

**Contract #:** RSS 993/1999 - Yordanka Gancheva

**Institution:** Institute for Market Economics

**Phone/fax, e-mail:** ++359 2 980 2472; ++359 2 981 2975; dany@ime.bg; ime@omega.bg

**Project:** *Rules, Regulations and Transaction Costs in Transition Bulgaria*

**Reporting time:** September 1999 - August 2000

## **Rules, Regulations and Transaction Costs in Transition Bulgaria**

### **I. Introduction**

This report presents the findings of a study made by Yordanka Gancheva, Researcher at the Institute for Market Economics, Sofia, within the framework of the project on *Rules, Regulations and Transaction Costs in Transition Bulgaria* funded under the Individual Research Support Scheme of the Open Society Support Foundation, Prague.

Both, the quantitative and qualitative approach were used in the study. The quantitative information was collected mainly by structured (closed-end) questionnaires and in-depth interviews.

The field work was carried out in March and April 2000 by the Agency for Social and Economic Analyses (ASA). The interviewees were managers, owners and chief accountants of 120 small and medium-sized businesses in 21 Bulgarian towns.

**The main objective of the study was to identify and estimate the transaction costs of small businesses in Bulgaria. This task is particularly important in view of the current macroeconomic realities in the country.**

Three years after the introduction of a currency board in Bulgaria, the economy is heading for a third successive year of moderate economic growth. If official statistical data is to be trusted, this or next year the real *per capita* income should reach its 1991 level. The forecasts are, that the *per capita* GDP in 2000 would amount approximately USD 1,600 or, in the event of purchasing power parity - USD 4,240. **However**, the problem is that official statistical data tends to be an ever poorer reflection of economic reality in Bulgaria. A number of studies<sup>1</sup> have confirmed the overall perception that the share of the shadow economy - *i.e.* those lucrative dealings which are not caught by either the National Statistical Institute, or the tax administration - is somewhere between 22 and 40%.

**We cannot be certain about the exact dimensions of the shadow economy, but seems it develops more dynamically than the registered economy.** This could mean two things: either a) the many newly-formed companies start operating in the shades, or b) companies having started in the daylight tend to go underground.

---

<sup>1</sup> See for example N. Nenovski and K. Christov, *A Study of Money in Circulation after the Introduction of the Currency Board in Bulgaria*, Bulgarian National Bank, May 2000. See also the report of a joint study of the Harvard Institute of International Development, Institute for Market Economics, and Agency for Economic Analyses and Forecasts, "*The Shadow Economy in Bulgaria*".

Generally, the reason is that the transaction costs of operating in the daylight grow as compared to the costs of operating in the shades. **Hence, the identification, measurement and reduction of transaction costs would be critical in curbing the "grey" segment of the Bulgarian economy.**

The present study focuses on the transaction costs of *small and medium-sized enterprises in the private sector*. There exist many reasons to choose them, but I would like to point out here only the following:

- by National Statistical Institute data, in 1998 there were 515,869 active private economic entities in the country, out of a total of 538,161 (96%);
- again, by data of the National Statistical Institute, the private sector share of GVA (Gross Value Added) was 63.75% in 1998, and 65.35% in 1999;
- according to official statistical data, out of a total of 3,071,913 persons employed in the economy in 1999, 63.26% were employed in the private sector. This percentage, however, must have been much higher in reality due to the informal labour market in that sector;
- according to statistical data, nearly 99% of Bulgarian private enterprises meet the definitions of "micro-enterprises" or "small enterprises" according to definitions of the Law on Small and Medium-sized Enterprises;<sup>2</sup>
- the on-going process of privatisation gives rise to the assumption that the private sector should prevail in the future also. For that reason, it is very important to identify and estimate the transaction costs in that sector. That would enable us to eliminate or at least reduce these costs at a later stage. It would promote production and increase the price competitiveness of firms and the volumes of exchange. And these are three out of the seven main sources of economic growth defined by Professor Gwartney and Professor Stroup.<sup>3</sup>

In order, however, to identify and estimate transaction costs, we should first of all define the underlying concept of "transaction cost".

It is well known, that the theory of transaction costs develops incessantly and no standard terminology exists yet. There are numerous and diverging definitions of transaction costs.

For instance, Kenneth Arrow<sup>4</sup> defines transaction costs as "the costs of running the economic system".

Yoram Barzel, though defines these costs as "the costs associated with the transfer, capture and protection of rights", while Trainn Eggertsson observes: "In general terms, transaction costs are the costs that arise when individuals exchange ownership rights to economic assets and enforce their exclusive rights. A clear-cut definition

---

<sup>2</sup> The Law on Small and Medium-sized Enterprises defines micro-enterprises as small enterprises employing up to 10 persons on average; small enterprises are those employing up to 50 persons on average, and medium-sized enterprises are those employing up to 100 persons on average.

<sup>3</sup> See James D. Gwartney and Richard L. Stroup, *What Everyone Should Know About Economics and Prosperity*, 1993.

<sup>4</sup> All citations used on this page were quoted by Alexandra Benham and Lee Benham in *Measuring the Costs of Exchange*, presented at the Second Annual Meeting of ISNIE, September 17-19, 1998, Université de Paris I.

of transaction costs does not exist, but neither are the costs of production in the neo-classical model well defined".<sup>5</sup>

Eirik Furubotn and Rudolf Richter consider that "transaction costs include the costs of resources utilized for the creation, maintenance, use, change and so on of institutions and organizations. When considered in relation to existing property and contract rights, transaction costs consist of the costs of the defining and estimating resources or claims, plus the costs of utilizing and enforcing the rights specified. Applied to the transfer of existing property rights and the establishment or transfer of contract rights between individuals (or legal entities), transaction costs include the costs of information, negotiation, and enforcement". Furubotn and Richter recognise two forms of transaction costs: *fixed* transaction costs, that is the specified investments made in setting up institutional arrangements, and *variable* transaction costs, *i.e.* costs that depend on the number or volume of transactions.

Professor James D. Gwartney and Richard L. Sroup define transaction costs as the time, efforts and other resources necessary to search for, negotiate and carry out an exchange.<sup>6</sup>

Based on existing definitions, **the concept of transaction costs** for the purposes of this study **has been defined most generally as “the costs of time and financial resources needed to enter, operate in or get out of business which result from the regulatory framework and the interaction of firms with public institutions”**.

## **II. Business regulations and transaction costs**

In an interview for ISNIE Newsletter,<sup>7</sup> Ronald Coase said: "**The relation of economics and law is the most interesting part of New Institutional Economics. Unfortunately, that part of the relationship of economics and law which analyses the legal system has gone ahead much more than that part of the subject which deals with the effects of the legal system on the economic system. That is to say, what people have done is to use economics to study the legal system rather than discuss how changes of the law affect the actual way the economic system operates**".

Being in full agreement with Professor Coase's statement, I intend to highlight the link between existing business regulations, their enforcement and the transaction costs of firms in Bulgaria.

---

<sup>5</sup> Eggertsson continues: "When information is costly, various activities related to the exchange of property rights between individuals give rise to transaction costs. These activities include:

1. The search for information about the distribution of price and quality of commodities and labour inputs, and the search for potential buyers and sellers and for relevant information about their behaviour and circumstances;
2. The bargaining that is needed to find the true position of buyers and sellers when prices are endogenous;
3. The making of contracts;
4. The monitoring of contractual partners to see whether they abide by the forms of contract;
5. The enforcement of a contract and the collection of damages when partners fail to observe their contractual obligations;
6. The protection of property rights against third-party encroachment - for example, protection against pirates or even against the government in the case of illegitimate trade."

<sup>6</sup> See James D. Gwartney and Richard L. Sroup, *What Everyone Should Know About Economics and Prosperity*, 1993.

<sup>7</sup> *Spring 1999 Issue*.

Over the period 1998-1999 only, the Bulgarian Parliament passed 314 laws. According to IME experts, 107 of those legal instruments affect directly or indirectly the public sector growth.<sup>8</sup>

Although the Rules of Organisation and Work of the Bulgarian Parliament provide for a regulation impact assessment to be made of every bill, no such assessments are carried out in practice. **As a result, many regulations in the country give rise to transaction costs and, even worse, these costs are often completely unnecessary or hidden** Numerous instruments of primary or secondary legislation could be used as examples here but let us take only two of them: the Law on Re-denomination of the Lev and Ordinance No. 4 of 16 February 1999 on Registering and Reporting Sales in Commercial Outlets.

The Law on Re-denomination of the Lev<sup>9</sup> is a very good example for such hidden or irrational transaction costs. In 1997, an amendment to the Commercial Code required all limited liability companies, joint-stock ventures and commandite partnerships with shares to increase their fixed capital. The existing companies of these three forms were obliged to bring their capital into line with the new statutory minimum and notify this change to the Commercial Register. Only 10 months later, the Law on Re-denomination of the Lev put the same companies under an obligation to notify the Commercial Register of the changes in their capital resulting from the re-denomination of the domestic currency.<sup>10</sup> That obligation was enacted despite the explicit provision of s. 2, subs 3 of the Law on Re-denomination of the Lev that "re-denomination shall take place by operation of law and shall not necessitate any express statement on behalf of the individuals or entities affected thereby". The view that the second notification (resulting from the re-denomination) would be free as the Law on Re-denomination (paragraph 5(2)) read that no stamp duties and fees for publication in the State Gazette would be collected, was more than groundless. Those fees form only small part of a company's transaction costs. According to the Commercial Code, the capital of a company of one of the three types mentioned above must be changed by resolution of the General Assembly of members (shareholders). The resolution must be put down in minutes on the basis of which an application is filed with the Company Division of the competent court to enter the change in capital in the Commercial Register. The costs of convening<sup>11</sup> and holding a General Assembly meeting, and for preparing and filing the required documents amounted to at least 6,062,632 Levs.<sup>12</sup> In other words, the "free-of-charge" re-denomination of the capital cost Bulgarian companies 0.03% of the GVA in the country's economy in 1999. The Law on Re-denomination was passed during the Kosovo crisis when it was already clear that the

---

<sup>8</sup> See IME, *Legal and Legislative Reform: Impact on the Private Sector*, IME Newsletter, issue March-July, 2000.

<sup>9</sup> By virtue of the Law on Re-denomination of the Lev, as from 5 July 1999 the Bulgarian Lev was denominated, with 1,000 old Levs equalling 1 new Lev.

<sup>10</sup> See paragraph 5, Transitional and Final Provisions.

<sup>11</sup> In the event of a public limited company and commandite partnership with shares, the general assembly of shareholders is convened by an invitation published in the unofficial section of the State Gazette. Every such publication cost 22,500 old Levs.

<sup>12</sup> The amount was calculated based on NSI data on average monthly wage in the country in 1999 - 205 Levs. The number of active commercial companies in the same year was 44,516 limited liability companies; 27,328 single-member limited liability companies, 5,324 joint-stock companies, 667 single-member joint-stock companies; 7 commandite partnerships with shares. Other factors taken into account in making the calculation were the minimum legal fees prescribed by Ordinance No. 1 on the Minimum Fees of Barristers (issued by the Supreme Council of the Bar), and the minimum rentals for halls where the meetings of the general assemblies took place. For further details on the methodology of calculations see Yordanka Gancheva and Ivaylo Maznev, *Firm Costs to Remove the Zeros*, Capital Weekly, 20 June 1999.

Bulgarian economy would suffer losses. Likewise, after June 1999, it was crystal-clear that GDP had gone down by 0.6-0.7% in the first quarter of 1999, and many economists were sceptical about the ability of the economy to catch up. **Then, was it logical at all to spend funds equal to 5% of the decrease already registered in order to carry out an entirely formal operation?**

In addition, re-denomination brought about other direct transaction costs, *e.g.* the recalculation of all accounting entries in new Levs, compulsory accountancy closing as at 5 July 1999, resetting all accounting software applications and all tills with fiscal memory,<sup>13</sup> etc. Finally, all companies were bound to display the prices of their products parallelly in old and new Levs until the end of 1999 which meant, if not large money outlays, at least higher costs in terms of time and efforts.

The above-described transaction costs caused by the re-denomination were not only devoid of any rationale. They also amounted to a clear-cut loss of firms' resources that could have been spent on other operations, including investments.

Another example along the same lines is the Ordinance on Registering and Reporting Sales in Commercial Outlets.<sup>14</sup> Section 2 of that instrument reads that every individual or entity subject to tax registration and carrying out sales of goods or services in a commercial outlet, as defined in the Ordinance, must register and account for those sales by way of issuing till receipts from a fiscal device, unless payment is effected by bank transfer.

As a matter of fact, the till devices with fiscal memories proved to facilitate nothing else but the work of and control by the fiscal authorities. The installation of those devices entailed myriad of unnecessary transaction costs, *e.g.*:

- Section 36 of the Ordinance obliged each firm to have a service maintenance contract with an authorised company. This resulted into absolutely useless transaction costs. The price of service maintenance varies between 20 and 240 Levs per year. In reality, however, this is the price of the contract itself which is entered into solely with the aim to avoid the fine under s. 48 of the Ordinance which is from 500 to 2,000 Levs. The prevailing practice is that service maintenance contracts do not include regular checks of the till devices and any repairs outside the warranty period or in the event of non-recognition of the warranty must be paid separately. In brief, the entrepreneurs do not pay in order to obtain a service in future but in order to get hold of the document itself;
- Section 4, subs 2 of the Ordinance obliged the persons with an average daily turnover exceeding 500 Levs (over a three-month period<sup>15</sup>) to acquire and register a back-up fiscal device that should be used, if the main device is out of order or under repairs. This means that every entrepreneur must own a back-up till device and enter into a service maintenance contract for that device as well, though he might never use

---

<sup>13</sup> By calculations of the Institute for Market Economics, only the resetting of the tills with fiscal memory cost nearly 2 million new Levs.

<sup>14</sup> Ordinance No. 4 of 16 February 1999 on Registering and Reporting Sales in Commercial Outlets, issued by the Minister of Finance, published SG, issue 16 of 23 February 1999, amended, issue 55 of 18 June 1999, in force as from 5 July 1999, amended and supplemented, issue 113 of 28 December 1999, issue 4 of 14 January 2000, supplemented, issue 16 of 25 February 2000, in force as from 25 February 2000.

<sup>15</sup> Except for outlets, where liquid fuels are on sale.

it. Besides, if the permit to use both the devices is not renewed five years later, the entrepreneur will have to purchase and install two new devices. This requirement is in fact unnecessary, as the entrepreneur is entitled to issue cash receipts from a stub certified by the competent tax service in the event of power failure or if the electric till is under repairs;<sup>16</sup>

- According to s. 13, subs 3 of the Ordinance, the certificate of worthiness of the type of fiscal device shall be issued for a period of 5 years and there is no guarantee that it will be renewed on expiry. Thus, a fiscal device, though perfectly worthy and well-functioning, would have to be changed five years later if the permit for its use is not renewed. Let us not forget that the cheapest fiscal devices cost 250 Levs and this not an immaterial expense for small merchants like most of the sellers at stalls and tables in the street. The existing requirements virtually encourage the transfer of operations into the "shadow" sector.

