

# Public procurement and organized crime – illustrated with examples from Bulgaria, Italy and Norway

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# Public procurement and organized crime – illustrated with examples from Bulgaria, Italy and Norway

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## Abstract

The paper provides a semi-popular exposition of the formulation of public procurement and privatization mechanisms and how they may be influenced by organized crime units. A number of possibilities are outlined using examples from Bulgaria, Italy and Norway.

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# 1. Introduction: Public procurement and the distribution of political rents

Public procurement gives rise to a large share of the rents that may end up as private illegitimate income from public governance processes. A major, almost banal reason is that when money is transferred internally in a public organization, it remains only accounting or specific-use money. When it leaves public control, it becomes non-specific, cash-like. It may be spent on anything. It is when the public sector procures larger items from the private sector that “cash” leaves in large bulks which may give an opportunity for siphoning out larger amounts as generally disposable rents. In an accompanying paper (Andvig and Todorov, 2011) we have seen how public procurement rents may either be shared between procurers and suppliers through corruption or be shared among suppliers through cartel-making.

In that paper we looked mostly on the situation from the point of views of suppliers and the impact of bid rules, how the private suppliers sometimes try to protect themselves against the inbuilt insecurity through criminal means or try to use their informational advantages for illegitimate profit. Here we will look at procurement more from the side of procurers. Here the EU appears to have formulated fewer rules except the general one that whichever organization that does the public procurement, it should organize its bid competitions in such way that EU’s bid rules are followed. Even in countries that try to isolate the procurement decisions from line administration to make the procurers more independent,<sup>2</sup> the reality of the situation is that the granting of contracts is also a disposal of political favors. Procurers like any other public bureaucrats have to be sensitive to political signals to ensure job survival and promotion prospects whatever the formal rule they are supposed to obey.

From this follows several implications. To really understand how larger procurement decisions are made it rarely suffices to study the interaction between the immediate procurement officers and the suppliers. For example, if a supplier in a country with extensive corrup-

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<sup>2</sup> In this way the decisions could be more strictly focused on the price and quality of the services and goods to be acquired, (an example of this is Statoil’s procurement organization. See Andvig, 1995). It also has a backside: If such isolation is successful and procurers are really isolated from the line, the risk of direct capture by suppliers is likely to increase.

tion problems try to win a contract by bribing the procurement officer only, he is likely to be disappointed. Somehow the politicians have to get a share – if political corruption is common. Even if it is not, public procurement decisions are important for the allocation of political favors, and in both cases the principles behind that distribution are difficult to assess from the outside.

## 2. Middlemen, mafia and the collection of information on informal contract power

Politicians are not the only ones who congregate around the rent capturing opportunities inherent in public procurement processes, however. From our study of corruption in the North Sea petroleum industry (Andvig, 1995) we demonstrated the importance of the existence of middlemen, so called information brokers then, for the corruption potential in that industry's procurement. The main form was to buy illegally bid information from the procuring agency and sell the information to one or several of the bidders. The existence of such middlemen reduced the search costs necessary to complete a corrupt deal and was likely to increase the frequency of corrupt transactions in a "market" where only a minority was likely to engage deliberately in corruption at each side.

Most of this information was of technical or economic nature. As pointed out in della Porta and Vannucci (1999: 173) their roles were in several respects similar to the middlemen who have operated in public procurement processes in Italy. When it comes to *public* procurement such technical information is not sufficient, however. The actual processes of reaching contract decisions are often complex and murky, influenced by a variety of political games. Their complexity combined with their importance has made it standard procedure for foreign bidders to employ middlemen who know (or pretend to know) these games so that they may influence the right people in the right way including paying them bribes. In the old (pre-1995) days one was quite frank about it and textbooks in international business presented recipes about how to treat such middlemen (e.g. Marsh, 1989).

In their book on political corruption in Italy, however, della Porta and Vannucci (1999) describe a set of middlemen who are linking the informal procurement procedures (the politicians) to the suppliers from the inside and not only by dealing in information but through other more hand fast illegitimate means of influence; middlemen belonging to well-known mafia organizations.

Since it is inherently difficult to for outsiders (such as researchers) to trace the actual political processes that impact public procurement, it is extremely difficult to find any good empirical basis for propositions

about their workings. The famous “mani pulite” investigations initiated in Milan early 1992 that snowballed through Italy and where many members of the political class were investigated and sentenced, gave us a rare glimpse into the mechanisms through which political rents derived from procurement may be collected. The extent to which the methods found there simply were a peculiarity of the political system including the voting procedures (Newell, 2006) and/or the organized crime complex found in Italy in the early 1990s or if they reflect some more general features of countries with a fairly corrupt political elite and a noticeable organized crime complex, will of course be impossible to determine empirically on the basis of a single case. Nevertheless, on this Italian basis we may surmise how public procurement and political corruption may be linked elsewhere.

It is also worthwhile in the following to note that the influence is two-ways: political rent-seeking is somehow influencing the procuring decisions while the choice of what, where and how to procure influence the rent-seeking possibilities among the politicians and the population at large. At least in the specific case of Italy in the early 1990s they were both influenced by organized crime however narrowly we define the latter.

Bulgaria is another country where organized crime is considered to have influence on the distribution of political rents including the ones generated under public procurement processes. It is also to some extent documented through research. This research could not be based on equally detailed description of actual mechanisms as was possible in Italy. No large number public court cases have become available there as was the case in Italy. Nevertheless it is based on longer sequences of systematic observations of crime organizations at fairly close quarters than most other research of its kind.<sup>3</sup>

As a matter of comparison with the situation in a country where organized crime is hardly any significant problem in public procurement processes I have chosen to look at Norway. Even here organized crime issues have popped up in a few cases. While these should for the most part only be considered as random events they may also indicate areas where public procurement may become vulnerable to organized crime activities. What is interesting here is that as income and the direction of public expenditures change, so do to some extent the vulnerability areas.

