

QUALITY OF THE POLICY RESPONSE – STATE-OWNED COMPANIES ROMANIA, BULGARIA, THE CZECH REPUBLIC AND ITALY 2018



CANDOLE PARTNERS



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Introduction

Public policies addressing issues such as preventing and combating corruption, or inefficient governing of state-owned enterprises (SOEs), differ significantly among member state of the European Union, even though the economic results of these enterprises are reflected, at national level, in each country's macroeconomic indicators.

The pilot research carried out as part of this report was aimed at conducting a first assessment of the quality of the public policy response in four EU member states – Romania, Bulgaria, the Czech Republic and Italy – based on the instruments used by these states to address phenomena such as the fight against corruption and prevention of corruption and state capture in SOEs.

The first and most important step is adopting an ambitious corporate governance framework, which can provide constant monitoring, in addition to professional, independent management. This is what Bulgaria and the Czech Republic are lacking.

Romania, on the other hand, adopted an ambitious model, under the pressure of the IMF and the World Bank, created enforcement guidelines for this framework, and had started good practice in the region. But even when there is a legal framework for corporate governance, major political influence will be exerted – including business interest groups and corruption - attempting to considerably limit the enforcement of this framework.

This pilot assessment also reveals why corporate governance alone - in the absence of control, preventive measures, and of imposed, dissuasive sanctions – will not result in performance, transparency or more responsible management.

The last resort - that of criminal investigations to discourage corruption and clientelism from within or in relation to the activity of SOEs in EU member states – is also very much indispensable. However, the experience of the countries in our analysis differs greatly, and the same applies to the rest of the EU. In states where criminal prosecution showed results, it is necessary to further outline control mechanisms, depending on the risks identified during criminal investigations, but prevention is also essential.

The report includes some documented case studies indicating that public policies based on repressive measures must be doubled by other measures. In the case of *Posta Romana* (Romanian Post Office), for instance, the anti-corruption prosecutors completed no less than seven corruption cases – most related to overvalued public procurement and influence peddling – but they all describe an almost identical pattern. Anti-corruption prosecutors concluded, based on this investigation, that more efficient control and internal instruments are required in order for the company to be able to identify irregularities itself in a timely manner and to be able to address them. These instruments are not yet efficient in Romania.

The Czech Republic is faced with an entirely different situation: there are dozens of journalistic investigations and suspicions featured in the Czech media during the past years, but there are very few criminal investigations that were finalised to reach circles of influence or politicians.

National SOEs operate on a European market, and, in the absence of concrete results in reforming or cutting off networks of influence or capture, a consolidated EU approach is needed.

This report provides some policy recommendations both at national and at EU level, meant to properly address the corporate governance and additional tools targeting SOEs.

Executive Summary

The report focuses on assessing the quality of the policy response to clientelism, poor governance and corruption in state-owned companies in four member states of the EU - Romania, Bulgaria, the Czech Republic and Italy.

This report uses five categories of indicators and assesses their implications at the level of state-owned companies: 1) the quality of the legal framework for corporate governance; 2) control mechanisms; 3) public policies on prevention; 4) repressive and anti-corruption policies; and 5) main risks and challenges faced by SOEs.

Having a corporate governance framework is mandatory for creating the incentives required for SOEs to perform on the market. It plays a crucial role in ensuring proper management for SOEs, better accountability and transparent mechanisms for a more efficient use of public resources. This framework also provides benchmark indicators, ensuring an objective analysis of these companies and their management.

Romania and Italy have an extensive corporate governance framework, while the Czech Republic and Bulgaria are faced with key legislative shortcomings. Although there are discrepancies between the quality of legal framework in all four countries, a common issue emerges: with no will for proper enforcement, the framework is systematically infringed and its applicability is limited. Legislative provisions in this sense are systematically infringed and national authorities are exploiting the shortcomings.

Romania adopted a very ambitious corporate governance framework as early as 2011, but the Parliament passed new amendments last year exempting over 100 SOEs from the scope of the framework. The Bulgarian legal framework is weakened by the lack of synchronization between the various laws and regulations, and by contradictions within the regulations. The Czech Republic does not have a state ownership policy. Czech SOEs are rather subject to arbitrary procedures. Italy, as host to the largest

number of SOEs in the European Union, has just proposed new legislation with a view to better controlling and monitoring these enterprises.

The quality of the control mechanisms is crucial in sustaining more efficient use of state resources and mitigating illegal behaviours. In the four countries under scrutiny, control is quite limited, both in terms of its scope and its legal consequences. State institutions responsible for ensuring proper control processes are faced with fundamental shortcomings: overlapping responsibilities, unclear control criteria (rare thematic controls, insufficient in terms of time span and human resources), limited identification of risks areas.

A similar situation can be identified with regard to the internal control mechanisms of these enterprises. It is more of a formality than a well-defined tool of checks and balances. It is often less efficient than external control, which is led by other institutions. At large, internal control is rather weak, and it fails to properly carry out its tasks. That is because, in practice, it is highly dependent on top level appointments and it is not an independent body.

With limited coercive measures and legal consequences, control measures usually fail to improve management and performance for SOEs. The cooperation between institutions with responsibilities in the area of criminal investigation and institutions with administrative control duties has been deficient. In the case of Romania, which has an impressive track record of combating high-level corruption, the prosecution highlighted the risk areas that should be further investigated or addressed institutionally, by the means of control and through proper enforcement of prevention tools.

Public strategies and measures in the field of prevention are common in most member states under analysis. In the cases of Romania and Bulgaria there is extensive regulation, cross-sectional and multi-sectorial, given their exposure to corruption. Romania targeted state-owned companies and business integrity in a specific manner, including using monitoring and prevention mechanisms within the National Anti-Corruption Strategy. Bulgaria has a broader approach in its National Anti-Corruption Strategy, which includes prevention, but lacks risk elements, since the efficiency of the fight against corruption is still limited. The Czech Republic is still confronted with the politicization of companies and the lack of drastic sanctions, which Italy is testing its new approach based on reporting, compliance and prevention at all levels.

Nevertheless, there is no monitoring of the implementation of these measures in most states, and risk analyses and vulnerabilities are addressed mostly bureaucratically. Transparency and the use of open data are still challenges for most of the state-owned companies analysed, but, there are also good practices, which should be documented and disseminated.

Effectiveness of **anti-corruption or criminal policies** remains a challenge in some of the countries included in this project, with Bulgaria and the Czech Republic lacking any relevant, well-documented investigations with final convictions, recovery of the proceeds of crime or extended confiscation. Like Bulgaria, Romania, is monitored by the European Commission through the Mechanism for Cooperation and Verification.

Every year, it manages to consolidate an impressive track record concerning the investigation and conviction of fraud against public budgets and resources, which includes relevant cases, at the highest level, involving state-owned companies.

Cases investigated by the prosecutors of the National Anti-Corruption Directorate (DNA) or the Directorate for the Investigation of Organized Crime and Terrorism (DIICOT) also lead to the prosecution and conviction of ministries, who took decisions favouring interest groups in the energy sector. Although the perception in the business environment is that corruption, nepotism and clientelism are very frequent in the other three countries in our analysis, only very few cases were investigated. Italy could be a future role model for the other countries, as it shifts from public policies based on repressive measures and intense enforcement of criminal laws, to a prevention-based approach. It is too early to assess the results.

The analyses carried out and the results of the quantitative and qualitative research conducted in each country for this project indicate that a more coordinated approach at European level is necessary and that it is also essential to consolidate reporting related to state-owned companies in a more structured, constant and transparent. The report shows that improving public reporting in state-owned companies at national level under the umbrella of Eurostat, for instance, as well as consolidating chapters regarding state-owned companies in other EU mechanisms (the European semester, the convergence programme, reports on public procurement etc.). At the level of the European Commission, recent initiatives could be continued to create a White paper for the performance of SOEs in the EU, with the prospect of a EU policy instrument.

Consolidating the reporting and a tighter coordination at EU level could be important steps in activating more efficient prevention and control mechanisms. Early warning instruments, public alert and monitoring should be supported and developed at an academic level and within the civil society and among stakeholders, to create antibodies and public awareness. Lastly, a more consolidated approach at EU level concerning the fight against corruption, where there are no coordination and verification mechanisms such as the MCV – as is the case of Romania and Bulgaria – should be designed in the near future.

Research Methodology

The conclusions and recommendations of this assessment are based on four national researches, conducted, between April and September 2017, in the aforementioned countries, by: the *Romanian Center for European Policies*, *Freedom House Romania*, *Expert Forum*, *Risk Monitor*, *Amapola Progetti* and *Candole Partners*.

This research uses both quantitative and qualitative methods:

- 1) **Desk research of relevant documents in each country:** the legislation in force

on corporate governance, amendments or new public policies proposals concerning SOEs, identification of case laws related to state-owned enterprises and uniform description of illegal mechanisms for obtaining public resources for private or political interests, journalistic investigations, official indictments of the national prosecution offices and courts, other studies (monitoring reports from the Ministries of Public Finance, reports of the IMF and of the World Bank, the European Semester, civil society reports, control reports - Court of Accounts, Competition Council)

- 2) **Structured request letters under the Freedom of Information legislation** targeting specific areas (the selection procedure for the management bodies, changes in the management bodies, public procurement contracts, monitoring compliance with performance indicators, etc.)
- 3) **In-depth interviews with relevant policy maker and decision makers:** six in-depth interviews with relevant experts in communications, energy, environment and transport were conducted in Romania, five in-depth interviews in Bulgaria - which included members of the Bulgarian Parliament, the Ministry of Economy, representatives of civil society and NGOs, four in-depth interviews in Italy, and two in-depth interviews in the Czech Republic.
- 4) **On-line expert surveys:** a database with high-level experts in the targeted sectors - energy, infrastructure, transport, telecommunications and environment. The research in Romania includes responses from 41 experts, 31 in Italy, 26 in Bulgaria and 4 in the Czech Republic.