The table below compares the mandatory particulars of primary accounting documents (as laid down in the Law on Accounting) and the particulars of a fiscal till receipt required by Ordinance No. 4:

No.	Particulars of primary accounting documents required by the Law on Accounting (s. 8)	Particulars of fiscal till receipt required by the Ordinance on Registering and Reporting Sales in Commercial Outlets, (s. 23, subs 2)
1	Title of document	Text "fiscal till receipt"
2	Name, address and tax number of issuing enterprise	– Name, registered office and address of management of issuing enterprise; – Tax number and BULSTAT number of person/entity in question
3	Name, address and tax number of enterprise with which the economic operation is carried out and names of its representative	
4	Place and date of issuance;	– Name and address of commercial outlet; – Sequential number of till receipt; – Date of issuance;
5	Christian and family names of the persons having issued document;	Name and number of cashier/teller
6	Grounds and subject matter of the economic operation	
7	Description and value of economic operation	– Name, quantity and price by type of goods or services purchased; – Total purchasing price.
8	Signatures of the persons in charge of carrying out and documenting the economic operation. If primary accounting documents are issued by way of automatic processing and the primary accounting information is not stored in a paper format, the signatures are to be replaced with identification codes.	– Name and number of cashier; – Individual numbers of the fiscal device and the fiscal memory.
9	Seal of enterprise (when invoices for sales are issued)	

Section 11 of the Law on Accounting stipulates that an accounting document not containing all the particulars listed in the Law cannot be used as evidence. The table clearly shows that the sole data missing in a fiscal till

<sup>16</sup> Section 37 of the Ordinance lays down the following time limits for repairing fiscal devices: 2 working days in cities and 4 working days in villages; if the fiscal memory needs to be repaired, the duration of repair works should not exceed 5 days.

receipt are those about the recipient and the grounds and object of the economic operation (a seal can be affixed to a till receipt as well). In return, the fiscal receipt contains far more data about the issuer of the document and this is much more important in the event of a tax audit than, say, the grounds or type of economic operation. Nevertheless, a fiscal till receipt does not meet the requirements of the Law on Accounting and, hence, cannot be used as evidence.

If this is added to the examples given earlier, it becomes much easier to see the absurdity of the prevailing portion of transaction costs incurred by merchants under Ordinance No. 4. It is also much clearer that this Ordinance obviously has no other purpose, but facilitate the fiscal authorities.

Another example of unnecessary and illogical transaction costs is supplied by Ordinance No. 2 on Categorisation of Tourist Outlets. Section 10, subs 6 thereof provides that if a tourist outlet changes hands, the new owner must file an application for the award of category following the general procedure laid down in the Ordinance. This means that the acquirer must pay a fee between 200 and 2,000 Levs on average (if the outlet is a hotel or another accommodation facility) or between 90 and 1,100 Levs (when it is a catering or entertainment). With all due respect, I fail to grasp the idea behind this procedure. The requirement gives rise to nonsensical costs since, if an outlet has once been awarded a category, this means the *outlet* meets the conditions laid down for that category and this has nothing to do with the owner. A five-star category is awarded to a hotel, not to its owner! Why should then the new owner apply again so that the same outlet to be given a category?

The temporary effect of various permits issued by the Administration is another serious source of costs. For example, Ordinance No. 2 (quoted above) says that a certificate of the category awarded to an outlet shall be issued for a period of three years. If the owner continues to carry out tourist operations in the outlet thus categorised, he must file, before expiry of the three-year period, an application for the outlet to be categorised anew under the general procedure. In other words, the owner - again - pays a fee and submits copies of documents at least 30% of which establish unchangeable facts, *e.g.* the BULSTAT registration number and the permit to use the outlet. Such transaction costs could be regarded as quasi-taxes and the entrepreneurs often resist their burden by way of tax avoidance and evasion.

**Frequently enough, the legislative rules transfer costs of applying and enforcing the existing regulations to the entrepreneurs themselves.** An impressive abundance of examples to that effect can be found in all instruments providing for the issuance of different licenses and in numerous other acts. Thus, the Ordinance on Ceiling Prices of Medicinal Products Permitted for Consumption in the Event of Retail Sales introduces a ceiling price for any medicinal drug to be complied with by the manufacturer, plus fixed profit margins for wholesalers and retailers. However, the costs of registering the "ceiling price" are transferred mainly onto entrepreneurs. A manufacturer must file an application for registration of this price at the Commission on Drug Prices with the Ministry of Public Health and justify his request at his own expense. As the Ordinance requires that the maximum price quoted by a manufacturer should not exceed the lowest registered price in a Member State of the Council of Europe, the applicant must study prices registered in all those countries and provide the Commission on Drug Prices with the relevant information. A manufacturer is entitled to change registered ceiling prices not more than twice in a calendar year, getting through the same procedure laid down for the initial registration. Those statutory requirements go counter to any market logic. Along the same lines,

subsections 1 and 4 of s. 9, which are just ten lines apart from each other, are mutually contradictory.

To be more precise, s. 9, subs 1 provides that within 14 days as from receipt of the proposal made by the Commission on Drug Prices, the Minister of Public Health shall issue an order to register the ceiling price or *refuse registration while stating reasons*. Out of the blue, however, subsection 4 provides that the failure of the Minister to pronounce within the time limit set by the ordinance shall be deemed a tacit refusal. No doubt, the reader would see here the same conundrum as me: **how could a tacit refusal be tacitly reasoned?!?**

We could also add the fact that according to s. 9, subs 2, the Minister of Public Health may *by derogation* register a ceiling price higher than the lowest price registered in a Member State of the Council of Europe. In this case, both the total inconsistency of the Ordinance, and the discretionary powers of the Executive come to the fore. The Ordinance fails to list the cases in which a derogation is to be allowed. Hence, the administration is able to make decisions on a completely discretionary basis and those decisions could be influenced in all sorts of manners, bribery being one the best known.

**This Ordinance is just one example of how imperfect and inconsistent regulations can impede the process of enforcement, corrupt the environment and push up the transaction costs of the firms operating in the country.**

Further to a detailed review of the existing legislation which affects business environment in Bulgaria, the following main groups of transaction costs were identified as stemming from the existing legal rules and the interaction with the bodies of public administration:

1. Firm registration costs;
2. Costs to obtain a license, permit for or registration of the business to be carried on;
3. Operating costs relating to:
  - legislative amendments;
  - access to lending;
  - search for and supplies of needed raw materials, goods and services;
  - office maintenance and product marketing;
  - labour market and social security legislation;
  - audits / inspections and reporting;
  - payments to the Treasury;
4. Contractual costs (entering into and performance of contracts);
5. Transformation and exit costs.

### **III. Methodology**

After the groups of transaction costs were identified, a questionnaire was compiled with a view to estimating these costs. In order to provide a sound basis for comparison, some of the questions asked in the survey

conducted by IME in 1996 were repeated<sup>17</sup> (let us remind that the survey of 1996 remains the only attempt to date to estimate transaction costs in Bulgaria).

The working definition adopted in the beginning and many of the other existing definitions of transaction costs were used to divide the questionnaire into four sections:

- A. Entry costs;
- B. Operating costs;
- C. Contractual costs (entering into and performance of contracts);
- D. Transformation and exit costs.

Interviews were conducted with 80 micro-firms and 40 small firms in 21 district centres of Bulgaria.<sup>18</sup> The number of firms in the different towns was determined *pro rata* to the total distribution of small and medium-sized businesses throughout the country.

The sectors surveyed included light industry, trade and services, and my choice was based on the following considerations:

- by data of the Unified State Registry of Economic Units (BULSTAT) there are 538,161 active economic entities in the country; 82% of them deal with, respectively, production (6%), trade (53%) and services (23%);
- by NSI data, the share of the three sectors in the gross value added in the private sector was 73% in 1999.

Based on data from the National Statistical Institute on the number, sectoral structure of and employment in small and medium-sized enterprises in Bulgaria, the sample was prepared for the sociological poll.

Table 1 shows the number of firms interviewed by sector, town and number of employees.

**Table 1**

	<b>Number of firms interviewed</b>
<b>Total</b>	<b>120</b>
<b>Prevailing business sector</b>	
Production	<b>32</b>
Trade	<b>70</b>
Services	<b>18</b>
<b>Town</b>	
Sofia	<b>21</b>
Large district centre (Plovdiv, Varna, Bourgas, Rouse, Pleven)	<b>36</b>
Smaller town	<b>63</b>
<b>Number of employees</b>	

<sup>17</sup> Respondents were 108 owners of private firms in Sofia, Plovdiv, Varna and Silistra. The sample was extracted on an accidental basis with a subsequent balancing to take account of the structure of the economic sectors (based on data of the National Statistical Institute), and is representative of the private firms in these cities.

<sup>18</sup> Interviewed were 120 representatives of private firms in Sofia, Plovdiv, Varna, Bourgas, Rouse, Pleven, Assenovgrad, Kazanluk, Doupnitsa, Turgovishte, Gabrovo, Pazardzhik, Silistra, Shoumen, Smolian, Kurdzhali, Vidin, Yambol, Haskovo, Dobrich and Stara Zagora.

Micro-firms (1 to 9 employees)	78
Small firms (10 to 49 employees)	39

The units of measurement most frequently used in the analysis are "percentage", "arithmetical mean" and "median".

The *percentage* shows the portion of interviewees having answered a question in a given manner. In some cases the total exceeds 100% as several answers were allowed.

The arithmetical mean is an mean value of the valid cases, whereas the median is a middle value with an equal number of values below and above it in a given set of values, *e.g.* number of licenses, number of days spent, number of visits to various institutions, etc. The median corresponds to the fiftieth cumulative percentage and is appropriate in sets with highly variable values (or standard deviations). Unlike the arithmetical mean, the median neutralises the effects of the highest and the lowest values.

#### **IV. The sociological poll: results analysis**

The results of the sociological poll are divided in the same sections as the questionnaire and, for the sake of clarity, bear the same titles.

##### **IV.A. Entry costs**

The entry transaction costs may be divided into two main groups:

- firm registration of the merchant,
- and
- obtaining a permit to carry on the business. The permit is labelled differently depending on the type of business.

##### ***IV.A.1 Firm registration of merchant***<sup>19</sup>

For the purposes of this study, "firm registration of the merchant" is taken to mean the process starting with booking a business name at the National Statistical Institute and ending with entry in the tax register.

The data from the sociological poll shows that the process of firm registration takes 15 days on average. If an intermediary intervenes, the period is reduced immaterially to 14 days, instead of 15. The maximum period of registration - with or without intermediary - mentioned in a response was 90 days, while the minimum period was

---

<sup>19</sup> For the purposes of this report "merchant" denotes any entrepreneur carrying out by occupation any of the activities listed in s. 1 of the Commercial Code, *viz.*: purchase of goods or other chattels for resale either in their original form or after processing or treatment; sale of goods manufactured by the merchant; purchase of securities for sale; commercial representation and agency; brokerage, shipping and transport transactions; insurance transactions; banking and foreign exchange transactions; bills of exchange, promissory notes and cheques; warehousing transactions; licensing transactions; supervision of goods; intellectual property transactions; hotel, tourist, advertising, information, programming, impresario and other services; purchase, construction or furnishing of real estates for sale; leases.

1 day. The minimum period stated in one of the answers is absolutely unrealistic. There is no possibility whatsoever for a company to go through all steps of the procedure described below for just one day.

Firm registration takes most time in Sofia, less time in large district centres and least time in small towns (see Table 2). The firms interviewed in this sample were registered between 1988 and 2000, with 1993 being the statistical median.

**Table 2: How did you register your firm and how many days did that take?: Responses grouped by town.**

<b>Without intermediaries: how many days?</b>	<b>Total</b>	<b>Sofia</b>	<b>Large District Centre</b>	<b>Smaller Town</b>
Arithmetical mean	21.74 days	31.4 days	22.93 days	18.51 days
<b>Median</b>	<b>15 days</b>	<b>30 days</b>	<b>20 days</b>	<b>10 days</b>
Minimum	1 day			
Maximum	90 days			
<i>Valid cases</i>	<i>81</i>	<i>11</i>	<i>27</i>	<i>43</i>
<b>Through an intermediary: how many days</b>				
Arithmetical mean	19.68 days	30.9 days	21.67 days	11.0 days
<b>Median</b>	<b>14 days</b>	<b>25 days</b>	<b>30 days</b>	<b>7 days</b>
Minimum	1 day			
Maximum	90 days			
<i>Valid cases</i>	<i>34</i>	<i>10</i>	<i>9</i>	<i>15</i>

The period differs substantially from town to town. This most probably is due to the different workload of the institutions involved in the process of firm registration. The poll also reveals dispersion by sector. Those differences however, differ from case to case and do not depend on a particular sector since, as we would see later, the process is the same for the firms in all economic sectors.

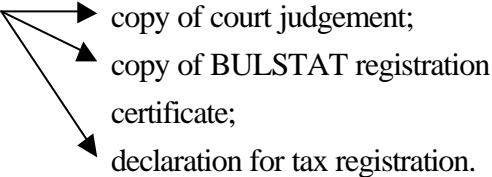
The procedure of a merchant's firm registration is governed by the Commercial Code, the Law on Statistics, the Code of Tax Procedure and Order No. 1 of 12 January 2000 laying down the Procedure and Conditions for Tax Registration.<sup>20</sup> It consists of five main steps:

1. Booking a name at the National Statistical Institute;
2. Delivery of a judgement by the Companies Division of the competent court to enter the firm in the Commercial Register.  
Documents required:   → application for registration<sup>21</sup>
3. Registration in the BULSTAT Registry.  
Documents required:   → copy of court judgement.
4. Registration as an insurer at the National social security Institute.  
Documents required:   → copy of court judgement;  
                                  → copy of BULSTAT registration certificate.

<sup>20</sup> Issued by the Director General of the General Tax Directorate with the Ministry of Finance, published, SG, issue 6 of 21 January 2000, in effect from 1 January 2000.

<sup>21</sup> The application for registration must be accompanied by various documents, depending on the type of merchant; all these documents are listed in the Commercial Code.

5. Tax registration at the Territorial Tax Administration.

Documents required: 

- copy of court judgement;
- copy of BULSTAT registration certificate;
- declaration for tax registration.

The procedure after the registration at court must close within 7 days as from receipt of the court judgement. The institutions involved must be visited *only* in the sequence prescribed and each next institution is given copies of the documents issued by the previous institutions. The lack of co-operation and co-ordination in the work of the different bodies of public administration actually turns the entrepreneur into a courier linking those bodies and entails unnecessary time costs.

