

## Regional Policy and Legislative Reform

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"The Yugoslavian case... demonstrates that structurally embedded economic warfare started years before the manifestly ethnically based political and military warfare we see now."  
*Carl-Ulrik Schierup*<sup>1</sup>

### Instead of Introduction

By regional policy is meant most often creating 'strategies for regional development'. Indeed, the strategies are the last thing to be made in terms of regional policy. First, institutional solutions to the structural disbalances of Bulgaria's economy should be found in the sake of increasing the domestic and overall mobility of factors of production (capital, entrepreneurship and labour). Otherwise any program would be artificial. Different regions are in unequal conditions in terms of income, living standard and own potential for economic and human development. With small exceptions (e. g. Sevlievo), the rule is that these disparities rarely turn into advantages. The main reason lies in the lack of economic freedom, in the conscious or unconscious supporting of non-freedom by political and legislative means.

### Prerequisites for Regional Policy

Most general prerequisites for regional policy are in the common status quo restrictions of any economic policy in Bulgaria, resulting from foreign indebtedness and unresolved domestic problems. I will focus on only three such prerequisites: the foreign debt, the fortune of loss-making companies, and ideas for infrastructural projects.

### Debt

At relatively probable economic development assumptions which include: the exchange rate Bulgarian Lev / US dollar of BGL 1,800/USD 1, though currently the EURO is depreciating; the real GDP growth for the next few years (under the condition that country overcomes external shocks as in 1998 and 1999) at the following schedule: 1999 – 2 %, 2000 – 3.5 %, 2001–2003 – 4.0 %, 2004 – 4.5 %; the consumer prices change at the following rates: 1999 – 1.9 %, 2000-2004 – 1.5 %, foreign debt to GDP and debt service developments are presented at the following tables.

#### Foreign Debt / GDP Ratio – 1999 – 2004 Forecast

Year	Gross Foreign Debt (m \$)	Amortization (m \$)	Nominal GDP (m \$)	GFD / GDP (%)
1999 (April)	8 661	-	12 742	68.0
1999 (year end)	9 074	420	12 724	71.3
2000	9 090	584	13 367	68.0
2001	8 878	812	14 110	62.9
2002	8 312	566	14 895	55.8
2003	7 775	537	15 723	49.4
2004	7 217	558	16 677	43.3

#### Foreign Debt Service

Year	Amortization (m \$)	Interest payments (m \$)	Total debt service (m \$)	Total debt service / GDP (%)
1999	420	463	883	6.9
2000	584	486	1 070	8.0
2001	812	523	1 335	9.5

<sup>1</sup> Carl-Ulrik Schierup. Prelude to the Inferno: Economic Disintegration and the Political Fragmentation of Yugoslavia. - In: Balkan Forum, vol. 1, N2, March, 1993, p. 90.

2002	566	479	1 045	7.0
2003	537	456	993	6.3
2004	558	443	1 001	6.0

In the medium-term perspective to the central budget expenditures should be added 2.2 % of GDP, which is the average yearly expenses for infrastructure investments (see further below). Because of the war in Yugoslavia, these expenses are one of the few sources of economic growth, the government would rather stick to them but not have resource for any additional programs. Because of the foreign debt service and the infrastructure projects, until 2002 any regional program, which counts on significant central subsidies, is doomed to fail, unless it matches with the respective projects of the infrastructure investment program. Another winning strategy for local development is financing, which is absolutely independent from the central redistribution. The foreign debt, however, remains the main obstacle before any expansion (on the basis of the current) local allocation of fiscal resources, and is a major medium-term restriction to fiscal decentralization.

### **Loss-making Enterprises**

The implementation of Financial Rehabilitation of State Enterprise Act has a dead-line, 30 June 1999. It is crucial for the success of the market reforms and the sustaining of financial stability.

The support of loss-makers requires state subsidies and quasi-subsidies. The following instruments were used for this purpose in the last two years:

- Extension of temporary financial assistance (direct subsidy);
- Increase of the stock capital in favour of the state (indirect subsidy);
- Non-payment of taxes and other duties to the state (indirect subsidy);
- Non-payment to suppliers – state companies, which in turn do not pay their duties to the budget (indirect subsidy);
- Exemption of taxes, tariffs and other state receivables (indirect subsidy);
- State guarantees on credits (indirect subsidy).