Based on the data obtained following the quantitative and qualitative analysis, a barometer of clientelism was conducted – as a tool for constant monitoring and for early warning with regard to the exposure of some state-owned companies to capture or corruption. The barometer contains a series of indicators which can be filled out from open data, public data or data that should be available for each state-owned company in any member state of the EU. The barometer can be adapted to any member state and can be used by interested researchers.

CHAPTER I - Legal framework on corporate governance

The existence of a **corporate governance framework** is mandatory for creating the incentives for SOEs to perform on the market. SOEs require clear rules and procedures, in addition to performance indicators. Ensuring proper management framework, accountability and transparent mechanisms for a more efficient use of public resources all play a key role for the economic success of these enterprises.

Although there are discrepancies between the quality of the legal framework in all

four countries, a common issue emerges: with no will for proper enforcement, the framework is systematically infringed and its applicability is diminished.

In Romania, significant improvements of the corporate governance have been made in recent years, although the framework has never been fully enforced and it is now facing political pressure. The Parliament's most recent amendment attempt of 2017 to Law 111/2016 on corporate governance exempting over 100 SOEs from enforcement was ruled unconstitutional by the Constitutional Court. The Bulgarian legal framework is weakened by the lack of synchronization of the various laws and regulations and by contradictions between regulations. The Czech Republic still does not have a policy on state ownership and SOEs are rather subject to arbitrary procedures. Italy, faced with the largest number of SOEs in the European Union, has recently proposed new legislation aimed at improved control and monitoring of these enterprises.

Solid enforcement of the corporate governance law remains a challenge in all four countries in our report. The law is systematically infringed and national authorities are exploiting its shortcomings. The evaluation of SOEs in the Czech Republic is rather chaotic as a result of the existence of benchmark indicators. In Romania, authorities "turned interim management into permanent management" by constantly extending the mandate of interim managers and by failing to organize management selection procedures.

1. ROMANIA

Starting with 2011, there has been significant improvement of the corporate governance legal framework for state-owned companies in Romania. Government Emergency Ordinance 109/2011, Law 111/2016 passed to approve G.E.O. 109/2011 and Government Decision 722/2016 are the cornerstone of Romania's legal framework on corporate governance. These introduced performance criteria for SOEs, new mechanisms for the selection of management and members of the administrative bodies, protection for minority shareholder or better transparency.

Despite these legislative improvements, structural weaknesses remain. Administrative control mechanisms and distribution of responsibilities between institutions are rather unclear (*responsibility of sectoral ministries vs. the Court of Accounts*). Selection of management is often eluded as the mandate of interim management or of the Board of Directors is often unduly extended. But what is of critical significance, is that during this past year we have witnessed attempts of the Romanian Parliament to except a large number of SOEs from the applicability of the criteria for corporate governance, and to lessen its applicability and make it obsolete. In December 2017, the Romanian Parliament passed amendments excepting almost 100 large SOEs from the scope of the corporate governance law, which would have dramatically hindered the enforcement of this law. However, the Constitutional Court declared these amendments unconstitutional in February 2018.

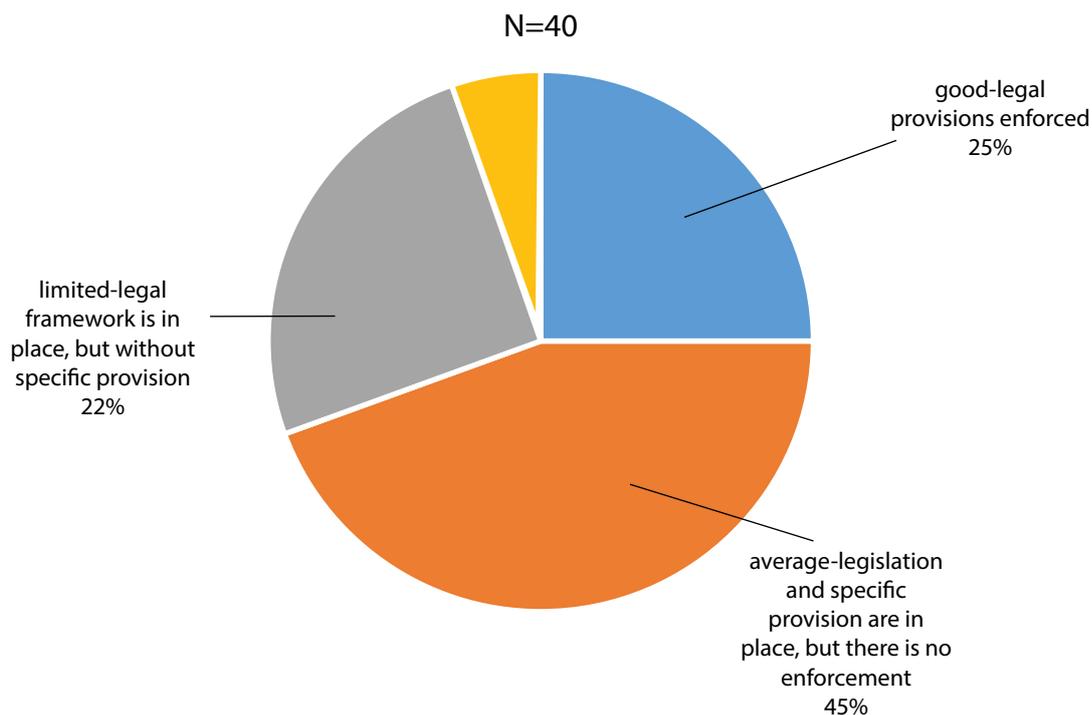
The expert survey conducted by the Romanian Center for European Policies, Freedom

House and Expert Forum in Romania¹ in 2017 shows that interviewed experts consider that the quality of the general legal framework on state-owned companies is average (45%) or good (25%). Only a third of the respondents consider the legal framework to be limited (23%) or very limited (8%). No respondents believed that the general legal framework in Romania is very good.

“The impact of G.E.O. 109 manifested itself in two phases. The first phase was immediately after it was passed, through a fairly strong attempt to implement it and to make recruitments. What followed was a regression, in which the political factor tried to mitigate as much as possible the effects of this ordinance in order to ensure continued control over the companies.” (former BoA member)

*“The idea of the IMF was to introduce professional management which we were not supposed to touch. This idea that *we were not supposed to touch it*, clearly, failed! I don’t know how well these people were selected, but definitely the idea was to give them a few years. When the Government changed, they brought changes and installed interim managers.” (expert, high-ranking civil servant)*

Quality of the legal framework on a national level - Romania



2. BULGARIA

The current legal framework on state-owned enterprises in Bulgaria is unclear, as its subject to a two-folded regulation: SOEs are regulated by both commercial and public

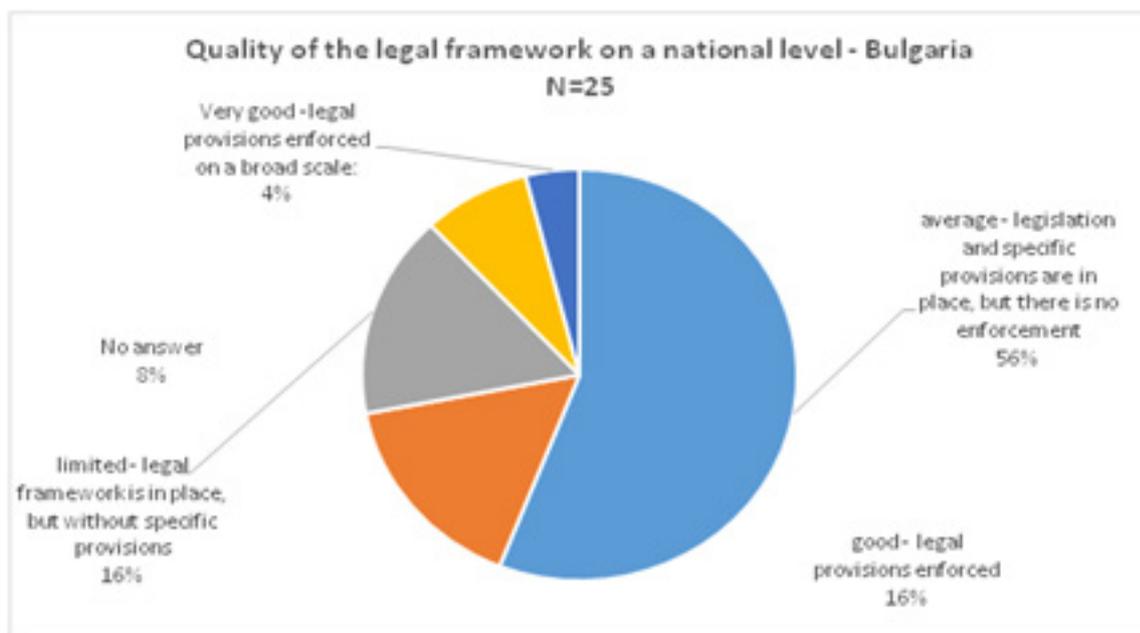
¹ Clara Volintiru, Gelu Trandafir, Bianca Toma, Ana Otilia Nutu, Alexandru Damian, *State-owned companies in Romania: preventing corruption, clientelism and state capture*, November 2017, available at http://www.statecapture.eu/wp-content/uploads/2018/01/RO_c.pdf

law. SOEs must comply with the common commercial regulations and, in addition, to a special code – the *Procedural code for the exercise of Government rights in companies with state participation*². A shortcoming of the Bulgarian legal framework is the use of secondary legislation to govern SOEs.

An extensive qualitative research conducted by Risk Monitor in Bulgaria³ concludes that the legal framework in Bulgaria is hindered mainly by the lack of synchronization of the various laws and regulations and by contradictions within the regulations. There is no clear legal framework regulating corporate governance and no formal compliance with international standards on good corporate governance. This situation affects the overall performance of SOEs, as there are no clear benchmark indicators or evaluation procedures, nor are there any effective mechanisms for the appointment and control of management bodies.

In addition, the survey reveals critical gaps in terms of enforcing corporate governance legislation. 60% of the respondents⁴ rated the framework as “Good, but not always enforced”, 15% very good, 20% poor and 5% fair. Two thirds of the respondents expressed views that the Bulgarian regulations are not in line with international standards on good governance (neither OECD, nor GRI).