Reviewing the legislative rules on firm registration, some inconsistencies become clear-cut and they prompt the following questions:

- ❖ Why should the merchant copy the court judgement for registration of the firm *X* times and submit it to each public institution as many times as he requests a service? Section 5 of the Commercial Code<sup>22</sup> provides that the Commercial Register of the Court shall be public, so all parties and institutions concerned have access to it;
- ❖ Why should the BULSTAT identification card (which certifies the BULSTAT code) be copied *Y* times and a copy be left to each public authority visited? According to ss. 42 and 43 of the Law on Statistics:
  - The information in the BULSTAT Registry shall be public, as far as it is derived from documents for the formation or setting up, transformation or winding up of economic operators;
  - The National Statistical Institute must provide the authorities of central and local administration with free-of-charge access to the public information contained in the BULSTAT Registry. Such access is provided within 3 days as from entering the relevant information in that Registry;
  - The National Statistical Institute must ensure a daily free-of-charge access to the information entered in the BULSTAT register to the National Assembly, the Council of Ministers, the Ministry of Finance, the National Social Security Institute and to other agencies determined by a decision of the Council of Ministers.
- ❖ Why should the merchant, at his visit to the territorial tax administration, submit copies of the court judgement and of the BULSTAT registration certificate, if:
  - According to s. 45 of the Code of Tax Procedure:
    - the tax authorities must receive free-of-charge information from any court and public registers concerning the tax payers, including those tax payers whose court registration is struck out;

---

<sup>22</sup> Section 5: "Everyone shall have the right to inspect the Commercial Register and the documents on the basis of which the entries therein have been made, and to receive copies therefrom."

– the courts, municipalities, Ministry of Regional Development and Public Works, National Statistical Institute and the Ministry of Interior must provide the tax administration, on a free-of-charge basis, with the existing information necessary to keep the Registry.

❖ Similarly, the legal ground according to which a merchant is required to register as an insurer at the National Social Security Institute seems to be fairly obscure. Until 1 January 2000 that registration was governed by Title III of the Labour Code (1951). The old Labour Code, however, was repealed when the Code of Compulsory Social Security came into effect. At present, the registration in question is carried out either without a legal ground or, if a legal ground exists at all, it is certainly an administrative instrument which has not been published. Under the Code of Compulsory Social Security, the insurer's code shall be the BULSTAT code. When registering at the National Social Security Institute, however, every firm is assigned - just in case - a file number which, of course, differs from the BULSTAT code.

The process of firm registration is connected with costs of time and financial expenses for State fees, fees for legal advisers, the elaboration of a firm seal, etc. The poll shows that the average outlay in respect of firm registration amounts 100 Levs. In analysing the results in this particular case we have used the statistical median, as the figures quoted by the respondents – 5,000 or 6 Levs (registration without intermediary), and 500 Levs or 1 Lev (for registration through an intermediary) - represent unrealistic maximum and minimum values and distort the arithmetical mean.

The figures in Table 3 show that the registration costs are highest in Sofia and lower in smaller towns and in the district centres, respectively. As the State fees are the same within the country, these differences are most probably due to different service fees charged in different areas.

**Table 3: Responses to the question *How did you register your firm and how much did it cost?***

<b>Without intermediary: How much did it cost?</b>	<b>Total</b>	<b>Sofia</b>	<b>Large district centre</b>	<b>Smaller town</b>
Arithmetical mean	211.12 Levs	151.33 Levs	128.78 Levs	286.20 Levs
<b>Median</b>	<b>100 Levs</b>	<b>190 Levs</b>	<b>90 Levs</b>	<b>100 Levs</b>
Minimum	6 Levs			
Maximum	5000 Levs			
<i>Valid cases</i>	<i>59</i>	<i>6</i>	<i>23</i>	<i>30</i>
<b>Through an intermediary: How much did it cost?</b>				
Arithmetical mean	157.08 Levs	275.00 Levs	206.25 Levs	115.13 Levs
<b>Median</b>	<b>140 Levs</b>	<b>275 Levs</b>	<b>155 Levs</b>	<b>70 Levs</b>
Minimum	1 Lev			
Maximum	500 Levs			
<i>Valid cases</i>	<i>25</i>	<i>2</i>	<i>8</i>	<i>15</i>

The table also shows that, on the whole, resort to intermediaries still makes the procedure dearer (which was also the case in 1996). The price actually goes down solely in smaller towns where the personal and family connections of an intermediary and his friendships play a major part.

As we have seen, the transaction costs at this stage of entry are mostly costs of time, rather than financial costs, and stem primarily from the inconsistent legislative framework and the lack of co-operation among the various

administrative bodies.

The costs of time could be substantially reduced by putting in place an information network linking the units of public administration. That would ensure a rapid and easy access to any public register and would make unnecessary the visits to any other institution after the court.

### ***III.A.2 Obtaining a permit to start up the operations***

The start-up permit is the second stage of entry. More often than not, the legislation relative to this stage is irrational and inadequately enforced.

Most governments in the world require entrepreneurs to comply with certain criteria, in order to start up some types of operation. Government regulation is justified by the need to protect the health of citizens, quality, national security or what is commonly referred to as "the public interest". Achieving these goals by way of government regulation, however, has its alternative price: compliance with the procedures and requirements burdens the entrepreneurs with costs of time<sup>23</sup> and financial expenses . As a result, some firms fail to enter the market in question.

**Any arrangements of this sort, regardless of whether they are labelled "licensing", "certification", "co-ordination" or "registration", represent entry barriers. On the whole, they produce the same economic result: restricting competition and increasing the cost of doing business in a given sector, thus reducing market efficiency and, as a repercussion, the economic growth.**

The Bulgarian legislation in force distinguishes among several different legal terms, such as: "license", "permit", "certificate", "approval", etc. These terms, however, are similar from an economic point of view: they all mean a document required by a legislative or statutory instrument and issued by a State or private institution to anyone willing to carry on a certain business. For the sake of clarity, again, all those concepts with similar economic content will be referred to hereinafter as *licenses*.

The following table displays the sharp increase in the range of activities for which licenses or permits were required over the period 1989-1999.

**Table 4**

<b>Year</b>	<b>Newly-introduced licenses</b>	<b>Existing licenses</b>
1989	2	2
1990	4	6
1991	3	9
1992	1	10
1993	5	15
1994	6	21
1995	21	42

---

<sup>23</sup> An experiment made by Hernando de Soto in 1983 in Lima, Peru, demonstrated that compliance with all legislative requirements and procedures to open a small textile mill, without paying (many) bribes or using political connections, took the team involved in the experiment 289 days. See: Hernando de Soto, *The Other Path* (1989).

1996	13	55
1997	10	65
1998	21	86
1999	20	<b>106</b>

Sources: Calculations of the Institute for Market Economics

The data above shows that in the period 1997-1999 only the number of activities for which license was required doubled. The introduction of more requirements in 1998 and 1999, however, has been repeatedly excused by claiming that this is the result of the harmonisation of Bulgarian legislation to the *acquis communautaire*.<sup>24</sup>

It is quite logical then, that 73% of the entrepreneurs interviewed responded that their business requires a license or permit. The average number of licenses required is 2 (2 for production and trade, and 1 for services). (See Table 5).

**Table 5: Responses to the question “How many licenses and permits are required for your business?”**

	Total	Production	Trade	Services
Arithmetical mean	5.48	13.47	3.57	1.31
<b>Median</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>1</b>
Minimum	1			
Maximum	200			
<i>Valid cases</i>	83	19	51	13
		Sofia	Large district centre	Smaller town
Arithmetical mean		2.75	10.93	2.89
<b>Median</b>		<b>2</b>	<b>3</b>	<b>2</b>
<i>Valid cases</i>		12	27	41

Here again, there is a huge difference between the median and the arithmetical mean as a result of the large standard deviation. Thus, for the purposes of analysis we should work with the statistical median.

The maximum number of licenses mentioned in a response was 200. This is unrealistic, as no business in Bulgaria requires such a number of licenses. The response rather expresses the opinion of the respondents of the unusually high number of licenses required as a whole.

A total of 88 firms responded to the question "Who deals with preparing and lodging the documents required to obtain a license or permit?". In 73 of them the owners themselves did the preparation and filing work, whereas 15 firms prepared and lodged the documents through intermediaries. Generally, the involvement of intermediaries accelerates the process of issuing a license, though in Sofia the trend is reverse. Perhaps, this is the

<sup>24</sup> For further details see *Licensing Requirements in Retail and Wholesale Trade and Commercial Road Transport*, IME Newsletter, issue January-February 2000.

reason why only two respondents in Sofia had resorted to intermediaries, whereas in large district centres and in smaller towns the firms using intermediaries were respectively 6 and 7.

The average time spent to prepare and lodge the documents for the license is 20 days (without an intermediary) or 7 days (through an intermediary). The maximum number of days indicated was 365 and the minimum number was 1. (See Table 6).

**Table 6: Costs of time (in days) for drafting and lodging documents for licenses, by sector and by town.**

Total cost of time for preparing and lodging documents	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
<b>Without intermediary</b>							
Arithmetical mean	36.40	64.78	26.96	27.8	27.2	48.35	31.83
<b>Median</b>	<b>20</b>	<b>18.5</b>	<b>20</b>	<b>30</b>	<b>25</b>	<b>30</b>	<b>17.5</b>
Minimum	1						
Maximum	365						
<i>Valid cases</i>	<i>73</i>	<i>18</i>	<i>45</i>	<i>10</i>	<i>10</i>	<i>23</i>	<i>40</i>
<b>Through intermediary</b>							
Arithmetical mean	23.17	2	28.4	15.3	45	20.83	18.86
<b>Median</b>	<b>7</b>	<b>-</b>	<b>13.5</b>	<b>13.5</b>	<b>45</b>	<b>13.5</b>	<b>7</b>
Minimum	2						
Maximum	90						
<i>Valid cases</i>	<i>15</i>	<i>1</i>	<i>10</i>	<i>4</i>	<i>2</i>	<i>6</i>	<i>7</i>

The big differences between median and arithmetical mean reveal the great variety of values given in the responses. The biggest dispersion is found in respect production and in large district centres.

The dispersion in the number of days by inhabited area and by sector could hardly be surprising, given the logic and the nature of Bulgarian licensing regulations.

The licensing procedure could be conditionally divided in two stages: *applying for a license* and *obtaining a license*.

*Applying for a license* is the process of collecting and lodging the documents required to issue a license. The time of preparing and lodging differs due to the different number of documents required in each case and, last but not least, to the large degree of administrative discretion allowed by Bulgarian licensing arrangements and the obscure powers of the authorities in charge of enforcing the various regulations.

A few examples could be invoked here:

- As regards the obtaining of a license for trade in tobacco and tobacco products, a statutory instrument<sup>25</sup> sets out the number and type of documents required and the carrying out of the licensing procedure is entrusted to the municipal administration. On the grounds of s. 22 of the Law on Local Self-government and Local

<sup>25</sup> Rules Implementing the Law on Tobacco and Tobacco Products.

Administration<sup>26</sup> and s. 8 of the Law on Legislative Instruments<sup>27</sup>, the municipal authorities fairly tend to expand, at their own discretion, the list of documents required (see Table 7).

---

<sup>26</sup> Section 22 (1): "The municipal council shall adopt, on issues having local significance, rules, ordinances, decisions and instructions which shall be forwarded to the Provincial Governor within seven days."

<sup>27</sup> Section 8. "Every municipal council may issue ordinances to regulate, in compliance with higher ranking legislative instruments, those social relations of local significance which are not governed by the higher-ranking instruments in question."

**Documents to be filed for license for trade in tobacco and tobacco products<sup>28</sup>**

<b>No.</b>	<b>Students' Borough</b>	<b>Mladost Borough</b>	<b>Lozenets Borough</b>	<b>Samokov Municipality</b>	<b>Septemvri Municipality</b>	<b>Statutory Requirements</b>
1	Standard application form	Standard application form	Standard application form	Standard application form	Standard application form	Standard application form
2	Court registration		Original document or copy authenticated by notary public for applicant's court registration		Court judgement	Original document or copy authenticated by Notary Public for applicant's court registration
3	Outlet registration certificate issued by Students' Borough	Outlet registration certificate	Documents proving that outlet meets the requirements of the Borough possibly imposed by order of the Mayor			Documents proving that outlet meets the requirements of the respective borough possibly imposed by order of the mayor
4	Criminal record certificate					
5		Certificate for current status of firm		Certificate for current status of firm	Certificate for current status of firm	
6	Sanitary permit by Hygiene Inspectorate for trade with alcoholic beverages and tobacco products				Sanitary permit	
7	Certificate by tax service for taxes and fees paid	Document for fee paid	Certificate by territorial tax directorate in the area of applicant's registered office for outstanding debts to State Treasury	Certificate by territorial tax directorate for outstanding debts to Treasury; cash receipt for rental paid under a lease contract with the municipality	Document for taxes paid	Certificate by territorial tax directorate in the area of applicant's registered office for outstanding debts to Treasury.
8		BULSTAT		Copy of identification card based on the BULSTAT Registry	BULSTAT	
<b>No.</b>	<b>Students' Borough</b>	<b>Mladost Borough</b>	<b>Lozenets Borough</b>	<b>Samokov Municipality</b>	<b>Septemvri Municipality</b>	<b>Statutory Requirements</b>
9	Tax registration		Document for applicant's tax registration	Copy of tax registration certificate	Tax registration	Document for applicant's tax registration

<sup>28</sup> The requirements are presented in the form in which they are shown on the premises of the respective municipality.

10	Existing lease contract or title deed					
11	Declaration that applicant: a) is not disqualified to carry on trade in wine, alcoholic beverages and tobacco products; b) shall label the products in way to avoid any misleading impression of their origin, quality, category or type					
12			Conclusion by corresponding municipal technical service as to the lawful use of outlet in accordance with Law on Regional and Town Planning and its Implementing Rules	Documents for putting outlet in operation in accordance with Law on Regional and Town Planning, its Implementing Rules, Ordinance No. 6	Permit to use site issued by Directorate of National Construction Supervision	Conclusion by corresponding municipal technical service as to the lawful use of outlet in accordance with Law on Regional and Town Planning and its Implementing Rules
13			Proposal to approve outlet working hours in line with public order requirements			Proposal to approve outlet working hours in line with public order requirements

Some of the documents to be lodged (*e.g.* certificate of firm's current court registration status, certificate from the territorial tax administration of outstanding debts to the Treasury, criminal record certificate, sanitary permit, conclusion of municipal technical department on the lawfulness of using the outlet, etc.) are issued in time limits set in different instruments. Because of the level of discretion allowed by the legislation and the non-existent practice of punishing the officials for failure to comply with statutory time limits, in some cases the actual time limits depend entirely on the government official in charge of applying the instrument in question.

