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**PROBLEM OF THE PRIVATIZATION IN THE FOOD  
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## Problems of the Privatization in the Food Industry

Since 1989, Bulgarian industry as a whole has been undergoing the hard process of transition to a market economy, with each of its subsectors suffering different sorts of problems. The recently observed revival is mainly concentrated in sectors which have a greater share in exports. These are predominantly raw material sectors (mining and processing industries which pollute the environment): the chemical and oil industry, paper-production, coal mining, and ferrous and nonferrous metallurgy. The food and light industry subsectors, which are the traditional industries in Bulgaria, still show falling output, and remain, more or less, obstructed in their recovery<sup>1</sup>.

There are several reasons why the food industry continues to experience greater hardships than other industries during the transition period. The major problem is the loss of the large and secure markets in the former COMECON countries, especially in the former Soviet Union as well as in the Arab countries. Because the Bulgarian Food Industry (BFI) was and still is oriented towards exports<sup>2</sup>, the restructuring process remains harder for it than for other industrial sectors.

Another reason is the decline in real income of the population which resulted in shrinking domestic foodstuff consumption.

The critical financial condition of the processing industry is due to high interest rates, the seasonal character of a lot of its subsectors and the need for large working capital over a long period of time. Raw materials are bought over a short time period and profits come only after processing (the length of which depends on the specifics of the product) and sales. With high current interest rates, companies which use credits become almost doubly indebted during the period between purchasing the raw materials and selling the final product. This explains both the accumulated bad debts and the almost total lack of investor interest since 1989.

Solutions to the BFI's problems can be sought in several directions: a new market policy for the country; creating conditions to attract domestic and foreign capital; changes in economic conditions (especially in interest rates and profit taxes); amendments to improve current legislation; and liquidation of ineffective companies, etc.

One of the basic ways to introduce quality changes into the BFI is with its privatization. Despite its difficult financial situation, the BFI still retains some attractiveness to local and foreign investors since most of its subsectors require little investment and can achieve fast turnover of working capital. However, changing hands in itself is not the most important thing. It is hoped that private ownership will bring about stronger incentives to manage companies with greater effectiveness, motivation that public companies' directors lack. Privatization alone, however, does not guarantee higher effectiveness. If private companies are forced to work in tough economic conditions (for instance, if large parts of their income are taken away through heavy taxation or if investment is crippled through high interest rates), if competition is underdeveloped or if financial control by the state is excessive<sup>3</sup>, private companies will not perform well either. Most economists agree that

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<sup>1</sup> According to NSI data for October 1995, compared to the previous year, production in the public sector has grown in the following subsectors: chemical and oil-refining - 35%; ferrous metallurgy - 10%; paper industry - 64%; electromechanical and electronic industries - 11.7%, electrical and heating power production - 4.1%, and coal mining - 17.2%. The output decrease in public, privatized and large private companies in the food industry for the whole period January-October 1995 compared to the same period in 1994 was 1.8, with an increase of 2.8% only in October. In light industry (glass and porcelain-faience, textile, tailoring, leather, furrier and shoe sectors), the average decrease in output for October was 12%, and for the 10 months - 9%. (Source: Fratev, D. "October - with a Record Output", *Statistical Barometer*, NSI, 84, 1995).

<sup>2</sup> In some BFI subsectors 80-90% of the output has been exported.

<sup>3</sup> A draft law for the organization and activities of the government's financial control was recently submitted to Parliament. There have been arguments over some of its provisions - for example the range of government financial control. There have been opinions that not only trade companies with government or municipal participation of over 50%, but all other trade firms, corporations (share-holding and limited joint-stock companies), cooperations, funds, foundations, charities, etc.. should be subject to government financial control. If this approach is accepted, the implication would be

decisive change in performance can be brought about not only by changing proprietors but also through increased competition and improving macroeconomic conditions brought about by the government.

Privatization in Bulgaria in general (and in the BFI in particular) has suffered a large delay. Even though the country is already in its fifth year of reform and in its fourth year since the commencement of the privatization process, cash privatization is still closer to its beginning than to its completion, and the so-called "mass" privatization has not yet begun.

Data from the Ministry of Agriculture and Food Industry (MAFI) show that 28 out of 443 farming companies, and 24 out of 362 processing companies within the system of the ministry have been privatized so far. The Privatization Agency has concluded deals for 25 companies in both sectors - farming and processing.

