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In the issue:

The Symbolic View of the EU from an Economic Aspect
The Economy In 2007 – a Forecast
Economic Freedom Presupposes Governmental Restraint
The Lies About NPP “Belene”
Follies in the Pharmaceutical Sector

IME with a New Executive Director

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The Symbolic View of the EU from an Economic Aspect

Krassen Stanchev

From an economic point of view, January 1, 2007, represents a relatively insignificant transformation. This date may and must be viewed in the context of previous events, which have proved to be economically historic and more directly significant than the actual commencement of the formal membership into the Union.

If we look forward, many changes are about to happen. These changes may set out in different directions. The chosen course will depend on the choices, which persons and companies (living and operating in Bulgaria) have made in the past, and which they continue to make now.

The more significant changes

Without doubt, far more significant for the economy and for the future of both the citizens and the country have been the choices made in 1997 to restrict the monetary policy of the government, to stabilize the rate of exchange, and not to re-finance banks and the government through the central bank. These decisions have led to the longest period of economic growth in the history of Bulgaria. Without it, nothing of what today characterizes the well being of households, their incomes and the value of their assets (including land and houses/apartments), as well as the value of the assets of companies, would have been realized.

The second series of important economic events is the realized since 1997, by several governments, considerable decrease of taxes. Moreover, even despite acknowledging the decrease of the corporate tax to just 10% as of this year, the process is far from completed.

The general idea of the last tax reform is, by keeping a relatively high level of taxation on the income of private persons (including through taxation of labor of those who work today), to stimulate investments by companies, respectively to create new jobs and to increase the revenues coming into the budget.

Besides, the amount of government expenditures – both as an absolute value, and as a percentage of GDP – are expected to either increase or to remain at a relatively high level. This level, as has been commented many times, historically is by about 6% higher in Bulgaria than in the faster growing economies of New Europe. The lack of changes in this line of policy is a mistake, which hinders the long-term development and is extremely shortsighted, but the government does not have any intention to make any changes.

The changes that have already occurred and that will influence Bulgaria's conduct in the EU

The days before New Year's Eve were characterized by a more visible and vaster, in comparison with previous years, increase in consumption. This was incorrectly interpreted as fear of the induction into the European Union.

The reason for such conduct is the circumstance that income levels in Bulgaria have been growing relatively steadily by about 5-6% a year in the last 8 or 9 years. Besides, they have not been artificially inflated to a significant degree, as was the case in Hungary in 2003, for example; the level of growth is for the most part in line with the productivity of the labor force. The Hungarian political crisis of last year, including its interpretation by Bulgarian observers and government economists, has prevented such a scenario from developing in Bulgaria, for now. The chief inflationary factor in Bulgaria is the financing of the public sector and the governmental fixing of some prices.

The increase in consumption in November and December is an expression of the confidence of Bulgarians in their own future. The contrasting interpretation, however, seems to be prevailing. From an economic point of view, it is foolish, but this circumstance does not make it less

important. It is rather the opposite. In 2007, precisely this mood will uphold the already strong desire to steal from the one next to you with the help of government and will uphold the paternalistic view of the government of itself and of the role of the state.

For the establishment (ruling class), the entry into the European Union is a transition from socialism to a 'EU'. And the EU is a substitute both for the CMEA ('Council for Mutual Economic Assistance', for those who are not familiar with the abbreviation) and for the Soviet Union. Such a paradigm of theirs is supported by the way in which the EU itself operates.

In 2006, the government made many decisions, which are comparable to the former dream of Todor Zhivkov to make Bulgaria part of the Soviet Union, and in this way to secure his own government. Those I have discussed on previous occasions and there is no point in dwelling on already known topics. What is important to state here is that those decisions will influence the conduct of the country as a member of the EU and unfortunately the Russian ambassador to Brussels will turn out to be right – Bulgaria will be Russia's Trojan horse in the EU.

