

2. RISKS FOR THE GOOD GOVERNANCE OF NGOs

2.1. FROM TROUBLEMAKERS TO KINGMAKERS

The evolution of Bulgarian NGOs from gadflies on the margins of the turbulent scene of the early transition years to holders of advanced expertise and authoritative suppliers of policy advice has been part of a broader international process of transformation of the role and potential of non-profits. Non-governmental organizations no longer confine their remit to dispensing charity and condemning government and no longer rely entirely on grants to fund their existence. They used to be good at pointing out what was wrong; they are increasingly better at developing solutions.

From the outset, NGOs in Bulgaria sought to embody the idea of **social entrepreneurship** which served to balance out market and government failures; they are now gradually developing new markets for services.²³ NGOs – and not only in Bulgaria – increasingly emphasize market mechanisms not as something which is deficient and should be corrected by them, but as a **means for facilitating social change**.²⁴ While 20th century NGOs have largely been outsiders (to power, the corporate world, or social elites) focused on the detection of problems and exercising pressure to address them, an increasing number of NGOs in the 21st century are becoming part of the elite and are integrated into the system (the corporate as well as political) through a constantly improving expertise of various public policies.

When the sector was emerging, most NGOs sought to enlarge the range of their donors as quickly as possible. This, in turn, entailed changes to the organizational goals and tended to shift the focus from the organization's original mission to achieving the objectives set by the donors. Today, as they strive for stability, social entrepreneurs are much more confident in pursuing their own agenda, not least because they have started to expand their sources of financing by branching out into commercial services.

The most important asset of a non-profit organization being its reputation has long been among the tenets of received wisdom in the sector. For some time now, however, NGOs have been trying to establish themselves as **mediators**, even brokers thus making their reputation seem tradable. Corporations used to fund non-profit work as means of brushing up their social image; now these interactions increasingly look like strategic partnerships. Fewer NGOs are engaged in anti-business campaigns, more are **providing advice and consultancy**, some even

²³ In Bulgaria, NGOs and social entrepreneurs were among the pioneers of private radio stations, internet providers, sociological agencies, and other businesses.

²⁴ *21 Century NGO in the Market for Change*, SustainAbility, 2003.

effectively underwrite corporate reputations. More ambitiously, many think tanks endeavor to have a say in the changing institutional structure of capitalism.

In a nutshell, over the years Bulgarian NGOs have advanced their expertise, built up their profile and broadened the range of their objectives. It is not uncommon now for think tanks to draft laws, for environmentalists to effectively challenge developers or for watchdogs to cause the introduction of new transparency regulations in state bureaucracies. In this context, for NGOs to seek to rewrite the rules of engagement with business and government would only seem natural.

Worldwide, partnerships of non-profits with businesses and government have been discussed and implemented for a while. International experience shows that a truly successful institutional partnership needs a number of conditions to be present: reciprocal accountability, equitable distribution of costs and benefits, performance measurement, trust, demarcation of responsibilities, financial transparency, and, ideally, a mechanism for making joint decisions. It would be enlightening to examine how the collaboration of Bulgarian NGOs with business and government measures up against this standard.

2.2. THE POTENTIAL AND PITFALLS OF PUBLIC-PRIVATE PARTNERSHIPS

The issue of the interaction between the three sectors in Bulgaria, and particularly the relationship between governmental and non-governmental organizations, has been of crucial importance ever since the beginning of the democratic changes. Despite the early notions that government and NGOs should view each other with suspicion, if not hostility, a more conciliatory *modus vivendi* was bound to emerge, even if only because the non-profit nature of the third sector makes it dependent on the other two. It is a *modus*, however, not easy to achieve, especially as the electoral and business cycles (vicissitudes, more like it, in a country in transition) tend to disrupt long term relationships.

Increasing rapprochement with state and business required NGOs to start thinking about finding a way to collaborate without risking to get bogged down in partisanship or slide into all-out commerce. From the perspective of NGOs, this aspect of their public activity created the need for a constructive balance between two functions – of a partner and of an opposition to government.²⁵ Finding this balance was indispensable because “...the absolute predominance of one of these functions would have a negative effect on both the civil society and the government. If civil society organizations only act as an opposition or a challenger, they would miss the opportunity to exercise influence over the policy and decision-making, thus reducing the chances of effectively representing and defending the interest of citizens that established them.”²⁶ Conversely, getting too close also creates risks: “A partnership at any cost involves the risk of participating in unacceptable or wrong decisions, de-

²⁵ See: *National Assembly – a Guarantee of a Responsible State*. Proceedings of a public hearing, October 15, 2008, p. 8.

²⁶ Statement made by Dr. Maria Yordanova, Director of the Law Program, Center for the Study of Democracy, at National Assembly – a Guarantee of a Responsible State, p. 8.

prising civil structures of the opportunity to correct such decisions and, in extreme cases, there is a risk of political endorsement."²⁷

Politicians could be expected to have an interest in associating themselves with NGOs promoting public objectives which are not necessarily on the agenda of the political parties. For example, think tank expertise could very well be used for a consensus around certain policies; for think tanks, in turn, being able to influence policy is their *raison d'être*. A certain residual patronizing streak, left over from communist times, is still discernible, however, in the attitudes of the political establishment towards NGOs.

