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## In the issue

### **GDP in 2005**

**The Tax Reform is Working (Analysis of Budget Statistics)**

**Liberalization is a Winning Strategy for the Energy Sector in Bulgaria**

**How Could the Government Save Some Money and Reduce Foreign Debt at Once?**

**One Step Forward, Two Steps Back: Ataka and the Effects of Nationalization**

**Gypsies' Contribution to Market Reforms**

**Support IME**

## **GDP in 2005**

Dimitar Chobanov

Preliminary data for the gross domestic product (GDP) in 2005 were released recently as well as revised data for 2004. Real GDP growth in 2005 is 5.5 per cent, which was not a surprise for the independent analysts and for the government agencies' experts. Some difference from the expected level can be found in the nominal GDP that reached BGN 41 948 million which means that the nominal growth is 9.6 per cent. The growth rate has slowed down relative to 2004 in real and in nominal terms which can be accounted as an unfavorable development for the economy.

Real growth rate of the gross value added (GVA) is 5.1 per cent and is also slower than 2004 (5.4 per cent). The tendency during the last few years is for the GVA to increase fastest in real terms in the industrial sector and in 2005 its growth was 7.3 per cent while the growth in services is 6.6 per cent. One of the reasons for this positive development is the increasing share of private property in these sectors due to the privatization and the natural emerging of new enterprises in the country. During the last year as well as the preceding years some measures were taken which created a better environment for business and the most substantial one is the reduction of the corporate tax rate to 15 per cent and the lowering of labor taxation. Unfortunately, the chance for more sizable

changes in tax legislation was missed because of the implemented policy for fiscal surplus. Thus more money than needed for financing the superfluous expenditures of the government was taken from companies and citizens.

In 2005, the ratio between the revenues in consolidated government budget and the GDP reached its highest value after the introduction of the currency board which implies that the total tax burden on the economy has risen. Thus the government restricts the freedom of Bulgarians to dispose the income they produce and reduces their incentives to work and to take a risk by entrepreneurship that, in turn, lowers the opportunities for higher economic growth.

Indeed, higher economic growth is a necessity for Bulgarians because the level of their income is still too low relative to the citizens of the European Union 25 (31.8 per cent) and relative to these of the United States (20.9 per cent). However, this is determined to a great extent by the labor productivity, taking into account all the inherent shortcomings in calculation of this indicator, which is 32.5 per cent of EU 25 average and 23.7 per cent of this in the United States.<sup>1</sup>

While one can observe real growth in the sectors of industry and services, this is not the case in the agriculture where the physical volume of the production falls by 8.4 per cent in 2005. The influence of floods is visible at the greatest

<sup>1</sup> Data are taken from Eurostat.

extent precisely in this sector although the effects stemming from it spread into the other sectors. Measures taken by the government were not adequate and granted funds did not achieve the desired results. Their utilization was nontransparent and almost unnecessary due to the way it was done. The lack of development in the agriculture is a substantial problem and if there are more floods again in 2006 the results will be similar.

Private sector share in the value added continues rising because of the tendency of its production to increase while that of the public sector decreases. While in previous years it was due to the privatization of the state-owned enterprises, in 2005, due to the parliamentary elections, the privatization process virtually stopped. Hence the amount of the state property did not change significantly, the number of employed persons in this sector rose but the "value added" dropped down by 5.2 per cent.<sup>2</sup> The private sector is the real engine of the economy and it created sustainable new jobs thus expanding the employment as a whole.

The other important elements of GDP are the adjustments which include net taxes on products and indirect assessment of the financial intermediaries' services. Dynamic development of crediting during the year and the rise in excises on some goods led to real growth rate of 8.1 per cent which is slightly higher than the rate in 2004. It looks like the attempts of the central bank to restrict the credit expansion have not affected the results of commercial banks in full strength in 2005 but one can expect that this would happen in greater extent in 2006.

The final consumption in 2005 accelerates its growth to 6.8 per cent from 5.1 per cent in 2004. Individual consumption has a larger contribution for this because it increases by 7.4 per cent while collective consumption rises by 2.2 per cent. The development during the last quarter is of particular interest because the collective consumption falls by 4.7 per cent which is a significant difference relative to the situation in the preceding years. Then, the growth rate of this indicator was the highest exactly in this quarter (in 2004 it is 7.8 per cent, in 2003 it is 8.2 per cent, in 2002 it is 8.3 per cent). Collective consumption is a measure for government's

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<sup>2</sup> One can argue if the public sector really adds value to the economy. This that is actually done in this sector is a redistribution of the value added in private sector.

expenditures on collective services like maintenance of settlements, scientific research, administration, defense and security of the country. Reducing these costs represents a positive development because their size is too high relative to the results which stem from them.

An important role for this progress is played by the persistence of the International Monetary Fund officials for a fiscal surplus which forced the government to limit the unnecessary spending at the end of the year. An example for such spending was the situation at the end of 2004 when a company for public investment projects had to be created because the government was not able to spend the money as was planned. Apart from this, in 2005 the amendments in legislation were made that limit the opportunities for budget spending without the approval of the parliament.

The rise in consumption, however, contributes to a fall in savings in the Bulgarian economy. Gross savings in 2005 represent 16.9 per cent of GDP while they were 19 per cent of GDP in 2004. This development is combined with a rise in investments measured by gross fixed capital formation which reaches its highest ratio to GDP since the democratic changes of 23.8 per cent. The result is a higher current account deficit due to insufficient savings to finance these investments. If the direction of these two indicators retains in 2006 one can expect higher deficit in the current account of the balance of payments.

The real growth rate of the GDP in 2005 is significantly higher than the EU average which is around 1.6 per cent but, on the other hand, it is lower than in Latvia – 10.2 per cent, Estonia – 9.8 per cent, Lithuania – 7.5 per cent, Czech and Slovak Republic – 6 per cent. These countries realize higher growth at higher base. Hence, the real divergence of Bulgaria from them is even larger. Data for these countries are indicative that the economic policies implemented by their governments during the last years are successful. These policies are directed toward broadening the economic freedom, lower and flatter taxes, facilitating starting and doing business, and advancing the protection of property rights. Some aspects of these policies were adopted in Bulgaria but, unfortunately, the political will for faster and deeper reforms that could accelerate growth is absent. For this reason one cannot expect that this will happen in the next few years

and the incomes in the country will remain low for a long time to come.