The reasons for the delay in privatization are not so much economic as they are an outcome of the conflicting interests of different political and financial groups and the lack of a united will among the main political forces to speed up the process. Like the process of land restitution, the privatization process has not only economic but also political and social aspects and bears the impact of contradictory interests. Delaying privatization, however, bears hard and mostly economic consequences for the country.

There are several basic reasons for privatization's delay. They are common for all economic sectors yet have their specific impacts on the BFI.

Cash privatization began in Bulgaria after the Law for Restructuring and Privatization of Public and Municipal Enterprises was passed (State Gazette, 38/1992). The first adopted annual privatization program was for 1993.

A major impediment to the course of privatization proved to be the valuation of companies under privatization. The basic dilemma which faced cash, and to a smaller extent, mass privatization was whether to accelerate the process and sell companies at cut-rate prices or sell high but slowly. The experience of the past 4 years has clearly shown that accelerating privatization and receiving high income from it cannot go hand in hand. It is therefore necessary to change tactics.

The major goals of privatization are to increase effectiveness, to raise the number of proprietors and to create and promote competition. Cash privatization, however, has some additional aspects - it brings revenue to the government and distributes companies' debts among owners. This is why cash privatization is a slower process than mass privatization. Under Bulgarian conditions however, much more importance is attached to the sum which has to be paid for a certain company than to some other conditions which ought to be regarded as being important. High values given to companies repel both local and foreign potential buyers. Government revenue is placed high on the agenda as it follows the interests of the institutions which run the privatization process. This state of affairs is not conducive to privatizing quickly.

There is also a conflict underlying the very privatization procedures. Under current law, the privatization value is a minimum sum which must be targeted by the contract. It would be much better if this value only provided orientation. More attention should be paid to investments which the prospective owner is going to make in the company itself or downstream to boost raw material production. Some other conditions also have to be considered. It is very important for our food companies to attract investments because they are in urgent need of restructuring and technological renovation. Higher revenue from sales is a short-term benefit and should not stand in the way of privatization's ultimate target - increasing the economic effectiveness in the BFI.

There are also other procedural matters<sup>4</sup> which delay privatization. The most important of them<sup>5</sup> follow:

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encroachment upon the autonomy of all these organizations in their policy making. All of them should be subject to taxation rather than to financial control.

<sup>4</sup> A detailed analysis of Bulgarian legislation and privatization procedures has been done by T. Popov in "Privatization from Law into Practice", "Trud I Pravo" Publishing House, 1993.

1. A contradiction arises between the privatisor, which is The Privatization Agency, and the share holders in the person of the Council of Ministers, individual ministries and municipalities. The owners of the properties are not interested in accelerating privatization. The staff of these institutions have professional and personal interests in remaining as members of managerial, directors and supervisory boards of companies. Privatizing their companies would exclude these executives from decision making positions and would take away their salaries. This is why issuance and transfer of temporary licenses from old to new owners (i.e. by institutions to privatized companies) is being delayed; and

2. Managers of companies under privatization are subordinated to the ministries and therefore have no means of defending their interests if privatization procedures are delayed or refused.

The conclusion is that the existing problems in privatization procedures have appeared because the process involves institutions which are interested in delaying rather than accelerating privatization.

Along with procedures, privatization is also delayed by heavy bureaucracy. Privatization in Bulgaria is decentralized, as it is in all former socialist countries in Europe (with the exception of Germany), which means that more than one institution participates in it. Here, however, there are too many institutions as participants - the Privatization Agency, The Center for Mass Privatization, the Ministry of Economic Development, the sector ministries, and the municipal privatization agencies. The requirement that privatization programs should be discussed and approved together with the Law for the Central Budget further delays the process. There are also conditions for corruption and raising the cost of privatization with the introduction of outsiders like valuers, foreign experts, etc.

Another reason for delay was the wrong choice for a starting point. Reforms in Bulgaria did not begin with privatization but with restitution. The latter is a matter of historical justice but the approach in restoring properties which has been adopted in our country contributed to delaying privatization. Whilst in most of the other former socialist countries historic owners have been compensated with money and/or equities, and only in a few has there been some element of restoring ownership of property in physical terms. In Bulgaria the principle of restoring physical property was adopted, with former owners being reimbursed with company shares only in very few cases. This is a reason why the interest shown by new proprietors has been reduced in some cases. The legal privatization procedure demands an analysis of the legal status for companies with any restitution claims on them. Finding the ownership rights and the share size of former owners takes a lot of legal effort and time, and in most cases seriously delays privatization.