The vulnerability of NGOs to political encroachments decreases with the increase of their professionalism. The Center for the Study of Democracy is the organization with the longest experience in the process of institutional interaction between the third and the other two sectors. For the past two decades, CSD has made a good use of the instruments for establishing public-private partnerships without having to compromise its non-partisanship. Cooperation has been carried out through programs and projects which involve experts from state institutions; memoranda of understanding have been signed with a number of central government ministries, particularly on projects financed by the European Commission. As such cooperation was not influenced by the change of government, it became a kind of knowledge cache allowing continuity in policy making. Most projects were intended to introduce European standards, and by financing them the European Commission effectively supported reforms in Bulgaria and helped the capacity of NGOs to establish partnerships. It is, therefore, much more effective – from the point of view of sustaining reforms and strengthening the NGO sector – **to finance think tank-government partnership projects** rather than get government agencies to administer NGO funding which still contains **considerable discretion** (e.g., projects under Operational Program Administrative Capacity-OPAC).

Public-private partnerships between Bulgarian non-governmental organizations and state institutions, as well as partnerships with business organizations, were originally facilitated by the process of Bulgaria's accession to the EU, as well as by exchange of experience and bilateral assistance from the US and European countries. The emergence of expert communities and the building of bridges between them and the institutions of policy making have been among the long-term results of the successful implementation of this mechanism. The Center for the Study of Democracy and other think tanks have even on occasions had to play the role of mediators among government institutions themselves as they often work in isolation.

There are still those in central and local government who view partnerships with NGOs with skepticism at best. This is particularly so with respect to human rights and watchdog organizations. A pertinent example would be the anti-corruption initiative *Coalition 2000* in which the Center for the Study of Democracy entered into partnerships with a network of local NGOs at the end of the 1990s and tried to involve local officials as well. Although no formal objections were raised, municipal authorities effectively boycotted cooperation. This was done through a

²⁷ Ibid.

range of methods, from rejecting civic monitoring as unlawful to playing down corruption threats to various administrative tricks that blocked cooperation. Pressure was exercised by local officials over journalists from the regional and local media participating in the anticorruption initiatives in their capacity of partners to the respective NGOs.

Typically, non-governmental organizations maintain relationships with the central and local authorities that are directly relevant to the organization's specific objectives. The ones most frequently mentioned in surveys are the Ministry of Labor and Social Policy, the Ministry of Education and Science, the State Agency for Child Protection, and local social assistance offices.

Due to budget shortages, municipalities often contribute to the work of NGOs by providing property for their activities or supporting fundraising initiatives. In some cases, municipalities get involved in finding solutions to specific problems, but rarely offer financial or material assistance to NGOs. The state and local authorities are often used as a source of information, and joint activities could include surveys. Most often, municipalities merely serve to administer funds from elsewhere and rarely contribute their own finances to NGOs.

In short, the collaboration between NGOs and representatives of local or central authorities is **not based upon any specific long-term strategy**. Instances of such collaboration are **rather sporadic**, depend on the existence of a specific need, and are based mainly on the personal expertise and contacts of the people involved. Usually, it is the NGOs that initiate public-private partnerships. They actively advocate for a sustained involvement of civil society organizations in public policy making at the central level (e.g. in designing and implementing democratic reforms and policies for European integration), as well as at the local level (in providing various social services).

A culture of public-private partnerships is strongly supported by Bulgaria's foreign partners in Europe and the US. Yet, the lack of genuine interest among state institutions in collaborating with civil society and the absence of reliable national donors create incentives for NGOs to focus on foreign sources of assistance (the European Union and member countries, the US, the UK, Norway, the Netherlands, etc.), and conversely disincentives for the third sector to search for local partners, thus further alienating the state and the civil society.

2.3. RISKS OF NGO CAPTURE

The strengthening of the non-profit sector may not have resulted in an explosion of public-private partnerships but that has not made it immune to unhealthy attention from politicians.

In the years of transition, **state capture** was not simply the most dangerous dimension of corruption but also a practice that very much shaped the structure of national governance, (de)formed the emerging private sector and created the class of entrepreneur-politicians. It has been mainly through the absorption of the

pre-accession and structural funds of the EU that the NGO clientele of national and local politicians emerged. Thus, the EU approach of having national authorities administer European funding for NGOs was “domesticated” to fit attempts at partisan domination of the non-profit sector. This has become yet another reincarnation of the mechanism of subversion of public governance by private interests.

The shortcomings of the legal and regulatory framework, discussed in the previous sections, make it easier for the authorities to misuse NGOs. The lack of mandatory procedures for transparency in the sector, ineffective financial control from the state (which should not entail interference in the work of NGOs), the low level of self-regulation, the cumbersome procedure for registration and re-registration of NGOs, all contribute to the vulnerability of NGOs and allow illegitimate interests to operate in a niche of very low transparency and accountability.

NGO capture is particularly evident at the local level where municipal officials take advantage of the inadequate regulatory framework and lowered control to the detriment of the third sector. An example of such inadequacy is the provision allowing mayors and their deputies to sit on the managing boards of non-profits. There is no regulation – respectively, no public registry or auditing – concerning the participation of municipalities in civic associations and non-profit organizations which would help to prevent conflicts of interests in the context of public-private partnerships. Thus, a partnership could take place without any transparency or accountability which is a prerequisite not only for involvement in corrupt practices, but also for undermining the very nature of non-profits by risking to turn them into a cover up for white collar crime.

