

INSTITUTE FOR MARKET ECONOMICS

Series of papers

Review of the Bulgarian Economy

**INVESTMENT AND SAVINGS IN THE
BULGARIAN ECONOMY: THE CONTRIBUTION
OF THE INFORMAL SECTOR**

on the joint project *Hidden Barriers to Economic Growth*
financed by **USAID**

by

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**April 1996
Sofia**

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INVESTMENT AND SAVINGS IN THE BULGARIAN

ECONOMY: THE CONTRIBUTION OF THE INFORMAL SECTOR

Overview

The present paper links two topics which usually are treated separately in the economic literature. The paper provides an analysis of the savings behavior of various sectors of the Bulgarian economy, and at the same time it provides an estimate of the size of "informal" economic activity. In principle, gross national savings from the national income accounts data should equal the sum of the savings of all sectors of the economy, that is, households, public and private enterprises and government. However, this paper shows that there is a discrepancy between the two, and this discrepancy can be used to get a rough quantitative assessment of the contribution of the informal sector to the savings of the national economy. Additional information can be obtained by comparing the data of the National Statistical Institute (NSI) to those of the Bulgarian National Bank (BNB).

Theoretical notes.

The traditional approach to economic growth emphasizes the importance of the process of capital accumulation which will expand the production possibilities of the economy and under certain conditions will result in an increase of the welfare.

In the case of a small open economy investment can be financed basically in two ways. The sources are the following:

1) Domestic savings, defined as the difference between the gross national disposable income and the consumption.

2) Attraction of foreign capital to fill the gap between the domestic savings and the required investment. Apart from that, the inflow of external capital has the advantage of loosening the constraint of the balance of payments (in terms of supply of foreign currency). This is very important for several major reasons. The first one is that most of the capital goods are imported from abroad. The second one is related to the structure of the Bulgarian economy which depends strongly on imports of inputs. So any higher level of GDP demands a greater amount of imports and therefore the need for foreign currency rises. The external capital requirement is determined not only by the investment needs. It grows with the amount of foreign debt servicing. Bulgaria has large debt payments and the supply of foreign exchange is one of the central problems in the transition period.

The Bulgarian experience of the last five years shows that the country cannot attract sufficient foreign capital. So the prospects for the future development are restricted primarily to the capacity of the economy to generate enough savings to finance investment in the export-oriented sectors.

Since investment depends on savings, we can broadly define as a barrier to growth any behavior that impedes the process of capital accumulation by diverting free resources in favor of current consumption.

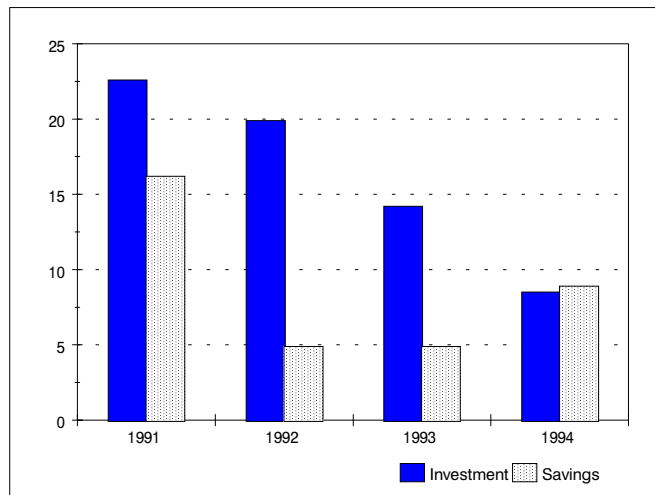
Investment and savings in the national economy.

In the centrally planned economy investment decisions were centralized and, as a rule, did not reflect the logic of the market. The focus was placed on the supply side, while the demand was considered not so important. This concept was based on the erroneous assumption that supply automatically creates demand. The overestimated role of investment at that time materialized in a production structure where priority was given to the branches producing capital goods. Later on this structure proved to be completely inadequate to the new economic situation.

The development of the investment process in Bulgaria during the transition period can be characterized by a steady decline in investment as percentage of GDP.

The high investment rate was kept until 1991, although at that time the economic agents already had certain autonomy and could make decentralized decisions. In part the high investment/GDP ratio could be explained by problems with the calculation of the GDP deflator and the price index for the capital goods in 1991. Another reason for overestimation of investment is the one-time revaluation of the capital stock and the non-finished construction. For most of the enterprises this process has been finished till the end of 1992 but for some it continued in the first quarter of 1993.

Graph 1. Investments and savings (% of GDP)



Source: NSI, BNB

In the period 1991-1994, gross capital formation as percentage of GDP decreased from 22.6% to 8.5%. Though a substantial decline occurred, the question of the sufficiency of investment is still open. It is possible to make an estimate of the investment requirements but for that purpose we have to postulate a constant

capital/output ratio (with a certain lag) and a target growth of GDP.

In the case of the Bulgarian economy however this approach is not applicable because of the difficulties in measuring the initial capital stock, as well as because of the fact that the use of the above ratio is consistent only when the growth of GDP is limited only by the supply of capital. For Bulgaria the problems come mostly from the demand side.

The dynamics of savings follows quite closely that of investments until 1993. The improvement in 1994 is largely due to the favorable current account balance.

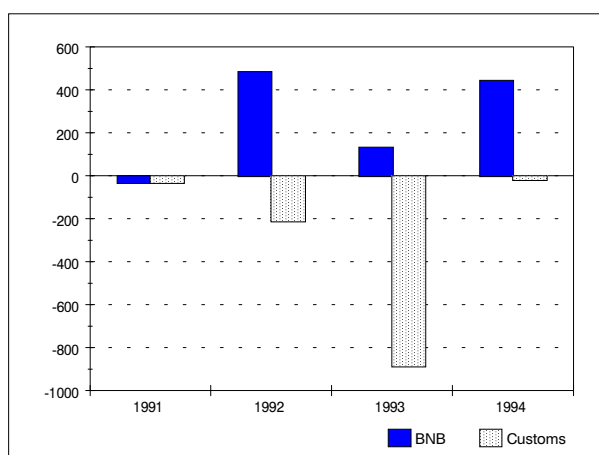
As it can be seen from Graph 1, in the period 1991-1994 domestic savings were not enough to finance investment and the savings gap increased from 8.6 bln. leva in 1991 to 30 bln. leva in 1992. (However the gap will be smaller if we take into account the problems with measurement of investment.)

