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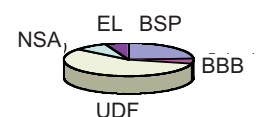
Krassen Stanchev, Ph. D.

For the first time in the post-Communist elections Bulgarians gave a full mandate to the non-Socialists. For a first time democrats have it took seven years, two hyperinflation peaks related to the Socialist rule and a total loss of confidence to bid farewell to their dreams to cut rents from a gradual transition.

Who is who in the Parliament?

The 240 seats in the new Parliament will be distributed as follows:

United Democratic Forces (UDF)	137
Bulgarian Socialist Party (BSP)	57
National Salvation Alliance (NSA)	20
Euro-Left (EL)	14
Bulgarian Business Block (BBB)	12



Election turnover was about 60% of the voters. The younger and mid-career generation voted overwhelmingly in favour of UDF. Its supporters are less educated than those of Euro-lefts whose predominant vote came from the most academic circles. BSP was brought to the legislature by the pensioners. NSA and BBB received a mixed mandate from odd voters.

NSA, a loose coalition dragged by the Movement for Rights and Freedoms (MRF, a party which Bulgarian Muslims vote for) is believed as most unpredictable faction. Besides MRF, it consists of Monarchists, Greens, Agrarians and Liberals expelled from other coalitions. They were put together by MRF intention to overcome internal splits and declining support, by the desire of the other NSA partners to get into the power and enjoy privileges, and, as rumours claim, by the financial backing of Multi-group. It is quite unlikely that they would be able to stay together or act as an united group in the Parliament.

BBB got considerably less votes in comparison with the recent presidential elections when its leader, Mr. George Ganchev, emerged as the third candidate with almost 22% of the vote. If there was a campaign against somebody it was Mr. Ganchev whose populism and chauvinism deserved intellectuals and opinion leaders' negative attitude. His faction in the Parliament consist of former Bulgarian KGB senior officers and a couple of intellectuals whose live path brought them into the company. In the previous Parliament BBB was voting in favour of the BSP and Mr. Ganchev played the role of a major criticist of the President Zhelev and

BSP opponents. It seems that he would sustain his „criticism“ towards UDF and the new President Stoyanov. His key campaign message was: If I were a caretaker PM, I could ensure \$2 billion support from the IFIs. BBB MPs would support the introduction of the currency board regime but immediately after they would start blaming the system advocating populist policies under the banner of the protection of domestic businesses and national interests.

EL marked an unbelievable success in the elections, after being established in mid-January. The faction consists of popular ex-Socialist dissidents who verbally opposed Mr. Zhan Videnov's cabinet while voting in his favour in the Parliament until early 1997. These are Socialist technocrats moderates, former members of the grouping around Lukhanov, who speak foreign languages and have some bureaucratic and/or business experience. They would support all initiatives of the new government with the idea to take their time and in the future to attract all the Center-left votes and constitute a stable Social-democratic party.

BSP has lost its reformist faces, they joined EL. Mr. Parvanov, the leader of the party seem is in a curious position to reject what his fellow-Socialist were advocating two-three months. The faction consists of apparatchics who manage to neutralise Videnov's guard but failed to elaborate their own message to the voters and sympathisers. In fact, BSP lost about half of its votes and it is hardly possible to recruit new ones. Except some odd business creatures, like the so called Orion-group, BSP will not enjoy any support from the local businesses. Links with the business community have gone with the Euro-leftists. Socialist MPs represent the most unreformed part of their predecessor Communist

party. Their choice would be to become more and more openly populist.

UDF faction consists of two sub-groups: Union of Democratic Forces and 14 MPs from the Peoples Union (PU). This division is not as important as it may seem at a first glance; PU wants to preserve its image of an independent political body; the very fact of constituting to sub-factions would mean to have twice more time during the plenary hearings in the legislature. The more significant is the fact that more than 100 of the UDF MPs are new-comers, UDF-insiders and functionaries with no experience in the Parliamentary debate. The unquestionable UDF leader is Mr. Ivan Kostov, former minister of finance in the coalition cabinet of Dimitar Popov (1990-1991) and UDF-government of Philip Dimitrov. There is no doubt that Mr. Kostov is the future Prime Minister of Bulgaria. One of the problems would be to ensure the unity and the strength of the faction to resist populist temptations and support the Council of Ministers. This task has to be carried out by two individuals. One of them is Mr. Eugene Bachardgiev, who was very instrumental in uniting UDF and is likely to chair the UDF faction in the Parliament. The other is Mr. Jordan Sokolov, a lawyer, ex-minister of interior, who is the most probable speaker of the Parliament.