What is happening currently in Bulgaria is somewhat applicable to Romania as well - vague regulations concerning municipal enterprises. Countries like Italy imposed regulations to limit these types of enterprises and have a clear acknowledgment of their usefulness and necessity, but Bulgaria and Romania do not follow this trend, with no clear compliance and regulations applicable to such enterprises.



2. Details on the Bulgarian legislative framework are available at <http://www.lex.bg/laws/ldoc/2135467843>

3. Georgy Ganev, Petia Kabarkchieva, Stefan Popov, Rada Smedovska-Toneva, *State-owned Enterprises: Preventing Corruption and State Capture The case of Bulgaria, National Report Bulgaria*, November 2017

4. Idem, page 6

3. ITALY

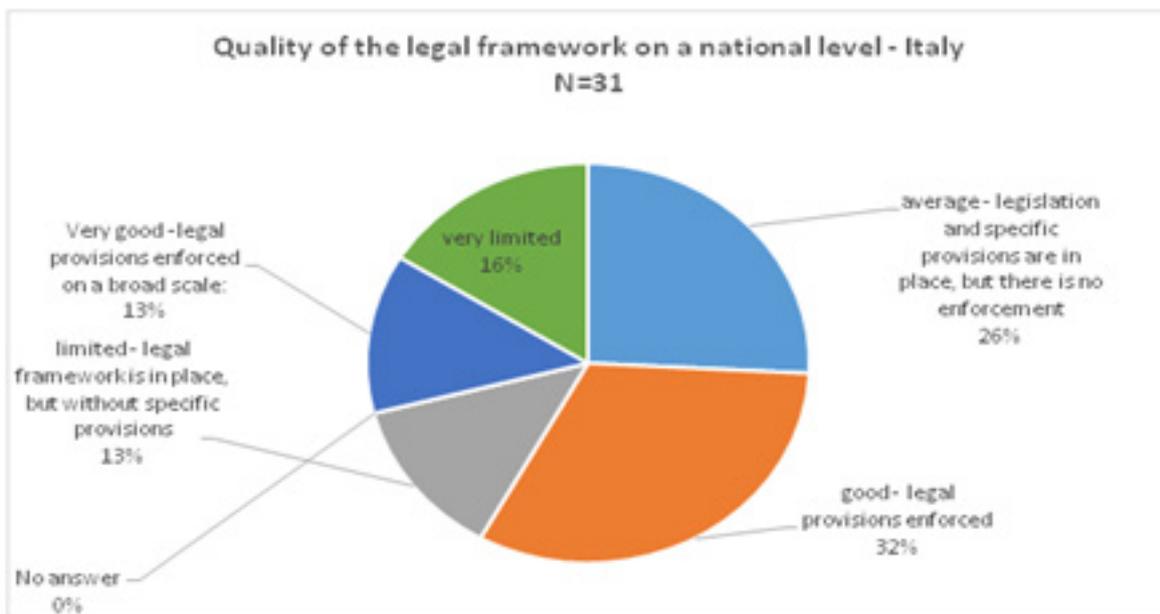
Italy is one of the EU countries with the largest number of state-owned enterprises, most of which are local. In an effort to better control them and to increase their efficiency, the Italian government passed a new legislative framework in 2016. There was one key change with regard to the justification of public ownership: public authorities are only allowed to own companies whose activity is strictly linked to their institutional purpose. In addition, by 30 September 2017, the public administrations had to map all state-owned companies, while new criteria for public participation in companies will be enacted starting in 2020.⁵

The new legislation provides new guidelines regulating SOEs: a maximum remuneration rate for board members, compulsory risk assessment plans. Profitability is prioritized, as public participation in companies incurring losses in four out of five consecutive years will be denied. And, as novelty, in cases of bankruptcy of SOEs, the parent authorities will not be entitled "for the following five years to establish new companies, nor to acquire or maintain participation in companies providing similar services".⁶

The Italian legal framework on anti-corruption was also modified recently - in 2012. Following these changes, new rules were enforced for SOEs:

- 1) Compulsory appointment of a compliance officer responsible for drafting, monitoring and implementing anti-corruption plans,
- 2) New code of conduct for employees,
- 3) New measures on incompatibility for the Board and Executive Directors,
- 4) Mandatory transparency measures and protection of whistle-blowers.

A nation-wide survey conducted by *Amapola Progetti* in Italy in 2017⁷ revealed that 32% of the respondents consider the legal framework on corporate governance good and properly enforced, while 26% describe it as average and with no overall enforcement.



5. Valeria Ferraris, Giovanna Spolti, Pier Paolo Maza, *State-owned Enterprises: Preventing Corruption and State Capture The case of Italy*, National Report Italy, November 2017

6. Idem, page 6

7. Idem, page 7

4. THE CZECH REPUBLIC

Czech legislation on SOEs and corporate governance legislation is very brief. The key shortcoming of the legal framework is the absence of state ownership policy. What is problematic is that without an ownership policy at state level, SOEs management can be described as chaotic, which contributes to a non-transparent environment, waste of public money and inefficiency of state administration.

“Because of the lack of a state ownership policy, the Czech state cannot provide the SOE and the public with criteria on which the State could assess the performance of individual SOEs and offer the SOE the necessary autonomy in decision-making, when conflict of interest is present” (Jan Ondrich, Jana Sebestova, State-Owned Enterprises: Preventing Corruption and State Capture. The case of the Czech Republic, National Report, Czech Republic, November 2017)

A research conducted by Candole Partners in the Czech Republic⁸ identified a number of challenges of the legislative framework in the Czech Republic, having as root cause, in particular, a key gap in the Czech legislation:

- 1) the absence of a state ownership policy, that leads to lack of clear criteria required for the state to assess the performance of SOEs and to provide them with the necessary autonomy in decision-making, when conflict of interests occurs, and
- 2) the lack of clear rules and procedures for nominating, appointing, evaluating and rewarding SOE management, which leads to a vicious circle that has allowed corrupt practices and clientelism within these companies.

There is also a gap in controlling the management of state-owned companies. The aforementioned report reveals that large companies, such as CEZ, do not fall under the authority of the Supreme Audit Office, creating a legislative void regarding their management and their control.

In addition, transparency is also neglected, as SOEs often do not fully observe the law on free access to information and do not provide adequate information on requested or within the annual reports.⁹

Q1: How would you assess the quality of the legal framework concerning state-owned companies in the Czech Republic?	Czech Republic
very limited	0
limited – legal framework in place, but no specific provisions	0
average - legislation and specific provisions in place, but no enforcement	2
good - legal provisions enforced	2
very good - legal provisions enforced on a broad scale	0
Total	4

8. Jan Ondrich, Jana Sebestova, *State-owned Enterprises: Preventing Corruption and State Capture The case of Czech Republic, National Report Czech Republic*, November 2017

9. Act No. 106/1999 Coll., On Free Access to Information

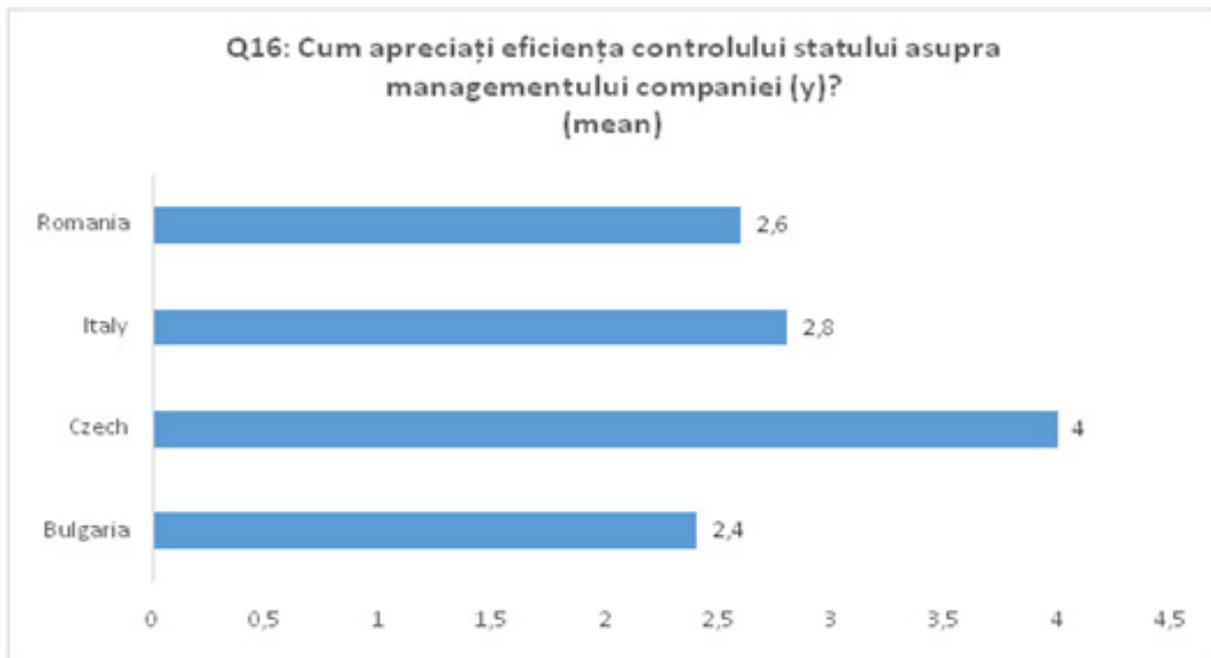
Legal framework for corporate governance	RO		BG		CZ		IT	
	Legal provisions	Enforcement	Legal provisions	Enforcement	Legal provisions	Enforcement	Legal provisions	Enforcement
Overall corporate governance legal framework	YES	AVERAGE	YES	AVERAGE	PARTIAL	AVERAGE	YES	AVERAGE
Latest developments in corporate governance law	Attempts by the Parliament in December 2017 to hinder corporate governance by exempting more than 100 SOEs from corporate governance principles. Eluded principles of corporate governance – e.g. “turning interim management into permanent management”		No clear general framework - lack of synchronization of the various laws and regulations and contradictions within the regulations		No state ownership policy – no will from the political class to promote better regulation on corporate governance		New rules for SOEs: Legislative framework on corporate governance on SOEs in 2016 and new anti-corruption strategy in 2012	
Framework for appointing management bodies	YES	Weak	YES	Poor, political influence	UNCLEAR	Rather poor, political influence	YES	Average
Existing monitoring procedures for implementing corporate governance	YES	Rather unenforced	YES	Rather unenforced	YES, but limited	Limited enforcement, narrow SOE competence	YES	Average
Framework on local and municipal enterprises	AVERAGE, unclear if they fall under corporate governance	NO	AVERAGE	NO	NO, unclear if they fall under corporate governance	NO	YES	New legal framework set in place in 2016

CHAPTER 2. Control measures (management, Court of accounts, Competition Council, ANAF, ANAP, administrative bodies)

The quality of the control mechanisms is crucial for supporting more efficient use of state resources and for mitigating illegal behaviours. In the four countries in our report, the resources of SOEs were frequently used to fund election campaigns and were treated as “post electoral rewards” through political clientelism, or simply exploited by influential groups of interests. It is mandatory to have well-established, enforced control measures (both internal and external mechanisms) in order to hinder any attempt to drain these resources.