Returning to countries where organized crime organizations appear to have serious impact: Are their vulnerabilities showing up in the same

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<sup>3</sup> A summary of this research is presented in in Bezlov, Tzenkov et al, 2007. A work that seeks to



arenas in countries exposed to larger clusters of organized crime, or are they distributed differently, depending on the structure and history of the society or structure of the organized crime organizations in question? What kind of involvement risks for public procurement might develop from organized crime in these countries where organized crime is believed to be a more significant policy issue? How important is historical specificity for the kind of influence organized crime may wield? Here a comparison between Bulgaria and Italy may prove pertinent, but I will also use the analyses and results in Bezlov et al (2010) for several other European countries including present Italy, although this study is more focused on the more traditional market for illegal goods and services than public procurement.



### 3. Organized crime defined. A choice

In his witty introduction to Duyne et al (2006) van Duyne underlines the importance of making a choice when it comes to a definition of organized crime, and particularly so when one seeks to make a quantitative analysis. While not attempting the latter here, the choice is of course important. For example, if following one van Duyne (van Duyne, 2006 where he describes the secrecy sought in a specific cartel) we may consider regular cartel-making as an organized form of crime. It is by definition organized and participation in a cartel has become criminal in most European countries now. If successful, it may last for decades as the one van Duyne analyzed and that asphalt cartels in the Nordic countries are likely to have (Andvig and Todorov, 2011) Similarly, bribes involve at least two agents, hence is organized, and it is criminal, but it may be a one-time affair and may not satisfy the demand of being a lasting activity/organization as has become one fairly standard criterion when defining organized crime.

We already have covered these organized crime activities. As already mentioned, here we will focus on the political side of illegitimate public procurement in which traditional organized crime organizations that dispose instruments of violence in their organizational repertoire. They will often work as subgroups among power brokers, consultants or middlemen that rely on information handling only.

Van Duyne argues –sensibly – that one weakness in most political definitions of organized crime is that they on the one side is based on a conception of organized crime as a kind of bogey man: subterranean, dangerous and therefore easily overblown in size, organizational capabilities and influence. On the other side the definition will also embrace rather trivial activities such as the smuggling or selling drugs by single citizens who naturally have to buy the stuff somewhere, giving these a sinister stamp they don't deserve. Moreover, by focusing on criminals supposedly being members of some large underground hierarchical organization or some network, one may study something that may not exist in many countries, and one may lose track of the many criminal activities performed by members of the “upper-world” organizations, all the respectable ones. The focus should in most cases be focused on activities not membership.

Here I will like to choose a definition that may connect the public *perception* of organized crime as something very dangerous with a concrete set of *activities*. It is in fact close to the standard one proposed in

many of the analyses of organized crime made by economists, for example the one proposed by Kumar and Skaperdas (2008):

“the defining activity of an organized crime group – in the absence of which its other activities could not take place at all or their nature will drastically change is the provision of *protection*. Protection is not an ordinary economic activity. It is supposed to protect the ownership of other goods and make their contractual exchange enforceable. And that enforceability does not come from the law or the courts – to which ordinary security firm and its clients have access – but ultimately from the barrel of a Mafioso’s gun.”

This definition is somewhat narrow for our purpose. It may fit nicely for Italy, somewhat for Bulgaria, but not at all for Norway. Organized crime will be defined away for that country. Nevertheless, to let all kinds of organized crime such as cartel-making be included is somewhat too wide for our purposes. Somehow, the deliberate use of instruments of violence as an essential part of the criminal design should be included in the definition as a distinguishing mark.

It is particularly the fear of being exposed to random violence (from the point of view of an “innocent” citizen) from individuals perceived to be outside the regular society that induces the popular fear of organized crime. Moreover instruments of violence give rise to strong incentive systems that may be applied for many other reasons than protection of property rights.<sup>4</sup> It may be used as internal disciplinary device, may be used to appropriate goods and services by force, appropriate rents or influence their division, etc. Applied once, and unlike monetary rewards, it may work for free a number of times through reputation mechanisms. It leaves its hail marks on what kind of actions individuals may be willing and able to do as well as the consequences of their actions. Importantly, through their triggering of fear, the use of forces may have a variety of spill-over effects difficult to control for its own practitioners. When practiced by an organized, disciplined group it then has to be controlled. I will tentatively keep the analysis of organized crime within the confines of the following definition:

With *organized crime* I will mean a repetitive string of actions performed by several individuals wherein at least one action is criminal and at least one of the actions presuppose the use or threat of force in order to implement the action string. *Force* includes the active use (or threat of use) of instruments of violence to create bodily harm or to kill, and the ability to implement incarceration. The motivation for implementing the criminal string is normally economic profit. The *performers* of the string may embrace members who are *deliberately* involved in its implementation, the *members* of the organized crime organization, as well as the *outside* performers who may indirectly contribute to the implementation of the string without necessarily knowing the links and the outcome. Hence, the

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<sup>4</sup> For a brief but thoughtful discussion of the role of force in various incentive systems, see chapter 2 in Wiles (1977).

string may link performers who are members of upper-world (van Duyne) as well as under-world organizations or both.<sup>5</sup> If it is essential for its implementation that some of the actions take place in different countries, we define it as *international organized crime*.

This definition is focused on action sequences, not organizational membership. In principle the actions may be linked through a regular hierarchical organization, a network of individuals or simply through an infrastructure where new groups may enter. From an empirical point of view it may be difficult to determine whether a certain criminal act (such as illegal trafficking of women) is organized in our sense by being somehow linked to the application of force (or threat of force) as input, or not. Sometimes it may be easier to follow the main other alternative to build up a definition: to determine who is member of a mafia-type of organization and who is not. In the case of public procurement in Italy it may imply that one needs to guess mate which politician who are strongly influenced by which mafia organization and then to try to determine their network connections to other decision makers. Finally, one would then explore the kind of network members that appear to be involved in each major procurement decision. Needless to add, even if all this was supposedly public knowledge, information of this kind is rather speculative. Network links are hardly sufficient to explain action. In court cases evidence of this kind can only be circumstantial. A string of action will have to be established.