- Another example is s. 26, subs 1 of the Rules Implementing the Law on Public Health. It provides that the State sanitary supervision authorities shall issue permits and give conclusions in writing within 25 days in respect of standardising documents, designs of construction sites, legislative instruments and design and construction norms, or within 10 days in all other cases. In both cases, however, the respective time limits start running from the submission of the full set of documents and provision of any additional documents if such additional documents were requested. There is no deadline by which such additional documents could be requested. In other words, the officials of the institution in charge could turn the period of 25 days into a term to their liking.

The general overview of licensing arrangements in Bulgaria shows that in almost all such arrangements the time limits within which entrepreneurs should act are fixed scrupulously, whereas various loopholes enable the administration to extend its own time limits. This is the reason why some entrepreneurs manage to collect the requested documents for one week and others need a year to do so.

A further element, which makes the time limits for filing the required documents so different is the power of the licensing bodies (proclaimed by the respective legislative instruments) to request supplementary documents in addition to those prescribed by the legislation. The example with s. 10 of Ordinance No. 2 on Categorisation of Tourist Outlets resembles that one with the Rules Implementing the Law on Public Health. Section 10 of the Ordinance stipulates that the categorising authorities are entitled to also request "*other information and documents to check data and circumstances relative to the categorisation procedure*". The entrepreneur applying for the award of category should submit the documents requested within a certain time limit. However, there is no time restriction on the categorising authority to request additional information. For that reason the filing of documents for the purpose of categorising a tourist outlet could take anything from 2 to 20 days.

***Obtaining a license*** is the process from receipt of the documents until the permit for carrying on the business is issued. It also depends both on the statutory time limits and on the work of the particular administration in charge of applying the legislative arrangements. This stage of the licensing process is also characterised by a large degree of administrative discretion and by statutory possibilities to extend the time limits. Section 11 of Ordinance No. 2 on Categorisation of Tourist Outlets (quoted above) provides that the time limit for categorisation shall be 4 months but it starts running after all documents listed in s. 10 of the Ordinance have been filed. Section 10 refers *inter alia* to "other information and documents" which the categorising authority can request. There is no deadline by which such additional information could be requested. Thus, the starting point of the 4-month time limit remains unclear.

Section 34 of the Law on Gambling is another story. It provides that the inspections and inquiries in connection

with applications to issue permits for organising games of chance must be finalised by the Directorate General for Control of Gambling from 3 to 6 months as from receipt of the written application. However, "in exceptional cases and by a reasoned decision of the State Commission, this time limit may be extended to 12 months."

Yet another example is Ordinance No. 6 on Authorising the Use of Construction Sites in the Republic of Bulgaria. It "sets out" time limits in the procedure for issuing a permit to use the sites after construction or reconstruction. According to the Ordinance, the time limit for the work of the State Acceptance Commission is 10 days but, based on a reasoned report from the chairman of the Commission, the period could become 30 days and in exceptional cases the work may be suspended for a period determined by the authority having appointed the Commission. The Ordinance does not define the concept of "exceptional circumstances" nor does it list the reasons that could justify an extension. Hence, any extension is entirely conditional on the subjective assessment of the public officials.

The question "*How long did it take until you got your license?*" was not asked in this study, as the different statutory time limits for issuing various licenses would distort the general information in terms of both arithmetical mean and median. In order to establish the specific period in which the licenses are obtained, a separate study should be carried out of each particular license. In order to get adequate information, we asked the entrepreneurs if they had encountered any administrative delays when starting up their business. Against the backdrop of everything we have described so far in terms of licensing procedures and legislative framework, it would hardly be surprising that 32% of all firms interviewed answered in the affirmative. The administrative delay for the sample amounts to 30 days on average, with 240 days being the maximum. The delay is most significant in the field of services (60 days) followed by trade (30 days) and production (15 days). As regards the comparison by town, both the arithmetical mean and the median show unambiguously that the institutions in Sofia are the slowest. There is a huge dispersion in the answers, due to the individual nature of the problems encountered in each particular case (see Table 8).

**Table 8: Was there any administrative delay in starting up your business and if yes, how big was it?**

<b>Days</b>	<b>Total</b>	<b>Production</b>	<b>Trade</b>	<b>Services</b>
Arithmetical mean	51.34	16.43	62.5	48.0
<b>Median</b>	<b>30</b>	<b>15</b>	<b>30</b>	<b>60</b>
Minimum	0			
Maximum	240			
<i>Valid cases</i>	<i>38</i>	<i>7</i>	<i>24</i>	<i>7</i>
<b>Days</b>		<b>Sofia</b>	<b>Large district centre</b>	<b>Smaller town</b>
Arithmetical mean		54.09	48.5	51.24
<b>Median</b>		<b>40</b>	<b>30</b>	<b>30</b>
<i>Valid cases</i>		<i>11</i>	<i>10</i>	<i>17</i>

The administrative delay in starting up a business most often results from the long statutory time limits for obtaining a license which, in turn, depend on the following procedural obstacles:

1. Too many institutions are involved in the licensing process. They must all be visited in a strict sequence, and every next institution issues its permit or license on the basis of certificates issued by the preceding institutions. It is impossible to visit the institutions in parallel and the conclusion of one body must be

obtained before proceeding to the next body. At the same time, there is an ubiquitous failure to comply with the statutory time limits for issuing certificates, permits, licenses and approvals by the public administration which is caused by a variety of reasons - starting from those envisaged in the legislation (requesting additional documents or requiring rectification in submitted documents) and ending with the absence of the official in charge, the lack of time to write the document or even the lack of paper to put the text on. If we add the fact that most institutions involved do not have computer equipment, the delays in the whole process become easy to explain and even logical;

2. The data from poll shows that, in order to obtain a license, one must submit 10 documents on average, with 7 being the statistical median. The largest number of documents is required in the sectors of services and trade and the smallest number is required for production. The surveys of the Institute for Market Economics have shown that, for example, to issue only licenses for trade in cigarettes and alcoholic beverages, some municipalities require a total of 28 documents to be submitted (while 11 documents are required by the legislation). Another example is the practice of the State Commission for Gambling which requires the submission of 29 documents before it issues a permit for organising gambling machine games. In this sense, the maximum number of documents indicated in the answers - 47 - is not exaggerated, but the minimum number - 1 - is completely unrealistic.
  
3. To obtain all these documents, one should visit 5 institutions on average (maximum 30 and minimum 1). 80 entrepreneurs had to visit those institutions 7 times on average, with the largest number of visits being 30 and the smallest number being 1. As regards the number of institutions visited and the number of visits, there are no explicit differences by town or by sector. The main reason for these numerous visits lies in the unclear rules and the restricted access to information as to what exactly should be done and how. For 57.5% of the entrepreneurs interviewed, the main source of information had been "the colleagues *having trodden the same path*", while 41.7% had to ask questions personally to an official of the respective institution. These facts suggest that: the procedures are not clear, nor are they easily accessible to potential licenses applicants. Only 32.2% of those interviewed relied on the sample documents affixed on the wall in the building of the respective institution. This is easy to believe, given the appearance and contents of such requirements and samples seen during the field work. As a matter of fact, the samples often contain instructions that can only be complied with after further explanation, *e.g. "and other documents depending on the type of site" or "etceteras"* and so on, and so forth. (See Table 9).

**Table 9: Responses to the question *Where did you get information about the necessary documents to be submitted for carrying on your business, such as permits, licenses, certificates and the like?* (more than one response allowed)**

Valid percentage YES

Sources of information on documents required	Total	Production	Trade	Services
State Gazette	42.5	63.2	34.5	46.2
Samples shown in the building of municipal administration or another public authority	32.2	21.1	36.4	30.8

Information received from an official of the institution on request	41.7	52.6	34.5	53.8
Colleagues <i>having trodden the same path</i>	57.5	36.8	63.6	61.5
No sources of information used	1.1	0	1.8	0
Other sources	17.2	26.3	16.4	7.7
		<b>Sofia</b>	<b>Large district centre</b>	<b>Smaller town</b>
State Gazette		46.2	48.1	38.3
Samples shown in the building of municipal administration or another public authority		46.2	48.1	19.1
Information received from an official of the institution on request		61.5	33.3	40.4
Colleagues <i>having trodden the same path</i>		38.5	66.7	57.4
No sources of information used		0	0	2.1
Other sources		7.7	14.8	21.3

It is clear that people in Sofia rely mostly on the information given by officials of the respective institution and least on information given by "colleagues *having trodden the same path*". The explanation is that many licenses are administered locally, so there are as many internal instructions and regulations for issuing licenses as there are boroughs in Sofia. Thus, it is crucial to obtain first-hand information in order to keep the number of visits to various institutions to the possible minimum.

Unlike the residents of Sofia, people in large district centres rely primarily on their colleagues having trodden the same path and on exhibited samples. In smaller towns entrepreneurs have advised each other in 57.4% of the cases, while 40.4% of the interviewees got information from an official of the relevant institution. Only 19.1% of the interviewees relied on samples. This low percentage is quite logical given that there are usually no samples in the smaller towns and information is obtainable only from the competent officials, on request.

An almost constant percentage of entrepreneurs rely on information published in the State Gazette (app. 42%). After the overview of licensing legislation, however, it could be stated that even those entrepreneurs have necessarily used at least some of the other sources of information in parallel, since:

1. Not all administrative instruments governing the process of licensing are public,  
and
2. The field work shows that in all probability there is no institution strictly abiding by the legislative rules that refrains from adding at least one more document or requirement to those laid down by law.

Hence, it is absolutely impossible for a firm to obtain a license only on the basis of the information given in the State Gazette.

In summary, the following main reasons for the long period of obtaining licenses could be identified: imperfect legislative framework and discretion of the civil servants in the process of enforcing the applicable legislation; compulsory sequence to be followed in the procedure; opaque requirements and poor technical equipment of the

institutions involved in the licensing process.

Any delay, regardless of its nature and cause, increases both the costs of entering the business<sup>29</sup> and the benefits lost. One possible way out of this situation is to start operating without a license but in this case there is always the threat of sanctions or racketeering by the supervisory authorities. Another solution is to bribe an official in order to accelerate the process of licensing and start legal operations as soon as possible. The choice depends on the financial standing of the entrepreneur concerned and on his preparedness to run risks.

The question "Did you have an opportunity to operate before all required licenses, permits, etc. had been issued?" was answered in the affirmative by 53% of the interviewees. 96% of those respondents actually used that opportunity and worked without license for 2 months on average (72 months was the maximum and 0.5 month was the minimum). The longest period of operations without license was found in the service sector, while the shortest was in the trade sector. The important difference between the arithmetical mean and the statistical median reveals a huge dispersion in the answers. (See Table 10).

**Table 10: Responses to the question "Did you avail yourself of the opportunity to work without a license and, if yes, for how long?"**

Months	Total	Production	Trade	Services
Arithmetical mean	6.55	5.77	6.63	7.57
<b>Median</b>	<b>2</b>	<b>2</b>	<b>1</b>	<b>4</b>
Minimum	0.5			
Maximum	72			
Valid cases	37	11	19	7
		<b>Sofia</b>	<b>Large district centre</b>	<b>Smaller town</b>
Arithmetical mean		2.17	2.65	9.67
<b>Median</b>		<b>1.5</b>	<b>1.5</b>	<b>2</b>
Valid cases		6	10	21

Besides the costs of time, licensing requires financial expenditure.

The following table shows the total cost of preparing and lodging the documents required to issue a license, in days and in Levs.

**Table 11: Cost of preparing and lodging the documents for licensing**

Without intermediary	Total		Production		Trade		Services	
	Days	Levs	Days	Levs	Days	Levs	Days	Levs
Arithmetical mean	36.40	665.71	64.78	346.07	26.96	694.27	27.8	1078.75
<b>Median</b>	<b>20</b>	<b>15</b>	<b>18.5</b>	<b>175</b>	<b>20</b>	<b>150</b>	<b>30</b>	<b>140</b>
Valid cases	73	63	18	14	45	41	10	8

<sup>29</sup> Regardless of the fact that the business operations have not started, the entrepreneur must:

- pay the rentals, as he has entered into a lease agreement (this is one of the main documents required by almost all licensing institutions);
- carry out repairs (in order to bring the premises in line with the requirements of the Inspectorate of Hygiene and Epidemiology and the National Fire Safety Service)
- etc.

Minimum	1	0						
Maximum	365	15,000						
			<b>Sofia</b>		<b>Large district centre</b>		<b>Smaller town</b>	
			<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>
Arithmetical mean			27.2	116.0	48.35	1408.48	31.83	256.14
Median			<b>25</b>	<b>120</b>	<b>30</b>	<b>200</b>	<b>17.5</b>	<b>150</b>
<i>Valid cases</i>			10	5	23	23	40	35
	<b>Total</b>		<b>Production</b>		<b>Trade</b>		<b>Services</b>	
<b>With intermediary</b>	<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>
Arithmetical mean	23.17	816.31	2	150	28.4	464.67	15.3	2093.33
Median	<b>7</b>	<b>200</b>	-	-	<b>13.5</b>	<b>200</b>	<b>13.5</b>	<b>30</b>
<i>Valid cases</i>	15	13	1	1	10	9	4	3
Minimum	2	0.00						
Maximum	90	6,250						
			<b>Sofia</b>		<b>Large district centre</b>		<b>Smaller town</b>	
			<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>
Arithmetical mean			45	1300	20.83	1243.33	18.86	110.4
Median			<b>45</b>	<b>1300</b>	<b>13.5</b>	<b>150</b>	<b>7</b>	<b>150</b>
<i>Valid cases</i>			2	2	6	6	7	5

The dispersion in the responses is tremendous. The maximum price indicated for preparing and lodging documents for licensing is, 15,000 Levs without intermediary and 6,250 Levs through an intermediary, while the minimum value in both cases is zero. Thus, in order to eliminate the impact of the highest and lowest values (which are apparently unrealistic) the statistical median should be used for the purposes of this analysis.

The data in the table shows that **now, quite like in 1996, intermediaries make the process of licensing more expensive as a whole**. Intermediaries in Sofia are least efficient as they delay the first stage of the process by 20 days and push the price up by 1,180 Levs. The highest prices for preparing and lodging the documents are found in the sector of production, with trade and services coming next. If an intermediary interferes, production and trade change place.

Table 12 displays the types of expenses incurred by firms to obtain the license. The state fees form the largest portion of these expenses, followed by technical and advisory services. This correlation remains unchanged, if we analyse the situation by town.

