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**STATE CAPTURE
THROUGH LARGE ENERGY
INFRASTRUCTURE PROJECTS**

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The Case of the
South Stream Pipeline Project



Policy Recommendations Report

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ATANAS GEORGIEV

JULIAN POPOV

STEFAN POPOV

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Atanas Georgiev

Julian Popov

Stefan Popov



RiskMonitor Foundation
29, Tsar Osvoboditel blvd., 1000 Sofia, Bulgaria
e-mail: riskmonitorinfo@gmail.com
www.riskmonitor.bg

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EXECUTIVE SUMMARY

This policy paper is a result of a two-year research project exploring state capture through large energy infrastructure projects, with a specific focus on the case of the South Stream pipeline project (SSPP). The paper offers a set of policy recommendations that would help in the prevention and countering of state capture through the energy sector. It identifies specific problems or flaws in the energy system that facilitate the systematic corruption in the sector and the takeover of key state government functions.

The Bulgarian energy sector is still highly centralized. A significant portion of the energy assets are still state-owned. The lack of a clear policy direction in the sector has led to large public spending for massive projects with questionable economic or public value. This deprives the sector from opportunities to react adequately to global, European and regional trends. The strategic confusion is an important precondition for corruption and capture processes, whose goal is to profit certain private interests and political entities, close to them, at the cost of adopting policies that are aligned with the public interest.

The policy recommendations in this paper focus primarily on the Bulgarian sector, especially from the perspective of state capture via the SSPP but they have a wider relevance for other countries as well. While state monopoly is a fruitful environment for state capture and corruption, is only one side of the problem. The other is that centralized and long-term policies are the opposite of what the energy sector as a whole is undergoing globally. Committing to such policies ultimately excludes the possibility of any alternative, especially given that they are by design aimed at the long term. The Bulgarian

energy sector as-is, is structured and managed in this redundant way that will only lead to its decline in the future.

The paper has tried to imagine this sector without the mainstream myths that politicians use to justify large projects, centralization and monopolies in the sector, not only from local point of view. Instead it has taken into account numerous local, regional, European and global realities in the world of energy and has tried to develop a vision of the Bulgarian energy sector as being part of the tendencies and shifts that constitute it.

The paper paints this vast picture in the effort to make policymakers and all stakeholders look at the many different aspects of current policy approaches that have led it to be inefficient at best. This includes ways to counter state capture in the context of a centralized sector but simultaneously provides a vision of the sector freeing itself from those burdens by decentralization, market liberalization, alternative energy sources, and achieving overall flexibility.

The underlying thesis of the research and the results from it are that flexibility of supply and demand is the only way to achieve energy security and efficiency.

CONCLUSIONS AND RECOMMENDATIONS

- In order to prevent state capture, there should be maximum accountability and visibility of the energy projects investment process.
- When new energy endeavors are considered, they should be tested against the general public interest.
- Independent energy experts – both national and international, should be involved in the process of analysis of large energy projects.
- Energy projects should be reviewed in a more general environment where their financial and other economic parameters are dependent on variables (such as climate and energy policies, etc.) which may have quite different values than in the official project documentation.
- Usually the investments needed are extremely large, while the project themselves take very long to build, which means they will become operational at a point in time for which no one could predict what the market would look like.
- An obvious alternative to building new infrastructure is to improve upon existing infrastructure – it is cheaper, more efficient and better in the long term, but is not appealing politically.
- The reality that there has been little to no public pressure to the government for spending money on energy projects that will never be completed is a problem in itself and an indicator for how ‘accomplished’ the captivity of the state is.

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- Long term strategic planning on national and regional level by both companies and governments will contribute to the protection against the buildings of unjustified large projects and wasting public resource.
 - In order to secure that a large energy infrastructure project fully complies with EU legislation any such projects should be properly consulted, from the stage of conception and before any binding negotiations, with all relevant officials in the European Commission.
 - The “Public Enquiry” procedure with the participation of public stakeholders is a possible solution, which may provide an official review of events or actions ordered by a government body – it is still not present in Bulgaria, but exists in many common law countries.
 - By taking energy market liberalization one step further and “liberalizing” energy investments (providing local communities with the possibility to produce their own energy), the state monopoly on the energy sector could be undone and processes of state capture will be less likely to occur through energy projects.

THE CAPTURED STATE

State capture is an extreme form of corruption. Usually this is related to the capturing of the state by a group (e.g. oligarchs) but may be also related to the notion of the almost failed state. In general, a captured state is one where the main functions of the state are distorted, especially in relation to the defense of general public interest. Thus, the captured state is not failed *per se*, but is also not performing the functions that define its existence. Rather the term is used to define a state where corruption is radicalized.

In Central and Eastern Europe, the energy sector is still heavily dependent (and in most cases – owned) by the state. This makes large energy infrastructure projects a likely victim of state capture. The process may involve many players – politicians promise low energy prices and need a state monopoly on the energy sector for this purpose; then a special group of executives are appointed to fulfill the energy projects; tenders are won by a set of predefined companies, who are close to the parties in power; and last, but not least, these projects may be related to a large external power – in the case of Bulgaria usually this is Russia.

The policy concept of state capture is a phase or level of development of the anti-corruption policy paradigm. The captured state is an extreme form of corruption. The phenomenon goes far beyond forms of corruption, including unconventional ones such as institutional or political corruption. State capture can be realized in different ways.