### The Tax Reform is Working (Analysis of Budget Statistics)

Georgi Angelov

The Ministry of Finance published data on the execution of the government budget for the first two months of 2006. The data is quite interesting and deserve detailed analysis.

In the first two months of 2006 the revenues in the consolidated government budget exceeded 2.7 billion leva – an increase of 6.6% compared to the same period of the previous year. The budget expenditures increase by almost the same rate – 6.5% and reach 2.56 billion leva. The budget surplus is also greater than last year – till the end of February it is 146.5 million leva, 9% higher than the corresponding level in 2005.

**Table 1: State budget – execution to February**

<i>thousand leva</i>	2005	2006	<i>Change</i>
<b>Revenues</b>	2,536,060	2,704,680	6.6%
<b>Expenditures</b>	2,401,677	2,558,217	6.5%
<b>Surplus</b>	134,383	146,463	9.0%

Source: Ministry of Finance

If we look at the budget expenditures, we can see that some expenditure rise a lot – wages, social security contributions, and other decrease considerably – subsidies, maintenance. As the state employees have not received 60% increase of their wages, we can explain the rise of the wage expenditures (and the decrease in other items) only with shift in the accounting of the expenditures. Because of this reason the comparison of the data is difficult and details are difficult to be analyzed.

In respect to the total spending, it is clear that its growth is higher than in the previous year, which is not a good sign. In order to have stability of the public finance, it would be better to have slower increase of expenditures.

**Table 2: Expenditures of the state budget - execution to February**

<i>thousand leva</i>	2005	2006	<i>Change</i>
<b>Wages</b>	243,825	390,792	60.3%
<b>Social security contributions</b>	87,778	125,211	42.6%
<b>Maintenance</b>	557,387	453,447	-18.6%
<b>Interest</b>	336,713	318,142	-5.5%
<b>Social expenditures</b>	947,714	1,076,113	13.5%
<b>Subsidies</b>	77,179	56,660	-26.6%
<b>Capital expenditures</b>	151,081	137,852	-8.8%

Source: Ministry of Finance

In the first two months of the year the revenues of all taxes are rising, with the exception of the excise duties. It is ironic, as excises are taxes that were increased significantly in the beginning of the year. The dividend tax revenues continue to rise by a tremendous rate – more than 50%. VAT receipt increase by almost 25% and the corporate and income taxes – by a little more than 10%. Even the social security tax revenues are increasing although their rate was decreased in the beginning of 2006 by 6 percentage points (from 42.7% to 36.7%).

**Table 3: Tax revenues – execution to February**

	2005	2006	<i>Change</i>
Social security tax	648,552	651,890	0.5%
Corporate tax	89,992	100,498	11.7%
Dividend tax	14,358	21,823	52.0%
Income tax	196,419	216,555	10.3%
VAT	695,181	867,600	24.8%
Excises	323,832	290,446	-10.3%
Customs duties	52,191	56,570	8.4%
Other	39,585	41,057	3.7%

Source: Ministry of Finance

There are several tendencies that can be seen in the data on the execution of the state budget for the first two months of 2006:

1. Social security tax revenues increase despite the lower tax rate. This is a sign for positive dynamic effects of the tax cut.

2. Dividend tax revenues continue to rise by enormous rates. Probably, the reason is the decrease by half of the tax rate in 2005 that stimulates the business.
3. The high rate of excises has a negative effect on the budget revenues – probably because of built reserves in 2005, decrease of consumption and buying cigarettes without excise label.

As a whole, the conclusion is that the tax reform brings results – tax revenues from decreased tax rates increase. This can encourage additional tax cuts in the beginning of 2007. If there is enough determination for reforms, a flat rate of 10 percent can be introduced for the corporate tax, income tax and social security tax.

### **Liberalization is a Winning Strategy for the Energy Sector in Bulgaria**

Adriana Mladenova

At the end of March the executive director of National Electricity Company (NEK) threatened the general public with a drastic increase in the prices of electricity as a result of the forthcoming liberalization of the energy market in Bulgaria, and consequently closing down third and fourth block of NPP Kozloduy. Creation of a competitive liberalized market is laid down in the EU Energy Directives according to which a common European market is expected to begin its operation in 2007. The government monopoly in transition, purchase and exporting of electricity is set to disappear then. For the purpose, until the end of 2006 NEK has to be restructured into two companies – one for transit and one functioning as a system administrator in the electricity sector.

Although the price of electricity has been rising in the country for the last years, the prices of electricity in Bulgaria remain among the lowest in Europe – for households as well as for the industry. Following the pessimistic prophecy of the executive director of NEK, the price of the electricity in the country will inevitably rise to reach the levels of the European market. And as such, the burden of the rise in the prices will be borne mostly by the household consumers according to him.

Imposing the idea on the public opinion that the supply of electricity is a social priority of the state makes people turn against private companies that are ruled by market signals. These firms are ready to invest, to modernize the equipment and optimize the expenses, and of course – to make profits. The argument that is often laid down is that the market mechanism will change the current status, which for the

moment is actually of benefit for consumers. According to statements by managers of NEK, at the moment the company sells electricity in Bulgaria at rather low prices, which in some cases even do not cover the costs of production and the company cross-subsidizes the losses in the internal market through its net income from the export of electricity abroad.