An indirect evidence of NGO capture is the otherwise inexplicable boom in NGOs registrations during the past few years. The number of non-profit legal entities in Bulgaria **increased eight-fold** between 2000 and 2010, reaching a total of about 8,500 (*chitalishte* not included). From 2008 to mid 2010, the increase was 40 percent which is equal to the number of active NGOs in 2002. In normal circumstances, such a growth would be considered an indication for innovative social entrepreneurship and strengthened civil society. In Bulgaria, however, the reasons should be sought elsewhere. During the first half of the transition period (1990-2000), NGOs were seen as an **instrument for modernization and democratization** of social and political life in the country. During the last 10 years, this has been reversed into a gradual **undermining of the civic nature** of NGOs.

As elected officials and civil servants were prevented from holding shares or sitting on the managing boards of business, they switched to NGOs as **optional means of benefiting their political and personal clientele and a safe heaven after public office**. For example, 76 percent of the members of the 2005-2009 parliament, and the same share of ministers and chairpersons of state and executive agencies under the coalition government of the time, as well as over 90 percent of municipality mayors in Bulgaria were members of managing boards of NGOs at the end of 2008.²⁸

²⁸ The information was obtained during the period from July through December 2008 through the information service Ciela.

A number of other influential government officials and members of political cabinets established new or joined existing NGOs. As a rule, such organizations – sometimes referred to as **PONGOs** (politically owned, or politician's NGOs) – have no websites, provide scarce information and do not advertise their relationship with the authorities. Unlike traditional party foundations or associations, which do not conceal their political affiliation, are comparatively open in their assistance to the respective party (providing mainly analytical services and securing additional income for party elites), and receive their main financing from sources other than the state, **PONGOs utilize their political and administrative capital without disclosing any conflict of interests**. While in office, their patrons secure funding, establish a background for the NGO and promote its image, thus ensuring that they have a fallback option should they leave public service.

A case in point is the National Institute of Public Procurement. Until recently, its managing board included most of the key figures in government institutions related to public procurement. This type of PONGO received state financing (through the NGO subsidy program of the Ministry of Justice or through various ministries and agencies mostly within OPAC) and often exercised influence over policy. In general, such organizations do almost no project work but serve as a façade for their members to sit on various public consultation bodies, thus effectively blocking truly active and independent NGOs from participation.

PONGOs are often registered at the address of the official institution where its boss is employed. After getting its first funding the PONGO would move to another address and even operate independently of the respective public institution in the case of change of government. Often, public officials work for the PONGO in their office hours – get trained, write project proposals (possibly even implement them) – before moving full time to the PONGO where they would receive a higher salary. This is the model of a typical PONGO financed through European funds allocated by the state (starting with PHARE, and later OPAC).

Although in 2009 the *Prevention and Disclosure of Conflict of Interests Act* outlawed the participation of elected officials and public employees in the managing boards of non-profit legal entities and required them to declare possible conflict of interests as regards their participation in NGOs, **the PONGO problem was only partially resolved**. There are two major reasons for that: the restriction did not affect local government officials and those who were forced to leave the managing boards were replaced by close associates. Although not instructed by the law, some mayors left their NGOs but installed close friends or subordinates (e.g., drivers).

Experts estimate PONGOs in Bulgaria to be between 9 and 13 percent of all NGOs. Taking into account that about 21-25 percent of the total number of NGOs are sports clubs and about 15 percent are business and professional associations, associations of municipalities or trade unions, it turns out that PONGOs constitute a significant part of the remaining non-profit organizations (between 14 and 22 percent). Although they are still **few in absolute numbers**, the fact that during the past several years these organizations **have received the bulk of state support and represent more than half of the turnover** in the sector is a serious hazard to civil society independence.

These developments constitute the **first significant change** in the nature of non-profit organizations, as compared to the period between 1990 and 2000. Nowadays NGOs are either much more dependent on central and local authorities for funding or are under direct control through the participation of public officials in their management. Non-profit organizations controlled by politicians and senior public officials are used only as **instruments for the absorption of funds**. Using various mechanisms, politicians created a **sizeable loop of NGOs owned by them**, with no international experience or expertise, yet receiving generous funding in a blatant conflict of interests.

The portion of the government budget allocated for funding NGO work still lacks priorities and goals.²⁹ The selection process is not transparent and there are no criteria for evaluating the outcomes of projects. Instead, this instrument is continuously misused by politicians and senior civil servants making the NGO capture a reality in Bulgaria.

In 2008, NGO financing controlled by the government (national budget or from the European Union) was approximately 40 percent of the total project funding for 2006. In contrast, at the end of the 1990s, most of the NGO funding came directly from foreign sources and was considerable – approximately 10 percent of FDI. Currently, external project financing of the sector (not administered by the Bulgarian government) is dominated by the EU Framework Programs and the Competitiveness and Innovation Program. The types of projects they fund, however, are relevant mostly for medium and large non-profit organizations and think tanks, leaving less than a hundred NGOs eligible to receive this type of financing. As a result, only a narrow circle of organizations can afford to remain independent from the discretion of government authorities.