What's next?

Next is Ivan Kostov. Election were a sort of no-intrigue choice between Reds and Blues, between ex-Communists who looted the country, and Democrats who, hopefully - fingers crossed, can make a difference. Voter did not pay attention to the list and the candidates. There was one or at least few leaders, Mr. Stoyanov, the incumbent President, Mr. Kostov, and the caretaker PM, Mr.

Sofianski. And there was one policy, that of the caretaker cabinet supported by Stoyanov and Kostov.

Mr. Kostov's main challenge is to sustain public support while moving reforms forward. His advantage, besides the most overwhelming majority a Bulgarian transition government has ever had, is that the reforms direction is already established by the policies of Mr. Sofianski and his cabinet agreements with the creditors.

Mr. Kostov was one of the few, if the first, Bulgarian key politicians who visited leading financial institutions on his own initiative. He has no other means to control domestic financial „sharks“ except relying on international expertise and institutions. He is likely to keep some key caretaker figures: at least Mr. Alexander Bozhkov, deputy PM, and Mr. Bogomil Bonev, minister of interior as well as many senior officials who initiated the start of the reforms in February and March. He will replace BNB Board member and the head of the Bank Consolidation Company, as a preparation for the introduction of the currency board and banks' privatization.

Mr. Kostov is no great communicator. But he was prompt is reaching the leading political parties consensus on self-evident reform objectives (introduction of the currency board, anti-corruption policies, EU integration etc.) thus ensuring more operational freedom of the future cabinet. As usual, however, the surprise may come from inside. There are already some mixed signals: Mr. Kostov fellows and allays started to talk about difficulties to privatise, protection of the profitable domestic industries and the needs to increase living standards. It seems that Mr. Kostov has no choice but be bolder than IMF and World bank in pushing market reforms faster.

BEYOND DISASTERS: WHAT POLICIES ENSURE GROWTH AND PROSPERITY

In the eve of the general elections, on 18th April, IME organised a conference called "Beyond Disasters: What Policies Ensure Growth and Prosperity". Among the key speakers were internationally renowned experts in developing economies as: Prof. Arye Hillman, Bar-Ilan University, Tel Aviv; President, European Public Choice Society; Prof. Marek

Dabrowski, Vice-Chairman, CASE - Warsaw; Dr. Richard Rahn, President, NOVECON; Dr. Michael Wyzan, Senior Economist, Open Media Research Institute (OMRI); Dr. Ilian Mihov, INSEAD, Paris.

Here IME Newsletter presents three of the presentations made by the Bulgarian participants. A summary of all other

Profit Tax and Investment in Bulgaria

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Rossen Rozenov, AECD

Pursuant to the State Budget Law the revenues from direct taxes for the year 1996 had to amount to about 26% while those from indirect taxes, duties and duty taxes had to be about 74% of the total. It is well known that Bulgaria's budget for 1997 has not been passed yet. Pursuant to the Budget Structure Law the revenues must comply with the laws that are operative at the moment. It is impossible to pass laws for a few weeks only and to carry out both a tax reform and a change in the ratio between direct and indirect taxes. The tendency in the relative share of taxes in the total tax revenues is connected with long-term strategy and at least for the next two years no changes of principal nature are possible therein. The tax law, which has been created for a very short time, with all its complexity of legal norms, shows the tendency of being "imposed" on the economic life, which is extremely various. Practice has proven that in these cases the law is incomplete and the tax rate is usually unacceptable. The reaction that usually emerges is one of avoiding the burdens created by the law as well as taking advantage of its incompleteness.