When judging eventual welfare loss connected to crime, the string of action point of view has some advantages. For example, the illegal cross-border trafficking of women when the criminal organization apply no force may cause far less welfare loss (may even cause a net welfare gain after the welfare loss connected to the criminal part of the action string is subtracted) than if the same action is connected to the threat of force.

Typically, larger organized crime structures (more complex strings) don't evolve initially through its rents from public procurement decisions<sup>6</sup>, but either through 1) more or less localized weakness of the

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<sup>5</sup> If an illegal organization that traffic women across national borders against payment and use the importing countries anti-migration (and/or anti-prostitution) laws to threaten the women to inform the police if it doesn't get a cut from their income as prostitutes, it will become an organized crime organization according to this definition. It uses the police's legal means of force as part of their deliberate criminal strategy. If it just traffics the women across the borders against profit and then give a dam, the organization falls outside the domain of our definition.

<sup>6</sup> Bulgaria may be an exception here due to the role of the initial large scale privatization. As argued in Andvig and Todorov (2011) procurement and privatization processes are often quite symmetrical. While rents may be appropriated in procurement through above market prices, rents may be appropriated in privatization through prices below the market rates. The difference is, of course, that in procurement rents may be appropriated at once or through a short construction periods while privatization rents may only be appropriated through either the reselling or actual management of the real assets that are acquired.

state monitoring and control apparatuses that allows private competitors in the protection business to rise or 2) through the handling of illegal goods or services where there are considerable returns to scale connected to at least one point in the string. In practical terms a weak and/or corrupt police force is a precondition for both, but more so for 1).

Let us first look at a Norwegian case of an organized crime structure.

## 4. Organized crime in Norway – any links to procurement?

As indicated above, there are no real indications that organized crime according to our definition is any major issue in Norway. The most likely reasons are its high GDP level and the associated fairly high efficiency of its police. The few areas where any systematic use of violence is observed are mainly connected to gangs organized around drug sales, debt collection<sup>7</sup> and probably also some trafficking activities. The impacts of these strings of organized crime on public procurement are likely to be zero or negligible. Neither prostitution services nor drugs are officially procured by any public organization although sometimes by their members. Some weak and indirect links to criminal forms of debt collection are at least thinkable, but I'm not aware of any actual cases where the debt collection institutions that have been used by the public authorities to settle debts have applied violence specialists.

The impact of organized crime on public procurement is mainly taking place on the labor market and is related to the high Norwegian labor costs and relative high wages for unskilled or low-skilled labor. The underlying explanation is fairly obvious: while wage levels for unskilled labor in Norway below 12 – 15 Euros are considered socially unacceptable, the minimum wages in countries like Poland and Bulgaria are less than a half Euro.<sup>8</sup> On the top of that both pension and other forms of social costs are higher in Norway than most other European countries. Needless to add this creates significant tensions. If a straightforward opening up of the labor market so Polish employers on a wide scale could simply hire Polish workers and pay them close to Polish wage rates for doing work in Norway it would create unbearable tensions. A number of legal frictions have to be built in<sup>9</sup>, frictions that the wide gap makes it potentially very profitable to circumvent.

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<sup>7</sup> Here we can observe interesting developments partly due to the exceptionally strict punishments for delayed payments in Norway and the financial liberalization taking place the last two decades. The latter has allowed institutions to resell claim packages on financial markets, and when combined with the high punishment rates for unfulfilled debts, this has become a profitable business. The organizations that are able to squeeze payments out of the lowest quality claims naturally are the ones that have an ability to resort to violence. Hence, Norway has developed a sort of organized cooperation between the underground Hell Angels type of organizations and upper world financial institutions. While interesting and largely unexplored, these developments are unlikely to have any impact on *public* procurement in Norway.

<sup>8</sup> Norway doesn't have any legal determined minimum wages, but they are given more area-specific minimum wages determined through bargaining between trade unions and employers' organizations.

<sup>9</sup> A number of them are described in Alsos et al (2008).

And it is particularly so in public bidding contests when the lowest price bids are supposed to be winning ones. Bidders who somehow are able to get labor cheap are likely to win.

Recently a number of cases have reached the public where winners of municipal service contracts have hired foreign labor power at below Norwegian acceptable wage rates under illegal conditions, for example by delaying their payment in order to make them stay longer, etc.<sup>10</sup> Have the organizations that have imported foreign labor power in illegal ways also directly or indirectly used or threatened to use violence towards their employees? While the foreign workers and their employers may have common (short-run) ex ante interests in avoiding wage regulatory measures, ex post their interests may diverge, particularly when the workers have been exposed to cheating.

Knowing that, the importers have some additional means of physical control over foreign labor power since it is difficult for a single, unemployed foreign worker to get the necessary work and residence permits on their own. They normally need an employer to get this. If they are fired, they may not be able to stay in the country. Whether this is a sufficient ground for classifying the organizations that do some form of illegal social dumping as organized criminal ones, may be doubtful. The level of physical force to be applied may be too weak. This is borderline activity. Hopefully, the ability to physically control their foreign employees are likely to weaken as the different nationalities get a broader base of fellow country men and women that may ease their jump from one employment in Norway to another.<sup>11</sup>

Except for this borderline case, I have only found one example of an organized crime unit that has been significantly involved in Norwegian public procurement contests. The case is somewhat bizarre, but it nevertheless highlights interesting aspects of Norwegian public policies and also some asymmetric information problems that is part of the governance issues that arise in public bid competitions.

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<sup>10</sup> The large Swiss-owned enterprise (Addecco) that originally only did labor exchange, but now also collect labor for collective service contracts has recently received extraordinary public attention for breaking Norwegian rules regarding wages and working conditions. From a quantitative point of view the impact on the outcome of public procurement contest for large building contracts have probably been more significant, but then as sub- or rather sub-sub-contractors..

<sup>11</sup> This is an area where we are still missing systematic research in Norway. That situation may change in the wake of the so called Adecco scandal. Studies from the Netherlands (e.g. van Duyne, 2006), where conditions in many ways are similar to Norway in the sense that wage costs are higher than in surrounding areas, make it likely that this become, if it not already is, an area of serious economic crime, although the violence component may not become serious.