At the same time, the chairman of the State Energy and Water Regulatory Commission (SEWRC) said in the press that despite the enhanced price of coal, the price of electricity for households would not rise for the moment. We can conclude that the change in costs of production are mandated by structural changes and increases in the prices of factors of production but keeping the prices at these levels by the state-owned company cannot be guaranteed for long. When a market is liberalized and competitive, only then are prices perceived as truly objective and as such, there is no need for the decisions of the Regulatory Commission to be constantly justified, especially in the minds of people. The signals that we get from NEK are that the company is not ruled by market principles only. When the third and fourth blocks of NPP Kozloduy close down and the export levels of electricity decrease (at least in the short run), how is the loss from the internal market going to be covered? From the other side, the lack of a market approach in pricing is a problem as it leads to discrepancies and distorts the market reality.

From 2004 onward, the so-called privileged consumers have the right to buy electricity directly from the producers and to negotiate individually the terms and prices of the contracts. After almost a year, all enterprises and households will be able to take part in the free market and buy electricity from different

suppliers and traders. That is going to happen in the common European energy market.

So, should we worry about this?

The irrefutable consequences of competition in every sector in the economy are the following:

- Optimization of costs of goods and services sold
- Broadening the set of choices for the consumers
- Tendency of falling prices
- Improvements in quality of services
- Investments in capital and technology

Part of the fears come from the fact that the energy companies tend to consolidate which in turn harms competition. Consolidation of enterprises, however, when not mandated by a government regulation or protectionism, aims at economies of scale or greater efficiency in utilization of resources and lessening of transaction costs. It is, however, important to have a free access to the market and a uniform treatment of all parties in order the benefits of the competition to be fully realized.

Bulgaria is characterized by a high level of energy consumption per unit of economic activity. Studies show that an increase in the overall output by 1% leads to an increase in the consumption of energy by more than 1%. The free market price regulates exactly these processes: it is a natural regulatory behavior of the energy dependency of the economy. If there are not enough inputs for production of electricity or the production is not competitive or efficient enough, the prices of electricity will go up which will, as a result, lead to a decrease in consumption, greater usage of alternative energy resources, more capital investments that optimize and decrease the costs of production. Bulgaria has traditionally developed its electricity infrastructure. At the same time, gasification, co-generation and heat-production cause fewer losses of primary energy resources. The lack of usage of these alternatives to electricity is one of the reasons for the high energy dependency of the economy.

The steps towards abolishing of the “one seller” model will lead to a real market. Liberalization

of the market and abolishing the monopoly of NEK in export and import, delivery and transit of electricity will have various effects. The usage of alternative renewable sources and investments in energy efficiency will become a real alternative for consumers that are going to be more greatly involved in that process. Artificial preservation of prices below the market ones is not a far-sighted strategy as it distorts consumer behavior. At the same time, with a liberalized market, strategies and coordination among authorities and government bodies are not needed. However, this is not the case with a government monopoly in the energy sector. That is important for the Bulgarian market as at the moment such coordination is missing.

If we have a look at the liberalization of the market in Europe, we can conclude that it is good for the sector as a whole. During the last ten years the prices of electricity on European markets has gone down by 15% in real terms. The size of the change, of course, differs in the countries as it depends on the particular level of liberalization. The decrease in the prices for industry is greater than the decrease for households.

Last month, the European Commission declared that it is ready to implement a common energy policy. However, opposition of France and Spain to strategic deals with big utility companies is a clear indication of the desire of the European powers to keep the leading energy companies under their control. Still, the energy market is dominated by interests and politics rather than by market principles. That is fully true for Bulgaria, as well. But the benefits of liberalization should not be doubted because the only interests that truly dictate the market are the ones of consumers and producers.

## How Could the Government Save Some Money and Reduce Foreign Debt at Once?

Veliko Dimitrov

Not long ago the Bulgarian National Bank (BNB) released preliminary data for the country's gross foreign debt that was EUR 14,3 billion at the end of January this year or approximately 60,7 % of the prognosticated GDP for 2006. Among others, this figure contains the debt of the government sector (EUR 4,15 billion), which, although has been constantly declining since 2001, shows that every Bulgarian taxpayer owed money to the rest of the world in the amount of EUR 1 393\*.

The gross government debt is solely long-term, nearly evenly split between non-securitized loans (simple credits) and bond-bounded debts,

namely the eurobonds and the global bonds issued on international markets by the previous Bulgarian government.

I purposely do not take it into account that part of the issued bonds (about 1/5) are held by residents of Bulgaria and thus do not represent a foreign but an internal debt. In the current situation this is an accurate approach by all means, bearing in mind that part of the bonds issued inside the country are respectively held by non-residents and are de facto considered as liabilities to the rest of the world. On the other hand, as it has already been pointed out, the aggregate public debt comprises also the obligations of government enterprises and government bails.

The parameters of the issued government bonds are as follows:

	Value (EUR, millions)	Maturity	Annual interest rate	Market price (% of nominal, 01.01.06)
Eurobonds	250	03.2007	7,25 %	105 %
Global bonds in euro	835,5	01.2013	7,50 %	124 %
Global bonds in dollars	1 050	01.2015	8,25 %	121 %

Source: BNB; Ministry of Finance

If the government is willing to manage the foreign debt, there are numerous possible combinations: starting with buying back all securities today and going all the way long to paying what needs to be paid bit by bit. The choice of action depends generally on the financial sustainability of the country and the predominant expectations of the authorized government officials for the future development of the market. We could not know what are the exact expectancies for the market, though we are quite able to know what financial resources the government is disposing of.

According to the latest figures released by the Ministry of Finance, the current fiscal reserve (the amount of the annual budget revenue that exceeds the expenditures) is slightly over 4,25 billion. For the second year in a row, the minimal reserve that is to be kept must not fall under 2,5 billion, which means that the rest of about 1,75 billion leva could be imperturbably spent on paying off government debts.

Of course this could be the case if the government has not already figured out a

“better” use of the money like investing into a huge project in atom energy sector or, which is nearly the same – bailing private investments there. There is also a need to bear in mind that almost all financial resources are put into accounts at the Bulgarian National Bank and the interest rates they bring to their owners (i.e. budget) are miserable and are not more than 2,5 % annually.