One possibility is dictatorial capture, which is executed by a certain group, which is the case in Russia, Chavez's Venezuela, Saudi Arabia, and as of late Turkey. Another

possibility is for the state to decentralize to the point of becoming a failed state. A third option is partial capture of institutional mechanisms of strategic importance, for example the energy sector, intelligence, judiciary and others. This scenario includes simultaneous capture of more than one sector. The possibilities are indefinite.

The captured state is a form of reaching the threshold of internal rupture and diversion of the state from its primal definitive purpose. This borderline is embedded in the concept because it projects the dissolution of the state and its default to pre-state state conditions.

As long as the state continues to function, the term state capture refers to the stages of capture, and not to the state's undoing. These stages are significant, hence the heavy term. They are endurable, however, only if the continuity of the state is intact. The term thus refers to a surviving state, not a failed state.

What is foremost striking is the reality of having the state integral but its functional profile altered at the same time. This double condition, in which the state is structurally integral, and its functions transformed is the distinctive point. Upon interest in the phenomenon, precisely this duality should be studied.

If the state is seemingly intact but its function altered, the following particularities should be observed and analyzed:

- In the captured state the resources of the state itself are organized in a way so as to revert them from being strictly state resources. In this obvious instance, the common definitions of the captured state apply. The version that has gained popularity is the one about the captured state as a radicalized form of corruption and not so much as an instance of rupture within the state capture paradigm.

- The fact that private interests, most likely organized, influence state policies for their own gain is a definition too abstract and closer to the general definition of corruption.¹ While this is part of it the description it is insufficient.
- Groups that undertake the capture of a state have economic goals. They do not seek power in order to change the nature or type of governance of the state. The goals are strictly in the realm of entrepreneurship.
- On the other hand, there is a possibility for multiple groups of this sort to be formed and a balance between them to be achieved via cartel agreements and divide of monopolized illicit markets.
- The state capturers see the state as an opportunity for criminal entrepreneurship. This itself entails a certain way of organizing crime. The state presents itself as a business opportunity, in which its recourses are the main goal.
- The state's resources are not subjected to theft. On the contrary, they are highly valued for they make up the investment field, which is what the criminal entrepreneur is looking to profit from.
- The boundaries that separate politics, institutions and economic action are blurred and rendered nonsensical.
- A capturing of a state is achieved through political representation and therefore may be fully legal or even legitimate. Once formed and gained political access it

¹ See Hellman, J., Jones, G., Kaufmann, D., *Seize the State, Seize the Day: State Capture, Corruption, and Influence in Transition*. Policy Research Working Paper 2444. World Bank Institute, 2000. <http://info.worldbank.org/etools/docs/library/17638/seize.pdf> . (accessed February 2016)

begins its operation in the fields of politics, markets and institutions.

- In cases of state capture there is a systematic and sustainable political capture of the institutions of the state. This is to ensure against criminal prosecution. In this respect state capture is close to organized crime. Certain transactions are protected against state intervention.
- In terms of separation of powers, the typical process of state capture includes the possibility that if such a need arises, state institutions may step in to further support a given undertaking.
- This necessary scope of state capture makes it very hard to explain through terms such as organized crime or corruption.

Apart from the conceptual separation and regional specifics, the corruptive matter varies in terms of the sector, in which it operates.

One of the prominent sectors through which state capture is achieved is the energy sector. It is a sector close to the state especially in Eastern European countries. State capture through the energy sector is very complex. It includes a great number of actors. As RiskMonitor has registered in past research, the reason why the energy sector is one of the most susceptible to state capture and most impenetrable as to preventing it is the fact that the state is extremely reluctant to privatize it even partly. The process of state capture through the energy sector typically includes the following steps:

- A populist election campaign is devised, which centers around low energy prices on account of state monopoly in the sector.
- If it succeeds the issue gains public importance.

- The active government centers the current agenda around the issue and the importance of the sector being state-owned.
- Activities begin for pushing forward the idea that the state should initiate new large energy projects, like a NPP.
- Through pressure or in cooperation with certain groups, the parliament majority appoints people to key in the executive branch in order to fulfill the agenda of the first group.
- Construction tenders are being organized, which are designed in a way that only a certain firm or consortium could win them.
- In many cases the project that has been put forward needs large support programs in order to move forward. These programs are outsourced to certain groups and firms.
- Typically, in a country like Bulgaria such projects are associated with an outside power, usually Russia in the case of the energy sector.

This is a general scheme of the process, which could be detailed further. However, the most important pieces of it are 1/ maintaining state ownership in key sectors, 2/ political governance that overcomes the barriers of separation of powers and 3/ structuring the sector in such a way as to ensure lowest possibility of it managing to free itself from capture processes.

SOUTH STREAM – A CATALOGUE OF FAILURES

The South Stream pipeline project (SSPP) failed. Putting aside the debate about its economic and strategic rationale the project has demonstrated a comprehensive catalogue of failures which could have been avoided in a different governance context. Below are listed some of the key issues during the life cycle of the ambitious plan – from its conception to its abortion.

The project was not based on a sound national or company strategy.

Neither Bulgaria, nor the other transit countries had a clear strategy that would justify the SSPP. The project was pushed and driven by motives that were not clearly stated and by the general belief that the benefits were obvious.

The project was not based on transparent economic assessment.