The arguments for diminishing and restricting this set of policies are the following.

The subsidies and quasi-subsidies redistribute income from all tax payers to a small group, which produces losses. This is obviously unfair and will make the people not to pay taxes. If this continues the financial stability will last no longer because of the increased budget deficit and deteriorated balance of payments.

The write off tax duty is direct increase of the budget deficit, so less taxes are paid than expected (at the moment tax arrears are bigger than the projected budget-buffer of BGL 240 bn.)

While, the non-payment of social insurance minimize the NSSI budget, which in order not to stop the pension and assistance payments, should get sources from state budget, and this again will increase the deficit.

On the other hand, the consumption increases through maintaining of artificial employment in non-functioning enterprises, which increases imports of consumer (not investment) goods and decrease the resources of domestic output and investment.

Only the group B enterprise total liabilities are BGL 911 billion at the end of 1998. The increase is by 315 compared to 1997. The liabilities to suppliers (mainly NEC and Bulgargas ) are BGL 418 billion., the direct liabilities to the budget and NSI reached BGL 96 billion NEC and Bulgargas act as institutions of commodity credit. But on their turn they pile liabilities to the budget and NSSI. The loses of the same enterprises increase from BGL 23.7 billion at the end of 1997 to BGL 167.7 billion at the end of 1998. In another words:

- only loses need by 55, 220 from each working tax payee in other private and government enterprises;
- the total debt ( as far as the budget covers it) is about 300, 000 (a month and a half payment) per working person.

### **New unemployment**

No matter how clear are the reasons for decisive law enforcement by the end of June, workers lay offs, workers who are not guilty for the present condition, would obviously follow. Besides political issues, this is a factor which every regional policy need to take into account. The effect for the different regions will be absolutely different, because it depends of special circumstances: mostly of the region size, for alternative employment possibilities - respectively the status quo employment level). According to Center for Territorial Development and Housing Policy, in Madan the unemployment is expected to reach 36%, in Ispirich and Devnja - 28, Chiprivzti - 27 and Cherven Brjag - 25%. But in total we talk about 4, 000 new unemployment. In Bobovdol the lay off of about 890 workers will increase the unemployment level from 3.4 to 18.3 to 100. (In Sofia and Pernik 12, 000 lay off workers will increase the unemployment from 3.5% to 5.7%)

As a result of the legislative reform of 1998 and 1999, the healthcare, social insurance and assistance, and the primary and secondary education were entirely or partly taken out of the scope of the direct municipal responsibility. The budgets seemed to be centralized. But this, however, does not cancel the circumstances, that they are again the ones who takes the indirect cost for the new unemployment problem. The choice is both simple and very complex: either to hang again on the central budget pump, or to own option for growth and prosperity

### **Growth and investment program**

There are three general concept of economic growth: income driven; government investment driven; and export (competitiveness) driven. Most of Bulgarian governments in 1990-1998 period were advocating the first, while silently implementing the third through different quasi-fiscal subsidies (via electricity and energy prices, and debtor protectionism). Quasi-fiscal subsidies were discontinued with the introduction of CBA and the 3-year agreement with IMF.<sup>2</sup> Living standards in Bulgaria remain low compared to most eastern European countries and below pre-crisis levels of 1995.<sup>3</sup> Respectively, domestic demand remains low and is not expected to contribute to competitiveness. Direct or indirect fostering the income (e.g. via remuneration of workers in government investment projects) would rather be channeled to cover delayed consumption, not investment.

In 1998, the current Bulgarian cabinet became a proponent of some sort of government led growth believed possible via budgetary investment in infrastructure and public works. This concept was believed to be, and was advertised as, a Bulgarian edition of F.D. Roosevelt's New Deal, without proper knowledge of US developments in the 30's but backed by the ambition to spent US \$ 6.1 billion between 1998 and 2001. IMF negotiation have reduced the ambition to the commitment to match private sector investment with not more than 2.5% of annual GDP (or around US \$ 0.8 billion for the entire period), if and only if private sector comes first. Eventually, the concept was redesigned. Currently, the government Programme for Investment in the Public Sector for the period 1999-2001 envisages total USD 3,948, of which, roughly, 1/3 from the consolidated state budget and 2/3 from the so called state-owned business entities. (An additional input of USD 1.3 billion is expected via concession contracts to implement projects of "national significance".)<sup>4</sup> Respectively, in 1998, corporate tax laws were amended to facilitate investment through state-owned enterprises.