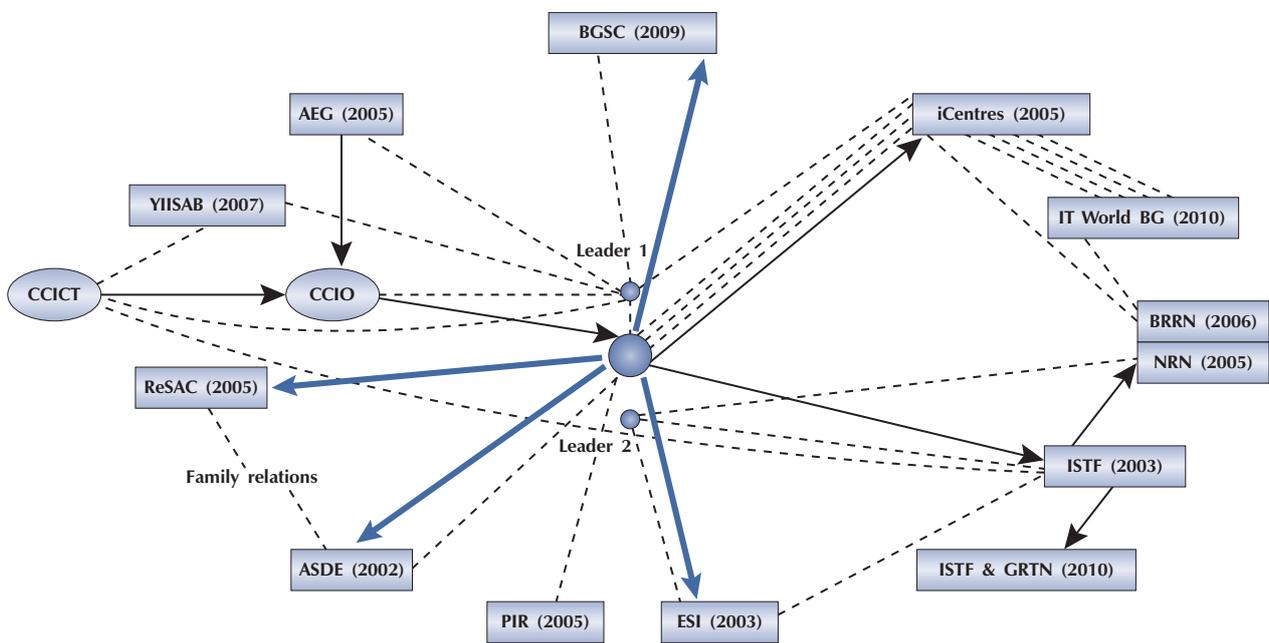
Today *non-profit*, rather than *non-governmental*, is the term of choice thus shifting attention away from their civic characteristics towards the fact that they do not generate or distribute profit. In the international experience, such organizations are known as **government-owned non-governmental organizations** (GONGOs). A pertinent example of these was the operation of the State Agency for Information Technologies and Communications in the period 2005-2009 (SAITC; succeeded by the current Ministry of Transport, Informational Technologies and Communications). The Agency was overgrown with GONGOs/PONGOs financed directly or indirectly by it and was advocating that the state must start establishing non-profit organizations as a means for the absorption of structural funds.

A problem for the analysis of PONGOs and GONGOs is that it is often difficult to distinguish between them. Even when the founding members are public entities, they appoint a managing board of individuals in their personal capacity. Moreover, the *State Property Act* does not require the maintenance of registries of the state participation in non-profit organizations and thus many municipalities do not have such registries (although they are required to do so by the *Municipal Property Act*). In such circumstances, it is very likely that newly elected local officials would not be able to figure out quickly what the non-profit interests of their institution are.

²⁹ In 2010, for example, sports projects were funded with priority. These should, however, be financed by the Ministry of Physical Education and Sports rather than the Ministry of Justice.

The NGO Registry does not allow public access to the constituent documents, thus making it difficult to discern whether an organization is a PONGO or a GONGO. This can only happen through a voluntary public disclosure of information or by closely monitoring changes to the managing boards. Approximately 25 GONGOs are known to the public; they have been active during various periods and appropriated considerable funds without any transparency and accountability.

Figure 3. Network of non-profit organizations around SAITC



Connections: - - - - - Connected by a person, who participates in two organizations
 —————> Institutional participation
 —————> Funding

- BGSC – Bulgarian Supercomputing Application Centre
- BRRN – National Research and Education Network of Bulgaria
- NRN – National Research Network
- ISTF – Information Society Technologies Foundation
- GRTN – Greek Research and Technology Network
- ESI – European Software Institute
- PIR – Public Internet Registry
- ASDE – Agency for Sustainable Development and Eurointegration
- ReSAC – Remote Sensing Application Center
- CCICT – Coordination Centre on Information, Communication and Management Technologies
- CCIO – Coordination Council on Information Society, chaired by the Chairman of SAITC
- AEG – Adaptation to Electronic Governance
- YIISAB – Youth Innovation and Information Society AB

Source: Center for the Study of Democracy

Box 3. A GONGO case study

Another example of a GONGO is the iCentres Association. Two weeks after the elections for the 2005 parliament, the Agency for Development of Information and Communication Technologies (the predecessor of SAITC) and Bulgarian Posts became founding members of iCentres. Both organizations have the Ministry of Transport and Communications as their principal. Approximately €5 million were spent for the iCentres project without public procurement, using UNDP as cover even after Bulgaria joined the EU and UNDP no longer operated in the country. An indication of the poor management of iCentres is the fact that it made its registration in the NGO Registry only in October 2007 – more than two years after its establishment and only after the Applied Research and Communications Fund, one of the leading NGOs in the field, made the omission public. Five years later, the result is an insolvent association with a debt of over quarter of a million euro. The last GONGO or PONGO, inaugurated by SAITC, was the National Super-Computer Center. A member of its managing board and executive director was the advisor to the SAITC chairperson who was also a secretary of the government Coordination Council on Information Society. The same person was involved in four other non-profit associations (two GONGOs and PONGOs), while holding an office at the Council of Ministers and receiving a salary financed by public funds through UNDP (the iCentres and several other projects).