The comment will be limited only to the suggestions for the changes that are necessary in the Profit Tax Law (PTL). This Law has been operative since July 1, 1996 and it is in conformity with the modern corporate tax laws as far as its structure is concerned. The idea of wholly settling this tax matter by way of a law was not actually realized and a significant part of the regulation has to be provided by the Rules for Application the PTL (RAPTL). Unfortunately, the Rules have introduced some additional changes in the PTL this being a violation of Statutes Law. However, it is impossible to make the necessary revision within the short time that is left until passing the 1997 State Budget Law of the Republic of Bulgaria, or more precisely - within the remaining part of the year.

PTL was passed on the ground of motives that no tax preferences exist in EU and according to the recommendations no possibility is allowed for the tax legislation to regulate the opportunity of any tax alleviation. Finally, the PTL contains some preferences, most of them being granted to privatized enterprises, companies with foreign participation, to takeover cases of alleviation used under Decree No 56, which has been repealed, as well as to cooperatives of disabled persons. However, no preferences were granted to the hundreds of thousands of companies, which are the actual taxpayers.

It is not the global preferences under the repealed Decree No 56 that are needed, but the specific preferences are the ones that are necessary now. They have to be in accordance with the economic realities and the interests of Bulgaria. There are a number of different classifications of the types of preferences but they interweave with each other. Due to that fact I will limit my comment to specific suggestions only.

1. Fixed Assets (FA)

1.1. Depreciation expenses

Tax recognition of accelerated depreciation is urgently needed due to the following reasons:

a) The rates established by art. 15 of the PTL concerning the depreciation that is recognized for tax purposes are meant to guarantee the fiscal aspect and not the interests of goods producers. They do not take account of the physical and economic wear and tear in the circumstances of the rapid innovations. Even under the conditions of normal economy these depreciation rates cannot ensure the normal turnover of capital, i.e. the restoration of the initial investments in FA in their pecuniary form. Pursuant to the Accountancy Law (AL), art. 18 and paragraph 4a of the Additional Provisions to the act, it is the "historical price" that matters. No annual revaluation is carried out considering the official statistical data about inflation;

b) The introduction of the currency board would significantly limit the inflation rate but for the time being the actual price of the FA that were acquired 3-4 years ago is approximately 10 times higher than the value on the grounds of which the depreciation expenses are calculated.

Suggestion: Paragraphs 2 and 3 of art. 15 of the PTL have to be repealed. The following is to be added at the end of art. 15, par. 1, second sentence: "... in the due order stipulated under art. 20 of the Accountancy Law".

Art. 15 can be edited again in the following sense: "Accelerated depreciation rates of FA are applied and they amount up to 50% increase of the depreciation rate recognized for tax purposes".

In any case it is reasonable to grant the companies the right to make a single reassessment of the FA and this reassessment must take the inflation into account. It is well known that since the Note of the Council of Ministers No 179/year 1991 no reassessment has been made. It is recommendable that the updating be carried out in due course

established by the Council of Ministers rather than by way of expert estimates. An opportunity of this type is stipulated under art. 33 of the AL but it is for 5 years now that the Council of Ministers has not exercised its rights of carrying out this revaluation.

1.2. Buying fixed assets

It is necessary that a mechanism be created aimed at facilitating the process of buying FA that are intended for the industry. The orientation towards important branches of industry is possible as well. It is preferable to establish a mechanism of tax on profit, according to which no tax on profit is charged in cases where the investments are intended for production purposes, these investments being meant for creating, expanding or modernizing the machines and equipment.

Should no tax on profit be due in cases of investments for certain purposes the budget will indirectly support the development of the industry. No structural reform is possible without the development of the industry. In the long run it is through these tax alleviation that the budget revenues will be guaranteed after a short period of time. The improvements in the actual state of economy would have their effect on the national income and this, on its part, would increase both the budget revenues and the opportunities of redistribution of national income.

Expanding the production immediately results in an increase in the indirect taxes (VAT, excise).

Suggestion: Here is a possible text:

"The profit tax is not due where investments are made for production purposes according to the subject of activity.

In case of impossibility of applying tax alleviation because of insufficient amount of the positive financial result at the moment of acquiring or creating the respective asset, this alleviation is used in the form of tax credit within a term of after creating or acquiring the asset.

Tax preferences apply regardless of the expenses on depreciation".

