that provides new insights for the implications and dangers of the Transition.

The caveat associated with this explanation is, as Federico Varese points out, that Gambetta has identified protection as the specific commodity that the mafia produces, promotes, and sells.¹⁰ Hence, “the mafia differs from organized crime in its relation to the state. The mafia and the state are both agencies, which deal in protection. While the mafia directly impinges on the state's jurisdiction, organized crime does not. Furthermore, the mafia is willing to lend protection both to legal (but poorly protected by the state) and illegal transactions.”¹¹ Mafia, then, is a type of organized crime that challenges and at the same time supplements the allocative and protective functions of the state vis-à-vis its citizens. This places the mafia, as the type of organized crime with the widest and most damaging structural and institutional impact, square in the fields of political economy and political science.

As Vadim Volkov points out, another important caveat in this new economic framework of organized crime is that it outlines a market for protection distinct from other markets be they legal or illegal.¹² It is this market shared by mafia and state which breaks

¹⁰ Federico Varese, *The Russian Mafia* (Oxford University Press), 2001, 4

¹¹ Varese, *The Russian Mafia*, 5

¹² Volkov, *Violent Entrepreneurs*, 20

the neat theoretical distinction in political science and political economy between crime as anomaly and the state as the norm. It is also important to notice that, although a purely economic model, the protection supply model of the Sicilian mafia bears enormous significance for political economy. If the cause is found in weak market institutions or a weak presence of the state on the market then theories such as neo-liberalism and theories of the Transition state become questionable.

To be sure Gambetta's model has already met with objections of a largely empirical nature. Varese draws attention to the assumption that there must be an automatic market response to arising demand for protection: "the existence of a demand for protection does not, however, necessarily imply that a supply of protection will emerge."¹³ Volkov suggests a sociological explanation for this empirical possibility: there has to be a certain kind of subculture which can produce effective wielders of force.

In the same vein of reasoning, the whole concept of a "market for protection" is tough to digest: an underlying assumption of the free market is that exchanges are voluntary and access to information is unlimited. However, since extortion and coercion are a part and parcel of the mafia's marketing strategies, it is hard to reconcile the reality of protection with the idea of the market. Volkov reformulates this intuitive objection in market terms: the model "underestimates the actual capacity of force-wielding organizations to determine choices available to economic subjects," and alludes to the popular movie line, "an offer one cannot refuse."¹⁴

Lastly, the economic analogy suffers from its assumptions of efficiency and equity. If indeed, protection was just another market, which could in fact be reconciled with the

¹³ Varese, *The Russian Mafia*, 2

¹⁴ Volkov, *Violent Entrepreneurs*, 20

neo-liberal framework of a thin state, then the mafia would be “normal.” On the one hand, Volkov attacks the efficiency premise and sees protection as interdependence enabling a redistribution of resources, but not a market in the ideal sense.¹⁵ On the other hand, Varese attacks the equity premise: the Mafia “never supplies protection as a public good...it does not recognize citizens’ rights...it does not recognize customers’ rights. In fact, mafia protection often starts as a form of extortion.”¹⁶ Any new theoretical framework for organized crime will have to incorporate the perspectives of political science and political economy. Among the questions one has to answer are what was the role of the state on the market during the Transition, and whether the Transition state was a state in the normative sense. The answers to these questions should illuminate the origins of organized crime, as well as its impact.

State or no state?

Rasma Karklins begins her study of corruption in Post-Communist states with the assertion that the region is unique in that it had to undergo “many simultaneous transitions.”¹⁷ What that implies is that something could go wrong on any level and affect the entire transition equilibrium, assuming there was such. In this framework Varese’s suggestion that the mafia emerged as the consequence of an imperfect transition to the market is legitimate.¹⁸ This explanation focuses on the state’s failure to regulate the market. Volkov is also a proponent of this economic-institutional approach: the mafia is about “producing a substitute for trust in a market economy where business culture does

¹⁵ Volkov, *Violent Entrepreneurs*, 23

¹⁶ Varese, *The Russian Mafia*, 5

¹⁷ Rasma Karlins, *The System Made me Do It* (Armonk, NY: M.E. Sharpe, 2005), 14-15

¹⁸ Varese, *The Russian Mafia*, 24

not encourage honest cooperation and where the state justice system is ignored.”¹⁹ This approach focuses on the inefficiency of the institutions, but those institutions are nevertheless taken for granted.

Indeed, if one is to criticize the economic-institutional approach in the context of the Transition, this is exactly what one has to aim at – the normative assumptions about the state. Thomas Schelling’s alternative approach is often quoted: an organized crime group seeks to govern the underworld; aspires to obtain a monopoly over the production and distribution of a certain commodity in the underworld.²⁰ Volkov takes the analogy a step further and suggests that in Schelling’s model the mafia effectively seeks a monopoly of force within the underworld.²¹ This is an interesting model since, if one recalls Max Weber’s definition of the state as the monopoly over the legitimate use of violence in a given territory, it would suggest that the underworld is a state within the state.

Understandably challenges to this model have arisen. Volkov objects to the artificial separation of the market into an over- and an underworld, and advances his idea that protection suppliers should not be discriminated among. Institutionally this means that “organized crime can be imagined only when the state and the system of justice it effectively enforces are in place,”²² otherwise there would be no crime, but two separate states theoretically defined.

Instead, Volkov suggests his own model of reconciling the tempting idea to think of organized crime in terms of monopoly over violence and its existence within the limits of an internationally recognized state. Volkov prefers to follow Ginafranco Poggi in

¹⁹ Volkov, *Violent Entrepreneurs*, 18

²⁰ Varese, *The Russian Mafia*, 4

²¹ Volkov, *Violent Entrepreneurs*, 22

²² Volkov, *Violent Entrepreneurs*, 22

distinguishing between wielders of force, and wielders of capital, and hearkens back to Veblen's predatory man, who is supposed to be subsumed into the modern economic or bourgeois man.²³ In fact, his study of the empirical reality in Transition societies led him to believe the two kinds of man can and do exist simultaneously. Moreover, the protection and extraction processes, in which the state and the mafia are two competing groups, are reminiscent of the very birth of modern states, theorized by scholars such as Charles Tilly. Volkov explains, "Conventional terms that reflect the standpoint of the state, such as organized crime and mafia, otherwise very useful, became inadequate for the purposes of sociological research."²⁴ Rather than redefine them, Volkov chooses to use different concepts - violent entrepreneur and violent entrepreneurship- and to study organized violence instead of organized crime. What is implicit in his choice of terms is that some form of market existed: "violent entrepreneurship is a means of increasing the private income of wielders of force through ongoing relations of exchange with other groups that own other resources."²⁵ But there was no state to define crime. The monopoly over violence is also seen in market terms: "a monopoly of forces within and unconstrained competition without are logical necessities for violent entrepreneurship."²⁶ It is tempting to assume the state away while explaining organized crime in the Transition, but the theoretical challenges that remain are still numerous.

If both theoretically and empirically adequate, this condition of statelessness should logically lead to the consolidation of some form of order, even a new state. If it is only an academic construct then it must be checked by the resurgence of the inefficient

²³ Volkov, *Violent Entrepreneurs*, 23

²⁴ Volkov, *Violent Entrepreneurs*, xii

²⁵ Volkov, *Violent Entrepreneurs*, 28

²⁶ Volkov, *Violent Entrepreneurs*, 25

but existing Transition state. Possible outcomes would span from democracy to authoritarianism. The empirical evidence is subject to interpretation.

However, before one even begins to consider the outcomes, one has to determine with certainty the absence of the Transition state – how and why were its institutions inexistent/inefficient, and to what extent have they been undermined by organized crime. An important first element in this analysis will be the notion of legality, or whether the state has in effect failed to define organized crime as crime. Secondly, corruption, or whether the post-communist state has failed to separate the public from the private sphere, or the “party” from the “state.” Thirdly, whether the state is the victim of organized crime, or it has *de facto* engaged in the competition for monopoly over violence as a private entity. If it has failed at the first two, and done the third, then the statelessness theory will hold.

The notion of legality

Organized crime is illegal, informal and exists outside the law. This is a truism in functioning liberal democracies, but barely in the Transitioning societies in the 1990s. If one recalls Gambetta’s economic model and applies it to the Transition reality, one will notice that on the protection market are both illegal and legal enterprises, to both of which the state does not provide protection.

Varese’s narrative is illuminating: “at the time of the transition to the market, property rights may be badly defined by the state and that protection may not undergo centralization and end up in the hands of the state. Other forms of protection may emerge especially in the face of an inefficient state and in the presence of people trained in the use of violence who have, as a result of the transition, found themselves without

employment.”²⁷ Why property rights are badly defined will be discussed later, but for the purposes of this analysis this legislative omission amounts to granting legality to the alternative providers of protection. In more explicit terms the immediate aftermath of the changes saw all entrepreneurs acquire negative fame – in Russia they were called *chastniki*, seen as Transition profiteers, and lumped together with the criminal underworld. Facing this public disapproval, the state authorities were reluctant to provide and enforce the legal framework for private business.²⁸

In a yet more drastic move toward blurring the limits of legality, neo-liberal reforms included the legalization of the private protection business. In effect it did not matter whether businesses applying for private protection licenses had been started up as a natural response to increased demand or had created a niche for themselves by locking small entrepreneurs into extortion schemes, which, as discussed earlier, was often the case. In effect the former rackets became private protection agencies without necessarily altering their methods. Moreover, nothing could stop former state structures, part of the massive Communist repression apparatuses, to also enter the market as private protectors, again blurring the limits of legality.

One could argue, as analysts such as Vadim Volkov and Elena Topilskaya do, that once organized violence groups become legal, free market dynamics will induce them to alter their behavior. In other words they will have to gain the trust of their clients instead of making them “offers they cannot refuse.” At first this sounds plausible, but is far from legitimate as a premeditated political strategy or an example of successful democratization. In essence it would imply that on the one hand the mafia opts to subject

²⁷ Varese, *The Russian Mafia*, 4

²⁸ Volkov, *Violent Entrepreneurs*, 31

itself to law enforcement in order to do better business, and on the other that the state capitulates before the mafia and offers a collaboration scheme.

In employing the term “violent entrepreneurship” Volkov introduces another dimension to the legality conundrum. He describes an economic reality (enforcement partnership) where organized gangs evolve to provide a range of services aside from physical protection, including security, contract enforcement, dispute settlement, informational support, and relations with higher agencies.²⁹ Violence becomes a deterrent in the business world, and, at least in the Russian case, court decisions are handed to private protection agencies to enforce. As Volkov comments, privatization and liberalization cause transaction costs, which in turn lead to innovative ways to use criminal elements, including as deterrent, or in conjunction with the law.³⁰ Legality is more than ambiguous in this picture of a market preceding society and replacing the state.

Corruption

Corruption is also a phenomenon, which in the post-Communist realm oscillates between the legal and the illegal sphere. While in constitutional democracies the well-mapped dichotomy public-private leaves no doubts about what constitutes corruption, or what constitutes organized crime for that matter, Transition countries are not constitutional democracies in reality. They are a flux of totalitarian elite mentality, and thin neo-liberal states. In other words abuse of public power and private gains are not defined or distinguished, and neither are many types of crime. The result is a well-theorized phenomenon of systemic corruption, richer and more complex than

²⁹ Volkov, *Violent Entrepreneurs*, 41

³⁰ Volkov, *Violent Entrepreneurs*, 43

conventionally defined bribing, and closely intertwined with, if not inseparable from, organized crime.

Johnson summarizes mainstream thinking about corruption over the past decade as “reduced to a synonym for bribery or rent-seeking, viewed as a problem in economic development, with the state judged primarily in terms of the extent to which it aids or impedes market processes.”³¹ Johnson advocates a new theoretical category in the discussion of corruption in post-Communist countries: systemic corruption, defined as “uses of/and connections between wealth and power that significantly weaken open, competitive participation and/or economic and political institutions, or delay or prevent their development.”³² In a more concise form comes Klitgaard’s oft-quoted formula systemic corruption = monopoly + discretion - accountability.

Rasma Karklins points to the benefits of post-socialist corruption research: it shows that institutions can be a façade, rules and regulations can be in place but political will and enforcement capacity can be lacking.³³ More illuminating in this direction is Joel Hellman’s partial reform paradox: a situation where reforms freeze halfway because state officials derive more gains from the unfinished reforms than they would after their completion, and feel no external pressure to continue reforming. It is evident how in this situation corruption is pervasive – as an opportunity within systemic reform, and as an environment within the system, which allows for officials to stay in office unpunished for lack of accountability. This also means that corruption in post-socialist societies can be multifaceted.

³¹ Michael Johnston, *Syndromes of Corruption* (Cambridge University Press, 2005), 6

³² Johnston, *Syndromes*, 10

³³ Karlkins, *The System*, 10

Instead of an opportunity for voters to exercise control over the political process, fraud and electoral abuse constrain reform-minded voters.³⁴ Ironically, anti-corruption efforts are used as smokescreens and strategic tools.³⁵ Election time is instead seen as dividing the spoils: “secretive power networks limit political competition and undermine democratic development.”³⁶ These networks are reflected in and enhanced through the control over public office and, where privatization is not complete, through appointments at state enterprises. Indeed, privatization is seen as a legal carve-up of state assets. The reason is simply the fact that regulatory and legal functions can be easily hijacked, and checks such as conflict of interest laws were slow to be written. Instead, formal checks and balances become what Johnson calls “checkpoints for oligarchs.”³⁷ In the event that the legislature is not accessible, the judiciary has proved susceptible to corruption – the vital missing source of reform and accountability pressure in Hellman’s theorem. Once one adds the control over public funds, and public contracts to the realm of corruption opportunities, the catalogue begins to encompass the whole state apparatus; the executive does not need mention.

What cataloguing misses is the fact that corruption was in fact “normal” during the Transition. Firstly, communist-time and new organized crime structures were readily available avenues for self-enrichment of officials. “During Communism the state was the biggest criminal,” says Kostadin Grozev, a historian at Sofia University in Bulgaria: smuggling within the state and in transit was not a secret for the authorities, and was

³⁴ Johnston, *Syndromes*, 45

³⁵ Johnston, *Syndromes*, 45

³⁶ Karlkins, *The System*, 32

³⁷ Johnston, *Syndromes*, 45

tolerated for a price.³⁸ Currency speculation might have died off as an option for organized criminal activity, but transit smuggling channels are even enhanced by globalization, and the spectrum of other “tax-evading” crime options has broadened. The result is an increase in the corruption clientele. Secondly, liberal reforms were perhaps the biggest catalyst and source of corruption. Privatization, market liberalization, and property rights were reform fields that allowed for an unimpeded carve-up of what were formerly state assets. In fact, corruption there became the norm instead of the exception.

The discussion of incentives for corruption invites mention of recent collective action analysis of corruption. What pervasive corruption does is change the incentive structure for legal practices throughout society.³⁹ Rasma Karklins puts it simply, “if most or all people within an institution engage in corrupt acts, the pressure on any individual to do the same increases dramatically.”⁴⁰ Klitgaard also imagines a theoretical stage where even honest citizens may need to be corrupt to get by.⁴¹ This analysis naturally connects with Ivan Krastev’s argument about the disincentives to engage in anti-corruption efforts: a culture of mistrust can hamper effective governance. In other words if exposing corruption does more empirical harm to a government by giving cause for heightened awareness and mistrust in the public, then there is no incentive to fight it.⁴² The government itself becomes the victim of a collective action problem.

Apart from the opportunities for corruption found in the Transition society’s encounters with privatization, access to rule making and appointments, as well as a sense

³⁸ Author’s interview with Kostadin Grozev, Professor of History, Sofia University, Bulgaria. August 30, 2009

³⁹ Johnston, *Syndromes*, 38

⁴⁰ Karlkins, *The System*, 152

⁴¹ Karlkins, *The System*, 152

⁴² Ivan Krastev, *Shifting Obsessions*, (Central European University press, 2004), 81

of immunity from the law, corruption is also encouraged through the reduced capacity of the weak Transition state. In Johnson's words, "a state that cannot guarantee property rights and basic liberties, collect taxes, enforce contracts, and provide legitimate channels for the expression of interests, will be ineffective and unresponsive and will invite private efforts to perform those functions, often by way of corruption and violence."⁴³

In fact, mainstream political science argues that neo-liberalism contributed to corruption through its focus on ends over means, flexibility, competition, homo economicus, consumption, free trade, reducing the role of the state.⁴⁴ The latter is what Johnson focuses on, "democratization emphasis has been on further liberalization, not on state and social institutional frameworks that sustain and also check democracy and markets."⁴⁵ In this situation state officials and civil society are poorly equipped to enforce the rule of law, and political factions are unstable and poorly disciplined. As Johnson suggests, more liberalization would add fuel to the fire.⁴⁶

The classical premise that proper taxation can increase state capacity is put to a test in the case of the corrupt Transition state. A phenomenon ensues, which Holmes calls "double extraction," or the dilemma whether to bribe or to pay tax. Hellman and Kauffamn elaborate on this dilemma by assuming a high level of inequality on the market: "firms are more likely to invest in bribery of individual officials either to gain advantages or to protect themselves – rather than in the support of state institutions. Naturally, such behavior further reinforces the weakness of state institutions in highly unequal

⁴³ Johnston, *Syndromes*, 37

⁴⁴ Holmes, *Rotten States*, 11

⁴⁵ Johnston, *Syndromes*, 1

⁴⁶ Johnston, *Syndromes*, 121

environments.”⁴⁷ Tax evasion is an entirely different issue, but the result is the same: state incapacity breeds state incapacity.

Communist legacy

A lot has been written on how corruption in Transition societies is also predetermined by a Communist legacy of sociological nature. In sum, the lack of civil society and a middle class behind it, the inherited informal networks, as well as the lack of any culture of accountability, made corruption ubiquitous and “normal.” In a more psychological vein, “the very nature of post-Communism encourages the spread of corruption, or is atleast highly conducive to it. One major reason is that the communist legacy is characterized by a fuzziness of boundaries between state institutions, and between the state and society; an ideology in which ends are often more important than means; and the near-absence conceptually and in practice of the rule of law.”⁴⁸ Given that in most post-communist societies oppositions were persecuted during Communism, and Transition governments were often composed of former Communists, political culture in the Transition state cannot but share Communist features. Karlins suggests that post-communist politicians try to recreate monopolies of decision-making and that a concentration of administrative control and the contradiction of public moral norms (public versus private) shape incentives for officials.⁴⁹ Holmes elaborates on the contradicting moral climate of which officials are a product: “formal rejection and informal toleration made the regimes opportunistic and hypocritical.”⁵⁰ As a result

⁴⁷ Joel Hellman, *The Inequality of Influence*, (In Zunia Knowledge Exchange, <http://zunia.org/post/the-inequality-of-influence>, Dec 2002), 21

⁴⁸ Holmes, 11

⁴⁹ Karlins, *The System*, 75-76

⁵⁰ Karlins, *The System*, 76

Karklins is justified in asserting that while the assumed dynamic of the corrupting is business corrupts officials, in post-communist states it is often the other way round.⁵¹

Perhaps equally important elements of the Communist legacy are informal rules and networks. Johnson suggests that black markets and systemic corruption were seen as necessary for the survival of the system, to the extent that they influenced a normative framework – the informal rules which guide corrupt transactions today.⁵² Similarly, Karklins quotes Ilja Srubar in defining a transition from what he ironically calls pseudo-“real socialism,” due to the perceived economic necessity for the informal market, to functional friendship networks.⁵³ State security service networks are another example of Soviet-time networks, which outlived the changes. Srubar invents an ironic term for the legacy of Communist networking: *clientura* instead of *nomenklatura*.⁵⁴

Apart from political culture informal networks, the Communist legacy is also found in social composition and preferences. Socialist societies emerged from decades of Communism without any structure of civil society, which could demand accountability; or a lobby of ordinary property owners (middle class), which could pressure the government into providing general and simple rules.⁵⁵ Moreover, in a discussion of why courts are by preference left out when settling business disputes, Volkov brings up the issue of a traditional and personalistic approach: apart from being cumbersome and expensive, courts ruin relationships and informal friendships.⁵⁶ The Communist legacy is therefore an

⁵¹ Karlkins, *The System*, 20

⁵² Johnston, *Syndromes*, 132

⁵³ Karlkins, *The System*, 87

⁵⁴ Karlkins, *The System*, 79

⁵⁵ Varese, *The Russian Mafia*, 28

⁵⁶ Volkov, *Violent Entrepreneurs*, 49

all-pervasive sociological factor, which contributes to the climate of fuzzy institutional boundaries and an unclear definition of private and public: a soil fertile for corruption.

Systemic corruption and Organized Crime

The logical question at the end of this corruption analysis is how does systemic corruption relate to organized crime?

Firstly, corruption in rapidly changing conditions creates insecurity for the very practitioners of corruption; hence, the resort to organized violence. Johnson explains that oligarchic gains are insecure because of rapid change and since the state is not there to enforce contracts or defend property, violence (*mafiyas*, private armies) becomes a rational resort.⁵⁷ Varese supports this analysis with a collective action dilemma: “corruption produces a demand for protection because the actors in this exchange do not know for sure if the other party will deliver what was promised (the money for the bribe or the favourable official decision).” He continues his analysis by suggesting that the dilemma does not weaken with iteration: “even if one actor establishes a long term relationship with a segment of the political elite, violence may be used to keep competitors at bay and politicians in line.”⁵⁸

Following the earlier collective action analysis of corruption, one reaches the point where a critical mass of actors acts in a corrupt way and creates incentives for everyone to act in the same way. In this discussion, the model implies that corruption in the law enforcement agencies creates unpredictability for all citizens and businesses; therefore, everyone is compelled to resort to private protection. Varese elaborates on this point: “a non-impartial ruling amounts to a form of legal confiscation. Once this takes place, people

⁵⁷ Johnston, *Syndromes*, 45

⁵⁸ Varese, *The Russian Mafia*, 27

will perceive that the legal system is becoming less impartial and at that point they will turn away from the state: they will form more of their agreements outside its jurisdiction, lowering the demand for its service. This in turn leads to a demand for non-state protection.”⁵⁹

Corruption would also imply turning a blind eye to the practice of extortion, which gives rise to protection racket organizations. The earlier discussion of state incapacity is illuminating but Volkov adds another dimension to the topic reflecting on neo-liberalism as the guiding state philosophy. He suggests that for the government the strengthening of security and police institutions were seen as going against the conventional wisdom of market liberalism.⁶⁰ As suggested earlier, corruption can become a factor when the state chooses to legalize private protection, ignore its previous and current criminal methods, and cede part of its monopoly over the legitimate use of violence to yesterday’s mafia. Moreover, corruption seen as the inefficiency of the state fits into the initial economic model of organized crime that this paper discussed: a case where the mafia supplies a service the state cannot offer. In Varese’s words, “the mafia banks on the inefficiency of the state in supplying efficient protection to legal transactions: the more confused the legal framework of a country, the more incompetent the police, the more inefficient the courts, the more the mafia will thrive.”⁶¹

Sociologically the most important connection between corruption and organized crime is undoubtedly the fact that corruption creates inequality, and inequality breeds crime. The economic consequences of corruption became clear in the mid 1990s when the

⁵⁹ Varese, *The Russian Mafia*, 25

⁶⁰ Volkov, *Violent Entrepreneurs*, 140

⁶¹ Varese, *The Russian Mafia*, 5

development community reached a consensus that corruption was a major barrier to economic growth. While analysts concede that unofficial growth can exist, and in Lane's model⁶² it can even be productive if conspicuously spent or reinvested, it will essentially serve only a few and will not be redistributed. Moreover, it is more likely that in a highly unequal and uncertain situation, firms will focus on short-term games, and if they are paying a double tax, as in Hellman and Kauffman's model, firms are less likely to invest in restructuring. According to the UN's Report on Crime and its Impact on the Balkans, unemployment and income inequality are by no coincidence indicated as the chief reasons for corruption and organized crime.⁶³

Models for organized crime

The specific case of the Transition state so far analyzed calls for a reappraisal of the model of organized crime presented at the beginning: does organized crime originate with the "bottom," or does it start from the "top." To summarize the two approaches the question can be paraphrased as whether unemployed "predatory men" set up protection rackets on street markets, which then become capitalist enterprises, and their leaders - oligarchs; or did oligarchs and high-ranking officials from the now obsolete Communist repression apparatus create protection rackets in order to reap and protect the benefits of privatization and liberalization?

The first option is the street market extortion model, which in broad lines follows Gambetta's model of the Sicilian mafia. As Volkov suggests, the supply of protection required a certain kind of subculture, a kind of Veblenian predatory man who could wield

⁶² Volkov, *Violent Entrepreneurs*, 37

⁶³ *Crime and Its Impact on the Balkans*, (United Nations Office of Drugs and Crime, www.unodc.org/documents/data-and-analysis/Balkan_study.pdf, March 2008), 28-30

violence. Varese quotes Lev Brekhman in identifying this subculture in Russia, and in fact throughout the Soviet Bloc: “sportsmen were the regime’s gems, well fed, cuddled, allowed to travel abroad, all acquainted with each other. When the regime collapsed, they found themselves without the money to buy decent food and without the skills to find an honest job.”⁶⁴

From this point onwards, the extortion model departs from Gambetta’s market model: while in both cases the state has not regulated the market and is incapable of doing it, in the Transition state extortion model, the demand for protection is not free or voluntary. Instead, as Volkov explains, the supply created its own demand by creating risk for small entrepreneurs, forcing them to subscribe for protection, and territorializing whole cities.⁶⁵ Volkov then traces how “separate episodes of extortion are transformed into a durable institutionalized, businesslike relationship.”

Varese and Volkov give their own versions of the end of the narrative. For Varese finally “the mafia penetrates politics, and corrupts the police and the judiciary to enhance its interests, although these are not defining characteristics of the phenomenon.”⁶⁶ For Volkov it is important “to show how such competition first corroded the foundations of the state in everyday economic activity and later created the momentum for forming a larger monopoly in place of a heterogenous realm of private protection agencies. The rebuilding of the state from above followed.”⁶⁷ In essence Volkov has to assume the state away, while Varese does not. In any case the common elements of the two authors’ models theoretically hold ground. Only reality can provide the final test.