The background<sup>12</sup> was that a foreign-born (Iranian-Turkish background) medical doctor received a specialist education in psychiatry in Norway and established an organization, the St. Lucia Foundation to take care of difficult (supposedly) orphanage youths with foreign background. He proved to be an imaginative criminal entrepreneur. He and his family had already established links to international drug smuggling organizations and had acquired ownership of a number of restaurants before he went into the care business. The private St. Lucia foundation won several contracts from the municipalities of Oslo and Akershus. It operated with a sub-contracting enterprise to which the psychiatrist moved most of the private profit from the care activities. At one point of time his set-up took care of four difficult youths against a payment of about 4500 euro per night. He recruited several of his staff by giving them permanent disability pensions and then let them work black in both his restaurants and his profitable charity foundation. The difficult youths got “nice” social training by these partly criminal employees including a well-known violent debt collector. They showed less indication of psychic disorders except that they now got involved in a large burglary streak under competent leadership.

The fields of operation chosen were classical Norwegian, care business for difficult youths and care for the elderly, but otherwise he organized classical Mafia-like operations. A competing care-making organization was exposed to arson, informants threatened, and so on.

These organized, criminal actions strings were finally exposed when this psychiatrist delivered and got the contract for a municipal-owned house that housed a famous group of left-wing occupiers (Blitz) who had lived in the house for years. The conservative municipality would like to see them thrown out. Since he disposed so many violence capabilities, the psychiatrist could make a better bid than any other organization. The high publicity level of the occupiers became his bane, however, and in the end a large part of his criminal network was exposed and the psychiatrist received several years jail sentence.

This is probably a rather unique growth of a classical mafia-like organization in Norway. Its leader was able to gain some influence in the Oslo municipality thanks to a mixture of his good education and social respectability combined with a certain naivety (?) on the part of the procurers. It revealed also that the procurers were unable to do any

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<sup>12</sup> The following brief story is based on prize-winning journalistic work of the then *VG*-employed journalists Strand and Widerøe. During their work they were exposed to serious violent threats from the subjects of their research. In addition to the Scoop report to the prize-giving institution (Widerøe and Strand (2004), the story is outlined in a series of articles in the newspaper *VG* from this period. The easiest way to locate the stories is through the name of the main criminal (psychiatrist) entrepreneur, Ezazi.

serious quality control in this case as well as in recent Adecco scandal cases of social dumping. Nevertheless, the criminal organization that had turned towards public procurement processes apparently has not been able to survive under Norwegian conditions, or so we may hope.

## 5. Role of classical Mafia and public procurement in Italy: regionally confined?

Both Norway and Italy are economically advanced countries. Like Norway public procurement in general and public construction in particular are among the set of public activities with the highest corruption risks.<sup>13</sup> Nevertheless, on average it is rare to see large clusters of organized crime to develop under such conditions. Norway is here typical while Italy apparently is an exception. Its experience indicates that larger organized crime clusters may survive even in modern economies at least if they are already established when modernization proceeds. It is quite trivial, as we will see, that if a mafia-like organization in a given area has some power, it will influence the public procurement processes in that area both at the procuring and at the supplying ends.

It is a more open question, however, whether the availability of such organizations with their violence-making capabilities have a serious impact on the kind of strings of criminal actions that are available at the national level. The evidence is mixed. On the one hand a number of politicians operating in cities in Northern Italy without old historically established mafia organizations were shown at least to have important links to mafia operators and to politicians with “proven” mafia connections in the large “clean hand” operation initiated in Milan.<sup>14</sup> On the other hand, the regular use of violence appears to be mostly confined to the traditional mafia “infested” areas of the country.

Today Gambetta’s (Gambetta, 1993) analysis of the rise of the Mafia in Sicily (and by implication the occurrence of a number of other organized, mostly geographically concentrated crime clusters in Italy such as Basilicata, Calabria and Naples) has been accepted by most researchers in the field as a most fruitful starting point. It is also the basis for the Kumar and Skaperdas (2008) definition above. The idea

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<sup>13</sup> Della Porta and Vannucci (1999: 65) refer to research from Italy where 396 corruption scandal episodes were explored. Of those 36,6% referred to public contracting episodes, 28,1% to building permits.

<sup>14</sup> This was an historically exceptional operation where a large fraction of the Italian political elite was incriminated (1/3 of the lower house representatives, five previous prime ministers and thousands of businessmen mostly connected to public contracting and the building industry). Between 1992 when the operation started and 2002 the Milan prosecutors prepared 4520 corruption charges, 1300 were indicted and 1320 passed to other jurisdictions (Golden and Picci, 2006: 470).

is about the following: In the beginning in Sicily (maybe in the middle of the 19<sup>th</sup> century), groups of people were hired to supply protection of the assets of large landowners in an uncertain legal and physical environment. This service was limited in scope and would not give rise to much expansion or give scope for increased mafia-organizational complexity, however. The quintessential mafia task that made for expansion developed in surroundings of deep mutual trust between economic agents and under weak central government was rather to protect the implementation of contracts on markets riddled with fraud. The need for such protection was exceptionally great in markets with large informational asymmetries like the once important market for used horses,<sup>15</sup> but where today either illegal goods such as drugs or building contracts are likely to be the most prominent. To implement such contracts a Mafioso has to work on both sides of the contract. The use or threat of using force is essential. When establishing a group with force potential, there obviously are great increasing returns to increase in scope: if the group is already protecting horse sales in a neighborhood it does not need much additional information or weaponry to protect exchange in its fish market.

Looking at its scale economies, it is a clear advantage to increase in size when it comes to eventual violent contests with mafia competitors, but at the same time it increases its visibility and increase the risk for judicial actions. In practice it is probably a reasonable efficiency on the part of the police and courts that is most effective in containing the size of organized crime organizations as Reuter (1983) has convincingly argued.

