

Economic Policy Review



May 2006

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ANNOUNCEMENT (The Board of the Institute is seeking to appoint an Executive Director)

What Does The EU Report Say About Bulgaria and What Is It Silent About ?

IME

Introduction

After almost five years of scrutiny on the economic criteria for EU membership of Bulgaria, at the eve of the accession the monitoring report by the European Commission unexpectedly turned its focus on the political criteria.

The objective reasons for that change, that is independent of Bulgaria, its government officials and citizens, are basically as follows:

- Weariness of the enlargement and concern (especially in France) from the fact that the number of beneficiaries of subsidies from Brussels will increase, together with alienation of the European Institutions from the voters and anti-reform attitude of the political leaders from the “old” EU members;
- Inability of EU to improve on a timely basis its mechanisms for political unification, economic lagging of EU behind the USA, intensive competition from new EU members and a global pressure to which the Union fails to oppose in an inadequate manner;
- Activity and clear reform-orientated attitude of the newly elected members of the European Parliament and of Brussels administration that comes from the new EU members;

- The resources that will be left if new enlargement takes place include costs for monitoring of only two, not ten candidate countries.

Of greater importance are the internal reasons for this redirection of the attention towards the political criteria. Among them, the most important ones are:

- The Bulgarian voters after fifteen-year attempts (sometimes going extreme) to find something better on the political market, sent to the parliament a configuration of parties that cannot build an effective executive power;
- The new government was late when it began its work, and secondly, began kicking up a row and fussing around, instead of undertaking elementary measures for transparency in order to use the social opinion as a correcting tool of the internal inefficiency;
- The views of the leaders are archaic, and the moods are pro-reform towards the reforms that took place in the period 1997-2001; archaic – meaning that they come from the era of communism, and especially archaic in the sphere of justice, property rights and administrative structure of the country.

In brief, the government turned out to be a problem to itself.

The current monitoring report by the European Commission, as it is already known, is critical towards the political criteria for accession and

positive to the economic development of Bulgaria. Because the economy is, fortunately, not under the direct control of the government, we can believe that the report is critical to the government but highly appreciates the efforts made by the Bulgarian citizens and the business to cope with the challenges of the accession.

The commentaries by the officials about the report are to a great extent excuses and appeals for unification of their own rows instead of suggestions of possible solutions to the stated problems.

To some degree, the action plan is already set in the report itself. Our notes below aim at assisting its reading.

As a whole, we think that the technical requirements will be completed by October but no proofs will be presented that the reforms in justice and home affairs are fruitful. This means that Bulgaria will become a EU member next year but most probably with a protection mechanism against the ineffectiveness of the Bulgarian judicial system. We believe that the real concern should address the effective protection of the Bulgarian citizens and their rights rather than the protection of the citizens of other EU members from Bulgarians. But the evaluation process is already set in that direction and it will be difficult to be redirected.

Justice and Home Affairs

“The constitutional amendments leave some ambiguities regarding the guarantees of the independence of the judiciary. Any ambiguity must be removed”

“Intensified enforcement of anti-money laundering provisions (acquis chapter 24)” [is needed].

However, certain outstanding issues remain to be addressed. The accountability, transparency and efficiency of the justice system need further strengthening.

The above-mentioned misunderstandings are a result of the following circumstances:

1. The Minister of Justice plays active role in organization of the activities of the Supreme Judicial Council and in the formation of the judicial system budget;
2. The inability of the Council to define its own budget, the lack of an internal

auditing system that helps the budgeting process and the lack of criteria for evaluation of the effectiveness of people that are in charge of it;

3. Inadequate constitutional amendments – the phrases used and the established procedures create a suspicion of a dependence (the meaning of the words used is the same in all languages, including Bulgarian); these amendments are in opposition of the amendments that were made last year in Romania (which used to have the same critiques as the ones that showed up in March and April this year about Bulgaria);
4. The base of these amendments is the reluctance of the government officials to change the place of the public prosecution in the judicial system, which is subject to the executive power; this reluctance motivates, at least formally, a submission of the whole justice system to the executive and legislative power, not de facto but in law.

The joint denominator of all these circumstances is very clear: the ruling coalition wants to use the system in the current form by its own view.

The elected prosecutor general, although excelling with his professionalism and positive characteristics, still has family relations with the government body under communism. It is well known that “the son is not like his father”, but it is also well known, by the EU observers too, that no political consensus was sought for the position of a prosecutor general.

This is an expression of arrogance, although entirely within the established set of practices. This arrogance has already played and will continue to play in the future its vital negative role during the reformation of the justice system in the country.

Organized crime

As for the so-called organized crime, the report in fact says that at present the government only demonstrates and boasts. The reply of the Bulgarian officials to this critique reveals basically two things:

1. They repeated in the form of self-criticism the assessment by the EU experts but justified themselves by saying that the problems have been

accumulating for years, “during a period of sixteen years”;

2. The government makes an attempt to change its own appearance in front of the eyes of the society, but for now there is no concrete idea what can and should be done as opposition to the organized crime as well as about the ambiguity concerning the independence of the judicial system.

It is obvious that the problems are not from last year and they have been accumulating for years. But the sources should be sought not in 1990 or 1991, but many years before that:

- In appointing of bankers in the period of May 1989 – August-September 1990;
- In the parallel activities of representatives from the organs of public order and security business in the official environment.
- In the artificially maintained secrecy of the actions of these organs in the past and present which is harmful for the social confidence in the government, and in the process of destruction of archives;
- In the methods of human resources management, which have lead mainly to incompetence and mediocrity.

In these circumstances, there is a great difference between wishing and capacity. The governing coalition expresses its wish. But it sees the roots of the problems only in the above-mentioned span of time, in the democratic rules and market reforms, not in the lack of such.

However, what is going to be done is due to the pressure from the Bulgarian and international social opinion. This is one of the benefits from the experience of Bulgaria to join EU.

Money Laundering

The non-intensive fight with the “money laundering” is maybe the only meaningless remark in the report, although it is marked as “a sphere of particular concern”.

First, the legislation system itself in this sphere is meaningless. It is based on the conception that all transactions and remittances of money over a

defined sum should be under strict control. This leads to the necessity of a costly flow of information and reporting that cannot be used for the pursued objectives. The Bulgarian organs – even being the cleverest ones – cannot do anything useful with this database in exactly the same way as the EU members cannot.

Despite this, as it was emphasized by the prosecutor general, in this sphere “tangible positive results” are most easily tracked.

Fighting Corruption

“Corruption continues to be a serious challenge within the justice system and this may affect the smooth and correct implementation of instruments in the area of mutual recognition. Preparations in this area need to be enhanced.”

The reaction of the Prime Minister with regard to this statement was to repeat several times in his public speech “*we shall*” be merciless to any form of corruption.

In a sense, such a behavior and the use of future tense is adequate because:

- a) He is supposed to say so;
- b) EU does not have any standards in this sphere, and according to external sources the country does not stand very bad according to this criterion;
- c) He has nothing to do except to repeat this statement before the coalition partners and ruling bodies.

There are two main problems that still stand out:

1. The obvious one is whether the politicians will have the courage, authority and talent to do what they have claimed – since 1999 there were no ruling politicians that have been expelled from their positions because of corruption suspicions;
2. Then comes the question whether, if this is done, the coalition will remain in place and whether a potential disruption of the coalition will delay the EU accession, despite the progress achieved.

The answer to these questions is not easy, but it is clear that doing nothing is a rational strategy. The report also states that the capacity should be strengthened and a better coordination within the

anti-corruption commission should be accomplished.

Our estimates show that through programs of European Commission and the US government about 30 million euro have been spent for this purpose. The result, if any, is rather ambiguous by general consent. Most probably, there is something wrong in the system. There are some problems and system factors which have not been included in the report due to the fact that EU does not have a common single practice to address this issue – and even if it does – there are no instruments by which to enforce it:

- A main problem is financing of the political parties and their election campaigns and the follow-up accountancy, the lack of publicity in this sphere leads to a lack of loyalty of all governments after elections;
- Practices exist for lump sums government spending such as Highway “Trakia” and NPP “Belene” Projects. The public procurement procedures are illegal, non-transparent and uncompetitive – however, the EC is silent with regard to this issue;
- Already two governments have deliberately deteriorated the accounting practices and have hindered the access to information by citizens; some ministries have almost classified all information concerning programs and budget resources, the meetings of the members of parliament are not public as well. However, none of the EU reports by now have paid any attention to this “tiny matters”.
- Bulgaria is the only country in new Europe (except Ukraine and Russia, but including Albania and Moldova) where the members of parliament keep their property and the property of the executive and judicial power away from the eyes of the outside world.