**Table 12: Specific Expenses Incurred to Obtain Licenses**

Specific expenses for licenses and/or permits	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
<b>State fees</b>							
Arithmetical mean	305.25	219.23	278.81	550	192	397.85	262.34
Median	<b>100</b>	<b>100</b>	<b>100</b>	<b>150</b>	<b>100</b>	<b>100</b>	<b>100</b>
<i>Valid cases</i>	63	13	41	9	5	26	32
Minimum	5						
Maximum	3500						
<b>Technical services</b>							
Arithmetical mean	98.54	139.17	67.14	147.5	75	96.15	107.2
Median	<b>65</b>	<b>100</b>	<b>45</b>	<b>150</b>	<b>75</b>	<b>40</b>	<b>80</b>
<i>Valid cases</i>	24	6	14	4	2	13	9

Minimum	5						
Maximum	300						
<b>Legal and consulting services</b>							
Arithmetical mean	73.2	120	82.94	23.83	150	65.58	74.42
Median	<b>30</b>	<b>50</b>	<b>30</b>	<b>20</b>	-	<b>30</b>	<b>27.5</b>
<i>Valid cases</i>	25	3	16	6	1	12	12
Minimum	2						
Maximum	500						
<b>Other</b>							
Arithmetical mean	560	-	730	50	2000	150	45
Median	<b>100</b>	-	<b>150</b>	-	-	-	<b>45</b>
<i>Valid cases</i>	4	0	3	1	1	1	2
Minimum	40						
Maximum	2000						

**The conclusion is that the present study would be of some help not by calculating the arithmetical mean of entry costs in terms of time and money but by identifying the underlying reasons for these costs. That could enhance any further efforts to minimise such costs in future.**

The huge dispersion in the answers is particularly disturbing. It means that the entry transaction costs are different for firms operating in the same sector and based in the same town. The difference of the start-up costs would affect the prices over the first months after starting up. It will decrease the price competitiveness of those firms, which have started later, and in return for higher costs as a result of the administrative discretion allowed by Bulgarian legislation.

### **III.B. Operating costs**

The following significant operating costs incurred by companies have been identified:

- costs resulting from legislative amendments;
- costs relative to the access to lending;
- costs of searching for and finding the needed raw materials, goods and services;
- costs of office maintenance and marketing the products, goods or services;
- labour market and social security costs;
- costs of debts to the Treasury;
- costs relating to audits / inspections and reporting.

#### **III.B.1 Costs resulting from legislative amendments**

These could be most diverse, *e.g.* costs of labour, taxes, customs duties, licenses, etc. In the section on *Business Regulations and Transaction Costs* we have already referred to the lack of preliminary impact assessment of regulations in Bulgaria. This entails frequent legislative amendments, which, in turn, force firms incur numerous extra expenses. The frequent amendments to business regulations make the environment highly volatile and often tip the balance towards operating "in the shades".

Table 13 exhibits the year of adoption and the number of amendments to the basic legislative instruments governing the business environment. The data is so articulate that they simply need no commentary.

**Table 13**

	CC	LA	LTP / CTP	LC	LHI	CCSS	LC old/new	RILC old/new	LVAT old/new	RILVAT old/new	LE old/new	RILE old/new	LPAYET / LPIT	RILPAYET	Decree 56 / LPT / LCIT	RI Decree 56 / LCIT	LLTF old/new
Before 1991				5			8	4			8		33			3	26
1991	1	1		3				2			2		3			7	1
1992	1	1		4				4			2		2			4	
1993	2	1	2					3	1		1		1			2	1
1994	1							4		2	1/1	1	2	1		2	
1995	1			2				3	1	2	2	1	2	3		2	2
1996	5	3	1	3					3	1	3	4	5	3	2	3/1	7
1997	3	1	3	1				5	3	1	1	1	2/1	1	4/1	3	1/1
1998	4	1	2	6	3		2/3	1/2	5/1	3	3		3		3		4
1999	7	4	1/1	3	6	1	2	1	6	2	1	3	3		8		1
2000		1	2		1	2	1	1	1	2							1
91 - 00:	25	13	12	22	10	3	8	26	21	13	17	10	24	8	18	24	19

**Key to abbreviations:**

CC	Commercial Code	LE	Law on Excise
LA	Law on Accounting	RILE	Rules Implementing the Law on Excise
LTP	Law on Tax Procedure	LPAYET	Law on Pay-As-You-Earn Tax
CTP	Code of Tax Procedure	LPIT	Law on Personal Income Taxation
LC	Labour Code	RILPAYET	Rules Implementing LPAYET
LHI	Law on Health Insurance	LPT	Law on Profit Tax
CCSS	Code of Compulsory Social Security	LCIT	Law on Corporate Income Taxation
LC	Law on Customs	RI Decree 56	Rules Implementing Decree No. 56
RILC	Rules Implementing the Law on Customs	RILPT	Rules Implementing the Law on Profit Tax
LVAT	Law on Value-added Tax	LLTF	Law on Local Taxes and Fees
RILVAT	Rules Implementing LVAT		

In this section we will dwell in more detail on the costs that entrepreneurs must incur as a result of legislative changes affecting already issued licenses without which the firms are not entitled to operate. The other costs mentioned in the brief list above will be tackled in other sections of the report.

The review of licensing regulations has shown that many of the licenses - acquired with so many efforts - are in fact temporary, as their term of validity is somewhere between 1 and 5 years. If there are any permanent licenses, these also should be renewed from time to time because of legislative amendments. The question “*How many times did the legislative provisions governing your operations change?*” prompted answers in the range of 3 times on average.<sup>30</sup> The maximum number of times indicated - 100 - is unrealistic, but it shows how irritated the entrepreneurs are of the frequent changes in the legislation. 42% of the interviewees were not disturbed at all by those changes, but 22% had to apply for a new license; 30% had to introduce make changes in their outlet or site to meet the new requirements, while 7% had to change their operations in general.

Legislative amendments cause firms to suspend their business for an average period of 33 days per year. Such period was identified by the service sector - 72 days; trade comes second with 31 days and production comes last with 8 days. The maximum period of suspended activities indicated in the poll was 730 days, that is nearly 2 years.

Legislative amendments entail not only costs of time, but also financial expenditure. According to the data from the poll, every such change costs the firms 200 Levs annually on average. (see Table 14).

**Table 14: Responses to the question “How much did each of those changes cost (per year)?”**

	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Arithmetical mean	3461.2	333.3	5748.62	261.1	116.67	9091.77	605.0
<b>Median</b>	<b>200 Levs</b>	<b>25 Levs</b>	<b>200 Levs</b>	<b>200 Levs</b>	<b>50 Levs</b>	<b>60 Levs</b>	<b>200 Levs</b>
<i>Valid cases</i>	<i>50</i>	<i>12</i>	<i>29</i>	<i>9</i>	<i>3</i>	<i>17</i>	<i>30</i>
Minimum	0.00						
Maximum	100,000						

The data in tables 12 and 14 shows, that the biggest costs of time and money are incurred in the sectors of services and trade. This is probably attributable to the fact that legislative amendments tend to affect these two sectors far more often as compared to production.

### ***III.B.2 Costs relative to access to lending***

---

<sup>30</sup> To take one example, out of many, just the ordinances on issuing licenses for trade in alcoholic beverages have been amended 9 times since 1993 to date.

The lending operations of Bulgarian banks are still fairly limited. Since the beginning of 2000, we have seen some increase in the loans granted, but this is mainly due to foreign lending programmes serviced by Bulgarian banks.<sup>31</sup>

That is to say that the bulk of the capital with which Bulgarian entrepreneurs start up, both in 1996 and now, are: *first*, private savings; *second*: informal loans (granted by friends and relatives), and, *third*: family chattels or real estate or inherited property. (See Table 15).

**Table 15: Responses to the question “Where did the main part of your start-up capital come from?”**

(More than one answer allowed)

Valid percentage YES	Total 1996	Total 2000	Production 2000	Trade 2000	Services 2000
Private savings	45.4	79.8	81.3	78.6	82.4
Family chattels or real estate / inherited property	15.7	18.5	15.6	21.4	11.8
<b>Bank loans</b>	<b>13.0</b>	<b>7.6</b>	<b>18.8</b>	<b>4.3</b>	<b>0</b>
Assistance from friends (relatives) / informal loans	21.3	29.4	9.4	38.6	29.4
Others	4.6	10.1	12.5	7.1	17.6

The table needs no explanation: while 13% of starting businessmen used bank loans in 1996, the percentage in 2000 hit a low of 7.6%.

The limited number of entrepreneurs using bank loans is due, both to reluctant lending by the banks, and to the attitude of entrepreneurs to this form of funding.

On the one hand, the relation between loans granted to the real sector and the total assets of the banking system dropped from 35.4% in mid-1997 to 28.3% in May 1999.<sup>32</sup> The conduct of banks in terms of lending policies derives from several factors:<sup>33</sup>

- commercial lending is deemed to be too risky as the business environment has not improved substantially and the risk in the real sector remains relatively high;
- most investment projects are not characterised by outstanding quality;
- the financial results of firms shown in their financial statements are lower than the real figures - in fact most firms maintain a system of "double accounting", in order to decrease their profit tax exposure;
- the rights of creditors are far from being adequately protected. The procedure for collecting default loans is slow and very problematic.

On the other hand, many entrepreneurs do not feel confident of the business environment in Bulgaria and, hence, are unwilling to run the risk of taking a loan.

---

<sup>31</sup> See the study of IME on *Business Pursuit Conditions in Bulgaria*, February 2000.

<sup>32</sup> See Assenka Yonkova, *Financial Markets Development as an Incentive for Economic Growth*, Banks, Investments, Markets, issue 2, 2000.

<sup>33</sup> *Idem*.

For the same reasons, only 34.2% of the entrepreneurs interviewed have used loans in carrying on their business. The actual percentage is highest in the production sector - 50%, followed by trade - 30%, and services - 22.2%. Small enterprises resort to loans twice more often than micro-firms.

Table 16 makes it clear that the structure of the loans has remained unchanged since 1996:

**Table 16**

*(More than one answer allowed)*

<b>Valid percentage YES</b>	<b>Total 1996</b>	<b>Total 2000</b>	<b>Production 2000</b>	<b>Trade 2000</b>	<b>Services 2000</b>
State-owned bank	36.6	46.3	62.5	38.1	25.0
Private bank	17.1	24.4	18.8	19.0	75.0
Friends and family	41.5	41.5	43.8	38.1	50.0
Inter-firm lending (deferred payments to partner firms)	4.9	19.5	18.8	19.0	25.0

Now, like in 1996, the loans used are primarily one-year, with a maximum term of 5 years and a minimum term of 6 months. The interest rate amounts to 15.5% on average, with 110% indicated as a maximum and 0% shown as a minimum. The huge dispersion in the answers is also due to the diverse structure of the loans and to the fact that they were obtained in different years.

Nearly 66% of the firms interviewed had to provide guarantees for the loan. 71.4% used as guaranty real estate, 25% movable property, and 22.2% used bank guarantees.

The interviewees managed to obtain loans in two ways: either on their own, or through an intermediary. In 33, out of 40, firms, which used loans, a representative of the firm dealt with the lending procedure and that cost 10 days on average. 7 firms used the services of an intermediary which shortened the period of obtaining the loan by 3 days (See Table 17).

**Table 17: Responses to the question *How much time did you spend to obtain a loan?***

<b>Without intermediary</b>	<b>Total</b>	<b>Production</b>	<b>Trade</b>	<b>Services</b>	<b>Sofia</b>	<b>Large district centre</b>	<b>Smaller town</b>
Arithmetical mean	38.73	27.4	46.3	26.0	77.6	30.75	32.2
<b>Median</b>	<b>10</b>	<b>10</b>	<b>12.5</b>	<b>30</b>	<b>7</b>	<b>22.5</b>	<b>12.5</b>
<i>Valid cases</i>	33	10	20	3	5	8	20

Minimum	0						
Maximum	365						
<b>With intermediary</b>							
Arithmetical mean	6.43	14.0	1.0	0	7.0	10.0	2.67
<b>Median</b>	<b>3</b>	<b>7</b>	<b>0</b>	<b>-</b>	<b>-</b>	<b>0</b>	<b>3</b>
<i>Valid cases</i>	7	3	3	1	1	3	3
Minimum	0						
Maximum	30						

The process is slowest in the service sector, and in large district centres.

The period of obtaining a loan is extremely important. The longer it is, the higher transaction costs the firms incur, and the larger benefits they lose as a result of delayed payments.<sup>34</sup>

The procedures for receiving a loan cost on average 195 Levs without an intermediary and 500 Levs, if an intermediary is involved. The maximum registered amount in both cases is 30,000 Levs whereas the minimum is zero. (See Table 18).

**Table 18: Responses to the question “How much money did it cost to obtain the loan?”**

Without intermediary	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Arithmetical mean	2,560.00	4,374.29	2,159.29	196.67	10,000	1,012.50	2,889.33
<b>Median</b>	<b>195</b>	<b>50</b>	<b>440</b>	<b>240</b>	<b>-</b>	<b>200</b>	<b>150</b>
<i>Valid cases</i>	24	7	14	3	1	8	15
Minimum	0						
Maximum	30,000						
<b>With intermediary</b>							
Arithmetical mean	4,928.57	10,500.00	1,000.00	0	30,000	333.33	1,166.70
<b>Median</b>	<b>500</b>	<b>1,000.00</b>	<b>0</b>	<b>-</b>	<b>-</b>	<b>0</b>	<b>500</b>
<i>Valid cases</i>	7	3	3	1	1	3	3
Minimum	0						
Maximum	30,000						

The large dispersion in the periods of obtaining a loan and the price of loans stems from the normal differences from one loan transaction to another.

Because the capital market in the country is underdeveloped, only 3 firms - out of 120 interviewed - used direct funding, which differs from a securities issue or debt-equity swap. Table 19 shows the structure of direct funding by sector and by town.

**Table 19: Structure of Direct Funding**

Valid percentage YES	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town

<sup>34</sup> For example: paying a higher price because of expiry of the deadline of a preferential offer; rentals for warehousing facilities due to unpaid customs duties and excise; penalties under existing contracts, etc.

Subsidies from State funds	0	0	0	0	0	0	0
Grants from State-owned enterprises	0	0	0	0	0	0	0
<b>Grants from private individuals</b>	<b>50.0</b>	<b>50.0</b>	<b>50.0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>50.0</b>
Grants from private foundations	0	0	0	0	0	0	0
Debt-equity swap	0	0	0	0	0	0	0
Securities issue	0	0	0	0	0	0	0
<b>Other</b>	<b>50.0</b>	<b>50.0</b>	<b>50.0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>50.0</b>

In contrast to the poll carried out in 1996, when 4.5% of the interviewees faced supplementary conditions - in addition to the interest - when obtaining direct or indirect funding, none of the entrepreneurs participating in this poll faced such additional conditions.

In conclusion, the access to direct and indirect funding does not give rise to high transaction costs for the firms. However, this access is too restricted due to the low supply of loans and the underdeveloped capital market in the country. The unstable business environment increases the risk for banks, on the one hand, and makes the entrepreneurs reluctant to resort to loans, on the other hand.