The environment impact of the SSPP was assessed in detail. However, its economic impact was never properly analyzed and evaluated. Company assessments were not publicly presented and debated even though the project was of great public, energy security and common security interest and involved significant public resource.

The project was not assessed against current and predicted energy demand trends in the transit and importing countries.

The companies and governments involved did not conduct serious gas and general energy demand assessments. Experts' perception of the gas demand logic of the project was probably based on IEA and EC gas demand predictions from the early 2000. These predictions have been repeatedly corrected and lowered. The updates however did not seem to affect the political appetite for the project.

The impact of the project on the energy market competition landscape was not taken into account.

Central and Eastern Europe have suffered many years by the Gazprom abuse of its dominant position in their gas markets. The impact of any new gas infrastructure on the gas market competition and supply diversification should have been analyzed and taken into account. This was never done.

The project was not properly publicly consulted.

The project was a subject of regular political overselling to the public but it was never properly publicly consulted or debated. There were very few independent opinions expressed about the SSPP, usually by individual experts. Most of the critical opinions were focused on the risk of an increased political dependency on Russia. This debate was legitimate and important but it kept the opposition to the project mostly in the framework of pro- and anti-Russia debate rather than in the context of a wider public interest and economic logic.

The project was not properly consulted with the European Commission.

The bilateral agreements between the Russia and the countries involved in the SSPP were negotiated and signed without consultations with the European Commission. At the same time the pipeline was crossing several EU states and the project was subject to European Union rules. The tactic of presenting the project to the EU institutions as a done deal did not work and led to serious political tensions and financial losses.

The countries involved in the project did not collaborate.

The SSPP was a highly complex and expensive endeavor which required a very close collaboration by all the companies and governments involved. The countries on the SSPP route, however, did not have a good collaboration and they did not negotiate with the Russian side, nor with the European Commission, as a well-coordinated group with a clear common interest.

Public procurement was not conducted under proper scrutiny.

Contracts were not awarded according to transparent procedures and according the EU rules. The improper awarding of the main contract for the Bulgarian section of the SSPP to Stroytransgaz was in fact the main formal stumbling block of the project that led the European Commission to open an infringement procedure against Bulgaria.

Speculative transactions spiraled out of control.

The expectation that a multibillion project will be built led to a number of massively overvalued transactions (such

as the purchase of a plot of land near the landing point of the pipeline for €100m), negotiations for large sponsorship deals for sports clubs and media outlets. These completed or expected transactions led to massive increase of the cost of the project and made it even more unrealistic.

The political support for the project was secured through improper political pressure.

In clear contradiction to the competition rules Gazprom secured political commitment for the SSPP by the Bulgarian government in exchange of lowering the price of gas delivered to Bulgaria. That came in addition to all other economically unjustified factors driving the project.

SPECIFIC RISKS REGARDING LARGE ENERGY PROJECTS IN A CAPTURED STATE

Large energy projects are typically undertaken not only without regard for their own energy and economic parameters but also without taking into account the energy demand and efficiency of the sector as a whole.

Building new energy capacities is an enormous undertaking. The two prominent cases in Bulgaria, the SSPP and NPP “Belene” clearly show that the motivation for their ongoing existence is purely political. However, there are two separate sets of assessments that are being disregarded from the discourse altogether. One is an assessment that would give a picture as to what amount of energy for what purpose would be produced and why. This is understandable in terms of the fact that being purely political, and lacking economic justification, part of the agenda pushing them forward to ignore this issue. Another aspect, however, deals with the energy sector as a whole, which is needed regardless of large energy projects: an assessment of the energy demand and supply in the context of major tendencies in the energy sector – local and global – first and foremost – energy efficiency, resulting in braking the unquestionable till recently positive correlation between economic growth and increase in energy demand.

Political justification for large energy projects include at least the following sets of justification, which are intertwined and dependent on each other:

A) An oversimplified and outdated notion of energy security.

Large energy infrastructure projects have been defended in the last years in the context of “security of supply”. However, current energy security debates in Bulgaria are based on an outdated notion that does not include a more comprehensive approach to this topic. Energy security should be scrutinized in several aspects: security of supply through more diversification; security of demand; cyber security; and security of government decisions and protection against state capture. Last, but not least, energy security is not equal to energy independence, because no country can fully be energy independent in an interconnected and interrelated global economy. The energy security paradigm should include energy interdependence arguments as well.

B) Projections for energy demand that are inherently unreliable.

Guaranteeing energy security is often seen only as securing the supply for a projected demand. There are several reasons why this approach is redundant. Firstly, projections for future energy demand are unreliable and more often than not – flawed. They are based on a centralized supply as a given, while decentralization is a stable tendency, even in countries like Bulgaria where the energy sector is extremely conservative in that respect and mostly state-owned. Another key factor that such projections do not take into account is the overall tendency for increasing energy efficiency. Ignoring these major factors result in equally great distortions in the projections. For instance, most energy policies have been largely based on the projection for a gas demand in Europe of 600 billion m³. The capacity for those 600 billion m³ has been satisfied but the actual demand in fact is 400 billion m³.

As a result, Europe currently has an oversupply of gas, which is a direct consequence of policies designed on the basis of flawed projections.

Technology today has given people the freedom to produce power instead of consuming it off the ‘normal’ grid; energy efficiency is rapidly growing among consumers across all social backgrounds.