What is about to happen

Bulgaria will be the most bureaucratic country in Europe.

Bulgarian citizens for now do not realize that their 'backwardness', meaning in terms of levels of GDP per capita in comparison to the average in the EU is at present their greatest advantage. This backwardness (or underdevelopment) sustains relatively low prices, low costs of labor and of operating a business, less the costs of dealing with the government. This increases and maintains Bulgaria's attractiveness to foreign companies and citizens and serves well for the development of the level of well being here.

The membership in the EU will demonstrate that the country is relatively uncivilized, its citizens – relatively backward, its businesses – often illegal, and the state – provincial.

The Economy In 2007 – a Forecast

Dimitar Chobanov

The beginning of the New Year is a good occasion for making a forecast on the Bulgarian economic development in 2007. The economic policy of the government which will be significantly influenced by the EU membership, the stability of the governing coalition and the upcoming local elections are the factors that will have a vital role in the forecast maneuvering. Of course, we should not undermine the potential of the private sector to generate growth, but this growth might be significantly hampered by the government economic policy.

The accelerated integration of the Bulgarian economy with the EU member states economies, the increased volume of foreign trade, and the liberalization of the financial account will lead to increased dependency on the European Commission and European Central Bank decisions, while the influence of the IMF will be considerably diminished. The steady increase of the interest rates determined by the ECB, which is expected to continue in 2007, will reduce the available liquidity funds and respectively limit the investment opportunities in the Bulgarian economy.

After the relatively rapid increase of the Bulgarian GDP in 2006, it is likely that in 2007 it will be stabilized but still reach values of approximately 6% in real terms. The most important factor for the noteworthy increase of the GDP is the EU membership which motivated higher investment in restructuring of the Bulgarian companies with the aim to meet EU requirements, as well as the optimism coming from the belief they will be able to participate in the EU market.

Furthermore, in the last years the business climate in the country has been improved, which is connected not only to the EU accession but to the decreased direct taxation and the relief of some regulatory regimes. This is evident when making some international comparisons but again the Bulgarian business practices are still by far worse than the acknowledged world practices. A crucial success was the reduction of the corporate income tax to 10% but the other

components are still not well developed and more efforts are required to improve them.

The increase of investment will continue to be higher than the increase of the GDP itself, but the differentiation between the two will not be so drastic in 2007. In all cases, the investment share in GDP will keep the value of approximately 30%. The stabilization of the demand for goods and services will lead to increase of savings up to 16% of the GDP values in 2007. The end result will be current account deficit identical to the one from previous years. Nevertheless, the EU membership will influence the domestic trade, which will alter the official data, respectively any forecast in the field become just hypothetical and tricky to make.

From the middle of 2006 the Bulgarian National Bank relieved the credit requirements for the commercial banks. The ECB increase of the interest rates made it less necessary for the BNB to have restrictive policy and this trend will continue in 2007. Moreover, with the EU membership the so-called single passport comes into force, which will allow legal financial intermediaries from any EU state to operate without restrictions in Bulgaria. This will lead to increased competition in the local financial market, which will have a positive influence on the economy as a whole.

After the significant increase of prices in 2006 (by almost 8%), in 2007 the increase will slow down and stabilize at values of about 4-5%. The continued increase of the prices, related to the increase of the credits, the higher values of the excise duties on fuels and alcoholic beverages, and the increase of the administratively set prices have inflationary pressures in the economy. At the same time higher interest rates in the international markets determined by the ECB (and the Federal Reserve System) contributing to higher interest rates in the Bulgarian market together with the withdrawal of liquidity funds via the budget surplus will counteract these inflationary pressures.

The labor market is highly probable to keep the trend towards job creation and reducing the unemployment levels. The rationale behind such reasoning is first the private sector development as a generator of employment opportunities, and second the EU membership, which eventually will lead to higher need of personnel in the public administration. The intention of the

government to reduce the public administration by 10% throughout 2006 did not realize and 2007 will not be different in this respect.