Private bailiffs system

“Private bailiffs still need to become operational”

Despite the passing of the law on private bailiffs (2005) and the tariff of charges to private bailiffs (2006), the system of private bailiffs could fail

to become as operational and efficient in the near future as the EU officials or we wish to. The reasons for this are as follows:

- The competence status of the private bailiffs is limited within specified regions. This is wrong because no conditions for free competition among bailiffs exist and incentives are created for private settlements and distribution of the market shares on a principle that differs from the idea “the client chooses”.
- The system of public bailiffs is still in place although it has proved its inefficiency through the years. The costs for its maintaining will continue to burden the budget of the judicial system without sufficient results to be accomplished.
- There is a tariff of the charges and fees that private bailiffs can get. However, the bailiffs are entrepreneurs like all the others and they should have the right to specify by themselves the prices for the services that they provide.

IME has many times proposed and justified the necessity of a national-wide competence status of the private bailiffs as a factor that stimulates competition, and fights against the inefficiency of the system of public bailiffs by giving greater negotiation power for all sides.

Economic Criteria

Macroeconomic Stability

“In view of the very high trade and current account deficits, the continuation of tight fiscal policies and measures to contain credit growth as well as moderate wage increases remain crucial.”

The current account deficit is the reason for the measures against extensive crediting that the Bulgarian National Bank and the government undertook. The restrictions by the central bank on commercial banks will loose, because the potential EU accession of Bulgaria means that banks, which are licensed in any country in EU, will have right to operate in the country and will not be treated with the same measures.

The budget surplus means that the government will continue to take away more money from the citizens than it needs to cover its expenses. Thus, it deprives people of the free choice to use and direct by themselves the resources they have produced. The tax burden hinders the efficiency of the economy, the incentives for work and entrepreneurship and the stimuli for tax avoidance and the operation in the gray economy flourish.

Privatization and industrial restructuring

“Out of a total of more than 5800 enterprises with state ownership foreseen for privatisation, the state still holds majority or minority stakes in 520 enterprises. Stakes in 74 enterprises were sold since September 2005, mostly involving minority shareholdings, but the share of privatized assets increased only slightly and remained just below 90% of all assets foreseen for privatisation. Of the larger privatisation deals mentioned in the 2005 report, only three (Boyana film studios, Varna thermal power plant and the river shipping company) were close to finalisation in April 2006.”

The process of privatization has been considerably delayed although privatization positively affects the competitiveness of the economy. The privatization of some of the state companies is even not discussed at all because their activities are believed to be an exclusive priority of the state. Such an example is “Bulgartabac”, which is handled as a policy instrument by one of the parties in the ruling coalition instead as an operating market subject.

*“In the area of **administrative cooperation and mutual assistance**, good progress has been made. The National Revenue Agency (NRA) became operational in January 2006 upon the entry into force of the new Code on tax and social security procedures. The NRA brought together the collection and servicing of both central government taxes (such as VAT and corporate taxes) and compulsory social security contributions (such as health insurance). The ongoing reform of the sector, in particular the successful transformation of the tax administration into the NRA, has improved the collection and control capacity, as shown by the increase in total tax collection.”*

It is too early to evaluate the efficiency of the newly established National Revenues Agency, but we should mention the problems with the information system and the additional costs that were needed for the start of the agency.

The greater amount of revenues from taxes (including social security payments) cannot be attributed only to the new administration structure. It is a result of the lowered direct taxes and social security rates and the consequential reduction of the stimuli for tax evasion.

Labor market flexibility

“However, certain outstanding issues remain to be addressed. Hardly any progress has been made on removing labour market rigidities and modernising the regulatory framework, in particular as regards working time or the use of fixed-term contracts. The integration of seniority bonuses into the regular pay scale has been delayed.”

IME has constantly appealed and publicly presented its proposals for the creation of a more flexible labor market. In the context of the suggestions of EU, the ideas of the social minister Mrs. Maslarova for tying the wages in the public and private sector with a specific formula is a step backwards toward abolition of market principles on the labor market. At the same time, if the proposals by the labor unions are undertaken, a negative assessment will follow by the European Commission. The flexible labor market is a prerequisite for reduction of unemployment, stimulation of labor productivity and mobility and more efficient utilization of human capital in the economy.

The above-mentioned obstacles in the report are only a small part of all impediments that employers and employees face every day. So, the following measures should be added:

- Regulations on working time should be abolished – limitation to the working time hinders those that want to work more, and respectively, to earn more. This increases the influence power of the labor unions with regard to the terms of labor contacts and that is rarely of any help for workers;
- The procedures for hiring and dismissing of workers should be simplified – thus, the labor market will

be more flexible, and more easily adaptable to the economic situation which allows greater labor mobility;

- The minimum wage rate and seniority bonuses should be abolished – these instruments create negative side effects for the employers as well as for the employees.
- Social security rates should be reduced to 10% (or less) – thus, the labor costs for the employers will decrease; the incentives for registering the full amount of wages will increase; the share of the gray economy will fall;
- A private capital-based pension system should be introduced as soon as possible instead of the current pay-as-you-go system (PAYG) that is prone to default.

“As from January 2006, pension contributions were reduced by 6 percentage points and the share paid by the employer was reduced from 70% to 65%, thus reducing non-wage labour costs and providing incentives for job creation and moving jobs out of the informal sector.”

IME welcomes the reduction of the social security rates. For years we have been educating the general public and have justified our conclusions by quantitative research that this is one of the main steps toward higher economic growth, prosperity and freer economy. There is both a possibility and enough resources for notable reduction of social security and tax rates. We hope that at the end of the next budgeting procedure a further reduction will be set. The only matter of concern is the reaction of the employers, who could not fully see the benefits from the reform for themselves and their opposition can cause a problem for implementation of further reforms in the future.

“Preparations for an evaluation of the effectiveness of active labor market programs have started”

The idea of assessing the efficiency of any government program financed with money of all taxpayers is excellent.

The order of the steps, however, should be different: let's assume that there is a problem – (1) an investigation of the causes of the problem

is necessary – (2) Can the problem be solved without government intervention? – (3) if no – estimation should be made whether the benefits for the society exceed the costs for the implementation of the proposed program – (4) the expected results should be evaluated – (5) full accountability and transparency of each step should be maintained – (6) after a certain period a monitoring should be made to assess whether the objectives have met or the program proves not efficient and should stop.

Up to present, we have never witnessed such a process, but even if one of the steps is undertaken, it will be regarded as an achievement by the Bulgarian administration. That is why we promote cost-benefit analysis of the government intervention and hope that the conclusions from such an analysis will be used to the purpose.

*“With regard to **social dialogue**, the bipartite dialogue needs to be further strengthened in order to prepare the social partners for their future role in the formulation and implementation of EU social policy. The representativeness criteria have to be applied in an impartial way for all social partner organisations. Participation in the tripartite dialogue needs to be restricted to social partner organisations with a social mandate. Preparations need to be stepped up.”*

At present, the Ministry Council based on the presented documents is verifying the representative character of the social partners. It will judge whether they meet the legal requirements. The problem is that the counting of the members is made solely by the organizations themselves and as such, the membership counting can be biased due to the lack of appropriate monitoring.

According to data from the last available membership counting, less than 18% of the workers regard themselves as being represented by the labor unions. Is this any representation power? In April 2006 the Ministry Council refused to recognize the status of the union “Promyana” and now there are only two official labor unions.

Agriculture

Common market organizations (CMOs)

*“Legislation has been adopted to enforce the CMO for **milk** and measures have been taken to put in place the milk quota as well as most of the mechanisms for the common market organization for milk and milk products. The database including the basic quota register has been finalized, covering all producers and direct sellers; allocation of the indicative individual quota is under preparation. The process of approval of purchasers is on good track.*

Detailed rules for management of milk quotas and of the national reserve have yet to be adopted. The national and regional milk boards are not fully operational nor are the independent laboratories for the analysis of fat content at all individual milk factories. The laboratories are neither installed nor accredited yet. Preparations need to be accelerated.”

The suggestions by the European Commission are rather technical and practical and the deadlines can be met if the government structures work effectively for this purpose. As a result of the introduction of the Common Market Organizations several consequences will follow on the dairy market. The small-scale and inefficient farms, that have been receiving subsidies for years, will close because they fail to meet the new EU requirements. However, the state grants have slowed down the process of restructuring in the agricultural sector. The initiation of strict quality and hygiene standards has necessitated investing in new technologies and equipment for those producers that want to comply with the new laws. But this was not possible for all farmers and as a result, the milk-processing sector will possibly face shortages of fresh cow milk that meet all EU norms. Farmers, that have accomplished to meet the standards, will win from the accession process due to the subsidies and grants they are going to receive and the enhanced demand for milk as a result of the decline in supply. Registering of the producers in special databases will make them go out from the gray economy into the official sector.