Large energy projects as a whole rely on public funds. The risk of such projects is not only extremely high but largely unpredictable and in effect unmeasurable. And while accountable governments would think twice before taking such a risk, a captured state would not.

The reasons the risk is unmeasurable are legitimate. The investments needed are extremely high, while the project themselves take very long to build. This means that they will become operative at a point in time for which no one could predict what the market would look like. For this reason, private actors - be it banks or large energy companies - do not get involved in such projects, unless – at the very least - they receive state guarantees for the risk.

The most prominent examples for large energy undertakings in Bulgaria are NPP “Beline” and the SSPP. They are purely political, and lack any economic or energy justification. Naturally the full project cost depends on public funding, and thereby risk falls entirely with the state. The reality of the captured state is the preeminent condition for these projects to be undertaken and to have been ongoing for decades.

Governments, especially captured ones, often have unlimited loan potential. This motivates them to come up with extraordinary projects that if beneficial at all, are

such only in the short term and ultimately serve a purely political agenda.

Another convenient factor for motivating governments to undertake high risk projects with little or no economic justification but which are politically profitable in the short-term, is the enormous freedom they have to take out loans. Having funds here-and-now is a sound populist strategy that helps to move the public's attention from issues that are likely important but inconvenient to the government, to something new that is essentially made up for the sole purpose of filling the public agenda with smoking mirrors. Covering loan costs will be a problem for a next government, while the one taking out the loan could capitalize politically on better budget numbers and having the public's attention focused where the government wants it.

Building is an economy and an end in itself.

The process of building large energy and infrastructure projects boosts GDP in the short term. So even if the projects themselves are known to not ever be finished and to inevitably result in losses in the long term, they are politically profitable for they give an immediate boost to GDP. An obvious alternative to building new infrastructure is to improve upon existing infrastructure. It is cheaper and more efficient. However, such a strategy is not appealing politically because 1/ it wouldn't boost GDP immediately, 2/ it wouldn't profit groups that would get involved now, and 3/ it will not result in short-term budget revenue. This is yet another instance of political interest contradicting public interest in terms of spending. In the context of the captured state political motives of this kind are amplified and effectively without alternative, especially given the fact that public recourses are directly profit the private interests of the capturer.

THE ENERGY SECTOR, SOUTH STREAM AND STATE CAPTURE. THE CASE OF BULGARIA

Decisions for large energy projects are (1) not based on transparent political or economic reasoning and (2) are taken to benefit the agents of a captured state.

Even if it is known by all parties involved that a project will never be constructed, those projects continue to function in a dormant state just enough to ensure that certain actors continue to profit from the cashflow. Years after SSPP was pronounced dead by Vladimir Putin, the company in charge of the Bulgarian sector of SSPP continues to operate and spend millions per year. The total estimated cost of SSPP by 2016 was around 2.8 billion euro. Most of these costs are among other things a result of overpriced tenders that have been tailored and awarded to specific firms with close ties to the government and/or Bulgarian oligarchs.

The Bulgarian section of SSPP is one of the most expensive. The official price has gone from about 1.8 billion euro to 4.1 billion euro by the time the project was ceased.

The cost of the Bulgarian land section of the pipeline is almost half of the whole land pipeline of SSPP. The price of the Bulgarian part of SSPP has increased over the whole period of the project before the announcement of its discontinuation. The initial negotiations were for 1.8 billion euro. By the end of 2014 the cost of the project reached 4.1 billion. For comparison, the Serbian section is valued at 2 billion euro. About 60% of the project's cost would've been spent for

the pipes, 15% were delegated for project management and consultants. According to experts given the specifics of the project, officially the benefit to Bulgarian construction and other relative firms would amount to no more than 10% of the total cost of the project.

According to official documentation financial profits for Bulgaria are close to none.

Even according to the draft contract for long term gas transport and financial model for the project the profit that Bulgaria would make is close to zero. The projected profit after the 25th year of exploitation is zero, while the transit tariff for the first 15 years, in which Bulgaria must return the loan from Gazprom is minimal. This would have led directly to the extension of the loan due to the impossibility to cover its costs.

Who is accountable for SSPP Bulgaria?

The SSPP as a project lacks a financial structure. It has no projections for revenue. As far as projections are made for Bulgaria, they cover no more than a timeframe for paying off the loan from Gazprom for building it, which is merely part of the agreement. A project of this magnitude (as is the case with NPP “Belene”) has no project management structure, which in any kind of normal project would be accountable for wrongful execution, spending etc. From this perspective, these projects are not projects at all but merely government (political) undertakings of massive proportions and cost to the budget. They are accountable as far as Gazprom in both SSPP and NPP “Belene” cases but are not accountable as to public funds expenditure. This is usually excused by announcing a project one of “national strategic importance” thereby essentially bypassing any form of public accountability.

The political narrative maintains that those are important *strategic* projects in order to keep the public support for them.

The narrative is not fact-based, rather vague and full of promise for a bright future. It directly toys with national pride and dreams (to become the energy center of the Balkans). At a point, the uselessness or damage in the long term of the project is unmeasurable. The more unrealistic and utopian it becomes the more public support it has the potential to gain by mere rhetoric and populist strategies. The question of why there is no counter narrative that reaches beyond the marginal and back to the well-functioning captured state goes to the fact that the media is also part of a capturing strategy. Capturing media outlets ensures that alternative narratives do not reach the public.