The mechanism of non-charging the tax on profit creates opportunities for controlling the expenses as well as for assessing whether the expenses are meant for creating FA. Thus an anomaly can be overcome, this anomaly having been a part of art. 87, par. 4, subpar. 2 of the repealed Decree No 56. Such expenses are recognized in Germany, the USA and other developed countries although perfect technologies are available there.

3. Current Expenses on FA

Art. 16, par. 2, subpar. 8 of the PTL, which is currently operative, states that the financial result prior to tax transformation is recognized if the expenses on improvements, modernization and reconstruction of FA are within the limits of up to 5% of their balance value. The basis is the "historical price" of acquisition reduced by the depreciation expenses. It is clear that this text prevents the owner of FA from making the expenses necessary for the normal utilization of the respective equipment.

Suggestion:

a) the percentage is to be corrected from 5 to 10-15 per cent on the basis of the updated price of the FA resulting from a reassessment (made after the Note of the Council of Ministers No 179/ year 1991);

b) art. 16, par. 2 subpar. 8 has to be edited anew in the following sense: "... where the expenses on improvements, modernization and reconstruction bring about an increase of the value of the assets and these expenses have been reported as current expenses exceeding 50 per cent of the balance value of the respective asset".

4. Corporation Credit

under the circumstances of a currency board turns out to be extremely topical. After art. 94 of Decree No 56 on Economic Activity was repealed, art. 21, par. 1 of the PTL has been operative so far. It is under a complex of requirements that it creates the limitation on this crediting, the limit being 10 per cent of a specific value pursuant to the Accountancy Law. I suggest that this limitation should be totally repealed.

5. Salary Regulation

Paragraph 5 of the Interim and Concluding Provisions of PTL was repealed and thus the tax nature of regulating salaries was dropped off. Actually, the Council of Ministers has no rights provided by law to carry out the process of income regulation. The compromise mechanism that has been established by way of an Enactment of the Council of Ministers could be challenged on the basis of the Statutes Law due to the lack of grounds for this regulation.

The restoration of paragraph 5 of the provisions of the PTL is unacceptable under the conditions of the liberalisation, which has already started. It is even less admissible to accept the resumption of the tax scale concerning the cases where the tax limit has been exceeded. Nevertheless, it is reasonable to accept a text that should grant

the Council of Ministers the right to regulate the incomes of commercial companies where the participation of the state is predominant. In 1997 the absence of limitations resulted in a turn on the labor market, the private sector not being capable to maintain the level of incomes. One of the numerous anomalies is connected with the fact that the available financial resources are used for increasing the salaries rather than for paying off the bank credits.

I am bewildered by the fact that the unrealistically high incomes in many regions and the insufficient goods' stock have not resulted in a second wave of inflation. The danger still exists as long as no limitations are introduced.

6. Tax Rate

The profit tax is 36 per cent; in cases when the profit does not exceed 2 million leva it is 26%. The municipal tax is 6.5%; insurance installment is based on the salary according to the labor category (the average is 44%); there are also obligatory contributions to the Professional Qualification and Unemployment Fund.

It is hard to accept both a reduction of profit tax and a simultaneous establishment of tax preferences. The very amount of a tax credit for FA is dependent on the amount of the profit tax.

My personal opinion is in favor of preserving the level of tax rates and introducing certain preferences. It turned out that the limit of 2 million leva for reduced taxation has lost its effect within the period from the elaboration of the PTL to the moment of its adoption. Less than an year after the adoption of PTL this limitation further lost its significance. The new level of differentiating tax rates should be corrected to at least 15 million leva (USD 10000).

7. Small and Medium-Size Enterprises (SME)

have still not received protection by the legislation. There is a consensus that this flexible form of production can help exiting the crisis, that it has good prospects and it is closely connected with the process of privatization and the elimination of monopolistic structures. Preferences for the SME must be regulated under the PTL but preferences should be granted at the right time. The draft law on SME could hardly be discussed prior to passing the Budget Law for the year 1997.

We hope that the Law on SME will be adopted by the end of 1997 and we do hope that tax preferences will be adopted simultaneously with the law, should this be necessary, due to the fact that

the precursory changes in the PTL do not satisfy some of the tax alleviations. The PTL is the law where the alleviation should be properly and systematically stated.