The possibility of a protective clause in the sphere of agriculture will have a direct impact on the market because the producers will not get free access to the common market and the export licenses will remain. At present, the milk-processing sector is a net exporter in the country and it is expected to further increase its export power after the accession. There are indications for a strong interest from foreign investors in the sector of food industry once the business

environment is equalized by implementing the EU requirements.

Despite the fact that the agricultural sector is highly regulated via Common Agricultural Policy (CAP), which leads to market distortions, the competition within the union and rivalry from the efficient farms in EU will stimulate the economic efficiency in the sector and will enhance the labor productivity.

Energy

*“Limited progress has been made on **competitiveness and the internal energy market**. Increased efforts and swift action are now needed in order to complete the opening of the electricity and gas markets before accession. In the area of **nuclear energy and nuclear safety**, the situation has deteriorated with regard to the decommissioning process. Increased efforts and swift action are now needed to guarantee the irreversible closure of units 1 to 4 of the Kozloduy nuclear power plant.”*

IME has clearly stated its position against the single-buyer model years ago and publicly defends the liberalization of the energy market, its restructuring and the abolition of government monopoly along the energy production chain – from production to trading.

The proposed steps that should be undertaken coincide with the prepositions by the EU and they are the following:

- Horizontal unbundling of the activities of production, import and export, distribution, preservation, delivery, and trading of natural gas and electricity;
- Restructuring of National Electricity Company (NEC) and Bulgargaz and privatization of the newly established companies;
- Free access for new entrants to the market and integration to the common European market – giving a competitive access to the resources and energy infrastructure is vital;
- Liberalization of the market and market establishment of prices of electricity and gas: direct negotiations should be established between consumers and suppliers– traders, distribution companies, importers.

- Deregulation of the market and where possible the sector should be left to the free market powers and principles.

The European Union, however, is silent about the grand projects such as NPP “Belene” although it is obvious that its realization will be irrational and is not based on the principles of market economy and free competition.

Industrial policy

“The privatization and restructuring process has continued in Bulgaria, albeit at a slower pace than planned. Privatization is almost complete but the process has slowed down significantly recently with few privatization measures actually terminated. The restructuring of network industries has continued. The privatization process is still not sufficiently transparent, and problems with post-privatization control persist.”

The privatization of all state companies should be a primary objective for the government policy – through privatization of all sectors the market will be characterized with greater efficiency in utilizing the scarce resources in the economy and the business environment will be more favorable. IME has many times criticized the process of privatization and has given concrete suggestions for evaluation of the privatization procedures and post-privatization monitoring system. The highly non-transparent rules are the reason for the failure of some privatization transactions in recent years: Bulgartabac, Bulgaria Air, etc. With the sole exception of a privatization type through the stock exchange, the access to information concerning the privatization of companies is not public – neither the privatization contracts, nor the concrete procedures and offers are accessible. The greatest number of transactions is made via negotiations with potential buyers and “competitions” which imply corruption practices in many cases.

Public Administration

“The decentralization strategy aiming at further decentralizing powers and financial resources from the central to regional and municipal level has not been adopted.

Overall, Bulgaria has made good progress in the field of public administration and is on the way to have an efficient state administration

provided that the current path of reform is maintained.”

Decentralization is the only way through which the municipalities will have incentives and authority to be efficient, to compete for business and attract investors. In this way the decisions of the municipality authorities are transparent and the citizens are able to take part in the government of the municipality in which they live. The process of decentralization supposes that the municipalities have the necessary resources to make reforms on a regional level.

Besides fiscal decentralization (taxes collected by municipality organs remain in the municipality budgets), decentralization is one of the main prerequisites for reforms that lead to restructuring of the administration in a more efficient way:

- Decentralization in education – implementation of a voucher system is a way through which schools will be able to set their own programs and will establish a policy for attraction of good teachers; parents will have greater control on education of their children and will take a more active role in the process;
- Decentralization in the healthcare system – privatization of hospitals and introduction of private healthcare funds which will take away the monopoly of the National Health Fund and will increase the quality of the health services;
- Decentralization in pension system – the greatest part of the social security tax (or all of it) should be invested in individual accounts governed by investment managers and funds and thus, greater yield and pension assurance is provided to employees. This method decentralizes the responsibility from the government to individuals;
- Fiscal decentralization and redirecting of the responsibilities to municipality authorities so that the government officials in Sofia can decrease by more than 50%.

“The review of regulatory regimes has continued, but with limited progress. The newly

established Ministry for State Administration and Administrative Reform is in charge of coordinating the review and optimization of existing regulatory regimes and of giving guidance on improving the methodology for impact assessments.”

IME is leading for years a public campaign for explaining and implementation of the practice of a preliminary regulatory impact studies and cost-benefit analysis of the laws that have been undertaken. In 2003 we made a conception for creation of a Better Regulation Unit (BRU) whose primary aim is to improve the regulation (look [here](#)) and for years we have served as an independent body and make cost-benefit analysis of laws and regulatory norms. Unfortunately, we do not believe that the Ministry of Economy has the capacity to implement and coordinate such an initiative.

What should be done (and is already a practice in many other countries such as Romania, new Europe, Russian Federation, Kirgystan, etc.) is as follows:

- a) Introducing legal requirements for regulatory impact assessment;
- b) The Prime Minister should coordinate the process by requiring that all ministries consult RIAs on draft regulations with the Unit;
- c) The ideas in the sphere in law making should be regarded on the presumption that they lack sufficient justification and mandatory consultations with NGOs, interested parties and the public should be enforced.
- d) Questions should be answered and analyses prepared at request of the general public representatives and committees; the access to online database with laws published in State Gazette should be free to all citizens and easy accessible.

“Measures to optimize the size and structure of public administration, to improve training and to promote the provision of e-government services have been proposed. The new Administrative Procedure Code has been adopted in March 2006.”

Measures proposed by the government for reduction of the number of administration

officials by at least 10% is a positive step forward. What we notice, however, is a process of redistribution of all laid off employees to newly established state structures such as the ones that have been established by request of the EU for acquisition of EU funds. There is no clear set of criteria for reappointing of employees in the public administration bodies.

Transport Policy

“Regarding rail transport, the rail operator and the infrastructure company continue to make losses and to accumulate arrears. Further progress in the restructuring of the railway sector, including through cost-cutting measures, will be essential to improve the financial situation.”

The proposed measures by EC for future reforms are not sufficient. Reducing costs is a good idea because this means fewer subsidies from the budget for covering of losses. However, the reduction of costs itself will not lead to better services. The only possible way is privatization of the *Bulgarian State Railways Company* and giving the railway infrastructure to a 20-year concession.

*“In the field of **air transport**, significant efforts have been made and most of the relevant legislation has been transposed and is generally in line with the *acquis*. Bulgaria has initialed the general air transport agreement and the European Common Aviation Area Agreement, and provisional application of both agreements is envisaged as of the day of signature.”*

Joining of Bulgaria to these two agreements is essential for liberalization of the market, increase in the competitiveness and greater benefits for consumers in the form of lower prices and greater availability of choice of airline companies, destination, etc.

Taxation

*“In the area of **VAT**, legislation which was planned for the end of 2005 has not yet been adopted. In the area of **direct taxation**, the draft Corporate and Income Tax Act has not been adopted either. Preparations need to be stepped up.”*

There are still no proposals for changes in the tax system set for public discussion – only ideas

are being discussed and there is no clarity what should be the official framework of the new tax proposals. What we have always defended and will repeat again is summarized below:

- There is a real possibility for reducing of revenue tax rates although at present the tax rate in Bulgaria is among the lowest ones in Europe.
- It is necessary and possible having in mind the balance of the state budget the income taxes to be reduced – a lower and flat rate will lessen the tax administration and will improve the revenues of the government budget.
- The tax procedures should be simplified and the administration - reduced as a result.

The commentaries by the European Commission are still aside from two main problems – one is internal Bulgarian, the other – common European.

The internal problem is the fact that the Bulgarian government for years now has been collecting more revenues from taxes than it actually needs to cover its expenses. This is a

source of temptation for breaking the financial discipline. IMF insists on having planned budget surpluses as a guarantee against loose government spending but it fails to say that the surpluses can be accomplished by lowering of government costs. For the government, the costs are “a sacred cow” that should not be touched and although it says that the fiscal policy should be prudent, the politicians in rule think of anything but how to increase government expenses.

The common European problem is a little bit easier to explain but difficult to solve. The union does not allow for a competition among jurisdictions in the sphere of indirect taxes. At the same time, there is commitment to a high level of redistribution through the EU budget and grants. This makes a necessity of maintaining a high level of indirect taxes on the territory of EU, which compared to other jurisdictions, is higher and as a result – an arbitrage possibility is created which leads to smuggling and “organized crime”.