Data problems.

The above estimates have been made on the basis of GDP figures found in publications of the National Statistical Institute (NSI) and the current account figures, taken from the balance of payments statistics published by the Bulgarian National Bank (BNB). Since for consumption and investment there is no reliable alternative source of information, it is not possible to check the consistency of the data provided. As for the third component of GDP, net exports, there exists a separate estimate based on the settlement data supplied by the commercial banks.

The disagreement between the two sources is very huge and we get a totally different picture of the economic situation when using the two sets of data.

Graph 2. Trade balance in million USD according to customs data and settlement data provided by BNB.



Source: NSI, BNB

When the settlement data are used, the level of the GDP rises between 4.5% and 11% for the different years.

There are many possible explanations for the discrepancy but none can be regarded as more reliable than the others.

First of all, it has to be pointed out that there exists a technical reason for the difference since in general

the physical crossing of the border by the goods does not coincide chronologically with the payment for the foreign trade transaction. Of course, this reveals only part of the story because this explanation can be applied when monthly or quarterly data are used but not for annual data.

Normally the customs statistics, which the NSI has been using, undervalues the volume of imports. This is particularly true for the excise goods, like tobacco and alcoholic beverages, which are the main object of violation of the foreign trade regime. There are many ways through which the payment of duties and excise tax is avoided. They range from pure smuggling to more refined techniques such as declaring lower quantities or lower unit prices for the imported goods.

As an indirect evidence for the frauds connected with foreign trade operations, we can compare the volume of temporary imports with the volume of the re-exports. For the two years 1993 and 1994, temporary imports exceed re-exports by 240 mln. USD. This means that goods for at least 240 mln. dollars have remained in the country and the importers did not pay duties and VAT.

Settlement data usually strongly overestimate trade volumes. There may be several reasons for that. First because of lack of experience, the commercial banks tend to classify as foreign trade transactions a number of international payments which are not related to the purchase of goods. Hence sometimes capital flows are referred to the current account.

Together with the errors resulting from unawareness, in a number of cases there is a deliberate violation of the regulations restricting the movement of capital. This is accomplished by preparing formally correct commercial documents behind which there are no real trade transactions.

Savings and investment by sectors of the economy.

Savings in the national economy should be equal to the sum of the savings of households, firms in the public and private sectors and the government budget.

These economic agents have different behavior in terms of income generation and distribution, and therefore we get a different picture for savings.

It would be convenient as well to examine separately the state-owned enterprises from those in the private sector because of some differences in the principles of operation between the two.

Households

The savings of households are a resultant variable, obtained as the difference between disposable income and consumption. (In this case only the money income is taken into account.)

The disposable income can be used either for purchase of goods and services or for saving. With its savings the population finances the purchase of durable goods and real estate. In a broad sense these can be regarded as investment of the households.

The difference between savings and investment expenditures determines the ability of the population to finance the economy. This is exactly the amount by which the acquired financial asset exceeds the taken liabilities.

We can roughly evaluate the savings of households by examining the dynamics of deposits in the banks, since the bulk of the savings of the Bulgarian citizens is in the banking system.

We have to take account of the increase of the money in circulation as well. The proportion of the government bonds, shares etc. in the total assets of the population is very small.

Before going any further, it must be stressed on the fact that in Bulgaria it is not possible to distinguish clearly the households from the small private sector. As the corporate business is still underdeveloped, the private sector is represented predominantly by sole traders or small partnerships.

The total number of the registered economic units by 31 December 1994 was 454 963. 341 818 (75%) of them are sole traders, 36 769 (8%) are partnerships of citizens and 20 005 (4%) are limited companies.

Many owners prefer to keep the free resources of their firms in personal banking accounts. This is partly due to the different interest rates, offered by the commercial banks to individuals and businesses.

According to the annual statistics of the Bulgarian National Bank (BNB) the increase of the households' deposits in 1993 is about 25 bln. leva and in 1994 about 18 bln. leva. The currency in circulation increased by 6.9 bln. and 13.3 bln. leva respectively.

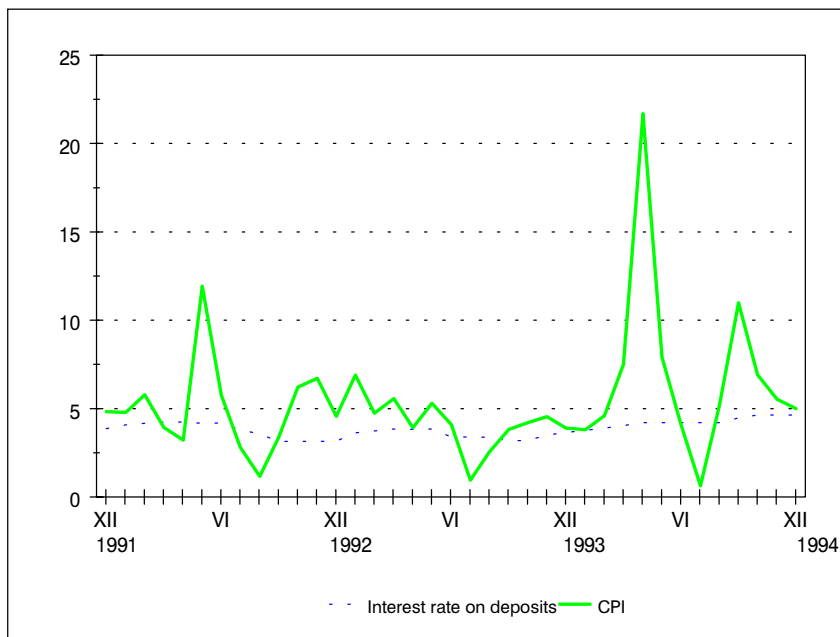
There was a considerable change in the structure of the deposits.