⁶⁴ Varese, *The Russian Mafia*, 57

⁶⁵ Volkov, *Violent Entrepreneurs*, 33

⁶⁶ Varese, *The Russian Mafia*, 6

⁶⁷ Volkov, *Violent Entrepreneurs*, 26

The second model, which deserves attention, derives its name from a corruption model developed by Johnson for post-socialist states: the oligarch and clan based model. In Johnson's words "oligarch and clan corruption takes place in a risky and sometimes violent setting of rapidly expanding economic and political opportunities and weak institutions. It is dominated by figures who may be government officials or business entrepreneurs, but whose power is personal and attracts extensive followings."⁶⁸

Given this description it is easy to convert the oligarch and clan based corruption model into a mafia model. The task is made easier by Volkov's reflections on Russian cases where "local force-wielding organizations formally belonging to the state [are] used by local power holders to protect affiliated economic subjects or pursue their interests at the expense of various competitors."⁶⁹ He also traces how "existing institutions, previously unrelated to the rule structure of the economy but equipped to use force, supplied cadres for new private force-wielding organizations that dealt in private protection and enforcement and accordingly governed the redistribution of the income of economic enterprises."⁷⁰ From these observations it is clear that at least part of the initiative for organization and monopolization in organized violence came "from above."

The problem is that in his analysis Volkov sees elements of the state as just another actor on the protection market: "the conundrum of the strong influence of the absent state can be partly resolved by looking at the quiet conversion of large segments of state "power ministries" into a private protection industry."⁷¹ In his view its high coercive potential altered its institutional form. The derivative view, which the author of this paper

⁶⁸ Johnston, *Syndromes*, 3

⁶⁹ Volkov, *Violent Entrepreneurs*, 173

⁷⁰ Volkov, *Violent Entrepreneurs*, 127

⁷¹ Volkov, *Violent Entrepreneurs*, 127

is more inclined towards, is that the state tolerated the use of violence against its own citizens through involving itself, and in effect participating and even monopolizing organized crime.

A more illuminating model draws on American history in the first half of the 19th Century. John Wallis examines the concept of corruption in the American context and distinguishes between two kinds of corruption before and after the year 1850 or the advent of the Progressive Era: systematic corruption and venal corruption. Systematic corruption “uses the economic rents generated by limited entry and economic privileges to control the political system. Political interests corrupt the economic system for political gains: politics corrupts economics.”⁷² In the American experience this kind of “rent creating” as opposed to “rent seeking” refers to controlling the market by granting charters. However, as far as controlling market entry goes, Wallis asserts that “many developing countries of the world today suffer from systematic corruption” rather than from corruption in its modern meaning that economic interests corrupt the political process. In Eastern Europe and Russia, where oligarchs, governments and racket groups are hard to tell from each other, Wallis’ model is especially valid.

Prospects for the future

The hardest but also most interesting part of this type of analysis is speculation for the future. On the one hand a plausible negative scenario presents itself, where “the more protection of illegal transactions is efficiently supplied, the more illegal markets will thrive.”⁷³ Corruption reaches a level, where the state’s legal rulings are non-impartial, and

⁷² John Joseph Wallis, *The Concept of Systematic Corruption in American Political and Economic History* (NBER Working Paper No. 10952, <http://ideas.repec.org/p/nbr/nberwo/10952.html>, December 2004), 2

⁷³ Varese, *The Russian Mafia*, 5

informal rules become formalized. Such a state is, in effect, run by the mafia and if it does not reach some kind of authoritarian equilibrium, it most probably becomes a failed state. The positive scenario unexpectedly meets with sound theoretical support. In the first place continued liberalization undercuts informal networks, violence becomes increasingly costly, and hence only a deterrent, and other protection tools such as courts are opted for. In other words, criminal leaders become capitalists and their interests change, analogically to Weber's "iron cage."⁷⁴ Those interests are namely: to be less vulnerable to the law, to secure gains under changing circumstances through increased predictability and trust. Schleiffer and Hay explain that the only viable reform strategy is private enforcement of public rules by a new capitalist class, or as Peter Rutland paraphrases "the oligarchs must be allowed to enrich themselves."⁷⁵ Another theoretical proof for the positive scenario comes from the Coase theorem: assuming there is a free market in assets, the productive resources will flow into the hands of the most efficient owners. As noted earlier, however, the type of capitalism practiced by oligarchs and organized crime does not focus on redistribution or on long-term growth.

Fortunately, the positive scenario has an international dimension: the revival of the Russian state with an authoritarian streak proved that oligarch and clan organizations are susceptible to regime and stock market change; while as seen in recent EU enlargement literature, the elites of new member countries from Eastern Europe, which

⁷⁴ Volkov, *Violent Entrepreneurs*, 25

⁷⁵ Peter Rutland, *The Politics of Anti-Corruption Campaigns* (International Council for Central and East European Studies Seventh World Congress, Berlin, Germany, Panel XX.3, 25-30 July 2005)

rule in what Andrew Barnes⁷⁶ calls a competitive capture situation, have reacted positively to the democratic and institutional pressure of the European Union.

⁷⁶ Andrew Barnes, *Extricating the State: The Move to Competitive Capture in Post-Communist Bulgaria* (Europe-Asia Studies, Vol. 59, No. 1, January 2007), 8

Chapter 2:

From Above

This is the untold story of the Transition. The paradigm in political theory describes the cataclysmic advance of neo-liberalism, inexperienced elites, reduced state capacities, and poor international economic conditions. In 1998 Joel Hellman's *state capture* theory became part of the mainstream paradigm marking an effort to look closer at the social dynamic within Transition societies. *State capture* tells the story of how the private sector infiltrates rule making and thus runs the state.

The revisionist Transition literature brings forth the theory of *systemic corruption* or rampant rent seeking whereby old elites try to preserve their positions in power by extracting rents from the new private sector.

How does organized crime factor in this story? In Bulgaria and Latvia, the two Eastern European countries with most rampant organized crime, it followed the model of the Sicilian mafia, but was also arguably guided from above, and came to be part of a criminal government machine not unlike Tammany Hall of late 19th Century New York. Orthodox criminal activities parted company with activities, which could only be sustained in the conditions of a Transition to democracy and the market. Unexpected developments and unpredictable results accompanied the criminal alliance between the state elite, the new oligarchs/former black market profiteers and the "thuggish" bottom of post-communist society.

Where the paradigm fails: what is the state?

The main failure of mainstream Transition literature is to be found in the fact that balanced government as written into post-socialist constitutions, liberalized markets as preached by the doctrine of neo-liberalism, and civil society as observed in the Velvet Revolutions are taken for granted or at least strongly anticipated. In such a picture problems are likely to be either exogenous such as a global financial crisis, or inefficiencies within the system. But such a picture overlooks a number of inherited pathologies and newly contracted maladies characteristic of the Transition period.

In a seminal work on 1990's Bulgaria, Venelin Ganev criticizes the conventional political scientific approach which tends to flounder between reform-minded elites, bureaucracies, markets, and society, and proposes a *state-centered* perspective. In his words 'the central premise of the state-centered analysis is that neither the inputs into the state domain (ideologies and reform proposals submitted by temporarily empowered electoral winners) nor the interplay of broader political forces and larger social constituencies may satisfactorily account for the sudden fluctuations of stateness. Behind such fluctuations lies a dynamic autonomously generated within the state domain itself.'⁷⁷ The idea is that the post-socialist state does not lend itself to conventional categories.

On the one hand it is hard to speak of Polanyian social transformations in states where society was highly etatized: the sprawling grid of organizational entities that the Communist state-builders left behind can hardly be abstracted from the society in which it was embedded.⁷⁸ On the other hand, the question of stateness is limited by the reigning

⁷⁷ Venelin Ganev, *Preying on the State*. (Cornell University Press, 2007), 3

⁷⁸ Ganev, *Preying*, 5

paradigm that “questions regarding stateness are irrelevant to political transitions that occur within established nation-states or state-nations.”⁷⁹ (Linz, Stepan, Gunther, Tilly)

If neither the market, nor society, or the nation is to be seen as the basis for social transformation in post-socialist countries, then Ganev proposes an approach, which focuses on the role of the elite and its predatory interests. To him social transformation in Bulgaria amounts to “a question of recombining the preexisting components of a state-centered system of control over flows of resources.”⁸⁰ The Latvian case is an interesting mixture of Ganev’s approach, and a reaffirmation of the Latvian nation-state vis-à-vis its past as a Soviet Republic and its substantial Russian minority.

Another critic of the Transition paradigm is the sociologist Georgi Petrunov, who draws on the Bulgarian experience in order to make the claim that “the problem with transformation models is that they “to a much lesser extent – even if at all – treat organized crime not only as an important aspect but even as an underlying factor for these [social] transformations.”⁸¹ In fact, he goes as far as to say “that organized crime may have infiltrated society and its institutions to such an extent that it has become not only the major social mechanism of transformation, but also that it serves to reflect the very substance of this transformation.”⁸²

In a radical statement on the state’s role in Bulgarian organized crime, Bogomil Bonev, minister of the Interior in the first opposition government (Union of Democratic Forces) after 1989, made a statement in 1997 advancing the idea that “Organized Crime in Bulgaria is an intentional result of planned activities with the participation of the state

⁷⁹ Ganev, *Preying*, 11

⁸⁰ Ganev, *Preying*, 4

⁸¹ Georgi Petrunov, *Organized Crime and Social Transformation in Bulgaria*. (European Journal of Sociology, 47:297-325 Cambridge University Press,2006),297

⁸² Petrunov, *Organized Crime* , 321

and that this is its most outstanding difference when compared to similar formations of the West.”⁸³ Moreover, he claims, “organized crime was employed by the former political and administrative apparatus as an instrument for the preservation of the political and economic power circumstances.”⁸⁴ Similarly, Andrejs Vilks, director of the Latvian office of European Cities Against Drugs (ECAD) says that “organized crime is turning into a social institution in Latvia.”⁸⁵

In Immanuel Wallerstein’s work, Petrunov finds an interesting confirmation of the alliance between predatory elites and organized crime in state transformations : “the bureaucracies and politicians of weak states (and even of stronger ones) becoming even weaker and losing popular legitimacy (and consequently some popular control) have tended in many cases to merge their interests with those of the extra-state mafias. In some cases it may not be useful or meaningful to distinguish the two groups.”⁸⁶ The challenge Bulgaria poses to this theory is that the élites in question were at the same time threatened by changes, and in complete control of them by virtue of their doppelganger identity as the former Communists and the new democratic Socialists. To illuminate this contradiction Petrunov draws on Georg Simmel’s thesis on secret organizations: that “social power threatened by social innovations becomes secret.”⁸⁷ He reverses it to make the claim that in the Bulgarian context secret organizations become supporters of social innovation and even official power.⁸⁸ The term “secret organizations” has a broad

⁸³ Petrunov, *Organized Crime* , 322

⁸⁴ Petrunov, *Organized Crime* , 322

⁸⁵ Swanström, Niklas L.P., Emin Poljarevic, Elisabeth Peterson. *Organized Crime and Narcotics in the Baltic Sea region: issues of national and regional Security* (Report from the Central Asia and Caucasus Institute & Silk Road Studies Program Conference in Stockholm, Sweden, 1-2 June 2005), 71

⁸⁶ Petrunov, *Organized Crime* , 322

⁸⁷ Petrunov, *Organized Crime* , 300

⁸⁸ Petrunov, *Organized Crime* , 322

meaning in the Bulgarian context, where it encompasses not only mafias, but also the communist nomenklatura.

Neo-liberalism and the unreconstructed elites: a sociological perspective

The deconstruction of the social transformation theory in post-communist states draws attention to another important failure of mainstream Transition theories: they assume that the causes of state malfunctioning are due to the policy preference of “free marketers”, who deliberately dismantled the state.⁸⁹ Ganev, however, questions the role of ideology in the Transition and instead looks to the “unique institutional legacy of state socialism, the unusual structure of incentives facing powerful elites, and the peculiar dynamics unleashed when fundamental social relations, related to the collecting, managing, and distribution of resources were radically altered.”⁹⁰ In other words, “the historical distinctiveness of the behaviour of successful predatory elites in post-Communism is that they have had an incentive to behave as state breakers, not state makers.”⁹¹ As their reform record reveals, Latvian political elites were not immune to these perverse incentives either. Put into the context of the structure versus agency debate in social science this argument would amount to saying that Transition theory has been getting the structure wrong.

Ganev draws on Stephen Fish’s singular political juncture theory, or that defeat in elections warrants a reformation of the communist party, and a victory – traditionalism, to contrast the Bulgarian experience with the Transition paradigm. In fact, the Communist (later Socialist) Party in Bulgaria preserved its grip on power until 1992 well past the first

⁸⁹ Ganev, *Preying*, 2

⁹⁰ Ganev, *Preying*, 2

⁹¹ Ganev, *Preying*, 96

multi-party elections of June 1990. Until the end of 1990 it had absolute and undivided control over all branches of power, veto over all decisions regarding personnel changes on all level of bureaucracy.⁹² The leader of the pro-reform group within the Party, Andrei Lukanov defined himself as a third generation Communist and had been involved in foreign export, foreign trade and international finance under Communism until he rose to Prime Minister in March 1990, appointed by the last Communist Government. Lukanov's ideological convictions consisted in resisting the restoration of capitalism in the country, in other words that fostering markets amounted to "social sadism".⁹³

At the same time Communist Party structures were already deeply engaged in the fledgling private sector. The latter was reluctantly opened as part of *perestroika* in the late 1980s by a piece of legislation called decree 56. The result was that, in Stanimir Vangelov's words, "when I looked at the trade register for 1986, it struck me, the security services founded the first company a week after decree 56 came into effect. And within the first year, members of the DS [state security] had founded 90% of the new joint-stock companies!"⁹⁴ This doppelganger identity is something most Transition analyses miss: Bulgarian elites in the early 1990s were anti-capitalist in rhetoric, but also the first capitalists in deed. In effect, "the resources and instruments of the state were left at the mercy of administrations and elites whose optimal strategy is to steal or secure their "local" schemes for quick enrichment and their dominant position in society."⁹⁵ A comparison across Russia and other former Communist states would show similar developments, although to varying degrees.

⁹² Ganev, *Preying*, 43

⁹³ Ganev, *Preying*, 44

⁹⁴ Glenny, Misha. *McMafia*. New York: Knopf, 2008, 7

⁹⁵ Ganev, *Preying*, 46

Although not overtly anti-capitalist, Latvia's post-communist political make-up also contained many old nomenklatura faces. Norgaard and Johannsen point to the period 1992-1997, when Latvia had five different governments and prime ministers, with a striking continuity of personalities.⁹⁶ After the elections for the 5th Saeima (Parliament) in 1993, Latvijas Cels (Latvia's Way) retained a central role as the kingmaker party in various coalitions, which also means that "Latvia never experienced a sharp break with the past in the form of an alternative elite coming into power as in Lithuania and Estonia."⁹⁷

The democratic identity of Latvia's new governing elite was put to the test with the first elements of shock therapy in 1991-2 as advocated by the IMF: ending of state subsidies to firms and for specific goods and services, lifting price controls, and limitations of currency emissions. Juris Dreifelds asserts that "political parties of different persuasions began to clamour for a slowing down of reform initiatives. Even the People's Front government [liberal democratic coalition] appeared at time willing to heed these determined pleas."⁹⁸ The reforms were pushed through only due to the unflinching stance of Latvia's Independent Central Bank and its chairman Einars Repse. This instance lends itself to a curious interpretation in terms of orthodox Transition theory: on the one hand exogenous neo-liberal ideas and the reform-minded executives of one state institution caused unpopular reforms to happen in line with conventional models; on the other hand the lack of consensus within Latvia's governing elite and its easy swing into a populist mode run counter to the neo-liberal paradigm.

⁹⁶ Ole Norgaard, and Lars Johannsen, *The Baltic States after Independence*, (Northampton, MA: Edward Elgar, 1999), 62

⁹⁷ Norgaard, *The Baltic States*, 62

⁹⁸ Juris Dreifelds, *Latvia in Transition* (Cambridge University Press, 1996), 114

Economic freefall without reforms: the economic bias

While the political scientific view incorrectly emphasizes the role of elites and their neo-liberal ideology while overlooking the sociological aspect of who constitutes the élites, the economic view of the Transition suffers from different limitations. The Transition presented economists of all persuasions with a paradox: while liberal reforms were supposed to wreak short-term havoc and result in growth in the long term, in reality economic freefall was proceeding without substantial liberal reforms.

The phenomenon acquired the name “partial reform” and originated with Joel Hellman’s 1998 article *Winners Take All: The Politics of Partial Reform in Postcommunist Transitions*. In short, “groups that gain substantial rents from the early distortions of a partially reformed economy have a stake in maintaining a partial reform equilibrium that generates high private gains, but at a considerable social cost.”⁹⁹ Bulgaria and Latvia very convincingly suffered from partial reform in the early 1990s, although Latvia’s record is mixed with some reform advancing faster than others.

In Bulgaria, the Lukanov socialist government put up a doppelganger performance. When the so called “Lukanov winter” of 1990-91 faced people with unprecedented goods and energy shortages, socialist rhetoric began “blaming the impoverishment of the nation on a shock therapy imposed by foreigners and their (alleged) domestic agents, but a shock therapy in actual fact never occurred.”¹⁰⁰ The price liberalization effected in 1991 was a half measure only and “a grudging acceptance of the

⁹⁹ Joel S. Hellman, *Winners Take All: The Politics of Partial Reform in Postcommunist Transitions*, (World Politics - Volume 50, Number 2, January 1998), 203-234

¹⁰⁰ Bruno Schönfelder, *Judicial Independence in Bulgaria: A Tale of Splendour and Misery*, (Europe-Asia Studies, 57:1, 61 — 9, 2005) 66

fact that the command economy had collapsed and most transactions had gone underground.”¹⁰¹ Not only was it not accompanied by anti-inflationary policies and opening of the economy, but was even partially reversed in 1995. The unambiguous empirical record behind the façade led Milada Vachudova to lump Bulgaria into the category of illiberal post-communist regimes in Eastern Europe, along with Romania and Slovakia.¹⁰²

While as seen Latvia’s record in price liberalization and its accompanying monetary measures was better than Bulgaria’s, its privatization policies deserve closer scrutiny. In a report carrying the positive title *Privatization Accelerates, Boosts Economic Reform* Imant Paeglis illuminates Latvia’s problems with partial reform:

“Initially, neither the government nor the parliament was particularly interested in privatizing profitable state enterprises, which were used as a source of funds for balancing the state budget. Instead, the worst enterprises were often the first to be offered for sale; in some cases, decisions to privatize were made only when bankruptcy was imminent. Not surprisingly, investors were rarely willing to take over such enterprises, and demand at public auctions for their shares was low. Latvia's "sell the worst first" strategy contrasted sharply with the strategies adopted in Central Europe, where the first firms slated for privatization were among the most attractive and the successes of national privatization programs were built on those initial sales.”¹⁰³

Having spotted this paradox, Joel Hellman devised a theory in order to explain it: *state capture*. Challenging conventional ideas of administrative corruption, where bureaucrats extract bribes from the private sector, Hellman takes a look at the private sector and suggests that “a recognition that powerful firms have been able to capture the state and

¹⁰¹ Schönfelder, *Judicial Independence*, 66

¹⁰² Milada Anna Vachudova, *Europe Unidvided: Democracy, Leverage and Integration after Communism* (New York: Oxford University Press, 2005)

¹⁰³ Paeglis, Imants. *Latvia: Privatization Accelerates, Boosts Economic Reform* (Transitions Online, 13 December 1996)

collude with public officials to extract rents through the manipulation of state power suggests that there are other dimensions of the relationship between the state and firms that could further enrich our understanding of the political constraints on the reform process.”¹⁰⁴ This analysis deserves closer scrutiny.

First of all, Hellman distinguishes between two types of corruption – administrative and state capture – which are not dissimilar to John Wallis’ venal and systematic corruption discussed in the previous chapter. However, while Wallis identifies systematic corruption (perpetrated by politicians controlling market entry) as prevalent in developing and transitioning societies, Hellman reverses the logic and suggests that in fact venal corruption or state capture (perpetrated by the private sector agents advancing the bribes and buying the rules) is the problem in Transition countries. The confusion originates with the attempt to cross-apply orthodox categories to unorthodox contexts. As Donald Bowser of Transparency International for the Former Soviet Union (FSU) asserts, “state Capture does provide a framework for examining the corruption issue in the Former Soviet Union but its reliance on the models presented by modern States needs refinement if it is to be used in analyzing anti-modern States.”¹⁰⁵

Hellman rightly draws attention to the fact that “after only a decade of transition, the fear of the *leviathan state* has been replaced by a new concern about powerful *oligarchs* who manipulate politicians, shape institutions, and control the media to advance and

¹⁰⁴ Joel Hellman, *Seize the State, Seize the Day: State Capture, Corruption and Influence in Transition* (World Bank Policy Research Working Paper No.2444, September 2000).

¹⁰⁵ Bowser, D. in a comment on “Measures addressing State Capture in Russia / Ukraine / Central Asia,” on the helpdesk page of the Anti-Corruption Resource Centre U4, Bergen, Norway. <http://www.u4.no/helpdesk/helpdesk/queries/query18.cfm>

protect their own empires at the expense of the social interest,”¹⁰⁶ but in post-communist states this distinction is only a theoretical one. While a number of cases of high-level corruption and conflict of interest in the Transition states might fall neatly under the category of *state capture* by the private sector, an even larger number merit more careful attention. As discussed earlier, in all of the Transition states, including Bulgaria and Latvia, the continuity between former and current political and economic elites was remarkable: it can be argued that Hellman’s *leviathan state* and the *oligarchs* are essentially one and the same group with the same powers, methods and networks.

Bowser asks the question, “while there exists rampant corruption in the countries of the Former Soviet Union and oligarchs in many countries have seized the lion's share of State assets, the question arises as to who is capturing who. Is it a case of the State being captured by the private sector or a fusion of the State and the private sector?”¹⁰⁷ He goes on to state that “there is no need to use *state capture* to establish or change the 'rules of the game' since the rules of the game are the same as in Soviet times. Different social networks operate as fractions within society to maximize their dominance and engage in rent-seeking. The losers of the game are those that don't have a 'krysha' or roof that is able to distribute patronage.”¹⁰⁸

Still, the Business Environment and Enterprise Performance Survey (BEEPS) carried out in mid-1999, to which Hellman’s state capture theory gave rise, is a reliable and illuminating economic index, which also highlights a correlation between state capture and partial reform. In Hellman’s words :

¹⁰⁶ Hellman, *Seize the State*

¹⁰⁷ Bowser, *U4 Help Desk*

¹⁰⁸ Bowser, *U4 Help Desk*

“the high capture group includes Azerbaijan, Bulgaria, Croatia, Georgia, Kyrgyzstan, Latvia, Moldova, Romania, Russia, Slovakia, and Ukraine. Most of these countries could be considered partial reformers in both the political and economic transition. While they have made progress in the liberalization and privatization fronts, lesser advance is evident in the complementary institutional reforms to support a legal and regulatory framework for the emerging market... The data suggests that state capture appears to thrive in such an environment of only partial economic and political liberalization.”¹⁰⁹

Hellman and Kauffman provide a “capture index” for states from the former Soviet bloc in the year 2000, where Bulgaria is rated at 28 and Latvia at 30 – the two highest rates among EU candidate states from Eastern Europe in 2000.¹¹⁰ From this study it becomes clear that Bulgaria and Latvia are the two most captured states in the current European Union portion of the former Soviet Bloc.

Privatizing the private sector: “if not for me, then for nobody.”¹¹¹

Narrowing in on the reforms it becomes clear that the Transition paradigm took antics for reality. In fact, the private sector that came into being in Bulgaria and Latvia after the fall of Communism was nothing but a direct continuation of the former underground economy, tolerated by the Socialist state, into an over-ground economy ran by the former Socialist “state”. While the act of “toleration” depended on the massive repressive apparatus of the Socialist state, the act of “managing” the private sector made room for organized crime.

Georgi Petrunov borrows the term “authorized” business from Russia scholarship (Kryshtanovskaya, 2002) when discussing the genesis of the Bulgarian private sector. What this means is that as soon as decree 56 was passed to mark the beginning of the Bulgarian

¹⁰⁹ Paeglis, *Latvia: Privatization*, 10

¹¹⁰ Hellman, *Seize the State*

¹¹¹ Deputy director of the state department of conversion, Latvia, Diena, Sept 21, 1991 quoted in *Latvia in Transition*

perestroika, the nomenklatura appointed certain individuals with the task of developing private business. They had to deposit the revenues accumulated from operations periodically and upon request they were obliged to return the initial capital they had been granted on appointment (Peykov, 1998). Petrunov supports this account through personal interviews of recipients of such start-up loans, who talked of a meeting of the Ministry of the Interior in 1988, at which they were informed that “private initiative was to be developed and they would be able to get personal loans.”¹¹² An interesting twist is socialist president Petar Mladenov’s amnesty of 10,000 recidivists in late 1989, convicted of economic crimes. They in fact formed the bulk of the newly established private business.¹¹³

The logistical issue of securing the return of the start-up loans engendered a criminal phenomenon, in which the role of the state is still debated among scholars. Petrunov outlines a self-enforcing dynamic, which began with a regular return of distributed money at first, and later on ended with racketeering of the self-developed proto-market.¹¹⁴ The racketeering was done by violence-wielders, whose affiliation with the political elites was hardly ascertainable any more. One of Bulgaria’s leading criminal journalists Jovo Nikolov opposes this view by saying that “organized crime in Bulgaria was not created in accordance with someone’s orders or a master plan,”¹¹⁵ but instead supports Gambetta’s Sicilian mode. As outlined in the previous chapter Gambetta’s model is one, where a “legal and institutional vacuum has been filled with criminal structures.”¹¹⁶ In so far as organized crime began a life of its own very early with the gang

¹¹² Petrunov, *Organized Crime*, 315

¹¹³ Petrunov, *Organized Crime*, 315

¹¹⁴ Petrunov, *Organized Crime*, 317

¹¹⁵ Jovo Nikolov, *Crime and Corruption after Communism: Organized Crime in Bulgaria*. (East European Constitutional Review, Vol.6 No. 4, Fall 1997)

¹¹⁶ *ibid.*

wars of 1992-3, Nikolov is right. The period 1988-1992, however, which Petrunov refers to, cannot be overlooked. In fact, as a precedent for a purportedly democratic Transition state predating on its citizens, it bears enormous significance for theories of the Transition.