The second problem is a source of problems for Bulgaria and all other EU members.

Foreign Direct Investment In Post-Totalitarian Bulgaria

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The purpose of this note is to examine the evolution of Foreign Direct Investment (FDI) in the Bulgarian economy since the dismantlement of the totalitarian communist State. With the recognition and protection of private property that one could expect to result from this change of political regime, investments from abroad should have quickly become a reality. The fact, however, is that FDIs in Bulgaria began to expand only in the late 1990s, i.e. almost a decade after the disappearance of the totalitarian State. On the

other hand, their progression has been remarkable since they began to grow. The average FDI flows for the period 1997-2004 amounted for 42 % of the gross fixed capital formation, which is by far the highest ratio of the whole CEE region (UNCTAD 2006a, 2006b). The following two tables illustrate this recent tendency and provide some additional information as to the allocation and origin of FDIs.

¹ I wish to thank Georgi Angelov for his careful comments, which helped me to correct a few inaccuracies.

Table 1. FDI in Bulgaria by host industry (stocks in million euros)

Industry	1999	2000	2001	2002	2003	2004*	2005*
Total	2173,8	2900,9	3323,6	3902,3	4946,2	6768,7	8530,7
Transport, storage and communication	261,8	215,4	264,3	469,0	569,7	1207,5	2229,3
Manufacturing	1049,7	1227,4	1454,7	1481,9	1754,0	1900,2	1747,0
Financial intermediation	212,6	530,6	508,1	662,2	925,5	1351,6	1744,0
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	216,1	435,0	582,9	633,6	871,5	1203,8	1093,2
Real estate, renting and business activities	104,8	202,4	196,5	251,1	416,2	531,4	769,5
Construction	41,8	78,7	82,9	104,3	75,9	164,2	279,3
Non-classified	46,0	26,1	26,4	2,6	26,5	83,4	271,0
Hotels and restaurants	32,1	57,3	62,6	78,2	84,9	108,3	141,7
Mining and quarrying	29,5	25,4	33,3	27,6	51,3	65,7	91,2
Other community, social and personal service activities	9,5	16,3	22,6	39,4	55,1	54,0	66,8
Electricity, gas and water supply	162,4	67,7	71,0	133,5	73,7	47,3	64,6
Agriculture, hunting and forestry	5,3	16,6	16,6	17,2	40,7	46,3	29,5
Fishing	0,7	1,0	0,2	0,3	0,3	2,9	3,0
Education	0,2	0,3	0,8	0,5	0,2	0,7	0,7
Health and social work	1,4	0,7	0,7	0,9	0,7	1,5	-0,1

* 2004 data are revised as of April 4, 2005. Preliminary 2005 data. Source: BNB (2006b).

Table 2. Top 20 FDIs in Bulgaria by their nationality (stocks in million euros)

Country	1999	2000	2001	2002	2003	2004*	2005*
Total	2173,8	2900,9	3323,6	3902,3	4946,2	6768,7	8530,7
Austria	122,2	203,8	297,7	579,5	671,1	1235,1	2415,6
Greece	95,7	233,4	273,4	472,4	532,6	635,3	863,7
Cyprus	209,1	290,9	289,7	357,6	433,5	473,3	529,9
Germany	419,4	353,8	326,0	438,0	428,9	520,5	522,0
Italy	37,2	314,7	308,0	329,4	412,4	482,3	515,9
USA	260,0	281,2	320,4	332,4	363,0	451,2	496,3
Belgium and Luxembourg	135,1	149,4	292,2	220,3	250,9	460,0	457,1
Netherlands	79,9	205,4	315,1	176,3	466,5	625,8	415,1
Great Britain	239,2	220,4	238,5	225,7	292,6	344,1	379,4
Hungary	8,2	6,4	8,9	18,3	178,1	250,6	343,6
France	59,7	101,6	114,9	134,5	135,7	185,4	184,4
British Virgin Islands	-0,9	21,7	25,6	94,3	62,6	125,1	181,1
Switzerland	76,6	95,3	103,1	107,5	194,4	298,1	135,4
Turkey	41,4	57,7	49,6	91,4	71,7	98,0	114,4
Ireland	4,9	11,9	3,7	1,0	2,4	18,6	94,1
Denmark	1,3	2,6	2,6	15,6	44,2	41,1	71,5
Liechtenstein	8,9	15,6	25,2	27,8	39,1	62,6	66,6
Russia	145,5	33,2	37,9	31,3	49,4	49,4	57,7
Canada	0,9	2,0	2,2	1,7	8,7	32,6	46,2
Spain	57,2	2,0	7,0	6,7	10,5	17,4	41,2

* 2004 data are revised as of April 4, 2005. Preliminary 2005 data. Source: BNB (2006b).

This particularity in the evolution of FDIs in Bulgaria since 1990 requires an explanation. In the first place, it is highly unlikely that only FDIs underwent such a two-stage development. Consequently, we begin our analysis by an overview of the general macroeconomic changes in the Bulgarian economy. The domestic macroeconomic situation should not however be taken as an immediate determinant of FDIs. As a matter of fact, macroeconomic data is produced by individuals acting within a given environment that itself is subject to change. In order to better understand the context within which FDIs are carried out, we will consecrate our second section to a more detailed survey of the microeconomic environment in Bulgaria. Only then will we be able to assess wholly, in our third section, the economic and legal aspects of FDIs in Bulgaria. We will conclude this note with some policy suggestions, and an attempt to qualify the height of FDIs in Bulgaria.

I. Bulgaria's Macroeconomic Background

Bulgaria's economic progress since the end of the totalitarian communist regime is clearly marked by two distinct periods. The first period goes from 1990 to 1997. Even though the privatization process has already started in 1992, it has been very slow, and by the end of 1996 it accounted for the transfer to private owners of only 10,84 % of the State-controlled assets subject to privatization.² In the context of a politically unstable climate, the socialist government rule (1993-1997) brought about substantial budget deficits, and announced a suspension on the payment of the State's debt to foreign creditors. It has been chosen to solve the financial difficulties through inflation. Thus, in 1996-1997, Bulgarians experienced their first hyperinflation in modern post-totalitarian history. Subsequent bank runs and the dollarization of the economy led one third of the banks to publicly avow their bankruptcy. Real GDP per capita reached its pre-1990 level.

The government that took power in 1997 oriented its efforts towards stabilization of the economy and creation of the conditions for the missed economic growth. Fiscal discipline was secured through the implementation of a currency board agreement, still in force today, that transformed the national currency, the lev, into a simple multiple, initially of the Deutsche Mark, currently of the euro (1, 95583 leva represent 1 euro). Strict regulation of the bank sector was introduced. This monetary reform naturally solved the problem of hyperinflation, but did not eliminate inflation itself, given the nature of the present-day media of exchange used in the world. In particular, from 1998 to 2005, the average annual growth rate of the quantity of media of exchange in the Bulgarian economy was 16,5 %. This steady increase in the quantity of money translated itself into a steady, even though relatively slower, erosion of money's purchasing power. Monetary prices of consumers' goods in the Bulgarian economy increased in average by 7,15 % per year over the period 1998-2005.

The most important reform that was achieved was related, however, to privatization. The new anti-communist government (1997-2001) privatized 66,96 % of the state-owned assets subject to privatization. The government that succeeded in 2001, and ruled until 2005 (the Tsarist government, so to speak), followed the same policy, even though at a substantially slower rate. Only 9,2 % of the state-owned assets subject to privatization were ceded to private owners. Up to day, 89,39 % of the state-controlled non-current assets subject to privatization have been transferred to the private sector of the economy. Or to put it differently, "The total amount of non-current assets privatized amounts to 59,03 % compared to the amount of all state-owned assets" (Privatization Agency 2006a). Despite this relatively slow speed of reducing State property, shown in Table 3, economic growth did appear. In average, real GDP grew by 4,5% per year since 1998. By the end of 2005, the GDP per capita reached 2771 euros per year.

² For these and any other data about the privatization in Bulgaria, cf. Privatization Agency (2006) as well as <http://www.priv.government.bg/apnew/Root/index.php?magic=0.62.0.0.2>. State-owned assets *subject to privatization* exclude infrastructure assets from the total possessed by the State.

Table 3. Percent of privatized assets in the total amount of the state-owned assets

	Privatisation Agency ³	All State Bodies	Center for Mass Privatization	TOTAL
1993	0.32%	0.37%		0.37%
1994	1.47%	1.63%		1.63%
1995	0.50%	1.07%		1.07%
1996	3.53%	4.09%		4.09%
1997	2.38%	3.78%	14.58%	18.36%
1998	1.76%	4.47%		4.47%
1999	13.99%	16.96%		16.96%
2000	2.32%	4.43%		4.43%
2001	0.60%	0.97%		0.97%
2002	0.99%	1.16%		1.16%
2003	1.36%	1.36%		1.36%
2004	2,58%	2,58%		2,58%
2005	1,51%	1,51%		1,51%
2006	0,06%	0,06%		0,06%
TOTAL	33,38%	44,45%	14,58%	59,03%

Source: Privatization Agency (2006b).

