IMPACTS OF YUGOSLAV WAR ON BULGARIA

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The institute is monitoring economic and political developments on the Balkans for five years. It maintains large network of professional contacts in all the countries, and in the days and weeks preceding the war IME researchers and I myself have been visiting all countries and provinces of the region working on a project Balkans In 2010.

Thinking the Unthinkable

Just started and with unclear resolution, the war in Yugoslavia is difficult to measure in terms of impacts on neighboring economies. It is not clear how long it will take, what is the likelihood of different post-war scenarios, and whether the war will be repeated in some form again. Assessments of provisional impacts are complicated by purely domestic factors that impede competitiveness and increase costs.

Short-term war, i.e. the government of Serbia to accept Ramboillet conditions, is almost a miracle. For the time being, the probability of a longer war seems greater. It well may be that there is a war which proceeds with interruptions lasting between 6 months to 2-3 years. These could be periods of delayed wars taken by the parties to prepare for the next step of desired solution.

Humanitarian disaster and ethnic cleansing in Kosovo, the current *casus beli*, emanate from deeper processes on the Balkans. The background driving force of a long-lasting warfare must be found in the formation of nation-states in the region, a process which in other parts of Europe had been proceeding between 17th and 19th centuries.

- Albania is undergoing such formation.
- Led by Milosevic and his clout and backed by the Serbian identity at home and abroad, residual Yugoslavia is defending its national pride and territory. At least it is the bold underlying perception of the people and politicians in Belgrade.
- Macedonia, with its recently gained independence, faces a challenge of defending itself.
- Montenegro is likely to embark on nation-state path in the nearest future.

Needless to say, whatever the national aspirations the genocide and ethnic cleansing can not be neither excused nor accepted as a tool of achieving them. The problem is that it is difficult to eradicate memories of the past violence when there is no shared vision of a common future and prosperity.

Yugoslav "Economic Options"

There is no information about the financial situation of Yugoslavia. From a recent interview of ex-governor of the central bank, Mr. Abramovic, it is known that forex reserves are about $ 80 million. Sources mention that a week before the war the country had a difficulty $ 1.2 million payment for gas-transits through Hungary. During the first week of the war the exchange rate did not change significantly. Since mid-March, informal market rate has reach the level of 50% higher values but currently the trade has virtually stopped. (Official central bank rates are 10.9 DIN/US$, and 6.2 DIN/DM while informal have freezed in the first days of April at 16.3 DIN/US$ and 9.2 DIN/DM.) Currency seems substituted. There are reports that the central bank of Yugoslavia blocked all commercial banks accounts. Official inflation figure for March is 3.5%. Informal subsistence to household budgets and barterization keep the societal fabric together. Another factors might well be "expropriation" of Kosovars' home savings. The production of food-stuff and basic goods seems self-sufficient, for the time being. This situation is not sustainable. If there is no aid from friendly governments, the rulers in Belgrade have no choice but printing money. It will be some sort of repetition of previous inflation history of the country. The likely outcome eventually is interruption of the warfare; in order to either rehabilitate the economy to fight again or to skip the violence path and take the cooperation, prosperity, and integration rout. If the latter, the instability factor may not be in the Serbian politics but outside the country. With the time passing, the international community will recognize these option and will probably bear some "containment" costs.

Politics in Bulgaria

What about Bulgaria? I think, it would rather stay away of these developments. It will live in a heated political debate on what is good and what is bad, on how to keep peace with neighbors not breaking with EU and NATO community, and who is guilty for setbacks in either direction. This natural debate will not have a direct impact on the reform orientation and policies of the current government. Though not decisive, its ability to tackle different public attitudes towards Balkans will be a factor in the local elections of 1999, and in the general elections of 2001. There is almost no danger of direct Bulgaria's involvement in any Balkan war.

Worst-case Scenario

In 1998 Bulgaria signed an agreement with CEFTA which was expected to double the trade with Central Europe. By December it amounted to 5.4% of the total trade, growing by 51% for the year. The war will most likely endanger this exchange. But so is the entire trade.

So, the worst-case scenario must be taken into account as a bench-mark of further attempts to draw a realistic picture of the provisional impacts. Such scenario would mean:

- closed Bulgarian trade with West;
- no replacement with new trade-routs;
- no revenue from trade and transport.