### What else could the government do with an over-reserve of 1,75 billion leva?

1. To buy right away all eurobonds at 105 % of the nominal price, which would cost EUR 262,5 million or to wait for about a year to the maturity and to pay then 268,125 both principal and interest<sup>3</sup>. The net present value of these 268,125 million, payable in one year at a 2,5 % discount rate is EUR 261,58

<sup>3</sup> We accept that an interest for a whole year has to be paid and it is payable upon redeeming the principal.

millions. Since it is about a million cheaper, it is right to await the maturity.

2. Buying back the global bonds now and today would cost the reserve EUR 1 036 million. If one wait for the maturity, which is in 2013, then would have to be paid more according to the net present value figure – EUR 1 065,6 million, which includes both – discounted principle and interest payments (altogether six – on 15 of January). In short, if the government buys now it would save its taxpayers about EUR 29,6 million.
3. Paying off all debts related to the global bonds in dollars now would cost EUR 1 270,5 million and paying the debt off at the maturity - altogether EUR 1 341,6 million, Figures are in favor of buying today – amount of money saved: EUR 71,1 million.

In this example I disregard the existence of transaction costs, which would make deals more expensive and thus logically less profitable. I still believe though, that the final results would be relatively unchanged. I also set aside possible alterations in market conjuncture and / or potential changes in the bond contract parameters like swaps.

To be able to save about EUR 100 million, the Bulgarian government should have at a free disposal and also agree to use about EUR 2,3 billion. That is generally an immense amount of money that not so many governments could afford to spend overnight without any serious implications on their economies. Thus, the presence of a huge fiscal over-reserve in

Bulgaria allows the use of about EUR 0,9 billion (currently in foreign exchange anyway), which would pay off over 1/3 of the bond bounded government debt and save the taxpayers over 35 million leva.

Besides the opportunity to reduce foreign debt that is to be paid off soon or later anyway, there are also some other reasons backing the direction of the fiscal over-reserve to buying back bonds:

- Raising the credit rating of the country – easier and cheaper access to credits for the government and for the private sector as well.
- Improving interest of the international investors towards Bulgaria due to lower investment risk, financial sustainability
- Using the accumulated, through higher than the breakeven point taxation, over-reserve in the best possible way
- Preventing its laying out on inefficient or even harmful for the economy activities
- And finally reducing the amount of money each taxpayer owes on average to the rest of the world.

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 \* The Public debt is actually higher, which is due to the fact that the government sector does not account for debts of banks and non-bank enterprises with over 50 % government participation, and for the debts guaranteed by the public sector as well.

### One Step Forward, Two Steps Back: Ataka and the Effects of Nationalization

Kevin P. Allen

Despite recent scandals which have resulted in internal discord amongst members of Ataka, the party retains relatively stable levels of support among its core constituents. The upcoming protests in regard to the visit of U.S. Secretary of State Condoleezza Rice will illuminate to what effect, if any, these scandals have had on the party. Irrespective one can assume that the party will persist and that its' very existence should be

a cause for concern as the social and economic proposals endorsed by Ataka will undoubtedly hinder the development of Bulgaria and the Bulgarian people. These proposals (usually delivered in the form of populist rhetoric) are encompassed in two documents, one of which is known as the “20 Principles.” Among the more damaging directives in the “20 Principles” is the idea to **‘reconsider’ the privatization process in Bulgaria**, a euphemistic manner of calling for the nationalization of private property. The effects of such an action would be far reaching in that the realization of the policy would:

- deprive the government of large fiscal gains resulting from the sale of state-owned enterprises.
- result in severe economic damage to the general public by nationalizing the 216,00 plus small and medium sized enterprises.
- have a significant negative effect on foreign direct investment (FDI) in the country.

### The Economic Impact of Privatization

Prior to discussing the possible fiscal gains associated with the privatization process, I would like to insert a disclaimer regarding the utilization of funds resulting from privatization. One might be quick to argue that money acquired by the state is often funneled off into the pockets of avaricious politicians and the impact of privatizing large companies is thus diminished. I recognize the potential for such behavior however the issues are very much different and the existence of corruption is a much more serious impediment to the well being of the country than is privatization. As such I speak of privatization in a theoretical sense i.e. in a sense that lawmakers will one day give the problem of corruption serious consideration, strip MP's of their immunity and make a concerted effort to identify and prosecute all those engaged in illicit activities.

That being said, the privatization of larger enterprises has a very significant impact on Bulgaria's economy. One example to reference is that of the Bulgarian Telecommunications Company (BTC). The total financial effect of the sale of 65% of the company to Viva Ventures amounts to over EUR 1.1 billion alone<sup>4</sup>. The remaining 35% of BTC was offered in the form of 2.8 million shares on the Bulgarian Stock Exchange. As of April 4<sup>th</sup> the selling price of one share of BTC stock was 10.20 leva<sup>5</sup> giving all shares a value of approximately BGN 28.5 million or just over EUR 14 million. Other examples of large fiscal transfers resulting from privatization can be seen in the energy and banking sectors.

The partial privatization (67%) of seven state-owned electricity distribution companies

garnered approximately EUR 693 million<sup>6</sup>. The project was partitioned into three regions and the winning tenders were as follows: the Czech company CEZ paid EUR 281 million for the western package, German company EON paid almost EUR 141 million for the northeastern package, and Austrian company EVN paid EUR 271 million for the southeastern package. If fully privatized, we can assume the total fiscal effect would reach approximately EUR 1.03 billion. In another deal worth EUR 260 million, a consortium of Mitsui & Co, Toshiba, and the Japanese Bank of International Cooperation will redevelop four units of the Maritza Iztok 2 thermal power plant.

The long-term process of privatizing the banking sector has also had a significant effect on the Bulgarian economy. One major player in the process was the Banking Consolidation Company (BCC). The BCC, established in 1992, was designed to expedite the banking consolidation process, manage the State interests in commercial banks, and establish an effective banking system within the country.<sup>7</sup> The first major step came in 1994 when the BCC sold its entire interest in six banks and reduced its shares in two others. In 1997, the company adopted a privatization strategy for each of the state-owned banks in which it was a major shareholder. These banks include Bulbank, Express Bank, Post Bank, Hebros Bank and Biochim. The 1998 sale of approximately 78% of BCC's shares in Post Bank brought USD 38 million. The BCC later sold its stakes in Bulbank to a consortium of Unicredit and Allianz for some EUR 360 million.<sup>8</sup> As well, Express Bank was purchased by the French firm Societe Generale for some EUR 36 million.

