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Support IME

IME – Think Tank of the Year

Institute For Market Economics was named **Think Tank of The Year** in the first ever UK awards of this kind. The inaugural Golden Umbrella Think Tanks Awards took place on **Wednesday 5th December 2007** at the National Liberal Club bringing together the Stockholm Network’s 130+ member think tanks from 40 countries ranging from Iceland to Azerbaijan, in addition to European politicians, journalists, policy makers and industry representatives.

The awards of IME are:



Think Tank of the Year – for spreading of the ideas of free market and personal choice in Europe.

Presented by

Dr. Jan Čarnogursky,
*former Prime Minister of
the Slovak Republic*

Accepted by

Dimitar Chobanov, *Chief
Economist at IME*

The Media Award – for successful work with the mass media and spreading of the ideas through different information formats.

Presented by

John Fund, *Wall Street
Journal*

Accepted by

Dimitar Chobanov,
Chief Economist at IME



We are honored to receive this recognition.

Already fourteen years we support and protect the ideas for market freedom and try to restrict the intervention of the government.

We believe that these awards are recognition for the intense and expert work in the Institute and the professionalism of our team. We want to express our sincere gratitude to Dr. Krassen Stanchev, Executive Director of IME (1993-2006) who worked hard for spreading the ideas of market and personal freedom. Also, we take this opportunity to express our gratitude to the members of the Board who support our work.

We are sure that this recognition owes to the fact that in Bulgaria there are many think tanks and people who support the freedom and are ready to protect their ideas.

We believe that these awards are recognition for the independence of IME and its presence on the public scene because we strive to inform the society about our positions, beliefs and work. Our understanding that we must be opened for the media and the people is the basic of our work and we demand the same from all.

We believe that this award shows that the development of the civil society is not considered only as charity, but also as accumulation of ideas, which help everyone.

The awards are challenge for the team of IME to continue and extend its work and stand up for the competition, minimum intervention of the government and greater opportunity for personal free choice.

We are thankful to everyone who supports IME and makes offers or criticizes our work and our ideas.

A contribution to receiving the awards have also the media because of their participation in spreading of the ideas of free market and choice in the country.

Svetla Kostadinova

Executive Director, IME

December 07, 2007



The rest winners are:

The Award for the Best Think Tank in New Market Economies - *Free Minds Association* in Azerbaijan

The Award for the Best Contribution to Free Market Thinking - *Jose Pinera*, former secretary of Labour and Social Security in Chile

The Best New Think Tank Award - *European Centre for International Political Economy (ECIPE)* in Brussels

The Personality of the Year Award - *Prof. Atilla Yayla*, Political Scientist and President of the *Association for Liberal Thinking* in

The Internet Award - *Institute of Economic and Social Studies* in Slovakia

The Award for Best Research - *Istituto Bruno Leoni* in Italy

The Innovation Award - *Taxpayers` Alliance* in London

The Stockholm Network is a pan-European [think tank](#) and network, located in London. In addition to it's own policy research, it is an umbrella organization for market-oriented think tanks in Europe. It has over 130 member organizations.

The organization was founded in 1997 by [Helen Disney](#) in response to the growth in market-oriented think tanks across Europe, with the aim of providing a forum for sharing, exchanging and developing pan-European public policy research. Interested in ideas which stimulate economic growth and help people to help themselves, it promotes and raises awareness of policies which create the social and economic conditions for a free society. Its stated goals include:

- Reforming European welfare states and creating a more flexible labour market.
- Updating European pension systems to empower individuals.
- Ensuring more consumer-driven healthcare, through reform of European health systems and markets.
- Encouraging an informed debate on intellectual property rights as an incentive to innovate and develop new knowledge in the future, whilst ensuring wide public access to such products in the present.
- Reforming European energy markets to ensure the most beneficial balance between economic growth and environmental quality.
- Emphasising the benefits of globalisation, trade and competition and creating an understanding of free market ideas and institutions.

Currently, the Stockholm Network has three programmes: The Health & Welfare Programme, the Intellectual Property & Competition Programme and the Energy & Environment Programme. Each was developed in order to further the objective of the Network in searching for practical market-oriented solutions to the endemic problems Europeans face today.

The Institute for Market Economics (IME) is the first independent economic research institute in Bulgaria, founded in 1993. The mission of IME is to promote and protect the market approaches for overcoming of the challenges of the citizens of Bulgaria and the region. The aims of IME include giving independent estimate and analysis of the government policy and to serve like a tribune for exchanging opinions and conceptions of economists and observers about different questions.

Flat tax

Dimitar Chobanov

During this week there was a discussion about the change in taxation of the personal income, which consists of the introduction of proportional tax from the beginning of 2008. The social security burden is not likely to be reduced, however the ratio of payments by the employer and the employee is changing from 65:35 to 60:40.

Proportional tax is the one where regardless of the size of your income the same tax rate is applied. In this case the rate will be 10%. That means that it is applied for income of 300 levs (30 levs tax) and for income of 1 000 levs (tax burden of 100 levs).

The opponents of this type of tax claim that, it is not fair, since it levies the same rate on all people. According to them the taxation should be progressive and thus fairer, since large incomes are levied higher taxes. However, here a very important fact is omitted, which refers to the essence of levying taxes. The tax is a mandatory payment to the state – in other words it is not a voluntary means to finance the government expenditures. In that sense it could not be fair, since against the will of the people part of their income is taken. Hence it is not possible to speak about fair tax, however the lower the rate less damage it makes.

Something more – the proportional taxation means that the marginal rate is the same. Thus for every additional euro earned are paid exactly 10 cents taxes regardless whether before hand we have earned 250, 500 or 1 000 euros. That

means that taxation does not aim at hindering employment additionally by imposing higher tax rate. In other words, this is a clear sign that through tax policy the state is aiming to encourage additional efforts and improved productivity and, as a result, higher incomes for the people.