The average deposit in leva increased almost three times, from 4.7 th leva in 1992 to 12.6 th leva in 1994. In 1992, 88.3% of the deposits were below 10 th leva while the deposits above 100 th. leva represented only 0.2% of the total. Two years later, these proportions changed to 71% and 1.4% respectively. To a great extent the change can be attributed to the high inflation but the increase of the big deposits can also be regarded as an indirect proof for the participation of the business.

The second aspect of the behavior of the population is the foreign currency substitution that took place in 1994, after the exchange rate crisis in the first quarter. While in 1992 and 1993 the foreign currency deposits of the population, as a share in the total deposits amounted to 12.5% and 11.3%, at the end of 1994 this share went up to 25.1%.

In the period 1991-1994 as a whole, the interest rate on deposits was lower than the inflation rate. The purchasing power of savings declined and depositors suffered losses.

Graph 3. Interest rate on 1-month time deposits and monthly inflation rate



Source: NSI, BNB

The negative real interest rate made some people look for an alternative to place their money. Doubtful appeared financial structures which attracted potential investors with promises for returns exceeding several times the interest rates quoted by the banks.

These so-called financial pyramids in fact were carrying out banking operations, ignoring the regulations and without being supervised by the central bank. Some estimates show that these structures gathered and transferred abroad some 6 to 10 bln. leva thus diverting savings from productive uses.

There is also a lot of evidence that licensed financial brokerage houses and exchange bureaus accept money in the form of deposits without having the right for such an activity.

State owned enterprises

The financial situation in the public sector deteriorated sharply after subsidies for the state owned enterprises were terminated. This step which was intended to put the enterprises into a market environment did not achieve the expected effects of strengthening discipline and raising efficiency because the firms found a substitute for the state grants in the form of credits from the banking system.

The decline of output, high inflation, vague prospects for the future economic development and emerging privatization are among the main causes for the reduced investment activity.

There are different reasons for the difficulties of the non-financial state-owned enterprises. Some of them refer mainly to the inherited production structure, formed in compliance with the role of Bulgaria in the international specialization within the former CMEA.

As a result, after the changes took place, a lot of enterprises proved to be completely incapable of operating in the new environment -- some because of the scale, others because of the quality of the goods they produced. These units should have been either closed or completely restructured. Since neither of these things happened, they turned to be one of the gravest problems of the transition economy, as they generated enormous losses, covered usually through an increase of the internal government debt.

The government, as an owner, did not fulfill successfully its task to monitor the management of the state-owned enterprises and at the same time, it did not provide incentives for a more efficient work.

The lack of motivation among the workers and the managers, underlies the bulk of the problems in the public sector.

In such circumstances, it is not surprising that investment was pushed to the bottom of the priority list of the firm management. The survival of some of the enterprises was under question and the immediate task of the managers was to keep the economic and the juridical unity of the firms. Thus, all the resources available were devoted to cover current expenditures. This behavior produced benefits both for the workers who could keep their jobs (though in most of the cases this could not be justified economically) and for the managers for whom remaining in position was often accompanied by huge additional benefits.

In many cases wages grew much faster than labor productivity. This was a tactic used by the managers of the state-owned enterprises to gain the support of the employees and at the same time to create the impression that everything in the company was going well.

The firm, just like the economy as a whole, has two sources to finance its investments.

1) internal sources -- undistributed profits and depreciation allowances.

2) external sources -- issuance of bonds or shares, or credits from the commercial banks.

Those two opportunities should be discussed separately.

Having in mind the poor financial position of the enterprises in the public sector, it is obvious that the possibility of using undistributed profits from past periods is very limited. The amount of the undistributed profit of the state-owned firms in the balance sheet for 1994 is only 1.15 bln. leva or 0.2% of their equity capital.

Since 1992 the enterprises in the public sector have suffered tremendous losses.

The net profitability¹ in industry, where the capital is largely concentrated (66% of the total), is -7.87 in 1992, -12.74 in 1993 and -4.89 in 1994.

In 1994, 4269 (43%) out of 9858 state-owned enterprises that submitted to the NSI their balance sheets and records of income and expenditures, ended the year with a negative financial result. The total loss for 1994 in the public sector amounts to 28.5 bln. leva. The performance of a relatively small number of firms determines the position of the whole economy.

The distribution of the firms, according to their sales profitability reveals a cluster of enterprises in the interval (-2, 2). 91.3% of the entities fall in this group. A weak advantage is accounted for the firms with positive results (between 0 and 2), whose number is bigger. It is worth noting that 379 of the remaining 756 firms, or 3.8% of the total, have sales profitability below -30%. These enterprises experience a lot of difficulties in servicing their obligations to creditors and the budget. Their further existence becomes meaningless since for one reason or another these firms are not in position to operate normally as autonomous units in a market environment.

The loss in the public sector is concentrated mainly in industry. Three industrial branches are in a very complicated financial position. These are energy production, coal mining and machine building. The loss as a percentage of the sales for the three branches is 19.1%, 18.5% and 16.7% respectively, and the covering of interest payments² is among the lowest in the economy.

The most successful industrial branches are the non-ferrous metallurgy and the printing industry.

¹The net profitability is measured as (profit-loss)/total income

²The ratio (gross financial result before taxation and interest payments)/ interest paid, multiplied by 100.

The strong differentiation among the firms which was witnessed in the previous years, revealed again in 1994. The main financial indicators, describing the position of the enterprises in the different branches, deviate strongly from the average.