Note that the police, if weakly monitored from an external center, may do many of the same tasks as a mafia organization. Within its space of operation the police may move rather freely across settings and demand bribes for settling disputes or extort to refrain from using its instrument of violence. Hence, the police and organized crime may compete – often with violent results or may collude where the police receive bribes from its mafia organization as it allow them to keep their influence or expand. In any case, corrupt and weak police and judiciary appear to be keys to the original accumulation in mafia-like organizations.<sup>16</sup>

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<sup>15</sup> Cf. Gambetta's (1988: 171 – 173) lively case of a Neapolitan couch man who had been tricked (in the year 1863) into buying a useless horse and had no remedy since his Camorra protector was in jail.

<sup>16</sup> In some policy discussions the threat that organized crime organizations may invest in legal establishment is perceived as making them more dangerous – coming up from the deep they are spreading their tentacles into legal business, directing it from behind. Here we suggest rather that the decreasing returns to scale of crime when operating in a fairly efficient police environment makes it profitable to expand into legal business even when realized rate of return is higher in the criminal branches.

Finally, elected politicians normally have to win election contests within given local neighborhoods. To win them it is useful to know about the various issues, economic and social events that take place, what kind of developments that may receive popular support *ex ante* and what is likely to cause most severe set-backs *ex post* the election in the neighborhood. Hence, in neighborhoods where democracy has some force, but corruption is rampant, the police and organized crime units crisscross the same economic and social space as the politician. The latter may need the information they collect and the force they may wield to win elections.<sup>17</sup>

If the original Mafioso accumulation stage is passed and the police and judiciary have grown in strength and honesty and begin to pursue them in earnest, the mafia may need political protection against the judiciary from the politicians in order to survive as large-scale organizations. How much politicians here are able to offer depends on the degree of judicial independences. Seemingly small reforms here may make a notable difference.

Another aspect of politicians' behavior was equally important for local mafia growth: it explained how the demand and supply for public works became like a used horses' market and the most lucrative one from the mafia point of view. After World War II and until the early 1990s a large expansion of public works took place in Italy with priority given to the Mezzogiorno (Southern Italy) where most of the local mafia-like organizations in Italy were working. Given the complexity on the demand or procuring side where shifting coalitions of politicians together with public administrators at local and central levels may become the effective decision makers, it was difficult to tell who to bribe. Fraudulent claims of influence may easily arise; promises about who would get the contract may easily be broken. At the other side of the market promises of bribes to be paid, quality to be delivered and so on may also be broken, but with somewhat more difficulty. In any case, this was a "market" where the state's legal institutions with their legally stipulated punishments for broken contracts were unable to assist. Mafia organizations could.

At the supply end mafia organizations were effective in stabilizing supply cartels. (della Porta and Vannucci, 1999: 228 – 231). Not only

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<sup>17</sup> Here the exact legal formulations of voting procedures as well as the local physical arrangements may have important consequences and strengthen or weaken the potential of mafia organizations to have direct impact on election results. This is a rather complicated research field since the effect of one rule will hinge strongly on which other rules it is combined with. While they are not unimportant for our analysis, I will not delve into here, just observe that the degree of mafia influence on the direct electoral results has significant impact on how the political rents from public procurement are likely to be divided between suppliers, politicians and the Mafioso. Parts of India appear to have evolved quite similar links between politicians, police and organized crime structures.

could they police whether the enterprises involved kept cartel agreements, they could control that the procurers did not allow new enterprises to enter the new bid “competitions”.

Given the fact that a larger share of local public works were directly financed from the central, national budget one would expect that the local mafias would seek and gain substantial influence also at the early stages of project creation, how the expenditures were distributed across regions. As mentioned, here the evidence is mixed. From the pre-“clean hands” period della Porta and Vannucci describe the central allocation of public funds for various forms of public procurement as dominated by political parties. Bribe collection of a party was monitored by a centrally placed but often anonymous “cashier”. He organized the collection process so that bribe receivers from the party stuck to their deals in the corruption “market” – a market that was heavily influenced by public works and the bribes generated there. Furthermore, the cashier monitored whether the income was properly divided between the party and the bribe receivers’ personal accounts;. At higher levels rules for division of the bribe income between the different parties had to be negotiated. Given their strong influence on administrative officials, the parties could police their debt collection.<sup>18</sup> Bribe payment promises by the business enterprises could be policed partly through their fear of not receiving new contracts, partly through the business leaderships’ own frequently close relationship to one of the parties. No obvious need for Mafioso monitoring of this market seemed necessary from the della Porta and Vannucci description (ibid.: 97 -111) although it clearly was a market where cheating was easy in principle and the deals must have been loaded with substantial informational complexity.

At the local level in the South party organizations were factionalized. The central party had less control and intermediation between local bosses became more important. One of the Mafioso task would be to make the different party factions stick to their corruption deals there. Presumably, something similar could happen at the central level and Golden and Picci (2006: 475) surmise that a recent diffusion of corruption in public works from the South to the North had taken place under the influence of organized crime. The difference though was that the mafia organizations could locally collect information about both entrepreneurs, workers, voters and politicians operating within the same rather narrow constituency.

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<sup>18</sup> The parties in Italy were much larger (and expensive) structures than what has been the case in the Nordic countries. According to della Porta and Vannucci (1999: 126) around 1990 elected political personnel reached 160 000 and the number of people with income mainly related to political activities about 2 million. These number divided by ten should give the comparable Norwegian figures. They are far below Norwegian data with any reasonable interpretation of what “related to” may mean.

Their surmise of a spread of organized crime up to the north was based on an ingenious combination of data. One set was a by-product of the “clean hand” operation. It picked up the regional distribution of legislators charged with corruption during the operation and reflected the situation around 1990. Some results were as expected: Sicily (Cosa Nostra), Calabria (Ndrangheta) and Campania (Camorra) were all among the highest share of perpetrators: 43-60% of legislators were charged in this group, but there were anomalies reflecting the connectedness to the initial Milan cases and the regional differences in severity of confession cascades.