The reduction of the maximum rate of taxation from 24% to 10% will affect significantly the income of the people from the so called middle class. The immediate effect will increase the available incomes as a result from the lower tax rate. The long term effect will be that the people will be encouraged to work, since this is the way to influence their choice between work and leisure. In addition the so called excess burden is reduced – that is the difference between the expenditure for society from the existing taxes and the state revenues. In other words the net loss of society from taxation will be reduced, which will result in more goods and services produced, which will mean higher real incomes.

One group of taxpayers will bare initially the costs of introducing the proportional tax. These are the people with gross monthly income of up to 450 levs (EUR 230). They will lose income due to the removal of the untaxed minimum, which for them means an increase in the effective tax rate. In the budget sector it is proposed to compensate the employees, but this does not apply to the private sector. Most affected will be respectively the people with low productivity, the young employees, which are at the beginning of their career, as well as those who are paid per working hour. According to the official data provided by the National Statistical Institute the average wages in several sectors are below the 450 levs (EUR 230) limit. An important fact in this case is that this data may

be different from the actual situation due to the existence of informal economy. This applies to a very large extent to the construction industry, where the salaries are much higher than reported. In other words, the claims that over 1 million employees will receive lower net income are too far fetched, since a large portion of these people are better paid, but do not declare the full amount of their incomes.

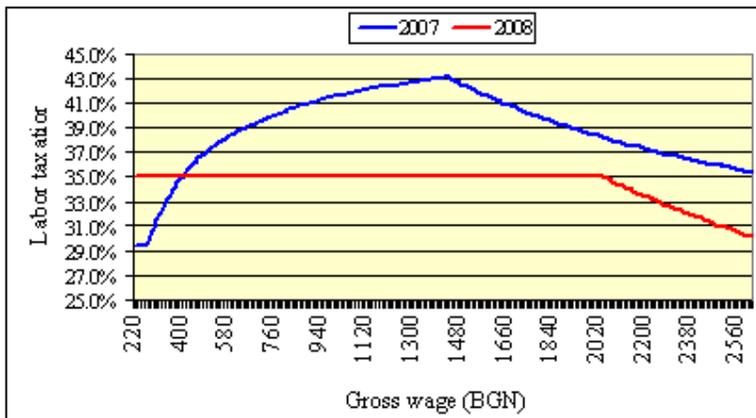
Besides, the growth of the incomes in the private sector for 2007 is over 20% and this high rate will probably remain similar over the next year. Factors leading to this effect are the continued growth of the money supply and the inflation, as well as the increased productivity of labor. For that reason part of people which at present receive lower incomes will go over the limit of

450 levs and will not be affected by the higher rate.

The other advantage of the proportional tax is the ease of administration due to reduction of part of the existing preferences. This will allow for reduction in the number of people in the tax administration.

Overall the progressive tax is replacing the proportional with a lower rate. Without any doubt this is a positive measure, which will affect positively the economic development of the country. In the long term this will mean higher productivity, growth in supply and higher real incomes. Stimulating the middle class, which are the generator of economic growth, is actually a social measure since it is directed at higher wealth.

Figure 1: Taxation of labor during 2007 and 2008 (percentage of the cost of labor for the employers)



Source: The author's calculations

Alternative Budget With Low Taxes For 2008

Georgi Angelov

Main objectives

The idea of alternative budget with low taxes is to show that, it is possible to significantly reduce taxation and at the same time improve the quality of public services. As in previous occasions, the alternative budget with low taxes for 2008 aims at:

- Reduction of the tax burden and the redistribution through the budget (a larger portion of the income remains in the hands of people and companies).

- Improvement of the effectiveness of the government spending and public services.

As a result of that we expect:

- Acceleration of investment, enterprising and economic growth,
- Increase in the growth of income.

Tax reform

This year again the main tax proposals in the alternative budget are related to the introduction of the 10% flat tax rate for each of: social security, income and corporate profit. Specifically, we propose:

- 10% flat income tax (20 – 24% at present);
- 10% profit tax (already in place);
- 10% social security contributions (33.7% at present);

Including:

- 10% tax for sole entrepreneurs (20 – 24% at present, 15% proposed by the government)
- No tax on dividends (7% at present, the government proposes 5%)

In addition:

- The local municipalities should have the right to determine the rates of the local taxes, and not only to increase, but also to reduce the current levels (for the moment, the government allows the municipalities only to increase the local taxes);
- One tenth of the income tax to become a local tax – respectively to be part of the local (municipal) budget and the municipality to be able to reduce it.

The reduction of all direct taxes to 10% each will complete the tax reform and will establish a very good climate for economic development and increasing of the welfare of Bulgarians. In addition, the budget also will benefit from the reduction of rates, as this will lead to economic flourishing and eliminate some of the incentives for tax evasion, and as a result, the state revenues will even grow.

We believe that the municipalities should have the right not only to increase, but also to decrease the local tax rates and at the same time to get the right to receive and to determine one tenth of the income tax (1% of the 10 percent flat income tax to be available to municipalities). This is important not only as an addition to the budget revenues of the municipalities, but as a direct connection to their efforts to improve the business environment and the budget revenues. Also, the municipalities will have the opportunity to influence the levying of taxes and thus, to influence the labor market and the dynamics of the economy.

The greater freedom of the municipalities is related to greater responsibilities and the possibility of financial problems. Although this will be a very rare event, it is better to have very clear procedures for municipal bankruptcy. It

should be clear what happens to a municipality, which is not meeting its financial obligations – whether or not the court should appoint a receiver or this is done by the regional governor and the Minister of Finance. The procedure is important in order to stimulate the local municipalities to behave in a responsible manner, and if they are not, they will be punished accordingly.