Table 1:
Relative share of exports to some groups of countries

	1996		*1997*		*1998 (6 month)*	
	USD m.	*share*	*USD m.*	*share*	*USD m.*	*share*
EU	1,912.5	39.1%	2,128.7	43.3%	1,083.8	49.7%
Other OECD	554.0	11.3%	661.7	13.5%	249.0	4.7%
EFTA	49.5	1.0%	44.3	0.9%	15.5	12.0%
CEFTA	94.8	1.9%	137.1	2.8%	119.9	4.8%
Balkan countries	514.2	10.5%	291.9	5.9%	397.6.	5.4.%

Table 2:
Relative share of imports from some groups of countries

	1996		*1997*		*1998 (6 month)*	
	USD m.	*share*	*USD m.*	*share*	*USD m.*	*share*
EU	1,780.3	35.1%	1,823.1	37.3%	1,044.9	48.8%
Other OECD	275.4	5.4%	343.8	7.0%	227.1	8,9.%
EFTA	86.4	1.7%	86.8	1.8%	34.0	1.7.%
CEFTA	159.9	3.2%	231.7	4.7%	120.0	6.0%
Balkan countries	163.3	3.2%	95.2	1.9%	68.4.	1.8%

Bulgaria's export to EU, CEFTA and EFTA amounts to 63% of the total export. The imports from the same countries is at the level of 52% of the total import. The average import dependence of Bulgarian export for the last four years is approximately 80%. Under these circumstances, the worst-case scenario would mean US$ 2 billion current account deficit.

Immediate Impacts

Immediate impacts are to be identified in the following areas:

- higher transport costs,
- lost tourism revenues,
- lost markets,
- less foreign investment,
- costs of refugee accommodation.

The most easy to calculate are the cost of refugees. Direct increases in transport costs are more or less known. Tourism revenues are difficult to predict in terms of impacts of the war.

Lost markets are virtually impossible to take into account. Foreign investment must be discussed separately.

Bulgaria, according to ratified conventions, is obliged to accommodate 5,000 refugees. Total cost were correctly calculated by *Cash* weekly. They would amount to almost to 582 thousand per month, or 0.1 of nominal 1999 GDP. However, the risk of receiving this number of refugees is rather low.

Bulgarian firms have long been active in international motor carriage. Due to the international nature of the competition, prior to 1989 these firms operated more efficiently than was typical of firms in other industries in the region. Their adjustment to market shocks in the 90's has been relatively fast and smooth. The different of the current from previous shocks is namely in the physical closure of Yugoslavia (during the UN embargo lorries were crossing Bulgaria's Western neighbor cutting time and informal taxes).

It is possible to assume that informal transport costs (time spent on border crossing, informal taxes etc.) would be the similar to those of the time of the UN embargo, adding up to 50% to the formal costs. Currently, all carriers report 1.5-2 million losses a day. With the time passing real losses of road carriers will go down due political pressures to reduce informal payments and other institutional adjustments. The cost of spediting a rail-way cargo through Romania are US$ 3-4 per ton of freight, and the time is four days more. Long-term transport hurdle will come if the high-way bridge Danube near Novi Sad will be destroyed.

Lost markets are expected to mostly in the EU and CEFTA area. There is a possibility for compensatory adjustment through regained positions in Russia and Former Soviet Union. This reorientation will rescue some immediate trade losses but is likely to have negative institutional consequences for firm-level strategies. The problems here are associated with lost competitive pressures which would later result in longer-term inability to compete in sophisticated markets led by enlightened demand.

Tourism losses are not clear due partially informal nature of the sector. Family hotels are those accommodate both winter and summer tourists from Macedonia and Yugoslavia. They are not more than 8-10% of all tourists. Competitiveness of the tourist sector is rather an internal matter: prices are comparable to Greece but quality of the services is much lower.

Domestic Hurdles

Similar to tourism all above mentioned direct an internal institutional impediments.

Rail-ways cargoes are more expensive. But the problem is also in the fact that it is difficult to find alternative routs. For instance, Bulgarian ports of Varna and Bourgas charge fee comparable to the Aegean port of Thessaloniki but three time higher than the neighboring Romania port of Konstanza.

A previous (1995-1996) research of IME and the American University in Bulgaria led by Prof. Richard Beilock reveal transport cost which Bulgarian carriers, ports and State Rail-Way Co. failed to reduce.

Movements in the Black Sea are more costly per kilometer than in Western Europe. The magnitude of the difference is surprising: a rate-distance gradient for movements in the Black Sea of $2.56 per kilometer ($2.20 + $.36), compared to $.36 per kilometer for movements in the Mediterranean. The high cost may be due to operational inefficiencies. An alternative explanation is that the high distance-rate gradient is due to capacity constraints which, admittedly, may be the result of inefficient utilization). The rate for crossing the Black Sea is comparable to the costs implied in the model of taking the land route. Due Black Sea freight and port rates, Danube barge costs rates would go up to the cost of the alternative (if the river is open for navigation).

Competitiveness of Bulgarian products is hampers by domestic factors as well. According to IME estimate, private sector companies have average 30% higher productivity than state owned. However, state owned enterprise (especially monopoly structures) investment is not taxed while private sector is taxed. Electricity and gaz monopolies are effective creditors of the state sector: their effective (quasi-fiscal) subsidy for 1998 is more than DM 900 million. In other words, it is ¼ of the worst case scenario losses, and in annual terms is higher than or equal to most pessimistic 1999 scenarios for the current account deficit (see below, the note on macroeconomic impacts).

Foreign Investment Losses

The Yugoslav war-related risk of provisional loss of foreign direct investment would rather depend on the size and attractiveness of privatization deals, the prospects for green-field investment and the size of the markets (including foreign) for Bulgarian products.