Control measures in all four countries were identified as rather limited, both in scope and in legal consequences. The efficiency of state control over SOEs is average. According to collected data, respondents rated state control at around 2.5 (on a scale from 1 to 5). Key shortcomings were: overlapping responsibilities, unclear control criteria (rare thematic controls, insufficient in terms of time and staff involved), and, in particular, weak coercive measures and almost inexistent consequences in changing patterns or legal consequences for management of SOEs.

The status of internal control mechanisms is similar. It is more of a formality, than a clearly established tool of checks and balances, and it is often even less efficient than external control, carried out by other state institutions. At large, internal control is rather weak, failing to properly conduct its tasks as, in practice, it is highly dependent on top level appointments and not an independent body.



* In the Czech Republic, the high ranking is mainly due to the reduced number of responses. Our analysis and in-depth interviews reveal a similar situation to that of the other countries in the study.

ROMANIA

The control of state-owned enterprises is carried out on two levels: an internal control system imposed and supervised by the Board of Administrators and the Supervisory Body, that is based on: 1) the mandate contract and the administration plan of SOE management plan and 2) the shareholders' expectation letters. There is also an external control system that can be exerted by the institution to which the SOE is directly subordinated, such as the Ownership Entity (e.g., line ministries) or the Ministry of Finance, but also by other institutions with control prerogatives, such as the Court of accounts, Competition Council, National Agency for Tax Administration or the National Agency for Public Procurement.

Quite often, the control of SOEs is insufficient and poorly substantiated, whether it is internal or external control. An EBRD Report from December 2016 describes the internal control of Romanian SOEs as "average" in the absence of clear policies appointing independent individuals to carry out the control process, of preventing conflicts of interest or the absence of audit mechanisms.

The external control of SOEs can be conducted more accurately, is more complex and can have a specific control topic, but it's rarely enough in terms of mitigation and punitive measures. This happens, on one side, because control institutions lack administrative capacity (limited number of staff, their limited expertise in some cases or the limited timeframe for conducting an audit) and, on the other hand, because of the size of the SOE sector (high number of enterprises and the fact that some SOEs are extremely large so conducting a large control operations for them would require all the resources of a control institution).

(on the control of the Ownership Entity) "It's insufficient and inefficient. Insufficient, despite there being a control plan. In my opinion, not in all, but in most cases the Control Body does not have the expertise for the type of complex crimes that we are faces with in some enterprises. There are SOEs with a lot of money and here we no longer speak of petty crimes; more sophisticated expertise is necessary for more complex crimes. Moreover, there is not enough time for in-depth control procedures." **(former Minister)**

"I don't want to be mean, but from my personal experience there were real monitoring and control mechanisms, but let's not forget that when the political side dictates some directions, the control subordinates to them, one way or another, because even the control body is politically appointed, so there's a certain level of checks and balances." **(former SOE Board Member)**

For instance, only during the past 4 years the Court of accounts carried out controls at TAROM (2013, 2015), CNAB (2015), *CFR Calatori* (2013), *Posta Romana* (2012) which, however, had a limited effect in terms of coercive or corrective measures. The number of notifications sent or highlighted by control bodies is increasing, like those of the Court of accounts (42 notifications to the Public Ministry in 2016) or control bodies (e.g., notifying the Ministry of Communications, the National Anti-corruption Directorate, after analysing the activity of the *Posta Romana* SOE, during the extended period 2008-2016), but the way in which these companies are managed stayed exactly the same, and the legal measures were limited.

(on the Court of accounts) "The Court of accounts is different. The Court of accounts can stay for a long period, they have access to all the data and, moreover, they have a certain control theme. The Court of accounts is definitely more efficient." **(former Minister)**

"SOEs should be checked one after another. Unfortunately, staff and time are usually not enough. After the media disclosures from last year, the control body tackled many areas, with the same people. Half of the Control Body was conducting a control on biocides, and all other actions were interrupted. And this is a shortcoming. But they should continue". **(high civil servant)**

However, control bodies quite usually recur to random thematic controls, without focusing solely on risk areas previously identified internally or from external sources. Because of this mechanism, administrative measures are not applied on time or are applied with delays (with negative consequences for loss recovery and identifying the criminal deeds). When presenting the 2017 DNA activity report, the Chief Prosecutor said that it happens quite often for control bodies to notify the institution even 9-10 years after the deeds were committed, and that mechanisms are needed as to make these notifications faster¹⁰.

10. Statement by Laura Codruța Kovesi, Chief Prosecutor of DNA, when presenting the 2017 DNA report "in many cases we receive notifications about crimes committed 9-10 years ago and we have to find mechanisms", available at <https://www.hotnews.ro/stiri-esential-22314345-live-video-text-raportul-dna-prezentat-laura-codruța-rovesi-fata-lui-klaus-iohannis-ora-11-00.htm>

BULGARIA

Public control of SOEs in Bulgaria rest largely with public supervisory bodies (in most cases, line ministries, or municipalities for local SOEs) and the Ministry of Finance. Quarterly financial reports are published by the Ministry of Finance for SOEs. Once a year, there is a financial audit of SOEs. A key role in control is also played by the Audit Office, which has the authority to evaluate the financial status of SOEs and to provide up-to-date assessments of their economic effectiveness and, if required, their social efficiency.

There are, however, systemic deficiencies in the control process. There are no clear, nor well-established criteria or procedures to ensure compliance with existing laws and regulations. The control process varies considerably, both at the level of line ministries, but also at the level of SOEs, as there are generally no performance targets or internal rules. The control mechanisms for the management bodies of SOEs and for the performance of the company are ineffective, in the absence of clear criteria.

The expert survey conducted by Risk Monitor in Bulgaria in 2017¹¹ also revealed that there is no specific internal mechanism to ensure oversight and control in none of the analysed SOEs, outside of existing common regulation.

ITALY

In Italy, SOEs are subject to both internal and external control processes. SOEs have an internal control body that must be nominated by the board. In the case of limited companies, it must be a registered audit company. The degree of independency of the internal control body is rather good and is not subject to political influence. However, key vulnerabilities persist: they are nominated by the board and are somehow under this umbrella of influence. An extra layer of control resides with the supervisory body, which has the duty to check the legality and legitimacy of the decision-making procedure of the board.

In Italy, external control is fulfilled especially by the Court of Accounts, the key institution controlling the SOEs. Its range of competences is quite broad - preventive control on legality of the acts, *ex post* control on the management of the SOEs, *ex post* financial control. A different situation occurs in the case of companies listed on the stock exchange. In this case, control mechanisms are similar to those applied to the private companies.

The national report on Italy conducted by Amapola Progetti underlines that 16% of the experts interviewed think that state control is of good or very good quality - meaning that there is not only a management strategy, but also well-established performance objectives and indicators - while 35% of the respondents thinks that there is a management strategy, but without any attention paid to performance.

11. Georgy Ganev, Petia Kabarkchieva, Stefan Popov, Rada Smedovska-Toneva, *State-Owned Enterprises: Preventing Corruption and State Capture. The case of Bulgaria, National Report - Bulgaria*, November 2017

THE CZECH REPUBLIC

SOEs in Czech Republic are subject to a two-folded control process. Internally, the process is managed by a Board of Directors (statutory board) and the Supervisory Board (generally including representatives of the government and trade unions), which are responsible for the company's overall performance and obligations towards third parties. In addition, the Supreme Audit Office is the key institution controlling the public financial management of SOEs.

Although SOEs are legally required to publish annual reports, to disclose financial reports or to submit to an independent audit, important gaps remain in terms of implementing an efficient control mechanism. The lack of an ownership policy makes it difficult for the state to oversee the management of the SOEs. In numerous cases, SOEs do not have any clear criteria for defining their performance indicators, no clear priorities or goals to measure their financial and non-financial performance. This is a vicious cycle: without clear benchmarks, the Supervisory Board is inefficient in controlling and evaluating the performance of the company, while the line ministries are inefficient in controlling and evaluating the activity of the Supervisory Board.

Internal control is rather weak, with a high dependency of nominees to the Supervisory board to electoral cycles. In a 2013, according to a CAE study¹², in the years leading up to the elections, 88% of the chairman of supervisory boards of companies owned by municipalities and those in regional companies were replaced. In addition, numerous reports show that the management of the company is controlling *de facto* the supervisory board, which hinders any real possibility of control.

The study conducted by Candole Partners in the Czech Republic in 2017 also reveals that the activity of Supreme Audit Office, the institution in charge of controlling the public financial management of SOEs, is hindered by:

- 1) its narrow competences and the lack of clear mechanisms for enforcing the legislation,
- 2) SOEs refusal to provide information, and
- 3) political influence (between 2005 and 2012, 5 out of 7 members of the Board were former members of the Czech Parliament).