The reduction of the payroll tax levels at the beginning of 2006 led to positive developments in the labor market and the wage levels in the country. In the present moment though it is not visible whether this trend will continue in 2007. Despite the lack of clarity regarding the payroll tax, it is expected that the increasing labor productivity will lead to higher wages in private sector, while the public sector wages will be used as a tool in government income policy by pushing private employers to increase their wage levels as well. Moreover, the decreased inflation will assure the increase of the wages in real terms.

The efficiency of the public sector is still quite low, especially in important fields like education and health care. In 2006, some efforts were made for improvement of the performance by introducing a single standard for the high school education, and financing the hospitals solely through the National Health Insurance Fund. Unfortunately, these efforts are far from being enough to solve the serious problems in the public sector. It is anticipated that the partial reform will continue in 2007 without changing significantly the quality of the public service.

The change in the Value Added Tax regime will influence the revenue in the budget, but still the budget surplus will be realized again. In comparative perspective the budget surplus will

be lower than the one in 2006 because of the payment to the EU budget, which is an additional expense, but probably it will be about 2% of the GDP for 2007.

Overall, the Bulgarian economy will maintain its good performance in 2007. The main source for economic growth will be again the private sector, while the public one will continue having low efficiency. The positive changes in the Bulgarian economy in the last years increased the economic freedom in the country that respectively will lead to continuous economic growth but without perspectives to catch up with the fastest developing economies in the world.

Table1: Selected Indicators

Indicator	2007
GDP real growth	5.5-6.5%
Inflation rate	4-6%
Unemployment rate	8.5-9.5%
Current account/GDP	10-14%
GDP redistribution through the consolidated budget	42-44%
Budget balance/GDP	1.5-2.5%
Real growth of wages	5-7%

Source: IME's forecast.

Economic Freedom Presupposes Governmental Restraint

Svetla Kostadinova

This week saw the publication of the 13th consecutive annual issue of the Index of Economic Freedom 2007, published by the Heritage Foundation and the Wall Street Journal. The index covers 157 countries around the world and appraises the degree of economic freedom in ten categories. The Institute for Market Economics is the local partner for Bulgaria of the Index, and, on our invitation, on February 14, 2007, the head of the research team that compiled the Index, Tim Kane, will present in Sofia the results in the last issue.

How is the Index compiled?

The highest score in each of the ten categories is 100, which corresponds to the maximum degree of economic freedom. The total score for each country is calculated by averaging the scores in all ten categories, which puts the country at a particular place in the general ranking. The period for which economic freedom has been assessed is June, 2005-June, 2006, and international sources of information have been used.

Where does Bulgaria stand?

In the 2007 Index, Bulgaria moves two places up, coming in 62nd place overall. This puts us in

the group of 65 countries that have improved their position in comparison to last year's ranking, which is in contrast to the 92 other countries that have seen their positions worsen.

In the assessment of economic freedom by region, Europe comes first with an average score of 67.5%, followed by North America with an average score of 62.3%.

Ten years of reforms in Bulgaria – the result is 15 positions higher in the ranking of the degree of economic freedom.

Reviewing the developments for Bulgaria, regarding economic freedom since 1997, we can draw the following conclusions:

1) For the ten-year period our country has registered an extremely slow increase of the level of economic freedom – from 47.2% in 1997 to 62.2% in 2007. This means that immeasurably many opportunities for the increase of wages and salaries, the decrease of the level of unemployment, the increase of well being of citizens, and for economic growth have been lost.

2) The most important improvement is in the category of Financial freedom – from 46.4% to 75.7%. This can be explained with the introduction of a monetary board in Bulgaria, which has contributed to the decreased levels of inflation. Between 1998 and 2006, inflation has been on average lower than 6% annually. The other component that influences the level of financial freedom is the regulation of prices. Since 1997 in the country the prices of some goods have been liberated, but the fact that still 21.3% (in 2005 according to the EBRD) of goods included in the consumer basket are with regulated prices does not allow for the attainment of a better than the present result.