The Latvian story as told by Paddy Rawlinson of the Sociology Department at the London School of Economics bears astonishing resemblance to that of Bulgaria on an empirical level. Rawlinson begins with force-wielders such as Komarnitski, Baulis and Abkumov, who moved into “more orthodox areas of protection, blackmail and crude forms of commerce - their foray into the nascent market was short-lived.”¹¹⁷ This early Sicilian-type phase corresponds to the period referred to by Petrunov for the Bulgarian case. Rawlinson then devises a periodization of 1990s organized crime in Latvia, in which “the Komarnitskis were soon pushed out of an increasingly sophisticated economy by ‘second wave’ *avtoriteti* [authorities], many of whom had worked as *tsekhoviki* [underground entrepreneurs during the Soviet era], ‘black millionaires’ with capital to invest in the plethora of business opportunities now available.”¹¹⁸ The *tsekhoviki* she mentions include figures such as Alexander and Emil Lavents, son and father respectively, and Vladimir Leskov, who went on to found Latvia’s most influential banks and financial groups.

From this account it becomes clear that due to the peculiar role of the *tsekhoviki* in Latvia, it is hard to pursue a “master plan” argument for Latvian organized crime. On the other hand the role of this particular group and the direction, in which they led Latvian organized crime does provide vistas for refinement of the Sicilian mafia model,

¹¹⁷ Paddy Rawlinson, *Russian Organized Crime and the Baltic States: Assessing the Threat* (ESRC “One Europe or Several?” Programme, working paper 38/01, 2001)

¹¹⁸ Rawlinson, *Russian Organized Crime*, 14

adopted in Transition scholarship. In so far as the Latvian *tsekhoviki* resemble Russian black market profiteers-turned oligarchs in post-Soviet time, the Latvian organized crime scene offers a clearer dichotomy between the elites and organized violence as commissioned by the former *tsekhoviki*. This dichotomy is harder to establish in Bulgaria, where former security services and nomenklatura controlled the new markets and organized crime at the same time: another Transition feature, which has been theorized in Russia scholarship. The fact that the Russian organized crime scene is populated by both former black-market profiteers (*tsekhoviki*) and former party and state security elites, whereas Bulgaria and Latvia have a prevalence of one of the two elements provides an opportunity for theoretical refinement of Transition models and organized crime models.

Having shown that existing Transition paradigms of political scientific and economic nature cannot grasp the nature of the Transition state, explain elite behaviour, account for economic downturn without reforms, or the peculiar privatization processes in Bulgaria and Latvia, it is time to ask why.

The fusion of public and private

The Transition paradigm operates with modern definitions of the democratic state, borrowed from Western social thought. In this sense the public sphere in democratic societies, as defined by Jurgen Habermas, is based on “(1) a notion of the public good as distinct from private interest; (2) social institutions, like private property, that empower individuals to participate independently in the public sphere; and (3) forms of private life, notably the family, that prepare individuals to act as autonomous, rational-critical subjects

in the public sphere.”¹¹⁹ In other words post-Socialist elites were expected to act in the public good and auction off or distribute equally ownership of former state assets to citizens, from which point onwards the private sector was to function along commercial and civil codes, imported from Western democracies.

In reality this turned out to be a profound misconception with direct bearing on phenomena such as partial reform, state capture, systemic corruption, and organized crime, which might in fact be synonymous. As Donald Bowser remarks, “the dominance of competing social networks and the fusion of private and public sectors allows the State to capture business as well as allowing the State to be captured by the private sector.”¹²⁰ Ganev theorizes the problem of economic transitioning by introducing the term “conversion costs” of the “conversion of political power accumulated under the old regime into economic influence in post-Communism.” Or just as “multiple transitions cause transition costs, conversions cause conversion costs that have to be absorbed by the infrastructure of governance.”¹²¹ Hence, partial reform, state capture, systemic corruption, and organized crime are conversion costs unaccounted for by orthodox theories.

Again what allows for conversion to proceed in this fashion is the fusion of public and private, which once again amounts to the elites’ doppelganger identity. On the one hand they are the “former members of the nomenklatura [who] possess know-how, money, and the ability to organize themselves”¹²² turned democrats, democratic socialists and private citizens. On the other hand they are “no longer attached in any way to the idea of ‘mature socialism,’ which would legitimate their past activities, but at the same

¹¹⁹ Social issues reference, (<http://social.jrank.org/pages/2743/public-sphere-private-sphere.html>), public sphere and private sphere – res publica,

¹²⁰ Bowser, U4 Helpdesk

¹²¹ Ganev, *Preying*, 63

¹²² Nikolov, *Crime and Corruption*

time they have not internalized the kind of thinking characteristic of free-market capitalism.”¹²³ Ganev summarizes: “the invisible boundary between the public and the private is moved on an ad hoc basis.”¹²⁴

Ganev illustrates this dynamic through the management of off-budget funds in Bulgaria. After 1991 100% of privatization revenue, as well as loans from the EU and foreign aid were channeled into off-budget funds. By the mid-1990s there were more than 24 000 bank accounts in Bulgaria servicing such funds and in certain years they outspent the parliament-approved budget by one third. Such manipulations were masked as “restructuring the state sector.”¹²⁵ In this interesting illustration public money very easily became private money in something that could pass for a legal transaction under the laws of the early 1990s.

Rawlinson comments on what she sees as a Hobbesian-Darwinian world of commerce in early 1990s Latvia by drawing on the neo-liberal paradigm and making a weak-state argument, which also reveals a peculiar confusion of ethics among the ruling elites. In attributing Latvia’s capitalist jungle to “the ethos of the free market in combination with lax and often absent regulation (which is what all free-marketers desire anyway)”¹²⁶ Rawlinson draws evidence for the latter from the apologetic attitude of a former Minister of the Economy, Janis Aboltnis on the involvement of criminal figures in the private sector and their corresponding methods. Aboltnis is quoted as saying “In my view, they are just the people who are prepared to work and get ahead.”¹²⁷ From a sociological point of view the confusion of public good and legality apparent in this

¹²³ Nikolov, *Crime and Corruption*

¹²⁴ Ganev, *Preying*, 69

¹²⁵ Ganev, *Preying*, 69

¹²⁶ Rawlinson, *Russian Organized Crime*, 15

¹²⁷ Rawlinson, *Russian Organized Crime*, 15

statement is emblematic of the fusion of public and private in post-communist states. In this case it can not only result in the elite engaging in predatory economic practices, but in the toleration of such practices at large in the economy by the heads of government.

The weak-state argument

Rawlinson's weak-state argument deserves some attention, especially as juxtaposed with the neo-liberal doctrine of lean states in her comment. The Transition paradigm mistakes the Transition state's activity on the market for a neo-liberal policy of *laissez-faire*. In fact, the Transition state is a lot more reminiscent of weak Latin American developing states than Margaret Thatcher or Ronald Reagan's governments. Misha Glenny's phrasing is telling: "the hopelessly weak states that emerged throughout the former Soviet Union and Eastern Europe had simply no capacity to define what was legal and what was illegal. They had neither the money, nor the experience to police the novelty of commercial exchange."¹²⁸

One of many cases in point across the former Soviet Bloc is the sale of the right to lease one of the largest department stores in Riga, the Minsk. Juris Dreifelds recalls the widespread media discussions about the undervaluation of existing stock, of the clandestine involvement of family members of the Council of Ministers and other similar charges."¹²⁹ Moreover, after the contract had been signed it became clear that the district that organized the sale had no jurisdiction to do so.¹³⁰ The first part of the case goes back to the issues of defining statehood in the Transition given that the political elite sees no compunction about appropriating state-owned assets in the market economy by capturing

¹²⁸ Glenny, *McMafia*, 15

¹²⁹ Dreifelds, *Latvia in Transition*, 124

¹³⁰ Dreifelds, *Latvia in Transition*, 124

the state they themselves represent. The second part points to administrative incapacity – the reason why the accession of Central and Eastern European states to the EU occasioned the addition of a new accession chapter to the *acquis*: administrative capacity.

The weak-state argument in its turn points back to Gambetta’s Sicilian mafia model as outlined in the previous chapter. If the state is absent and unable to regulate market relations and define property rights, then other structures will rise up to fill that vacuum, namely organized crime. An important part of this model is its sociological dimension: the existence of organized, disciplined, and violence-wielding elements in society who are able to step in and supply the demand for contract enforcement. In no way can orthodox Transition theory have foreseen or accommodated the sociological factor – the presence of the sporting and security service institutions of the Socialist state and the incredibly fertile socio-economic environment for their criminalization.

Sports clubs as liability

Jovo Nikolov gives a good sociological summary of the qualities of Bulgarian sports clubs, which enabled them to fill the market regulation vacuum the state had created:

“The most romantic and popular part of this story is the transformation of former athletes into all-powerful “businessmen.” Prior to 1989, these darlings of the former communist regime spent many long years together, training under harsh conditions resembling a military boot camp. Their camaraderie was tested in adversity, and long-lasting bonds of trust were forged among them. These durable relationships proved to be a valuable asset after 1989, when state subsidies for athletics simply evaporated, and former sports stars had to find alternative sources of income to maintain their relatively luxurious lifestyles.”¹³¹

It is evident that not only was the social organization of the sports clubs perfectly attuned to violence-wielding, but the very purpose of the sports clubs (as a propaganda tool in the

¹³¹ Nikolov, *Crime and Corruption*

Olympic Games, which mirrored Cold War tensions) and the privileges, which stemmed from it, created a dependence of sports clubs on state support. This dependence was to prove dangerous. In protecting sportsmen, who had committed crimes from the law, this mutual dependence also created a moral hazard. As a result many athletes had acquired an extensive criminal record long before the start of the political changes in the country.¹³²

Petrunov draws attention to another important dimension of the sport story: the institutional. Sports clubs under Communism were often established by the state institutions of repression: the army and the militia. Then they gradually became integrated in into the party power structures for reasons of control and propaganda: “of decisive importance for the improvement of the party leadership in the many sports organizations is the election and inclusion of the sportsmen, who are members of the communist party, as members of the central, district, and grassroots organs of the party...Many of them have been commissioned to study at the ASSSM or the central commission of the BCP [Bulgarian Communist Party].”¹³³ In discussing the naissance of one of Bulgaria’s early and most powerful racket groups, the wrestlers’ brigade, Nikolov illustrates this institutionalization process: “this group was originally assembled as a part of the “Olympic Hopes” program and was later attached to the special sports platoon of the Bulgarian People’s Army.”¹³⁴

In short, “sports structures and institutions gradually merge with the central components of the structures of official power and the general political system in spite of the fact that they still remain at a considerable distance from the supreme structures of

¹³² Petrunov, *Organized Crime* , 307

¹³³ Petrunov, *Organized Crime* , 307

¹³⁴ Nikolov, *Crime and Corruption*

power where the most important decisions are taken.”¹³⁵ This fact automatically makes them part of the informal networks spanning post-communist society, which undermine formal law through normalizing informal rules. Not only were sportsmen capable of wielding violence effectively, but also the existence of their very structures undermined the new liberal-democratic state.

The situation in early 1990s Latvia is similar. Rawlinson discusses Latvia’s main organized crime groups - Ivan Haritonov’s (the Latvian godfather), and Boris Raigorodski’s Pardaugava brigade – discovering the same dynamic of impoverished athletes hijacking the market. “As in Russia, they formed their complex networks through sporting associations, particularly boxing, and have been able to transform the physical prowess and skills demanded from this sport into successful security/protection businesses as well as other commercial ventures.”¹³⁶ In the Latvian context it is important to note Rawlinson’s remark that the categorization of these criminal associations is in fact comforting compared to the difficulty of categorizing “the ambiguity”¹³⁷ around the status of Lavent and Leskov, former *tsekhoviki* turned businessmen. What this remark highlights is the interconnectedness of groups, shifting partnerships between criminal and legal entities, as well as the morphing legality of practices and private bodies on the post-socialist market landscape.

The security apparatus as liability

Another crucial actor on the post-communist criminal scene are the former security services. Precise numbers vary, but according to Jovo Nikolov

¹³⁵ Petrunov, *Organized Crime*, 307

¹³⁶ Rawlinson, *Russian Organized Crime*, 16

¹³⁷ Rawlinson, *Russian Organized Crime*, 16

“By 1991, approximately 17,000 employees of the Ministry of Interior had been forced to resign from their jobs. Many of them had committed no serious sins against society and naturally resented the way they were treated. A majority offered their services to the new protection firms. There they found a welcoming environment where they could benefit from their contacts with former colleagues, and criminals, and from economic information that was classified as top secret during the totalitarian period. Others became security consultants to newly emerging private businesses and banks. And some went into private business themselves, capitalizing on their exclusive knowledge of the legal loopholes of postcommunism and their proficiency at navigating the notorious “gray zones” of the unregulated economy.”¹³⁸

Nikolov borrows a term from social psychology to define these human agents in the context of the fused public-private society of the early 1990s Transition state: “marginal groups.” His psychological interpretation reads: “arguably, every marginalized group is prone to slide into criminal activities.”¹³⁹ He draws on studies by Boicho Panev and Vassil Prodanov in order to define the psychological make-up of former state servants: “former cadres who were politically purged viewed the newly emerging market not merely as a refuge, but rather as a gold mine in which they could flourish.”¹⁴⁰ Also interesting is Nikolov’s structural comparison between the largest economic groups, which came about after 1989, and the Socialist state: “they maintain giant security, intelligence, and data processing departments, which in turn can mobilize dispersed financial, commercial, and industrial resources in the pursuit of various projects.”¹⁴¹

Ganev employs imaginative sociology in order to theorize this dynamic: the flip side of post-communist success is the deinstitutionalization of the public domain; as institution entails reproduction, informal networks reproduce themselves instead.¹⁴² In Bulgaria it was again Andrej Lukanov who was responsible for the exodus of large

¹³⁸ Nikolov, *Crime and Corruption*

¹³⁹ Nikolov, *Crime and Corruption*

¹⁴⁰ Nikolov, *Crime and Corruption*

¹⁴¹ Nikolov, *Crime and Corruption*

¹⁴² Ganev, *Preying*, 119

contingents of state security officials. Crucial departments, especially in charge with economic crimes and overseeing Bulgarian investments in foreign countries were curtailed to the effect that the laid-off took their know-how and many incriminating documents with them.¹⁴³ The dismissed agents were charged hitherto with overseeing managers of state property and reemerged in civil society as “protection agencies,” which worked closely with the Bulgarian Socialist Party and bosses of the underworld.¹⁴⁴ Ganev concludes that the “privatization” of the power ministries was complete before Lukanov left office.¹⁴⁵

In Latvia the picture is more varied, but has some similar elements. The main difference lies in the fact that Latvian security services were in fact Moscow’s security services in what was the Soviet Socialist Republic of Latvia. Not only was the KGB mainly Russian, but “the government, the local party and the KGB formed a cozy web of Russian-speaking camaraderie.”¹⁴⁶ Rawlinson, however, points out that “despite the vociferous anti-Russian rhetoric and draconian legislation on citizenship and language the population ratio was arguably the major determining factor for the significant presence of Russian-influenced crime.”¹⁴⁷ To be sure, the ethnic ratio in the security services was strategically tipped in favour of the Russians, who simply “latvianized” their names after reforms in the criminal justice system began.¹⁴⁸ In essence Russian-speaking nomenklatura and secret service networks were reproduced in Latvian society similarly to local networks in Bulgaria.

¹⁴³ Ganev, *Preying*, 48

¹⁴⁴ Ganev, *Preying*, 48

¹⁴⁵ Ganev, *Preying*, 48

¹⁴⁶ Dreifelds, *Latvia in transition*, 49

¹⁴⁷ Rawlinson, *Russian Organized Crime*, 13

¹⁴⁸ Rawlinson, *Russian Organized Crime*, 14

For Latvia, however, this continuity arguably has the important implication that foreign (Russian) crime is an actor in the Latvian underground. Rawlinson comments on the continuity of Russian-speaking personnel in the security services by saying that “While this in itself does not prove close links between the Russian and Latvian underworld, it suggests a possible empathy towards Russian-speaking individuals, which was decidedly not present in either Estonia or Lithuania.”¹⁴⁹ What is more certain, however, is the link between politicians and oligarchs with organized crime along the Russian example. Rawlinson quotes a retired security agent in saying that “The fortunes and ‘career’ of many contemporary leading Russian businessmen and even politicians were often parallel with those of their Latvian colleagues.”¹⁵⁰ In other words, former cadres used their previous know-how in order to hijack market and state to their advantage.

The fact that both former sportsmen and former state security agents and policemen were all on the “protection market” brings back the problematique of statehood as defined by monopoly on violence, mentioned in the previous chapter. Did large segments of the “power ministries” become simply another agent on the market as Volkov suggests,¹⁵¹ or did their involvement mean that the state used violence against its own citizens by virtue of the fact that those former state agents retained their relationship to the post-communist state elites?

The criminal Transition state

¹⁴⁹ Rawlinson, *Russian Organized Crime*, 14

¹⁵⁰ Rawlinson, *Russian Organized Crime*, 14

¹⁵¹ Volkov, *Violent Entrepreneurs*, 127

Petrunov makes a cogent argument on the extreme. In his opinion “the differentiation between the three major groups who have provided recruits for the criminal organizations – sportsmen, officers from the organs of repression (the army, the police and the secret services) and the criminals from the Communist era – is to a great extent false and misleading.”¹⁵² Petrunov advances the thesis that “the establishment of criminal organization in BG is not a spontaneous act but rather the result of a carefully elaborated plan.”¹⁵³

In order to prove this claim he provides sociological evidence: the groups are hierarchical, i.e. a strict order of rank where one only has contacts with the immediate levels next to him; control is centralized at the very top; pay is based on the rank principle; tasks and jobs are handed down from above; death follows upon failure to deliver; the goal of the organization, the remaining members and etc. remains a priority limited only to the high levels.¹⁵⁴

Another set of evidence focuses on the timing of the creation of the first organized crime groups and their evolution. Groups created later enjoyed more autonomy, while the older suffered sanctions for certain actions, imposed by the nomenklatura controlling them.¹⁵⁵ Reiterating an argument already made for Russia and discussed earlier in this chapter, “the establishment of the first groups of *mutri* [thugs] comes before the “market demand” for their services, i.e. the organizations appeared first and only several years later followed the reason for their appearance.”¹⁵⁶ Hence, Petrunov is suggesting that the elites planning privatization and creating the private sector also planned a means for debt

¹⁵² Petrunov, *Organized Crime* , 304

¹⁵³ Petrunov, *Organized Crime* , 309

¹⁵⁴ Petrunov, *Organized Crime* , 312

¹⁵⁵ Petrunov, *Organized Crime* 311

¹⁵⁶ Petrunov, *Organized Crime* , 315

collection and contract enforcement for their own ventures before embarking upon reforms, i.e. a criminal master plan.

The most suggestive of all of Petrunov's evidence is perhaps the anonymous athlete he interviewed and quotes as saying "they say that Ognian Doinov asked Ilia Pavlov to gather them, then he gave the money and they started to recruit us."¹⁵⁷ Ognian Doinov was one of the Communist party's grey cardinals, engineer of the November 10th palace coup against the last Communist leader Todor Zhivkov, and financial magician in the Socialist governments of 1990-92. Ilya Pavlov, on the other hand, was a former sportsman affiliated with State Security (the Bulgarian KGB) through family ties, and founder of an economic empire, which ran the Bulgarian economy for the most part of the 1990s.

Reconsidering the models

Petrunov's argument poses a significant challenge to Gambetta's Sicilian model as far as it puts agency in the hands of the Socialist state turned post-socialist criminal state. It is important to keep in mind, however, that the period Petrunov and his Russian references consider are the years 1990-2 – a very short period, overlooked by mainstream studies and unaccounted for in orthodox Transition theory. After this initial period the protection market took on its own dynamics and developed its own features in Bulgaria, which were not necessarily identical with those of the protection market in Russia.

¹⁵⁷ Petrunov, *Organized Crime*, 311

Jovo Nikolov explores the link between Bulgaria's legally licensed protection firms (in 1994 between 3,600 and 3,800¹⁵⁸) and the fledgling banking sector. Due to the lack of regulation and enforcement the so-called credit millionaires were able to obtain huge loans from banks without returning them. The sluggishness of the judicial system and rampant inflation left the banks no choice but to seek the services of debt collectors: banks either created their own "bad credit" departments or hired protection firms and corrupt policemen to coerce the debtors.¹⁵⁹ To be sure, no statistical data exists about what kinds of entities the banks hired to collect their debt, but the situation is to a large extent reminiscent of Volkov's theorizing that if government agencies do not enforce court decisions, those decisions are simply handed to private agents for enforcement.¹⁶⁰

What is peculiar about the Transition state is that the relationship between organized crime and legitimate business is not limited to the private sector. The model of systemic corruption is instrumental in explaining how this relationship extends to include former nomenklatura members turned businessmen and state capturers in order to limit market entry to the nomenklatura and protection agents.

This is in essence Nikolov's argument: on the one hand "The new entrepreneurs [former nomenklatura members], who as a rule shun public attention, need private enforcers to settle scores with shady business partners," on the other hand "the enforcers, who seek to channel their money into the profitable sectors of the national economy, crave the opportunity to establish contacts with the new political establishment."¹⁶¹ This scenario posits party business and enforcer business as autonomous agents: a fusion

¹⁵⁸ Nikolov, *Crime and Corruption*

¹⁵⁹ Nikolov, *Crime and Corruption*

¹⁶⁰ Volkov, *Violent Entrepreneurs*, 43

¹⁶¹ Nikolov, *Crime and Corruption*

between a Sicilian mafia model and systemic corruption into a collective action scheme. Rawlinson confirms this fusion by stating that in early 1990s Latvia “corruption, the *sine qua non* of organized crime’s integration into the legitimate structures, was systemic.”¹⁶²

Petrunov’s scenario undermines the neatness of this new mafia-nomenklatura cooperation model. In fact, Rawlinson also leaves room for doubt in her description of Latvia’s complex banking wars of 1993-5, which “involved some of the leading political figures of the day, as well as the top echelons of the security and law enforcement agencies. The myriad and often bewildering relationships between the criminal underworld, ‘new business’ and officialdom helped simultaneously shape and stymie Latvia’s reforms.”¹⁶³ The distinction of autonomous agents and collective action among them is not an easy one to make in the Transition context and must be qualified.

In her argument, however, Rawlinson draws attention to the effect of systemic corruption on partial reform through state capture. Both political elites (current and former) and structures of organized violence were capturing the state in a curious alliance. This collusion is clearly distinct from Wallis’ systematic corruption model taken from the American context, where control is predominantly in the hands of the rent-creating government. The elite-crime alliance is also distinct from the pure models of state capture and systemic corruption as discussed previously in that it challenges established notions of agency and autonomy.

The reason lies in a simple and obvious peculiarity of the Transition, which Ganev points to: “unlike Tillian rulers, Marxist ruling classes, Olsonian redistributive coalitions, elites in post-communism do not need the state, they do not need its extractive

¹⁶² Rawlinson, *Russian Organized Crime*, 16

¹⁶³ Rawlinson, *Russian Organized Crime*, 15

or redistributive capacities, everything they need has already been extracted for them and stored in the loosely monitored public domain.”¹⁶⁴ The idea is that the fight for control was yet to begin: the state domain offered enough opportunities for everyone - be they elites in power, former nomenklatura, or enforcers. Market entry was indeed restricted, but the restrictions were broader than conventional models can account for, with relationships of agency and autonomy more complex than orthodox models can accommodate.

¹⁶⁴ Ganev, *Preying*, 120

Chapter 3:

How the Transition State Became a Criminal State

The early Transition state created a unique climate for the thriving of organized crime. On the one hand there was weak state capacity to regulate the market (Gambetta's Sicilian mafia model) as well as an easily corruptible administration (models of systemic corruption based on Western experience). On the other hand, as concluded in the previous chapter, it supplied the unique condition of an initial stock of state-owned property and informational resources which could be looted and exploited without the necessity to first hijack the state apparatus of extraction. Another unique condition was the ongoing legislative and administrative reform which lent itself to capturing (the refined *state capture* model) so that criminal practices could be at least temporarily if not permanently legalized.

Hence, privatization of the state's property and activities enabled organized crime to thrive in areas such as banking, industry, transport, public procurement, real estate, retail, and even international business. This early and untheorized development lasted until the mid-1990s, when the state-owned domain began to run out and organized crime gradually took on more conventional forms. An important factor in this "maturation" was the end of the collusion between the governing elite, former nomenklatura businessmen, and private enforcers. The governing elite began to capture the reform process in such a way as to crowd out competitors for the shrinking state-owned domain. Eventually, by reason of the expiration of the state domain, and by force of the democratic dynamic of electoral results, the governing elite found themselves engaging in more conventional

forms of systemic corruption. To be sure, informal arrangements and practices endured, the same personalities kept reappearing on the political, economic, and criminal stage, and many institutions entered the new millennium bearing the lasting marks of the “Criminal state.” Around the same time, however, another factor, which will be discussed in later chapters, began to make itself felt - European Union leverage.