There is now a **clear risk** of a new influential group of predominantly PONGOs, with some GONGO elements, dominating a particular NGO field of work. These are the so-called Local Initiative Groups (LIG) the formation of which was required by the EU LEADER initiative for the development of rural areas.³⁰ These are public-private partnerships which need to have as members at least two municipalities (having less than 50 percent of the membership), local businesses, and (other) non-profit organizations. The funds allocated for activities resulting from LIG decisions are €77 million.

Local authorities usually have a strong influence over the structures and membership of the now 80-100 LIGs registered. Aside from direct municipal participation, they involve friendly businesses and non-governmental organizations (which are sometimes the classical type of PONGO or GONGO). In this way mayors secure their total control over the membership of the managing board and its decisions.

Governance risks associated with the quasi-NGOs arise from two main factors:

- The lack of clear regulation by the Ministry of Agriculture and Foods over the procedures concerning the establishment of these NGOs and the lack of mechanisms to monitor compliance.
- The *Prevention and Disclosure of Conflicts of Interest Act* does not apply to the operation of LIGs.

The governance risks in GONGOs are increasingly acknowledged internationally. In a recent decision³¹ by the UK government 192 GONGOs will be scrapped and 289 others will be merged or substantially reformed in the long-awaited “bonfire of quasi NGOs”.

³⁰ For more details about the initiative and the accompanying difficulties and risks see: Koleva, Y. and A. Dimitrov. *Dalgiyat pat na evropeiskite pari kam balgarskoto selo*. Dnevnik Online, 14.07.2010.

³¹ Gordon, Gavin. *192 GONGOs to be scrapped*, The Independent, October 14, 2010.

The trends described above mark the main risks related to the **capture of NGOs by government authorities**. Somewhat paradoxically, these have been taking place through the funding instruments of the European Commission. It is worth remembering, however, that **the Commission did not pay timely and adequate attention to the early signals of corrupt practices** in the state appropriation of funds designated for civil society. Clientelism and corruption in the third sector were disclosed to the public in 2005 when the Bulgarian Chapter of Transparency International accused officers at the Delegation of the European Commission in Bulgaria and the Ministry of Finance of manipulating the evaluation of proposals to the Phare Democracy program; suspicions of corruption have not yet been disproved.³² Later, other Bulgarian NGOs alerted national and European institutions on other cases within then existing EU funding instruments and mechanisms with significant corruption risks.

Box 4. Corruption risks within the EU funding instruments and mechanisms

Being the guardian of the EU Treaties and the key institution in the enforcement of the standards of the Union requires a high degree of transparency and accountability by the European Commission. By implication, this applies to its Delegations and Representations in member and candidate countries, in particular in instances where these are instrumental in monitoring the compliance with EU's good governance standards. To this end, it is important that the image of these institutions is impeccable.

Still, there is a concern among Bulgarian civil society that the EC Delegation/Representation in Sofia might have failed in a number of occasions to achieve the standards of transparency it advises Bulgarian institutions should live up to.

Unresolved corruption allegations. In 2005, the Chairman of Transparency International – Bulgaria accused the officer in charge of civil society at the EU Delegation, of corruption and clientelism in relation to the management of the Phare Civil Society Program. Documents disclosed by the media showed how expert evaluations of project proposals had been manipulated to ensure the awarding of the contract to the “right” candidate. This case provided strong evidence that the grants to the civil society organizations in Bulgaria might have not been allocated through a competitive bidding but seemed rather a result of a compromise between decision-makers in the EU Delegation and in the Bulgarian Ministry of Finance, each of them defending their own clientele.

As a result of the public scandal ACCESS Foundation, a leading Bulgarian anti-corruption outfit, surveyed 250 Bulgarian civil society organizations who had been awarded Phare grants. One third of the respondents admitted that the selection procedures under the Phare Civil Society Program “lacked any transparency”. Despite these allegations, no action to clean the image of the Delegation had been taken thus far.

³² The only reaction of the European Commission to the issue was contained in the regular monitoring reports and the letter of Ms. Catherine Day concerning a draft for the amendment of the conflict of interests law.

Box 4. Corruption risks within the EU funding instruments and mechanisms (Continuation)

Lack of adequate oversight mechanisms. A serious deficiency – favorable for corruption – of many programs funded by the EU in Bulgaria was the lack of adequate oversight. On the one hand, according to the applicable EU rules and procedures if the contracting authority was a national institution any appeal for errors or irregularities was subject to the beneficiary country's national legislation. On the other hand, the relevant Bulgarian legislation and related case law excluded any funding from international organizations, including the EU, from any domestic supervision, including judicial control.

Conflict of interest risks. In the second half of 2006, the European Commission's Directorate-General for Enlargement carried out an Extended Decentralised Implementation System audit of the of procedures and structures related to the implementation of all the National Programs in Bulgaria. Subject to audit were the Implementing Agencies for the EU assistance programs.