In short, privatization brings in a great deal of money for the state. As of December 2004, the total number of state-owned enterprises sold was roughly 2,878. In addition, stakes and shares in around 5,181 enterprises and 2,303 self-contained facilities have been sold. Over the course of twelve years, the total overall financial effect from the deals signed concerning the transfer of enterprises is approximately USD 9.74 billion<sup>9</sup> (an amount roughly equal to the country's 1995 GDP<sup>10</sup> and approaching 1/6<sup>th</sup> of

<sup>6</sup> Ibid.

<sup>7</sup> A Review of Bulgarian Privatization – OECD, 1998

<sup>8</sup> Press Review - b-info.com, July 2000

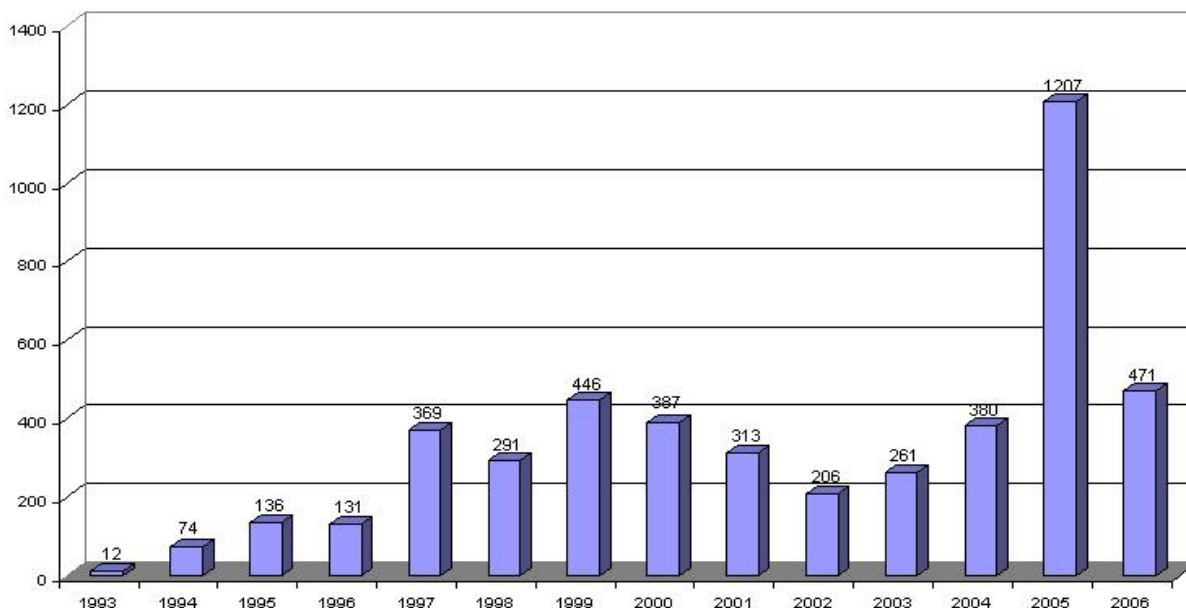
<sup>9</sup> Summary Report of the Privatization Process – Privatization Agency, Rep. of Bulgaria

<sup>10</sup> Black Sea Energy Review.

<sup>4</sup> Summary Report of the Privatization Process – Privatization Agency, Rep. of Bulgaria

<sup>5</sup> Bulgarian Stock Exchange, Sofia

Privatization revenues  
for the period 01.01.1993 - 31.03.2006  
(USD mln.)



the country's 2005 GDP<sup>11</sup>) while the actual payments made amount to approximately USD 4.6 billion<sup>12</sup>.

### SME's and the Effect of Reconsidering Privatization

The decision to reconsider privatization would not only affect large enterprises in the banking and energy sectors but would have severe consequences on small and medium-sized enterprises in the country. As previously mentioned there are some 216,000 SME's which account for 99.2 percent of total enterprises and 99.8 percent of all private enterprises.<sup>13</sup> In 2003, small and medium-sized enterprises were responsible for the employment of some 1.1 million people in Bulgaria, approximately 79 percent of the total number of employees in the private sector.<sup>14</sup>

An examination of the impact of SME's across various sectors will assist in understanding the negative impact of nationalization in Bulgaria. In **manufacturing**, SME's comprise 98.9 percent of all enterprises in the sector. The number of people employed by SME's constitutes just over 63 percent of all employment in the sector. Regarding **construction**, SME's account for 99.6 percent of all enterprises in the sector and employ over

85 percent of those working in the sector. Medium sized enterprises alone account for over 35 percent of the employment. SME's dominate the **wholesale and retail trade, repair of motor vehicles, and personal and household goods** sectors. Large enterprises account for only .03 percent of all enterprises while micro enterprises make up just under 95 percent. **Trade** is the most attractive sector for SME's who employ over 95 percent of all people working in the sector. In the **hotel and restaurant** sectors, SME's account for over 99 percent of all enterprises while similar numbers can be found in the **transport, storage, communication, real estate, and business activities** sectors. Due to the nature of production in some sectors such as mining and electricity, SME's are not nearly as dominant.<sup>15</sup>

A brief look at the introduction to the *Annual Report on the Condition and Development of SME's in Bulgaria, 2004* will provide perhaps the most compelling argument against the nationalization of private property.

"Small and medium-sized enterprises account for 99 percent of total Bulgarian enterprises. They generate 79 percent of employment, 75 percent of the turnover, and 61 percent of the value added of private enterprises." The report later adds: "They account for 54 percent of the export and 73 percent of the import of private business."

<sup>11</sup> CIA World Factbook - Bulgaria.