Criminalization of the banking sector

The banking sector in both Bulgaria and Latvia was one of the first to be privatized and became an arena of public scandals and contract killings. Venelin Ganev traces criminal developments in the banking sector in Bulgaria in two phases, not dissimilar from simultaneous developments in Latvia. In the first phase a two-tiered banking system appeared in 1989-90 with the Bulgarian National Bank (BNB) serving as license-giver for new banks, while its local branches turned into state-owned commercial banks. Ganev points out that until 1994 owners of banks were not required to account for the origin of the money with which they applied for a license and “the banking system became a niche where resources withdrawn from the state were stashed.”¹⁶⁵ Moreover, most private banks in Bulgaria were set up with money borrowed from the BNB and the State Savings Bank.¹⁶⁶ In the second phase commercial banks began to give considerable loans to insiders, who never paid them back and became the so-called “credit millionaires” mentioned in the previous chapter.¹⁶⁷

In this simple way the national bank was drained of its assets, which passed into private hands. The role of informal networks in the loan approval process and the role of

¹⁶⁵ Ganev, *Preying*, 86

¹⁶⁶ Ganev, *Preying*, 86

¹⁶⁷ Ganev, *Preying*, 87

private enforcers in the scramble for debt collection have already been discussed in the frameworks of sociological and institutional analysis. Jovo Nikolov contributes another aspect to the study of the criminalization of the banking sector: the ease with which it was turned unto a money-laundering machine immediately after 1989.¹⁶⁸ Nikolov's argument goes as follows: "after several years of racketeering, massive violations of the [Yugoslav] embargo, smuggling, and other criminal activities, profits had to be laundered and then legally banked abroad."¹⁶⁹ Factors, which will be discussed later such as the Yugoslav war and asset-stripping of State-owned enterprises (SOEs), were interlinked with the criminalization of the banking sector in massive financial crime schemes, facilitated by the institutional melt-down of the Transition state.

In a discussion about the failure of the Bulgarian National Bank as an institution, Ganev exposes the perverse teleology of government actions in banking regulation. In theory the BNB could determine its own credit policy and maintain the hard-currency reserve. Direct securitized lending to the government was prohibited and only the central government could borrow. In practice not only was up to 50% of the state deficit covered by the bank several times between 1993-96, but budget subsidies to the state-owned sector were replaced by credit injections administered by the bank. Moreover, the BNB was forced to refinance other banks and to increase credit ceilings for them so that they could issue more loans.¹⁷⁰ In 1994 the BNB was pressured to purchase 80% of the bad debt loans of "Economic Bank" and in 1995 it had to do the same for "Agrobiznes Bank."¹⁷¹

¹⁶⁸ Nikolov, *Crime and Corruption*

¹⁶⁹ Nikolov, *Crime and Corruption*

¹⁷⁰ Ganev, *Preying*, 164

¹⁷¹ Ganev, *Preying*, 165

Ganev concludes that “Rather than restraining profligate politicians, the BNB was a lender of last resort.”¹⁷²

The tools employed for these activities were physical intimidation¹⁷³ as well as legislation: in 1996 the BSP passed a Law on the BNB to allow dismissal of the bank’s chairmen and deputies before the end of their term, de facto abolishing the bank’s independence.¹⁷⁴ Similarly, Antol Liven commented in 1993 that “a major threat to the future of the Baltic states lies in the connections between its new entrepreneurial class and the leaders of organized crime, particularly in connection with the seizure of state property”¹⁷⁵ and adds that autumn 1992 saw a spate of explosions throughout the Baltic, especially in Latvia, which were evidently the work of organized criminals fighting over property.

What was also important was the significance that organized violence had not only on individual court decisions or administrative procedures, but also on attempted institutional reform. The lack of enforcement in the banking sector was due to intimidation of tax officers and higher officials: whole investigative bodies were dismantled under pressure.¹⁷⁶

Latvia’s banking sector, although led by a markedly better performing Central Bank modeled after the German Bundesbank and headed by the staunch liberal Einars Repse, did not fare better in the years preceding 1995. The banking sector, as in Bulgaria, attracted the capitals and entrepreneurial spirit of soviet-time black market profiteers and

¹⁷² Ganev, *Preying*, 165

¹⁷³ Ganev, *Preying*, 162

¹⁷⁴ Ganev, *Preying*, 167

¹⁷⁵ Anatol Lieven, *The Baltic Revolution: Estonia, Latvia, Lithuania, and the path to independence* (Biddles Ltd, King’s Lynn, Norfolk, 1993), 345

¹⁷⁶ Ganev, *Preying*, 90

enforcers. Two cases in point are Alexander Lavent and Vladimir Leskov, both of whom had served time under the previous regime, co-founded the Paudargava Concern. This was a large commercial structure and one of Latvia's two rivaling criminal concerns mentioned in the previous chapter, built on the estimated 25 million rubles, which the two had accrued during their underground Communist-time careers.¹⁷⁷

Lavent was behind Banka Baltija, and Leskov behind Banka Olympia – two of Latvia's biggest independent banks embroiled in the 1995 banking scandals. The scandals involved missing government credits¹⁷⁸ – the same siphoning of funds from the central bank that Bulgarian commercial banks were engaged in. The bank crashes affected Latvian privatization. In April 1995 Latvijas Kugnieciba (the largest Latvian enterprise measured by turnover, and one of the world's 20 largest shipping companies) had deposited substantial funds with Banka Baltija, which later went bankrupt.¹⁷⁹ The draining of funds reduced the value of firms, which had deposited funds at or were co-owned by the ailing commercial banks, and weakened the credibility of Latvian privatization.¹⁸⁰

Although not untypical of non-Communist contexts in the modern world, the scale, personalities and mechanisms of the criminalization of the banking sector do show a connection between Latvia and Bulgaria's Communist legacy and the pervasive role of the unique product of the Transition period from Communism to the market – organized crime.

¹⁷⁷ Rawlinson, *Russian Organized Crime* 15

¹⁷⁸ Rawlinson, *Russian Organized Crime* 15

¹⁷⁹ Paeglis, *Latvia: Privatization Accelerates*

¹⁸⁰ Paeglis, *Latvia: Privatization Accelerates*

Hijacking the logistics of the state

One of organized crime's prime activities being smuggling, the state-owned transport sector was unsurprisingly privatized first and in a rush. Ganev points out that in Bulgaria by the end of 1989 its privatization had already finished.¹⁸¹ In late 1989 regulation of the ministry of transportation allowed state managers in trucking companies to sell at second hand prices state-owned vehicles and farm machines.¹⁸² As a result out of 29 trucking companies, 240 regional and 17 000 private companies emerged, owned by former nomenklatura.¹⁸³ This had two long-term effects: loss of revenue and a loss of the state's discretionary powers over the price and available amounts of fuel in the country in periods of fuel crises. In effect the private competitor outbid the state during the Yugoslav embargo to the effect that ambulance and fire engines had no fuel to run on.¹⁸⁴ Ganev's illuminating metaphor for this development is that the Communist Party was ready to "surrender the kingdom" only after it had appropriated the "horses".¹⁸⁵

Similarly, Louise Shelley of the Terrorism, Transnational Crime and Corruption Center at George Mason University asserts that in Latvia alleged capturers often have held positions as Ministers for Transport.¹⁸⁶ In Latvia, however, the main target were the ports, as seen in the prolonged and problematic privatization of the Latvian Shipping Company. In fact, holding the right to use transport facilities and public facilities was another main aspect of privatization of the state domain, which gave rise to creative criminal entrepreneurship. The facilities can include cleaning, catering, parking lots,

¹⁸¹ Ganev, *Preying*, 48-9

¹⁸² Ganev, *Preying*, 48-9

¹⁸³ Ganev, *Preying*, 51

¹⁸⁴ Ganev, *Preying*, 51

¹⁸⁵ Ganev, *Preying*, 51

¹⁸⁶ Klas Kaerrstrand, *Countering Narcotics and Organised crime in the Baltic Sea region* (Report from the Silk Road Studies Workshop in Tallinn, Estonia May 9-10 2007), 16

garages, real-estate, hotels, resorts, but also distributional deals such as the monopoly over energy supply, and customs traffic.¹⁸⁷

1993 witnessed tensions in Bulgaria between protection firms run by former policemen and security service agents, and those run by former athletes. As Jovo Nikolov explains, the most contested loot were the seaside resorts since whoever controlled them also profited from the daily operations of state-owned hotels and numerous currency exchange offices, while at the same time tapping traditional sources of mob revenue such as alcohol, gambling, and prostitution. Nikolov explains that “frequent dismissals of hotel managers, perennial uncertainty about the validity of legal titles, fuzzy property rights ambiguously assigned, and the unpredictable cancellation of privatization deals created favorable conditions for the spread of corruption and the cozy coexistence among criminals, former policemen, and members of the nomenklatura.”¹⁸⁸

The retail sector in Bulgaria provided an unlikely, but lucrative arena for organized crime. Food-processing and the export of sugar and wild berries are businesses that can hardly be reconciled with the violence that surrounded their acquisition and management in Bulgaria. Jovo Nikolov points out that a series of municipal privatizations put a large number of food-processing companies in the hands of private protection bosses, “a strategic move that gave them control of the agricultural products market.”¹⁸⁹ The export of sugar was monopolized by one of the two biggest private protection networks in Bulgaria – SIC. To highlight the extent to which Bulgarian private markets were controlled if not even developed by those highly efficient networkers, Georgi

¹⁸⁷ Petrunov, *Organized Crime*, 320

¹⁸⁸ Nikolov, *Crime and Corruption*

¹⁸⁹ Nikolov, *Crime and Corruption*

Petrunov draws on the distribution of Coca Cola and Pepsi in Bulgaria. Pepsi was distributed by former wrestlers to the shops they protected and reached a ratio of 10:1, unprecedented in any other country in the world apart from, possibly, Romania,¹⁹⁰ where it was developed along innovative non-criminal business strategies.¹⁹¹ Nikolov explains that behind this successful entrepreneurship was not only the training in violence and discipline, but corruption on all levels, which enabled those groups to acquire export and import licenses and quotas, win public auctions, and benefit from lucrative privatization projects.¹⁹²

The social capital consisting in informal networks spanning business and institutions, combined with the geographical position of the Transition states of Eastern Europe, created a chronic smuggling problem. Immediately after the fall of Communism Latvian ports were flooded with exports of colored metals, acquired at knocked-down prices from Russian state-owned enterprises and sold on world market value, as well as gutted factory equipment exported for scrap.¹⁹³ Rawlinson explains that the Baltic corridor, “not entirely a new phenomenon, became a focus of this [post-communist] illegal economic free-for-all as goods and people passed through from east to west and west to east.”¹⁹⁴ The traffic was not one way, Rawlinson emphasizes. In another instance the same factor, which spurred Bulgarian organized crime by creating an enormous demand for fuel and arms, and a highly restricted market in neighboring Yugoslavia, made the Baltic

¹⁹⁰ Petrunov, *Organized Crime*

¹⁹¹ Aviad Meitar, *An Unimaginable Journey: How Pepsi Beat the Odds in Romania*, (Booksurge Publishing, November 2009)

¹⁹² Nikolov, *Crime and Corruption*

¹⁹³ Dreifelds, *Latvia in Transition*, 128

¹⁹⁴ Rawlinson, *Russian Organized Crime*, 8

route double its importance as drug and vehicle smuggling passage, respectively for drugs entering the EU, and cars exiting it as payment.¹⁹⁵

The Bulgarian example provides a clearer insight into the informal networks that made it possible for smuggling and trafficking to happen with ease. Ex-policemen and nomenklatura businesses engaged in tariff evasion schemes to trick the state out of colossal sums of money, while former athletes, who had already established full control over the country's retail and wholesale markets, oversaw the distribution of the smuggled goods.¹⁹⁶ Leslie Holmes illustrates the callousness of the collusion between former and current security services, customs and institutions through the notorious Atia case. In 1993 in the Atia military base was discovered a cigarette and oil-smuggling ring with the involvement of senior officials, which took over 7 years to reach the courts.¹⁹⁷ On smuggling strategies Nikolov ventures a game theory argument: "perhaps because of the size of the huge profits, a deal between the major groups of players was relatively easy to strike."¹⁹⁸

Another callous example of criminal collusion of the highest order is the hijacking of Bulgaria's energy supply. In 1997 the joint venture Topenergy (TE) was granted the right to represent Bulgaria in negotiations with Russia – Bulgaria's monopolistic supplier of natural gas. Interestingly, TE was half-owned by the Bulgarian gas company Bulgargaz and the Russian Gazprom; and was headed by the Socialist Party's grey cardinal Andrej Lukanov after the end of his prime ministership. Lukanov's chairmanship, once rejected by rivals on the Bulgarian side and then in an ironic twist of fate upheld by the Russian side, solidified the link with Bulgaria's biggest criminal concern Multigrup (MG).

¹⁹⁵ Rawlinson, *Russian Organized Crime*, 8

¹⁹⁶ Nikolov, *Crime and Corruption*

¹⁹⁷ Holmes, *Rotten States*, 75

¹⁹⁸ Nikolov, *Crime and Corruption*

Multigrup secured 16.5% of TE's shares, at which point the Bulgarian state's shares fell below 50%. Multigrup then allied itself with Gazprom on the Russian side and extracted rents from the Bulgarian state. Ganev concludes this account by stating that in the course of 2 years Bulgaria was buying the most expensive gas in Europe and in fact paid Multigrup \$100 million in rents per year.¹⁹⁹ The criminalization of the energy sector would not have been possible had the informal connections behind Multigrup, Andrej Lukanov and Gazprom not been activated in order to entrap the Bulgarian state.

As a member of the Council of Mutual Economic Assistance (COMECON) of the former Soviet Bloc the Bulgarian state was charged with breaking the COCOM regime – a regulatory body set up by the United States, which included Western Europe and Japan, to prevent sensitive high-tech equipment with possible military usage from making its way through the Iron Curtain and into the Soviet Union.²⁰⁰ This entailed the establishment of an intricate international ancillary system to evade embargoes. As a result according to a 1991 report, prepared by Bogomil Bonev, former minister of Internal Affairs in the United Democratic Forces government in the late 1990s, “Bulgaria was the principal owner of more than 250 joint ventures and trading companies in countries such as Germany, Italy, France, and Great Britain. More than \$200 million had been invested in these firms, and their combined commodity turnover in 1989 was well over \$1 billion. For obvious reasons, these firms were never required to abide by strict accounting guidelines, which turned them into irresistible embezzlement targets. After 1989, they were scooped up in a wave of illegal privatizations.”²⁰¹

¹⁹⁹ Ganev, *Preying*, 104-5

²⁰⁰ Glenny, *McMafia*, 7

²⁰¹ Nikolov, *Crime and Corruption*

The implication, as Nikolov explains, is not only that those lucrative enterprises could be appropriated, but also that the earliest entrepreneurs could capitalize on considerable experience. By dint of logic, they could be none but those who had been involved in these Communist-time enterprises: a telling example is Ilya Pavlov of MG. At the end of 1988, as a former wrestler and the son in law of a powerful figure in the State Security Department, he was sent to Malta on business, when few people could obtain permission to leave the country. His business consisted in buying submarines from the Soviet Black Sea fleet and sending them for scrap in Turkey as he was obviously well connected to Moscow arms dealers.²⁰²

Latvia's lack of secret missions under the Soviet Union did not leave its elites, and especially the *tsekhoviki* without international connections of criminal and economic significance. In Latvia these connections originated with the *vory-v-zakone* or thieves in law – a powerful underground thieving society, which dated back to the 19th Century. The society thrived in the Soviet prison camps and, upon release, new converts, who were also natives of different Soviet republics, in effect, extended the *vory* networks across the whole Soviet Union, including Latvia, and beyond. Under socialism the *vory* engaged in the traditional spheres of contemporary mafias activity – drugs, firearms, gambling, theft, prostitution, but also currency operations and all kinds of smuggling, copying and trading of Western and illegal goods.²⁰³ Those were precisely the black market activities which the Soviet State tolerated, but did not lose sight of, in order to mitigate its own deficiencies.

The enduring connections became obvious during the banking wars of 1995 between former partners Leskov and Lavent, when Leskov claimed that Vyacheslav

²⁰² Ganev, *Preying*, 100

²⁰³ Swanström, *Organized Crime*

Ivankov, the so-called “Godfather” of the “Russian Mafia” (internationally known as ‘Yaponchik’) had urged the two adversaries to sort out the problem, advising that Lavent should pay what he owed to Leskov. Rawlinson comments that “While this might simply be a case of Leskov alerting the underworld to his powerful contacts in Russia, it demonstrates that the two regions were inextricably linked (and indeed continue to be so) where ‘respected’ *avtoriteti* [crime bosses] from Russia could wield at least nominal power in Latvia.”²⁰⁴ The theoretical implication of this striking episode of mafia drama is that due to Soviet-time national and international illegal practices and their informal toleration, the Transition state’s social capital has been dissipated and made prone to criminality.

International Communist-era criminal connections did not end with Russia. The above-mentioned Bulgarian shell companies, which had been created in order to break the COCOM regime, needed foreign collaborators. For the Bulgarian Communist Party, the connection was Robert Maxwell, media mogul and one of the brightest foreign “investors” in the tumbling regimes in the East, especially Bulgaria and Russia. Maxwell weathered the Nov 1989 coup and was given a role in creating Bulgaria’s new, free economy under the auspices of Andrei Lukanov.²⁰⁵ The method: more shell companies for laundering money abroad won in smuggling of rare and excise-tax goods to the West. Essentially, the Bulgarian nomenclatura elite was gaining a foothold in what had previously been the territory of the Italian, French and American mafias.²⁰⁶ Maxwell also agreed to resolve the Bulgarian foreign debt on the condition of gaining shares in the Bulgarian

²⁰⁴ Rawlinson, *Russian Organized Crime*, 15

²⁰⁵ Gordon Thomas, Martin Dillon, *Robert Maxwell, Israel's Superspy: The Life and Murder of a Media Mogul* (New York: Carroll&Graf, 2002), 176

²⁰⁶ *ibid*, 178

Agricultural Bank. As a result Maxwell drained \$500 million out of the country without doing anything about the foreign debt.²⁰⁷ To this astonishing degree the nomenklatura elites in post-Communist states felt no responsibility for the state they were running. The public domain was the private domain of the few and the fate of a country's currency reserve could easily be reduced to the personal ties between individuals.

How State-owned Enterprises were run into the ground

There was an asset-stripping scheme which spanned the post-Soviet world and became emblematic of the Transition economy: the *spider-trap* or also the *entry-exit* scheme. It was devised in Russia, but used equally successfully in other Transition states. As Jovo Nikolov explains, the *spider-trap* consists in privatizing the assets and nationalizing the liabilities of state enterprises. The phenomenon was made possible by the late start of privatization, which rendered the accumulation of fortunes by former communist officials considerably easier.²⁰⁸ In political scientific terms “The process of decentralization that preceded privatization in the transition countries exacerbated rent-seeking activity by granting effective control over assets to managers lacking clearly defined ownership.”²⁰⁹ The *spider trap* consisted of two parts: on the input end “private suppliers that enjoyed virtual monopolies sold inputs to large state firms at marked-up prices” and on the output end “the state firms sold their output to private purchasers at knocked-down prices.”²¹⁰ The state enterprise managers were either pressured to participate or were offered a kickback.

Imant Paeglis theorizes the spider-trap as practiced in Latvia:

²⁰⁷ Thomas, *Israel's Superspy*, 164

²⁰⁸ Nikolov, *Crime and Corruption*

²⁰⁹ Lotspeich, crime in transition economies, 568

²¹⁰ Nikolov, *Crime and Corruption*

“Many members of Latvia's new political elite serve on the boards of directors of large state enterprises, where their salaries in most cases are several times higher than those for governmental or parliamentary posts. Officials in such positions have diverted funds through state enterprises by having the enterprises guarantee loans to private firms in which the officials themselves had interests. Those loans were seldom repaid, and the money was often laundered through a series of bank accounts before finally ending up in the account of some offshore firm - in which the officials might also have ownership stakes. Examples of that kind of maneuver are the Latvenergo energy monopoly's guarantee of a Banka Baltija loan to Finansu norekinu centrs and the Ventspils Nafta oil company's guarantee of another Banka Baltija loan to the German firm ZuS.”²¹¹

An emblematic case from the Bulgarian experience is the Himko-Kremikovtzi steelworks affair, in which the chief player was the head of Multigrup, former wrestler and secret service cadre Ilya Pavlov. Misha Glenny quotes Boiko Borissov, former Head Secretary of the Ministry of the Interior and current Prime Minister of Bulgaria, on the mechanics of the Kremikovtzi *spider-trap*:

“it was called the spider trap. Ilya walked into the office of the director of Kremikovtzi, one of the biggest steelworks in Eastern Europe. He was accompanied by a boss of the most powerful trades union, and then sitting there is Dimitar Ivanov, the man who until recently was head of the Sixth Directorate [secret service]. And these guys tell the director of the enterprise – “You have a choice...work with us or we will destroy you!” Pavlov told the director that from that point on, he would be buying raw materials not directly from the Russians at a subsidized price but from one of his companies at the world market price. And then instead of selling the end product directly to the consumer, the director would have to sell it at a knock-down price to another of Ilya's firms, which would then sell it on the open market. He controlled the entrance and the exit to the factory – the spider trap.”²¹²

The Kremikovtzi affair reveals an enormous amount of the mechanics relevant to systemic corruption, state capture, the involvement of organized crime and the collective action dilemmas within the political elite. First of all, the alliance between the leader of

²¹¹ Paeglis, *Latvia: Privatization Accelerates*

²¹² Glenny, *McMafia*, 9

the biggest Trade Union in Bulgaria, Podkrepa, with the biggest state capturer Multigrup is revealing of the pervasiveness of informal networks among members of the elite, who must presumably be of different ideological persuasions. This in turn testifies of the fuzziness of the boundary between private and public interest. In this context it was in fact normal that Multigrup resorted to three assassination attempts of the manager of Kremikovtsi, who initially refused Ilya Pavlov's offer before he was fired on May 9 1995.²¹³

In another emblematic development the former Socialist elite behind Multigrup found a rival in the face of the young Socialist Prime Minister who came to power in 1995 – Zhan Videnov – and who had his own economic interests to pursue. He attempted to parry Multigrup's forays into Kremikovtsi by passing a special amendment to the 1995 Budget law: that state debts were not to be transferred to third persons. The result was farcical: 54 deputies from different caucuses signed a petition to the Constitutional Court claiming the new amendment violates freedom of contract, regardless of the fact that such petitioning is not constitutional. The Court complied, but delegated the MG dispute to ordinary courts. The justices of the lesser courts blocked what they adjudicated to be retroactive legislation.²¹⁴ In a jungle of rival state capturers, the Bulgarian courts exhibited the only bit of independence in an otherwise dysfunctional system.

The court battle that ensued between the state and MG on the basis of existing legislation was led in a "siege-like atmosphere" of threats and physical intimidation.²¹⁵

²¹³ Ganev, *Preying*, 109

²¹⁴ Ganev, *Preying*, 108

²¹⁵ Ganev, *Preying*, 109

The Supreme Court adjudicated against MG and the concern, which had by then presented the collected debt as collateral for a 700 million lev loan from the state Savings Bank, lost the collateral after the court decision. However, MG managed to pocket \$70 million, since the court order to return the money was never enforced. Ganev concludes, “The government’s Pyrrhic legal victories did not lead to the restitution of hijacked resources.”²¹⁶ In fact, the government was waging a battle to define what was legal and what was not, while lacking the credibility to do it. This fact points back to earlier theoretical discussions about the state’s role as rule creator and enforcer or just another rival on the violence market, or yet worse, an absent academic construct.

The result of the *spider-trap* in fact exacerbated the state of another catastrophic area of the Transition economy: banking. Nikolov talks about a vicious circle, where enterprises “first lost money to private firms, then they borrowed from commercial banks, then they failed to repay the loans, and finally the banks received refinancing from the National Bank to cover the bad loans from the public treasury, thereby fueling an inflationary spiral.”²¹⁷ As in Latvia in 1995 many Bulgarian banks collapsed in 1996 for reason of this same dynamic of asset-stripping and nationalizing of liabilities. It is now clear the widespread criminalization of all aspects of economic life resulted in an economic freefall without reforms. Not neo-liberalism, but the “Criminal state” was responsible for the bankruptcies of Transition states in the mid-1990s. As discussed in chapter one, private business run by the mafia cannot generate growth.

²¹⁶ Ganev, *Preying*, 109

²¹⁷ Nikolov, *Crime and Corruption*

The Evolution of Organized crime or the public domain runs out hypothesis

Various scholars have noted what Rawlinson calls an “ongoing transformation of organized crime.”²¹⁸ The transformation refers to the normalization of activities that organized crime engages in. From privatization of banking, logistics, and SOEs, criminal organizations move to conventional smuggling of illicit goods, drugs, prostitution and gambling. The factors for this evolution have not been thoroughly explored: hypotheses range from better policing to EU leverage. However, in the context of the early Transition state, namely the collusion between ruling elites, former nomenklatura business, and private enforcers, it is not hard to conceive of a collective action dilemma arising from scarcity.

In other words, the state domain was bound to expire sooner or later and give rise to a new wave of rule capture and rent creation through elimination of competitors. Former nomenklatura capitalized on their control over institutions and legislation in order to clamp down on the athlete-run protection business. More struggles followed within elite circles of differing loyalties, generations and professed ideologies, which accompanied every election.

Temporary equilibrium settled at the end of the 1990s and early 2000s and created an illusion of democratic normality and organized crime within limits. Old practices, networks and faces, however, remained and were tolerated by the societies they had so deeply scarred during the early Transition phase. Institutional defects, which served these practices, networks and faces, posed a paradox to EU monitors, but in fact can be directly traced to the “Criminal state” period.

²¹⁸ Kaerrstrand, *Countering Narcotics*

This theory stems from the Bulgarian context and is comparable with similar experiences throughout Eastern Europe. The historical analysis presented here will draw overwhelmingly from existing Bulgarian sources since these developments have been best documented by Bulgarian scholars and investigative journalists.