The deterioration of the financial results and the payment difficulties are reflected in the lower liquidity of the state owned firms.

The liquidity coefficient, calculated as the ratio between short-term assets and the short-term liabilities decreases from 1.08 in 1993 to 1.05 in 1994. (It should be kept in mind that the liquidity coefficient is a strongly conditional indicator for some of the firms because in the short-term assets the inventories are included and their liquidity is doubtful.)

The distribution of the firms according to the value of this coefficient shows that the largest number of units can be found in the interval (1.0, 2.0). 2631 firms have liquidity coefficient below 1.0 and the number of the super-liquid firms (with coefficient above 20) is 342.

Again printing industry and non-ferrous metallurgy³ account for the best results (liquidity coefficients 1.74 and 1.38 respectively). These two branches are in a better situation regarding the rest of the financial indicators as well. The dependence on creditors⁴ is below 0.10, and the profitability of sales⁵ is 18% and 15% respectively.

Although the growth of GDP in 1994 was achieved mainly due to the increase of exports, there is no clear relationship between the financial results and the market orientation of the firm (in terms of export-oriented or import-substituting production).

A typical example is ferrous metallurgy which is definitely export-oriented and shows results far below the average for the economy -- low liquidity (0.68), negative profitability of sales (-5%), relatively high dependence on creditors (0.9).

At the same time, in printing industry whose production is designed for the domestic market, the picture is just the reverse.

Table 1. Liquidity, sales profitability, dependence on creditors and share in the total exports.

Branch	Sales Profitability	Liquidity	dependence on creditors.	Share in exports
Energy production	-19	1.0	0.06	0.27
Coal mining	-13	0.6	0.03	0.01
Ferrous metallurgy	-5	0.68	0.90	11.24
Non-ferrous metallurgy	18	1.38	0.09	6.9
Machine-building	-14	0.94	0.47	11.9
Production of electrical appliances and electronics	-11	0.94	0.64	5.24
Chemical and oil-processing industry	1	1.04	0.60	25.13
Industry for building materials	-2	1.05	0.12	1.68
Wood and wood processing	-1	0.87	0.23	3.1
Paper industry	6	1.05	0.60	1.11
Glass industry	6	0.93	0.32	0.91
Textile industry	-3	0.86	0.49	3.66
Wearing and apparel industry	6	1.19	0.41	3.00

³ The oil-drilling industry is excluded from the analysis because its share in the total production is almost zero.

⁴The indicator "dependence on creditors" is measured as a ratio between the credits received and the own resources.

⁵The ratio is defined as gross financial result/ sales.

Leather and footwear industry	5	1.02	0.61	2.95
Printing industry	15	1.74	0.06	0.12
Food processing industry	0	0.91	0.83	16.89

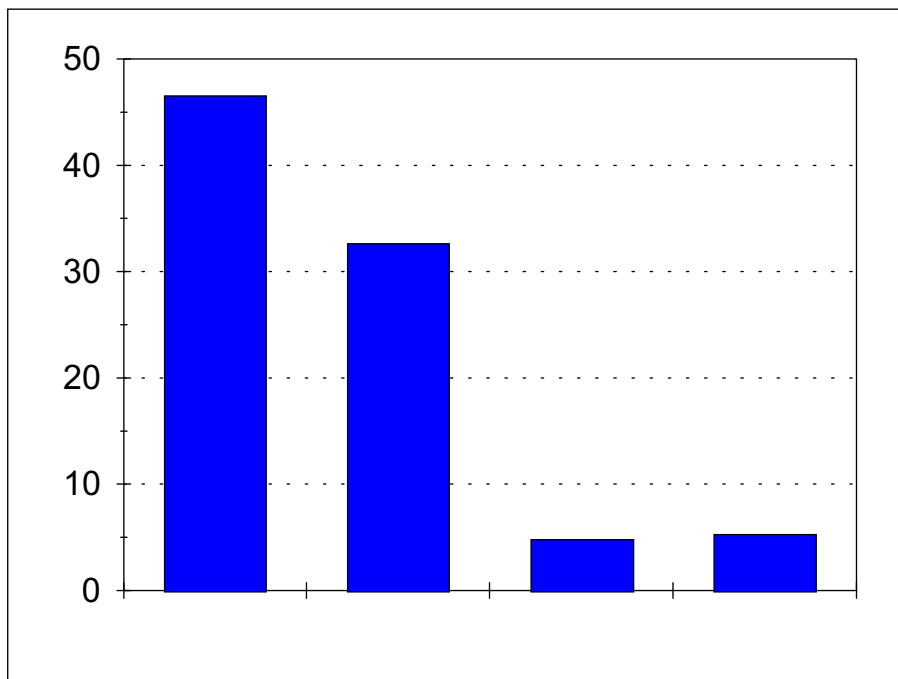
The second internal source of funds are the depreciation allowances. Generally their purpose is to finance the recovery of the worn out fixed assets. The role of depreciation however is not restricted only to the restoration of capital. It may become a major resource for expansion of the firm.

In the transition period the use of the depreciation allowances is quite different. The enterprises seize every opportunity, including depreciation, to cover their current expenditures.

In the presence of enormous losses and negative savings in the public sector, obviously the enterprises cannot accumulate enough internal resources and therefore they must turn to external sources to finance their activities and cover the losses. This can be done in two ways 1) by attracting free resources from the capital market and 2) by borrowing from the banks

Since the capital market in Bulgaria is not well-developed, the firms rely entirely on credits from the commercial banks. They cover their losses mostly by increasing their indebtedness to the banking system and by extension of inter-firm credit.

Graph 4. Long-term credit to the public sector (% of total)
(stock end of year)



Source: BNB

The banking data, as presented on the graph, show that the outstanding long term debt of the non-financial state enterprises has sharply been reduced since 1992. This is due to the transformation of claims of the commercial banks into government debt in agreement with the Law on Settlement of Non-Performing Credits. Those were investment loans extended by the banks to the state-owned enterprises before 1990. (After the economic situation changed, most of the companies found themselves in a position of inability to service their obligations and the adopted solution was to transform these credits into long-term government bonds.)