If most macroeconomic indicators were unsatisfactory until 1997, they are all improving, even though slowly and not always constantly, since 1998. Thus, unemployment increased until 2001, when it reached 17,3 % of the active population, but it has been decreasing since (10,7 % at the end of 2005). Average wages and salaries are increasing, but at the end of 2005 they remained still at the low level of 163,4 euros per month. The openness of the economy remained relatively constant during the period, with imports culminating at 64,5 % of GDP and exports reaching 44,1 % of DGP at the end of 2005. Gross capital formation is continuously increasing. From 9,4 % of GDP in 1993, it reached 15, 1% of GDP in 1998, and attained an average of 23 % of GDP for the last 5 years. The very structure of the economy, estimated by the distribution of the gross added value into agricultural, industrial and tertiary components, undergone significant changes. In 1998, agriculture accounted for 26,2 % of the total added value, industry for 27,9 % and services for 45,9 % respectively. In terms of property, 56,7% of the GDP was generated by the private sector. In 2005, agriculture accounted for 9,3 % of the

³ The Privatization Agency to which the Privatization and Post-Privatization Control Agency succeeded in 2002 was in charge of organizing the privatization of the big assets. Small assets were privatized by the ministries that controlled them. Since 2002, all assets are privatized by the new Agency.

gross added value, industry for 30,4 %, and services for 60,3 %. The private contribution to GDP rose to 68,2% of the total.⁴ While the contribution of the industrial sector remained relatively stable, the tertiary increased significantly at the expense of the agriculture.⁵

Considering the public sector, total tax revenues of the State remained relatively constant at a level around 30 % of GDP. However, tax revenues do present a tendency for increasing during the last 5 years, reaching 34,5 % of GDP at the end of 2005. Total government expenses remain relatively constant at the level of 40 % of GDP, of which non-interest expenses constitute the most significant, and slowly increasing, part, reaching 38,1 % of GDP. Owe to the importance of non-tax revenues and grants (8,4 % of GDP), the overall budget is well balanced, and presents even a surplus of 3,2 % of GDP for 2005. Government debt has been significantly decreasing since 2001, when it was 69,9 % of GDP. It went down to 31,9 % of GDP by the end of 2005. This decrease is mostly due to a reduction of the external debt of the public sector. However, the gross external debt of the country increased during the last five years because of an offsetting, and more important, tendency with regards to the evolution of the gross external debt of the private sector.

Having reviewed the current macroeconomic situation in Bulgaria and its recent evolution, let us now examine more specifically the general business environment and in particular the way it is being affected by Bulgaria's modern State.

II. Business Environment And Government Intervention

Economic activity and perception of revenue on the territory of Bulgaria is subject to regulation

⁴ For the data on the distribution of the GDP, cf. National Statistical Institute (2006a).

⁵ If analyzed in terms of employment, the tendency of a decrease of the public sector has to be qualified. In 2001, 779 384 of all 1 889 874 employed in the economy, i.e. 41,23%, were employed by the public sector. In 2004, this percentage fell down to 33,87% of all 2 152 301 employed. In nominal terms, all employed by the public sector did decrease by 50 491. However, the size of the public administration increased during the same period by 22 843 administrative workers, i.e. by 23,83 % (idem., 2006b). It must therefore be concluded that the tendency of a decrease in public property goes hand in hand with the consolidation of Bulgaria's modern democratic State. We therefore observe the transition from a collectivist State engaged mainly in the monopolistic production of economic goods into a democratic state engaged mainly in expropriation and redistribution.

and taxation by the Bulgarian government. Value-added tax is currently established at 20 percent.⁶ Corporate income tax has fallen from 23,5 % in 2003, to 19,5 % in 2004 to 15 % in 2005 (lower than in Romania, but still higher than the 9 % in Montenegro). Personal income tax is collected on an annual base, according to a progressive scale, the first 90 euros per month being free from taxation. Marginal rates of taxation are of three levels, 20%, 22% and 24 % (down from 29 % in 2004), the latter being the highest. Even though taxation of the product of labor seems relatively low, social security payments are an additional means of confiscation of private income to be taken into consideration. Social security costs to the account of the employer amount to 23,6 to 24,3 % of the monthly salary, to which one has to add 12,3 % that are imposed on the employee. Despite the high cost of the fiat social security system, labor costs in Bulgaria were the lowest in the region by the end of 2005, namely 1,1 USD/hour (1,4 USD/hour in Romania, 2,4 USD/hours in Turkey, 13,7 USD/hour in Greece, with an average in the European Union of 28,3 USD/hour).

Exchanges of goods and services between Bulgarians and foreigners were subject to an average tariff rate of around 1% in 2004, remaining therefore relatively stable in comparison to the 1,5 % in 2002. However, additional difficulties for foreign trade arise from non-tariff barriers that the US Department of Commerce identifies as “excessive documentation requirements, slow processing of shipments, and corruption” (Heritage Foundation, 2006, p.1).

Labor legislation stipulates an 8-hour working day, with a 24-hour rest period required during a 7-day period. A minimum monthly gross salary of 82 euros is imposed. Termination of labor contracts of employees other than senior managers requires a sufficient justification. Notice periods are usually 30 days. Legally fixed compensations in case of termination of the labor contract based on “mutual consent” must not be lower than 4 monthly gross salaries. Upon dismissal due to staff reduction, closing-down of a productive facility, reduction of the volume of work or work interruption for more than 15 working days, unemployment compensations paid by the former employer amount to 1

monthly gross salary. Employment of foreign persons requires a permit. A temporary work permit is valid one year, and can be renewed twice. All foreign persons that have a permanent residence permit can be employed in the same way as Bulgarian citizens. The total of employees who are foreign citizens cannot exceed 10 % of the total workforce, however. All employers must register a new labor contract with the National Agency of Revenues within three days of its conclusion.

Human capital quality is very positively assessed by analysts. The education is estimated to be among Europe top 5 %. 7 % of the workforce has engineering degrees. English language is studied by 70 % of students. Post-totalitarian emigration, even though expatriates are typically of the age of the active population, is considered to have a negligible effect on the potential for development of the economy (Gächter 2002)

Registration of companies in Bulgaria is relatively easy. For example, registration of a limited liability company requires the presentation of 11 documents to the Commercial Register of the local District Court, takes one to two weeks, and costs around 125 euros. Registration of trade representative office of a foreign person requires producing 8 documents, takes 3 days and costs 100 USD. However, starting real economic activity is significantly more cumbersome. Various certificates are required, and the administrative agents supposed to furnish them seem to be of a very low efficiency, unless incited by non-legally required financial means. The US Department of Commerce characterizes the situation in the following terms: “An abundance of licensing and regulatory regimes, their sometimes arbitrary interpretation and enforcement by the bureaucracy, and the incentives thus created for corruption, have long been seen as an impediment to investment” (ibid., p.2).

Infrastructures in Bulgaria are relatively poor. Roads, state-owned, are in a bad shape, and the percent of highways comparatively to the total length of roads is negligible. The first end-to-end highway to connect the capital city of Sofia to the Black Sea coast is to be built by 2009. Financed by a 35-year concession to a consortium between Portuguese firms (51 %) and the Bulgarian government (49 %), the project does not seem to have begun yet. Railways, all of which are state-owned, are old, slow, and of low efficiency too. There are a significant number of airports. Airport traffic of

⁶ All data herein quoted come from InvestBulgaria Agency (2006a, pp. 4-16).

passengers grows by roughly 20 % per year, reaching 1 605 000 passengers in 2004 for the airport of Sofia, and 1 334 000 and 1 353 000 passengers for the airports of Varna and Bourgas respectively (the two biggest coastal cities).

It appears from our survey of the microeconomic conditions in Bulgaria, that the fiscal burden on enterprises is relatively low, and has been decreasing in recent years, in comparison to taxation in other European countries. On the other hand, however, general conditions for doing business are spoiled by a high degree of administrative regulation that goes hand in hand with corruption and low efficiency of the infrastructure. Let us now try to describe and explain, within that context, the evolution of FDIs in Bulgaria.

III. Foreign Direct Investment: Economic And Legal Aspects

Foreign direct investment in Bulgaria is of two types due to the particular structure of ownership in the country at the end of the totalitarian regime. The first type, which could be called FDI from privatization, consists in the acquisition by foreigners of state-owned property. The second type, which could be called Greenfield FDI or FDI from expansion, consists in the acquisition of property that has already been private and/or in expanding an existent private property. The following table gives an idea of the extent of both types of FDI.