The primitive stage

Jovo Nikolov advances a creative interpretation of Marx's "primitive stage of capital accumulation" in order to explain the rise of organized crime in the Transition state. After the collapse of Communism former athletes proceeded to established firm control over motels along Bulgaria's international highways. Nikolov explains that "this first take-over campaign enabled them to tap various sources of revenue, running the gamut from trading in hard currencies to prostitution."²¹⁹ Nikolov also speaks of armed robberies, especially of Turkish Gastarbeiter transporting their earnings home from Germany. At this point it is important to recall Petrunov's distinction between the activities of earlier "authorized" enforcers and later more autonomous self-organized enforcers. The authorized nomenklatura-led organizations were in fact punished for such indiscretions – they were primarily debt collectors and contract enforcers.²²⁰

A parallel wave of gang wars deserves some attention. Nikolov explains that between 1991-1992 the wrestlers were able to subdue all small urban gangs and pocket a percentage of their profits, but essentially to span networks and strengthen criminal hierarchies across the country. The battle for control culminated in the Nov 16 1993 incident at the sports center, *Deskrim*, in the Bulgarian Capital, where the "wrestlers'

²¹⁹ Nikolov, *Crime and Corruption*

²²⁰ Petrunov, *Organized Crime*, 309

brigade” first clashed with the “karate brigade.”²²¹ The wrestlers, arguably controlled by the nomenklatura as discussed earlier in reference to Georgi Petrunov’s work, eventually won out and would define many aspects of Bulgarian economy and society for a considerable length of time. The “primitive stage of capital accumulation” is the key period in which the “masterplan” hypothesis of organized crime can be advanced.

Another important aspect of the period is car theft. Given the characteristics of the Transition state – zero capacity to protect mobile property or enforce penalties, and an explosive expansion of the car market after Communism throughout the former Soviet block – should provide the explanation for the unprecedented proportions of car theft in Eastern Europe. In Bulgaria the first wave of theft was international: in the early 1990s cars stolen from the West were smuggled across the country’s porous borders and to the former Soviet Union.²²² International car theft followed a similar pattern in Latvia, where cars stolen in Germany were sold on the local market or smuggled to Russia.

There often was no difference between the perpetrators and private insurers, as the transformation of the mafia-type protection racket VIS-1 into the private insurance company VIS-2 would suggest: “before they would steal cars and demand ransom, now they would simply insure.”²²³ The secret of the success of this business lies in the criminal know-how of its entrepreneurs, who had “advantage over ordinary insurance companies because they knew the risks better and had links to the criminal world.”²²⁴ Commenting on this eccentricity of the car market in Bulgaria, Tsvetkova points out that “Bulgaria

²²¹ Eleonora Guncheva, Jovo Nikolov. *Karate – Character Training, Sport, and Business.* (Kapital, Bulgaria, Feb 17 2001)

²²² Nikolov, *Crime and Corruption*

²²³ Tzvetkova, Marina, *Aspects of the Evolution of Extra-legal Protection in Bulgaria (1989-1999)*. Trends in Organized Crime, 2008, 11:326-351, 337

²²⁴ Tzvetkova, *Aspects of the Evolution* , 341

provides an experience quite different from many other countries precisely because the names of many legal private security firms became synonymous with organized crime and violence during the 1990s.”²²⁵

These private enforcers gradually filled the protection void in the market analogously to Gambetta’s Sicilian model. After 1989 the Interior ministry pulled out of guarding industrial sites and private actors stepped in to fill the niche. By the end of 1993 ex-athlete protection rackets like VIS-1, SIC and Club777 had nation-wide representation²²⁶ and were guarding small businesses and entertainment establishments, while protection firms of ex-policemen were hired for large enterprises, private companies, banks.²²⁷ Tsvetkova asserts that in the early 1990s warehouse markets throughout the country were quickly territorialized not without violent incidents.²²⁸ The Interior Ministry spoke of “mass forcing of protection contracts on small and medium-sized private firms” in a 1995 report. In order to highlight the power and influence of enforcers Tsvetkova draws attention to a key incident at the “La Strada” night club in the sea resort Diyni in 1991, where security refused to let police enter the building even though a homicide had been reported inside.²²⁹

Before one concludes, however, that the circumstances in the early 1990s protection market neatly fit into Gambetta’s protection supply model, one needs to take a closer look at the protection firms run by former policemen and state security agents. Chief army prosecutor general Yotsev alerted the public to the obvious in the year 2000 by stating that “state security groups are a threat to the state because of their “military

²²⁵ Tsvetkova, *Aspects of the Evolution* , 329

²²⁶ Tsvetkova, *Aspects of the Evolution* , 335

²²⁷ Tsvetkova, *Aspects of the Evolution* , 331

²²⁸ Tsvetkova, *Aspects of the Evolution* , 333

²²⁹ Tsvetkova, *Aspects of the Evolution* , 333

subordination, iron discipline, high-quality communication devices, ultramodern cars and arms which the police did not have.”²³⁰ The argument to be made out of this peculiar circumstance is that the state versus private enforcer dichotomy is not as clear in the Transition state as in Gambetta’s model. The informal networks binding former state security and party officials in a state domain looting coalition were still functioning underneath the gloss of democratic legality. Perhaps the state, understood as a competitive disequilibrium of elites and institutions of shifting ideologies, did not have an interest in regulating the private protection sector, because the opportunity cost was too high.

Latvia offers far less information on the unorthodox activities of organized crime groups. Although conventional activities such as drug dealing and trafficking, prostitution, car theft, smuggling of oil and metal for scrap from Russia to the West as well as private protection were part of the repertoire of Latvian mobsters, a major event in 1994 disturbed the Latvian underground. On the day after the lavish celebrations of his 40th birthday the Latvian “godfather” Ivan Haritonov was arrested and sentenced to 8 years in prison.²³¹ An end was put to his underground monopoly over the shipment of oil products in and out of Latvia.²³² According to the *Baltic Times*, “Haritonov's group was powerful enough that when brought to trial in 1994 none of the 10 witnesses showed up.”²³³ This incident and the collapse of the Paudargava criminal concern after the Latvian bank crisis of 1995 the major actors in the Latvian underworld were either in jail

²³⁰ Kapital volume: 9-15, Dec 2000

²³¹ Rawlinson, *Russian Organized Crime*, 16

²³² The *Baltic Times*, Aug 19, 1999

²³³ The *Baltic Times*, Aug 19, 1999

or escaped to Russia. Hence, the second “legalization” phase of organized crime in Latvia was not characterized by the same continuity of faces it featured in Bulgaria.

The state roots for its own: legalizing private protection in Bulgaria

The 1994 move to legalize private protection in Bulgaria is a key moment for the evolutionary hypothesis of organized crime. In 1994 the so-called Regulation 14 was passed, imposing conditions for obtaining protection licenses on all currently operating protection businesses. Out of 1313 applicants by the end of 1994, 1034 were approved.²³⁴ Among the few rejected, however, were the most powerful wrestler-run state-wide protection rackets such as First Private Militia (FPM) and VIS-1. This amounted to a weeding out of undesired competition. Yet, at this point it is difficult to argue that a scarcity dilemma had kicked in and led to this restriction of market entry. In fact, Tsvetkova brings attention to the existence of an alleged proposal dating from late 1989 for the establishment of firms attached to RDVD (regional directorates for internal affairs/police) in order to provide employment for former cadres, which did not materialize, but was implicitly realized by the regulation.²³⁵ The official explanation was that athlete-run companies were not meant to provide security anyway, but were instead debt-collectors and racketeers.²³⁶

On this count, Tsvetkova argues that the law did not have an immediate effect, because protection went underground, but was still more restrictive than Russia’s 1992 law on legal protection.²³⁷ The Bulgarian 1994 Regulation 14 did not legalize protection as such and prevented mafia-like organizations to operate as private security companies.

²³⁴ Tsvetkova, *Aspects of the Evolution* , 335

²³⁵ Tsvetkova, *Aspects of the Evolution* , 336

²³⁶ Tsvetkova, *Aspects of the Evolution* , 336

²³⁷ Tsvetkova, *Aspects of the Evolution* , 335

They had to withdraw from dispute settlement and debt recovery, refrain from giving personal guarantees and participating in acts of intimidation and violence, i.e. extra-legal protection. In this sense the Bulgarian protection market did not mirror Volkov's enforced partnerships discussed in chapter one.

What followed was the so-called *force insurers'* era. The protection companies, which had been denied licenses reregistered as "insurance companies." The owner of the wrestler organization VIS-1, Vassil Iliev is reputed to have "godfathered" this idea. According to Nikolov, VIS-1 was among those blacklisted by the government; but only days after Iliev was forced out of business, he announced that a newly formed company, VIS-2, would offer insurance plans to owners of expensive Western-made cars.²³⁸ The emergence of such "insurance agencies" was made easier because the largest state-owned insurance company usually took more than a year to pay indemnities for a stolen car.²³⁹ At the same time all the force insurers were in fact protecting their former victims, now customers, from themselves. On the ground, force insurers had an advantage over legal insurance companies because of their social capital and criminal experience.²⁴⁰

By the spring of 1995, VIS-2 controlled a fifth of the insurance market (Zarkova, 2005), and their rival : SIC – a tenth of the market (Noev, 2002).²⁴¹ The force insurers even began reputation campaigns. Ilia Pavlov, president of Multigrup and friends with the force insurer SIC, who was his former bodyguard and driver, used a tasteless metaphor denoting this transformation that became emblematic for the period: the lizard sheds its

²³⁸ Nikolov, *Crime and Corruption*

²³⁹ Nikolov, *Crime and Corruption*

²⁴⁰ Tzvetkova, *Aspects of the Evolution* , 343

²⁴¹ Rumén Yanosvki, *What do you call a lizard without a tail?* Kapital, Bulgaria, Jan 14, 2006

tail.²⁴² Bulgaria's soccer and Olympic stars, Hristo Stoichkov and Stefka Kostadinova, helped promote VIS-2 in media campaigns.²⁴³

The triumph of Bulgarian criminal genius was stymied by an unexpected development in 1997 – the beginning of the first Democrat-led government of post-communist Bulgaria. It seemed that fresh political ideology was about to shake the criminal “over-world.” In March 1997, the force insurers were warned of forthcoming regulations and some of them proceeded to change their legal status, but most were caught unawares by the unanticipated interpretation of the traffic law, which in May 1997 was used to ban insurance stickers on car windows.²⁴⁴ Shortly after, a very strict licensing regime for insurance companies was introduced. Reportedly, after its legal death, SIC invested in the state-owned “BUL-ins” insurance company, VIS-2 in the legal Jupiter, and another main force insurer, “Levski Spartak”, was bought by two Israeli firms.²⁴⁵ Thus, a process that began as a “masterplan” for insider control of a criminal protection market, ended as a commendable government campaign against organized crime.

The weeding of the private protection sector was part of a wider evolutionary development in Bulgarian organized crime. Towards the middle of the 1990s, athlete organizations had reoriented towards the large-scale privatization of state assets in tourism, the food and beverage industry, oil and gas trade, cigarette sales, and agriculture, and employed illegal methods in running those businesses.²⁴⁶ One such criminal enterprise was VAI Holding. Its owners had devised a business entrapment similar to the *spider trap* in order to acquire private firms through bankruptcy by making use of the

²⁴² Kapital, Nov 10 2009

²⁴³ Tzvetkova, *Aspects of the Evolution* , 343

²⁴⁴ Tzvetkova, *Aspects of the Evolution* , 344

²⁴⁵ Tzvetkova, *Aspects of the Evolution* , 345

²⁴⁶ Petrunov, *Organized Crime* , 319-20

existing bankruptcy law. They would force a company to employ them for supply or distribution; the company would accumulate debt towards them and would be forced to merge with the criminal enterprise.²⁴⁷

In short, some areas of business seemed to be reserved for former athletes/enforcers and for entrepreneurs with close government links. Tsvetkova argues that entry into such markets – oil, gambling, duty free shops, public contracts for services and the use of municipal properties, tourist areas, large construction and repair works – remained prohibitive into the early 2000s.²⁴⁸ The role of mafia-like organizations did not decline for lucrative areas of business throughout the 1990s since those were the entrepreneurs with networks and later experience, acquired in the early Transitions period.

Conventional mafia activities also became more popular at the end of the decade. The Center for the study of democracy argues that 97-2001 is the period, when because of government pressure and restricted access to previously profitable protection and force insurance businesses, organized crime started taking full control of the drug trade.²⁴⁹ However, according to Tsvetkova, “both lines of business, legal and criminal remained subordinated to the same characters, that is, the leaders of grupirovki [protection rackets].”²⁵⁰

Implications of the “state domain runs out” hypothesis

The implications of this seemingly evolutionary development away from extra-legal protection and towards other kinds of legal and illegal business at first lead one to

²⁴⁷ Petrunov, *Organized Crime*, 320

²⁴⁸ Tsvetkova, *Aspects of the Evolution*, 347

²⁴⁹ Tsvetkova, *Aspects of the Evolution*, 345

²⁵⁰ Tsvetkova, *Aspects of the Evolution*, 345

consider Volkov’s hypothesis of a “happy-end” story: the former racketeers become oligarchs and then the wealthy backbone of the state. In Volkov’s words, they “did much of the preliminary dirty work, each capitalizing on the decay of the state and further worsening it, yet producing in the long run, a range of consequences that few of them intended but which made them change their pattern of action”.²⁵¹ Ganev disagrees with such a projection. His objection to Hector Schamis’ idea of a link between privatization and state-building, since it can generate new rents i.e. reassert state power, is that privatization in fact undermines state capacity.²⁵² Ganev says that the question of when winners will feel the need for a stronger state is empirically unprovable in the Transition state: “Multigroup’s targets on all state levels were exactly the components of the state machinery that might be used in the pursuit of gradual and meticulous market transition.”²⁵³

Ganev quotes Randall Collins in making an important, but often overlooked, theoretical distinction between the modern democratic state and the Transition state: “in a capitalist economic domain success goes to those who use the state to force others to play by market rules while they themselves remain exempt from these rules; in Post-Communism powerful networks seek to become exempted from the state; winners formalize exemptions by weakening state capacities.”²⁵⁴ They can do this simply because they can capture the rule-making apparatus in a Transition state.

The following chapters will diverge from the state-centered perspective and explore the institutional damage the Great Criminal Transformation incurred on the

²⁵¹ Volkov, *Violent Entrepreneurs*, 191

²⁵² Ganev, *Preying*, 114

²⁵³ Ganev, *Preying*, 114

²⁵⁴ Ganev, *Preying*, 116

transitioning states, in addition to the external factors that reinforced or mitigated this damage.

Chapter 4:

Conflict, Ethnicity, Ideology, EU Leverage, and Organized Crime

So far in this work organized crime has been seen in the context of a failure of statehood, characteristic of the Transition period in post-communist societies. The phenomenon has also been traced back to the lasting informal social structures and rules, which were created during the Communist period. Although an illuminating perspective on slow democratization in Eastern Europe, it should not be considered in isolation from other important factors: the proximity of armed conflict, the perceived threat of a substantial foreign minority, the rotation of elites and their corresponding ideologies, as well as European Union leverage. These factors have on the one hand influenced organized crime by mitigating it or giving it more opportunities to flourish. On the other hand, both the above-mentioned circumstances and organized crime have determined the course of democratization.

The presence, absence or combination of these factors can explain the differences in the activities, scale, stamina and development of organized crime in Bulgaria and Latvia, and also across the Transition states of Eastern Europe. Why Latvian authorities were more effective in breaking up major criminal concerns like Ivan Haritonov's in the mid-1990s, while Bulgarian anti-corruption and organized crime combating reforms were slow to come and yield results, is one question. Why the Latvian economic system collapsed twice since independence is another. And so is the question why Bulgaria's pre- and post-accession record on the count of systemic corruption and high level organized crime has earned the country unprecedented sanctions from the EU.

In order to find out why and how organized crime has been so influential in both countries, the above-mentioned factors deserve more attention. In order to find out why Latvia was faster to join the EU regardless of its past as a subordinate Soviet Socialist Republic, while Bulgaria, previously an independent People's Republic, took much longer to complete its liberal reforms requires an analysis, which takes into consideration both organized crime and the rotation of elites. These are the questions this chapter is going to tackle.

The proximity of armed conflict: trade under an embargo

The UN study on “Crime and its impact on the Balkans” highlights an important relationship between conflict and organized crime. The working hypothesis of the report is that the prerequisites for organized crime are of a social and demographic nature: young, predominantly male and poor populations. The Balkans, however, are not “especially young, nor especially male, nor especially poor.”²⁵⁵ The special factor in the region is found to be the presence of armed conflict.

From a sociological point of view, “In a war zone, social controls are often lost entirely – criminal acts can be committed with impunity, and local predators enrich themselves through profiteering.” From an economic perspective, “The regular economy may collapse, and armed strongmen can become the only source of sustenance for some communities, enhancing their wealth and power.”²⁵⁶ This description is heavily reminiscent of Gambetta’s Sicilian mafia model – the state cannot regulate the market, therefore organized violence takes over the economy.

²⁵⁵ *Crime and Its Impact*, United Nations ,23

²⁵⁶ *Crime and Its Impact*, United Nations ,47

The report goes on to point to an important consequence of violent entrepreneurship during conflicts: “If these activities [smuggling for profit or fundraising] prove to be sufficiently lucrative, they may carry on in the post- conflict period.”²⁵⁷ In the particular socio-political climate of the Balkans “those who had made fortunes in war profiteering were able to use the political capital they had accumulated to magnify their wealth in the privatization process.”²⁵⁸ Furthermore, the UN study group asserts, it has been observed outside the Balkans that “low levels of conventional crime are found in precisely those transitional countries which experienced the most violent conflict.”²⁵⁹ Hence, two crime-labile socio-political phenomena – Transition and war - combined in the Balkans in order to generate organized crime and give it a distinctive character.

Although not an arena of violent conflict itself, Bulgaria did not remain unconcerned by the international trade embargo imposed on Yugoslavia in the early 1990s and later in the late 1990s. The embargo interrupted formal trade channels and created scope for large-scale smuggling operations between criminal elements abundant in both countries at the time. The criminal relationship in the early ‘90s as seen in the previous chapter baptized Bulgarian sports clubs-turned-organized criminal squads and gave many former sportsmen and nomenklatura members start-up capital for larger operations such as privatizations and insurance companies. Privatizing the transport sector enabled former sportsmen to smuggle large quantities of fuel and arms to the war zone along channels, controlled by the nomenklatura and secret services. The money they accumulated then had to be laundered internationally through shell companies or

²⁵⁷ *Crime and Its Impact* , United Nations ,47

²⁵⁸ *Crime and Its Impact* , United Nations ,47

²⁵⁹ *Crime and Its Impact* , United Nations ,47

domestically through unregulated private banks, private protection agencies, participation in the privatization process, etc.

The late 1990s were a revelatory sequel to the Bulgarian organized crime saga: the participants were the same as in the early 1990s and the connections on the Serb side remained. After 1999, Bulgarian police noticed that many members of various criminal clans from former Yugoslavia were visiting the country increasingly often. Dushan Spasoevich - Shipter, a leading member of the Zemun criminal clan, was reported to have been a partner with two prime Bulgarian drug lords Poli Pantev and Rumen Ianevski throughout the late '90s and early 2000s.²⁶⁰ War hero and crime boss Branislav Lainovich – Dugi registered a company in Sofia at an address which was leased by the Bulgarian Bureau for Diplomatic Services. According to the Bulgarian media a number of other Serbian firms had been residing at the same address since 1994, even though it is against the law for firms to be registered and have their headquarters in a building used for diplomatic visits.²⁶¹ The fact that an investigation of the Foreign Ministry into this affair did not begin until 2003 raises a number of speculations about the relationship between Serbian criminal entrepreneurs, their Bulgarian counterparts, and the Bulgarian authorities.

As in the early 1990s all goods banned under the embargo were smuggled underground. Petkan Iliev studied mirror statistics in order to determine the volume of illegal trade between Bulgaria and Yugoslavia (Serbia and Montenegro) in 2001, the biggest inconsistencies being in oil products and electricity. The corresponding number for

²⁶⁰ *The Serb mob in Buglaria*, WEB. <http://mafiabg.wordpress.com/category/serbian>

²⁶¹ *ibid.*

the former is \$39 million and for the latter \$21 million.²⁶² The fact that only 38 tonnes of oil products allegedly entered the Yugoslav border from Bulgaria, while over 182 tonnes were exported, leads Iliev to assume not only contraband, but also widespread customs fraud. This exported electricity does not even exist on paper since it ran on illegal cables crisscrossing the border. These facts give an idea of the degree of sophistication and the scale of collusion of organized crime during and after the two Balkan conflicts in the decade of the '90s, and suggest a grey margin of complicity between the gangsters and the customs authorities. When the profits were so great and the level of involvement so high in the economy and politics, there can be no wonder at the slow pace of democratization, customs reforms and anti-corruption campaigns.

The Russian problem

Latvian liability to organized crime was shaped by another external factor: its large Russian minority, inherited after the fall of the Soviet Union. As Geoffrey Pridham summarizes Latvia's plight after independence, "economic distress and the post-Soviet sensitivity to national identity, combined with a nationalist phase that affected political discourse for at least the first half-decade of the new democracy—made for a difficult political transition even though there were no serious threats to democratic choice."²⁶³ Even if democratic in every other aspect, the presence of a large and powerful Russian minority, concentrated in the key cities (42.3% of the population in the capital Riga and

²⁶² Iliev, Petkan. *The Price of Legalizing Bulgarian Business*, (Manager magazine (in Bulgarian), No. 7, Jul 16, 2003)

²⁶³ Geoffrey Pridham, *Securing the Only Game in Town: The EU's political Conditionality and Democratic Consolidation in Post-Soviet Latvia*. (Europe-Asia Studies, 61:1, 51-84, 2009), 63

53,5% in the second largest city, Daugavpils²⁶⁴, predetermined that minority rights would be a lacking area.

For a considerable period of time Latvia ignored the problem, leaving close to 600,000 ethnic Russians without citizenship and lacking a number of fundamental rights. Due to mounting international pressure during 1997 and 1998 the citizenship law was amended, but not before the nationalist party TB/LNNK blocked the proposal and forced a referendum on the issue.²⁶⁵ The saga continued with a new language law, which was drafted to strengthen requirements for citizenship and passed in 1999. The law had to be vetoed by the president Vaira Vike-Freiberga in order to lead to a more democratic proposal in the autumn of the same year.

Although not directly related to organized crime, as observed in previous chapters, the Russian minority in Latvia indirectly affected a very important prerequisite for organized crime in Transition economies – the privatization process.

Heavy political maneuvering was employed in order to exclude ethnic Russians from the privatization process in a nationalistic socio-political context. The privatization law stipulated that “length and place of residence in the republic” was a criterion for participating in an auction and privatization commissions allegedly added further conditions, for instance that the purchaser speak Latvian.²⁶⁶ In mid-1992, the first year of privatization, before the Latvian ruble or the lat were introduced as currency, Latvian privatizers were afraid of massive purchases by Russians in possession of Russian rubles.

²⁶⁴ WEB, http://en.wikipedia.org/wiki/History_of_Russians_in_Latvia

²⁶⁵ Pridham, *Securing the Only Game*, 64

²⁶⁶ Roman Frydman, Andrzej Rapaczynski, John S. Earle et al. *The Process of Privatization in Russia, Ukraine and the Baltic States* (Central European University Press, 1993), 223

As Frydman asserts, “this drastically slowed the politically possible pace of privatization, due to the fear of a sell-out to foreigners.”²⁶⁷

When vouchers were introduced, their allotment proceeded according to an intricate ethnically-biased system, which granted more vouchers to Latvians.²⁶⁸ The peculiarity of ethnically biased privatization might have precluded Russian Communist party members and security agents from grabbing away the state domain as in Bulgaria, but it did not stop former Latvian *tsekhoviki* and ethnic Latvian nomenklatura members from capitalizing on privatization and becoming Latvia’s oligarchs. In many cases, as Rawlinson points out, changing one’s name in the political world also did the trick and many second-wave *avtoriteti* (crime bosses) were in fact ethnic Russians.²⁶⁹

For the purpose of this study, however, one aspect of Latvian privatization is key: its slow pace. While in Bulgaria prime sectors such as transport and, later on, real estate and land were parceled up quickly and under the carpet, in Latvia democratic reforms and EU monitoring caught up with the process. Hence, the Latvian Shipping Company, mentioned in Chapter 2 and discussed in more detail below, was privatized late and with complete transparency and participation from the NGO sector. Two extreme examples are the profitable Latvian telecom giant, Lattelecom and the Latvian electricity monopoly, Latvenergo that are in fact protected from privatization due to their profitability and political importance.²⁷⁰ This is why it is harder to say that the Latvian private sector is as representative of former racketeers and mobsters as is the Bulgarian one.

²⁶⁷ Frydman, *The Process of Privatization*, 225

²⁶⁸ Frydman, *The Process of Privatization*, 227

²⁶⁹ Rawlinson, *Russian Organized Crime*, 14

²⁷⁰ WEB. <http://www.bertelsmann-transformation-index.de/181.0.html?L=1>

Culture of Corruption

A lot has been said about moral values in post-communist states, but whether post-communist culture is conducive or not conducive to corruption, and concurrent to predatory economic behavior, remains a relatively open question.

In a work titled “Culture of Corruption” Miller, Grodeland and Koshechkina develop an engaging framework for the study of cultural values in Transition societies.