The social security contributions of 10% must go to private pension funds, and the monopoly of the state healthcare fund must be abolished so that a person could select a health fund where to put his money aimed at health insurance. This will make the contributions not only significantly less, but will link them directly with the services provided and a person will have the right of choice. As a result the stimuli for tax evasion will be significantly less.

Budget reforms

In order for such large decreases of the taxes to take place, it is necessary to use more effectively the state expenditures, including a reduction of part of the non-effective expenditures. Here below are some realistic reforms for 2008:

- 20% reduction of the staff in the budget sector – the state officials and budget employees are too much for a small country like Bulgaria, while at the same time in the private sector there is a shortage of personnel.
- 25% increase of the salaries in the budget sector – the savings resulting from staff reductions will be more than sufficient to cover that increase in salaries. Thus, the remaining employees in the budget sector will get a good increase of their income, without any requirements to the budget for more funding (as it is done every year).
- Decrease of the expenditures by 14% - together with the reduction of the budget staff, it will allow for significant savings from the collateral expenditures.
- The introduction of real program budgeting – to finance only programs , which utilize more effectively the funds provided, have clear goals and specific indicators to measure success/failure.
- Reduction of subsidies for loss-making companies and activities by one third – gradually the state must complete the reforms in the unreformed sectors of the

economy and to step aside from those sectors. The State Railroad Company is a typical example for a company, which rather than paying money to the budget every year, receives generous funding from it even though the quality of service is low.

- Evaluation and termination of the ineffective employment programs – with such a sharp drop in the unemployment rate and lack of workers it is not possible to justify the financing of programs for artificial employment. They must be terminated.
- Covering the expenditure for infrastructure by the private sector through open tenders – a significant part of the infrastructure could be financed based on market principals (airports, ports, highways) and to bring income to the budget rather than the budget to finance its construction and maintenance.
- Reforms of basic budgetary systems by increasing their effectiveness.
- Reducing the expenditure for interest payments on loans through:
 1. Stop taking new state loans;
 2. Reduce the size of the state dept;
 3. Rarely providing state warranties.
- 25% increase of the pensions – as a result of the optimization of expenditure, reduction of the tax burden and growth of the economy and increased employment it will be possible to set aside a larger amount of money for pensions.

Structural reforms

Completing of the retirement program reform:

- The entire social security payment of 10% is paid to a chosen private pension fund;
- The pensions of the existing pensioners will be financed entirely by the state budget.

Through these two changes it is possible to warrant the long term stability of the system as

well as adequate financing for the pensions of the existing retirees. The 10% pension installment in a private retirement fund is sufficiently low to avoid burdening the working people, but on the other hand provides sufficient savings for financing the pensions after retirement. In addition, in this way are accumulated savings, a large portion of which could be invested in the economy and that will increase additionally the growth of productivity and personal incomes.

Completing the health reform:

- Breaking the monopoly of the state health fund – every person to decide by himself/herself where to insure against illness;
- Competition between the various health insurance funds – to offer better healthcare packages and prices;
- The state to define the minimum healthcare package, which should be offered by the funds;
- The state to finance the payments for the retired people, children, unemployed and the poor;
- Market negotiation between the healthcare funds, the hospitals and the medical professionals.

Through such a system, on one hand, the administrative approach is removed from financing of the healthcare and on the other, a state healthcare system is proposed for the vulnerable groups of society. Thus, we could use the advantages of the competition even in the sphere of healthcare services in order to enhance the efficiency of the sector without government interventions.

Everyone who is not satisfied with the chosen health insurance fund could change it. In this way the competition between funds will lead to the supply of a large number of different services and coverage packages, while the insured will have the opportunity to influence what they get for their money. The hospitals and the healthcare funds will negotiate according to market principals, which will eliminate the current problems of defining the prices of the different clinical paths.

Improving high school education through:

- Decentralization of school management;

- Delegated budgets for all schools;
- Voucher system – the money follows the student, including in the private schools;
- Competition between the schools to attract students;
- Teachers' labor market – the competition will create a market for the teachers' labor, such labor markets already exist in most sectors of the economy, and
- External evaluation – of the educational results.

Research indicates that decentralization together with competition and external evaluation leads to better results with respect to the quality of education. In that respect a similar system could improve the level of education, which shows significant downfall in the last few years.

Reform of university education and science

- Autonomy of the universities – allowing them to define their own tuition fees and the number of students;
- Providing scholarships and credits to the students, not subsidies to the universities;
- Removing the obstacles to open a foreign university in the country;
- Financing science on a project basis rather than subsidies to such organizations as the Bulgarian Academy of Science;
- More science at the universities.

All of these will foster competition between the universities to attract more students and to improve the quality of training. It is also important to foster scientific research in the universities where the students could implement their ideas and to have real results from financing of science.

Alternative budget – effect on the economy

In the alternative budget are foreseen the following revenues and expenditures:

- Revenues: 24 billion leva (27.2 in the

government draft)

- Expenditures: 22.3 billion leva (25.4 in the government draft)

As a share of the GDP this is:

- Revenues: 39% (44.1% in the government draft)
- Expenditures: 36.2% (41.1% in the government draft)

The reduction of the tax burden will lead to:

- higher economic growth
- more investments – local and foreign
- reduction of the gray economy
- increased incomes due to the lower taxes
- increased incomes due to the higher growth of the economy

As a result from the tax and budget reform Bulgaria will be able reach growth rates which are closer to the Baltic States, including Estonia that is the fastest growing economy in Europe in recent years. The convergence to income levels and the standards of living in Western Europe will be much faster and will not require 50-100 years to take place.