Restitution in the BFI meant returning over 700 mills and water-mills, bakeries and dairies to former owners. In many cases, when food industry enterprises include parts of older ones, restoring ownership to former proprietors legally requires that the public company should either free the site or conclude a rental deal. All this is another reason for delayed privatization in such companies.

Municipal privatization has lagged behind as well because, at present, municipalities, squeezed for funds as they are, prefer leasing their properties rather than selling and thus gaining certain profits. There are some legal problems in financing municipal privatization, too, but the major impediment remains the municipalities' low motivation to sell. A proper economic stimulus must be found, therefore, to alter the way income from privatization is distributed or to provide incentives in some other way.

Mass privatization has also been delayed and is just now starting, with legislation and implementation methods being developed at this moment. The ends of mass privatization are different from those of cash privatization. The former has less ambitious economic targets, but the political and social aspects are stronger (involving the general public in privatization and securing their support for it). The major goal is to rapidly establish the basis of a market economy through transferring state ownership into private hands without accentuating so much on the profitability of the process. Mass privatization does not

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<sup>5</sup> The problems arising from the privatization procedures are very often discussed in the daily press and the periodicals. The article "Privatization before the dilemma: faster or more expensive", Cash newspaper, 47, 22 November 1995.

easily attract investment which is why it is done by individual companies or parts of companies at a time.

The economic consequences of privatization delays are hard for both the BFI and the country as a whole.

The first of these consequences is that the longer privatization drags out the less attractive BFI companies become to potential buyers. BFI companies recede into worse financial straits<sup>6</sup> as their debts grow and finding purchasers or drawing internal or foreign investment becomes correspondingly difficult.

Financial performance of companies prior to privatization, as mentioned above, is often aggravated by the fact that their managers are countermotivated in improving the performance of their companies, except in cases where a managerial or a managerial-worker privatization is envisaged. Cases of bad husbandry and poor management, as well as of the so-called "hidden privatization", are becoming more frequent.

Another negative impact of delay is the underutilisation of economic resources. Some new facilities are being or have been constructed in quite a few subsectors of the food industry (smaller or larger private businesses), while at the same time existing facilities in public companies remain unutilised. Facilities in the BFI's public sector are now functioning at 20-30% of their capacity, and some of the companies have closed down.

Delays in privatization have negative economic and psychological effects on society as a whole. With the fall in real income and the decline in savings, the probability that some of these savings will be committed to privatization is becoming smaller. The psychological outcome is that people lose their positive attitude and support for privatization and private property. Recent polls surveying attitudes toward mass privatization show most people do not expect any benefits from privatization. Good results cannot be expected from privatization, particularly from mass privatization if the public interest is lost.

A top priority in privatization has to be its acceleration. In order to achieve this, society as a whole, certain interest groups and the political forces have to show united will.

Cash privatization can be accelerated through putting the emphasis on its speed and not on its profitability to government.

The ways to speed up cash privatization are as follows:

3. simplify procedures and reduce bureaucracy along the process line (some of the ways to do this have been suggested above);

4. endorse greater inventiveness and resilience in privatization methods, by allowing delayed payments to companies' staff and stimulating paying out some of the enterprises under ZUNK or Brady bonds;

5. satisfy as comprehensively as possible the claims of former land or other estate owners through their involvement as share-holders or partners; and

6. Carry out privatization with a better view to the investments of future owners in both the processing company and raw material production.

It was suggested that agricultural producers receive 20% of the BFI's public companies free of charge, as a way to bind the interests of farmers with the processing industry. The idea was reasonably rejected because it would bring about even greater legal impediments and would further slow privatization. The most obvious of these impediments would be the identification of agricultural producers.

With mass privatization, it is necessary to quickly specify the model and then implement it.

The economic conditions companies will face in the post-privatization period are very important. Revival and growth in the BFI may only be expected with tax and credit concessions and with reasonable financial control on behalf of the government without its interference in their management.

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<sup>6</sup> Credits of companies in grain and food industry within the MAFI system reached 19 154 856 000 levs in 1994, and the credits transformed into government debt amount to 4 356 173 000 levs (data from the MAFI).