LARGE ENERGY PROJECTS AND EU REGULATIONS.

The case of the Bulgarian bilateral agreement between Russia and Bulgaria for South Stream

The bilateral agreement between Bulgaria and Russia contradicts EU law.

The case of the agreement between Russia and Bulgaria is essentially a case, in which a non-EU country (Russia) attempted to bypass EU law by “entering” through a EU country (Bulgaria). Regardless if this was an attempt that was thought to be actually successful or a mere experiment to see how far it could get, the case itself reveals weaknesses in EU legislation. The Commission cannot intercept such attempts before the official start of a project, which is a long time after the intent for the project is a fact and the political agenda adjusts to the reality of the project being realized accordingly, regardless if that would ever be the case. During this time gap, numerous policies and agendas could be put forward and realized. Moreover, a large energy project undertaking focuses policy efforts on it (gas, in the case of SSPP or nuclear power in the case of NPP “Belene”) thereby annulling the pursuit of energy policies or actions concerned with alternatives. The EU needs additional legislative tools to be able to stop such initiatives at their inception, especially in cases as the SSPP, which was sure to violate EU law.

In the negotiating process leading up to the bilateral agreement, Bulgarian legislation was altered so as to make the project possible.

This is a case to be studied itself as an example of a very private and non-domestic interest managing public interest through legislation and the judiciary system through *de jure* business negotiations between two private entities. Since the negotiations were between two companies, Gazprom and Bulgargaz, instances in which laws were altered as part of the negotiation was initially not susceptible to the Freedom of Information Act. However, upon an appeal, a judge ruled that the documents be released. Thanks to this initiative and thanks to the ruling of a particular judge this information was uncovered. This is an instance, in which it is apparent without any doubt that a predictable and independent judiciary system is the foremost condition for countering state capture and large corruption initiatives.

Although the agreement contradicts EU regulations, it did in fact set the political agenda in Bulgaria for years to come.

The SSPP initiative cost taxpayers nearly 3 billion euro to date. The government was determined to keep the project alive and revert from the reality that in its very essence the project could not be realized, given the fact that it is indirect violation of EU laws. The intent at the end was to prolong the project as much as possible because it directly profited companies that are involved in it. This is a classic instance of state capture. Money are continuing to flow into companies for the project although it's been canceled years prior. The reality that there has been little to no public pressure to the government for spending money on something that will never be is a problem

in itself and an indicator for how ‘accomplished’ the captivity of the state is.

POLICY RECOMMENDATIONS

Introducing sound strategic planning.

Long term strategic planning on national and regional level by both companies and governments will contribute to the protection against the building unjustified large projects and wasting public resource. It is essential that such strategic plans are sufficiently transparent and based on adequate analysis of the long term needs and public and company interests.

Large energy infrastructure projects should be based on transparent economic assessment.

Better understanding of the wider economic impact of large energy infrastructure projects could reduce the risk of both state capture and stranded assets. It is essential that economic impact assessment of large projects financed with public funds and with significant public impact is conducted with the same vigor and detail as environment impact assessments. The economic impact assessment should be independent, transparent and subject of public and experts debate. The government, or the European Commission, should institute such studies for future projects.

The project needs to be assessed against current and predicted energy demand trends in the transit and importing countries.

Building large energy infrastructure projects is often justified by the need governments to address security of supply. This justification is often exaggerated. Energy demand is changing both in volume and in mix. Independent assessment of future energy demand scenarios and their public debate will help adequate decision making. In cases of complex multinational and trans-border projects it is necessary to assess the demand options in all countries that might be affected by the project or might affect the project.

The impact of large energy infrastructure projects on energy market competition should be assessed.

Large energy infrastructure projects could have significant impact on the competitive environment and could lead to high national, regional or European dependency on a single supplier or transit route. Such dependency could suppress competition and increase the supply security risk.

Project proposals should be properly publicly consulted.

Meaningful public consultation procedures for large energy infrastructure projects should be introduced. It is essential that such public consultation procedures offer (a) clear independent expert opinions, (b) alternative options, (c) sufficient time for reaction, (d) high visibility of the announcement, background information and process.

Large infrastructure projects should be consulted with the European Commission in advance.

In order to ensure that any large energy infrastructure project will fully comply with EU legislation any such projects should be properly consulted, from the stage of conception and before any binding negotiations, with all relevant officials in the European Commission.

Countries involved in large energy infrastructure projects should collaborate closely.

It is essential that large international energy infrastructure projects be properly and on the appropriate level discussed by all countries that are directly involved or affected by the project.

Public procurement must be subject to proper scrutiny.

Since a key driver for large energy infrastructure often is the building itself and not the actual energy demand there is a need for stricter procedures and higher visibility in the procurement process. Involvement of neighboring affected countries would be a good step. The European Commission should also participate in the procurement procedures even in cases when a third country is not involved.

RECOMMENDATIONS FOR INTRODUCING NEW PRACTICES

Public enquiry.

The “Public Enquiry” procedure is an official review of events or actions ordered by a government body. It is not present in Bulgaria, but exists in many common law countries, such as the UK, Ireland, Australia and Canada. A Public Inquiry accepts evidence and conducts its hearings in a public forum. Interested members of the public and organizations may not only make written evidential submissions, but also listen to oral evidence given by other parties. The conclusions of the inquiry are delivered in the form of a written report, given first to the government, and soon after published to the public. The report will generally make recommendations to improve the quality of government or management of public organizations in the future. In the Bulgarian case, such new type of extended parliamentary enquiry could inform the public, legislators, experts, policy makers how to prevent cases of high importance, large scale and significant public expenditure.