What is next

During the subsequent years, the policy of tax decreasing should be maintained with a possible level of **the flat tax on profit and incomes of about 5%, as well as zero tax on the reinvested profits.**

This continuous reduction of direct taxes is possible due to two reasons:

1. Increased growth of the economy and of the revenues to the budget as a result of the tax reform and the reduction of the tax burden.
2. Increased revenues to the budget due to the EU requirement to harmonize the excise tax rates.

Table 1: Revenues - comparison between the official government and the alternative draft budget (mln. levs)

	2008	2008	Comparison
	Official	Alternative	
Total revenues	27,192.3	24,067.7	-11.5%
Tax revenues	22,098.9	18,853.0	-14.7%
Direct taxes	9,251.3	5,011.3	-45.8%
Corporate taxes	2,261.8	2,364.5	4.5%
Income taxes	2,190.0	2,646.5	20.8%
Social security and healthcare contributions	4,799.5	0,0	-100.0%
Contributions for the State Pension Fund	3,831.9	0,0	-100.0%
Healthcare contributions	967.6	0,0	-100.0%
Indirect Taxes	12,102.7	13,091.7	8.2%
VAT	8,110.0	8,128.3	0.2%
Excise Duties	3,797.7	3,990.1	5.1%
Customs fees and duties	195.0	223.3	14.5%
Other Taxes	744.9	750.0	0.7%
Non-tax Revenues	3,193.3	3,314.6	3.8%
Subsidies	1,900.1	1,900.1	0.0%

Table 2: Expenditures - comparison between the official government and the alternative draft budget (mln. levs)

	2008	2008	Comparison
	Official	Alternative	
Total Expenditures and contribution in the EU budget	25,370.9	22,340.0	-11.9%
Total Expenditures	24,711.0	21,680.1	-12.3%
Total non-interest expenditure	24,042.9	21,180.1	-11.9%
Current non-interest expenditures	19,091.0	16,700.1	-12.5%
Compensation (salaries and scholarships)	3,610.5	3,200.0	-11.4%
Social security contributions	1,021.2	400.0	-60.8%
Maintenance and operating	4,775.6	4,100.0	-14.1%
Total Subsidies	1,342.6	900,0	-33.0%
Subsidies	1,139.7	900.0	-21.0%
Social expenditures	8,341.1	8,100.0	-2.9%
Pensions	5,276.8	6,000.0	13.7%
Social assistance	1,578.0	1,300.0	-17.6%
Health Insurance fund	1,486.3	800.0	-46.2%
Other social security expenditures			
Capital expenditures	4,257.9	4,000.0	-6.1%
Contingency	694.0	480.0	-30.8%
- structure reforms and fiscal stability	409.0	300.0	-26.7%
- budget	205.0	100.0	-51.2%
- natural calamities	80.0	80.0	0.0%
Interest	668.1	500.0	-25.2%
Contributions to the EU Budget	659.9	659.9	0.0%
Balance	1,821.4	1,727.7	-5.1%

(Not)Unnecessary Budget Questions*

Svetla Kostadinova

There is a well-known truth that, when you are spending someone else’s money you are not interested in effectiveness, which is different from the case, when you are spending your own. This is the reason why when we are talking about spending the budget surplus it is best to ask several questions.

The most fundamental is: **Why is there a budgetary surplus?**

It turns out that, the Bulgarian Governments since 2003 up to now could not calculate properly or do not want to make the efforts to be closer to reality. Data about the budget indicates that, in five consecutive years the Government is collecting more money from the tax payers than it needs for the planned expenditures. It must be

mentioned that, the budgetary expenditures are growing, in other words, even when the expenditures are growing every year again more money is collected.

The reasons for the high level of collection are various – certain taxes are reduced and as a result the people and the companies are paying them; due to the reforms the economy is developing well, investments are attracted, which expands the base on which taxes are levied. Simultaneously with that, the Government underestimates the expectations for revenue, for various reasons – forecasting is difficult; does not believe in the stimuli which affect the taxpayers when taxes are reduced; it is not confident that, it will perform the reforms, which lead to more payments and more investments, etc.

Whatever are the explanations, it is important that, for five years they could “guess” less and less accurately the budget surplus at the end of each fiscal year.

Budgetary Surplus

Million leva	2003	2004	2005	2006	2007
Forecasted surplus/deficit	- 262.8	- 284.2	-195.6	0	385.6
Actual - surplus	0.9	656.4	1 333.7	1 747.6	3 353.6 *

Source: Ministry of Finance; *data is from September 2007

The most important question is: **Do we agree, as taxpayers, our money to be spent for the proposed activities?**

In order to answer this question, we have to know exactly how is spent part of the surplus. The information at present indicates the following:

- Infrastructure – roads, railroads and ecological – expenditure for activities already done and not for new investment projects. Most analysts claim that, investments in infrastructure are probably the best way to spend the surplus. There are however, contradictions in the explanations of the Minister of Finance – he claims that the money will be spent for activities already done, in other words things that

should have been already in the budget and which must have received funding. On the other hand, stands the question: is it possible that these expenditures should not come from the budget, but from the private sector? If the process for granting concessions was fast, transparent and with clear rules, up till now a significant part of the infrastructure could have been built or improved. Unfortunately both variants for building the infrastructure are strongly compromised – the Government is extremely ineffective, while granting concessions is associated mainly with corruption.

- Interest free loans to the municipalities, related to completing of euro-projects – this also sounds logical, but only at first

glance. The problem with the European money is that, with them there is also highly motivated ineffectiveness and when it is necessary part of that ineffectiveness to be financed from the budget that now is a problem.