In the Czech Republic, there is also a loophole in the supervision of the economic activities of SOEs – for example, companies such as ČEZ do not fall under the jurisdiction of the Supreme Audit Office.

Numerous sanctions are decided by the Anti-Monopoly Office. The main railway company in the Czech Republic, České dráhy, received the highest sanction in the history of the country - 25 million CZK, due to an issue in a public procurement tender. The ČEZ Electric Group was also sanctioned by the Anti-monopoly Office in 2004.

12. Centre of Applied Economics: Political Control and Corruption Potential of Publicly Owned Enterprises, 2013 Available at <http://www.zindex.cz/data/2013-09-10-SOEs-studie.pdf>

The Forestry Company Lesy ČR was sanctioned in 2010. The Czech Post Office was sanctioned repeatedly, mostly for issues and non-transparency in public tenders. Currently, the Antimonopoly Office is investigating the post company for abuse of dominant position.

State-Owned Companies - Control Mechanisms

Control	RO		BG		CZ		IT	
	Legal provisions	Enforced	Legal provisions	Enforced	Legal provisions	Enforced	Legal provisions	Enforced
Internal control mechanisms	YES	Weak, rather informal mechanism with limited effects	YES	Weak, limited effects as performance targets or internal rules are generally not set in place.	Partially	Weak, de facto controlled by the management of the company	Yes	Average
External control mechanisms (Court of Accounts, Competition Council, etc.)	YES	Average	Yes	Average	YES	Average, narrow competences for the Audit Office	Yes	High Average
External control – line ministries and Ministry of Finance	YES	Weak, analysis of the situation of SOEs for 2016 is still unpublished. MFP never applies sanctions systemically infringing Law III/2016,	YES	Weak, quarterly reports by SOEs with limited effects	YES	Weak, no clear overview of financial or management reports by the MFP	YES	Weak, new mechanisms set in place since 2016
Follow up of the control mechanisms	Limited effects in terms of correction or coercive measures		Low, limited effects of both internal (rather informal mechanisms) and external ones		Low due to the lack of state ownership policy and no indicators/benchmarks for the SOEs		Average, new control mechanisms set in place in 2016	

CHAPTER 3. Quality of public policies in the field of prevention and implications for state-owned companies

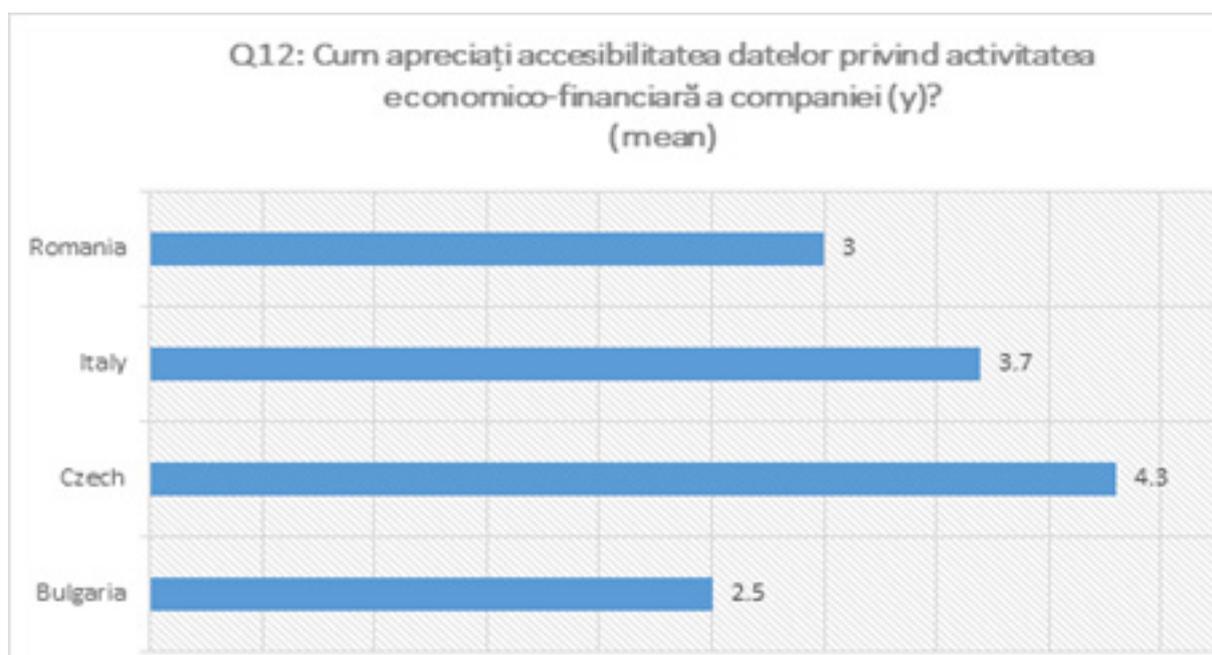
The existence of prevention tools - legislation on conflict of interest, whistle-blowers, code of conducts and code of ethics, declaration of interests and assets, anti-corruption declaration, transparency policy or others - country-specific tools - does not guarantee enforcement, and, even less so, their efficiency. The results of not applying the preventive measures efficiently is revealed in the following stage – the enforcement of criminal procedures, as is the case of Romania, and, less frequently, for Bulgaria.

Although, in terms of incompatibilities and conflicts of interest, all four countries have clear institutional and legal frameworks, which are extremely ambitious and extensive, even in Romania and Bulgaria, there are no relevant examples of sanctioning conflicts of interest in any of the countries in our analysis. Moreover, the politicisation of the BoA and the so-called political rewards – from positions to contracts – are still present in the Czech Republic and in Italy.

Risk analyses and preventive measures are still used infrequently. Romania targeted SOEs and business integrity in a specific manner, including through the prevention and monitoring mechanisms in the National Anti-Corruption Strategy. Bulgaria has a broader approach in the National Anti-Corruption Strategy – which also includes prevention – but lacks risk elements, since the efficiency of its anti-corruption fight is still low. The Czech Republic is still dealing with SOE politicisation and the absence of drastic sanctions, whereas Italy is testing a new prevention-focused approach, at all levels.

In terms of basic elements related to measures for early detection and prevention of irregularities, transparency policies and disclosure of financial information and key indicators concerning SOEs have been assessed in each country covered in this research.

Moreover, in terms of accessibility of the financial data, public procurement plans and management decisions, this report analyses the formal or informal framework for the disclosure of such data by SOEs or by central and local authorities.



The tools listed above have been assessed by a team of experts from each state in the report, and a compared analysis is available at the end of this chapter.

ROMANIA

The legislative framework for preventing and sanctioning conflicts of interest is extensively regulated in the Romanian legislation, and it includes drastic sanctions, which are consistent and put into practice (but not as much in terms of criminal sanctions) by a special institution - the National Integrity Agency (ANI). ANI deals with cases of conflicts of interests, incompatibilities and personal wealth of public officials, including management of SOEs. ANI manages over 300,000 declarations of assets and interests, one of the largest databases amongst Member States. There is also a long, consistent track record of investigating and sanctioning conflicts of interest. During 2008-2013¹³, 138 cases were referred for prosecution on suspicion of criminal conflicts of interest: in 36% of the cases no proceedings were launched while 50% were investigated by prosecutors.

For conflicts of interest, the law provides harsh sanctions, of up to five years in jail and the interdiction of occupying a public position. In terms of prevention for SOEs, the possibility of addressing questions and submitting requests for clarification to ANI to avoid incompatibilities was a best practice example in terms of incompatibility - especially in the case of restrictions concerning the civil servant status and the capacity of being a BoA member - including for local *Regies*.

G.E.O. 109/2011 on corporate governance provided for some key prevention measures for SOEs, such as codes of ethics and monitoring systems for conflicts of interest. At the same time, it introduced centralized oversight of all SOEs, carried out by the

¹³. EU Anti-Corruption Report 2014, https://ec.europa.eu/home-affairs/sites/homeaffairs/files/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report/docs/2014_acr_romania_chapter_en.pdf

Ministry of Finance.

The National Anti-Corruption Strategy 2012-2015 had specific objectives, targeting business integrity, including SOEs (*Objective 1.7. Promoting a competitive, correct and fair business environment*). The new document, the National Anti-Corruption Strategy (NAS) 2016-2020 brought about even more concrete elements targeting SOEs and their vulnerabilities. Thus, the new strategy introduced a standard for disclosing public interest information concerning SOEs, which binds SOEs to provide a statement accepting the 2016-2020 strategy, its integrity plan (developed in line with the Good Practice Guidance on Internal Controls, Ethics and Compliance of the OECD) and the mechanism for signalling integrity incidents.¹⁴

The implementation of these measures is monitored by teams coordinated by the Technical Secretariat of the NAS, but there are no sanctions and there is no significant dissuasive capacity, to cause SOEs to take ownership of and to apply these mechanisms on its own.

BULGARIA – RISK ASSESSMENTS AND CONCRETE PLANS

There is a selective package of preventive measures – included in regulations on public companies, the commercial code and/or administrative regulations – targeting state-owned companies in Bulgaria, but it is lacking coherence, concrete areas of interests, or identification of vulnerabilities.

An extensive framework addressing prevention of corruption is in place in Bulgaria. A list of the most relevant strategies and documents targeting state-owned companies includes: The Commission on Preventing and Combating Corruption, The Statute of the Public Procurement Agency, The Rules of Organization and Operation of the Commission for Prevention and Ascertainment of Conflicts of Interest, The Integrated Strategy for Preventing and Combating Corruption and Organized Crime, The National Strategy for Preventing and Countering Corruption 2015-2020, The Strategic Guidelines for Preventing and Combating Corruption 2015-2020.

According to the results of the expert survey conducted by Risk Monitor¹⁵ under this project, decision makers and SOE representatives indicated that there is a strong need to improve the enforcement of the preventive mechanisms. As the EU recommendation also highlights¹⁶, proactive *ex-ante* and stronger *ex-post* controls, based on risk assessment, are necessary to prevent and to address corruption in a timely manner in Bulgarian public procurement.