In 1993 the share of the non-performing credits increased immensely, from 981 mln. leva at the end of 1992, to 27 289 mln. leva. The classified claims went up from

25 to 31.5 bln. leva for the same period. (The increase in 1993 is due to the adopted regulation for classification of the credits.)

In 1994 the classified outstanding claims were 21.1%, the bad loans were 15%, and the interest overdue 28.6% of the total claims of the commercial banks to the public sector.

The above figures should be viewed rather as the lower limit of the irregular claims. The loss-making banks temporarily are not interested to classify the credits since the provisions are created before taxation and for these financial institutions such tax preference does not change their financial situation. (According to Regulation N9 the commercial banks are obliged to raise provisions amounting to 20% of the principal for the credits of group A, 50% for the doubtful claims in group B and 100% for the non-performing credits.)

Savings and investment in the private sector.

Background

The emergence of private entrepreneurs in Bulgaria began in the late eighties, before the political reforms and the liberalization of the economic activity. The private sector formation became legally possible after Decree N56 was enforced in the beginning of 1989. Two years earlier, in 1987, Decree N 35 of the Council of Ministers was adopted, which regulated the rent relations. The decree allowed the Bulgarian citizens to lease from the state long term assets like real estate, machines and equipment, transport vehicles, etc. The idea behind this decision was to induce a new type of attitude towards the public property, i.e. a more rational use of capital. Thus the rent turned to be one of the first legal opportunities for capitalization of the private sector. This opportunity was quite limited in the beginning because of the existing control on the activity of the state-owned enterprise at that time. Later on, when the agents received autonomy, the leasing of state property by individual entrepreneurs was one of the most attractive ways to achieve significant profits with minimum expenses. At the same time, the state was losing potential income because of the low rent tariffs.

In the first period of the private capital formation in Bulgaria (before the start of reforms in 1991) the forms and the scale of this process were restricted to narrow limits.

After the private entrepreneurs received the right to engage in independent economic activity, quite naturally, most of them directed their efforts to the trade sector. It is well known that the link between the producer and the consumer was one of the weakest points of the socialist economy. So trade and services became the main source of income for the emerging private sector.

By the end of 1989 1371 private firms were registered in the trade sector, which performed 0.2% of the turnover in the retail trade. In 1991 already 26.2% of the turnover was in the private sector, and in 1994 this share reached 69.3%.

A very typical feature of the process of initial capital accumulation in the transition economy is the emergence of different techniques for transferring public funds into private hands.

Some of the most widely spread methods of illegal capitalization of the private sector include the following:

- Creation of parallel firms by managers of state-owned enterprises or persons connected with them. These managers transferred in their private firms the public assets at their disposal. Having done that, later they usually quit the state organization and set private businesses.

In the first years of the transition period this was a widespread phenomenon.

- Avoiding payment of taxes, duties and fees.

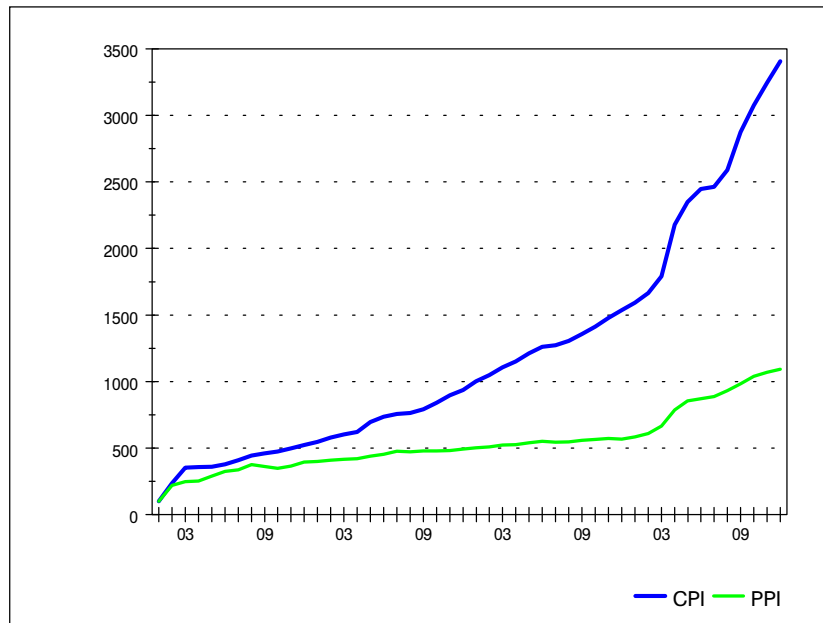
Sometimes certain gaps in the legislation assisted this practices. (For a short while there existed a tax preference for the cooperatives of students. These

cooperatives were used as a cover behind which enormous quantities of cigarettes and alcoholic beverages were imported without paying the taxes due.)

- Creation of financial structures (often with bank loans) which accept deposits and extend credits without having the right to perform banking operations. Several cases of hidden privatization of state-owned banks through rising their capital became known in 1991, though the BNB either was not informed or refused to give permission for such an operation.

- Private firms, supplying inputs to some state enterprises at very high prices and buying production cheaply. Thus the private sector earns profits while the public sector accumulates big losses. An indirect proof for that is the much slower increase of the wholesale prices than the consumer prices.

Graph 5. CPI and PPI dynamics (cumulative).



Source:
NSI

- "Money laundering". Part of the funds of the former totalitarian organizations was distributed among many firms. The purpose was to hide the origin of these money and to avoid possible confiscation.

Large amounts were converted in foreign currency and transferred abroad.

In addition, all the income obtained in a criminal way was (and is) freely legalized.