3) Business freedom in Bulgaria is the second category, which registers the next highest improvement – from 30% in 1997 it reaches 66.9% in 2007. Considering, however, the very low starting point, we cannot be very happy. The freedom to start, operate, and close down a firm, quickly and easily, is of particular importance. The burdening regulations hinder entrepreneurship, and if we are 30% unfree in doing business, this should be a signal to the

government. The state should help entrepreneurs, not the opposite.

4) The third greatest development is in the direction of improving the category Fiscal freedom. The decrease in the profit tax in the period 1997-2007 is from 42.5% to just 10% in 2007; the highest rate of the profit tax decreases from 40% in 1998 to 24% in 2007. These developments give Bulgaria a result of 91.3% fiscal freedom. Here, however, it must be noted that the methodology does not include social insurance. We know that if this were the case, it would turn out that we are rather unfree, according to this category.

5) The largest decrease is registered in the category Property rights – in the period 1997-2007, people's capability of owning private property, which is effectively protected by clear and executable laws, has practically declined. From 50% freedom in 1997 it has decreased to 30% in 2007, as a result of which we fall into the group of unfree countries in this category. A general rule in economics is that if people do not feel secure about their property, they take fewer risks and invest with more difficulty, and they also do not plan long-term due to insecurity, or the costs of obtaining that security (bribes and costs for personal security) increase. All of this halts economic growth, drives foreign investors away, and leads to the losing of opportunities for prosperity and well being of citizens and businesses.

It is important to know why economic freedom is being assessed so thoroughly, diligently, and persistently for 13 years now. Various researches show that economically free countries register:

- high average wages/salaries
- low unemployment
- low levels of corruption

Since every government in Bulgaria declares that it wishes for such developments to occur during their mandates, we recommend that they use the report Index of Economic Freedom 2007 in their agenda.

The Lies About NPP “Belene”

Veliko Dimitrov

For months, as a result of ambiguous and unclear appearances of ministers and politicians in the media, there was no clarity regarding the construction of the nuclear power plant. The tremendous amount of contradictory statements and comments created, day by day, confusion in the minds of people, and important questions such as who will be building, for what period of time, at what price, and if there will be NPP “Belene” at all, were left without clear answers.

Speculations ranged from alleged construction of the plant entirely with the capital of only one company, through the formation of a consortium with or without the provision of state guarantees, to the creation of a joint venture company with the state. Besides, there was no clarity regarding the type of the nuclear reactors, the nuclear fuel, the price, the subcontractors, etc.

It was on another occasion, namely the announced, by the Public Procurement Agency (PPA), annual statistics regarding the value of the signed contracts for public procurements, that the answers to all the above-mentioned questions suddenly surfaced.

At a value of BGN 3,3 billion in 2005, the signed in 2006 contracts turned out to be to the amount of BGN 11,9 billion, or about three times more. Part of the increase, as one may assume, can easily be explained with the increasing state and municipal costs on the one side and the exposition of part of the agreements circumventing the PPA and the RASPP¹ up to this moment, on the other. Nevertheless, given the relatively continuous dynamics, this explains no more than 4 of the totally registered almost BGN 12 billion, or as it is evident, there is no source where about BGN 8 billion must have come from. Exactly those funds, however,

¹ PPA – Public Procurements Act; RASPP - Regulation on the Assignment of Small Public Procurements

constitute part of the money for the construction of the NPP “Belene”.

1. More than a year and a half ago it was very clear that a nuclear plant will be constructed

The decision for opening of a procedure for assignment of a PP for designing, constructing, and bringing into use of Units 1 and 2 in Belene has been made on May 10, 2005. That is to suggest that not only the present, but also the previous government, has supported the idea for a second nuclear power plant. This is something, which was not clearly stated by either of the two governments (I exclude is Mr. Ovcharov, who, as a former employee at NPP “Kozloduy” and an open supporter of a state monopoly in the energy sector, has always sought the creation of a megastructure, which is to include “Belene” and to be administered by his ministry).