The recommendations made by the Bulgarian experts were focused on key measures needed to significantly improve the quality of the preventive measures targeting SOEs:

14. National Anti-Corruption Strategy 2016-2020, <http://www.just.ro/strategii-si-politici/strategii-nationale/>

15. Petia Kabakchieva, Georgi Ganev, State-Owned Enterprises: Preventing Corruption and State Capture, The case of Bulgaria, November 2017

16. EU Anti-Corruption Report, Bulgaria, February 2014

making business plans compulsory; issuing an annual public report on the overall development of the enterprise and on the implementation of the business plan; more detailed regulations of conflicts of interest and the standardisation of indicators for reports, to include not only economic indicators, but also transparency and good corporate governance indicators.

Transparency plans are mandatory and are reviewed every three years, according to recent regulations, which also include measures to protect whistle-blowers. SOEs must also adopt specific organizational measures to avoid conflict of interests¹⁷.

THE CZECH REPUBLIC – POOR REGULATION ON PREVENTION

Czech legislation poorly regulates conflict of interests, leaving SOEs extremely vulnerable to political temptations. In the past, Czech legislation imposed measures to prevent political influence in public administration, through conflict of interests and incompatibility of official offices in the Czech Republic, as prescribed by Law No. 159/2006. However, the law allows public officials to act as members of Supervisory Boards.

The national report from the Czech Republic highlights the “revolving door” phenomenon, when influential executives and/ or politicians switch from important positions in the state administration to private companies and vice-versa. This phenomenon is not addressed properly and consistently.

As indicated by the Czech experts¹⁸ nominations to supervisory and management boards tend to be political. As revealed in the cases of Romania and Bulgaria, legislation covering SOEs does not target professional appointments and individuals appointed rarely have the required professional background, knowledge or previous working experience. The national Czech report also indicates that “it is a challenge to detect conflict of interest early on; it fosters clientelism and hinders the autonomy of SOEs”¹⁹.

ITALY’S ANTI-CORRUPTION STRATEGY – A FOCUS ON PREVENTION

By comparison to the other states analysed in this report, Italy is a role model in terms of prevention, given its track record and its recent legislative amendments, which place prevention at the centre of its anti-corruption policies.

Unlike legal provisions in Eastern European countries, in Italy the anti-corruption law requires SOE to take specific prevention measures targeting early detection of corrupt practices and bad management²⁰: (1) appointment of a compliance officer responsible

17. Idem 5

18. Jan Ondrich, Jana Sebestova, Corporate Governance in Czech state-owned companies – regulatory review, November 2017

19. Idem 8

20. Valeria Ferraris Giovanna Spolti, Italy’s SOEs: a situation on the move, October 2017

for the drafting of the anti-corruption plan; (2) monitoring the implementation of the anti-corruption plan and assessment of its sustainability; (3) multiannual anti-corruption plans, based on the National Anti-Corruption Plan, published on the website of SOEs, covering high-risk areas or vulnerabilities to corrupt practices; (4) introduction of the code of conducts for employees, which includes provisions for enforcement of disciplinary sanctions.

Implementing the amended legislative framework is currently made difficult by the level of bureaucracy, as indicated by Italian experts interviewed for this report and by the European Commission in its anti-corruption report: “the wide preventive framework provided by the new legislative framework puts significant burden on the public administration and requires considerable efforts to ensure the necessary capacity for effective implementation”.²¹

Comparative overview – preventive measures concerning SOEs in Romania, Bulgaria, the Czech Republic and Italy

Public Policy on Prevention for SOEs	RO		BG		CZ		IT	
	Legal provisions	Track record	Legal provisions	Track record	Legal provisions	Track record	Legal provisions	Track record
Conflict of interests (legal, relevant cases, sanctions)	Yes	Yes	Yes	No	Yes	No	Yes	No
Restrictions to political influence (poor, medium, strong)	poor	poor	medium	poor				
Whistle-blower policy (legal, protection)	Yes	Yes	No	No	Yes	No	Yes	Yes
Transparency (formal, effective)	Yes	No	Yes	No	Yes	No	Yes	Yes
Independent monitoring tools			Council of management of state-owned enterprises, comprised of representatives of NGOs with experience in relevant industries and sectors, independent experts, and academics. This Council would receive the annual reports of state-owned enterprises and would intervene in case of critical situations in the sectors and industries where there are SOEs.					

21. EU Anti-Corruption Report, Italy, February 2014

CHAPTER 4. Quality of public policies from a criminal law perspective – with regard to state-owned companies (anti-corruption legislation, track record, dissuasive sentences)

The most important outcomes of anti-corruption policies are relevant, well-documented, investigated cases resulting in convictions and, more recently, in recovery of the proceeds of crime and extended confiscation. In the cases of Romania and Bulgaria, the quality of public policies from a criminal law perspective – and, in particular, of anti-corruption policies – is assessed every year by the European Commission through the Mechanism for Cooperation and Verification (MCV). This is an exception-mechanism imposed on these two member states after joining the EU and maintained, as a result of their shortcomings in the field of justice, the anti-corruption fight or organised crime. Both countries are faced with endemic corruption, but they also host ambitious institutional or legislative structures that are carefully monitored.

Nevertheless, the outcomes are very different: Romania managed to build an impressive track record in the fight against corruption, and it succeeded in addressing the specific problem of state-owned companies and that of institutional links at the highest level (political or executive) through abundant case law, which is unique in this region. Final court convictions and confirmation of damages following criminal investigations revealed the huge dimension of the frauds.

Investigations are pending in Bulgaria as well, but there are very few finalised cases with regard to state-owned companies, and, consequently, few cases for us to relate to in our report.

Moreover, the law limits the criminal liability of the members of collective administration bodies, such as the executive board or supervisory boards of public companies. There are many legislative and institutional methods at local level to provide early warnings, but the actual results must be assessed.

Despite these ambitious institutional establishments, there is negative perceptions of corruption in the business environment, for both Romania and Bulgaria.

- Companies in Cyprus (100%), Greece (96%), Romania (96%) and Italy (94%) are

the most likely to respond that corruption is widespread in their country.²²

- Most companies in Romania (62%), Bulgaria (62%) and Greece (52%) indicate corruption prevented them from succeeding in public tenders²³.

Moreover, in the most recent Eurobarometer on the attitude of the business environment towards corruption, 38% of companies across the EU indicated patronage and nepotism as problems. Similar to 2015, Romanian businesses were the most numerous to indicate this - approximately eight in ten (82%) responded in this manner.

Bulgaria ranks 4th, 58% of the businesses interviewed considering patronage and nepotism to be a problem, followed closely by Italy (54%) and the Czech Republic (50%).

In Romania's case, this trend is increasing, as compared to previous measurement – 63% in 2013.

The Italian determination in the fight against corruption and against organised crime meant, for many years, legislation based on measures taken by police action, prosecution and courts of law. The new laws aimed at corruption shift the accent to efficient control, combined with the work of the prosecution – considered “unique” by the European Commission – to recover damages caused by illegal decisions taken by public administration²⁴.

From this perspective, the modernisation and shift of Italy's anti-corruption public policies to new instruments can be better documented and followed by countries such as Romania and Bulgaria.

ROMANIA'S IMPRESSIVE TRACK RECORD

No less than 21 managers in Romanian public companies were prosecuted in 2016, following investigations by the prosecutors of the National Anti-Corruption Directorate – the Romanian prosecution office specializing in investigating corruption.

High-profile investigations carried out by DNA or DIICOT: *the Romanian Post Office* (insurance policies and IT procurement), *Romsilva* (acquisition of a decommissioned military tank as “forestry equipment”, of various products and services at overvalued process or illegal retrocessions), *the “smart boys” in the energy industry* – these are just a few examples which revealed the size of the corruption, theft and damage incurred by Romanian state-owned companies.

In terms of incidence by sector, all areas of the economy where there are state-owned companies proved exposure to corruption. Final convictions were ruled in energy, infrastructure, communications, the environment, utilities. In Romania's case, the

22. 'Businesses' attitudes towards corruption in the EU, Flash Eurobarometer 470, Conducted by TNS Political & Social at the request of the European Commission, DG Home Affairs, December 2017

23. Idem I

24. EU Anti-Corruption Report, Italy Chapter, February 2014, available here https://ec.europa.eu/home-affairs/sites/homeaffairs/files/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report/docs/2014_acr_italy_chapter_en.pdf

incidence is much higher at local level as compared to central level.

In some sectors, such as the energy industry, investigations conducted by the anti-corruption prosecutors lead to the dismantling – at least temporary – of criminal networks with influence at the highest state level.

In the absence of adequate prevention measures and efficient control mechanisms, both prosecutors and professional managers in other state-owned companies warn that capture of key resources in the energy industry may occur again.

Despite an impressive track record in the investigation of corruption and despite analyses carried out by prosecution offices indicating areas vulnerable to capture – procurement in local public administration, including in local autonomous administrations and utility companies – there is still weak response though public policies for control and monitoring of management decisions.

A recent decision of the Constitutional Court of Romania of June 2016 restricted the scope of application of *abuse of office*, to include only deeds perpetrated through infringement of the primary legislation – laws, emergency ordinances, simple ordinances – thus excluding a series of decisions made through infringement of Government decisions (for example, the enforcement guidelines of some important laws), or infringement of the job description or the operating regulations. These changes have an impact on many decisions made in public companies or companies where the State is a shareholder.

BULGARIA – MONITORED FRAMEWORK, FEW CASES

In Bulgaria, the legal framework for combating corruption is extensive and it targets the central administration, public institutions and local authorities. Any development is closely monitored by the experts of the European Commission as part of the MCV.

In terms of state-owned companies, the sectors of the economy at risk are: infrastructure, energy and healthcare²⁵. However, current problems are deepened by “the scarcity of dissuasive sanctions applied in public procurement fraud cases”²⁶. This also affects the exposure of the SOEs to political capture and to different forms of corruption.