Table 4. Flows of FDI in Bulgaria, 1992-2004 (in million US dollars)

Year (1)	Greenfield and Expansion FDI (2)	FDI from Privatization (3)	Total FDI (4)	GDP (5)	G and E FDI /GDP (2)/(5)	Total FDI /GDP (4)/(5)
1992	34,4		34,4	8605	0,40%	0,40%
1993	80,4	22	102,4	10812	0,74%	0,95%
1994	76,7	134,2	210,9	9484	0,81%	2,22%
1995	136,6	26	162,6	13055	1,05%	1,25%
1996	180	76,4	256,4	10368	1,74%	2,47%
1997	214,8	421,4	636,2	10198	2,11%	6,24%
1998	404,4	215,6	620	12735	3,18%	4,87%
1999	592,1	226,7	818,8	12946	4,57%	6,32%
2000	635,5	366	1001,5	12597	5,04%	7,95%
2001	793,7	19,2	812,9	13599	5,84%	5,98%
2002	839,7	130	969,7	15651	5,37%	6,20%
2003	1732,8	364,1	2096,9	19860	8,72%	10,56%
2004	1667,3	1216	2883,3	24131	6,91%	11,95%

Source: InvestBulgaria Agency (2006d).

The table suggests that FDI from privatization was not the most important type of FDI, except for 2004, when the big national telecommunications company and most of the electric distribution plants were sold by the government to foreigners. We have also to note that the dynamics of this type of FDI is mostly determined by the State's discretionary decision to sell parts of its property or not. In this respect, table 4 shows how much unstable politicians' behavior may be. On the other hand, FDI from privatization is doomed to disappear once the privatization process has been completed. Finally, this type of FDI does not consist into an increase of net investments in the Bulgarian

economy, but only into a transfer of an already existent property. This implies that FDIs from privatization are not a net investment at all.⁷ Therefore, an economic analysis that aspires to explain the evolution of FDIs and their overall effect on the economy should concentrate on greenfield and expansion FDIs only. Legally, however, FDIs from privatization have to comply, in addition to other laws, with the

⁷ We do not affirm here that this transfer of existing property does not increase efficiency of property management. However, we do want to stress upon the fact that these two issues have to be examined independent from one another.

Privatization and Post-Privatization Control Act, first voted in 2002, and last amended in 2005.⁸

Focusing our attention on the Greenfield and Expansion FDIs, we can notice that this type of FDI shows a steady increase, unless maybe for 2004, in nominal terms as well as comparatively to GDP. Here again, two periods must be distinguished, namely before 1997, and after 1997. As a matter of fact, the Encouragement of Investment Act was adopted at this time, and it is perfectly understandable that FDIs increased after the adoption of this new piece of legislation. Also, since the implementation of the currency board, all restrictions on imports and exports of capital were abrogated. Thus, a favorable environment for investments was created, and we should now analyze it in more details, especially from a legalistic standpoint.

The most essential legal fact that has to be mentioned first is that Bulgarian law does not differentiate between investments made by residents and investments made by foreigners. This is one of the central provisions of the 1997 Act.⁹ The legislation on investments, therefore, does not discriminate at all against foreigners. Investment projects, which shall all be realized within three years and create new jobs in order to be considered eligible for encouragement by the government (InvestBulgaria Agency, 2006b, art.12), fall into three classes: first class for investments over 70 million leva, second class for investments from 40 to 70 million leva, and third class for investments from 10 to 40 million leva (idem., 2006c, art.2). In addition, the Encouragement of Investment Act provides a certain number of real incentives that vary according to the size of the investment. First, an InvestBulgaria Agency is created, whose role is to facilitate the implementation of the investment project. For third-class projects, the Agency provides pre-developed information materials, information about potential partners in the country, and information about all the administrative procedures. For second-class projects, the Agency offers also individual administrative servicing with respect to all central and regional bodies of the Executive. First-class projects benefit, in addition, from

individual information and administrative services, as well as from assistance with real-estate “titling” issues. Also, they may require infrastructure building support from the government (idem., 2006b, art.12).

In addition, the Encouragement of Investment Act provides significant tax incentives. Investment projects in the manufacturing industry in regions of high unemployment benefit from complete corporate tax exemption, even though some additional conditions have to be met.¹⁰ Thus, all business sites and premises of the taxpayer have to be located in the respective high unemployment region. The tax exemption takes the form of a tax credit that has to be reinvested in the company. The investor is also obliged to make an additional investment that amounts to at least 25 % of the tax credit. The assets thereby acquired could not be disposed of within 5 years, unless in cases of mergers and reorganization. Another complete tax exemption of VAT is granted for the import of goods necessary for completion of the investment project. Finally, the corporate tax base is reduced by the amount of expenditures made for research and development in cooperation with research institutes and/or universities.

Notwithstanding taxation of income, foreign property in Bulgaria is generally well-protected by the law. Bulgaria’s post-totalitarian State, in its foundational document, acknowledges that “Private property shall be inviolable” (Bulgarian Parliament 2006, art.17(3)). However, private property may be violated and encroached by the government if there is no other way to satisfy important State and municipal needs: “Property may be taken by eminent domain for state and municipal needs solely in pursuance of a law subject to the condition that these needs cannot be satisfied in another manner and after an advance and equivalent compensation” (ibid., art 17(5)). It must be added here that foreigners are prohibited from acquiring and owning land, even though this prohibition will disappear soon, with Bulgaria’s expected accession to the European Union (ibid., art 22(1)). In any case, this provision has not been a real obstacle to foreign investors, provided that they can acquire property on the account of a moral person registered in Bulgaria. An important provision of the Encouragement of Investment Act is that if an international agreement stipulates more

⁸ This Act replaced the original law on privatization, first voted in 1992.

⁹ One may even suggest that the absence of discrimination toward foreigners is already solidly grounded in the Bulgarian Constitution: “The investments and economic activity of Bulgarian and foreign citizens and legal persons shall enjoy the protection of the law” (Bulgarian Parliament, 2006, art.19(3)).

¹⁰ The list of the high unemployment regions is annually approved by the Minister of Finance.

favorable conditions for foreigners than the domestic legislation, then the most advantageous conditions should apply: "If an international agreement, party to which is the Republic of Bulgaria, stipulates more favorable conditions for carrying out economic activity by foreigners the more favorable conditions shall apply according to the international agreement" (InvestBulgaria Agency 2006b, art.3).¹¹

Concerning international treaties, the Bulgarian government has signed the convention for the establishment of the Multilateral Investment Guarantee Agency (MIGA) as well as of the International Center for Settlement of Investment Disputes (ICSID). As of June 2005, Bulgaria had already signed 62 BITs (Bilateral investment treaties), of which 56 were in force by April 2006. In that direction, the continuous tendency for the Bulgarian government in recent years has been to engage in an increasing number of BITs. In 2000, Bulgaria already ranked 15th among the top 30 countries in terms of BITs concluded (UNCTAD 2000, p. 18). In addition, 58 double taxation prevention treaties are in operation (InvestBulgaria Agency 2006a, p. 4), and discussions for a treaty on double taxation with the US government are in progress.¹²

It can be concluded that FDIs are well protected in Bulgaria, and that the Bulgarian government shows a stable and positive attitude towards the protection of foreigners' property rights. This, together with a relatively attractive taxation, is certainly an important factor explaining the progress and the very high levels of FDIs in Bulgaria. The correct attitude of the Bulgarian government towards foreigners' property and the satisfactory legal protection FDIs enjoy in Bulgaria are illustrated by the fact that only one international dispute opposes currently the Bulgarian government to a foreign investor at the ICSID.¹³

¹¹ Once again, one can see here the strict application of a provision contained already in the Constitution: "Any international treaty, which has been ratified according to a procedure established by the Constitution, which has been promulgated, and which has entered into force for the Republic of Bulgaria, shall be part of the domestic law of the land. Any such treaty shall take priority over any conflicting standards of domestic legislation" (ibid., art.5(4)).

¹² The only impediment to the treaty seems to be the US government's reluctance to make a concession concerning its strong desire to obtain a change in the Bulgarian law that would allow to investigate bank accounts without a prior decision by a court of law (AmCham in Bulgaria 2006).

¹³ The case, opposing Plama Consortium Limited to the

The very satisfactory legal aspects of investing in Bulgaria since the 1997 Act clearly explain the significant amounts of FDIs in that country. It would be quite impossible and rather awkward to conclude this very empirical note by a resume of its content. Instead, it would be more suitable to close it with a final section that suggests some policy measures for making investment conditions still more attractive. It would also be the right place to position FDIs within some other important international flows between residents in Bulgaria and non-residents.