It is not yet clear how and why domestic and foreign private sectors would identify their own participation opportunities. Envisaged investment overall for the period is around 16.7% of GDP. Of them 6.8% by the public sector (i.e.: 3.3% from the state budget, 3.3 from concession contracts, and 1.4% grants). Private sector contribution is expected at 9.9% of GDP, or 30% higher than the public sector.<sup>5</sup>

International programs are invited to play a significant role, through by-lateral agreement with UK, Denmark and Switzerland, via US TDA, EU PHARE, PHARE-CBC, IPSA, SAPARD etc.

The war in ex-Yugoslavia may put a question mark on 1999 GDP growth projection. But 65% of the envisaged nominal growth is due to the above summarized central government investment program (mostly infrastructure). The risk here is in the difficult design of the program: it intention is to match private

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<sup>2</sup> See for details: Krassen Stanchev, Three-Year IMF Agreement for Bulgaria, IME Newsletter, vol., 5, No 7-8, pp. 1-4.

<sup>3</sup> OECD Economic Surveys 1998-1999: Bulgaria, Paris, OECD, 1999, pp.: 54-57.

<sup>4</sup> Medium-Term Investment Programme of the Republic of Bulgaria: 1998-2001, Council of Ministers of Bulgaria, 1998, p. 5.

<sup>5</sup> See: Program and Policies for Investment Growth 2001: Macroeconomic Environment, A document of the Council of Ministers, 1999, p. 7 [in Bulgarian]. (I would like to acknowledge the readiness of the Government Information Service to disclose this document for the purposes of this reflection of possible public/private partnerships.)

investment while the cabinet has little skills in co-financing and procuring out services. 3.7% growth of GDP should be corrected to 1.5-2%. Rules for public procurement are not well-suited to serve the volume of the program. A new public procurement bill is pending in the parliament committees, and will be adopted in the second half of 1999. The war is likely to speed up some of the projects, e.g. road (and bridge) construction to Romania and Greece - pan-EU corridor IV) but put on hold other important investment (e.g., pan-EU corridors X and VIII<sup>6</sup>).

One of the infrastructure key problems is procurement regulations, including concessions. These regulations are just being created. For their normal functioning, an administrative adjustment period is necessary. Foreign financing will accelerate implementation of good practices. Bulgarian companies cannot be competitors to leading EU companies, but can be successful sub-contractors. In five-year term, company structure in the sector, will be dominated by mixed and joint venture companies.

## **Practical Requirements**

The main aim of the Investment Program is establishment of big and economically reasonable infrastructure projects. Their realization by local or even foreign private companies is quite problematic, especially in short term, and with the presently increased political risk on the region.

It should not be considered, that public investment aims at employment creation in particular region.

It should also not be forgotten, that public resources are tax-payers money. Investment projects must be selected, based on economic effectiveness and sustainable restoration, not on the fact whether a region has suffered structural reforms.

One should not, also, rely on the investment program alone to create permanent employment. What could be achieved is a temporary employment for the projects' duration period, and on the one hand, and creation of new opportunities for private business due to the improved infrastructure.

The construction of a transit highway will create jobs in the sphere of tourism, trade and the supply of services due to the intense traffic in the region. Hungarian experience shows that if there is no positive impact on a 30 - 50 km zone the highway is financially useless by itself. In Vidin (where the unemployed ratio is expected to reach 15% ) there is no bridge to Kalafat not because of bad people not allowing to be built. The reason is in the lack of trade between the two regions and the two countries; so, everybody tries to "shear" a rent on the transit. The simple evidence for this statement is the timetable of the ferries as well as the intentionally complicated procedure for border - crossing.