The model they advance is the “escape from domination” model, which

“predicts an immediate and dramatic change in behaviour, though not in thinking as people suddenly escape from the constraints of a historic domination. Later change may not be progressive and may often reverse or attenuate the initial change. Reform is possible, but it must address the problems of the present, often problems created by the excesses of the escape, rather than the legacy of the past.”²⁷¹

The authors of “Culture of Corruption” assert that Communism did not encourage respect for the law, which was applied arbitrarily and only took a second place in importance to the party line.²⁷² They then proceed to set up the premise of their investigation: “if citizens are contented accomplices in petty corruption then reform is likely to be more difficult and less effective. It would then be necessary to reform the people as well as to reform the administration.”²⁷³ The study looks for traces of apathy or condoning of corruption among the population and establishes that only a third of the public in large-scale surveys in the Czech Republic, Bulgaria, Slovakia and Ukraine were apathetically resigned to regard “the use of money, presents, favours and contacts to influence officials” a permanent part of their country’s culture.²⁷⁴ The study then concludes that high corruption in Eastern Europe is an exceptional response to

²⁷¹ William L. Miller, Ase B. Grodeland, Tatyana Y. Koshechkina, *A Culture of Corruption?* (Central European University Press, 2001), 18

²⁷² Miller, *Culture of Corruption*, 134-135

²⁷³ Miller, *Culture of Corruption*, 165

²⁷⁴ Miller, *Culture of Corruption*, 282

exceptional times, namely a social and economic crisis, and that “at a deeper level, public norms and values remain intact.”²⁷⁵

Although viable for corruption in post-communist societies, the “escape from domination” model misses two interesting angles on corruption as potentially determined by culture. In the first place it might be useful to distinguish between professional morality of state officials and that of society at large, especially since there was no new trained civil service to replace the one inherited from the Communist period, which was proficient in corruption. In this spirit is the remark of the Bulgarian Prime Minister Ivan Kostov, whose Union of Democratic Forces (direct heir of the first opposition movements in Communist Bulgaria) took power in 1997, that officials in the country are “corrupt, secretive and reluctant to give up power.”²⁷⁶ The assumption that a certain type of immutable nomenklatura mentality exists led him to wage an anti-corruption campaign, which merited the headline ““Filchev [attorney general] imitates Clean Hands.” Comparing East European anti-corruption campaigns with Clean Hands, an anti-corruption campaign in Italy in the 1990s that led to the collapse of Italy’s post-war party system, was popular in the late 1990s.

The problem, however, lies only partially in bad work ethics among the civil service. The Center for the Study of Democracy offers another simple explanation: due to the unstable political climate in the 90s well-qualified civil servants would often find themselves unemployed and recruited for the company of an oligarch. Thus, oligarchs became an important recruitment factor for the high level administration. Moreover, unlike politicians, who only exercise influence over a limited time span, civil servants or

²⁷⁵ Miller, *Culture of Corruption* , 283

²⁷⁶ Miller, *Culture of Corruption* , 285

directors could be around significantly longer. The think tank concludes that consequently, “a symbiotic model comes into existence where it is not clear where state ownership ends and where private ownership begins.”²⁷⁷

From the above examples follows the supposition that a new young civil service drawn from the post-communist generation would not be as susceptible to corruption. And indeed, the Transition period in Eastern Europe was marked by a widespread comparison with the “Biblical experience of the Jews, who spent 40 years in the wilderness after they left Egypt. Only a fresh generation with no experience of slavery would be capable of building a new, free society.”²⁷⁸ In a broader examination of Russian mores according to de Tocqueville’s criteria for a highly democratic society, Peter Rutland finds that not only did the Russians have a profound neglect of religion by the end of the Communist period, but they had the “wrong” kind of religion (Eastern Orthodoxy emphasizes life in heaven instead of earthly deeds) and “bad” social capital (informal rather than formal associations).²⁷⁹

With a weaker democratic and religious tradition than Latvia, where the inter-war republic is looked back on fondly and Protestantism and Catholicism share the religious ground, Bulgaria fits the Russian anti-democratic model as drawn up by Rutland more closely. Even so, however, “bad” social capital and disrespect for religion are enough to challenge the temporary nature of the “escape from domination” model.

Nevertheless, a climate of quiet condoning of corruption among the population as a reaction to socio-political cataclysms can contain a self-reinforcing element. Latvian

²⁷⁷ *Crime without Punishment, CSD : Countering Corruption and Organized Crime in Bulgaria*. (9th Report of the Center for the Study of Democracy, Sofia, Bulgaria, 2009), 48

²⁷⁸ Peter Rutland, *Democracy in Russia: A Tocqueville Perspective* (The Global Democratic Revolution in the 21st Century, Rowman & Littlefield, 2008)

²⁷⁹ Rutland, *Democracy in Russia*

surveys conducted in 2008 by the Open Society Institute shed light on this thought experiment. Respondents were asked to rank their political party affiliations and justify them based on the party's "corruptedness" and technocratic pragmatism. The results were revealing: "The negative trait of corruption may be balanced with other qualities, for example, a party's ideological closeness to voters on certain important issues, or its technocratic capacity to generate solutions to complicated and current policy matters. At other times, voters might have the conviction that corruption is found in all major political parties, and then the corruption factor can lose meaning during elections."²⁸⁰

Not only did Latvians ignore corruption as a voting decision factor, but also more than half of the respondents fully or partially agreed with the view that political corruption is part of "human nature." 56.1% of the respondents agreed "any person who found oneself in a position of political authority would also try to use it for their personal benefit."²⁸¹ Given this apathetic point of view of voters in Latvia, an equally interesting observation can be made about the business community in Bulgaria, where, according to the Center for the Study of Democracy, professional associations continue to be passive without internal professional quality assurance procedures and lacking investigation and disciplinary measures against non-compliant members.²⁸² It seems that the predatory entrepreneurial version of the *golden rule* (do whatever it takes to survive and get rich, because everyone would do the same in your place) has a self-reinforcing aspect.

This is yet another factor which directly influenced organized crime by justifying individual participation in it to a large extent. It is also clear why Latvia, which has more

²⁸⁰ *Corruption °C: Report on Corruption and Anticorruption Policy in Latvia*, (Center for Public Policy Providus, Riga, Latvia. No. 8 second semiannum 2008), 18

²⁸¹ *ibid*, 29

²⁸² *Crime without Punishment, CSD*, (2009) 70

of the “good” social capital than Bulgaria, can be expected to do better at limiting it and fighting it than Bulgaria.

Political will or the lack thereof

Milada Vachudova advances the argument that rotation of elites is key to a successful Transition: “the most successful recipe for a liberal pattern of political change is the alternation in power of political parties that originated from a strong opposition to communism, and from a reforming communist party. This creates the most favorable conditions for the checks and balances of a liberal democracy, but also for the consensus and compromise of a political system that avoids polarization.”²⁸³ Indeed, the change of faces in power would be beneficial to limiting oligarchic tendencies and organized crime in the economy. The reason lies in the links between former nomenklatura members in both Bulgaria and Latvia and small-time black market profiteers and organized violence wielders in the form of sportsmen or former security agents. Criminal cartels would have to renew their political capital with every new election and compete with rising criminal rings – a rather daunting task.

While one could say that Latvia saw a rapid turnover of elites and cabinets between 1990 and early 1995²⁸⁴, the same cannot be said about Bulgaria. There the continuity of the unreformed Communists (renamed the Bulgarian Socialist Party) was only interrupted by a brief opposition government between October 1991 and October 1992 to be followed by the so-called “experts” government close to the BSP. An issue in Latvia was the multiplication of political parties and what Dreifelds calls “pervasive narrow sectarian view of interests lacking broader perspective on the interrelationships

²⁸³ Vachudova, *Europe Unidivided*, 13

²⁸⁴ Dreifelds, *Latvia in Transition*, 102

between the various elements of the population and the state.”²⁸⁵ The problem in Bulgaria was the domination of a counter-reformist unreconstructed left. In Latvia Club 21, founded by Janis Kruminis and Valdis Birkavs of the centrist and reformist Latvian Way, in order to provide a forum for informal interaction between parliamentarians, business representatives, diaspora Latvians and interested activists quickly became stigmatized as conspiratorial. In Bulgaria the equivalent of such a forum remained within the confines of former nomenklatura circles.

The fluid political rotation in Latvia presents a problem for criminal economic empires in the search of enduring political connections; while the divisive political make-up in Latvia suggests that the market and the law will be weak enough to allow for organized crime to take roots, especially on a local level. In Bulgaria the fossilized anti-reformist stance of Bulgarian socialists secured the positions of criminal cartels such as Multigrup and guaranteed weak law enforcement, insufficient market regulation, and, therefore, a fertile ground for organized crime.

Conflict of interest

On the ideological colours of the elite in power depends the passage of landmark legislation such as regarding the prevention of conflicts of interest, corruption, and defining the crime of participating in an organized crime group. By tracing the development of legislation in these areas one can get a good idea of how much of a scope for action oligarchic and criminal elements in the Bulgarian and Latvian society had at any given point during the Transition period.

²⁸⁵ Dreifelds, *Latvia in Transition*, 102

Conflict of interest became an issue in Latvia very early on with the elections for the fifth Saeima in 1992. Given that the members of Club 21, who represented 10 out of 15 cabinet members in Birkavs' cabinet, were primarily businessmen or returning émigrés with investment interests as well as political good will, the government soon found itself legislating against corruption. Receiving state contracts or employment in for-profit organizations was proscribed.²⁸⁶ A concurrent campaign was the opening of the KGB records and a lustration process, which also contributed to the early weakening of informal power networks, inherited from Communism.

These developments set the tone for a tradition of liberal-minded reformist governments in Latvia, which pass anti-corruption legislation along Western standards and less liberal governments, which focus primarily on the citizenship issue. Latvia's Law on conflict of interest was passed in April 2002 by the cabinet of Andris Berzins of Latvia's Way and a Parliament dominated by the People's Party, also founded by businessmen and with a center-right-of-center attitude.

For comparison, a law on the prevention of conflict of interest was not passed in Bulgaria until October 2008, under extreme pressure from the European Union, and only after a big 'conflict of interest' scandal broke out in February the same year, which led to the freezing of EU infrastructural funds.²⁸⁷ These circumstances made it possible for this piece of landmark legislation to be passed by a socialist-led government. One can only speculate as to why it took Bulgaria seventeen years after signing the Europe

²⁸⁶ Dreifelds, *Latvia in Transition*,

²⁸⁷ *Bulgarian Parliament Adopts First Conflict of Interest Law*, EU Business, Oct 16, 2008. <http://www.eubusiness.com/news-eu/1224164826.94/>

Agreement for EU accession preparation in 1993 in order to adopt this legislation, while it took Latvia only four since its Europe Agreement in 1998.

The results of implementing the laws in the two countries are contradictory. While the Latvian State Revenue Service has punished more than 100 officials every year, the fines imposed are insignificant.²⁸⁸ Moreover, the practice of semi-secret “management contracts” that doubled the salary of top civil servants was not barred until late 2008 and bonuses to civil servants still draw the attention of the State Audit office.²⁸⁹ A law on Property Disclosure for civil servants and MPs had been in force in Bulgaria since May 2000 with a requirement of submitting income and asset declarations on an annual basis, analogous to the Latvian law. The center for the Study of Democracy, however, labeled this law as containing “wishful” provisions.²⁹⁰

While in Bulgaria declarations submitted under this legislation have been serving in lieu of public party finance registers, Latvia also adopted a law on party financing as early as 1995 to amend it again in 2002 and 2004. Although the results for both countries remain in the low range for Eastern Europe the conclusion to draw from these legislative dissimilarities is that, agreeing with Vachudova, it mattered who was in power and who held the most informal power in order for landmark anti-corruption legislation such as conflict of interest acts to be adopted.

Although damaging to domestic politics and welfare, conflicts of interest in the new member states in Eastern Europe have also proved dangerous to European intuitions. In a most recent scandal, at the hearings for the new European Commission,

²⁸⁸ *Corruption & Policy in Latvia*, (report of the Open Society Institute, Latvia, 2002), 308

²⁸⁹ WEB. <http://www.bertelsmann-transformation-index.de/181.0.html?L=1>

²⁹⁰ *Corruption Assessment Report*, Coalition 2000, Sofia, Bulgaria, Dec 2000, 12

Bulgaria presented a candidate who had had an undisclosed conflict of interest as Member of Parliament for the years 2008 and 2009 as both manager and owner of Global Consult, a company that was registered on her name in the Bulgarian Commercial register.²⁹¹ There were also allegations against her husband's involvement with the Russian mafia on the Black Sea coast. She had to resign as Foreign Minister and withdraw her candidacy for the Commission. The scandal caused a delay in the inauguration of the Commission as the Bulgarian government had to scramble to find a more suitable candidate. This event should have sounded the alarm about defective democratization and corruption in Eastern European member states and its potential damage abroad.

Anti-corruption campaigns

Anti-corruption campaigns are a common election platform in Eastern Europe. They are usually associated with liberal democratic governments and European Union leverage. They tend to unravel political as well as economic scandals, but are rarely conclusive. In Bulgaria the first government to win on an anti-corruption platform and to begin a fight against corruption was Ivan Kostov's UDF (Union of Democratic Forces) government, which came to power in 1997, as noted above, under the media slogan of "Clean Hands." The campaign went quiet until the liberal democratic GERB (Citizens for European Development of Bulgaria), founded by Bulgaria's "top cop" (former Chief Secretary of the Interior Ministry Boiko Borissov) took over in 2009 and began institutional reshuffling as well as reopening cold corruption and organized crime cases.

²⁹¹ European Commission hearings, Jan 13 2010

Anti-corruption campaigns in both Bulgaria and Latvia were accompanied with controversial institutional reforms. When Einars Repse, former head of the Bank of Latvia at the beginning of liberalization in the early 1990s, became prime minister in 2002, his tough liberal reputation did not disappoint: the Corruption Prevention and Combating Bureau (KNAB) came into being and has consistently met with very high trust from the population.²⁹² Not only has the agency built up its own good reputation, but Repse made a point of emphasizing that it was not the product of EU pressure, but of domestic initiative: “we took issue with corruption on our own; this linked in with our economic development policies, fiscal discipline and proper judicial system.”²⁹³ Four years later, however, the People’s Party Kalvītis government began political power games against KNAB, accusing it of excessive self-promotion and irregular bookkeeping, while KNAB had been investigating members of the People’s Party.²⁹⁴ The scandal eventually led to the downfall of the Kalvītis government in 2007.

Bulgaria’s record in institutionalizing the fight against corruption is inextricably linked with the fight against organized crime. It has also been one of coping with the Soviet operational legacy within the Interior Ministry. The National Unit for Combating Organized Crime (NSBOP) was a remnant from the communist-era State Security apparatus and was gradually suppressed until its powers were severely curtailed in 2006 and again in 2008, when it was removed from the Interior Ministry and attached to the Criminal Police, its organized crime prerogative being transferred to the State Agency for National Security (DANS). The maneuvers are allegedly due to the clash of lobbies within

²⁹² Kalnins, Valts (ed.) *Corruption °C: Report on Corruption and Anticorruption Policy in Latvia*, Center for Public Policy Providus, Riga, Latvia. 2005 second semiannum, 2006, 72

²⁹³ Pridham, *Securing the Only Game*, 75

²⁹⁴ Pridham, *Securing the Only Game*, 76

the Socialist Party, which held power at the time.²⁹⁵ In April 2008 a big corruption scandal shook the foundations of the Interior Ministry, when it came out that its officials had been leaking confidential information to leaders of criminal groups under surveillance.²⁹⁶ A year later the DANS was embroiled in a similar scandal which proved its inability to keep files “confidential.”²⁹⁷ The current government has announced its plans for reforming both agencies, reinstating corruption combating within the prerogatives of NSBOP.

Party financing

Political party financing is one of the most problematic corruption areas in Eastern Europe. Until very late in the Transition period many Eastern European states did not have public registries for campaign expenditure and instead the only kind of control exercised was through income and asset declarations of members of parliament and senior officials. Latvia has achieved far more than Bulgaria in the area of political party regulation mainly due to the earlier political impetus coming from its liberal and émigré political elites. Nevertheless, irregularities persist.

Latvia began grappling with the issue in 1992, when the legal regulation of political parties was reinstated. The first law in this area, in force between 1992 and 1995, provided the independence of political organizations from public interests and at the same time prohibited parties from receiving state funding for political activities.²⁹⁸ The 1995 amendments introduced penalties, which did not amount to more than written reprimands sent to the party headquarters, but also set a limit to individual donations and

²⁹⁵ Dimitar Peev, *The Tiger Which Does not Bite*. Kapital, Buglaria. Aug 6, 2009

²⁹⁶ Rossen Bossev, *Five Reasons to dismiss Rumen Petrov*. Kapital, Apr 11, 2008

²⁹⁷ Ivan Mikhalev, *The Spies' League* Kapital, Oct 30 2009

²⁹⁸ *Corruption* °C,(2005), 20

prohibited using third persons as intermediaries.²⁹⁹ That this was not enough became apparent in the 2001 local elections and a warning from the World Bank about “state capture” in Latvia. The 2004 law tightened the rules for donations by prohibiting legal persons from making donations and setting a limit to the total campaign expenditure.³⁰⁰ That this law and its implementation in the hands of the KNAB showed results can be seen in a 2008 audit case, where KNAB ordered the Prime Minister Ivars Godmanis’ party, Latvia’s Way, to pay 530,000 LVL (€750,000) into the state budget due to irregularities in its campaign financing.³⁰¹

The Bulgarian law on party finance, subject to five redrafting measures and initially postponed until April 2000, exists in its present form since 2001 and was amended in 2003 in order to regulate the conditions of granting state subsidies. However, according to Transparency International surveys conducted in 2004, political party financing as a whole was not transparent with an index value of 1.98, where 1 means not transparent and 10 means transparent.³⁰² In early 2010 State Audit Agency investigations of campaign financing for the 2009 EU parliament and national parliament elections revealed gross irregularities committed by all parties, whereby most of them omitted to declare TV advertising expenses.³⁰³

The fact that a business-founded party in Latvia initiated actions against the well-reputed corruption combat agency and that party finance legislation in Bulgaria did not become reality until the liberal and the Europe-minded Simeon Saxe Coburg-Gotta

²⁹⁹ *Corruption* °C,(2005), 20

³⁰⁰ *Corruption* °C,(2005), 21

³⁰¹ *Corruption* °C,(2008), 8

³⁰² *Index for Transparency of Political Party Financing in Buglaria*, Transparency International, Buglaria, 2004, 2

³⁰³ Juliana Koleva, *The Scandalous black PR video against GERB was financed from the budget*. Dnevnik newspaper, Bulgaria, Mar 19, 2010

government came to power in 2001 says a lot about the role of political will in areas sensitive to corruption and organized crime such as party financing. Loopholes in this type of legislation amount to giving organized crime a springboard into the government.

Tell me what kind of democracy you are and I will tell you what kind of mafia you have

In “Europe Undivided” Milada Vachudova devises a theory of Eastern European integration into the European Union. The theory distinguishes between liberal and illiberal states, hence fast and slow reformers, fast and slow to integrate. Bulgaria is described as an illiberal democracy with a number of consequences, which come into play when it applies for EU membership but also make it fertile ground for large-scale organized crime. If one follows Vachudova’s criteria in an attempt to define Latvia, the result will be a middle, issue-specific ground.

According to Vachudova illiberal Eastern European states like Bulgaria, Romania and Slovakia are victims of the lack of rotation of the governing elite. As discussed above the result is stagnation of reforms and institution building. The illiberal pattern involves episodic market reforms as well as subverting democratic institutions and using ethnic nationalism to build legitimacy.³⁰⁴ In this way Bulgarian communists managed to stay in control, if not directly in power, for close to 7 years after the fall of the Communist regime in 1989.

Since this was not the case in Latvia it is worth taking a look at Vachudova’s scheme of the actions of a liberal post-communist government: 1) open the political arena to groups oppressed by the political regime; 2) former dissidents set the parameters for

³⁰⁴ Vachudova, *Europe Undivided*, 20

mainstream political debate, marginalizing extreme nationalists and calling for ethnic tolerance; 3) the former dissidents help electorates to understand and accept difficult economic reform as part of the democratic revolution.³⁰⁵ One might say that Latvia had the necessary human capital in the form of its émigrés, reformed communists and business elite in order to complete the first and the third parameter. Indeed, Latvia has a broad and even fragmented political arena. But it failed in so far as ethnic tolerance goes.

Vachudova suggests that the quality of political competition depended on the presence or absence of an opposition to communism strong enough to take power in 1989.³⁰⁶ Indeed, Bulgaria did not have an active opposition of any kind before late 1987, when the Federation of Clubs for Glasnost and Democracy was founded. The case in Latvia is interesting in so far as the Helsinki accords brought the Latvian Helsinki Watch into being. It, however, did not materialize until 1986 and even then its biggest commitment was to hold protests on the anniversaries of the deportations of 1941, the Ribbentrop-Molotov Pact and the 1918 proclamation of Latvian independence. Instead of building a democratic opposition to Communism, Latvian civil society focused on recovering its inter-war independence and constitution: a fact, which had problematic implications for liberal development after Communism.

Another important prerequisite is the presence or absence of a communist party that was already undergoing internal reform in 1989.³⁰⁷ Interestingly, this was not the case in either country, the Latvian Communist party being dominated by ethnic Russians and Latvian communist hardliners and the Bulgarian Communist party's intransigence

³⁰⁵ Vachudova, *Europe Unidivided*, 26

³⁰⁶ Vachudova, *Europe Unidivided*, 21

³⁰⁷ Vachudova, *Europe Unidivided*, 21

having earned Bulgaria the nickname of Moscow's fortress on the Balkans. By this criterion Latvia also seems to have been on the way to an illiberal future. Latvia, however, very quickly developed what Vachudova calls a post-communist left and a post-opposition right³⁰⁸ due to the obsession with independence and the pan-societal consensus on westernization.

Vachudova's illiberal scenario ends with economic crisis caused by the illiberal regimes' reckless bookkeeping and anti-reformism. This in turn forces new parties of whatever origin onto the political arena.³⁰⁹ Bulgaria saw such a turn in 1997 due to the Jean Videnov government's excessive grain exports and poor economic decisions with the aim of self-enrichment.³¹⁰ Interestingly, Latvia did not follow an even path of economic development either. The Latvian government, having created an independent Central Bank to preside over the banking sector, overlooked an unprecedented banking boom in the years 1992-1995 built on speculation with high interest rates, insider loans, and suspicious deposits from Russia and the CIS. In late 1994, the banking system began to crumble and eventually lost 40% of its assets and liabilities.³¹¹ The difference between these two crises lies in the distinction between a classic *state capture* by the private sector in Latvia, and the unorthodox *state capture* by the rent-seeking political elite in Bulgaria.

In fact, in the early 1990s one of Latvia's biggest banks, Parex, ran advertisements on Russian television with the evocative tagline "We're closer than Switzerland."³¹² The government's policy on bank creation was that any person or entity should have the right

³⁰⁸ Vachudova, *Europe Unidivided*, 37

³⁰⁹ Vachudova, *Europe Unidivided*, 34

³¹⁰ as discussed in Chapter 3

³¹¹ Alex Fleming and Samuel Talley, <http://www.worldbank.org/html/prddr/trans/m&a96/art2.htm>

³¹² Pauls Raudseps, *Latvia Bank Failure Dashes Hopes*, (Transitions Online, Dec 5 2008)

to establish a bank so that people could gain access to a much cheaper source of funding than would be possible through existing banking institutions.³¹³ As a result regulations were minimal and *tsekhoviki* such as Lavent and Leskov as well as former members of the Communist Party's youth organization "Komsomol" could use their Communist-era social capital in order to grab a share of the banking sector and later on political influence. Such is the story of the owners of Parex Bank Kargins and Krasovickis who, according to Paul Raudseps of the Latvian daily Diena, secured one of the first licenses to run a foreign currency exchange in the USSR even before Latvia was completely independent.³¹⁴ The clannishness and trade with influence in Latvian banking would have lasting repercussions for Latvia's economic and political stability.

If considered a liberal Transition democracy it would be hard to justify Latvia's degree of *state capture* and organized crime in the 1990s as well as the legacy of these two phenomena in Latvia's flawed financial system in the 2000s. On the one hand, the fact that Bulgaria neatly falls into the category of an illiberal Transition democracy explains its high rates of organized crime. On the other hand, organized crime can account for dragging reforms after the year 2000.

Enter EU – passive leverage

The conundrum Vachudova is trying to resolve is one of how illiberal regimes could sustain their illiberal policies at home, while signing Europe Agreements for EU accession and courting the West at the same time. A related conundrum would be how criminal economic practices on a large scale with the involvement of the political elite could be sustained in countries, which had an interest in showcasing a good political and

³¹³ Fleming and Talley, <http://www.worldbank.org/html/prddr/trans/m&a96/art2.htm>

³¹⁴ Raudseps, *Latvia Bank Failure*

economic environment for foreign investment and partnership. Bulgaria epitomizes this conundrum, while Latvia is almost an exception and an interesting one at that.

Milada Vachudova points out that “the domestic requirements of EU membership proscribed the very mechanisms by which governing elites in illiberal states consolidated political power and cultivated their domestic power base: limited political competition, partial economic reform and ethnic nationalism.”³¹⁵ The rewards of greater market access and international development aid as well as the popularity of the EU project with the electorate meant that the illiberal elites could not afford to abandon it. They therefore relied on their monopoly over information flows in and out of the country and practiced what Vachudova calls “foreign policy arbitrage.”

In fact, both Bulgaria and Latvia practice forms of foreign policy arbitrage. However, while Bulgarian predatory elites awoke early on as to the EU’s emphasis on minority and ethnic policy and used it to deflect attention from rampant economic corruption and rent-seeking, Latvia dragged its ethnic intransigence to a point where it threatened to cast shadow on its economic success. In Bulgaria, the socialist president, Petar Mladenov reversed the assimilation campaign against Bulgaria’s ethnic Turks, while several Socialist governments relied on the support of the Movement for Rights and Freedoms (MRF), the Turkish ethnic party which was well integrated into the structures of the Bulgarian state and society.³¹⁶

At the same time Latvian elites felt threatened by a powerful Russian minority, which not only constituted more than half of the population in major cities, but had been pulling the strings of government, the economy and society until recently as part of

³¹⁵ Vachudova, *Europe Unidivided*, 73

³¹⁶ Vachudova, *Europe Unidivided*, 155

Moscow's design for domination. Ethnic Russians were indeed active and won seats in a number of parliaments, but did not influence politics significantly. To a more important extent, it was the role of EU passive leverage in this matter that made Latvia lose its game of arbitrage. A rejection from Brussels in late 1997 to open membership negotiations forced Latvia to liberalize its citizenship law.