8. Export Preferences

would be much more easily regulated by means of by-laws - the customs regime, premiums, subsidies and other instruments. The establishment of tax preferences is a long process that takes time and it is connected with a specific complex of conceptions that have not been clarified so far and as a result they cannot be hastily included in the eventual changes of the PTL.

9. Establishing Branch Priority

is a long process too, which is a result of an advanced strategy, so it could not affect the PTL at this stage.

10. Income Tax (IT)

belongs to the category of indirect taxes and in 1996 its share in the total tax revenues was 13.6%. This share is high for a country with high rates indirect taxes if inflation is not taken into account and the great increase in the incomes, which is due to inflation, is not considered.

There is a direct link between the tax under art. 13 of the Income Tax Law and art. 4 of the same law. The sharp rise in inflation emerged after passing the changes and amendments to the Income Tax Law for 1997. In early May the minimum salary fixed by the Council of Ministers amounts to more than the minimum income, which is not subject to taxation. The current changes in the tax brackets would bring about some complications and this particularly refers to the level that fixes the obligation of advance taxation.

Once the principle of "tax vacation" is accepted with reference to direct taxes some changes in the Income Tax Law should be accepted as well. It is well known that the increased tax rate does not necessarily result in adequate increase in tax revenues. It is generally accepted that Bulgarian informal economy amounts to 45-50% of the gross domestic product. The relative reduction of taxes, in particular the direct ones, would result in a significant increase in their collection and this would increase budget revenues. Prerequisites should be gradually established for decreasing the relative share of the informal economy, especially as some actions of the present cabinet would inevitably bring about their results.

11. Savings, Investments and Economic Growth

The primary importance of capital accumulation for economic growth is a well too known tenet of economic theory. Abundant empirical evidence corroborates the high correlation between the investment rate and income growth.

Investments both increase the production capacity of the economy (physical capital) and support technical innovation (higher factor productivity).

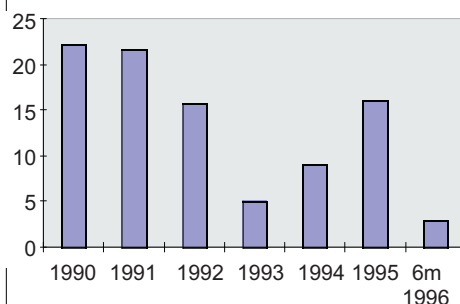
Savings are used to finance investments. The shortage of domestic savings is not considered a constraint to investments in an open economy - foreign savings presumably make up for the difference. A National Accounts identity sets that the difference between gross savings and investments is equal to the current account balance of the balance of payments (ex post). Hence, given a low rate of savings, investments can only expand if foreign indebtedness grows. Balance of payments deficits exert pressure on the exchange rate and fuel inflation.

(Sometimes economic development is viewed as the outcome of the interplay of two complementary scarce resources - foreign currency and capital. The foreign currency shortage limits growth since the attainment of higher GDP levels requires higher imports.)

Foreign imbalances can be avoided if such economic policies are pursued that encourage the accumulation of savings and their transformation into investments. Such policies brought about remarkable economic prosperity in certain East-Asian countries.

11.1. Savings and investments in Bulgaria

Gross National Saving
(percentage of GDP)



Until 1990 the savings and investments levels (share in GDP) maintained in Bulgaria were comparable to those in the developed economies. The high savings rates in the 80'ies however were due to shortages of consumer goods and services rather than to autonomous decisions of economic agents who have strong preferences for future con-

sumption. When prices and imports were liberalised (1991) and real incomes fell, the share of savings in GDP declined.

During the period of central planning investment resources were allocated by force of administrative decisions; no consideration was given to the return on capital. Besides, the distorted prices did not allow for meaningful assessment of such market indicators.

Investments were drastically reduced after 1992. Macroeconomic instability, low demand and delayed privatization all contributed to the slump in investment. The shortage of financial resources was another important constraint.

It should be clear that reduced investment is not an inevitable outcome of economic transition. Unlike Bulgaria, the remaining countries from Central and Eastern Europe managed to maintain a relatively high ratio of investment to GDP.