<sup>12</sup> "Summary Report of the Privatization Process." Privatization Agency - Rep. of Bulgaria.

<sup>13</sup> "Annual Report on the Condition and Development of SME's in Bulgaria, 2004" – SME Promotion Agency.

<sup>14</sup> Ibid.

<sup>15</sup> Ibid. All of the statistics in the preceding paragraph can be found in the Annual Report.

To reverse the process of privatization would have serious negative effects on Bulgarian SME's. Due to the number of people who are employed by SME's, one could assume that the implementation of such a policy would result in extremely high unemployment, serious deterioration of a large part of the service sector, and acute macro-economic damage to the Bulgarian economy.

### **Nationalization and Foreign Direct Investment**

In regards to FDI, it should first be noted that the effects of FDI are not sole monetary; foreign firms also bring access to global markets, transfer technologies, train local executives, and often provide better paying jobs than domestic firms.

That being said, the reversal of the privatization process will virtually halt all foreign direct investment (FDI) into Bulgaria. This is significant as inflows of FDI account for a sizeable portion of funds in the country. The pending entry into the European Union has heightened investor interest in both Bulgaria, a trend that is clearly visible when one considers the increases in FDI over the past few years. In 2000, FDI in Bulgaria measured around EUR 1.08 billion. Since that time it has fallen once in 2001 (down to EUR 896 million) and steadily increased measuring approximately EUR 2.5 billion in 2004.<sup>16</sup>

One of the largest investors is Business Park Sofia, a Bulgarian firm who, in conjunction with the construction group German Lindner, was awarded a First Class Investor certificate upon the agreement of a three-year investment amounting to BGN 1.6 billion. There are numerous other examples in the same vein. The Canadian firm Dundee Precious Metals agreed to a two-year, BGN 1.1 billion investment to modernize the process of extracting and processing ore in Chelopech. The company is slated to invest another BGN 101 million in the future. In May 2005, the French company Montupet agreed to a BGN 70 million investment to establish a car part factory in Rousse. Trakya Glass Bulgaria, a subsidiary of the Turkish holding Sisecam, is investing some BGN 367 million to produce glass in the town of

Turgovishte.<sup>17</sup> To allay any fears stemming from the last example (i.e. that Turkish companies are buying up Bulgaria), the largest investors by country are Austria (32.5%), Switzerland (14.2%) and the United Kingdom (13.5%)<sup>18</sup>. The point here is that foreign direct investment is crucial for the Bulgarian economy and according to the website invest.bg, accounts for almost 11% of the country's GDP.

As demonstrated by the preceding paragraphs, Ataka's plan to 'reconsider' privatization is deeply flawed in many respects. As well, it would erroneous to assume that Siderov and his party have the capacity to somehow successfully reverse the privatization process without causing severe damage to the country's economy and leaving hundreds of thousands unemployed. Thus we are left with the following questions:

- Does Ataka have the USD 4.6 billion to cover the income gained from financial transfers stemming from privatization?
- How will the party provide employment for the roughly 1 million people who stand to lose their jobs as a result of nationalization? (This is particularly important considering the current levels of unemployment in the country.)
- How will they preserve the country's service sector as it is largely dependent on SME's who will ultimately be put out of business as a result of nationalization?
- How will the party recover the BGN 3 billion lost in foreign direct investment as a result of nationalization?
- Does the party have a definitive plan on how to go about engaging in nationalization without an end result that parallels that of Zimbabwe?

Siderov and his party members have plenty of bad ideas and the party has neither the financial resources nor the experience to adequately handle the consequences of their own proposals. As shown by the preceding examples, the party offers little more than implausible and poorly thought out solutions. Committing economic

<sup>16</sup> "Bulgarian Reforms Foster Growth, Foreign Investment." World Bank.

<sup>17</sup> "FDI in Bulgaria up by 11.5% Jan – Sept." Bulgaria National Bank / Evroportal.bg

<sup>18</sup> Ibid.

suicide will do absolutely nothing to improve the quality of life in Bulgaria. It is time for the general public to look past populist slogans and

realize that Ataka can only set Bulgaria on a regressive economic path.

## Gypsies' Contribution to Market Reforms

Krassen Stanchev

From a societal stratum with most pro-market economic behavior, Bulgarian gypsies, after 1989, have become a key reform agent although this role has never been properly reflected and explained. In this article I would like to discuss the specific niches they occupied in the last 16-17 years, how they were influenced by the culture and how they were motivated by outside factors and welfare state incentives. As in the previous article, I speculate on and attempt to offer an interpretation of well-known facts and developments without pretending to be empirically rigid. I am confident that a specialized survey is likely to provide sufficient hardcore evidence to the interpretation I offer.

### Definition of property rights with the help of gypsies

#### *Gypsy entrepreneur: a bare foot capitalist*

At the eve of the late 1980's reforms, the Gypsy population of Bulgaria had played an important role. Before the political reforms of November 1989 - June 1990 (the political crisis of the Communist regime and the first free post-Communist elections), the regime had loosened its' grip on the economy allowing private individuals to establish individual small businesses in the services and other sectors.<sup>19</sup>

In countries with oppressed individual rights, small changes lead to significant unintended consequences. The gypsy business in the late 1970's and 1980's have contributed to two key justifications of those partial reforms: they have demonstrated that private initiative is not subject to eradication, that it flourishes in all societal

strata and that it produces prosperity gains on all levels.

In the economy the key manifestation of private property right is the right to be a consumer, a master of own preferences and the choice to buy what is wanted from whom it is wanted and at a price that is freely negotiable. The consumer surplus drives this right even under Communist conditions. This phenomenon is well discussed in the literature<sup>20</sup> and we have seen that via the role of Bulgaria Gypsies in the previous article.

The institutional side of the consumer surplus is that it helps in searching and establishing the link between production and consumption: under normal conditions, if consumers do not need certain goods and services then the producer does not have other prospect besides closing production.