While Bulgaria's arbitrage policies are indisputably beneficial to and at the same time dictated by organized crime and corruption, Latvia's uncertainty on the liberal path is ambiguous. It can suggest that due to repressive nationalistic laws Russian informal networks were weakened, hence organized crime lost its foothold early on. It can also suggest that as an illiberal state Latvian elites were rewarding insiders and creating circles of oligarchs. Both can be true.

The EU – active leverage

Once a country is in negotiations with the EU and begins opening the chapters of the *acquis*, Vachudova suggests that the relationship between the candidate country and the EU is strengthened to an extent that democratization and economic reforms do in fact materialize and remain. Moreover, “as candidates move through the pre-accession process toward membership, it becomes less likely that the polity will slide back by becoming less competitive or rolling back reform.”³¹⁷ Whether Latvia and Bulgaria were obedient candidates, and further down the road - obedient members, is an interesting issue. This would imply a clampdown on organized crime and stronger institutions.

Active leverage has two important aspects, one is cooperating with the country's government, hence replacing rent-seeking with reform-minded governments; the second

³¹⁷ Vachudova, *Europe Unidivided*, 106

one is, reinforcing civil society through changing the information and institutional environment.³¹⁸ In Bulgaria the Union of Democratic Forces represented the “modern, technocratic and uncorrupt”³¹⁹ alternative to the rent-seeking socialists. In cooperation with the NGO sector the UDF government began an anti-corruption campaign which resulted in improvements in corruption perception according to TI’s index for each of the four years from 1998 to 2002.³²⁰ The government that followed the UDF also partook in the political consensus around Bulgaria’s EU aspiration and followed up on reforms neglected by the UDF such as the state’s overbearing role in the economy.

With this Vachudova seems to end on a positive note: once the EU takes over all doubt must disappear. Pridham takes a more critical stance of early membership for Eastern European states and suggests that while democratic inversion such as in Belarus or Russia is unlikely in the new member states,³²¹ the wide party-political consensus, which accompanied accession, inevitably expires once this goal is achieved.³²² More starkly yet, Pridham refers to “Potemkin harmonization,” “whereby formal structures were created to please the EU but with little impact as to actual domestic outcomes.”³²³ The case Pridham invokes is the 2006-2007 campaign of bad publicity on NGOs, which began with an attack on George Soros and the Open Society Foundation in populist press initiated by prominent politicians and oligarchs. This, Pridham asserts, would almost certainly not have occurred during accession.³²⁴

³¹⁸ Vachudova, *Europe Unidivided*, 106-7

³¹⁹ Vachudova, *Europe Unidivided*, 169

³²⁰ Vachudova, *Europe Unidivided*, 212

³²¹ Pridham, *Securing the Only Game*, 53

³²² Pridham, *Securing the Only Game*, 58

³²³ Pridham, *Securing the Only Game*, 61

³²⁴ Pridham, *Securing the Only Game*, 72

Some of the continuities in the 1995 and 2008 economic crises in Latvia are also strikingly evocative of *Potemkin harmonization*. A more stringent banking law followed the 1995 crisis in 1998 as well as the positive evaluation of an independent IMF jury for Latvia's banking sector.³²⁵ In 2008 the government's excessive borrowing and subsidizing of unprofitable industries reportedly brought the economy on its knees, but a big part of this was also an easy credit frenzy and lack of regulation for bad loans.³²⁶ Even then the main reason for the 2008 crash was reminiscent of 1995: failure to monitor credit flows.³²⁷ Jason Bush writes for *Business Week* that "it's a familiar tale of an overheated property market, fed by lax credit, excessive borrowing, and complacent regulators."³²⁸ Oddly enough precisely the real estate market had absorbed criminal profits from the 1990s and was an arena of contract killings in the mid-2000s (4 in 2005 and 4 in 2006).³²⁹ Yet again *state capture* had thwarted Latvia's liberal and Western aspirations weakening two very important sectors of the *acquis*: banking and real estate.

An exemplary case from Bulgaria was a proposition the former Prime Minister Sergey Stanishev (Bulgarian Socialist Party) made in March 2009 for a "new, pragmatic partnership within a well defined institutional framework" between Bulgaria and the European Commission. In essence the proposal envisioned the Commission's experts being implanted at different levels of Bulgarian administration in different departments in order to provide advice and manage those departments better. The scheme was supposed to supplant the current procedure of the Commission's annual reports on the member

³²⁵ <http://www.bank.lv/eng/main/all/pubrun/lbgadaparsk/lb1998gp/ku/regulations/>

³²⁶ Chase Nordengren, <http://www.scribd.com/doc/23673799/The-2008-Economic-Crisis-in-Latvia>

³²⁷ Jason Bush, *Latvia's Crisis Mirrors Eastern Europe's Woes*, (*Business Week*, March 2 2009)

³²⁸ Bush, *Latvia's Crisis Mirrors*

³²⁹ Kaerrstrand, *Countering Narcotics*

states and emphasize cooperation as opposed to review and critique. Instead of zeal, the Commission and the Bulgarian public read in this proposal an inability on the part of the government to handle EU funds, corruption, organized crime and European legislation in all areas of governance.³³⁰ The proposal itself cites as its motivation “the weaknesses, which can be qualified as structural and stubborn and which the government cannot resolve on its own.”³³¹

Pridham’s “backsliding” hypothesis provides a challenging continuation of Vachudova’s theory of EU leverage. Both Bulgaria and Latvia provide good examples for bad performance, although very different in their political, social, historical and economic circumstances.

An ambiguous liberal democracy in the 1990s Latvia has shown propensity to backslide in anti-corruption and banking regulation – precisely those areas, where former *tsekhoviki* and nomenklatura oligarchs left their marks. It was Kalvits’ oligarch-founded People’s Party that challenged Latvia’s anti-corruption body in 2006. In 2008, speculation and lack of regulation in Latvia’s banking sector caused the state to apply for IMF emergency aid. The structural weaknesses in Latvia’s banking and real estate sectors can be easily traced to infiltration by oligarchic interests.

Bulgaria’s weak anti-corruption institutions and poor administrative performance can be traced to the period of the “criminal state” in the 1990s and its identity as an illiberal democracy in the same period.

The next chapter provides a more detailed account of how the two countries’ bad records compare in specific areas of high corruption and organized crime risk.

³³⁰ Kapital, Mar 13, 2009

³³¹ Kapital, Mar 19 2009

Chapter 5:

Democracies or Not?

A look at the corruption and organized crime record in Bulgaria and Latvia in the 2000s will resolve two important questions of this work. In the first place, how far has organized crime infiltrated democratic institutions and marked the process of democratization in the two states immediately before and after EU accession.

In the second place, the institution-by-institution analysis might shed some light on whether and how Bulgaria and Latvia's experience with democratization can be compared. One possibility is that they can be compared along a performance curve consisting of EU-leveraged reforms and backsliding as discussed in Chapter 4. Another possibility is that - what is holding back or advancing democratization in both countries is so different that comparisons do not apply.

If the timing of the passage of landmark legislation affecting organized crime were considered, the idea of a Transition performance curve would make sense. If the nature of corruption in the two states is considered, classic *state capture* by business interests will prove more prevalent in Latvian institutions, whereas Bulgaria will seem affected by large-scale systemic corruption perpetrated by well-connected individuals on both sides of the public-private divide. In other words, Bulgaria was closer to the model of the "criminal state" in the 1990s, whereas Latvia was not. The comparison might, however, provide insight into the common causes and pathologies of Eastern European states and the role of organized crime.

The legacy of the 1990's: organized habits die hard

In February 2010, Bulgarian media exploded with the news of a series of arrests made by the organized crime unit searching a number of night clubs and the homes of alleged gang leaders, suspected of “racketeering and forceful debt collection, incitement to prostitution, drug dealership and trafficking, financial fraud and embezzlement related to the steelworks “Kremikovtsi”, trade with influence, money-laundering, tax evasion and VAT fraud.”³³² The arrested were seven, all suspected of belonging to a criminal ring with the above-mentioned vast portfolio of activities. The operation was the second of its kind, code-named *Octopus* (after an Italian TV series about the mafia, popular in the ‘90s). It relied on months of surveillance and followed another such operation under the name of *The Impudent*, which broke up a kidnapping group in December 2009.

Among these seven colorful personalities of the underworld, three deserve special attention: Alexei Petrov, commando in the Anti-terrorist squad under Communist rule and a very influential security agent under the current and last governments; and the Stoyanov brothers, owners of two export and import firms servicing the “Kremikovtsi” steelworks, much like Multigrup did in the 1990s.³³³

Alexey Petrov’s biography is a journey through recent Bulgarian history and extremely enlightening to the institutional weaknesses caused by the Communist legacy of informal networks and the collusion between governing elites and organized crime throughout the 1990s. After serving at the most notorious 6th department of the former State Security and then with the Special Anti-Terrorist Unit, he left the security structures

³³² *Octopus connects Alexey Petrov, DANS, Striptease Clubs, Prostitution and Kremikovtsi*, Kapital, Bulgaria, Feb 10 2010

³³³ refer to Chapter 2

and in the early '90s he founded the insurance company "Apollo and Blakan", along with Zlatomir Ivanov - another former commando, charged with organizing a drug trafficking group. Apollo and Balkan was one of the notorious "force insurers," which crossed the boundary between legal insurance business and pure extortion in the 1990s.³³⁴

After an assassination attempt in August 2002 he recovered and completed a PhD at the University for National and World Economy in Firm Security, which he then proceeded to teach. In March 2008 his State Security file was opened as part of a national lustration campaign and his collaboration and service for the Communist regime publicized. However, he was then hired as an adviser to the director of the State Agency for National Security (DANS). As discussed in the previous chapter, DANS was the agency dubbed the Bulgarian FBI and only lasted for a year, after its institutional inauguration in 2008, before it became embroiled in infighting and corruption scandals. What is odd about the whole affair, organized crime expert Iovo Nikolov states for "Kapital," is that "up to this point it is not clear exactly when he joined the National Security Service [predecessor of DANS]."³³⁵ Any sense of responsibility for this continuity of criminal and Communist-era faces in the security services seems to have evaporated from the high levels of power.

The two other characters deserving attention, the Stoyanov brothers aka the Dambov brothers, speak to the continuity of large-scale criminal economic practices previously thought impossible with the advance of privatization and EU membership. The two Dambovs own "Echometal Engineering," which imports scrap metal to the "Kremikovtsi" steelworks and "Vezen – Dimitrov and co." which exports slag from the

³³⁴ refer to Chapter 2

³³⁵ Nikolo, Jovo. *Bandits ON Cover*, Kapital, Bulgaria, Feb 26 2010

steelworks. Experts from Kapital clarify that this means they were at the “entrance” and “exit” of Kremikovtsi, which is another way of referring to Ilya Pavlov’s “spider trap.”

Old habits die hard.

Why do old habits die hard?

Experts at the Bulgarian think tank Center for the Study of Democracy, part of Bulgaria’s most influential anti-corruption NGO “Coalition 2000,” offer a challenging explanation of the reasons for the persistence of criminal economic practices:

“[there is] a parallel system of management of the economy, which controls about 1/3 of the turnover. The horizontal and vertical links built by this parallel power will not lose their importance even if there was a functioning market economy in the country. Even in such circumstances considerable money flows will pass through the budget. This is why the claim that development itself will solve the problems of corruption in the economy is wrong; first, because the symbiosis between the state and the private sector generates the gray sector, which will serve as a brake on economic transformations; and second, the consolidated structures of this parallel power will always try to perpetuate the existing channels of corruption. The control over a considerable part of the national economic turnover provides the necessary resources for maintaining the status quo.”³³⁶

Hence, what is unique about former socialist societies and their economies is a self-reinforcing symbiosis between rule-makers and rule-breakers (“state capture”) and the argument that economic and political development is useless to the elimination of the grey sector is a challenge to all orthodox literature about Eastern Europe. The fact that as late into the Transition period as 2007 and 2008 the size of the hidden economy in Bulgaria ranged between 20% and 35% overall with more than 50% for specific sectors, such as construction, is telling.³³⁷

³³⁶ *Crime without Punishment*, CSD (2009), 45

³³⁷ *Crime without Punishment*, CSD (2009), 59

Looking for the key to the same problem Geoffrey Pridham dwells upon Communist legacies in different spheres of social and institutional life: corruption as a social habit, a judiciary with close subservient links with the old regime that could not grasp its role in a democratic society, attitudes of intolerance towards minorities. However, he brings up another important element, which is often missed in Eastern Europe scholarship: deepening patterns of corruption in the region were due to the fact that marketization had been carried out by means of crony capitalism.³³⁸

Not only this, but according to the Center for the Study of Democracy, at one stage the state can present oligarchic structures and violent entrepreneurship groups with the opportunity to bring their business activities out of the dark, undisturbed however by the tax and police authorities or by the judiciary.³³⁹ This amounts to giving a chance to organized crime to take part in the redistribution of national wealth consecutively through privatization, public procurement, concessions and the absorption of EU funds.³⁴⁰ This is a bleak evolutionary theory, which rather amounts to saying that the governments and economies of modern Eastern European democracies have in fact regressed – a theory, which must not be overlooked.

Civil Society or the lack thereof

The existence of the NGO sector in Bulgaria and Latvia can be described as controversial to say the least. At first NGOs were given credit in the late 1990s and early 2000s for the first conclusive and consistent democratic reforms, which were not just a top-

³³⁸ Pridham, *Securing the Only Game*, 61

³³⁹ *Crime without Punishment*, CSD (2009), 51

³⁴⁰ *Crime without Punishment*, CSD (2009), 51

down socialist era exercise, but close to grassroots change. However, by the late 2000s and the end of EU accession conditionality, the NGO sector became victim of gross abuses.

Both Bulgaria and Latvia boasted active NGO communities at the turn of the century. In Bulgaria, as mentioned in the previous chapter, they found a ready donor on the part of the EU and a welcoming partner in the Union of Democratic Forces government, the first opposition government to be in power in Bulgaria after 1989. Latvia went even farther by devising procedures of legal consulting with NGOs and by proposing legislation, which could grant them the status of “public good organizations” according to strict criteria.³⁴¹ To go even further, the Latvia Privatization Agency signed an Integrity Pact with Delna/Transparency International Latvia in 2001 for full access to documentation and proceedings concerning the privatization of the Latvian shipping company.³⁴² The deal was remarkably transparent as a result.

This is where the positive story ends. In Latvia it ends with the attacks on the Open Society Institute in 2006 and 2007, as well as numerous other NGOs on charges of foreign conspiracy pressed by powerful politicians and oligarchs through the yellow press (discussed in chapter 3). In Bulgaria it ends with the creation of an entirely new NGO phenomenon, the MONGO or Mafia Organized NGO.

The NGO sector registered considerable growth, its financial turnover more than doubling between 2000 and 2006, even though its share of grants went down from 50% to 34% as agricultural and infrastructural projects for EU funding increased their share at that time. In 2008 60% of the funding for NGO grants came from the government, the rest from the EU and other sources channeled through the central administration.

³⁴¹ *Corruption °C Policy in Latvia*, (report of the Open Society Institute, Latvia, 2002), 303

³⁴² *Corruption °C* (2002),303

Bulgarian NGOs, according to the Center for the Study of Democracy's description, receive state funding, offer paid training, publish scarcely and conceal their political ties.³⁴³ This they do in a regulatory environment, where the state does not have the administrative capacity to keep up with market-based competition in the sector: ranked priorities are absent, ad-hoc NGOs are not scrutinized before approval for funding, micro-management of fund allocation and usage is episodic.³⁴⁴

There is a real danger, the report concludes, that government and EU grant money can be used to finance political parties. Wary of irregularities, the Bulgarian chapter of Transparency International pressed charges in 2005 against a delegation of the European Commission and the Ministry of Finance for manipulating the assessment of project proposals under the PHARE Democracy Program.³⁴⁵

Given this dysfunctional NGO landscape it is time to delve into the corrupt practices in the sector. The narrative must begin with the increase in the public's perception of corruption in the NGO sector between the year 2000 and 2007 from 18% to 32%.³⁴⁶ The Center for the Study of Democracy proceeds to cite data: over ¾ of members of parliament, cabinet ministers and heads of executive agencies and over 90% of mayors are represented on boards of directors of NGOs. As of January 2009 there are 550-570 persons liable under the ban on high officials participating in the management of not-for-profit legal entities. To add to this, NGO links with organized crime and even Russian oligarchs are not a far-fetched claim.³⁴⁷

³⁴³ *Crime without Punishment* (2009) 38

³⁴⁴ *Crime without Punishment, CSD* (2009), 38

³⁴⁵ *Crime without Punishment, CSD* (2009), 63-64

³⁴⁶ *Crime without Punishment, CSD* (2009), 38

³⁴⁷ *Crime without Punishment, CSD* (2009), 40

So far the NGO sector has been characterized as inefficient and a vehicle for attracting foreign funds into government insider hands. What turns many NGOs into MONGOs is an elaborate scheme for control by local mayors and local mafia bosses. At first an NGO is founded by persons close to a senior local official; the official's reputation and position is used to attract the first grant; address registration changes after the first project is awarded; after elections or even before the official leaves civil service for a higher salary at his/her NGO.³⁴⁸ Unless the above-mentioned ban is enforced, and local NGOs begin to be managed by the municipality and not by the mayor, this will be yet another area of *Potemkin harmonization* with EU rules.

Very often the reason why such gross irregularities are allowed to happen is the inaction of the media or the lack of professional investigative journalism – indeed too much to hope for in countries emerging from decades of complete media eclipse, which did not always end with the Velvet Revolutions. In Bulgaria “serious investigative journalism is impeded by imperfections in the existing legislation, as well as by the obsession with secrecy and the lack of transparency about the activities of most state and municipal institutions, inherited from the communist period.”³⁴⁹ The World Press Review was inconclusive about Latvia's investigative journalism: in 1998 it had begun to resemble a tradition and in 2000 it was back to unprofessional level.³⁵⁰ Nevertheless, Latvian media's frequent reporting about breaches of the Corruption Prevention Act in 1996-1998 did force officials to resign and raised awareness of high corruption levels.³⁵¹

³⁴⁸ *Crime without Punishment*, CSD (2009), 41

³⁴⁹ *Crime without Punishment*, CSD (2009), 35

³⁵⁰ *Corruption* °C (2002), 341

³⁵¹ *Corruption* °C (2002), 342

Investigative journalism meets the same challenge in both Bulgaria and Latvia: both states have *de jure* signed international conventions, which exempt journalists from the obligation to disclose their sources, but *de facto* journalists are still forced to disclose their sources and the “sources” in question are often sanctioned from within their institution.³⁵² This climate of uncertainty for the freedom of the press can only mean that a possible obstacle on the way of organized crime and systemic corruption has been prevented from emerging.

Customs – the most corrupt institution

In both Bulgaria and Latvia Customs are perceived to be the most corrupt state institution. Both countries set out to reform their Customs in the early 2000s, but the results have been contradictory. Bulgaria for instance continued to grapple with its die-hard excise good shops on border crossing points and hired a team of British agents to monitor and train its customs officials.

Latvia’s reform in 2000 was considered a success initially. The Bureau for Combating Organized Crime and Corruption arrested seven customs officials in 2000 and three more in 2001 as part of an intensified anti-corruption campaign. Other measures in the customs reform included simplified and digitalized procedures, more precise delineation of duties and rights of customs officers, rotation of staff, and cooperation schemes with other institutions. Between 1999 and 2001 the improvement in corruption perception by companies of the customs authorities was marked.³⁵³

Seven years later, however, the improvements seemed to have not taken root. From May to October 2007, customs officers had formed an organized group of persons

³⁵² *Crime without Punishment, CSD* (2009), 35; *Corruption °C* (2002), 338

³⁵³ *Corruption °C* (2002), 333

engaged in bribe-taking and extortion of bribes in exchange for not filing violations of customs regulations.³⁵⁴ The group also had agreements with several Latvian and foreign enterprises about bribe rates and cargo volumes. Bribes amounted to \$100-200 on average paid possibly several times a day. A clear instance of *Potemkin harmonization*, this case illustrates how the post-accession period for CEE can in fact produce corruption and organized rule breaking.

A more emblematic case is the Bulgarian customs reform process, which was accompanied with two major controversies: the hiring of the British finance and security consultants Crown Agents to “assist in the modernization of the financial system” with a focus on Bulgarian customs from 2000 to 2006 and the fiasco surrounding the shut-down of the excise good shops along the Bulgarian land borders.

The latter, referred to as duty-free shops, had been signaled as a tax evasion and smuggling instrument by the Kostov government in the late 1990s.³⁵⁵ A motion was not made for their closure, however, until July 2003, when the Council of Ministers proposed an amendment to the Law on Excise Goods. It fared badly in parliament, where it was blocked by the ethnic Turkish MRF and the Minister of Finance was compelled to renew the licenses of the affected companies.³⁵⁶ In late 2006, a new law was voted into existence, which, according to the Center for the Study of Democracy, effectively secured the oligopoly of those companies.³⁵⁷ The government’s argument, according to Petkan Iliev, was that the revenue from those shops would be lost, although it is for the large part only

³⁵⁴ *Corruption °C* (2008), 11

³⁵⁵ *On the Eve of EU Accession: Anti-corruption Reforms in Bulgaria*, Center for the Study of Democracy, Sofia, Buglaria, 2006, 23

³⁵⁶ *On the Eve of EU Accession (2006)*, 23

³⁵⁷ *Crime without Punishment, CSD* (2009), 67

formal since the goods sold there are free of tariffs.³⁵⁸ A motion for closure finally passed in February 2008 under pressure from the EU, although various MPs from almost all parliament-represented political parties voted against, often in defiance of their party line.³⁵⁹

The contract between the Bulgarian state (the Finance Ministry) and the British “Crown Agents” offers another insight into *Potemkin harmonization* and foreign policy arbitrage. The contract, according to investigative journalist Christie Petrova amounted to a breach of Bulgaria’s sovereignty. Firstly, it was signed by the Finance ministry without being ratified by Parliament and secondly, it obliged the interior minister Milen Velchev (Simeon government) to consult Crown Agents on all possible amendments to domestic legislation which could affect Crown Agents.³⁶⁰ The contract, for the value of £10 million did not contain an opt-out clause for the Bulgarian state; Crown Agents was protected from all liabilities.³⁶¹ Their contribution in sum is controversial.³⁶² Petrova gives an example of large-scale contraband remaining undetected between 2002 and 2003 of 270 trucks operated by the group of Nikolai Metodiev the Chicken. Moreover, according to the then opposition parties the contract was signed without the knowledge of the EU and cost the state a series of potential programs, funded unconditionally by the EU.³⁶³

In 1998 mirror statistics revealed \$375 million in undeclared export and \$483 ml in undeclared import goods costing the state millions in revenue loss.³⁶⁴ In 2010 it seems that Bulgarian customs have been underperforming regardless of reform efforts. In

³⁵⁸ Iliev, *the Price of Legalizing Bulgarian Business*.7

³⁵⁹ *Crime without Punishment, CSD* (2009), 67

³⁶⁰ Christie Petrova, *Kings of Contraband* (Sofia: Slantse publishing, 2007), 244

³⁶¹ Petrova, *Kings of Contraband*, 243

³⁶² Petrova, *Kings of Contraband*, 240

³⁶³ Petrova, *Kings of Contraband*, 245

³⁶⁴ Iliev, *the Price of Legalizing Bulgarian Business*

February the BBC quoted the Finance Minister Simeon Diankov, former chief economist at the World Bank, as saying that one in four employees did not know how to fill out a customs form and that “they [customs officers] weren’t there to do their work, but to extract bribes.”³⁶⁵ It seems that organized smuggling of rare and taxable goods as well as drugs and humans has found its best ally in the customs institution and has capitalized on old friendships, political connections and lack of rotation of the staff within it.

The judiciary – a heavy legacy

Both Bulgaria and Latvia share a high risk factor for corruption and for toleration of organized crime in the form of the judiciary and especially the procuracy. Pridham points out that for Latvia the problem lies in the quality of judges. It can be traced to the fact that “a great number of judges working in Latvian law courts have received their legal education in the Soviet system and had encountered difficulties working with the principles of democracy and the rule of law.” He also points out that even though various judicial training programs were instituted, including some funded by the United Nations Development Program, the lack of a sufficient number of good judges was still evident in 2008.³⁶⁶

Bruno Schönfelder comments on the Bulgarian judicial system as still strikingly Soviet due to the “outstanding role, which it bestows on prosecutors.”³⁶⁷ He notes that while Central European states quickly abandoned this inheritance and shortened prosecutors’ mandates, Bulgaria dealt with the issue much like Russia did – endowing the

³⁶⁵ Oana Lungescu, *Bulgaria's war on organised crime* (BBC, Feb 20 2010)

³⁶⁶ Pridham, *Securing the Only Game*, 73

³⁶⁷ Schönfelder, *Judicial Independence*, 70

chief prosecutor with a seven-year-long mandate, during which he is irreplaceable and completely unaccountable.

Pridham refers to a 2007 report of the Corruption Prevention Bureau, in which the judiciary's evaluation is not flattering and to a wiretapping scandal again in 2007, when transcripts circulated in the media, "casting serious doubt over the integrity of the legal system."³⁶⁸ In Bulgaria, while judges receive little attention, the two chief prosecutors after 1989, Tatarchev and Filchev became notorious figures in the eyes of the Bulgarian public through self-styled purges of the procuracy, arbitrary treatment of cases, alleged links to the underworld and political interference. In fact, only the Union of Democratic Forces was surprised when their appointee to the position, Nikola Filchev, began to surround himself with loyal cadres: military prosecutors, many of whom serving from long before November 1989 and famous for their army-style loyalty to superiors.³⁶⁹

In fact, when in 2000, amendments to the Code of Criminal Procedure foresaw transforming the trial stage into the central stage of criminal procedure at the expense of pre-trial proceedings, public opinions suggested that this will only amount to moving corruption from the prosecutor's office to the court.³⁷⁰ Latvia's experience with corrupt judges is testimony to this trend in Eastern Europe's judicial reform.