To overcome the difficulties that currently plague the Bulgarian economy, policies that encourage savings and investments should be pursued. The tax reform features among the most important policy measures.

11.2. Impact of the tax legislation on savings and investments

The share of corporate savings in total savings has stood as high as 50% in the developed economies. In Bulgaria however, the only sector that generates non-negative savings has been the households sector; (the informal sector may be another net saver but no reliable information is available). The non-financial sector has been recording negative savings in recent years, which is partly due to regulations that put at disadvantage state- and municipally-owned firms (the former Decree No.56).

Company savings generally take the form of depreciation allowances which are not taxed, so the size and time structuring of savings strongly depend on the depreciation method adopted. With accelerated depreciation tax payments are postponed and savings accumulate rapidly in the first years of the asset's life.

Retained profits form the second component of company savings. Retained profits depend both on tax rates and the firm's dividend policy. It is well known that higher tax rates have a strong negative impact on savings.

The incentives of the potential investors should be examined when assessing the tax policy impact on investment activity. We use here the theoretical framework provided by Musgrave, R. and Musgrave, P. (1989)

Three main factors affect the

investor's behaviour, acting jointly or on their own: (1) expected net rate of return, (2) sales dynamics and its relation to existing production capacities (3) amount of internal resources, i.e. after-tax profits and accumulated depreciation allowances. Among the three variables profits are the most important for the investment decision. The higher tax burden lowers profitability. Investments are reduced whereby the amount of the reduction depends on the elasticity of the investment function. (We consider here the effective tax rate, which includes both the nominal tax rate and the tax treatment of depreciation; both components are used to derive the rate of return.)

Each firm strives to achieve high enough profits to cover the market interest rate and depreciation, i.e. the price of capital. When taxes are imposed, net rates of return depend also on the amount of the tax rate, the tax-deductible depreciation and the investment credit (if applicable). The higher the investment credit and the tax deductible depreciation, the lower the required rate of return and the higher the probability of taking up the investment. Alternatively, high tax rates push up the required rate of return and discourage investors.

Besides, investments bear certain risks that are accounted for in the probability distribution of the expected return. This factor carries an additional importance in Bulgaria due to the high macroeconomic instability.

11.3. Tax treatment of investments in Bulgaria

Decree No.56 regulations were applied prior to the adoption of the new Law on the profits tax (July 1996). These regulations provided for a highly unequal treatment of economic units, depending on their form of ownership.

Higher tax rates were applied to state- and municipally-owned firms, their depreciation allowances were not adjusted for inflation and only 75% of interest was tax-deducted.

Private firms in turn benefited from the existing legislation. They were offered a choice between a one-shot deduction of the full purchasing price of the asset and a deduction of the principal of a loan, used to finance the investment. The preferential treatment applied however only if the amount deducted did not exceed before-tax profits, which caused troubles to small, newly created firms with no recorded profits.

It can be inferred that the former legislation did not impose taxes on investments, financed by internal resources and even provided for subsidising private investments, financed by borrowed funds. At the same time investments in

the state-owned firms were discouraged, which resulted in decapitalisation.

The new Law marks a significant progress by introducing equal treatment of the different types of ownership. Another positive development has been the reduction of the corporate profits tax rate to 36% (26% for profits below 2 mln. leva). However, investments receive a worsened treatment: the one-shot deduction at asset acquisition has been abolished; a depreciation period has been fixed instead, whereby depreciation allowances are not indexed for inflation. In a high inflation economy such an approach deprives firms from internal resources (savings) and thus eliminates one of the major sources of investment financing. The changing macroeconomic environment together with a repressive tax policy will further reduce the rates of saving and investment. Unless the pending structural reform includes measures to encourage investments, the prospects for renewed economic growth may remain unclear.

11.4 Proposed legislative changes concerning depreciation

Provided that the principle that depreciation allowances are deducted during the asset's life is maintained, the law should be modified in several important respects.

First, adjustments for inflation should be introduced - high inflation makes it impossible to recover capital outlays if depreciation is based in the initial purchasing price. High inflation poses the threat of decapitalisation, hence the book value of the assets should be adjusted to reflect their current market price. Asset indexation requires revaluation of all balance-sheet items.