### ***III.B.3 Costs of searching for and finding the needed raw materials, goods and services***

42 out of 120 firms interviewed manufacture goods. 83.3% of them are able to find the necessary raw materials on the official market, 4.2% find these materials on the unofficial market, while 5.8% buy materials on both markets. This proportion is more or less the same as in 1996. The largest portion of raw materials obtained on the unofficial market is in the production sector - 12.5% . This is due to the largest price differentials between the two markets there.

To the question "*Are there any differences between the prices of raw materials, goods and services on the official and unofficial market?*" the following answers were received: 36.7% respond that the difference amounted to nearly 50%, and 1.7% claim that the difference exceeds 100%. The data shows that the largest differences in the prices on the two markets exist in Sofia, on the one hand, and in the sector of production, on the other hand.

50% of the 42 firms interviewed find the necessary raw materials and obtain them straight from the manufacturer, 30% use intermediaries, only 2.5% use services on the Internet, while 10.8% combine the first three options.

It takes 2 days on average for firms to get information on where to find raw materials, goods and services. The maximum period indicated was 120 days. Average periods do not differ by sector or by town.

Finding the relevant information costs firms 45 Levs on average, with substantial differences existing by town and by sector. (See Table 20).

**Table 20: Responses to the question “*How much money do you spend to find raw materials / supplies?*”**

Levs	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Arithmetical mean	301.28	241.47	402.27	32.78	65.00	415.92	263.45
<b>Median</b>	<b>45</b>	<b>75</b>	<b>50</b>	<b>10</b>	<b>75</b>	<b>20</b>	<b>50</b>
<i>Valid cases</i>	<i>60</i>	<i>17</i>	<i>34</i>	<i>9</i>	<i>7</i>	<i>24</i>	<i>29</i>
Minimum	0						
Maximum	5,000.00						

The supply of raw materials and goods takes 2 days on average. The average period in Sofia, though, is much longer - 7.5 days. The maximum period indicated for supply was 240 days.

The direct financial expenditures of firms for the supply of raw materials and goods is 80 Levs on average, with supplies for the production sector being the most expensive - 250 Levs. The maximum direct cost of supply indicated in a response was 15,000 Levs.

75.8% of the entrepreneurs interviewed think that the price of raw materials, goods and services differs depending on whether an intermediary is involved or not. 5.8% deem that supplies through an intermediary are cheaper. The other 70% find that involving an intermediary makes supplies 10 to 100% more expensive (see Table 21).

**Table 21: Responses to the question “Does the price of raw materials / goods/ services differ depending on whether an intermediary is involved or not? “**

Percentage	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Cheaper through intermediary	5.8	9.4	4.3	5.6	9.5	11.1	1.6
No difference	8.3	6.3	10.0	5.6	4.8	5.6	11.1
Intermediary: 10% more expensive	30.8	21.9	40.0	11.1	23.8	30.6	33.3
Intermediary: 10-20% more expensive	29.2	34.4	27.1	27.8	33.3	41.7	20.6
Intermediary: 20-50% more expensive	8.3	9.4	5.7	16.7	14.3	2.8	9.5
Intermediary: 50-100% more expensive	1.7	3.1	0	5.6	0	0	3.2
n/r	15.8	15.6	12.9	27.8	14.3	8.3	20.6

In conclusion, the costs of time and money in finding and procuring supplies of raw materials and goods are huge and could be substantially reduced if the information exchange on the market is improved. It is fairly abnormal to spend 2 days to obtain information on where to find the necessary materials or goods. The business associations and the chambers of commerce could be particularly helpful in this respect by facilitating the access of entrepreneurs to commercial information. On the other hand, entrepreneurs must realise how important it is to provide up-to-date information to all registers related with their operations. They must be fully aware that they are in fact the first beneficiaries of having up-to-date information in the existing data banks.

### III.B.4 Costs of office maintenance and costs of marketing the products, goods or services

The total office maintenance costs include items, such as rentals, telephone expenses, electricity and heating expenses. For 75% of the firms interviewed, these costs amount to between 5 and 25% of the total revenues. However, 8.3% of the firms claim that the office maintenance costs amount to somewhere between 50 and 100%. This could mean either of the following two things:

- either these firms are extremely inefficient and it is impossible to explain how they avoid going bankrupt, or
- which is in fact more probable, the entrepreneurs interviewed are not fully aware of the amount of these costs. Most small and medium-sized businesses in Bulgaria are simply unaware of the concept of *financial management*. Many owners, managers and chief accountants are not familiar with the percentage share of various firm expenses. This is due, *inter alia*, to the lack of understanding about the importance of this information and to the huge number of reports, statements, declarations and registrations which are required by the State<sup>35</sup> and are extremely time-consuming for the entrepreneurs.

The largest percentage of such firms is present in the sector of trade, and in Sofia (See Table 22).

**Table 22: Responses to the question “What percentage share of your total revenues do you spend on office maintenance costs (rentals, telephone etc.)?”**

Percentage	Total 1996	Total 2000	Production	Trade	Services	Sofia	Large district centre	Smaller town
Up to 5%	45.4	18.3	31.3	14.3	11.1	9.5	19.4	20.6
5 - 15%	21.3	32.5	21.9	35.7	38.9	38.1	27.8	33.3
15 - 25%	13.9	24.2	31.3	18.6	33.3	19.0	27.8	23.8
25 - 50%	15.7	15.0	9.4	20.0	5.6	9.5	16.7	15.9
50 - 100%		<b>8.3</b>	<b>3.1</b>	<b>11.4</b>	<b>5.6</b>	<b>23.8</b>	<b>8.3</b>	<b>3.2</b>
Over 100%	<b>3.7</b>	0	0	0	0	0	0	0
n/r		1.7	3.1	0	5.6	0	0	3.2

The above data reveals a significant increase in the office maintenance costs since 1996. In 1996, nearly half the firms maintained their offices against more or less 5% of their total turnover. In 2000, however, the majority of firms maintain the offices against 5 to 25% of the turnover. The fact that the office maintenance costs of 3.7% of the interviewees exceed 100% clearly shows that the financial management problems are far from being new.

Quite like in 1996, the costs of marketing a product in 2000 amount to 20% of its selling price on average (See Table 23).

**Table 23: Responses to the question “What percentage of the total selling price of your goods/services do you spend on marketing?”**

<sup>35</sup> See below, *Audits / Inspections and Reporting*.

Percentage	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Arithmetical mean	34.61	38.23	33.86	29.62	36.94	37.5	32
<b>Median</b>	<b>20</b>	<b>25</b>	<b>25</b>	<b>10</b>	<b>25</b>	<b>27.5</b>	<b>20</b>
<i>Valid cases</i>	<i>102</i>	<i>30</i>	<i>59</i>	<i>13</i>	<i>16</i>	<i>34</i>	<i>52</i>

Out of all 120 firms interviewed, 84.2% market their products mostly directly to the consumer, 12.5% use mostly intermediaries, and none resorts to electronic commerce. The highest number of firms using intermediaries is in the sector of production (25%).

It is quite logical, then, that 73% of the marketing costs are linked to intra-firm payments and 20% to external payments.

Table 24 contains the costs most frequently incurred in marketing the product. The percentages in the table in fact show the percentage of firms having responded that they incur such costs when marketing their products.

**Table 24**

Valid percentage	Total	Production	Trade	Services
Labour	83.3	84.4	85.7	72.2
Office maintenance (telephone, electricity, water, etc.)	82.5	90.6	80	77.8
Transport costs	81.7	81.3	88.6	55.6
Rentals	66.7	71.9	67.1	55.6
Insurance and security	38.3	43.8	37.1	33.3
Advertising	36.7	50	31.4	33.3
Market surveys	33.3	56.3	24.3	27.8
Commissions cash	22.5	34.4	18.6	16.7
Representative expenses (dinners, meetings)	15.8	21.9	14.3	88.9

The largest number of firms responded that their marketing costs include labour costs, office maintenance costs, transport costs and rentals. These four elements are the same by town and by sector, with one strange exception: in the service sector, 88.9% of the entrepreneurs interviewed said that representative costs were part of product marketing costs.

Given the specific operations in the three sectors under review, we could say that the distribution of firms having identified the remaining product marketing costs is completely logical.

Table 25 shows the percentage of firms which indicated a particular cost as the highest of all the costs.

**Table 25**

Valid percentage "Highest cost"	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Rentals	42.5	21.7	57.4	20	35.3	53.6	37.1
Labour	39	55.6	25	69.2	38.9	30.3	44.9
Market surveys	22.5	22.2	11.8	60	16.7	20	26.3
Office maintenance	16.2	17.2	17.9	7.1	6.3	14.7	20.4
Commissions cash	11.1	9.1	15.4	0	20	0	13.3
Transport costs	10.2	0	12.9	20	20	8.6	8.3
Advertising	9.1	6.3	13.6	0	14.3	0	15
Representative	5.3	14.3	0	0	25	0	0
Insurance and security	0	0	0	0	0	0	0

In general terms, the largest number of firms - 42% - find that rentals are the highest costs they incur. For 39% of the firms, the highest costs are connected with labour, for 22.5% the market surveys rank first, and for 16.2% the highest costs are attributed to office maintenance. It is impressive that many firms - 11.1% - have indicated as highest costs the commissions paid cash, that is to say the bribes. The largest percentage here is found accordingly in the sector of trade (15.4%), and in Sofia (20%). This means that **corruption gives rise to serious transaction costs for a significant number of firms in Bulgaria.**

### *III.B.5 Costs relating to the labour market and social security legislation*

Table 26 shows the percentage of total revenues spent on labour.

**Table 26**

Percentage	Total 1996	Total 2000	Production	Trade	Services	Sofia	Large district centre	Smaller town
Up to 5%	37.7	10.0	12.5	11.4	0	4.8	13.9	9.5
5 - 15%	30.2	25.0	12.5	31.4	22.2	14.3	25.0	28.6
15 - 25%	19.8	23.3	25.0	24.3	16.7	14.3	25.0	25.4
25 - 50%	11.3	22.5	21.9	21.4	27.8	33.3	27.8	15.9
50 - 100%	0.9	9.2	18.8	4.3	11.1	23.8	5.6	6.3
Over 100%	0	0	0	0	0	0	0	0
n/r	0	10.0	9.4	7.1	22.2	9.5	2.8	14.3

Since 1996, labour costs have been gradually increasing and tend to move to the area above 25%.

In order for an employee to receive 100 Levs, he or she must work out 176.65 Levs. In other words, the State must be paid 76.65 Levs in the form of taxes and social security contributions on every 100 Levs (See Table 27).

**Table 27: Tax and social security burden, 1991-2000**

Year	Average monthly salary (NSI)*	PAYE	%	Pension, health insurance / VTU** paid by employee	%	Pension, health insurance / VTU** paid by employer	%	Labour costs per 100 Levs salary	Payments at the expense of employee	Payments at the expense of employer
1991	959	116	12.10%			354.83	37%	<b>155.85</b>	12.10%	37.00%
1992	2,047	301	14.70%			757.39	37%	<b>160.62</b>	14.70%	37.00%
1993	3,231	445	13.77%			1195.47	37%	<b>158.88</b>	13.77%	37.00%
1994	4,960	700	14.11%			2083.20	42%	<b>165.33</b>	14.11%	42.00%
1995	7,597	969	12.76%			3190.74	42%	<b>162.76</b>	12.76%	42.00%
1996	14,392	2639	18.34%	288	2%	6044.64	42%	<b>178.25</b>	20.34%	42.00%
1997	141,640	20208	14.27%	4108	2.9%	59488.91	42%	<b>171.43</b>	17.17%	42.00%
1998	208,135	35746	17.17%	6036	2.9%	84502.81	40.6%	<b>175.91</b>	20.07%	40.60%
1999	218,900	33353	15.24%	9851	4.5%	90186.80	41.2%	<b>175.92</b>	19.74%	41.20%
2000	228	31	13.62%	21	9.0%	83.68	36.7%	<b>176.65</b>	22.62%	36.70%

\* NSI: National Statistical Institute

\*\* VTU: Vocational Training and Unemployment Fund

### III.B.6 Audit/Inspection and Reporting Costs

#### 1. Audits

Every business is subject to the main following types of audits or inspections:

- tax audits;
- audits by the National Social Security Institute;
- inspections in relation to the maintenance of the license;
- other inspections, *e.g.* for compliance with labour law, conditions at work, etc.

According to the poll, tax audits are most time-consuming (in days). They take 3 days on average, with the lengthiest audits being those in Sofia - 5 days on average. The maximum duration indicated in a response was 120 days.

The direct financial expenses attributed to those audits and inspections are quite different. In the general case they amount to zero, but for some firms they could well be as high as 3 200 Levs, with an arithmetical mean for the sample 102.58 (See Table 28). These are, most probably, costs relating to the auditor's stay or paid directly in cash in order to ensure him making a compromise.

The big standard deviation is due to the specificity of each individual audit, the number of documents audited, etc.

**Table 28**

Tax audits	Total		Production		Trade		Services	
	Days	Levs	Days	Levs	Days	Levs	Days	Levs
Arithmetical mean	7.93	102.58	6.39	277.14	9.05	29.44	5.54	0
<b>Median</b>	<b>3</b>	<b>0</b>	<b>5</b>	<b>0</b>	<b>2</b>	<b>0</b>	<b>3.5</b>	<b>-</b>
Minimum	0	0						

Maximum	120	3,200						
Valid cases	92	45	23	14	57	25	12	6
			<b>Sofia</b>		<b>Large district centre</b>		<b>Smaller town</b>	
			<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>
Arithmetical mean			18.13	462.86	4.78	15.71	6.72	48.17
<b>Median</b>			<b>5</b>	<b>0</b>	<b>3</b>	<b>0</b>	<b>2</b>	<b>0</b>
Valid cases			15	7	31	14	46	24

The audits of the National Social Security Institute must establish the compliance with the Code of Compulsory Social Security and its implementing instruments. As we have seen from Table 27, in 1999 the social security burden on the employer was 41.20%, that is every paid salary of 200 Levs cost the employer 282.40 Levs. This often makes employers try to avoid paying the contributions due. The task of the National Social Security Institute is to compare the contributions paid with the amounts due, check the benefits paid for temporary incapacity for work, etc.

The audits from the National Social Security Institute take 1 day on average, with 40 days being indicated as the maximum period. The average direct costs of this type of audits also amount to zero but in some firms they reach the sum of 320 Levs (See table 29). Interestingly, the maximum direct costs of social security audits are nearly 10 times lower than tax audits costs. This results from the fact that the social security receivables of the State are lower than the corporate taxes due by the firms. There is a unwritten rule that the sum given to the auditor is a percentage of the sum that would be paid if the auditor does not make a compromise and refuses to neglect his duties.