Experts performing state functions, “state recapture”.

Recent developments from the spring of 2017 show, that the state is not the only actor, which could defend the public interest in significant energy affairs. In April and May 2017, a group of independent experts took the lead and sent an “alternative view” on the matters related to Gazprom’s case 39816 “Upstream gas supplies in Central and Eastern Europe” to the European Commission’s DG Competition on behalf of Bulgaria’s stakeholders. The state-owned enterprises (Bulgarian Energy Holding and its subsidiaries Bulgargaz and

Bulgartransgaz) have sent their own opinions with the scrutiny of the Ministry of Energy, but many independent experts have viewed this position as insufficient. This example shows that in many cases the “state” is not the only actor, who can deal with “state affairs”. The competition regulations in the EU allow for independent opinions to be expressed directly to the respective institutions (e.g. DG Competition). These processes have to be encouraged via informal meetings between national and other European experts. The “state recapture” is possible and the positions of independent experts could turn the scales toward more competition in the electricity and gas sectors while bringing ill-grounded ambitions for new mega-projects to a halt.

PREVENTION OF STATE CAPTURE THROUGH THE ENERGY SECTOR

Accountability and transparency.

The first step toward “recapturing” the state in the energy sector is through increased level of accountability and transparency. The first stage in this process is to set up more opportunities where state-owned energy companies’ affairs are discussed. These could be set up in both official institutions (the Parliament, consultative bodies under the Energy Ministry, etc.) and informal discussion groups – thematic conferences or work-groups with the participation of both state and private stakeholders. The second stage is related to formal accountability and transparency options through the privatization of minority (and majority) stakes in state-owned energy companies. The listing of shares of state-owned energy companies at the stock exchange would ensure a higher level of accountability and will make it harder for non-state factors to capture these companies.

Braking the state monopoly in the energy sector and giving power to local communities.

The Third Energy Package, presented in 2009, had several goals, united under one vision – to increase the transparency in retail energy markets for the benefit of consumers. On November 30, 2016, the European Commission announced its “Clean Energy Package”, which will take liberalization one step further, enforcing consumers with policies, tools, and market environment where they can produce alone their own energy, turning themselves into “prosumers”. By “liberalizing” energy investments and providing local communities (households and businesses) with the possibility to produce

their own energy, the state monopoly on the energy sector will finally see its end.

Generating knowledge on current tendencies and realities in the energy sector to the public thus developing a critical civil pressure against government undertaking such projects.

The general public in Bulgaria is not very interested in learning more about the way the energy sector works. This notion is aggravated by the pre-exposition of energy prices as the only matter of importance by national media. It would be difficult to overturn this trend, but some steps that could achieve a gradual change include giving a wider voice to the professional community (with media coverage), expert articles and interviews in national media, as well as more energy-related topics in the primary, secondary, and higher education. Last but not least, “non-captured” public servants and politicians must be given more facts and explanations on how the energy sector works, thus giving them more arguments in defense of policies of national interest.

Countering expert capture.

The use of “expert” views in the Bulgarian energy sector has been twisted in the last decade in a way, which depreciates the value of all expert opinions. State capture in the energy sector, combined with a capture of the majority of media outlets by the same power centers, is topped with the “capture” of expert opinions, which are popularized by the very same media outlets. In order to stop this trend, there has to be more self-regulation in the media on who is an expert on what and how is he/she connected to different business interests. Moreover, credentials have to be checked and expertise has to be thoroughly explored before the floor is

given to some of these experts. Most importantly, local expert opinions have to be cross-checked with expert opinions from abroad (European Commission, European energy think-tanks, etc.) in order to confront non-realistic opinions and project ideas with the reality of European energy policy.

CONCLUSIONS

The case study done as part of the ENCAPTURE project reveals, that state capture in the Bulgarian energy sector is a not only present but overwhelming. It has taken different forms but was most apparent in the projects for NPP “Belene” and the Bulgarian section of SSPP.

However, state capture is not irreversible and could be countered and prevented through more transparency of the investment process as well as more accountability of state-owned companies and state institutions. This could be done through both formal and informal measures. Formal ones may include actions by institutions (National Audit Office, the Parliament, etc.) and informal ones may include settings where energy matters and energy investments are scrutinized and discussed in an open manner.

Another tool for reversing state capture is to involve more independent experts for analyses and actions in defense of the public interest. This tool may include local as well as international experts who can analyze and comment current and future energy projects and provide their expertise for preventing state capture practices. It should be taken into account, that energy projects – even if they are considered “national”, have serious energy security implications on a regional and global level.

ANNEX I

SPECIFIC PROBLEMS OF THE BULGARIAN ENERGY SECTOR

Bulgaria is 100% dependent on one gas supplier via one route.

Data from the national incumbent wholesale supplier Bulgargaz show, that Bulgaria consumed 3.04 m³ of natural gas in 2016, and 99.83% of this gas was imported from the Russian Federation. The rest of the gas consumed is produced locally – right off the Black Sea coast, from a small field at the end of its capacity. It is operated by the British company Petroceltic. Currently there is no real gas market in Bulgaria. The country buys all the gas it needs from Gazprom, receives it via one pipeline (through Ukraine, Moldova, and Romania), and this gas is sold internally by the incumbent Bulgargaz EAD – a subsidiary of the state-owned Bulgarian Energy Holding EAD.