2. The current government extends the term for submission of bids

The position is already definite – a nuclear power plant will be constructed despite the enormous costs, the bringing into use after 120 months (10 years), the much higher price for electric power, and the overall absence of any kind of argumentation to support economic advisability.

3. The nuclear power plant will be constructed with the use of funds, collected from the present and future tax payers

The claims that in some way the realization of the project will be financed with private capital turn out to be false. The implementation of public procurements is financed from the budget; this is how it will be paid to the Russian company, which has been assigned the construction of Units 1 and 2. If the project was justifiable from an investment point of view, it is sure that willing investors would have come forward to realize it. Since, however, ultimately taxpayers (who are obligated to pay their taxes, which the government, as it turns out, pretty much does not hesitate to spend hastily) will pay

for the project, NPP “Belene” is apparently not a very good investment. And if it is not a good investment for a private company, it also cannot be a good investment for the citizens, when it is financed and administered by the government.

government is going to force the people, part of whom have voted for this very government, to do precisely that.

4. Employment of subcontractors – maximum 30% of the total value of the contract

The comments for the possibility for Bulgarian subcontractors to assume more than 1/3 of the activities relating to Belene are also incorrect. According to the information, found on PPA’s website, regarding the signed contract, it becomes clear that the maximum likely participation of subcontractors will be 30%, and it is stated nowhere that these will be Bulgarian companies.

5. The value of the contract² – 7 817 961 026 BGN (VAT excluded).

This is the price only for the design, the construction, and the bringing into use of Units 1 and 2. The total value of the project at its completion, however, will be much higher, first, because there is a large number of other activities connected to the construction, which are the subject of separate public procurements, and second, because, as it usually happens, (as the PPA allows this) a higher price will be re-negotiated.

At an expected total price BGN 12 billion and with about 3 million citizens in employment at the moment, it would mean, most generally speaking, that each tax payer should earn about BGN 4,000 to be spent on Belene, and then buy electric power at a price higher than today’s.

It is understandable why Belene is not going to be built by a private company – because no one is going to purchase what it will produce – however, it is not clear why the Bulgarian

² The described information can be found in the register of public procurements, available on the website of the PPA at www.aop.bg. Unfortunately, however, a registration is required, which is free but does take some time to complete.

Follies in the Pharmaceutical Sector

Adriana Mladenova

The establishment took a characteristic turn ‘to the left’ and backed out from the texts of the bill on medical products in human medicine. The bill was already adopted at first reading last August, but its debate at a second reading was continuously delayed. The proposed bill stipulated for liberalization of the procedure for establishing pharmacies and for allowing all traders (including legal entities), not only master pharmacists, to own pharmacies. This would have legalized the already existing practice of current pharmacy chains. But as the numerous statements made in the press and the shorthand records of the sessions of the Healthcare Committee reveal, free market logic and common sense will once more fail to triumph. As it has been until now, only master pharmacists will have the right to own and operate pharmacies.

The ruling class are haggling also over the issue regarding the regulation of prices – the Socialist party wishes for prices to be fixed on prescription medical goods, instead of allowing for maximum prices to be determined, which is the current practice. This is precisely what the Union of Pharmacists in Bulgaria has also been lobbying for. Such a move would very much stultify any competition between pharmacies and would in effect mark the impossibility for prices to go down, except if they are amended by a state decree.