**Table 29**

Audits by National Social Security Institute	Total		Production		Trade		Services	
	Days	Levs	Days	Levs	Days	Levs	Days	Levs
Arithmetical mean	3.17	23.49	4.25	35.0	2.93	25.0	2.21	0
<b>Median</b>	<b>1</b>	<b>0</b>	<b>3</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>2</b>	<b>-</b>
Minimum	0	0						
Maximum	40	320						
Valid cases	62	33	16	10	37	17	9	6
			<b>Sofia</b>		<b>Large district centre</b>		<b>Smaller town</b>	
			<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>	<b>Days</b>	<b>Levs</b>
Arithmetical mean			3.25	25.0	5.03	35.56	2.06	16.94
<b>Median</b>			<b>2.5</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>0</b>
Valid cases			8	6	20	9	34	18

The third type of inspections are those related to the supervision of licensed firms. The licensing of certain types of business operations would be meaningless if no one exerts *ex-post* control to check compliance with the qualifying requirements. Hence, 91% of the entrepreneurs interviewed answer in the affirmative when asked "Do the competent institutions control your compliance with regulatory requirements by way of inspections?"

These inspections take 1 day on average. According to the statistical median, the direct costs amount to 0 but the arithmetical mean is 21.32 Levs. The maximum duration of such inspections is 60 days, the maximum expenditure is 270 Levs and the minimum is 0. Inspections in the production sector cost most time and money, while trade

and services come next. As regards the data by town, the inspections are lengthiest in Sofia and most expensive in small towns. (See Table 30).

**Table 30**

Inspections for compliance with licensing requirements	Total		Production		Trade		Services	
	Days	Levs	Days	Levs	Days	Levs	Days	Levs
Arithmetical mean	3.32	21.32	3.87	30	3.5	18.95	1.56	6
<b>Median</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>0</b>
Minimum	0	0						
Maximum	60	270						
<i>Valid cases</i>	<i>74</i>	<i>38</i>	<i>16</i>	<i>14</i>	<i>48</i>	<i>19</i>	<i>10</i>	<i>5</i>
			Sofia		Large district centre		Smaller town	
			Days	Levs	Days	Levs	Days	Levs
Arithmetical mean			9.8	0	1.78	9.17	2.67	36.84
<b>Median</b>			<b>1</b>	<b>-</b>	<b>1</b>	<b>0</b>	<b>1</b>	<b>0</b>
<i>Valid cases</i>			<i>10</i>	<i>7</i>	<i>26</i>	<i>12</i>	<i>38</i>	<i>19</i>

Other inspections that firms are subject to last 1 day on average, and no large discrepancies exist by sector or by town. The statistical median of the expenses is 0 but the arithmetical mean is much higher - 350.31 Levs due to the exceptional maximum price indicated at the response (5,000 Levs).

During the inspections by State administrative authorities, 29% of the interviewees are forced to incur "informal" expenses. The distribution of those having paid bribes by town and by sector is almost equal.

In conclusion, audits and inspections of firms' operations give rise to varying amounts of transaction costs which are sometimes especially high.

## 2. Reporting

The data from this poll shows that 85% of the firms keep regular accounting and only 15% prepare their financial statements in a rush before the close of the relevant reporting period. 51.7% of the firms use double-entry book-keeping, while 33.3% use single-entry book-keeping.

Compared with 1996, the share of "rush" and single-entry accounting has declined and has given way to regular double-entry accounting.

In most firms (43.3%) the accounting work is entrusted to a special accountant hired under a service contract, or to an accountancy firm. In 28.3% of the firms, accounting is entrusted to an accountant employed on a full-time basis, while in 20.8% of the cases the accounting work is carried out by the owner or the director.

The accounting work is done by 1 person on average. In 65.8% of the firms it takes up to 10 days (See Table 31).

**Table 31**

Percentage	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Up to 5 days	42.5	31.3	41.4	66.7	38.1	38.9	46.0
5 - 10 days	23.3	12.5	28.6	22.2	23.8	22.2	23.8
10 - 20 days	11.7	18.8	10.0	5.6	9.5	19.4	7.9
20 - 30 days	20.0	31.3	20.0	0	23.8	19.4	19.0
n/r	2.5	6.3	0	5.6	4.8	0	3.2

According to the Code of Compulsory Social Security, insurers must submit to the National Social Security Institute, on a monthly basis and separately for each employee, the following data:

- income chargeable for social security purposes;
- amount of contributions for social security, health insurance, for the Vocational Training and Unemployment Fund and for supplementary compulsory pension insurance;
- amount of social security benefits paid out and working record.

The filling and submission of declarations containing these data take 2 days on average, with a maximum period of 20 days.

37.6% of the sole proprietors interviewed do not pay sickness benefits or child allowances to their employees. 60% of those do not pay, because they do not have employees with children under age, 17% because they do not hire employees at all, and 3.1% refrain from paying, because of the huge bureaucracy at the National Social Security Institute.

The practice shows that, during the study period, sole proprietors are placed in a particularly disadvantageous situation as insurers. Like all other insurers, they also pay monthly social security contributions by bank transfers. However, if they claim reimbursement by the National Social Security Institute of sickness benefits and child allowances paid out to their employees, the claim must be certified by an inspector of the National Social Security Institute and could only then be deposited at the insurer's bank<sup>36</sup>. This process takes 2 days on average, with 30 days being indicated as the maximum.

The maximum indicated periods of interaction with the National Social Security Institute are largely exaggerated and rather mirror the negative attitude of entrepreneurs to the bureaucracy and to the work of that institution.

As a result of various instruments of primary and secondary legislation, Bulgarian entrepreneurs must file numerous declarations, statements, etc.

In addition to the declarations filed with the National Social Security Institute, already referred to, we could list the following examples:

- annual tax return;

---

<sup>36</sup> This situation was changed at the beginning of year 2000. At the present time sole proprietors are equal in rights to the other insurers.

- statement of the sums paid under service contracts during the accounting year;
- annual statistical report;
- declarations each and every time that a bank account is opened or closed (to be filed with the territorial tax administration);
- declaration of the number of employees and the conditions at work (to be filed at the National Employment Service as many times as circumstances once declared have changed);
- and occasionally other specific papers.

The filling and submission of all these documents take 4 weeks annually on average.

### *III.B.7 Costs of debts to the Treasury*

The debts to the Treasury include primarily:

- customs duties, fees and excise;
- VAT;
- corporate profit tax (sole proprietors pay personal income taxes);
- health insurance and social security contributions.

Judging from the answers to the question "*What portion of your firm's total revenues is used to cover debts to the Treasury?*", this portion is indeed large (See Table 32).

**Table 32**

Percentage	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Up to 10%	7.5	6.3	8.6	5.6	14.3	0	9.5
10 - 20%	15.0	21.9	12.9	11.1	14.3	8.3	19.0
<b>20 - 30%</b>	<b>25.0</b>	<b>18.8</b>	<b>27.1</b>	<b>27.8</b>	<b>23.8</b>	<b>30.6</b>	<b>22.2</b>
<b>30 - 50%</b>	<b>30.0</b>	<b>34.4</b>	<b>28.6</b>	<b>27.8</b>	<b>38.1</b>	<b>36.1</b>	<b>23.8</b>
Over 50%	18.3	15.6	20.0	16.7	4.8	25.0	19.0
n/r	4.2	3.1	2.9	11.1	4.8	0	6.3

The high amounts of debts to the Treasury makes 27% of the entrepreneurs interviewed attempt to reduce or avoid the payment of customs dues, thus saving up to 25% of the outstanding amounts. 11.7% of the interviewees keep two accounting systems: a formal one for the tax authorities plus an informal one for their own internal use.

As regards sole proprietors (which are 70.8% of the firms in the sample), their debts to the Treasury in 2000

have increased by 15 to 22% as compared to 1999. This results mainly from the increased tax and social security burden after the entry into force of the Code of Compulsory Social Security and the increased amount of minimum monthly salary in the country (See Table 33).

**Table 33**

Monthly income in Levs	Health insurance premium 6%	Pension premium 32%	Income after deduction of premiums	Personal income tax	Net income	Total tax and social security burden
<b>Second half of 1999</b>						
250	15.00	21.44	213.56	34.53	179.03	28.39%
500	30.00	21.44	448.56	95.63	352.93	29.41%
750	45.00	21.44	683.56	152.83	530.73	29.24%
<b>First half of 2000</b>						
250	15.00	80.00	155.00	15.40	139.60	44.16%
500	30.00	160.00	310.00	55.70	254.30	49.14%
750	45.00	240.00	465.00	101.10	363.90	51.48%

Source: Calculations of IME

Under the Code of Compulsory Social Security, as from 1 January 2000, all persons registered as sole proprietors must mandatory pay social security contributions amounting 32% per month. The income for social security purposes equals the taxable income declared in the annual tax return but cannot exceed 10 minimum monthly wages. The increased level of income chargeable for social security purposes results from the type of pension system in the country. At present, the Bulgarian pension system is of the pay-as-you-go type, *i.e.* the contributions paid by today's employees cover the pensions of today's pensioners. The problem stems from the adverse proportion between employees and pensioners which is 100:90. In order to make 100 employees to be able to support 90 pensioners, either collection should be improved, or the amount of contributions or of the chargeable income should be increased. As the National Social Security Institute manages to collect only 75% of the contributions due, it regards the increase in the chargeable income as the easiest and painless method of fund-raising. Thus, the tax and social security burden in 2000 has reached the absurd level of 50% per month. This will naturally drive the sole proprietors to concealing their income and transferring a large portion of their operations to the grey sector.

### **III.C Contractual costs (entering into and performance of contracts)**

The contractual costs could be attributed to several stages:

1. Costs of preliminary studies of the future partner, unless this is the State;
2. Costs to participate in public tenders under the Law on Public Procurement;
3. Costs to prepare, negotiate and enter into contracts;
4. Costs to ensure contractual performance.

The poll has shown that Bulgarian firms usually do not engage in studying their partner prior to making a contract. Only 6.7% of the entrepreneurs interviewed sought information about their future partners in the Commercial Register at the court or at the BULSTAT Registry. This cost them 5 Levs at the minimum and 10 Levs at the maximum and the information was obtained for a minimum of 1 day and a maximum of 5 days. Preliminary

studies are carried out mostly by firms in Sofia and, in terms of sector, by firms in the service sector.

The non-existing practice of studying the partner in advance probably explains why 81% of the firms prefer to enter into contracts with firms they already know. (See Table 34).

**Table 34: Responses to the question “What firms do you prefer to make contracts with?”**

Percentage "contracts preferred primarily with"	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
<b>Firms we know</b>	<b>81.1</b>	<b>76.5</b>	<b>81.3</b>	<b>100.0</b>	<b>90.0</b>	<b>60.0</b>	<b>95.7</b>
Popular firms	25.8	16.7	22.7	66.7	25.0	20.0	33.3
Large firms	20.8	16.7	23.5	0	0	30.8	16.7
The State	14.3	50.0	0	0	20.0	0	50.0
No preference	77.4	100.0	64.7	87.5	80.0	66.7	85.7
Others	33.3	100.0	33.3	0	0	50.0	33.3

Given the minimum thresholds for public procurements which existed until recently (as set out in s. 7 of the Law on Public Procurement),<sup>37</sup> it is not surprising that only 9.2% of the firms interviewed have ever participated in a public tender (respectively 12.5% in the production sector, 8.6% in the trade sector and

5.6% in the service sector). The distribution by town is almost the same and larger firms naturally prevail.

The drafting of the tender documents, the payment of tender guarantees and participation in the tendering procedure take 11.5 days on average. Some firms which resorted to additional advice and incurred extra expenses needed 12 days more. The average costs of preparing the tender documents is 222.5 Levs and the average amount of guarantee is 2,000 Levs.

The costs of preparing for and participating in a tender amount to 1.5% of the firm's total revenues on average. Only in 54.5% of the cases participation in a tender resulted in making a contract.

In April 2000, a special instrument was adopted, namely the Ordinance on the Award of Public Procurement Contracts below the Thresholds laid down in s. 7, subs 1 of the Law on Public Procurement. The Ordinance introduced the concept of "small-scale public procurement". It also set out the types of procedure for the award of "small-scale" procurement contracts and the ceilings for the contract price, with a maximum amount of 600 thousand Levs. S. 18 of the Ordinance sets the price of the tender documents which may not exceed the actual

---

<sup>37</sup> Section 7 (1) "The provisions of this Law shall mandatorily apply to the award of public procurement contracts of the following value at the date of advertising the procedure, VAT-excluded:

1. construction contracts under s. 3, subs 1(1): above 600 thousand Levs;
2. supply contracts under s. 3 (subs 1(2): above 50 thousand Levs;
3. service contracts under s. 3, subs 1(3): above 30 thousand Levs."

expenses incurred in preparing these documents.<sup>38</sup> All these measures are expected to lower the costs and enable small and micro-business to be more prominently represented in the tendering procedures.

If a contract is entered into outside the context of public procurement, the preparation for, negotiation of, and entering into such a contract need 3 days on average, at an average cost of 30 Levs. The responses are characterised by a huge standard deviation. The maximum period indicated was 450 days and the maximum cost was 60,000 Levs. Likewise, the median differs substantially by sector and by town. The procedure takes most time and most expensive in Sofia. In terms of sector, the procedure is lengthiest in the service sector but is most expensive in the production sector.

Table 35 shows the types of costs incurred to prepare, negotiate and enter into contracts, and the percentage of firms having indicated that they incur such costs.

**Table 35**

Valid percentage	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
<b>Expenses to study partner</b>	<b>30.0</b>	43.8	24.3	27.8	33.3	38.9	23.8
<b>Expenses for legal drafting of contract</b>	<b>32.5</b>	43.8	27.1	33.3	14.3	47.2	30.8
Consulting expenses	20.0	25.0	19.1	22.2	14.3	25.0	19.0
Commissions cash	19.2	25.0	18.6	11.1	19.0	19.4	19.0
<b>State fees</b>	<b>40.0</b>	37.5	44.3	27.8	38.1	58.3	30.2
Others	20.0	21.9	14.3	38.9	23.8	25.0	15.0

The expenses most frequently incurred are those for State fees followed by legal drafting, and the costs of studying the partner. Consulting expenses, commissions paid cash and any other expenses come fourth with almost equal percentages.

Table 36 presents the percentage of firms having indicated a given expense as the highest one in the process of preparing, negotiating and entering into contracts.

**Table 36**

Valid percentage "highest expense"	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
<b>Expenses to study partner</b>	<b>50.0</b>	<b>64.3</b>	<b>35.3</b>	<b>60.0</b>	<b>71.4</b>	<b>50.0</b>	<b>40.0</b>
Expenses for legal drafting of contract	12.8	7.1	15.8	16.7	33.3	0	21.1
Consulting expenses	20.8	25.0	16.7	25.0	33.3	0	33.3
Commissions cash	43.5	62.5	30.8	50.0	50.0	28.6	50.0

<sup>38</sup> By contrast, s. 36, subs 2 of the Law on Public Procurement provides that the price of tender documents shall be determined by the contracting authority.