- The implementation of telephone 112 – this project became notorious with its delays and the threats of sanctions by the EC. When the budget for 2008 was being prepared there was a request for over 300 new staff for its implementation, fortunately not satisfied by the Ministry of Finance, and more than 60 million leva in additional financing. It is not clear how the additional funding will insure the successful start and whether or not it will become the second Company Register or the information system of the National Agency for Revenues, which with the same problems are still not operational. In all cases, it is mandatory to present an analysis of the causes, which lead to the delays in successful completion, the measures, which have been taken not to repeat the same mistakes and responsibility which must be sought.
- The silver pension fund – it must guarantee the stability of the pension system and will receive the remaining from the surplus after spending the 1 billion leva under discussion and placing up of 3% (1,6 billion leva) in the fiscal reserve. This may be the most sensible idea to utilize the budget surplus. It is not clear however why do you provide funding for a reform, which is not clearly seen in the proposed budget for 2008. It is written, that premium for the mandatory pension contribution of 5%, for those born after 1959 will remain the same up 2011 and it is not intended to have a new reduction of the contribution. In other words, all who are working will continue to pay the pensions of the current pensioners without any prospective in subsequent years to get a larger portion of their payments to enter neither their personal account, nor the pensioners will get a significant increase of their pensions. During 2006 only 46% of the revenue in

the National Social Security Institute are payments from the private sector, in other words at present the State provides a larger portion of the amount for pensions, mainly from the tax revenues collected again from the working people. The logic of the Silver Fund is that in 10 years, there will be a strategic reserve to cover the permanent deficit in NSSI. This is happening however now and for that reason a radical approach is necessary by reduction of the contributions and that they are entered into personal account. In that sense the Silver Fund is a good solution, if it is used to reform the system, and not for filling wholes in the present model, which is bound to fail.

The next question which we must ask is still: **What could be done with the surplus, which anyway already exists?**

The best option is to actually start the second phase of the pension reform. Our proposal is to reduce payments of labor.

Instead of the current 33% social security payments we propose that people pay only 10% social security from their gross salaries into private pension fund. The other payments for – unemployment, health, and maternity are dropped completely, while the Government covers the costs for these cases from the general revenues of the budget, as it is at present.

With respect to the health care contributions, we propose they are dropped, where everybody selects alone his private health fund, while the Government defines the minimum package for health services, provided by these funds. The competition between the funds will lead to improved quality, will offer a choice and will insure market negotiation between the health funds, the hospitals and the medical professionals. The State will continue to finance the payments for the retired, the children, the unemployed, the poor and thus will fulfill its social function.

* This article was published for the first time in the 24 hours newspaper on 26th November 2007.

STATEMENT

On

Plans for Nuclear Power Plant “Belene” in Bulgaria

To the Attn:

Energy and Transport Directorate – General

European Commission

Energy Commissioner **Andris Piebalgs**

cab-piebalgs-archives@ec.europa.eu

Sofia, Bulgaria

November 22, 2007

The **Institute for Market Economics (IME)**, supported by independent analysts and energy experts, for years opposes the project for construction of the NPP “Belene”. The project has many pitfalls and has not proven economically feasible for Bulgaria.

Herein we present to your attention a brief list of main argumentation against the second nuclear plant project in Bulgaria:

1) There is **no detailed economic and social impact assessment** of the project. All questions concerning economic feasibility of the project remain unanswered as the only backing used insofar are based either on populist grounds (Bulgaria to become center of energy on the Balkans) or on unproved expectations for electricity shortages around 2010-2011.

2) There is **no calculation about the net present value of the project**. For instance, the costs for the secondary infrastructure may turn to be considerable higher than all existing expectations. The same issue exists with waste disposal. Electricity price per kWh will most probably turn to be much higher than existing promises of 3.5-3.6 eurocents per kWh. If comparing with similar plants in other countries and most recent studies it would be more reasonable to expect prices above 5-6 eurocents per kWh.

3) The project **may significantly hamper energy market liberalization**. The majority share of the nuclear plant will be owned by the government, which closes the door for true market liberalization and emerging of competition among energy producers. If government promotes nuclear power, a large part of the energy market will be subject to government intervention. Suppliers of gas and coal, on grounds of consistency, may well want to receive some kind of favored treatment. A return to a protectionist energy policy would restrict competition in product markets, adversely affect efficiency, raise prices, probably reduce security of supply and disadvantage all energy consumers.

4) At present, Bulgaria is mainly reliant on energy resources from Russia: oil, natural gas, high-quality coal and nuclear fuel. **The project will further increase the dependence of Bulgaria on Russian resources** and thus, the Bulgarian economy will become even more vulnerable to Russian

energy policy. Bulgaria has awarded a contract to “Atomstroyexport”, in which the Russian gas company “Gazprom” owns an 84 percent stake, to build the plant and install two 1,000 megawatt water-pressurized reactors. The design of the plant will be based on Russian technology. Russia will also provide all the nuclear fuel for the power plant, and recycle its spent fuel.

5) The very need for additional power in Bulgaria has not been proved. Bulgarian economy exhibits a very high-energy intensity. The energy intensity of the Bulgarian economy, defined as the amount of energy needed to produce one unit of economic output, is seven times higher than EU average according to 2005 Eurostat figures. Therefore **potential savings and energy efficiency activities are a serious alternative to building new power facilities.**

6) Electricity transportation losses in Bulgaria are from two to three times higher compared to Germany or Italy. Thus, **it is not clear why efforts are not focused on transportation saving technologies instead of building additional powers.**

7) Even if needed in the long run, it has not been proven that any additional electricity production should be nuclear. Rehabilitation of existing thermal and building additional hydro plants and utilization of local renewable energy resources appear to represent a serious alternative to nuclear projects. Up to now **there is no cost and benefit analysis of different alternatives.**

8) **Electricity imports may turn to be more cost efficient than local production.** With this respect the biggest problem appears to be stereotypes from the past as imports are considered lost per se. This way of thinking is wrong especially if we realize that Bulgaria is importing around 80%-85% of all energy resources.