IV. Conclusion: Policy Measures And Quasi-FDIs

Provided that there is a clear link established between FDIs and their protection against any form of expropriation, only one policy measure could be suggested: abolish any impediment to start quickly business and abolish any confiscation, in monetary or regulatory form, of the investment results. The Bulgarian government has done a lot in this direction in terms of tax reduction and tax exemptions. Our policy conclusion is that this effort should be continued, until complete abrogation of any taxation. Much less has been done, however, with respect to governmental regulation of economic activity. Starting business, as reported by the World Bank, takes in average 32 days, and this number has remained constant for recent years (World Bank 2006). Corruption is estimated at a very high level, especially in the judiciary, i.e. in that body of the State that supposedly is responsible for the application of law. The practical implication of the improper functioning of the legal system is that a lawless state of arbitrary rules is created. Much has to be done in this direction by the future Bulgarian governments.

One positive fact of the law on investments in Bulgaria is that no discrimination is made on the base of the nationality of the investor. However, a discrimination does exist according to the size

Bulgarian government, concerns an oil refinery in northern Bulgaria, which was privatized in 1996, but was acquired by its current owners in 1998 after having gone bankrupt. In addition to previous controversies related to the legal ownership of the company, the current owners dispute the fact that the Environmental Protection Act voted by the Bulgarian Parliament in 2002 puts the entire liability on the company and absolves the Bulgarian government of any responsibility. For the moment, the case became notorious in international law for the difficulties it rose in determining whether the ICSID had jurisdiction over it or not. On the case, cf. International Institute for Sustainable Development (2005).

of the investment project. This discrimination should be abolished too, through an extension of the currently most favorable conditions to all investments, irrespective of their size. We suggest also that the more favorable regime of corporate income taxation should be extended to personal income taxation. Even though the economic nature of profit is indeed different from that of contractually determined revenues, there is no reason why the latter should be taxed more than the former.

Also, the privatization of all infrastructures seems to be an immediate necessity. Investors need the guarantee that they can quickly and at a low cost ship their production and generally communicate with their partners and customers. The current condition of the state-owned infrastructure does not allow for this. Much more competition is needed in road building and exploitation, and in telecommunications.

Finally, if FDIs are investments undertaken by non-residents, then investments in Bulgaria carried out by Bulgarian emigrants should be taken into account too. This remark, which may seem odd analytically, turns out to be statistically very important. Legal Bulgarian emigration abroad since 1989 amounts to some 700 000 individuals, which is roughly 9 % of the total population. According to the United Nations, 100 000 Bulgarians leave the country every year (Dimitrova 2006). These emigrants are typically very much oriented toward saving an important part of their incomes. Systematically they send one part of these savings to their family members with the goal to sustain them, or in order to acquire real estate property in view of their future return in Bulgaria. The amounts sent back are quite considerable, as indicated by the following table.

Table 5. Monetary flows from emigration (in million euros).

Year	1998	1999	2000	2001	2002	2003	2004	2005
Current Transfers	170,2	233,3	305,9	472,5	531,7	613	815,1	765,5

Source: BNB (2006c)

Recently, only a few weeks ago, the Bulgarian National Bank announced that a new, more correct, methodology of reporting current bank transfers from abroad accounts for additional 818,4 million euros for the period 2001-2005

(Standart Daily, 2006). Distributing this amount equally among the five years, the thus corrected data can then be easily compared to Greenfield or Expansion FDIs:

Table 6. Monetary flows from emigration compared to FDI

Year	2001	2002	2003	2004	2005
Private Current Transfers (in million Euros)	636,18	695,38	776,68	978,78	929,18
Greenfield and Expansion FDI (in million dollars)	793,7	839,7	1732,8	1667,3	

Source: BNB (2006c)

It appears that the monetary flows from Bulgarian expatriates, for the period 2001-2004, are equivalent to three fourths of the amount of FDIs, at an exchange rate of 1,2 US dollars for 1 euro. When it is recognized that much of the expatriates, especially if their stay abroad is illegal, do not use the services of financial institutions in order to transfer their savings, it appears that monetary flows from Bulgarians abroad into the Bulgarian economy are probably equal to FDIs.¹⁴ It is true that one part of the

savings thereby received is used for the purchase of consumption goods. However, much of the current transfers serve to acquire real-estate property and certainly contribute to explain the boom in the construction as well as in other industrial sectors.

¹⁴ The importance of current transfers from emigrants is even bigger if another, we believe necessary, adjustment is applied to the gross data. All contemporary banks are fractional-reserve banks. Any investment into a fractional-

reserve bank is equivalent to the purchase of the right to open deposits financed by circulation credit based on thin air. If this is indeed an investment from the standpoint of the individual banker, there is no net investment, in terms of increased property, for the whole of the economy. It would not even be unreasonable to subtract these amounts from the gross investment, for due compensation of the expected damages in terms of misallocated real savings brought about by the operation of a fractional-reserve banking system.

It appears therefore that Bulgarian emigrants are another very important category of non-resident direct investment in the country. An immediate policy conclusion is that the Bulgarian government should secure their property in Bulgaria and increase as much as possible the incentives for non-resident Bulgarians to invest their savings into Bulgaria. A general tax cut of

any kind of taxation seems to be the best measure in that direction.

The full list of literature and sources are available on IME website.

On Competitiveness of Bulgarian Education *

Svetla Kostadinova

What is competitiveness?

One of the most used definitions is that competitiveness is the ability of a country to achieve sustained high rates of growth in GDP per capita. A similar but more detailed definition, supplied by the OECD, is that competitiveness is the degree to which a nation can, under free trade and fair market conditions produce goods and services, which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long-term.

Why is education important?

For individuals, education and skills are the most important determinants of employment opportunities and income. Similarly, for any society overall, the skills and entrepreneurship of the human resources available to that society

are the single most important factor in determining its economic output, growth and standards of living.

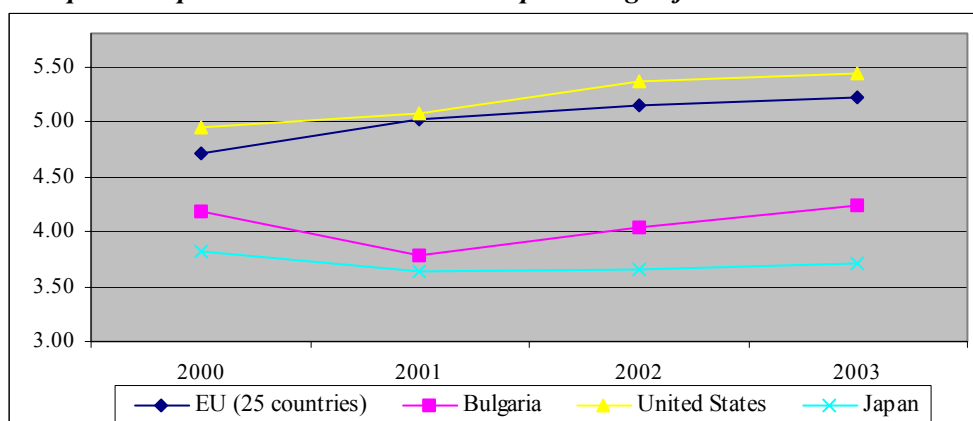
Education is increasingly important to economic performance. It increases individual incomes, and an increase in a country's average education level positively affects aggregate output. High levels of personal investment in education lead to a number of other personal and social benefits, including increased social inclusion, lower crime, reduced welfare dependence and better health.

Having said that, we can easily examine Bulgarian education competitiveness by perceiving it as a good. In the text below, we will try to assess Bulgarian tertiary education in terms of competitiveness.

Investment – education input

The system of financing education is of great importance. Most countries allocate significant sources to education system. This has different effects depending on the efficiency of the system itself.

Total public expenditure on education as a percentage of GDP



Source: Eurostat

The data shows that Bulgarian state steadily increases funding for education but is still well below European average. Unfortunately, lack of money is not the problem. Increased funding in Bulgaria has not led to increased achievement. Over the past years, per pupil education spending has increased by more than 10% since 1998, but students performance have seen no significant improvement. An international comparative assessment study, prepared by OECD puts Bulgaria on 32nd place for average reading literacy score with overall result of 430 points whereas the average across countries is 473. Countries like Czech Republic, Russian Federation, Thailand and Greece rank higher.

The other consideration regarding the data is that Bulgarian population is decreasing for years, which is not the case for Europe. Therefore, we cannot justify the increase in public spending for education. On the other hand, the very system of financing of education is based on historical budgeting principle – the funds are calculated based on expenditures for the previous year, which are indexed according to total public revenues. This way, there are no incentives to improve financial performance since almost all expenditures will be financed. Another problem is that there is no equal treatment of state and private school and universities – the latter does not receive funds from the state and therefore there is no competitiveness element between the two systems.