These observations were connected to the outcomes from a corruption indicator that used long time series of public construction data cleverly used to reveal long-lasting regional differences in corruption propensities, as well as specific effects of mafia-like organizations. The indicator was constructed as follows: (1) an existing indicator of the existing stock of physical infrastructure per capita in each region in 1997 is compared to the national average. The southern regions on average possessed only 67% of the national average regarding physical infrastructure per head. Then a similar index (2) of the cumulated real flow value of resources the government had spent on acquiring this stock for each region was also compared to the national average.<sup>19</sup> Then they interpreted (1)/ (2) as a corruption indicator where lower numbers indicate higher corruption levels.

Taking Campania (Camorra) as an example: It had a corruption index of 0.362 which means that this region received only about 1/3 of as much physical infrastructure for each lire invested compared to the national average. If the lira was spent in Piedmonte (index 1.638) one will possess five times more infrastructure than if it was spent it in Campania. The strong points of this index are the following:

- a) it indicates some of the real costs of corruption and organized crime
- b) it is built on the sector where corruption is likely to be most significant in developed countries.
- c) it allows a direct comparison across areas since it focus on the same productive and administrative processes.
- d) it fits well with observers’ subjective impressions.

It is not perfect, of course. The labor force in different parts of the country may not be equally efficient, public construction may be more resource-demanding in real terms due to difficult ground, mountains,

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<sup>19</sup> The latter indicator of the cumulated flow value represented a very cumbersome and involved estimation reflecting historical developments in principle stretching back to the year of independence (1861) and until 1997..

etc. Earthquakes may destroy public infrastructure in some regions and not in others leaving less infrastructure intact. But given the importance of corruption in public works in Italy it is also likely to reflect differences in corruption propensities and other governance issues, among which organized crime is likely to be severe and regionally concentrated. It is striking that Campania and Calabria<sup>20</sup> both show extremely low public investment efficiency and both have had strong mafia organizations for a long time. This suggests that organized crime may stimulate corruption (and vice versa), but also that the effects of organized crime on cartel-making may be significant. In fact, mafia-organizations are well organized for the creation and monitoring of cartels (Schelling, 1984)

Regarding the spread of mafia organization: Areas with high infrastructure efficiency, but a high rate of “clean hand” legislator confessions could indicate a spread of mafia-like activities from their base to this area.

The research of Golden and Picci focused on the key mechanisms where both corruption and organized crime were linked to the impressive development of infrastructure in the Mezzogiorno despite the waste and sometimes serious human misery caused by the various mafia organizations. That development more than drug trade and trafficking made rents collected from public procurement activities the major basis for mafia growth at the same time as it brought the Mafioso and the politicians at local and central level into closer contact.

How close they were at the central level is not yet clarified. For example, was the priority given to Mezzogiorno only due to the political decision to prioritize the poorest and least accessible parts of the country, or was it due to the fact that it was easier to build in larger political rents in projects allocated there inclusive larger cuts at the central level? That is, was the political support for a more regionally equitable income growth as well as it's partly lack of success connected to the same flourishing mechanisms of corruption and mafia growth?

In any case, if this kind of indicator could be constructed for other countries too, it would be extremely helpful in order to assess corruption risks across countries at similar income and productive efficiency levels as Italy. If combined with further information it could also be used in assessing organized crime risks. Alas, it presupposes a huge statistical effort as the one made in Italy in aggregating real indicators

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<sup>20</sup> The results for Sicily and Apulia (Sacra Corona) are less striking, although both are quite corrupt also according to this index. Regarding Sicily the region is large and we know that the influence of the regular mafia is very uneven across the island (see Newell, 2006: 152) A possible explanation for Apulia is that the mafia organization there has been more into smuggling and trafficking not rent collection related to public construction.



for the quantity of public infrastructure stocks (a work inspired and made possible by the impressive infrastructure developments in Italy alluded to above) not available, as far as I know, elsewhere.



## 6. Transitions to market economy – may organized crime become a lasting aftereffect?

In a document sent from the office of the American Ambassador in Sofia as late as July 2005<sup>21</sup> it is told that they consider that

“The strength and immunity from law of organized crime (OC) groups is arguably the most serious problem in Bulgaria today. OC activities underlie corruption and the ineffectiveness of the legal system in Bulgaria and inhibit the country’s economic development.”

Whether this is a reasonable judgment or not, it has been widely shared.

In the following we will focus on Bulgaria as another example where organized crime (including active and illegal use of means of violence) may rise also under industrial conditions – but this time quite suddenly – and become a significant economic and political phenomenon. Hopefully its shorter history will prove organized crime organizations to become less entrenched than they have become in Italy.<sup>22</sup>

It is well documented that organized, violent crime (as well as regular crime) increased during the transition to a market economy in most of the former socialist countries in Europe and the former Soviet Union. This is mostly explained by what happened during the transition – mainly the loss of livelihood or strong declassing of such groups as artists or wrestlers and the extreme uncertainty of property rights that characterized this period. As pointed out in Volkov (2000) regarding the latter we may find an important precursor in the old socialist system in Bulgaria as well as in the former Soviet Union in the shape of the illegal market economy developed before the transition, but for the most part it is a recent phenomenon.

Almost by definition any informal or illegal economy will give rise to the problems of how to protect property rights and how to implement contracts – problems where mafia organizations may become the solu-

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<sup>21</sup> The document is found at Wikileaks search engine <http://cablesearch.org/cable/view.php?id=09STATE62392> , accessed March 8, 2011.

<sup>22</sup> It is reason to worry though. In a number of economic analyses of mafia forms of violent competition, such as Kumar and Skaperdas (2008), there appear to rise plausible stable equilibrium outcomes.

tions. Particularly in the areas where the illegal market economy constituted a large share of the actual economy such as Azerbaijan and Georgia (about 50% in 1979 according to Alexeev and Pyle 2001) the original growth conditions for mafia-like organizations were exceptionally fertile- up to a point. However, in addition to informal violence-making capabilities to implement contracts the enterprises involved were so highly visible that higher level protection from the Communist Party and the police, particularly the secret police, was also needed.<sup>23</sup>

It was only after the centripetal forces of the state had weakened, that crimes of various sorts increased and the unofficial economy had to survive on its own, that politically independent mafia-like organizations really mattered and increased in numbers and members in the former Soviet union area. While the share of the informal economy in GDP indicates the demand for organized crime during the transition, the decline in output (and the corresponding increase in unemployment) suggests the size of the impact on the supply of recruitment. Using 1989 as the basis, production in Azerbaijan at it lowest point was only about 37% of 1989 production while Georgia's constituted about 25% (Andvig 2002: 59) .