9) There is ambiguity about **the cost of the overall project.** At a value of EUR 1.7 billion in 2005, the signed in 2006 contracts for the construction of NPP “Belene” turned out to be to the amount of EUR 6 billion, or about **three times more.** That makes that project the most expensive public works project in the country's post-Communist history.

10) The Bulgarian government plans to retain more than 50% ownership of the plant and to provide loan guarantee for 50% of the cost of the project. Thus, the nuclear power plant will be constructed with money, collected from the present and future taxpayers. It is imperative that politicians justify their decisions to spend taxpayers' money before the general public and explicitly prove that the benefits of the project are more than the costs. Instead, there is **lack of public debate** and a more clear reasoning behind the state-backed financial guarantees.

11) The proclaimed idea of the merger of “Kozloduy” power plant to “Belene” plant is an example of non-transparent privatization. It would complicate or would rather **make impossible all economic calculations** and would hide the actual results from “Belene” project. If this idea takes place we would probably never know the real price per kWh since all data will be mixed.

All these arguments show that rather than meeting Bulgaria's economic needs, the project seems a response to lobbying pressures thus open to corruption and mismanagement and will further multiply Russian dominance of Bulgaria's energy sector.

Market solution of “Belene” case would be if the existing infrastructure is sold at an open tender and is used according to decision of new owner. If there is private interest to build additional nuclear facilities without any government support then all related risks will be taken by private investors.

Signed:

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ABOUT Institute for Market Economics (IME)

IME is the first and oldest independent economic policy think tank in Bulgaria. Its mission is to elaborate and advocate market-based solutions to challenges citizens of Bulgaria and the region face in reforms. This mission has been pursued since early 1993 when the Institute was formally registered as a non-profit legal entity.

IME objectives are to provide: independent assessment and analysis of the government's economic policies and be a focal point for an exchange of views on market economics and relevant policy issues.

Human Development & Climate Change in Bulgaria

Peter Ganeyv

“Fighting climate change: Human solidarity in a divided world” is the theme of 2007/2008 Human Development Report. With governments preparing to gather in Bali, Indonesia to discuss the future of the Kyoto Protocol, the United Nations Development Programme’s Human Development Report has warned that the world should focus on the development impact of climate change that could bring unprecedented reversals in poverty reduction, nutrition, health and education.

“Ultimately, climate change is a threat to humanity as a whole. But it is the poor, a constituency with no responsibility for the ecological debt we are running up, who face the immediate and most severe human costs,” commented UNDP Administrator Kemal Dervis.

The report comes at a key moment in negotiations to forge a multilateral agreement for the period after 2012 – the expiry date for the current commitment period of the Kyoto Protocol. It calls for a “twin track” approach that combines stringent mitigation to limit 21st Century warming to less than 2°C (3.6°F), with strengthened international cooperation on adaptation.

On mitigation, the authors call on developed countries to demonstrate leadership by cutting greenhouse gas emissions by at least 80% of 1990 levels by 2050. The report advocates a mix of carbon taxation, more stringent cap-and-trade programmes, energy regulation, and international cooperation on financing for low-carbon technology transfer.

Looking at this point of view it is true that climate change will be an obstacle for development. But it is not the climate change itself, but the policy of **“fighting climate change”** that will stop the progress.

Recent research from general equilibrium models suggests strongly negative impacts on European economies from adopting Kyoto targets (or going beyond the targets, as in the case of the United Kingdom). One model shows the economic effects by 2010 of adopting Kyoto targets as follows (remember that the Protocol achieves virtually nothing in reducing global temperature):

- Germany -5.2% GDP / -1,800,000 jobs
- Spain -5.0% GDP / -1,000,000 jobs
- United Kingdom -4.5% GDP / -1,000,000 jobs
- Netherlands -3.8% GDP / -240,000 jobs

Bulgaria continues to be in the group of countries with high levels of human Development, states the Human Development

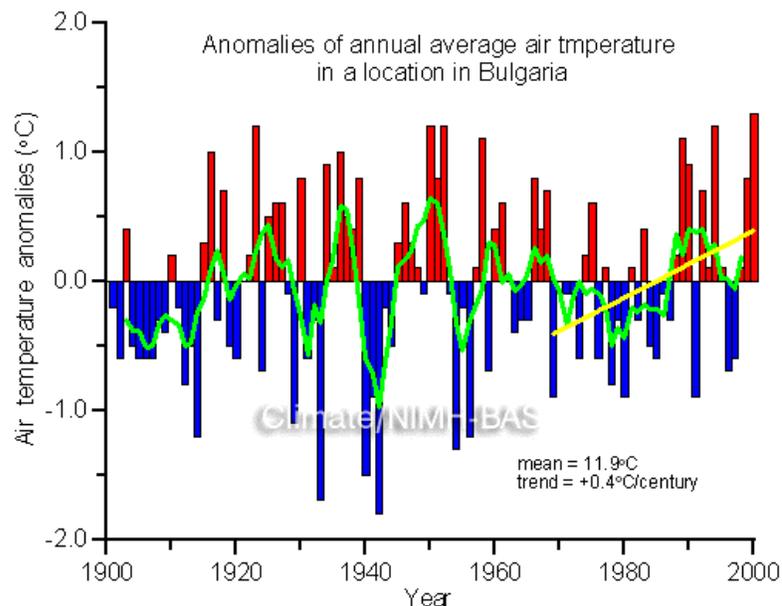
Index (HDI), which is an important part of the Human Development Report. The HDI for Bulgaria is 0.824, which gives the country a rank of 53rd out of 177 countries with data. During the last years Bulgaria ascends with one place each year in the HDI ranking.