State fees	64.6	33.3	77.4	60.0	37.5	71.4	68.4
Others	45.8	28.6	50.0	57.1	40.0	55.6	40.0

The largest number of firms responded that State fees were their highest expense. A slightly smaller number placed expenses for studying the partner highest. According to the Report on Bulgaria of Transparency International, in 1999 the country ranked 69<sup>th</sup> in the world in terms of corruption. Nevertheless, a disturbingly large number of firms (43.5%) stated that the commissions payable cash were their highest cost. Of course, there has been some progress here: in 1996 the figure was 78.8%.

There is, though, a slight inconsistency, which makes us doubt if all entrepreneurs are really aware of what the contractual expenses consist in and how big they actually are. If only 6.7% of the firms sought information from the public registers and moreover information is neither expensive, nor time-consuming, why did 50% of the interviewees claim they incurred the highest costs in studying the partner? It is hard to believe that 60 out of 120 interviewed firms maintain investigation departments to inquire about and study their possible partners - they can simply not afford it with their average annual turnover of 50,000 Levs.

As regards the costs to ensure contractual performance, 54.2% of the firms encountered problems with defaulting partners. However, 45.8% were in default themselves. In such a case, firms tend to negotiate, rather than refer the matter to court. Firms in Sofia are the ones to most often negotiate and warn, whereas firms in small towns most often go to court or threaten their partners by using crime organisations. (See Table 37).

**Table 37**

Percentage	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Problems not encountered	54.2	46.9	57.1	55.6	33.3	55.6	60.3
Negotiations	18.3	25.0	15.7	16.7	28.6	19.4	14.3
Warnings	2.5	0	4.3	0	9.5	2.8	0
<b>Court</b>	<b>1.7</b>	<b>3.1</b>	<b>1.4</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>3.2</b>
Resort to security firms	0.8	0	1.4	0	0	0	1.6
Others	13.3	18.8	10.0	16.7	0	22.2	12.7
n/r	9.2	6.3	10.0	11.1	28.6	0	7.9

The extremely low percentage of firms having chosen to refer their disputes to court mirrors the low degree of confidence in the judicial system.

If the partners are in default, the process of ensuring contractual performance takes 15 days on average at an average price of 225 Levs. The procedure in Sofia is both slowest and most expensive. (See Table 38).

**Table 38**

Cost (days and money) to ensure performance by defaulting partners	Total		Production		Trade		Services	
	Days	Levs	Days	Levs	Days	Levs	Days	Levs
Arithmetical mean	148.93	2775.22	28.79	4,300	92.83	3,003.85	754.6	126.25
<b>Median</b>	<b>15</b>	<b>225</b>	<b>20</b>	<b>500</b>	<b>12</b>	<b>500</b>	<b>20</b>	<b>127.5</b>
Minimum	0	0						
Maximum	3,650	24,000						
<i>Valid cases</i>	43	22	14	5	24	13	5	4
			Sofia		Large district centre		Smaller town	
			Days	Levs	Days	Levs	Days	Levs
Arithmetical mean			101.42	400	234.82	2,591.67	89.58	4,107.86
<b>Median</b>			<b>90</b>	<b>500</b>	<b>14</b>	<b>225</b>	<b>10</b>	<b>200</b>
<i>Valid cases</i>			7	3	17	12	19	7

The large dispersion in the responses is quite logical. The duration and the cost of the process differ from case to case depending on the type of problem, the method of settlement chosen, etc.

### III.D Transformation or Exit Costs

In a dynamic and frequently changing business environment, such as that in Bulgaria, the costs of transforming or leaving the business are also very important. They must be reduced to a minimum in order to enable the firms to survive in times of market crises.

The question "*What would you do if the market of your business shrinks dramatically?*" was answered mostly by "shrinking the administrative and labour costs". The next two choices were "shrinking the external marketing costs" and "entering another business sector". (See Table 39).

**Table 39**

*(More than one answer allowed)*

Valid percentage YES	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Shrinking administrative costs (rentals, telephone etc.)	64.0	71.0	63.2	53.3	60.0	71.4	61.0
Shrinking labour costs	64.0	67.7	61.8	66.7	75.0	60.0	62.7
Shrinking external costs of marketing goods/services	41.2	48.4	39.7	33.3	35.0	34.3	47.5
Entering another business sector	42.6	45.2	40.6	46.7	35.0	50.0	40.7
Liquidation of firm	23.5	12.9	26.1	33.3	20.0	27.8	22.0
Others	12.3	9.7	14.7	6.7	15.0	5.7	15.3

Table 40 shows which of those measures were used in practice and by how many firms

**Table 40**

*(More than one answer allowed)*

Valid percentage YES	Total	Production	Trade	Services	Sofia	Large district centre	Smaller town
Shrinking administrative costs (rentals, telephone etc.)	60.3	52.2	68.9	40.0	63.6	69.2	53.7
Shrinking labour costs	62.3	52.2	68.2	60.0	72.7	68.0	56.1
Shrinking external costs of marketing goods/services	27.3	26.1	29.5	20.0	27.3	16.0	34.1
Entering another business sector	36.4	39.1	31.8	50.0	54.5	24.0	39.0
Liquidation of firm	0	0	0	0	0	0	0
Others	5.2	4.3	4.5	10.0	9.1	0	7.3

The data in the above table shows that the methods most frequently used to survive a crisis are the reduction of administrative and labour costs, followed by entering another business sector.

The transformation of a business takes 60 days on average (5 days at minimum and 730 days at maximum). The average "price of survival" is 100 Levs (minimum zero and maximum 10,000 Levs). The transformation of business is most protracted and expensive in Sofia (See Table 41).

**Table 41**

Cost (days and money) to transform business	Total		Production		Trade		Services	
	Days	Levs	Days	Levs	Days	Levs	Days	Levs
Arithmetical mean	152.13	2,064.29	238.89	1,683.33	112.5	2,431.82	131.14	1,625.00
<b>Median</b>	<b>60</b>	<b>100</b>	<b>60</b>	<b>50</b>	<b>60</b>	<b>100</b>	<b>60</b>	<b>1,750</b>
Minimum	5	0						
Maximum	730	10,000						
<i>Valid cases</i>	32	21	9	6	16	11	7	4
			Sofia		Large district centre		Smaller town	
			Days	Levs	Days	Levs	Days	Levs
Arithmetical mean			354.17	5,837.5	56.11	400	131.65	2,050.0
<b>Median</b>			<b>287.5</b>	<b>6,625</b>	<b>50</b>	<b>0</b>	<b>60</b>	<b>1,650</b>
<i>Valid cases</i>			6	4	9	9	17	8

The huge dispersion in the responses is due to the specificity of each individual case.

## IV. Conclusions

The review of existing Bulgarian legislation and the analysis of the empirical data prompt me to make the following conclusions:

1. The identification, measuring and, mostly, the reduction of firms' transaction costs are of particular importance to the Bulgarian economy at present, as the share of its informal segment tends to be between 22 and 40%. We cannot be sure about the exact dimensions of the shadow economy but it seems to grow more dynamically than the registered one. This could mean that either many newly-formed firms start operating "in the shades" or that firms operating in the daylight tend to go underground. In general terms, the reason is that the transaction costs of operating in the daylight grow as compared to those of operating in the shadow. Hence, the identification, measurement and reduction of transaction costs would be critical in curbing the "grey" segment of Bulgarian economy;
2. The present study would be of some help not by calculating the arithmetical mean of entry costs in terms of time and money but by identifying the underlying reasons for these costs. That could enhance any further efforts to minimize such costs in future;
3. As a result of the lack of preliminary regulation impact assessment, many regulations in the country make the firms incur transaction costs which are often completely unnecessary or hidden. In Bulgarian legislation there are a lot of examples in support of this assertion;
4. The legislation often transfers the costs of enforcing and applying the rules onto the entrepreneurs or introduces quasi-taxes which are compensated by income concealing and tax avoidance. The licensing legislation as a whole and many other instruments could serve as good examples in this respect;
5. Further to the review of the legislation that affects the business environment in Bulgaria, the following main groups of transaction costs have been identified as stemming from existing legal rules and from the interaction with public authorities:
  - firm registration costs;
  - costs of obtaining a license, permit or registration of the business to be carried on;
  - operating costs relating to: legislative amendments; access to lending; search for and supplies of the indispensable raw materials, goods and services; office maintenance and product marketing; labour market and social security legislation; audits / inspections and reporting; debts to the Treasury;
  - contractual costs (entering into and performance of contracts);
  - transformation and exit costs.
6. The transaction costs that entrepreneurs incur to register their firms are costs of time rather than financial costs and are mainly caused by the thoughtless legislative framework and the lack of cooperation among the bodies of public administration involved;
7. The transaction costs of obtaining licenses and permits are high and stem from the irrational and

inconsistent regulations as well as from their unsatisfactory implementation. The licensing procedures and requirements make the entrepreneurs incur costs in terms of time and money and actually represent an entry barrier. At the same time, they restrict competition and increase the transaction costs within a given sector, thus decreasing the market efficiency and increasing the segment of the shadow economy;

8. The licensing and permission procedures are the main reason for administrative delays in starting-up a business in the country. The lengthy time limits for obtaining permits result from the unwise regulatory framework and the discretion of public officials in the process of its enforcement. The compulsory sequence of the steps in the procedure, the non-transparent requirements and the poor technical equipment of the institutions involved make even bigger the waste of time and money;
9. The discretion of the officials mentioned above also causes large discrepancies in the entry transaction costs incurred by firms within the same sector and in the same town. This inevitably affects their price competitiveness and places at an extreme disadvantage those firms which start up later and by incurring higher costs as a result of the existing administrative discretion in Bulgarian laws;
10. The lack of preliminary regulation impact assessment results in frequent legislative amendments which, in turn, burden the firms with numerous extra transaction costs. The frequent amendments to existing regulations make the business environment highly volatile and increase the transaction costs, thus offering more incentives to operate "in the shades";
11. The access to direct or indirect funding is very restricted due to the low supply of loans and the underdeveloped capital market in the country. The unstable business environment keeps high the credit risk for banks, on the one hand, and make the entrepreneurs reluctant to use loans, on the other hand;
12. Many small and medium-sized enterprises in the country suffer from bad financial management. Some Bulgarian entrepreneurs are not really aware of the level of transaction costs relating to office maintenance and product marketing. This could be explained by failure to realise the importance of this information and by the huge number of reports, statements, declarations and registrations which are required by the State and are quite time-consuming for the managers.
13. Interacting with the State (by way of audits, inspections and reports) takes each entrepreneur 5 weeks per year on average and gives rise to different levels of transaction costs;
14. The high percentage of debts to the Treasury (customs duties, excise, taxes, social security and health insurance contributions, etc.) encourages the firms to conceal revenues and to transfer many of their operations into the shadow sector.

## **V. Recommendations**

The review of present Bulgarian business legislation, the empirical data analysis and conclusions made during the study, prompt me to outline the following recommendations:

1. Entry transaction costs of time and money could be substantially reduced by putting in place an

information network linking the bodies of public administration. This would ensure a rapid and easy access to public registers and would make unnecessary the visits to any other institutions after the court;

2. The administrative delays in starting up and the transaction costs involved could be significantly lowered by streamlining the licensing procedure as follows:
  - reducing to a minimum the number of licenses and replacing the transfer regimes with declaratory regimes for all types of business, except those bearing on the health of citizens, public policy and national security;
  - if licensing is deemed to be the proper approach, at least four principles should be observed:
    - a) licensing regimes should only be introduced by a law which stipulates all necessary and sufficient requirements to obtain the license in question. The legislative instruments should not contain provisions enabling the administration to impose other requirements in addition to those laid down by law;
    - b) the State institutions must be prohibited from requesting information already provided to another public authority or to a public register. In other words, the cost of exchanging information among the different bodies of public administration should not be incurred by the business;
    - c) the time limits for issuing a license must be set out in the law and the licensing authorities should not have a chance to modify them;
    - d) the licenses should be termless and not issued for a limited period of time. They should only be revoked on the grounds of violations.
3. In order to reduce the transaction costs in the course of firms' operations, the existing Draft Law on Legislative Instruments should be modified so as to insert in it a preliminary impact assessment requirement for all legislative instruments. In other words, preliminary debates and analyses must always be carried to make clear the expected positive or negative implications and who would suffer what. The wide public involvement in such debates would make it possible:
  - to assess the upsides and downsides for various social circles;
  - to avoid needless costs for the implementation, explanation of and compliance with the legislative instruments; and
  - to compare the costs and advantages of introducing a rule with the benefits lost as a result of not opting for other solutions.
4. The transaction costs of time and money in finding and supplying raw materials and goods could be seriously reduced by improving the exchange of information on the market. The business associations and the chambers of commerce could help a great deal in that respect by facilitating the access of entrepreneurs to business information.<sup>39</sup> In addition, entrepreneurs themselves should realise how important the up-to-date information on their operations and whereabouts is, and should accordingly notify any change.
5. The efforts of NGOs in training representatives of SMEs are particularly relevant, especially in the field of financial management and corporate governance.

---

<sup>39</sup> An appropriate example is the following web site: [www.major-companies.ro/](http://www.major-companies.ro/).

## Bibliography

1. Alexandra Benham and Lee Benham, *Measuring the Costs of Exchange*, presented at the Second Annual Meeting of ISNIE, September 17-19, 1998, Université de Paris;
2. Assenka Yonkova, *Financial Markets Development as an Incentive for Economic Growth*, Banks, Investment, Markets, issue 2, 2000, Sofia;
3. Douglas C. North, *Transaction Costs, Institutions and Economic Performance*, ICS Press, San Francisco;
4. Harvard Institute for International Development, Institute for Market Economics and Agency for Economic Analyses and Forecasts, *The Shadow Economy in Bulgaria*, October 2000;
5. Hernando de Soto, *The Other Path* (1989);
6. IME, *Business Pursuit Conditions in Bulgaria*, February 2000, Sofia;
7. IME, *Legal and Legislative Reform: Impact on the Private Sector*, IME Newsletter, issue March-July 2000, Sofia;
8. James D. Gwartney and Richard L. Sroup, *What Everyone Should Know about Economics and Prosperity*, 1993;
9. N. Nenovski and K. Hristov, *Study of the Money in Circulation after the Introduction of the Currency Board in Bulgaria*, BNB, May 2000;
10. Oliver E. Williamson and Scott E. Masten (eds.), *The Economics of Transaction Costs*, Edward Elgar Publishing Ltd., UK;
11. Roger Clark and Tony McGuiness (eds.), *The Economics of the Firm*, Vek 22, Sofia;
12. Ronald Coase, *The Firm, the Market and the Law*, University of Chicago Press, 1988.