The chief motive of the establishment for the decisions made *ad hoc* and for the change in their position is the ‘protection’ of small businesses from the imminent threat of ‘monopolization’ of the market. If one is to follow that sort of logic, every bookstore owner should also be a professional writer, for instance. And the resources used for fighting the establishment of monopolies are by no means restriction of competition and non-liberalization of the market, quite the opposite. How is it possible in a state claiming to be free and democratic, rights to property to be enforced by the ruling class? Small businesses do not need protection against competition but protection

against unlawful government intervention. The attempts to artificially thwart the natural processes of consolidation of pharmacies cannot lead to anything good; on the opposite, a gray sector shall emerge, in addition to the ‘selling’ of diplomas and corruption, as a result of which customers will lose the most. With this decision the country erases 18 years of progress. What is more, this decision overbears the fundamental tenets of the EU for free movement of capital. The right of establishment and the freedom of disposing of one’s own property are fundamental rights of the free and rational person acting out of his own choice. It is a pity that in Bulgaria such anti-free market, immoral and irrational decisions can be made by those in power out of hypocritical motives ‘in the interest of society’.

It is a matter of money, a lot of money...

Here is what Todor Kumchev, a member of parliament from the ruling Socialist party, comments in the daily *Sega* regarding the delay in adopting amendment to the Law on medical products: ‘The pharmaceutical sector is worth many millions, and this is the reason why it is hard to make a decision.’ The MP acknowledged that personal interests are the crucial factor in decision making, rather than economic logic, the rule of non-interference of the state in business transactions, or the free movement of capital. It should not follow that the size of a particular sector of the market is the decisive factor in the passing of laws, because this would suggest a lack of objective and uniform criteria in the ‘creation’ of laws and would signal the presence of large-scale interests and financial appetites.

What will the European Commission say?

On July 28, 2006, the European Commission (EC) initiated infringement proceedings concerning Italy, Austria, and Spain with regard to the limits and restrictions, existing in their national legislations, pertaining to the acquisition and ownership of pharmacies. The EC decided to take Italy to the Court of Justice on account of restrictions imposed by its national legislation on the acquisition of holdings in and ownership of retail pharmacies.

According to the Commission, the Italian legal provisions, as interpreted by the Constitutional Court, are not consistent with Articles 43 and 56 of the EC Treaty concerning freedom of establishment and free movement of capital within the EU. The Commission also made a formal request to Austria and Spain to amend their national rules relating to the setting-up of pharmacies. Under the Spanish legislation, only pharmacists can own and run a community pharmacy open to the public. It is also forbidden for one and the same pharmacist to have a holding or a joint holding in more than one pharmacy at any one time. In Austria, there is discrimination based on nationality with regard to the establishment of pharmacies; non-Austrians do not have the right to obtain a license to operate a pharmacy. There are also

various limitations on the number of pharmacies in a particular territory according to the number of inhabitants and the minimum distance between pharmacies.

With regard to all of these cases, the European Commission has declared its position, namely that the imposed restrictions are in contradiction with the principles of the Treaty establishing the European Community (TEC). Despite the presence of this precedent, the governing class in Bulgaria does not conform to the decisions of the European bodies and is ready to jeopardize the national interests while making use of unpersuasive motives and contradicting goals.

IME with a New Executive Director

By unanimous decision, the Board of the **Institute for Market Economics** elected a new Executive Director. *Svetla Kostadinova* will take up the position from January 2007 and will replace *Krassen Stanchev*, who has been elected the new Chairman of the Board.

Svetla Kostadinova works in the IME since 2001 and has held the position of Senior Economist since 2004. She was born in Varna, where she studied at the specialized economics high school. In 2001, Svetla finished her Bachelor's degree, and in 2005 she also completed a Master's degree in Finance at the UNWE, Sofia.

Institute of Market Economics, Bulgaria (www.ime.bg/en)

Krassen Stanchev, Svetla Kostadinova, Dimitar Chobanov, Adriana Mladenova, Veliko Dimitrov, Metodi V. Metodiev, Momtchil Krastev

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For comments and recommendations: metodi@ime.bg

Contacts: Phone/Fax: (+359 2) 952 62 66, 952 35 03