With 0.1% of the world's population, Bulgaria accounts for 0.1% of global emissions – an average of 5.5 tonnes of CO2 per person. These emission levels are below those of Central and Eastern Europe and the CIS. If all countries in the world were to emit CO2 at levels similar to Bulgaria's, we would exceed our sustainable carbon budget by approximately 147%.

Bulgaria has signed and ratified the Kyoto Protocol. As an Annex I Party to the Protocol, Bulgaria is bound by a target to reduce its greenhouse gas emissions by -8% by 2008 – 2012.

The fear of climate change in Bulgaria is highly doubtful. Data from **National Institute of Meteorology and Hydrology (Bulgarian Academy of Sciences)** shows that such unprecedented climate change (global warming) has never happened in Bulgaria.

It's obvious that air temperature anomalies were stronger in 1950's than at the end of the century. Still, the yellow line shows the desire of Bulgarian scientists to prove some global warming in the country, but that's only the last 20 years. We can see the same temperature level as today even in 1923.



Expected Long-Term Budgetary Benefits to Roma Education in Bulgaria

IME

In June 2007 IME, together with Georgi Angelov, produced an analysis of expected long-term budgetary benefits to Roma education in Bulgaria. The analysis was sponsored by the Roma Education Fund (REF) in Hungary.

By budget benefits we envisage the direct financial benefits to the education to the national budget. The basic perception is that investing extra money into Roma education would pay off even in fiscal terms. In order to be successful, investments should take place in early childhood. Successful investments are also expensive, but if it is done the right way, such investments compensate the costs in terms of extra tax benefits in the future. This study looks at the expected budgetary benefits of a successful investment. However, *it does not deal with how to achieve success.*

When considering the results of this study one should bear in mind that investing into one child education will have long-term benefits not only for the child itself, but also to the entire society. We anticipate the benefits to the society from such an investment in a narrow sense – the fiscal benefits to the budget in the form of more payments (social security contributions, personal income tax, indirect taxes) and less transfers from the budget to citizens (welfare payments, public employment programs, unemployment benefits and costs of incarceration). The overall effect of investment in education is expected to be *net budgetary benefits*. These budgetary benefits are equivalent to return of investment in education and in such way can be viewed as return similar to various financial investments. Respectively, the idea is to consider the government as an investor that anticipates returns from an investment project called *Investing in Roma children education.*

We estimate the net budget benefit from investment in education that enables young Roma to complete basic, secondary and higher education. We assume that without the investment she/he would complete 4 grades or 8 grades with certain probability. Benefits of the secondary education are the weighted average of

the benefits of secondary and higher education, where the weights are the probability that young Roma who has a basic education gets a secondary and then higher education. After that, we estimate the probability that a person with given level of education and given age is in the particular state of the labor market. Our study considers five statuses on the labor market: full time employed, registered unemployed, registered welfare recipient, registered participant in subsidized employment, and prisoner.

The analysis is based on national estimates adjusted for Roma differences because of lack of enough data for the Roma population characteristics in Bulgaria. The latest census (2001) gives limited scope of data concerning Roma community. Therefore, we use the available data and try to estimate the missing figures by adjusting national data. For the estimation of Roma figures we used the fraction of Roma in specific state, the educational distribution and the fraction of Roma in population.

According to the calculations, the more education, the more a person contributes to the government budget. If we take into account the expected contributions for a representative Roma and subtract the government investment in his/her education, *the net benefits from education amount to more than EUR 82 thousand* (present value, 2007 prices). The benefits are almost twice as higher for Roma achieving higher education and a more than a third lower for Roma having secondary education only. Still, in both cases the investment in Roma education yields significant long-term benefits for the national budget.

Our analysis shows that benefits for the budget would come from increased government revenues from *personal income tax* and *social security contributions* on earned income and from *indirect taxes on consumption.*

Our check of the sensitiveness of results to the key parameters (discount rate, the growth rate of nominal education spending, nominal wage growth, and Roma employment and wage adjustment ratios) shows that the investment in Roma education should be successful. Fiscal benefits are more sensitive to the change of the discount rate. But even the worst case when the

discount rate is 8% leads to over *EUR 36 thousand* net gains for the state budget.

If we combine the change in the determinants in the worst scenario when the discount rate is 10%, the growth rate of wages is only 4% and the growth rate of educational spending is 12%, then there is still small net positive benefit for the budget. This “stress” test shows that the investment would be successful even in unfavorable environment in the country.

The present value of the net budget benefits from education in one Roma child is more than

EUR 82 thousand. For example, if investment is made in the education of 10 000 Roma children now, this would lead to net budget benefits of more than **EUR 822 million**. Respectfully, if investment in the education of 30 000 Roma children is made now, it would lead to more than **EUR 2.468 billion** net budget benefits.

The report can be downloaded on IME webiste (<http://ime.bg/en/articles/expected-long-term-budgetary-benefits-to-roma-education-in-bulgaria-2007/>)

The legislation throughout November

Veliko Dimitrov

During the first days of November a bill was introduced¹ to amend the Law on Commerce to reduce ten times the minimal requirements for capital to register a Limited Liability Company (Ltd.) and a Joint Stock Company (JSC) – from 5 000 to 500 and respectively from 50 000 to 5 000 levs. The basis for this proposal is that the lower required minimal capital reduces the cost of registration and could lead to increase in business activities, employment and incomes. Although the currently existing legislation offers certain flexibility, for example a Ltd. could be registered with 70% entered capital, based on the average income for the country, the requirements for minimal capital are really high. According to the study „Doing Business”² by the World Bank, the minimum required capital in Bulgaria represents 56,30% from the gross national income per person, which is placing us at 136th place among 178 countries. Another peculiarity of the Bulgarian practice is that the capital is withdrawn immediately after registration of the company, which logically leads to the following question: since the requirement for a minimal capital does not serve any other purpose than registration/administrative, is it necessary to exist and burden with additional expenses exactly those which are at the beginning of their development?