These "normal conditions" are well-defined individual rights to private property and consumer choice and absence of coercion and plunder. Under the system of central planning and limited to homes and small slots of land private property, as was the situation in Bulgaria between 1948 and early 1989<sup>21</sup>, all forms of servicing consumer rights were forms of a deconstruction of the status quo (while private

<sup>20</sup> See: Mansur Olson, *Power and Prosperity*, New York, Basic Books, 1998, William W. Lewis, *The Power of Productivity*, Chicago, Chicago University Press, 2004.

<sup>21</sup> In Bulgaria, the "excessive ownership" of homes (flats and houses) was nationalized (in 1947-1948); in fact there was a rationing of this type of property. However, during the entire communist period private homeownership was comparatively high – 80–85%, the urban population retained full ownership of their houses in the rural areas and the slot of land around them (40-50% of the urban population has had such ownership); the ownership titles on arable land, forest, etc. remained private but the use of land was "collectivized", more or less completely after 1962 while the forest was nationalized. Totally expropriated were about 4,500 – 5,000 families. One of the key reforms after 1989 was the restitution of all types of ownership – see: Krassen Stanchev, *Denationalization in Bulgaria*, in: *Contemporary Economic Libertarianism in Bulgaria*, IME, 2004, available also at: [www.easibulgaria.org](http://www.easibulgaria.org).

<sup>19</sup> That partial liberalization was launched by the Decree 56 of 1989 (titled "On Citizen's Economic Initiative") that prescribed how companies are to be registered and what taxes they pay.

business has been effectively treated as crime in all walks of life until early 1989 when the prohibition was partially lifted from some sectors). The deconstruction:

- Defines the limits of central planning,
- “Creates” and sustains the alternative to central planning,
- Destroys the central planning since consumer surplus motivates plundering from state owned assets.

In this situation, the Gypsies in Bulgaria are the only societal group to fulfill the above said deconstruction; other groups were performing it by accident and on a sporadic basis. This is because the Gypsies as a group were:

- a) Deprived of social status, career and influence,
- b) Completely pauperized, a “proletariat with any avant-garde”,
- c) Group market economy actors under Communism.

The liberalization of the hard currency shop trading in 1970's and the involvement of Sofia and other big city Gypsy communities performed an example of barefoot capitalism. Such capitalism was, however, not only the mercantile into highly valued goods as jeans. Besides the already mentioned specific craft niches and agriculture free-lance, an even more important market role of the Gypsies was their involvement in the creation and functioning of the early 1980's open air bazaars of “Iliantzi” and “Malashevtzi”.<sup>22</sup> Both were the first official alternatives to centrally planned distribution, official in the sense that they were not disturbed by authorities in their first weekend and consequently in daily operations.

In early 1989 and then after political changes of late 1989-early 1990 and with the start of the economic reforms of 1991 such markets grew in size and spread around the country.<sup>23</sup>

<sup>22</sup> Both are named after villages, which in the 1970's have become Sofia districts.

<sup>23</sup> Bulgaria has successfully led economic reforms

Later, the role of the Gypsies as a group of almost exclusive bazaar operators gradually faded away. They were substituted by other “foreigners”, Arabs, Afghani and Palestinians who were settling in Bulgaria on their way to Europe or who had chosen not to go back to their countries since Bulgaria offered better prospects. This was the same phenomenon of barefoot capitalism but more international and globalized as not only the goods but the merchants and buyers were from many different countries. (The buyers become international in 1991 and especially in 1992, after the outbreak of the wars in ex-Yugoslavia.)

From this moment on, a new specialization has begun of bazaar Gypsy intermediaries.

In 2000 and 2001 Prof. Julian Konstantinov observed with criticism the operations of the Gypsies on “Iliantzi” market and on a similar bazaar in the town of Dimitrovgrad. He found that in those markets there was a special additional service offered – fake invoices, and that this service was totally dominated by Gypsies.<sup>24</sup> Those were (are) not invoices for the goods purchased on the market. The service is issuing invoices for tax reporting on a desired amount of money (but not 5-6 thousand US dollars) against 1% of the book price (or a lump sum). Mr. Konstantinov complains that the invoice trading by “mostly Gypsy” vendors takes place before the indifferent eyes of the street police on the market, especially in Dimitrovgrad. At the end of the day, however, such invoices are in great demand: the marginal tax rate in 2000 and 2001 is 65% for a medium size entrepreneur and the regulatory system is characteristic with its harassing controls over private enterprise.

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according to then best Central European standards between December 1990 and the fall of 1991 when they were somewhat delayed due to elections and eventually stopped in late 1992 due to political crisis.

<sup>24</sup> Julian Konstantinov. Kam formalisirane na sivata ikonomika v Bargaria? (Targovtzite na otkritite nazari). Dokrad of terenno prouchvane iuli-avgust 2001. - Evgenii Daynov (redactor). Sivata Ikonomika v Balgaria: prichini, sledstvia, politiki, Sofia, Tzentar za sotzialni praktikiq 2002, str. 83-84 I sl. (In Bulgarian, the English title: Julian Konstantinov, On the Formalization of the Grey Economy in Bulgaria: Open Air Bazaar Merchants, (A Report from a Field Servey), in: Evgenii Daynov (editor), The Grey Economy in Bulgaria: Reason, Consequences, Sofia, The Center for Social Practices, 2002, p. 83-84 a.f.).

*Copyrights promoter in hard spirits*

Copyrights and patent protection used to be one of the key problems of the Bulgarian economy in the beginning of the 1990's. The legacy of the Communism in this area is that those rights are relatively well established in high tech and scientific fields but almost non-existent in trademarks in food processing, pharmaceutical, perfumery and wine industries. More specifically, they existed on paper but the actual implementation and protection did not present a problem in Communist years due to the state ownership of enterprises and government monopoly on wholesale and retail trade.

In the early transition years it was generally quite easy to enter those markets, especially the wine and spirit industry.

Gypsy entrepreneurs, some of whom served the hard-currency-shops trading in 1970 and 1980's, somehow naturally directed their ingenuity towards those markets.