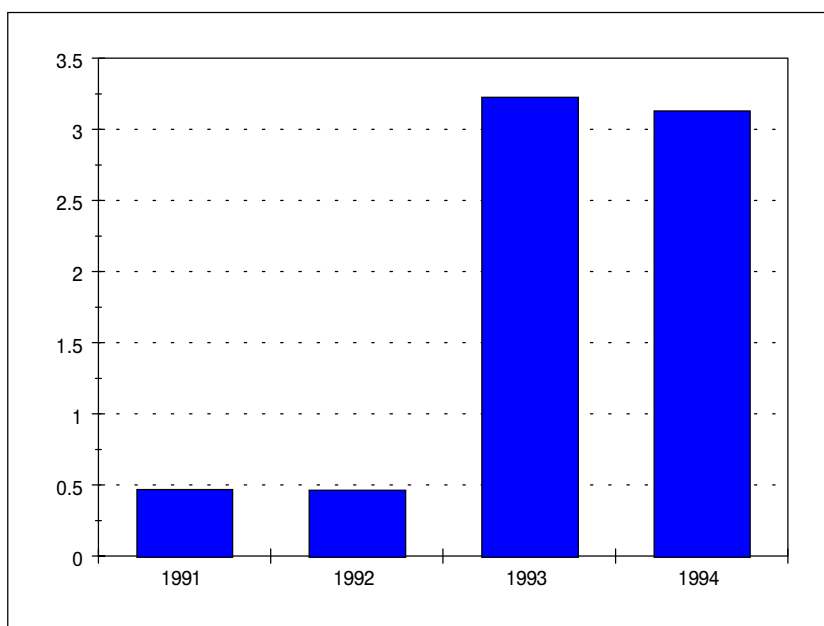
A special role in the private capital accumulation played the banking sector which created the so-called credit millionaires.

Financial situation of the private sector

In 1994, 30.5% of the gross value added was created in the private sector. The sectoral distribution is as follows: agriculture and forestry 10%, industry 6.6% and services 13.9%. According to the data, submitted to the NSI, at the end of 1994, the private firms own 5.2% of the total fixed assets in the economy.

Again the NSI data show a "boom" in the investment activity of the private sector in 1993. The expenditures for acquisition of fixed tangible assets in nominal terms in 1993 were ten times higher than those in 1992.

Graph 6. Expenditures for acquisition of fixed tangible assets (% of GDP)



Source: NSI

The considerable increase is partly due to the opportunities which the tax legislation provided by acknowledging a wide range of expenditures as reducing the taxable profit. Thus the "investment" expenditures of the private

businessmen essentially consisted of purchases of personal motor vehicles and real estate. (According to the later amendments in Decree 56, the taxable profit is reduced only by the acquisition of buildings for production and commercial purposes and vehicles for transportation of passengers or loads, excluding motor cars.)

The comparison between the structure of the assets in the balance sheets of the private and state enterprises shows substantial differences.

The share of the tangible fixed assets in the total assets is more than twice higher in the public sector, 53.8% (against 22.7% in the private sector). The share of the claims of the private enterprises is particularly high, 22.6% of the whole assets. 7.1% of them are claims on sales and 14.8% are classified as "other claims". The large volume of such claims may be attributable to extension of money loans. Such practice exists though it is not regulated by the law.

The interfirm credit is widely used in the private sector. In 1994 the obligations to suppliers exceeded the claims on sales by 10.02 bln. leva! What is interesting in this case, is that the state-owned enterprises are also net debtors to their partners (with 1.9 bln. leva). Partly this could be explained with obligations to foreign companies and budget organizations, but another possible explanation is that the creditor companies are not recorded by the statistics.

Evidence for incompleteness and inaccuracies in the recording of the public and private sectors activity can be found when the data of the BNB for credits and deposits are compared to those presented by the NSI.

**Table 2. Disagreement between the data of the NSI and the BNB (mln. leva)
Private companies, 1994**

	NSI	BNB
Money	10334	45366
of which foreign currency	6030	25806
Loans	32060	107770

State-owned enterprises, 1994

	NSI	BNB
Money	47134	66031
of which foreign currency	20990	37706
Loans	153164*	122854

**In the amount of the credit to the public sector there is a very big difference between the two sources of information in the stock of the long term debt. This reflects the loans, transformed to a government debt.*

It is clear from the table that a substantial part of the private sector is not captured by the statistics. This is only part of the explanation for the huge disagreements in the data and it cannot be applied to the public sector. The difference in the credit stock is partly due to the fact that some enterprises do not report interest in the balance sheets or account for it in the item "other liabilities". As for the money, a lot of companies both private and public have several banking accounts but declare only one for reasons related to taxation.

The financial indicators of the private firms, which have submitted data for their activities show a much more unfavourable picture than the one in the public sector. What is remarkable here, is the low covering of the loans with own capital⁶ -- 0.27, against 1.4 in the public sector. The dependence on creditors in the private sector is five times higher -- 1.58, against 0.3.

Similar to the state-owned enterprises, in the private sector the best performance is accounted by the non-ferrous metallurgy -- high sales profitability, high liquidity, and zero dependence on creditors.

However, as a whole, the private sector ends 1994 with a loss of 2214.9 mln. leva and negative savings. Surprisingly this is due to the poor performance of the trade sector, where 49% of the recorded private firms are operating.

It would be helpful to compare the basic financial indicators of the public and the private sector in trade, where private property is most strongly represented.

Table 3. Financial indicators in the trade sector

	Public sector	Private sector
Liquidity (coeff.)	1.30	0.94
Covering the loans with own capital (coeff.)	1.18	0.09
Dependence on creditors (coeff.)	0.17	4.15
Covering of interest payments(%)	196	78
Financing the activities with own funds (coeff.)	0.52	0.08
Sales profitability	3	-1

The distribution of the firms according to the value of the liquidity coefficient in a large extent coincides with that of the state-owned enterprises. 20.5% of the firms are with coefficients between 1.0 and 1.5. The difference from the public sector is in the high proportion of the companies with liquidity coefficient above 20. In this group fall 641 firms (11.2% of the total number).