There should be a will for realization of economically reasonable projects only, not of such just creating employment in the seriously affected regions. Otherwise, after the projects' end the unemployment will rise again and we enter a vicious circle.

The programs for temporary employment should be approached carefully, too. About 1/3 (or 13,500) of the newly unemployed will be in Sofia and Pernik but about 10% in the Varna and Bourgas regions. Having in mind the low at the moment - under 4% - unemployment in the three regions' centers as well as the strong business activity of the private sector in the services supply, trade and tourism in these regions, we can hardly state that the liquidation there will have serious and long-lasting social consequences. It is most likely that the private sector will absorb the unemployed in relative short terms - 6 to 12 months. Before the set up of programs for temporary employment the potential of the private sector to take up the free working force should be studied profound by analyzing the past experience of similar programs. An example for poor realized program is the one for creating a temporary employment in Varna within the UNDP project "Beautiful Bulgaria" where it turned out that there are no candidates for participation and they had to transport workers from the neighborhood municipalities.

## **Mobility**

When the capital is not mobile, such to certain extent can be the workforce and the entrepreneurship. The population mobility is a positive, not a negative factor of economic development. In some cases, people will just have to move to the neighbor town where the possibilities to find a job are better. Such decision is

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<sup>6</sup> Respectively: Central Europe - Istanbul, and Black Sea - Albania's Adriatic coast.

probably the best for the Haskovo region where will be about 25% of all unemployed due to the structural reform. In the region investments are foreseen for construction of the Maritza - Highway (Orizovo - Kapitan Andreevo), electrification of the Plovdiv - Kapitan Andreevo railway, restoration of Maritza Iztok mines and the regional mobility will to a relative high extent neutralize the effect of closing several big enterprises.

The government should support institutionally the mobility of capital, entrepreneurship and workforce. In order to do this it should support at least the market of land and real estates which are a very important factor for the population mobility. The housing financing in rudiment state. In the Parliament, a draft law that can initiate mortgage financing still mellows.

It is hardly possible to create financial preconditions for capital mobility, subsidies, guarantees, interest, etc. the capital will move wherever economic opportunities are. Though, it is very important to specify "capital". It is not just money. It is all created by men resources that enhance production in the future. This is why it is very important to remove non-financial barrier for conducting business, rather than establish centralized institutions for local and foreign investment re-distribution.

### **Regulations and Decentralization**

The following conclusion is in place: any delay in general market reforms reflects in aggravation of economic environment in the country, particular regions, households. Such a delay may be result of:

- abolishing the Currency Board regime and resuming money printing for covering deficits;
- increasing tax burden;
- increasing sovereign debt.

All options will have far bigger negative effect on the economy that liquidating non-performing enterprises. The best way should be immediate liquidation of those enterprises from the Financial Recovery Program list for which no buyer is found. After selling their assets, at least some of the budget liabilities will be covered. Another result from the liquidation process will be identification of operational activities within non-performing enterprises, followed by rapid privatization. Experience (from Kremikovtzi, Himko Vratza, and Balkan Airlines) proves privatization am-block to be slow, sometimes impossible without debt remittance.

In practice, any real economic freedom, decentralization of mechanisms for economic and financial decision-making, competition between different regions, remains left aside in all reforms planning.

Current financial relations between central and local budgets create a system of inefficient economic behavior:

- there is competition for subsidies from the central budget, rent-seeking instead of development - actually a dozen municipalities credit the rest;
- financial resources exchange between central and local bodies is overgrown with behavior "boss-knows-better";
- finally, it becomes easier and painless to remain poor.

Centralized appointment of Regional Governors, by mutual consent of all political parties, will soon turn out to be a quite expensive decision, which leaves little room for local initiatives and hampers development. An additional obstacle is the centralized electoral system.

According to the Bulgarian Constitution, autonomous entities are prohibited. Also, there is a prohibition for foreigners to buy land. Foreign investment are hampered by bureaucratic barriers. If this environment remains, interrelation between different regions and present possibilities will be limited.

Solving regional discrepancies does not necessary mean richer regions to become less rich, in order to equalize with the rest. Equality in development is utopia; what is possible - is creating more chances for development.