Production of fake alcoholic beverages by mostly Gypsy vendors has had at least three positive impacts:

- 1) They dismantled and eventually expropriated the state monopoly on the production of fake alcohol, which existed for years undisturbed and flourishing as part of the centrally planned "wine-proms"; notably, the Gypsy vendors produced fake wines and hard spirits at quality levels that were comparable and even better than those of the state wine industry;
- 2) Hard spirit and wine lovers with relatively low purchasing power had the opportunity to taste they could not afford otherwise;
- 3) The fake production had eventually forced formal "wine-proms" implement quality controls systems, consumer information, apply brand controls and rationalize production and marketing.

There were other factors that supported development in this direction – privatization of the wine industries (although somewhat delayed) and establishment of sectoral self-regulatory bodies in 1999 in addition to the opening of the retail markets to large retail chains (Metro, Billa) and so on. But the Gypsy vendors were the first to identify the niche and to challenge the government monopoly. Today it is possible to

argue that there were better and more civilized ways to push for reforms but I can hardly imagine any reforms emerging by itself given the government reluctance to privatize wine industry that was common for number of governments before 1997.

This industry was viewed as a "strategic one", as a "core Bulgarian comparative advantage", and from these notions the, mostly Socialist, government derived the "justification" to postpone privatizations until 1996. The actual disagreement with the production and marketing of fake alcoholic beverages stemmed in those years from the fact that someone else is doing the same business as state owned wineries. The state monopoly lasted for more than forty years. "Tzar Kiro" – the most famous Gypsy vendor in fake spirits, although it is rather a nickname - has been in this business for not more than four years.

A part of the production concepts are now in the hands of formal wine producers, they continue selling healthy drinks at low price.

*Nature produce collectors, determinants of "public goods" and aid addiction*

The definition and redistribution of property rights through privatization has been slower in Bulgaria than in other countries.<sup>25</sup> Particularly unclear those rights remained in the area land ownership (the restitution proceeded between 1991 and 1998, and some instances of collective use were sustained). Simultaneously, the redistributionist policies via "social benefits" and "social aid" during the same period were particularly non-transparent and unreasonable and to a large extent remain unreformed even today.

In this respect is one of the most important, positive but publicly controversial role of the Bulgarian Gypsies in the transition.

By ways of culture and due to social status they collect everything that is not properly collected but could be of some use. These could be trees and wild mushrooms in the forests, garbage paper, metal scrap, electricity distribution wires, street sign, maternity "benefits", "social aid", heating subsidies for poor families, electricity bills and anything else.

Public "goods" do not exist per se. Some of those could be seen as public when and if they

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<sup>25</sup> For details, see: Krassen Stanchev, op.cit.

are available for everybody's use amidst little or costly opportunities to exclude free riders and punish them.

In general, what is not protected as belonging to someone is not valued. The Bulgarian press and public opinion blame "The Gypsies" for the utilization of such public goods.

The actual constellation is very different and the Gypsy collection is:

- Of great significance for the determination of the value of the properties that were either privatized or returned to previous owners but remained unprotected for a certain period of time; in cases where the private property was reestablished but remained unattended, the Gypsy collectors motivated owners to be vigilant and organize protection on their own, to the extent it happened the Gypsy collectors, as a rule disappeared from the sight;
- Completely in the normal course of the events and in the framework of the law when they benefit from otherwise useless government programs; racist politicians and members of the public usually blame "the Gypsies" but, in fact, Not He is to be Blamed Who Eats the Cabbage Cake – That's the One Who Gives It, as Bulgarian saying goes;
- Very useful for the separation of the urban waste and for its recycling; for the time being, the latter is almost not at all common practice in Bulgaria; for this reason the quasi-industrial separation is done manually and sold to recycling companies; with the gradual industrialization the Gypsies would be forced out of this niche;
- With regard to metal constructions with public functions and the alleged habit of Gypsies to collect those as the Bulgarian press claims (i.e. metal element of sewage facilities, street signs and electric wires), it needs to be mentioned that it is typical only for Bulgaria, although Gypsies live in other countries as well. The key explanation here is that there is a regulatory problem related to the oversight on scrap buyers and recycling plant: they buy such metal

articles that should normally be not subject to recycling;

- Perfectly legitimate with regards to natural produce of forests (mushrooms, wood, herbs, etc.) – the ownership of the forest is 85% public and poorly regulated while there is a significant demand for wild mushrooms and herbs by respective industries in Bulgaria and abroad.

I think it is obvious that none of the above instances represents a violent expropriation. There were clashes between restitution landowners and Gypsy collectors but they quickly disappeared when owners began protecting their properties and production.

#### The positive role of the Gypsies

The eventual impact of the Gypsy collection is that it caused a spontaneous effort to protect land and agriculture production by vigilant farmers and guards hired by farmers. Similar was the story with common village properties, trees and fields. When those are not protected Gypsies and everybody else could reap the harvest and sell it to the market.

Similar is the case with "Gypsy"crafts, they produce knives, axes and other metal instruments. The raw material inputs are basically collected entirely from the garbage litter. It takes time to do this job and it is far from pleasant but the unemployment is high, the labor cost is very low and often craftsmen have the family and friends taking care of the supplies. The human capital and the skills to produce the instruments also come from tradition and family. The cash is needed for the fuel and coal. As I know from a survey of informal credit I conducted in 1996 and 1997, these costs are roughly \$ 500 a year. There are schemes to reduce them: use heating subsidies provided by the government in coal or wood or alternatively, collect wood in the forest where and if possible.

As in all cases of collection, there is a use of resources that otherwise are neither valued nor used and they are put into service someone benefit or further converted into capital.

#### The misunderstanding

The lack of normal understanding of Gypsies' ways and days in the last sixteen years of Bulgaria history are typical for the Bulgarian press, the public opinion and newly emerged chauvinist political parties.

More importantly, however, they are misunderstood by the agencies and policies to

support "Gypsies". The most common development in this respect is the aid addition on behalf of the donor. If Gypsies take care of themselves, as they have proven they can over years, the "benefactors" will be forced out of job.

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