As long as the sales profitability is concerned, again the picture is similar to that in the public sector. With positive profitability between 0 and 2 are 53.6% of the enterprises while in the interval (-2, 0) fall 34.2% of the units.

Sales are most unprofitable in glass industry, the industry for building materials and in agriculture.

There seems to be a complete lack of correlation between the financial position of the sector and the number of firms in that sector. The share of the private companies in the most profitable branches is minor.

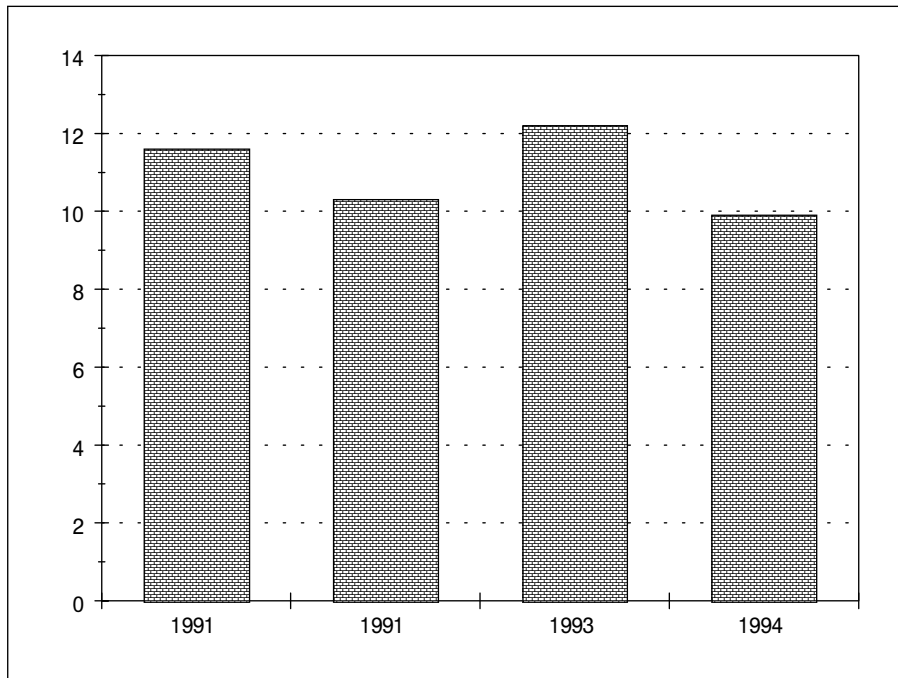
In 1994, 3141 enterprises from the private sector were profitable and 2442 ended with a loss. In the structure of the expenditures of the private firms a very low share is attributed to the expenditures for salaries -- 4.2% of the total, whereas for the public sector the share is 10.4%. There is a widespread practice among the employers to

⁶The ratio between the own capital and the borrowed funds.

negotiate contracts with the employees for the minimum wage so as to avoid large payments of social benefits.

As an estimate of the investment activity of the private sector we can use the change in the long-term credit. This is justified in view to the lack of capital markets in Bulgaria, so the firms cannot finance their investment projects through issuance of bonds.

Graph 7. Long term credit dynamics, as % of the total credit to the private sector. (stock, end of year)

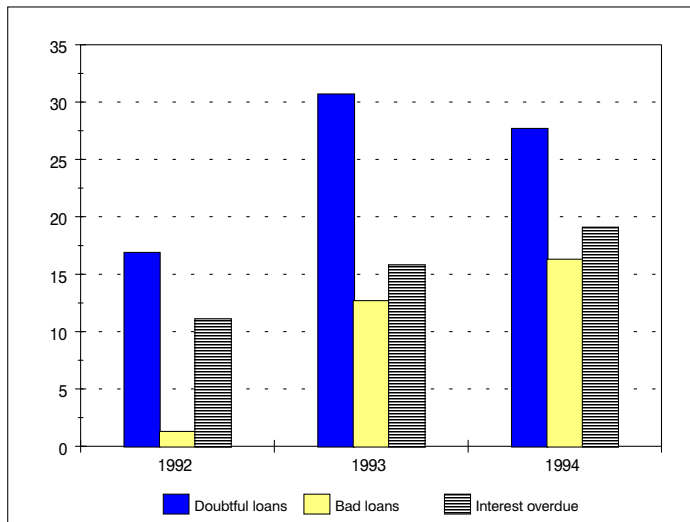


Source: BNB

Obviously, as a whole, private enterprises are not inclined to take investment loans and banks are not willing to extend such credits.

On the other hand, short term credit for the private sector grows at a very high rate. In 1994, claims of commercial banks on private firms account for 46.7% of the total credit for the real sector (government and households are excluded). This ratio seems inconsistent, having in mind that the private sector creates only one third of the gross value added. Naturally, the credit expansion increased sharply the share of the doubtful and bad loans.

Graph 8. Doubtful and bad loans of the private sector as % of the total credit.



Source: BNB

It can be seen from the data that in 1993, 59.2% of the claims on the private sector are irregular. In 1994, the share rises to 63.1%. Though some private companies experience difficulties with their operation and they are not able to pay off their debts, still there is a large number of entrepreneurs who borrow money from the banks with the intention

of not repaying the loans. Usually, such credits are not collateralized at all, or if they are, the collateral is of doubtful value.

The statistics reveals that at the end of 1994, the commercial banks had extended 35 975 credits in leva to private firms. Only 28 354 (less than 80%) of them are collateralized. In money terms, the difference between the total amount of the credit and the collateral is about 16 bln. leva. Foreign currency credits are in a much better position. The amount of the unsecured loans is 2.8 bln. leva.