Envisaged amount of 1999 FDI's is DM 420 million cash revenues from sales of state owned enterprise, and DM 580 million green-field, joint-ventures and reinvestment. Both figures are rather modest. The cash component is to exceeded due the sale of Bulgarian Telecommunications Co. alone. The second component is up 50% investment in the power sector which has contracted electricity export agreements with Turkey, and the bulk of this investment is secured through a joint venture between the power monopoly, National Electric Co. (NEC), and Entergy Power Group.

Bulgarian economy still have number of "holy cows": NEC, Bulgargaz, roads, utilities, etc. Concession regulations hamper both green-field investment and privatization. Formerly public services in pensions and healthcare are poorly reformed. Banking sector privatization is underway.

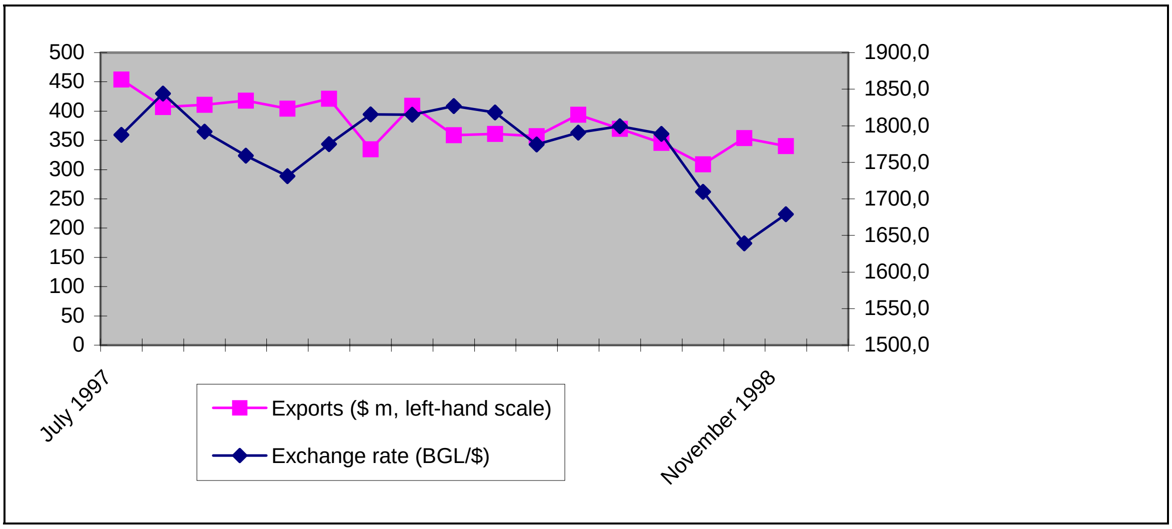
For most of these sectors the Yugoslav war will mean cheaper price and lower green-field investment not only and not so much in 1999 but later.

A Note on Macroeconomic Impacts

Salomon Smith Barney survey of what the introduction of the EURO would means for Central/East European economies (quoted by *CEER*, February 1999) forecasts that movement in US$/EURO rate will have a large effect on Bulgaria's export competitiveness.

The graph below show there is direct link between export and exchange rate in recent eighteen months. The reasons must be found in institutional influences already mentioned above.

Merchandise exports and exchange rate after the introduction of the currency board



This fact is important in two ways. First, it makes very difficult to prove to what extend external factors and the war itself hamper the balance of payment, most domestic factors are tricky to measure. And, second, it transfers the argument with creditors (IFI's) on provisional effects on the balance of payments in the area of structural policies, still the weakest segment of Bulgaria's economic policies.

The measurable risk is for the current account deficit. It is equal to the share of Bulgaria's foreign trade at risk, i.e. about 60%. In absolute terms it is likely that instead of the currently envisaged US$ 380 million the current account deficit can easily reach the level of 550-560 million. This would rather mean that 1999 balance of payments is endangered (other factors neutral).

The war may not mean contraction in 1999 GDP. 65% of the envisaged nominal growth is due to the central government investment program (mostly infrastructure). The risk here is in the difficult design of the program: it intention is to match private investment while the cabinet has little skills in co-financing and procuring out services. Anyway, 3.7% growth of GDP should corrected to 1.5-2%.

Conclusions

Going back to issue of the duration of the war and taking into account institutional factors, the “pure” provisional impacts of the Yugoslav war are likely to be the following.

indicator	1999 risk	2000 risk
balance of payments	low	medium
current account deficit	medium	high
FDI	low	medium
markets	medium	medium
transport	medium	medium
tourism	low	low

These estimate should taken *con grano salis*: domestic impediments and institutional policies give room for maneuvering but hardly can compensate losses. There is another factor which is difficult to quantify: inactivity of the government due upcoming elections in 1999 and 2001, and the temptation to blame "the international constellation". Such factors we expect to be relatively neutral due cabinet’s commitments under the IMF 3-year program. In an event of a miracle shorter war, the decisive force of domestic policies remains as desirable as always.

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