Among the initial findings of the auditors was a potential conflict of interest in the appointment of the Head of the Financial Unit of the Central Finance and Contracts Unit (CFCU) at the Ministry of Finance. Apparently, a former employee of a Greek consultancy firm was appointed Head of Unit of the CFCU three weeks after leaving the firm. This happened at a time of evaluation of a tender in which the consultancy was among the bidders. Two months after this appointment, the consultancy – Planet SA – was awarded the contract.

In a letter (dated November 30, 2006, the date of award of the contract) quoted in the auditors' report³³ the Delegation of the European Commission denies the existence of any conflict of interest in this case, contrary to the findings of the Commission's auditors. Particularly worrying in this case is that even EU institutions (in this case the then Delegation of the European Commission), which the public expects to be the guardian of the integrity of the spending of EU funds in Bulgaria, failed to act.

Continued EU funding for NGOs through the mediation of the government increases the risks of corruption.³⁴ A partial solution could be found in the fact that during the next programming period (2013 – 2020) the European Commission will also work directly with authorities in the planning regions and less through central governments. Still, this will not change the ways of financing NGOs. Direct funding for NGOs from Brussels is very limited and does not distinguish between GONGO/PONGO and truly non-governmental organizations. Furthermore, the bilateral donors of the 1990s and early 2000s, both American and European, did not allow remuneration to be received by public officials from the projects they funded; such restrictions no longer apply.

Source: *Anti-Corruption Reforms in Bulgaria: Key Results and Risks*, 2007, Center for the Study of Democracy

³³ *Final Audit Report on the Request by the Republic of Bulgaria for the Conferral of Management of Aid Under Extended Decentralisation*, Brussels, 19 January 2007, p. 50.

³⁴ *Anti-Corruption Reforms in Bulgaria: Key Results and Risks*, Center for the Study of Democracy, Sofia, 2007, pp. 62-63.

2.4. THE BUSINESS OF NON-PROFITS

Business is not an altogether alien concept for Bulgarian NGOs. In fact, it is decreasingly so. Understanding why and how they opt for profit would help chart their future development.

The Bulgarian NGO law allows **commercial activities by the third sector** but only if these are related to their declared main area of activity and the proceeds finance the accomplishment of the non-profit objectives. Neither the law, nor the NGO Registry regulations, however, specifies any compliance monitoring procedures. Thus, some NGOs take advantage of their legal status and use it to engage in for-profit activities competing with businesses.

Three categories of NGOs could be differentiated according to their business methods. The first group is comprised of organizations that **do not engage directly in commerce** and rely entirely on grants, membership fees, and donations. For instance, organizations which have judges on their managing boards are obliged by law to be in this category. Such NGOs could wholly own a commercial company whose profit is used exclusively for the non-commercial activities of the NGO. Other NGOs, conduct business mainly for **securing the co-financing required by donors** or report grants from business as commercial revenue. The share of the for-profit activities in the total turnover is below the average for NGOs in the country. NGOs in the third category operate almost as a typical business with commercial revenue reaching up to 100 percent of their income.

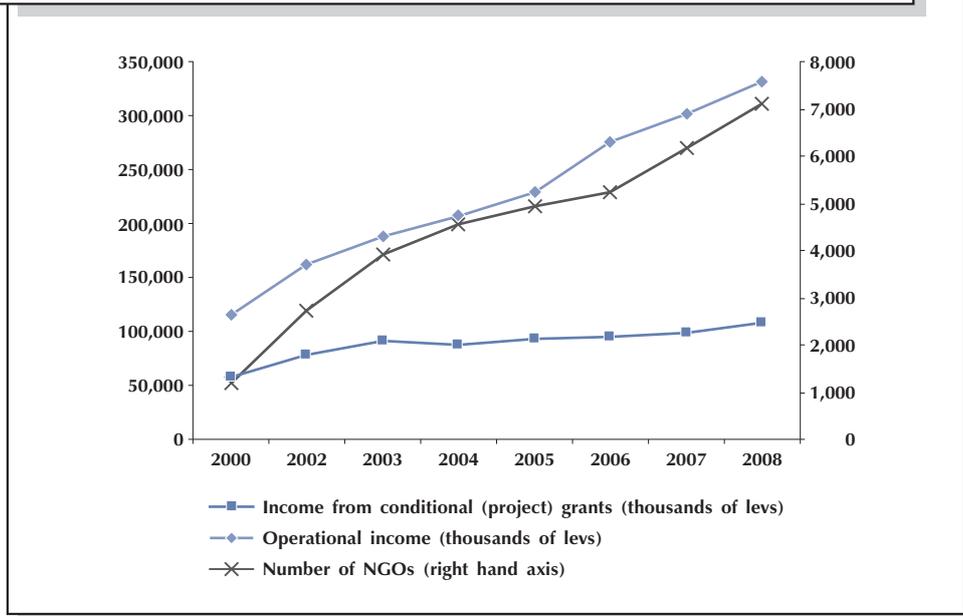
NGOs possess a considerable expertise that could be used in for-profit work. Between 2001 and 2008 the third sector (excluding *chitalishte*) had approximately 13,700 employees (in full-time equivalent employment-FTE) and 14,300 service contracts with individuals. Larger NGOs (with more than 15 – 20 full-time employees)³⁵ prefer to use this human resource for the institutional development of the non-profit operation and have their own commercial companies where experts are involved via consultancy contracts. Some mid-sized NGOs (which are usually the largest organizations outside Sofia) perform their supplementary commercial activities by maintaining separate accounting for commercial and not-for-profit activities. In the case of the smallest NGOs, their for-profit work is usually performed by board members or staff in individual capacity.