The Security Sector – a gallery of familiar faces

Bulgaria is plagued by a baggage of former security agents and policemen laid off from or still working in its security institutions. As discussed in chapter 2, this has immense implications for legislation and criminal action upon commercial or criminal code

³⁶⁸ Pridham, *Securing the Only Game*, 73

³⁶⁹ Milev, Momchil. *A not so harmless pensioner*, Kapital, Bulgaria, Feb 19, 2010

³⁷⁰ *Corruption Assessment Report* (2000), 21

violations, committed by members of pre-existing informal networks, who now find themselves on two different sides of the law. It seems that Latvia suffers from similar problems.

While Bulgaria's experience with the State Agency for National Security (DANS), as discussed in Chapter 4, illustrates the continuity of cadres in the security services (the appointment of former agent Alexey Petrov to the post of adviser), there is a lot to be said about new appointment practices, which reinforce informal and illegal networks in state security agencies. According to the Center for the Study of Democracy, appointments to Bulgarian Security services are done in order to keep young appointees loyal to interested parties, while senior positions are filled with malleable non-experts. The services' intelligence-gathering amounts to security officials maintaining links with crime bosses and in fact facilitating their activities. Self-monitoring in turn means that security officials investigate their subordinates in order to tap in on the gains or prevent leakages of information. The services' welfare function is to secure market monopoly for private companies, which act as informers of their competitors. Information is kept secret by being privatized unofficially. Immunity from prosecution can be arranged through election-time fundraising by the interested party and through informal channels between the government and the security organs in question.³⁷¹

As a result of these careful strategies, investigations crash at the primary level by direct or indirect order, deliberate negligence in commissioning expert analysis or summoning witnesses, employing inexperienced investigators or staff reshufflings.³⁷² Of more dire consequence are corruption and informal links on the highest levels of the

³⁷¹ *Crime without Punishment*, CSD (2009), 52

³⁷² *Crime without Punishment*, CSD (2009), 52

security structure. Former Bulgarian Minister for the Interior, Rumens Petkov resigned after his ministry became the center of an unprecedented corruption, crime and intelligence leaking scandal in early 2008. It was found that he had been blocking information from foreign investigative agencies about Bulgarian organized crime suspects with whom he was in close contact. One of his “intelligence-gathering” meetings was with the notorious local mafia bosses the Galev brothers, who as of May 2009 were being prosecuted for establishing and leading an organized crime group and racketeering, and were also running for parliament in the June elections as local candidates for two regional centers in the Southwest.³⁷³

A telling case happened in Latvia in 2002 following a surprisingly successful reform of the traffic security department. The newly appointed director of the agency carried out a comprehensive reform plan in 1999 consisting of simplification and digitalization of procedures.³⁷⁴ The only drawback, the Open Society Institute in Latvia notes, is “the fact that many of the staff sacked for suspicion of corruption have moved to positions in the police or customs, some have even been elected as MPs.”³⁷⁵

It might be astonishing for the Western observer but informal networks from Communist time are still alive in Eastern Europe after twenty years of transitioning to democracy and are inextricably linked with crime. In areas such as the judiciary and the security services, where citizens’ rights, freedoms and lives are at stake this is an especially heavy legacy.

³⁷³ *Bulgaria Alleged Mafia Boss Runs as Majority MP Candidate*, WEB. www.Mafiatoday.com, May 25 2009

³⁷⁴ *Corruption* °C (2002), 336

³⁷⁵ *Corruption* °C (2002),336

Private property unsettled

One of the most important tasks for the young democracies of Eastern Europe was to establish and protect private property. It has also proven their biggest challenge. In the year 2000 the World Bank refers to the problem as *state capture*. The EU accession process was supposed to minimize *state capture* and raise the post-socialist states economically and politically to the level of Western European democracies.

In 2002 the problem was persisting in Latvia. The Open Society Institute Latvia quotes an investigative journalist in describing the process of influencing legislation by business in Latvia: companies use a network of PR firms with connections to politicians and political parties, which systematically mediate payoffs to parties and individuals. Although this practice has not been proven, companies at the free port of Ventspils, namely Ventspils Nafta (oil transit company) have allegedly influenced the passage of restrictive legislation on pharmacies or the approval of lower taxes for free ports.³⁷⁶

What Latvia's ports represent for oligarchic interests can only be matched by what Bulgaria's state-owned land and forests represent to former sportsmen and nomenklatura-members-turned-businessmen. With the bulk of privatization completed under the Simeon government and a real-estate boom in Bulgaria's largest cities and resorts under way in the period 2006-2008, shady entrepreneurs invented a new type of legal vehicle for redistribution of the national wealth – the so-called “swaps” of land, forest, and real estate.³⁷⁷ In theory swaps should be logical market transactions, whereby one asset is exchanged for another after their value has been legally declared equal. However, the

³⁷⁶ *Corruption* °C (2002),321

³⁷⁷ *Crime without Punishment, CSD* (2009), 57, 92

current law does not stipulate that the property sought after be valued at its present market value, instead its historical costs, much lower than during the real estate bubble, are considered.³⁷⁸ The result is a colossal loss of revenue for the state.

In 2008 these developments were accompanied by a curious legislative proposal: amendments to the Law on Management of the Black Sea coast, which granted administrative discretion to end or prolong concession agreements and which enabled public-private companies (not yet subject to regulation) to participate in tendering or appraisal.³⁷⁹ The Law on Concessions was also subject to such tinkering: in 2008 it was amended to enable companies to be automatically granted concessions for 35 years at a high risk of concession abuses and creation and sustaining of oligarchic interests.³⁸⁰ This is a clear example of legislation-induced higher risk of hidden economic activity, and an unnecessary amendment if juxtaposed with European regulations.

Democracy turns sour

Party financing, as argued in Chapter 4, is an extremely problematic issue in Eastern Europe, where campaign contributions are traditionally not reported or publicized, although progress is being made in the direction of pressuring parties to submit declarations of campaign expenditure and in the direction of auditing these expenditures.

The Center for the Study of Democracy brings forward an incident in Bulgaria at the end of 2007, when the annual budget was running a surplus and the government used it to distribute subsidies to certain companies and earmark projects in an opaque manner.

³⁷⁸ *Crime without Punishment*, CSD (2009), 94

³⁷⁹ *Crime without Punishment*, CSD (2009), 70

³⁸⁰ *Crime without Punishment*, CSD (2009), 91

Budget surplus spending doubled at the end of the year and was channeled mainly in the defense, public order and safety sector, in general public services (departmental expenses of executive and legislative bodies) and in transport and communications (infrastructure) as well as municipalities: areas highly susceptible to political corruption.³⁸¹ The money was channeled to politically connected companies, among which partially or fully state-owned companies such as Bulgarian National Rail, the National Rail Infrastructure Company, Kremikovtsi steel mills, the tobacco giant Bulgartabak, Bulgarian post, and the Bulgarian Energy Holding with its constituent enterprises.³⁸²

This spending spree testifies to the sponsorship connections between parties and business, which can neatly fall into Hellman's term *state capture*. Conversely, audits of municipal companies in Sofia in 2007 and 2008 show that the risk of misappropriation rises, if subsidies are provided through non-transparent procedures, which amounts to the political elite corrupting business.

Early 2000s Latvia was suffering from a more traditional kind of *state capture*. Corporate contributions were being disguised as private donations, but two commercial sectors emerged as major contributors over time: financial institutions (banks and insurance companies), and companies engaged in transportation of oil and chemical products. The latter were particularly influential, followed by the food industry, which had been the third most important financial contributor since 1998.³⁸³ After a decade of reforms in the area of party finance, conflict of interest and corruption prevention, Latvian parties are still found to exceed the allowable limits of campaign expenditures and there is

³⁸¹ *Crime without Punishment*, CSD (2009), 75

³⁸² *Crime without Punishment*, CSD (2009), 77

³⁸³ *Corruption °C* (2002),326

little to suggest that connections between prominent politicians and powerful industries such as Ventspils Oil have died out.

As seen in the discussion of the 2008 financial crash in Chapter 4, the government was borrowing excessively to keep its economy afloat, while spending the credits in unprofitable industries or on high public sector salaries. In its country report on Latvia the Bertelsman Foundation emphasizes that “the overt politicization of the upper levels of management and executive bodies of ministries, agencies and government owned enterprises has meant the creation of a class of managers appointed to positions of authority by dint of who they know, not what they know.”³⁸⁴

In not entirely dissimilar ways, Bulgarian and Latvian governments are catering to informal networks which operate along Communist-era rules with very little transparency. This is a fact that can only open the door wide to organized crime and a criminalization of politics.

Decentralization turns sour

A yet bigger political challenge for countries, which had endured decades under totalitarian regimes, was decentralization of power and an activation of local government. The results have been controversial, the negative effects being the birth of peculiar forms of local political mafias and corrupt relationships with local businessmen.

Local abuses in Latvia are as wide in range as in Bulgaria. The 2002 Open Society Institute report on Corruption in Latvia asserts that “the tax authorities and local authorities appear to have considerable discretion to provide tax breaks to selected

³⁸⁴ Bertelsmann Stiftung, *Latvia Country Report*

companies.”³⁸⁵ It cites an example, whereby Riga City forgave €2 million tax debt for a company operating in the port of Riga. The company’s shareholders included a member of one of the governing political parties and businessmen that had sponsored a number of political parties in the early 2000s. In August 2008, a case was filed against the chairman of Ventspils City Council, Aivars Lembergs, for repeated acceptance of bribes, extortion, and asset and money laundering on a large scale as member of a group.³⁸⁶ Three years earlier the municipal elections in the city of Jurmala had been marred by the Jurmalagate scandal, where a former mayor and a MBW auto dealer had attempted to bribe the City Council and influence the elections.³⁸⁷

While local corruption scandals abound in Bulgaria, the country is also a victim of organized violence on a local level. Amendments to the Electoral Law preceding the Parliament elections in 2009 changed the Bulgarian electoral system from proportional representation into a mixed one with 30% single constituency seats. The amendment gave a number of local bosses a chance to run for government and acquire immunity from prosecution. The Galev brothers, notorious in the Bulgarian Southwest were among these unconventional candidates who garnished local support through various means including threats, control over local jobs and pay, as well as the allure of public works. The energy mogul Hristo Kovachki, prosecuted for large-scale VAT fraud, was running with his own newly founded political party, while also supporting a party from the incumbent governing coalition. Vesselin Danov, accused of extortion, money laundering and luring people into prostitution, was running for the Black Sea city of Varna on the list of the Alliance of

³⁸⁵ *Corruption* °C (2002), 335

³⁸⁶ *Corruption* °C, (2008), 13

³⁸⁷ *Final Jurmalagate Appeal Overruled*, The Baltic Times, Aug 27, 2008

Bulgarian Patriots. Alexander Tomov's embezzlement trial as the former director of the insolvent Kremikovtzi steelworks was suspended to allow him to run in the elections.³⁸⁸

The consequences of the development of local mafias in control of municipalities can be of lasting detriment to the economy. The Center for the Study of Democracy stresses that "there are certain sectors in the economy, highly dependent on municipal legislation and heavily dependent on state policies, which remain impenetrable to foreign investors without a suitable local partner. During the past several years such relationships could be observed in the granting of concessions over airports and seaports, in the establishment of law firms, etc."³⁸⁹ The report advances a projection for the future trend of criminalization of local politics: "brought to its extremes the tendency for criminalization would translate into the cartelization of the economy, the loss of the efficiency of markets as well as of the effectiveness of state control mechanisms, which would dampen the entrepreneurial spirit of the nation."³⁹⁰ This is a bleak domestic forecast, the international implications of which would be equally interesting to pursue.

Public procurement - Eastern Europe's new bane

A new administrative tool for Eastern European states, public procurement has become increasingly associated with organized crime and corruption. A closer look at public procurement domestically and in an EU context will reveal the international implications of the criminalization of the economy and politics of post-communist states.

Public procurement is a market instrument that the state resorts to when it wants to carry out a project of public importance, for which it does not have the administrative,

³⁸⁸ McLaughlin, *Dan Running for Parliament the New Escape Route for Prisoners*, The Irish Times, June 15, 2009

³⁸⁹ *Crime without Punishment*, CSD ,(2009),47

³⁹⁰ *Crime without Punishment*, CSD ,(2009), 55

managerial, manpower or information capacity. For lean neo-liberal states this should be a relatively cheap tool, which obeys market logic: a client contracts for a service, the best contractor wins, the contractor has an interest in doing the job well so that he can get future contracts. In Eastern Europe, however, the state as a rule loses from public procurement, the contractor is not the best performer in a public tender, and neither does he do a good job. The reasons range from corruption and conflict of interest to communist-era friendships and election-time favours, the difference being hard to tell.

In 2002 the going rate for winning a contract in Latvia was reportedly 10-20 percent of the contract's value, most of which was channelled to political parties. Moreover, a deal could be struck with the rejected bidders, whereby they agree not to appeal the tender in return for a contract in the future.³⁹¹ In this way, in 1998, a Ministry of Transportation tender for the construction of road signs was written in such a way that only one Latvian company with business relations with officials of the Ministry qualified for the tender, while an Estonian company could do the same job for half the price.³⁹² The practice is just as perfected in Bulgaria, although one might argue that it began later due to its slower liberalization.

The domestic implications of corruption in public procurement are obvious, but the issue in Eastern Europe far exceeds the domestic dimension. Since public procurement funds now come from the EU domestic fraud very quickly becomes international fraud of great consequence.

³⁹¹ *Corruption* °C (2002),331

³⁹² *Corruption* °C (2002), 331

Public Procurement in Eastern Europe – the EU’s bane

In a recent broadcast the BBC mentioned that the European Commission sent a letter to the Bulgarian government pointing out that only 1 percent of EU regional aid to Bulgaria had reached the intended beneficiaries since accession in January 2007.³⁹³ Although regional aid is not the only type of aid the EU offers to new member states, this fact is representative of a trend in overall EU funds allocation: embezzlement, corruption and subcontracting happen on all levels of administering aid to the effect of diminishing it and undermining its final goal. While it is true that even established market economies have trouble using public procurement, the scale and mechanisms of fraud in Eastern Europe must be analyzed. It is very possible that the problem has features indigenous to Eastern Europe that cannot be resolved in conventional ways.

The Center for the Study of Democracy advances the *infrastructure trap* hypothesis: infrastructure firms become too dependent on the administration; the administration has too much power and might use it to extract bribes; the quality of projects and implementation decreases, award money is saved for future bribes.³⁹⁴ Thus, two lots of a single Bulgarian highway in construction can take up to 10 years from 2000 until 2010 to be assigned to valid contractors even though half of the highway was completed in 10 years under Communist rule.³⁹⁵

Strategic abuse of EU funds turned 2008, Bulgaria’s second year as a member state, into a year of scandals. The Republican Road Infrastructure fund scandal was exposed in January 2008 and represented a rampant conflict of interest. The director of

³⁹³ Lungescu, *Bulgaria's war on organised crime*, BBC, Feb 20 2010

³⁹⁴ *Crime without Punishment*, CSD (2009), 80

³⁹⁵ Kapital’s special “Trakia” highway chronology

the fund, Vesselin Georgiev had been awarding projects to his younger brother's company to the value of 120 million leva (\$80 million) coming from the EU's ISPA program for infrastructural development. Shortly after Brussels blocked all infrastructural funds for Bulgaria and even demanded some of the already absorbed money back.³⁹⁶ The case against Georgiev was filed two months later, but began with a major oversight by the Finance Ministry to press indemnity charges against him. Kapital suggests that this has a lot to do with the fact that the ministers responsible for the oversight were also on the jury for the approval of the public procurement projects – suspicions of a political umbrella are not unfounded.³⁹⁷ Most importantly, however, the scandal led to the adoption of Bulgaria's first Law against Conflict of Interest.

In the summer of 2008 a Commission report and an indignant letter by the head of the European Anti-Fraud Office (OLAF) caused another big splash: an emblematic fraud scheme worth €6.5 ml in stolen funds was revealed. The Stoykov-Nikolov group, the one a former force insurer with the VIS racket³⁹⁸ and on top of the Bulgarian President's election campaign donor list, the other a meat products magnate, had been awarded six EU projects in the period 2001-2006 from the EU's SAPARD agricultural fund. They exported second hand meat processing equipment to Germany and Switzerland, where it was dismantled and imported back to Bulgaria as new equipment, the money for the purported purchase coming from the EU.³⁹⁹ The two had been arrested in February, and then released through political protections to the dismay of

³⁹⁶ Kapital, file on Republican Infrastructure Fund

³⁹⁷ Kapital, file on Republican Infrastructure Fund

³⁹⁸ Petrova, *Kings of Contraband*. 145

³⁹⁹ Jordanova, Liuba, *A Lesson in Justice*, Kapital, Buglariaia, Aug 8 2008

German courts, which had already convicted the German part of the organized group.⁴⁰⁰ Nikolov did in fact receive a 10-year sentence two years later, while Stoykov's political connections have been keeping him aloof.

Because of this case the European Commission froze additional funding to the amount of €250 million adding to the previous €546 ml suspended in February.⁴⁰¹ Bulgaria's access to the first sum expired in November 2008 and the state was obliged to pay a large amount of the embezzled funds back into the European budget while at the same time subsidizing the ongoing projects. The Commission's measures against Bulgaria were unprecedented for any EU member state. The current government has been working hard to convince Brussels of its zeal in the fight against corruption and organized crime.

Although far less notorious Latvia's public procurement has been experiencing similar difficulties in assimilating EU funds. The problem was realized very early on when in 2002 the State Audit Office was granted an additional mandate to monitor the use of EU funds down to the level of final recipients.⁴⁰² However, as far as public procurement goes, the experts at the Open Society Institute (OSI) in Latvia do not consider the disbursement or the implementation stage the most liable to corrupt practices. Instead, they suggest that the infiltration of interests takes place at the initial stage, when the criteria of eligibility are drafted and special interests are concealed behind legalistic terminology, which overtly meets the regulations of the European Commission.⁴⁰³ The

⁴⁰⁰ Jordanova, Liuba, *A Lesson in Justice*, Kapital, Buglariaia, Aug 8 2008

⁴⁰¹ EU condemns Bulgaria over Corruption, freezes Funds, AFP, Jul 23 2008

⁴⁰² Corruption °C (2002), 310

⁴⁰³ Corruption °C (2005), 49

report identifies clannishness as the chief problem in Latvia: procedures lack substantiation and are drafted so that insiders fulfill the requirements.⁴⁰⁴

The Latvian Investment and Development Agency (LIDA) is responsible for drafting project requirements and organizing tenders. In the early 2000s it met with severe criticism from the business community for its unclear guidelines, arbitrary alterations in the last minute, arbitrary project submission deadlines and lack of publicity of the changes.⁴⁰⁵ When approached, the Agency referred to the Cabinet of Ministers regulations and EU regulations as the basis for its procedures and project requirements, but the OSI points out that these guidelines are not binding and are subject to interpretation.⁴⁰⁶ In fact the Latvian business community suspected LIDA of being influenced by two specific political parties. As soon as a new Minister of Economics arrived on the scene, four of the projects already awarded were submitted for reappraisal in March 2005 and all of them were found to have been appraised incorrectly.⁴⁰⁷

In 2007 there were 52 fraud investigations concerning EU fund allocation, initiated by the European Anti-Fraud Office (OLAF) in Bulgaria, while there were only 2 in Latvia.⁴⁰⁸ Behind this data hides either the fact that new member states perform on a curve after accession or that the Bulgarian “clannishness” is more severe than Latvian “clannishness” for reasons already named: strong nationalism in Latvia, which broke up informal Communist-era networks (consisting mainly of Russians) and a lack of rotation of elites in Bulgaria for a long time in the 1990s, which perpetuated those networks within Bulgarian society.

⁴⁰⁴ *Corruption °C* (2005), 50

⁴⁰⁵ *Corruption °C* (2005), 53-57

⁴⁰⁶ *Corruption °C* (2005), 53

⁴⁰⁷ *Corruption °C* (2005), 57

⁴⁰⁸ *Crime without Punishment, CSD* (2009), 52

Recent developments in Bulgaria might corroborate the curve argument: the Center for the Study of Democracy reports a positive trend of increases in the share of open public procurement procedures throughout 2008 following amendments to the 2006 public procurement law. The law, however, still has deficiencies: misses the point of getting value for money; ignores the implementation stage; foresees regressive penalties; and fails on the point of public availability of information.⁴⁰⁹

Another development on the public procurement market in Bulgaria might suggest that a comparison between the Latvian and Bulgarian public procurement market is not applicable: the growing concentration in the Bulgarian procurement sector. According to the Center for the Study of Democracy, the share of companies, which have participated in public procurement, has declined from 40% in 2003 to below 10% in 2008, the largest 25 commanding more than 45% of the total value of the market.⁴¹⁰ In some sectors, the report continues, public procurement accounts for a sizable portion of firms' revenues, creating additional risks of corruption pressures.⁴¹¹

The curve versus no comparison argument

An important question in this chapter was whether a comparison between Bulgaria and Latvia is at all viable. Indeed, the institutions of a liberal democracy (according to Vachudova's criteria) such as Latvia must be different from those of an illiberal democracy such as Bulgaria. The comparison, however, helps draw up a performance curve for Eastern European EU candidates consisting of a period of heightened reform and a period of backsliding within limits. Moreover, the deficiencies in

⁴⁰⁹ *Crime without Punishment*, CSD (2009), 84

⁴¹⁰ *Crime without Punishment*, CSD (2009), 81

⁴¹¹ *Crime without Punishment*, CSD (2009), 81

the eight important institutions and administrative mechanisms reviewed in this chapter were found to be similar pathologies of post-communist states. These structural weaknesses can be traced back to the formation of these institutions in the unstable political and economic climate of the 1990s. Communist-era informal networks and 1990s organized crime led to a type of crony marketization, the impact of which can be observed in the functioning of today's Eastern European democracies.

Conclusion

This thesis has aimed to establish a connection between democratization in Eastern Europe and organized crime, understood as the criminal alliance of former nomenklatura political elites, new oligarchs and groups of musclemen released from disbanded sports clubs and security structures. Organized crime in Eastern Europe was proved to be the product of Communist-era informal networks, economic instability, the weak regulatory and law enforcement capacities of the receding state, as well as the uniquely profitable privatization and institution-building processes.

At the same time the mafia infiltrated legislation and institutions on the national and local level to the effect that criminal practices in the economy and government became legalized. The evidence was found in protracted reform; loopholes in key anti-corruption legislation; undermining of institutions responsible for combating crime and corruption; enduring bad practices in real estate and public procurement contributing to loss of state revenue and EU funding on a large scale.

The degrees of impact and the most affected sectors vary between Latvia and Bulgaria, but the analysis as conducted proved that a comparison between a former Soviet Socialist Republic turned liberal democracy and a former Soviet Satellite turned illiberal democracy respectively, both now EU member states, can yield important results.

The first political implication of the comparison relates to the perceptions of administrative incapacity in Bulgaria and Latvia. To the contrary from common understanding institutional weaknesses in Eastern Europe are not comparable to those in Western Europe. Not only did new terms have to be devised to capture the discrepancies (state capture, partial reform, systemic corruption, etc.), but the role of organized crime

for their emergence has been overlooked. The nature of the problems would necessitate revisions of personnel and informal practices on a much larger scale than currently imagined. Moreover, the European Union's commitment to sovereignty and hence cooperation with the very governments and institutions suffering from major structural flaws, creates a reinforcing dynamic of poor performance and squandering of national revenue and EU funding. It is only through the interference of third parties, preferably civil society, that the current lack of monitoring can be amended.

From the institution-by-institution analysis in chapter 5 follows another important implication: the performance curve argument. The phenomenon of *Potemkin harmonization* with EU rules is endemic in Eastern Europe. Undergoing constitutional amendments and institutional tinkering twice two decades in a row, both times in a non-transparent manner, has limited chances of producing sticking results. Independent monitoring mechanisms run by civil society in conjunction with international bodies disseminating best practices and know-how is an option the EU and its new members should consider.

This thesis has several implications for existing theories of the Transition. The faltering neo-liberal paradigm has been challenged by analysis of doppelganger reformers and their practice of partial reform and collusion with oligarchs and other criminal groups in society. More refined views which include society in the state-market dichotomy have been corroborated: enduring Communist-era informal networks are the key to the smooth functioning and ubiquity of organized crime in the Transition state in the 1990s and modern Eastern European democracies in the 2000s.

Theories about the weakness of Transition states have been found insufficient on their own, but complementary. Thus, Joel Hellman's theory of *state capture* needs to be refined by John Wallis' theory of *systemic versus venal corruption* so that the unclear dynamic

between business and politics corrupting each other in Eastern Europe can be captured. Moreover, models of oligarchic equilibrium stemming from Russia scholarship have been challenged: oligarchs cannot define property rights or generate welfare.

This last proposition about the irreplaceability of the state leads to an interesting caveat to theories of the nation state. Although taken for granted in established nation states, statehood in the Transition state can be questioned. This thesis advanced a radical theory of the “criminal state,” which is hijacked by doppelganger predatory elites to the detriment of fundamental rights and the equality of the law. The purportedly democratic “criminal state” becomes a competitor on the private protection market and preys on its citizens.

This adventurous argument leads back to the question posed at the beginning of this work: is Eastern Europe democratic enough to rejoin Western Europe? In this thesis it has been estimated that the answer is a hard one to give: by appearance and aspirations yes, but by habit and informal procedures no. A wider study of all Central and Eastern European states, now EU member states, will either corroborate or mitigate the harshness of the “criminal state” theory. Moreover, it will reveal whether and under what conditions post-communist states have a chance to achieve an acceptable level of administrative capacity to get things done in conditions of transparency.

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