The Bulgarian energy sector is predominantly state-owned.

The majority of power generation in Bulgaria is owned by the state through the 100% owned Bulgarian Energy Holding EAD (BEH). BEH is the 100% shareholder in the following companies: NPP Kozloduy (2000 MW), the lignite-fired TPP Maritsa East 2 (1600 MW), Maritsa East Mines (lignite), the public supplier NEK EAD (with hydro capacities of 2700 MW, including all the pumped storage hydro power plants with a total capacity of 940 MW), and the whole transmission network and TSO under the subsidiary company ESO EAD. NEK EAD also possesses two PPA contracts with two US-owned lignite

thermal power plants for 100% of their production – TPP AES Galabovo (670 MW) and TPP ContourGlobal Maritsa East 3 (908 MW). BEH is also the 100% shareholder of the public supplier for natural gas Bulgargaz EAD and the national gas transmission system operator Bulgartransgaz EAD.

Bulgaria is firmly reluctant in closing down power capacities that are old and high in pollution.

The largest TPP using lignite in Bulgaria (TPP Maritsa East 2) is state-owned and relies on a resource, produced at the adjacent 100% state-owned Maritsa East Mines company. Both companies have a large number of workers in a region, which has few alternatives for employment. Any decrease in the activities of these companies can have detrimental economic and social effects and there is still no policy for overcoming this challenge in the coming years. Other coal-fired TPPs in the region and in the country also rely on regulated quotas for their revenues. If the state considers the employment of the people in the coal-fired power plants as a challenge, there have to be new policies for creating alternative jobs in the process of decarbonization in the energy sector.

Extreme inflexibility of the sector as a result of the overall policy approach.

The overall policy inclination to focus on large projects, centralization and old technologies leads to extreme inflexibility of the sector and by default excludes alternative energy solutions. It ultimately deprives the sector of any opportunity to react to changes in the energy markets and tendencies. The state still controls most of the energy sector through the Bulgarian Energy Holding – 100% of both electricity and gas transmission grids, 100% of the nuclear power plant, more than 90% of the hydro power plants, and control over the

production of most of the lignite power plants (through 100% ownership or through power-purchase contracts).

EUROPEAN ENERGY MARKET TRENDS

Gas demand and gas supply.

According to the 2016 Reference Scenario of the EU, until 2020, the consumption of gas is expected to remain stable at around 430 billion m³. After 2020, there would be a slight decrease in gross inland consumption of gas (412 billion m³ in 2030). Meanwhile, natural gas will maintain its role in the power generation mix until 2030, at slightly higher levels compared to 2015, but other fossil fuels will see their share decrease. Gas imports are projected to increase slightly in the long term reaching approximately 370 billion m³ net imports in 2050. After the 2005 peak, energy consumption is projected to steadily decline until 2040, where it stabilizes. Natural gas and nuclear energy keep relatively stable shares in the energy mix. The volume of imported gas is projected to increase in the period 2015 – 2040 and then to stabilize in the long term, at about 15% above the 2010 net import level (369 billion m³ in 2050).

Renewables.

Electricity generation mix in the EU is expected to change considerably in favor of renewables. The share of RES is expected to grow from 21% in 2020 to 24% in 2030 and 31% in 2050. While solid fuels will witness a significant reduction in their share of the energy mix, the biggest increase is expected for renewable energy. According to EU projections, biomass and bio-waste will continue to be the most used fuels in the EU mix, but the share of solar and wind will also grow from

around 17% in 2015 to 36% in 2050. The rise of renewables until 2020 is expected as a result of the replacement of natural gas and resulting from the policy to meet 2020 targets. In the period after 2020, the rise of renewables is a result of a further coal to gas shift, driven mainly in anticipation of increasing CO₂ prices.

Nuclear power.

Nuclear power production is expected to remain stable in the period until 2050. The limited decline in nuclear energy production would be compensated in part by an increase in domestic production of renewables. Overall, the share of nuclear energy in the mix is expected to decline slightly from 27% in 2015 to 22% in 2030. New nuclear power plant investments will be concentrated mainly in lifetime extensions until 2030. In the longer term, new nuclear build may develop in countries such as the UK, Finland, Sweden, France, Poland, and other Central European Member States. However, the costs of new nuclear build and the cost of nuclear refurbishment have been steadily going up in the past years and will continue to grow in the years until 2050.

Decentralization.

EURELECTRIC data show, that European consumers have been increasingly opting for distributed generation, driven by policy support and regulatory intervention in many countries. The electric industry association is quoting data from the IEA, showing that one third of the global PV capacity was installed at residential level in 2014. Electricity customers are now able to choose a tailor-made energy supply system that suits their individual needs, thus bringing down their consumption from the grid and potentially leaving the electricity supply system altogether. In this process, as “prosumers” consume

less electricity, the costs they avoid are shifted to other customers, thus creating a “consumer divide”. The move toward decentralization will eventually mean less electricity produced in large power plants (using nuclear, coal, and gas) and more renewable generation close to consumption centers and households. This will also decrease the need for imported fossil fuels in the EU.

EU energy policy.