For the period 2000 – 2008, the commercial turnover of NGOs increased almost twelve times and the share of business income in their overall revenue grew from 9 percent to 36 percent. This growth was accomplished in the context of a continuous decrease of project grants from 50 percent of the total turnover in 2000 to 32 percent in 2008; total NGO **turnover increased almost three times** for the same period. For the first time in 2008, income from project grants was less than commercial revenue. Although data for 2009 will not be available any time soon, it could be assumed that this trend will remain. There would have been nothing inappropriate in greater income from business, had this been accompanied by increased accountabil-

³⁵ Raymond Struyk places a similar limit of 10 researchers, employed full time, for think tanks in their second phase of development in *Managing Think Tanks: Practical Guidance for Maturing Organizations*, The Urban Institute and LGI / OSI, Budapest, 2002.

ity of its spending, better transparency of the activities, and if the managing boards of these organizations were not dominated by senior public officials.

Figure 4. Dynamics of NGOs and their income (2000 – 2008)



Source: National Statistical Institute, 2001 – 2010

An indication of how the institutions of the state decided to deal with growing NGO business could be found in the 2008 amendments to the *Municipal Property Act*. By way of these, municipalities were allowed to **conduct business through non-profit institutions**. Though it may be suggested that the legislature sought to better regulate these activities, in fact the law did not provide for **any oversight mechanism** of the operation of commercial companies in which the municipalities would participate indirectly through NGOs (and to which they grant municipal property, usually buildings). There are a number of cases where a mayor bypasses the restrictions for sitting on commercial boards by becoming the manager of an NGO which in turn runs the business. NGOs could also be used to bypass various requirements of the *Public Procurement Act* and could even facilitate privatization of municipal property by stealth.

Another indicator of the changed place of non-profit organizations is their profit margin. In 2008, it was 35% – well above the average for the economy. A possible explanation would be that some of the costs of the organization are charged to project grants.

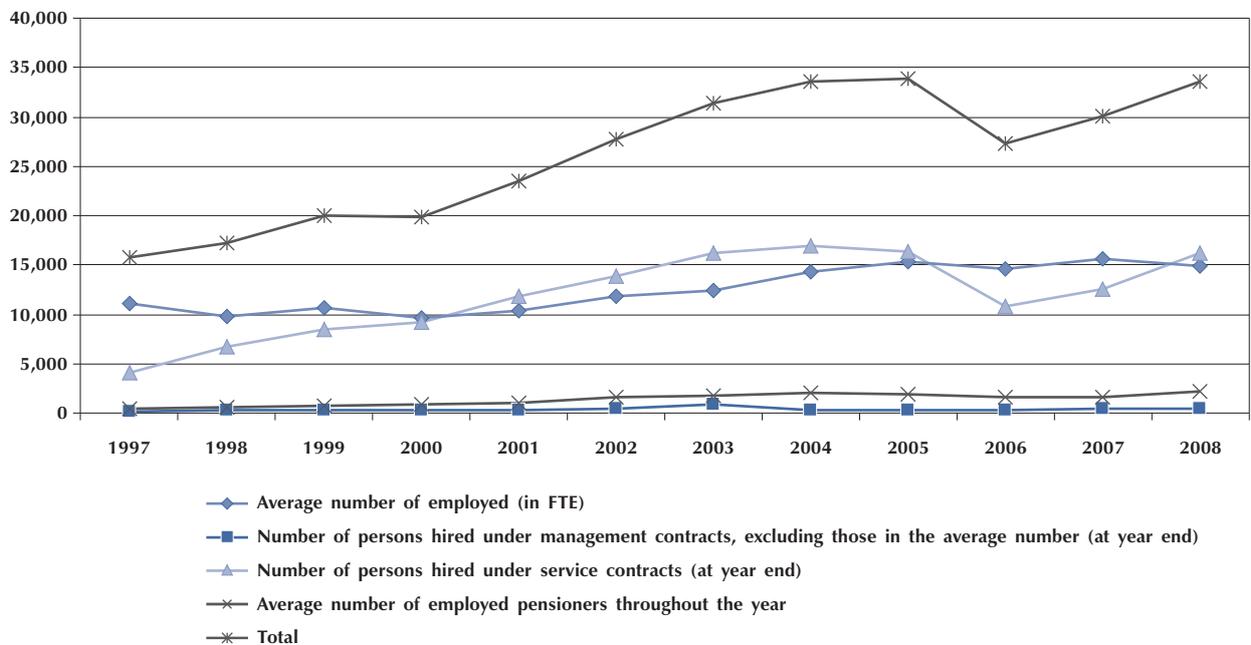
Another way of looking at this business is to compare commercial revenue to corporate donations to NGOs. In 2006, profit constituted a fifth of the unconditional grants (donations); in 2008, it amounted to 70 percent. This implies that non-profit organizations are better motivated and equipped to undertake commercial work than rely on donations. Also, as mentioned in 1.3., often corporate donations

come as advertisement contracts related to a certain event or activity of the NGO. This not only increases the share of profit in revenue but also its margin, because of the requirement for separate accounting of non-profit and commercial activities, where the former is financed by the profits from the latter.