¹ Proposed by Martin Dimitrov (UDF)

² <http://www.doingbusiness.org/ExploreTopics/StartingBusiness/>

After the bill for the State Budget and the Budget of the State Social Security for 2008, entered at the end of the previous month, as a logical continuation of forming the fiscal policy for the next year, specific changes³ in the material tax law had to materialize. The following fundamental changes are foreseen:

1. Law for the corporate income tax

It is proposed to reduce the tax on dividends from 7 to 5 percent. Although the change is in line with the policy in recent years to reduce the direct taxes, one opportunity to eliminate this tax entirely has been missed. Against the background of the overall budget revenues and the surpluses achieved, elimination of the dividend tax would not lead to misbalance or danger, but will have the role of a positive sign to the direct and portfolio investors. The proposed bill envisages that, companies with a net revenue from sales for the previous year of up to 100 thousand levs would not make advanced tax payments, but will pay their corporate tax once a year before March 31st of the subsequent year. From the reduction of transaction costs such as preparation of bank payment documents and bank charges, according to the Council of Ministers, about 146 000 companies are expected to gain.

2. Law on the personal income tax

In the first place the bill proposes to replace the existing proportional tax with a progressive tax and a single rate of 10% is being proposed. This is a very positive and long awaited development, which in addition to bringing to “light” part of

³ Proposed by the Council of Ministers

the grey incomes, will lead to increase in the productivity of labor, particularly in places, where the pay is related to the achieved results. In second place, from the beginning of next year it is proposed that the tax breaks for children and donation are eliminated, as well to reduce the size of some of the legally recognized costs before taxation. For activities for which at present the officially recognized costs have been 70, 60 and 50%, the bill proposes 40%, respectively from 35 to 25 percent and from 20 to 10 percent. Although the changes are prepared and initiated by the Council of Ministers they could be amended until the time when published in the State Gazette. There is a possibility to keep the family income taxation because of the claims that the planned increase in the child benefits will not compensate entirely its elimination for next year. This is not going to be a precedent – the Government changed its position with respect to the legally recognized costs, which initially should have been eliminated completely. In that sense, the proposed a few months ago idea for an “ideal” flat tax – neutrality and simplicity – with each modification, loses more and more from its attractiveness in both directions – with respect to the people and the administration.

3. Law on municipal taxes

The main changes are two: from 2008 the municipal councils could determine the size of local taxes but within limits, defined by the central government: minimal – as the existing local taxes at the end of 2007; and maximum – up to two times (real estate tax, donation tax, tax on purchase of real estate, inheritance tax); or up to three times (car tax) higher than the minimal. We would like to point out at two things: the financial decentralization is extended, which is a positive development, however the conditions under which this will take place are not very well thought out, which could lead to undesirable consequences. Placing an upper limit on local and municipal taxes is a very good idea, but the limitation from below is not a good one. The idea of the fiscal decentralization is to allow the municipalities to compete on a level of taxation, but it has to take place on the basis who will propose a lower tax, not on a basis who will offer less higher tax (compared to the current situation). In second place, the final annual (patent) tax which applies to individuals and one person companies on the provided by them patent activities, becomes from national a local

tax and beginning from next year will be a revenue to the municipal budget (as a result the clauses are transferred in that bill). Although these are steps in the right direction, the new rights of the municipality must help to reduce taxation, not to increase or only redirect tax revenues. The law should not place minimal limits on local taxes, which will help financial decentralization itself and it will not be compromised in its first year.

Around the middle of the month we became witnesses how an absolutely unnecessary bill reached the floor of Parliament – this time the Law on managing condominiums⁴. The proposal includes together with the detailed rights and obligations of the people living in a block of flats, the election of a general assembly, management council or a manager, audit council, cashier, the definition of the monthly payments, creation of funds, acceptance of plans, acceptance of an annual budget of revenues and expenditures, ... following the example of the Parliament or even of the State. The question about who would finance the staff required remains open (I suppose that no one would audit, plan, administrate, at cetera – without salary) and whether or not would want to do it. As a continuation of the bill’s logic, it is necessary to prepare a new bill which to introduce mandatory tax, which should be collected and than passed along to the managers of the condominium, since even if the proposed bill is passed, we do not expect that the entire structure would become operational due to the “lack of financial resources”. The next natural step will be to incorporate in the Public Procurement Acts articles which mandate that the management councils of the condominiums spend the funds collected only through the procedures of public tenders, since that will improve their efficiency.... it is necessary to know that at present respective regulations already exist (two-story) that regulate the relations within the condominiums – The Law of Property and the Regulation for Management, the Order and Control in the Condominiums The efforts of the law makers should not be directed towards its expansion and creation of a separate bill, but towards its reduction or total elimination as it is not necessary. The possibility for voluntary association and resolving common problems functions satisfactory at present (even though this relations are not strictly institutionalized) although there are some

⁴ Proposed by the Council of Ministers

exceptions, this is not a reason to create a bill. As if areas, regulated by laws function perfectly – for example: the legal system, the state administration, the public tender system, customs, ...

From the beginning of November until now a number of other bills have been entered to change and complement the Penalty Code, The Traffic Law, The Law of Storage and Commerce with Grains at cetera. Since the vicious practice not to publish some of the proposed bill continues, it is difficult to comment. During all

the years since “the Proposed Bills” register exists and the Internet site of the Parliament, always a part of the proposals are being “missed” and become known only after they are published in the State Gazette (if they have been rejected, it is possible that it would never become clear what is all about in those proposals). These (in)actions violate the principle of public and transparent introduction of bills and does not assist the preliminary public discussions and do not support the right of every one to express his/hers informed opinion and position.

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