The cornerstone of the current EU energy policy is the Energy Union. This is a European priority project, identified by the Juncker Commission as one of the 10 political priorities, in which five dimensions are closely interlinked: energy security, solidarity and trust; a fully integrated European energy market; energy efficiency contributing to moderation of demand; decarbonizing the economy; and research, innovation and competitiveness. According to the Second Report on the State of the Energy Union, progress has been made on all these dimensions. The Energy Union is about more than energy and climate alone: it is about accelerating the modernization of Europe’s entire economy, making it low carbon and efficient in energy and resources, in a socially fair manner. Its ultimate goal is to make sure that Europe’s consumers, workers and businesses benefit from it.

GLOBAL ENERGY TENDENCIES AND THE FUTURE OF BULGARIAN ENERGY POLICY

Decentralization of electricity production.

The production and consumption of energy in Bulgaria is still heavily centralized. Even renewable energy (e.g. photovoltaic) is still present mainly in the form of standalone installations,

mostly above 1 MWp capacity, at locations away from the centers of consumption. Bulgaria has to adopt new energy policy, supporting decentralized production of electricity and heat in the households, using renewables (solar, biomass, etc.) in order to deal with several problems at once: low energy efficiency of the energy system (caused by losses due to transport and transformation of energy); decarbonization of the energy consumption; improvement of the security of supply; and decreasing imports of fossil fuels.

Gradual moving away from gas dependency on one source and supply route.

Bulgaria has to open its gas market for competition and to improve its import infrastructure by building new interconnections with neighboring countries and by upgrading existing ones to be bi-directional. The second level of actions should be related to the development of own gas sources (offshore and onshore) from conventional and eventually from shale gas resources. The connection to the Central-European gas market is crucial for diminishing the dependency on one source and could be achieved by promoting more connectivity in the North-South corridor – between Bulgaria, Greece, Romania, Hungary, Poland, etc.

Policy to help make the price of renewable energy sources competitive to conventional energy sources.

Currently, there are many hidden subsidies for the consumption of electricity produced by fossil fuels. The regulated energy mix includes a large share of electricity produced in coal power plants and its regulated price is not covering all the expenses. The losses of the largest state-owned TPP Maritsa East 2 (~70 million BGN in 2015 and ~92 million BGN in 2016) are covered by its sole shareholder – the Bulgarian Energy

Holding. Instead of subsidizing fossil energy use, the budget has to promote the decentralized use of renewable energy production at homes and businesses through a support scheme, which could be using fiscal, grant, and preferential loans mechanisms. A larger number of smaller decentralized renewable generating units may increase the resiliency of the electricity system.

New technologies for heating buildings and the role of energy efficiency.

New technologies, using biomass, geothermal, and solar energy at the buildings, may provide better energy efficiency for the buildings in Bulgaria. The national institutions should explore the best current technologies for support through diverse mechanisms – preferential loans, grants, etc. These technologies may provide better efficiency for both individual consumers and the energy system through diminished needs for energy imports, as well as diminished quantities of transported and transformed energy. At the same time, buildings refurbishment has to be supported in order to diminish energy losses at the end of the energy use vertical.

The role of high efficiency cogeneration.

Still many district heating generating units produce only heat and do not have cogeneration capacities. Cogeneration has to be promoted where possible in order to increase the efficiency of large natural gas consuming capacities. Efficiently produced electricity from such capacities may replace other fossil fuel capacities (e.g. TPPs using coal) and will improve the overall energy efficiency of the Bulgarian energy system. There should be also more support for smaller cogeneration units closer to homes and businesses for replacing heating with electricity or heating with other non-efficient technologies.

Electricity and gas oversupply.

Until now, the main focus of state-owned electricity producers has been on investing in new large capacities (NEK – with NPP “Belene” and HPP Tsankov kamak, etc.). New capacities have to be rethought in the framework of Bulgaria’s energy market coupling with the neighboring countries (Greece, Romania, etc.). The resiliency of the system and the security of supply have to be considered in a regional perspective, thus choosing the most cost-efficient ways to supply electricity for Bulgaria and the other countries in the region. The same is applicable for gas supplies as well – the focus should be on analyzing and improving the gas supply security of the whole region of South East Europe through new interconnections with more developed regional markets in the EU (Italy, Austria, Germany, etc.).

Paris climate conference goals and EU climate and energy policy.

In the light of COP21, Bulgaria has to rethink its energy strategy and energy policies in order to reflect the new global realities. In order to have a competitive economy, Bulgaria has to be in the front of the global energy revolution through the support and implementation of low-carbon, decentralized energy technologies. New energy capacities and infrastructure have to be streamlined with the latest global and European energy trends. State-funded investments should be directed only when private capital is not available or hesitant. The state should not crowd out energy investments in sectors, where private capital is available.

Role of energy regulators.

The role of the energy regulatory authority and other economic regulators has to be to support the transition to a low-carbon

and resilient energy system and to ensure the full liberalization of the electricity and natural gas markets. There are tools that national regulators can use in order to promote decentralized, low-carbon energy use while at the same time keeping costs at reasonable levels. With the liberalization of electricity and natural gas production and trade the role of regulators will be related mainly to regulating natural monopoly infrastructure (transmission and distribution grids for electricity and gas) and the main tasks there are to ensure the timely and efficient development of this infrastructure so that it can accommodate new energy technologies and solutions.