Foreign currency loans were advantageous for the borrowers in 1992 and 1993 because of the relatively stable nominal exchange rate and high inflation rate. The share of foreign currency credit increased from 14.9% at the end of 1991 to 19.4% in 1992 and 35.2% in 1993. After the strong depreciation of the lev in 1994 a lot of debtors found themselves in a serious trouble and the share of the classified loans rose significantly. In 1993, 49.8% of the total amount of the doubtful loans was in foreign currency, while in 1994 the percentage went up to 69.6%.

Problems of the banking system.

The substantial amount of the non-serviced liabilities of the private and public companies reflects in the position of the banking system.

The large proportion of the nonperforming assets in the banks' portfolios, dispersed among a great number of banks does not allow for a radical solution of the problem with the bad debts.

To a large extent the difficulties of the commercial banks are a consequence of an incompetent management. However, sometimes deliberate actions stand behind the bad performance of the banking system. Extension of uncollateralized loans is a prominent example. Another example is the excessive binding of some commercial banks with their borrowers. The share of big credits in the assets of the banks increases. Apart from the large state-owned enterprises, who have traditional relations with some of the banks, more private firms become recipients of big credits.

These are represented mainly by the large business groups, who virtually drain the resources of the banks and make banks heavily dependent. (Of course, most of those credits become bad loans).

However not only the state banks are a target of abuse. Very typical is the case of a private bank, which was created with the purpose to extend credits to the firms of its founders and main shareholders. Huge amounts were transferred to such related organizations and as a result, the bank practically fell in insolvency.

These are only a few of the many problems of the banking system in Bulgaria but since our task is to find the place of banks in the framework of savings and investment, we have to point out that similarly to the state-owned enterprises and the recorded activity of the private sector, the commercial banks earn negative profits. The net loss of the banking sector in 1993 was 5 bln. leva and in 1994 -- a little below 7 bln. leva.

The negative financial results decapitalize the banking system. Some estimates show that the decapitalization in 1994 was around 80 bln. leva.

The policy of the BNB towards the commercial banks was not firm enough and could not introduce discipline. On the contrary, the increasing refinancing (though BNB declared many times that refinancing will be reduced and even stopped for some banks) created the impression that whatever the credit policy and the financial results of the commercial banks may be, the BNB will support them in any case. Several government decisions for transformation of bad loans into government debt played a considerable role for the worsening of the financial discipline as well.

The bad financial results of the banks caused a serious liquidity crises. Because of the incapacity of the commercial banks to cover their current expenditures with the current income from banking operations, they fell in need of fresh resources. Since these resources usually come from the central bank a considerable inflationary potential is being accumulated.

As an indicator of the liquidity difficulties may be regarded the circumstance that since the middle of 1994 the overdraft almost permanently exceeds the funds in the accounts of the commercial banks in the BNB.

The bad structuring of assets and liabilities in some banks adds to the problem.

The Budget.

After the beginning of the reform the role of the direct taxes in the budget revenues decreased. The share of the profit tax revenues in the total tax revenues of the republic budget in 1994 is only 14.6%. The budget increasingly relies on indirect taxes as a source of revenue. The share of the VAT in 1994 is 37.3% and that of the excise and duties --17.5% and 14.5% respectively.

The decline of the share of the direct taxes in the budget revenues is due both to the narrowing of the taxation base as a consequence of the stagnation in the economy and to the poor collection. The taxation policy also contributes to the bad performance of the budget revenues. The different treatment of the firms according to the form of ownership and type of registration placed the state-owned enterprises in a relatively unfavourable position since they had to pay bigger taxes and only a part of the interest paid was acknowledged as reducing the taxable profit. In 1992 50% of the interest payments were acknowledged and in 1993 the share was increased to 75%. The change was reflected in the higher ratio "profit tax paid/ profit tax due" for 1993.

Table 4. The ratio "taxes paid /taxes due", based on the NSI data for the state-owned enterprises.

	Excise tax	Turnover tax*/VAT	Profit tax
1992	87.7%	77.0%	66.3%
1993	96.5%	70.8%	71.2%
1994	89.6%	88.2%	70.1%

**For 1992 and 1993*

The primary balance of the consolidated budget was negative in 1993. The savings of the government for 1993 can be estimated as a difference between the primary deficit at the end of 1993 and the primary surplus for 1992, that is about -3 bln. leva. The primary surplus that was recorded in 1994 resulted in a positive change in the savings through the budget of about 29 bln. leva.

Conclusion

The analysis of the economic situation reveals a troublesome picture. The investment in real terms is permanently declining. The state-owned enterprises either do not have enough resources to invest, or their expectations for the future are adverse.

The private sector is not interested in investing because it can use the assets of the state-owned enterprises.

The savings, estimated according to the national accounts statistics, do not match the sum of the savings in the different sectors of the economy. For 1994 only the households and the budget appear to contribute to the increase of savings. The net disposable income⁷ of the enterprises from the public sector, which is used as a measure of the savings of the firms, was negative in 1994 (-30 bln. leva). The net disposable income of the accounted private sector was also negative (-1 bln. leva).

This means that the huge disagreement between the savings in the national economy and the savings of the different sectors may come either from misreporting, or from unaccounted activities. In support of the last assumption is the enormous discrepancy between the banking data and the NSI data. The unrecorded savings for 1994 can be roughly estimated to 5% of the GDP.

The unaccounted activities are not necessarily illegal although there are such examples. For instance, the positive effects of the embargo trade can be related to the illegal activities. However the majority of the cases refer to hiding income in order to avoid taxes. The government loses considerable potential revenues and this impedes fiscal policy.

The above conclusions cast some doubts on whether the positive real economic growth that was achieved in the last two years can be sustained. The huge disproportion's which come to light when different data are analyzed reveal a picture of a distorted and inefficient economy. The diffusion of property, the weak enforcement of existing legislation, and the lack of hard budget constraints create a perfect environment for the development of the informal sector.

⁷The net disposable income is calculated on the basis of the taxes due.