At local level, there are significant responsibilities for a large share of the public procurement, including the responsibility of local SOEs for community utilities. According to EC reports, local public administrations have implemented a wide range of anti-corruption measures: ‘one-stop shop’ system to reduce the number of officials in direct contact with the public, enhancing transparency, recruiting hundreds of internal auditors and local ombudsmen²⁷. All regions in Bulgaria (28) have anti-corruption councils, unlike any other country

25. EU Anti-Corruption Report 2014, Annex 2 Bulgaria, Brussels, 3 February 2014

26. *Idem* 5

27. *Ibidem*

in this report, but the impact of these local bodies on diminishing corrupt practices in public administration, including local companies, remains difficult to assess: no concrete information was made public by 2014²⁸.

The 2015 Anti-Corruption Strategy included a focus on rolling out practical measures to address corruption in specific high-risk sectors. The 2017 MCV report noted that progress on this level was still at an early stage.

Other ministries have adopted action plans, although in a number of cases it has been unclear to what extent they went beyond existing practices²⁹ and how advanced they were in terms of implementation, as the latest MCV Report on Bulgaria concluded.

A recent assessment conducted by Risk Monitor in Bulgaria³⁰ has shown very limited investigations targeting irregularities in SOEs. Among the few investigations on irregularities or corruption cases linked with SOEs, the only case with a recent final sentence regards a former manager at Toplofikacia – the heating company in Sofia, for allegations revealed in 2006.

Case law – Bulgaria³¹:

“Former CEO Valentin Dimitrov received a final three-year sentence, for committing asset fraud (draining the company assets) through parallel import of unnecessary equipment at prices several times higher than those delivered by the World Bank and the International Bank for Reconstruction and Development. The initial charges were money laundering, tax evasion and mismanagement, but only mismanagement and excessive waste charges were confirmed. Without direct evidence, this were indications of party and state interference in the company and indications of corruption. Currently, the website of Toplofikacia is a model for transparency – all the information is available, including the company’s financial statements from 2013 onwards; all licenses, certificates, legal regulations, etc. This may be the result of the court sentence”.

THE CZECH REPUBLIC – POLITICAL CONTRACTS, ONE OF ITS VULNERABILITIES

A strategic framework for fighting corruption has been put in place in the Czech Republic over the last years, but vulnerabilities are still high and broadly un-addressed in the public procurement area and on interactions between the business and the public sector, while the perception surveys show that corruption is widely believed to represent a major obstacle to doing business³².

Two-thirds of companies perceived *nepotism* and *patronage* to be a problem³³, while a significant majority indicating *bribery* and *the use of connections* as the most usual

28. Idem 1

29. General integrity-related policies exist in different sectors of government, including training of new employees, rules on gifts, etc.

30. Petia Kabakchieva, Georgi Ganev, State-owned Enterprises: Preventing Corruption and State Capture -The case of Bulgaria, November 2017

31. Idem 4

32. EU Anti-Corruption Report 2014, Annex 3 Czech Republic, Brussels, 3 February 2018

33. Businesses’ attitudes towards corruption in the EU, Flash Eurobarometer 374, Conducted by TNS Political & Social at the request of the European Commission, Directorate-General for Home Affairs, February 2014

tools to get a public service. However, the Czech Republic has seen a recent change in the perception of companies doing business from the perspective of patronage and misery, which is indicated as a problem by half of the companies (50%), but declining significantly from 70% in 2013. The EU average is 13% lower³⁴.

The provisions of the national legislation addressed the issue of conflicts of interest as early as 2006, with the introduction in 2015 of additional measures for public service personnel, measures to prevent political influence over public administration, including operation of SOEs.

An unusual situation is reported in the Czech Republic, which hosts the highest percentage of companies that appreciate that funding political parties in exchange for public contracts or influence over policy making is a problem in the business environment. Six in ten (60%) of businesses in the Czech Republic brought up this issue, in a significant increase (by 19%), compared with previous evaluations.

Similar to the other Eastern European countries analysed in the report, the manipulation of public tender procedures is one of the largest vulnerabilities that facilitates the award of the so-called "political contracts".

One of the biggest corruption scandals in the Czech Republic - with suspicions of influence from the highest level political - is linked to a public procurement contract. In a corruption case, an adviser to the former Czech Prime Minister Mirek Topolánek (2006 – 2009) has been charged with taking a multi-million-dollar bribe from a foreign company in exchange for a public contract in the defence sector concluded in 2009.

The Supreme State Attorney's Office in Prague had pressed charges in the case of purchase of armoured transporters for the Czech army from a foreign company in 2014³⁵. In November 2017, the country's Supreme Court issued a five-year jail sentence for the former Czech prime minister's adviser³⁶.

With regard to the sectors of the economy - energy, rail, forestry and postal services are particularly exposed to political influence and conflict of interest. The annual reports of the Czech Security Information Service consistently raise concerns related to public procurement, "pointing to undue influence and conflicts of interest in sectors such as energy, railway infrastructure, forestry and postal services"³⁷.

Railway infrastructure and forestry are the most vulnerable to corruption, clientelism and political influences. The 2010 Security Information Service BIS annual report also warned of the dangers of clientelism: "*Czech organized crime at the highest level takes the form of influential (clientelistic) networks and entrepreneurial-power structures. It benefits through legal entities in particular by systematic enrichment from public budgets and companies with state-owned participation*".³⁸

34. Businesses' attitudes towards corruption in the EU, Flash Eurobarometer 470, Conducted by TNS Political & Social at the request of the European Commission, DG Home Affairs, December 2017

35. Former Prime Minister's Advisor Facing Corruption Charge Over Austrian Armored Car Purchase: Report, Czech Radio Prague, 15 May 2014

36. Marek Dalík turns up to serve jail sentence, Czech Radio Prague, 6 November 2017

37. 3rd of February 2014, EU Anti-corruption report, available at https://ec.europa.eu/home-affairs/sites/homeaffairs/files/what-we-do/policies/organized-crime-and-human-trafficking/corruption/anti-corruption-report/docs/2014_acr_czech_republic_chapter_en.pdf

38. 2010 Annual Report of the Security Information Service. Available at <https://www.bis.cz/vyrocní-zpráva2b2d.html?ArticleID=27>

ITALY – HIGH QUALITY OF THE NEW LEGAL FRAMEWORK

After ratification, in 2012, of the Criminal and Civil Law Conventions on Corruption promoted by the Council of Europe, a new anti-corruption Italian law was adopted, shifting from a mainly based on repression towards a more comprehensive prevention approach focused on planning, coordination, monitoring.

The new provisions of the legal framework apply “to the entire public sector (public administration at national, regional and local level, universities) as well as to the state-owned companies, subsidiaries, and controlled companies which provide public services or services of public interest”.³⁹

The anti-corruption legal framework is not applicable to the listed company but the National Anti-Corruption authority should define with the supervisory authority for the stock exchange which applies the specific rules in accordance with the profile of the companies.

A qualitative research conducted by Amapola Italy for this report⁴⁰ highlights that a significant number of experts, asked to assess the anti-corruption legal framework, indicated the quality is high and it is implemented on a broad scale (10%) and is high, but the implementation is limited to certain situations (58%).

According to the Italian experts, the most relevant limitations to implementing the legal framework are: the risk analysis is carried out as a bureaucratic task and it isn't used to prevent corruption or to increase competitiveness of the public work. The Italian national report indicated limited examples of sanctions for irregularities and/or further investigations in terms of criminal or corrupt conduct within the state-owned companies.

Fig. Comparative overview on the quality of the repressive policies response

	RO	BG	CZ	IT
Legal framework on anti-corruption	Yes	Yes	Yes	Yes
Track record - criminal investigations concerning SOEs	Yes	Yes	No	No
Dissuasive sentences	Yes	No	No	No
Recovery of the proceeds of crime	Yes (poor)	No	N/A	N/A
National Anti-Corruption Strategies targeting SOEs	Yes	Limited	Limited	Yes

39. Ferraris V, Spolti G. Italy's SOEs: a situation on the move, November 2017

40. Idem 17

CHAPTER V – The greatest risks for SOEs

State-owned companies are exposed to major risks with impact on their activity, influenced both by political and private interest groups. Political patronage and interference ranked first as obstacles in the activity of SOEs in our analysis. Strong politicisation results in low performance, as often SOEs are “occupied” by individuals without the skills and competencies required to run the company, making them subject to intense influence from both public and private areas.

There is a sort of interdependence between SOEs management and election cycles. Political influence acts as a disruptive agent for the development of SOEs.

In Romania, for example, the director of a state-owned enterprise remains in office, on average, for less than one year. Main consequences: impossibility of medium and long-term planning, due to frequent changes in top management, reluctance of the middle management to assume key decisions, low competitiveness of SOEs on competitive markets, or overall inefficiency.

SOEs are also subject to the influence of private interest groups (usually at cross-roads between public and private interests), non-enforced legislation, leading to political interference, bureaucracy, low financial capability as a result of “draining” of resources for political gains, and hindered investments.

ROMANIA

The main risk identified by the experts and officials interviewed for our analysis in Romania⁴¹ is the strong politicisation of the management of these companies and their dependence on the political influence or the frequent political changes during each election cycle. This analysis is also revealed by the research carried out by the authors of this report, which indicated that the average term of a director in an SOE is of approximately 1 year, as political changes often cause changes of the management of state-owned companies.

Excessive politicisation of state-owned companies causes further interdependent risks, such as the lack of a clear medium or long-term development policy, administrative bottlenecks, difficult decision-making mechanisms, as well as postponing of decision-making by the middle management. Another risk indicated by the experts interviewed for this report is the frequency of conflicts of interests and, implicitly, corruption – as often, these go hand in hand with politicisation.

41. Clara Volintiru, Gelu Trandafir, Bianca Toma, Ana Otilia Nutu, Alexandru Damian, *State-owned companies in Romania: preventing corruption, clientelism and state capture*, November 2017

In addition, political interference does not reflect only in top management appointments, but also in the administration of the companies (e.g.: budget adoption), state interference in the selection of the BoA, intentional infringement of the legal framework on corporate governance (OUG 109/2011).

Therefore, there are immediate consequences of political interference: lack of medium and long-term planning, poor performance of companies in monopoly positions, declining market share, lack of competitiveness for companies on competitive markets (e.g. *TAROM*, *CFR Calatori*), but also insolvency and lay-offs.