The only visible approach is introducing of voucher system in Bulgaria. This means that the money spent on education now will be in hands of students and they will decide which university to choose. This way, the best colleges and universities (both private and state) will receive more of the state funding and will have the resources to maintain and increase the quality. On the other side, those universities that exist only because of the current system will have three options – to increase the teaching quality, close or merge with other university. The reform will not be full if cuts in administration expenditures are not done. The staff of the Ministry of education is too much for the poor quality of the system that they maintain.

Freedom of doing business – establishing of schools

Article 9 of the Law on higher education in Bulgaria stipulates that the Parliament is responsible for establishment, restructuring, renaming and closing universities, as well as

branches and departments. In other words, if someone (a company, group of parents, church or **foreign university**) wants to create a university (or branch) in the country, and be recognized, it would need Parliament approval. This requirement incredibly burdens the freedom of establishment and is a great impediment for competition within the country. Moreover, we should note that this requirement has nothing to do with state financing – it is not bounded by any means with state funding after approval. The only explanation given by lawmakers is that “state knows better”.

Apart from this, different rules and regulations are cumbersome and detract universities from the primary task of educating students. The reasoning is that if taxpayers’ money is spent there should be tight control. The problem is that a great amount of resources – time and staff, is wasted on administration of the system without any significant positive effect.

The role of the state should be to provide with clear rules on provision of information to interested parties – data on curriculum, expenses, timing, lecturers and educational approaches. The rest has to be left to the judgment of consumers of their services. The professionalism, knowledge and reputation will serve as the best indicator for the quality and competitiveness of the university.

Teachers’ pay and qualification

Teachers’ salaries are always quoted as one of the major reasons why are they not stimulated to improve qualifications and commit strongly to teaching process. In Bulgaria, teachers are paid the average salary in the country. Their pay does not correspond to achievements of students, which is the main problem. In other words, the responsibility of teachers for students’ results does not exist. This does not stimulate quality and even if a state university is performing well it cannot attract more funding from the budget.

All those in charge of the tertiary education, from professors to administrators, must be held accountable for their actions and decisions. Given the nature of institutions of higher education, those in power at universities operate with a certain degree of autonomy. Teachers are free to instruct in any given way that they might like, oftentimes neglecting the needs of their students, and instead giving quick, meaningless lectures and then return to their latest book or paper. Administrators, too, display sometimes astonishing lack of foresight when it comes to

running a school. They fail to manage resources appropriately, and do not establish sensible priorities. As a result, students end up graduating with a relatively low level of skills and are forced to take jobs that are less than meaningful.

The solution is binding teachers' pay to results that can happen by introducing voucher system. This way the money will follow the student and will be a reward for good done job.

Quality – students' employment prospects after graduation – education output

The very nature of higher education is to provide with greater opportunities in the job market. If we examine the chances of one graduate in

employment, we can assess the quality and added value of imputed efforts and funds. On the other hand, this is not one-way process – the labor market has to have the potential to “accept” the newcomers. According to many studies, the labor market in Bulgaria has potential for enlarging and EU accession will be additional factor for such development. Recent economic reforms (lowering the rate of social security contributions, privatization, etc.) create favorable environment for entrepreneurship where education and knowledge can help people in achieving success.

Unemployment rates of the total population by level of education (population aged 25 to 59)

%	2000	2001	2002	2003	2004	2005
	Secondary education					
EU (25 countries)	8.0	7.6	8.0	8.2	8.4	8.1
Bulgaria	13.8	17.3	15.9	11.2	10.2	8.1
	Tertiary education					
EU (25 countries)	4.4	3.9	4.3	4.6	4.8	4.6
Bulgaria	6.4	8	7.7	6.4	5.3	4

Source: Eurostat

The indicators show the "probability" of being without a job for those who would like to have one, broken-down by level of education. The indicators provide a measure of difficulties that people with different levels of education have to face in the labor market and offer a first idea of the impact of education in reducing the chances of being unemployed.

Unfortunately, in Bulgaria the most of the university instruction is delivered in a manner as it was generations ago. There are many reasons for that but among most important are teachers' pay that is not correlated to students knowledge, lack of direct participation of students in curriculum formation, continuous increase of state financing to universities that is not related to results, impossibility of establishing closer cooperation between the business and the university, etc. All these provide current students with a diploma that does not correspond strictly to knowledge.

Relevance to reality - education does not go in line with economic changes

Without a strong core curriculum, students lack the most basic knowledge about the world in which they live. Often, the elements of university curricula designed to acquaint

students with the major areas of learning had become devalued and very irrelevant to business needs and expectations. On the other hand, great shares of students receive very specialized education that cannot be utilized for employment. The profile of the long-term unemployed in the country shows significant number of university people with specific knowledge.

Bulgarian economy is still in a process of transition – the privatization is undergoing, the government is trying to stimulate economic activity and secure more friendly business environment. In this situation, we need entrepreneurs and resourceful people and universities should intermediate the process. Of course, this cannot happen without involvement of the business itself, which is already happening in Bulgaria.

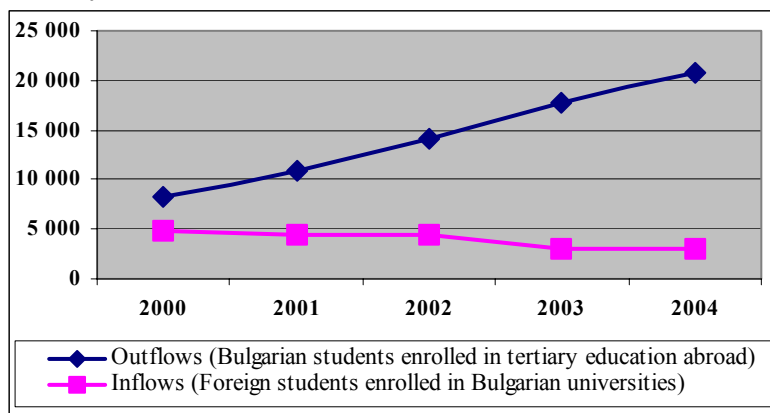
Bulgarians' assessment of Bulgarian education

According to Eurostat, the number of Bulgarian students enrolled abroad increases over the years. The figure is very tentative since some of the emigrants are just using this path to secure their stay in host country. Nevertheless, it clearly describes the trend of Bulgarians who can afford or receive scholarship to leave the country. This is by no means explicit indicator of the

preferences of some of consumers of Bulgarian education. In terms of competitiveness, this indicator shows that Bulgarian education is

losing position and this process is unlikely to change if radical reform towards quality is not introduced.

Mobility of students



Source: Eurostat

Recent survey on universities' quality worldwide done by Spanish council for higher education shows that only 3 Bulgarian universities are ranked – one state financed and two private. Sofia University is ranked on 1 291 place, American University takes 2 570 place and New Bulgarian University is ranked 2 928th.

voucher system, privatization of state universities and business participation is the only way in achieving higher quality and competitiveness of education in Bulgaria.

The conclusion is obvious – full autonomy on curriculum, equality in financing through

* Version of this article first appeared in Sofia Echo newspaper on May 25, 2006.

ANNOUNCEMENT

The Institute for Market Economics, based in Sofia, Bulgaria, is one of the most renowned economic think-tanks in Eastern Europe.

Presently, the Board of the Institute is seeking to **appoint an Executive Director** to lead the Institute during these critical early years of the 21st Century.

The mission of the IME is to develop and to advocate market-based solutions to the challenges that Bulgaria and other countries in the region face as they complete transition to the market economy and begin to take their place as modern nations with full-standing in the European Union. In this regard, the Institute works in a variety of ways to influence public opinion and policy making, to include consulting with government, providing liberal solutions to contemporary social and economic issues, and through education or other means to advance economic understanding and to disseminate economic knowledge. In pursuit of this goal, the IME is strictly independent from the influence of the government or any other vested interests.

A long-standing transition plan provides that Krassen Stanchev, who founded the Institute in 1993 and since has been its sole Director, will assume the position of Chairman. As a result, the Board of Directors is seeking a highly motivated individual to work with Krassen to continue the IME's 13-year record of distinguished performance.

- The ideal candidate would have experience in
- Successfully managing a team of young, ambitious professionals;
 - Non-government, not-for-profit activity and/or public service;
 - International networking;

- Consulting and
- Fund raising.

macroeconomics, possibly evidenced by academic and/or media publications;

- High energy and a strong but personable way with people;

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The right person also would have:

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- A passion for liberal policy making;
- Extensive knowledge of Bulgarian and European economic policy issues;
- Training and understanding of

Those interested should send a letter of interest, curriculum vitae and references to Martin Zaimov at martin.z@gmail.com



Institute of Market Economics, Bulgaria

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