The average turnover of a non-profit organization in Bulgaria is around €25,000 for 2007 and 2008. At the same time, only about 10% of all non-profit organizations are registered for VAT purposes (threshold for compulsory registration is 50,000 levs – a little over €25,000). There were 787 registrations as of August 2009 and 836 as of June 2010.³⁶ These numbers include non-profit organizations with turnover for the period below the threshold which still had to register or organizations for which the restrictive period after cancelled registration had not expired. Organizations with a turnover exceeding the threshold but no for-profit activities are not included. These statistics reveal that most NGOs are very small, both in terms of turnover and employment (the average employment in NGOs in Bulgaria is 2-3 full-time employees and additional 2-3 hired through ad hoc contracts).

Another effect of these developments is an increase of what is in effect a market concentration in the sector proceeding along two lines. On the one hand, it is related to **the size of the turnover**. If in 2000, an annual turnover of half a million

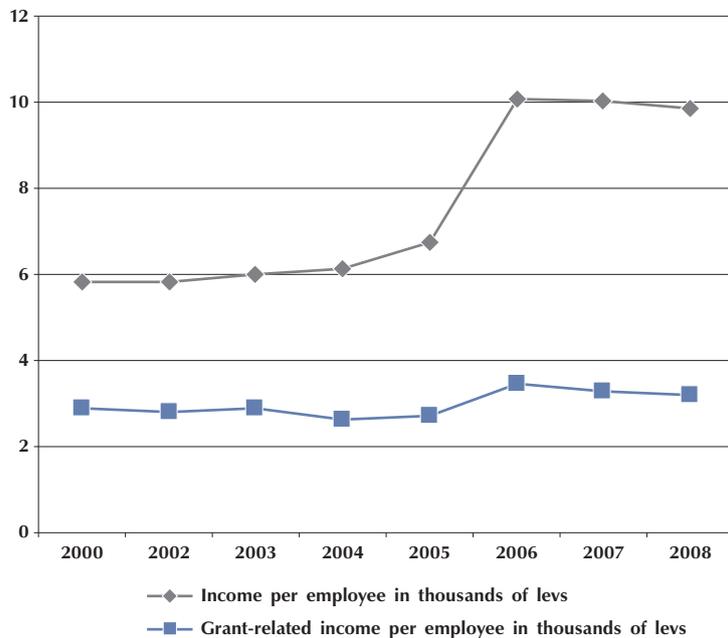
Figure 5. Employment in the third sector



Source: National Statistical Institute

³⁶ Based on the National Revenue Agency bulletin about VAT registrations and additional calculations by the authors.

Figure 6. Output of the third sector



Source: National Statistical Institute

euro rendered a certain non-profit organization a leader in the sector, nowadays this could be the worth of a single project or procurement contract. Approximately 10 percent of non-profit organizations in Bulgaria account for over 70 percent of the turnover in the sector. Contracts for 3 – 5 million euro are not uncommon in both structural fund programs (and not only for targeted funding of employers’ organizations but also for standard projects) and in public procurement.

Such contracts raised reasonable doubts about their appropriateness. For example, contracts between the State Agency for Information Technologies and Communications and two non-governmental organizations concerning earthquakes and floods were awarded without a procurement procedure by being classified as R&D which is exempt from tendering by the *Public Procurement Act*.

The second concentration is related to management control over organizations and the sector in general. The number of non-profit organizations increased six fold for the period 2000 to 2008, while for the same period the average number of employees increased by only 55%; the number of those with management contracts rose by 31 percent and experts with service contracts were 76% more.

Such a discrepancy could be due to several factors. One is **increased productivity in the sector.** Total productivity (as measured by income per employee) increased by 50 percent in 2006 and remained rather stable at this level. However, productivity as related to project grants remains practically at its level of 2000. This could be explained by better efficiency of for-profit work compared to non-profit.

Another more likely and significant contributing factor is that many of the newly emerged non-profit organizations are merely **new covers** for individuals that are already part of the third sector. The practice in the business sector where a single enterprise is served by several legal entities has already spread to NGOs. Even when it comes to brand new PONGOs, the administrator-entrepreneurs do not confine themselves to just one organization but create a whole portfolio of them. NGOs established and developed at the beginning of the transition (1990-1995) are also interlinked through exchanges of membership in the general assemblies and even in managing boards.

The two types of NGO concentration reinforce each other since the biggest non-profit organizations in terms of turnover (10 percent of all) are also the ones with the highest rate of interconnectedness through the participation of the same individuals in the management of several organizations. Often experts work on projects for a number of different NGOs thus possibly inflating the employment statistics in the third sector (a total of 33,647 at the end of 2008).

Another risk related to non-profits getting involved in business is the evident reluctance of many NGOs to hire independent financial auditors (only a handful are audited by external auditors). There are no publicly accessible reports that would allow watchdogs to monitor whether a certain non-profit organization conducts business, what are the balance sheet results and review how profits are used for the achievement of the non-profit goals. Such reports could, for example, allow courts to enforce the provision banning judges from being members of the managing board of a non-profit entities conducting business.

There are other risks stemming from the penetration of serious **organized crime in civil society**, mainly at a local level. It started in the period 1990-2000 when organized crime started penetrating the non-profit sector through sport clubs and lobby organizations established to promote their business interests. A recent development is that some of these organizations present themselves as think tanks. The associated risks include allowing shadowy figures to obtain public legitimacy, turning these NGOs into a tool for money laundering or the appropriation of European funds for illegitimate use. The same risks derive from the **entry of non-profit organizations close to the Russian oligarchs** and from the non-transparent financing (e.g. under OPAC) of NGOs in municipalities of particular interest to the oligarchs.