Compared to these developments the positive shocks on the organized crime potential during the transition in Bulgaria were less dramatic, nor was its starting point so congenial. The relative size of the informal economy was around 30% in 1989 (Kyle et al, 2001) and its share of the total economy increased only with 4.4% (1996) and then declined steeply (ibid.) so in 1998 it constituted only 22%.<sup>24</sup> Moreover, the aggregate output fell only with about 37 %, a severe decline for sure, but around the average for the transition period of the former socialist countries in Europe.

Her we should add that there were also reasons external to the processes emphasized here, which are likely to have stimulated organized crime in Bulgaria. The main one is that Bulgaria had for a variety of reasons better international networks into the former Soviet union than

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<sup>23</sup> Heidar Aliyev, the later president of Azerbaijan was an exceptionally clear case Starting out in the secret police and combining local party leadership with effective control of an organized crime network operating in a local economy where the illegal sector was about as large as the legal one.(Alexeev and Pyle 2001) His influence and private fortune was in the end transformed to Azeri presidency and effective control and private appropriation of a large share of the rents from of the local petroleum industry Shevardnadze in Georgia also led the local communist party watching an extraordinary growth of a local illegal economy, shared some of his features, but it was less clear-cut. Note that, somewhat surprisingly, the size of the informal economy increased the first years after market principles were accepted as the ruling ones. According to Alexeev and Pyle (2001), in 1995 the share of the unofficial economy increased to 70% in Azerbaijan and 71% in Georgia. It has later subsided in both.

<sup>24</sup> Note that all these estimates of the informal economy size are very uncertain and rely on very doubtful assumptions about either electricity consumptions or constants i financial markets that may easily lead the estimates into wild directions

the other Balkan countries at the same time as it was relatively open towards Western Europe, which opened up for various brokering activities, including criminal ones. Partly fed by those, organized crime would have also stronger pull in the processes we are focusing on.

Bezlov et al (2007) organize their analysis of the rise of organized crime in Bulgaria mainly around the character of the supply shock: how the agents' pre-transition original social and economic positions suddenly changed causing members of some groups to lose their livelihoods or status completely or in part. This led to a high propensity among members of some groups to join organized crime activities, highest if their former work experience was of some relevance for the new criminal tasks. The outcome was the rise of three distinct groups: 1) the violent entrepreneurs, 2) the extreme-risk entrepreneurs, and 3) the oligarchs.<sup>25</sup> The recruits to the 1) group were often former sportsmen in violent arts, former violent criminals or former members of the police; the recruits to 2) taxi drivers, bartenders, and if educated, accountants, lawyers. 3) were recruited from groups who already had a position where they commanded labor power such as former communist party officials.

Most of the activities that characterize organized crime such as violent competition for drug markets, trafficking, smuggling, plain extortion and racketeering, etc. – all needed to build up the financial resources for organized crime organization – is of secondary interest for us here. The question is whether such organizations had and have influence on public procurement. Or rather – in line with our definition – were public procurement decisions heavily influenced by systematic strategies that contained both criminal and violent actions?

Here we should note that for the first part of the period it was not public procuring of assets, goods and services that was the key issue, but the somewhat symmetrical activity of selling public assets to private individuals or enterprises, privatization. During periods where states are weak, the ownership to the public assets becomes unclear and disputable. Formally it belongs to the people, but in practice they have become a kind of non-agricultural commons ready for enclosure by agents who for various reasons are well positioned for it. Before it is a question of how the division of the rents between agents should be divided, the question is which individuals/public institutions will conquer the right to sell them and thereby also gain a position wherein it is possible to gain a share of the rent. There will be fights both *ex ante* and *ex post* of a privatization decision. With procurement most of the fights taking place are *ex ante*, *ex post* it is normally quite clear which

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<sup>25</sup> Note that the basis for classification applied on organized crime here is the *type of agents*, not the *type of actions* that we introduced in section 2.

organization that is the supplier, even who formally is the procurer, but who actually are influential is fuzzy in this case too *ex ante* and part of a political process that is difficult for outsiders to access, as we have noted before..

Privatization is selling an *asset*, something which is supposed to last, while procurement deals mainly with short-run projects even when dealing with service contracts that in many cases *should* last for long, but rarely do. A lucky acquirement of a privatized asset implies an expectation of a lasting flow of rents. A good contract means only a one-shot rent. Another difference is, of course that a public procurement operation normally means that something new has to be created. If that is an asset the exact ownership to it is not so essential. It may just remain fuzzy without any further consequence. With privatizing it becomes essential to establish exclusive ownership rights.

Given the potential lack of clarity of who the rightful public disposer of a public asset is, the acquirer needs to defend his property right by political, legal and also potentially violent means. In practice it will often be embezzled by the person or group who dispose it before the privatization decision, that is he (they) will become the owner, in the end. If the asset is acquired illegally, it is a matter of definition whether the whole private enterprise activity that results should be considered an organized crime venture or not. The illegality increases the likelihood that the new ownership rights have to be defended by violent means, at least until it is accepted as the *de facto* situation. Needless to add, processes of illegal or illegitimate privatization of public assets protected by violent means are organized crime ventures according to our definition.

Rents in a privatization process means that the final private owner of a public asset normally buys it below its capitalized market value. If that is all that happens, it will be the new owner only that appropriates the whole rent. The effective disposer, if different from the new owner, could also receive a share if he could embezzle some of the funds resulting from the sale of the asset, but this implies some form of financial fraud or weak accountancy at the public end. Another peaceful way to share the rent would be for the buyer to pay the disposer a bribe. The same problem arises here as for procurement decisions: who should be bribed? This needs a good knowledge of the political disposal process. In practice the problem may be even more complicated than simply the allocation of bribes because it will not only be money involved, but political influence –promises and threats – will be traded. – And maybe – as just mentioned – also some violent threats.