In addition, the respondents referred to the existence of interest groups from the **private sector**, well-connected to politicians and with vast resources. Examples were provided from each sector of the economy (the well-known „smart guys“ case in the energy sector, the transport sector - railway and air transport – employment of former Directors of national companies in the field, private interest groups in the oil industry - in particular, *Valea Jiului*, etc.). Two specific sectors were mentioned by respondents, at the crossroads between private and political influence: the energy sector and transport sector, which often the Government fail to regulate and monitor properly. This is also reflected by the numerous cases investigated by the Anti-Corruption Directorate in Romania.

BULGARIA

The situation in Bulgaria is somewhat similar. The expert survey conducted by Risk Monitor in Bulgaria⁴² indicates four main categories of risks: political, financial, managerial, lack of regulation and other.

Firstly, and most importantly, as indicated by more than two thirds of the Bulgarian respondents (71%) there are political risks: political appointments (especially top-level), direct interference of politics in the activity of SOEs and draining their resources for political purposes.

Another key risk indicated by the experts (66% of the respondents) points to the managerial challenges faced by SOEs. This is also directly linked to political interference, as most experts indicated appointments of „*friends*“ of the political party, interdependency between their management and political changes, incompetency, corruption and conflict of interests.

Similarly, Bulgarian SOEs have no clear development policies, weak control mechanisms and lack of transparency.

A third risk refers to financial aspects (indicated by 52% of the respondents), mainly „draining“ profitable companies of resources and using SOEs as „post-electoral rewards“ for party voters/ supports. Lastly, there is missing regulation (indicated by 20% of the respondents) as there are no clear strategies concerning SOEs, there is a

42. Georgy Ganev, Petia Kabakchieva, Stefan Popov, Rada Smedovska-Toneva, *State-owned Enterprises: Preventing Corruption and State Capture The case of Bulgaria, National Report Bulgaria*, November 2017, p 8

lack of normative regulations or, where regulation is available, it is not properly enforced.

Bulgaria is also facing high influence from private interests, whether it is influencing public policies, allocation of public funds or “dedicated” public procurement bids.

THE CZECH REPUBLIC

In the case of the Czech Republic, the Candole Partners research⁴³ revealed “political risks”. Whether it is political appointments, nepotism, instability generated by political changes or draining of resources, politics plays an important role in managing SOEs in the Czech Republic. Most often, political risks are directly linked to private interests, highly visible in the activity of some of the large Czech companies, as underlined by our interviewees.

The Czech Republic does not have a state ownership policy, there is missing regulation, non-enforced control mechanisms that lead to inability to control and monitor the management. Thus, medium and long-term development plans are often theoretical and are not applicable in practice.

ITALY

Political actors, either at **national or local level**, are considered to have an influence over most SOEs in Italy, with a special emphasis on local influence, due to the high number of companies managed by local public authorities. It involves management nominations, discretionary allocations of funds or rigged public procurements.

According to the qualitative research conducted by Amapola Progetti⁴⁴, three typologies of risks affect the framework of state-owned enterprises. Firstly, there is a poor regulatory framework and bureaucracy, which are hindering development prospects for SOEs and, then, there is an inability to make medium and long-term forecasts for SOEs. In terms of bureaucracy, duplication of public and private reference standards is causing confusion within SOEs management with regard to observance of the legislation.

Like in Romania, Bulgaria and the Czech Republic, there is “too much interaction with politics”, there is direct influence of politics on top level appointments and SOE management, and also **private interests of third parties** (private companies, private individuals), which often overlap with the interests of political actors.

CHAPTER VI -

43. Jan Ondrich, Jana Sebestova, *State-owned enterprises: Preventing Corruption and State Capture. The case of the Czech Republic*, National Report - Czech Republic, November 2017

44. Valeria Ferraris, Giovanna Spolti, Pier Paolo Maza, *State-owned Enterprises: Preventing Corruption and State Capture The case of Italy*, National Report - Italy, November 2017

Recommendations

The assessment of the quality of the public policy response with regard to addressing phenomena such as corruption, clientelism and state capture within SOEs revealed the extent to which the effects, the level of implementation and enforcement monitoring differ from policy to policy. Cross-country comparative assessments and field research has made it possible to extract some recommendations valid for all four member states in our report. They are supplemented by a few good practice examples from these countries.

In addition, national recommendations also take into account the tools, mechanism and reporting frameworks at European level, with the possibility of having them redesigned and updated so as to include, to a greater extent, elements related to SOEs, in each member state.

Country-specific recommendation

Report standardisation and concrete sanctions for non-compliance: national reports and cross-country comparisons carried out as part of this document revealed that, in the absence of correctly collected and relevant data and of standardised reports, it is impossible to properly address some needs and vulnerabilities related to SOEs. Moreover, it remains difficult to address accountability-related issues at management level or at the level of the Ownership entities.

Report standardisation would also play a role in establishing efficient intern procedure (within SOEs, Ownership entities, or at sector level), aiding the institutional memory for these entities, which, once exposed to clientelism, also suffer from a deficit of stable human resources.

Improving transparency in the use of public money and resources, including with respect to management decisions. Even though they collect and publish data, they do so due to minimum formal compliance requirements. SOEs and Ownership entities must understand why it is imperative to have effective, and not just formal transparency, observing responsibility in the use of public resources, towards all shareholder and all taxpayers. One of the main obstacles in our research for this report was related to the availability and accessibility of public data.

Even when additional clarifications were requested and there was availability on behalf of the representatives (for instance: basic data regarding the top management of SOEs, length of operation, payroll and bonuses, main suppliers, enforcement of integrity policies concerning suppliers, adjusting procurement plans, achievement of the management plan)

Public policies specifically targeted at SOEs – the legal framework regulating prevention public policies or cross-sectorial strategies should target SOEs more

specifically, as well as risk areas and vulnerable sectors. Monitoring the implementation of certain measures meant for SOEs could be used further to carry out risk analysis, better focused *ex ante* and *ex post* controls and functional prevention mechanisms.

For instance, in response to criticism and recommendations in reports of the European Commission and the IMF analysis and World Bank reports, Romania's Anti-Corruption Strategy (2015-2020) tackles corporate governance and corruption prevention in SOEs specifically, providing clear reporting references, standardised modules and an implementation monitoring programme.

For example, the introduction of corporate governance legislation for SOEs in Romania was aimed at improving transparency and it highlighted the costs to society of supporting mismanaged companies from a financial perspective. Similarly, in Portugal, appointing BoAs for SOEs came under the scrutiny of an independent committee, to ensure increased transparency, impartiality, accuracy and independence in the recruitment process. In other Member States SOE reforms were introduced in the context of the European Semester. Croatia, for instance, has recently adopted a new framework for the selection of supervisory boards, with a parallel reform of management board nominations expected to follow in the second half of 2015.

Increasing awareness and knowledge about the role and importance of corporate governance in SOEs for national economies – the extent of the expertise and the involvement of other actors, as well as supporting independent monitoring regarding SOEs, including at local level, by involving more social partners and stakeholders.

Integrity partnerships between certain companies and civil society or some sectors with increased exposure to clientelism and state capture (energy, infrastructure, local utilities) or encouraging tools, such as the Transparency Index, report monitoring and publication of reporting results, carried out in partnership with the academia, would result in:

- 1) an increase in the level of understanding of SOEs and the sector in which they operate, by a larger number of relevant social partners
- 2) facilitating the transparency of certain processes and correct information of social partners and the state by the companies.

At EU level

EU pressure is required, through more policy coordination and EU common policies tools, in addition to pushing for more reforms within SOEs. These tools are in place in various reform packages of the EU, but they have to be put into practice in a coordinated manner. For instance, the European semester can address the issue of SOEs in a structured and consistent manner, with reporting requests to member states and periodical assessments, with recommendations. With regard to the data and the results of this pilot research, the EU can impose several reforms to address the issue of state-owned companies. There are three ways to achieve this:

- 1) Consolidating policy coordination and reporting within the existing mechanisms – European semester, convergence programme, public procurement assessments, MCV report - where applicable. Some lines of actions could refer to:

- Introducing assessments aimed at SOEs in the economic governance coordination mechanism - convergence programmes
 - Harmonised statistics that helps compare SOEs status and performance and standardise the indicators within Eurostat reporting
 - Publicly available regular national reports and standardized balance sheets of SOEs (also with standardized indicators)
 - Transparency: Enhance the methodology of measuring corruption and state capture in the SOEs (formal vs real transparency)
- 2) Designing a general framework, with guidelines and reporting regulations, to take the next step towards Corporate Governance Framework for SOEs at EU level - White paper for the performance of SOEs in the EU, with a prospect of a EU policy instrument to be prepared. The following could be included in a good governance framework for SOEs at EU level:
- Clear definition in statutory documents of the two roles of SOEs
 - **Separation between ownership and other state functions:** reforms may also ensure a clearer distinction between the ownership, policy-making and regulatory roles of the state, especially as regards sectoral policies and regulation. Clarifying the role of the Ministry of Finance vis-à-vis the sector ministries.
 - General indicators to evaluate financial performance and evaluate and remunerate the social services provided by the SOEs separately. Commercial and non-commercial objectives must be clearly defined, they must be undertaken in a very transparent manner and they must be made available for the public
 - Efficient remuneration systems performance based
 - Improve state aid rules for SOEs at EU level
 - Regular surveys among customers
 - Straightforward systems for control increasing the role of Audit Chambers
 - Involvement of non-political experts (academic, private sector) in the monitoring and assessment systems
- 3) Design and promotion of a compulsory reporting framework, through EU regulation/ directive on corporate governance of SOEs. This would be the most ambitious plan, but it depends on the progresses made in terms of a more profound integration of the single market. The first tests could begin with raising conditions for some reforms in the field of SOEs, in areas which are subject to assistance or investment programmes or structural funds. In addition, a first definition of a corporate framework for SOEs at EU level could bring more clarity both for member states, as well as for the European Commission.

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National reports, comparative reports and the clientelism barometer are available at www.statecapture.ro.

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