We see here that there is much symmetry between the privatization and public procurement processes. In addition they may apply the same formal bidding systems when the pretence of mass ownership is shredded except that sale bids are based on highest possible and procurement bids on the lowest possible price auctions.

But the differences are also quite striking. When considering the role of organized (violent) crime, the needs for organized crime during a privatization process appears, *ceteris paribus*, to be much stronger than during flows of public procurement decisions due to the need of establishing and possibly re-establishing *ex post* ownership rights.

Center for the Study of Democracy (2009) suggests a difference between the Bulgarian and Russian oligarchs that may point towards an interesting way corruption and organized crime interventions can have been linked in Bulgaria. The recent economic openness of Bulgaria has made many of the old state enterprises unprofitable even when in private hands. If that was forestalled, not much fighting will take place to get ownership rights to those assets, except<sup>26</sup> for the cases where public procurement subsequently constitutes a large chunk of the demand for their output or services that has remained highly profitable.<sup>27</sup> Hence, if this was the case the privatization processes may have been linked to the present public procurement processes where these enterprises are involved.

Let us compare the ways organized crime impact public procurement including the political bribing games in Italy and Bulgaria. In both countries corruption in procurement processes is significant and organized killing for profit is not really rare, and may be linked sometimes to procurement (and privatization) decisions. In Italy the police and judiciary and the political system appear to be more permanently differentiated, however, than in Bulgaria. This implies that mafia-like organizations would have less need for political protection to influence the judiciary. It should suffice to bribe the police, eventually the judiciary.<sup>28</sup>

On the other hand, given the unreliability of the judiciary and the need to establish permanent ownership rights during the privatization pro-

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<sup>26</sup> Their expected scrap value may of course be considerable, particularly so if the ownership of the assets also has given ownership rights to the associated land on which the assets are located.

<sup>27</sup> National preference in public procurement is not something unique for Bulgaria. Despite all the efforts by EU to ensure international bidding only 1.6% of public contracts are awarded to operators from other member states (European Commission, 2011:4).

<sup>28</sup> Note that in most former socialist states the judicial organizations had very little political independence at the outset, and rightly so since it was the party who could claim to represent the people's feeling of justice. Harsh penalties and the fact that it was citizens, a hard cash carrying sector, who would be punished, meant that it was easy to collect bribes in this sector (Andvig, 2002). With a complete change in the conceptions of justice it was no wonder that this behavior was carried into the new order.

cess in Bulgaria, any owner may risk that some of his competitors may also bribe the judiciary to undo his ownership right which called for either a more permanent political protection or some violence apparatus under his own control. Seen against this background it is somewhat surprising that there apparently are not built any violence apparatuses into core business organizations. Those apparatuses appeared to have been functionally separated. The violence connected to public procurement and privatization processes appears to have been mainly outsourced in contract killings. Violence as well as corruption connected to private enterprises appears now to have subsided as these enterprises have gained in legal status or at least have become accepted as part of the status quo distribution of power.



## 7. Conclusions – or how to tell whether organized crime impact public procurement?

The extent of organized crime is in itself a phenomenon that is difficult to locate empirically. For obvious reasons the agents involved will like to keep every aspect secret, actions as well as organization. The political processes likely to determine the outcomes of public procurement contests are also likely to remain obscure for outsiders, including researchers. To ask how unknown organized crime institutions may impact procurement decision procedures and to expect precise, empirically based answers, border on foolishness. If that is the demand for presenting an analysis, we will, except for luck, have to exclude the study of the phenomenon and to know nothing.

But to have an idea about how organized crime may become influential in procurement is important in some societies both for understanding the actual workings of their governance processes and the actual allocation of public assets. Hopefully, a better understanding may also give us ideas of how the eventual impact of organized crime may be weakened.

How to tell whether organized crime is an empirical issue or not? In the end one has to rely on the information the police are willing to convey, what citizens tell about from their eventual experience with such organizations, and what former members of organized crime organizations are willing to reveal. The rest is luck. While fear may make people silent it may also create wrong and often exaggerated perceptions about the size, extent and impact of the organized crime organizations including their cleverness.

A number of external (to the organized crime units) indicators may reveal potential risks. High unemployment rates among youth or pockets of poverty may indicate potential supply risks. From the demand side the relative size of the informal economy is significant. If large, contracts there need informal policing. Clear indications of high corruption rates among the police are clearly of direct significance. Here we have data – although not reliable ones – from a number of countries. High *and* uneven murder rates are another, potentially useful indicator. Economic income levels are obviously important. Rich countries rarely develop organized crime organizations of real signifi-

cance, but Italy is a partial exception. Income levels will also influence the sectors where organized crime may rise. The high wage rates for unskilled labor with potential violence skills in the sector could act as a stimulus.

The historically deeply entrenched mafia-organizations in Italy and the sudden flare up of violent crime organizations in Bulgaria both suggest the importance of historical analysis, the path dependency of the phenomenon. Regarding organized crime's potential impact on public procurement we noted that a procurement "market" has many of the used horse characteristics of Gambetta that may generate a demand for a mafia-type of organization there, and particularly so if the allocation of the procurement decisions between political and bureaucratic institutions are not clear. At the supply side there is much to be gained for suppliers by cartelization, an arrangement that organized crime could easily facilitate.

Of other factors worth mentioning we have seen that the organizational architecture that in fact links the police, the judiciary and the political system, their mutual degree of independence may prove of significance. For example, when pursued by independent magistrates political protection would be in great demand by crime organizations. Whether it will be supplied, would of course hinge upon the political system and the degree of the politicians' profit orientation. If we were to acquire any substantial empirical information, that will have to be collected from the courts, the police, or from informants that are fairly close to the procurement process. In general, we may be satisfied with something much less solid and informative: *a risk analysis*.

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