Second, the principle of „tax-neutrality“ should be observed, i.e. taxes should not distort the structure of investments. A necessary prerequisite thereto is that the true economic depreciation equals the normative one - if so, the effective tax rate equals the nominal one.

Third, the annual depreciation rates provided for in the Law can be corrected according to the principle of the „best business practice“ which ensures neutrality. If the principle is adopted, certain assets may depreciate at a faster rate, e.g. computers (20% depreciation rate according to the Law). A more flexible approach can be undertaken and taxpayers may be given some freedom to vary the asset's life within certain limits. The reduced normative life of the asset will encourage investments.

Fourth, the depreciation method can be reconsidered. Only straight-line depreciation is currently applied. It may

be preserved for buildings, whereas the method of decreasing book value can be applied for machinery and equipment (under the latter method the present value of depreciation allowances is higher). Accelerated depreciation is usually thought to benefit investors, since the tax rate is reduced as tax payments are postponed. This is mostly true for long-term investments. (The theory of investment decisions again supports such a statement. To assess an investment one needs to compare the present value of the (before-tax) income flow to the present value of taxes due. Obviously, the faster the depreciation, the lower the present value of taxes.)

Some countries apply an „investment tax credit“. It is intended to encourage investors by tax-deducting some fixed percentage of the value of the investment. This credit resembles the accelerated depreciation but for one key difference: the latter postpones the tax payment whereas the former directly reduces it. The term of the investment should also be taken into account, since the investment credit benefits shorter-term investments. The joint application of accelerated depreciation and investment credits can be successful as well.

Given the current economic crisis in Bulgaria, a more radical approach has been proposed by Zodrow (1995) - „capital recovery during the first year“. The proposal essentially states that the sum of the present values of all future depreciation allowances should be deducted in the first year after the asset acquisition. The discount rate used should be applied for adjusting the value of losses brought forward to future reporting periods as well. The advantage of this method (which is a version of the accelerated depreciation) is seen in the elimination of the adverse impact of inflation and the increase in the firm's free resources. Savings however can only be accumulated if income is generated through other investments.

When tax policy is devised all advantages and drawbacks of the above approaches should be assessed. A reduction of the tax rate to 20-25% is also desirable. Besides, budget revenues may not suffer from such a reduction, since part of the „informal economy“ may enter the formal sector, which is particularly plausible if the tax legislation reform is paralleled by an improvement in the tax administration. The proper assessment of the fiscal effect naturally requires an in-depth analysis which cannot be undertaken in the present paper.

1. Structural Disproportion in the Present Social Security System

1.1 The services offered by National Social Security Institute (NSSI)

According to the Labor Legislation in Bulgaria the Social Security System obligatory includes all workers in state, public, corporate and private enterprises and organizations or joint ventures. The type of the work, its continuation and the way it is paid for does not reject the obligation for insurance.

The social security services are provided through Social Security Fund which is run by NSSI.

The main incomes in the Social security Fund are collected through:

- contributions to the fund which vary between the category of the labor and the risks covered.
- subsidy from the State Budget if needed
- transfers from the State Budget for special kind of pensions

The main expenditures of the fund consist of:

- benefits, monthly aids for child, pensions
- aids according Labor Legislation, Ch. III, (illness benefits, professional decease, labor hazard, pregnancy, child-birth, etc.)

- pension indexation

1.2. Structure of incomes

According to the National Statistical Institute (NSI), the employees for the 1995 have totaled about 3 310 884. 58,13% of them were employed in the public sector and 40,71% - in the private sector. Social security contributions into the National Social Security Institute (NSSI) budget for 1996 are given below:

Contributions: Percentage:

Public Sector	94.02
Enterprises	76.73
Budget Sphere	17.29
Private Sector	5.8

The discrepancy between the percent of employees in each sector and the related contributions could have been even bigger since the state sector enterprises have still in arrears to the social security budget with more than 27% of the total contributions they had to make. This disproportion can be attributed to the following reasons:

- the low base of the income on which the contributions are calculated by the private sector. The Bulgarian legislation limits the income on which the contributions are determined from one to eight minimum wages and the most frequently used is the lowest limit. A more detailed research over the data for 1996 shows that only about 41% of self-ensured people pay installments of 32% of the minimum wage to cover all

Reform in the Social Security System

Mariella Nenova, Gabriella Stoyanova, Petia Petrova

risks, while the rest 59% make pension contributions (equaled to 22% of the minimum wage). Such a behavior is reasonable since a higher social insurance contributions do not guarantee higher pension in the future. In the same fashion if one person works at more than one job she usually prefers to select the lowest income for insurance. The so established

pension system directs much less money to the pensioners compared to the income received by workers.

- The second reason stems from the Labor Code (chapter III, article 149) according to which even if the enterprise does not pay the obligatory contributions, eligible workers receive their benefits. This encourages employers to register the employees in the social security system since the due benefits are paid automatically by the fund. This explains why only 2,5% of the private employers pay contributions to the Social Security Fund based on the minimum wage.

1.3. Structure of expenses

According to the Bulgarian legislation the insurance contributions are proportional to the received income, although the percent varies among the different labor categories due to the different retirement age. However, such installments covered not only pensions but illness benefits, labor hazards, child-birth, motherhood and so on. In the most common category of labor, the contribution consists of:

- 22% of the base insurance income for pension (56% of the total contribution ¹)
- 10% of the base insurance income for motherhood, illness benefits etc. (26% of the total contribution)
- 5% of the base insurance income for labor hazards and accidents (13% of the total contribution)

The above data, provided by the National Social Security

	Percentage of:	
	Own Incomes	All Incomes
a\ Pensions	87.23	83.28
b\ Aids on LC, Ch.III including:	8.48	8.09
<i>Illness benefits</i>	4.49	4.28
<i>Rising a child</i>	1.62	1.55
c\ Aids on bred including:	7.26	6.93
<i>Motherhood</i>	7.26	6.93

Institute, reveals that the pension expenditures consume almost the entire accumulated fund. Hence the contribution rate for pensions is 34% to income instead of the normative 22%. It means that the public sector is the main contributor to the Social Security Fund.

¹The total contribution is made by two part: the first part is paid by the employer and equals either 37%, 47% or 52 % of the base insurance income according to the different labor categories. The second part is always 2% and is paid by the employee. All contributions are subtracted from taxable income.

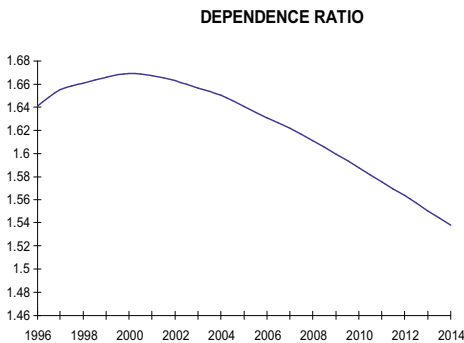
²Birth Rate Encouragement Decree

The so described mismatch explains the significant deficit in the Social Security Fund.

2. Age Structure Development and Movements in the Dependence Ratio (DR³) and Replacement Ratio (RR)

The big variety of risks covered by the Social Security Fund must be separated. Due to the big part of pensions in the social payments the stress of this paper is put on the establishment of separate Pension Fund. The analysis of the two main ratios for the pension insurance - dependence ratio and replacement ratio is made below.

For the year 1996 the DR has been



calculated to be 1,641 and the ratio between the average wage in the public sector and the average pension - 0,32. The last number is close to the so called replacement ratio (RR) but it is overvalued assuming that the average wage in the private sector is higher than in the public one.

The data from NSI (for the age structure of the population) and from NSSI (for the age structure of the pensioners) have been used to make an age structure forecast of the population until the year 2014. This forecast assumes:

- all people above 18 are either pensioners, unemployed, mothers or workers.
- all working people pay their contributions to the Social Security Fund
- the average wage equals 100%
- there is only one labor category
- 12% of the population is unemployed
- the annual percent of mothers totals 4,18% of the women between 18 and 40

- the annual percent of students totals 11,44% of the peoples between 18 and 35

- 2/3 of students are employed
- a single pension contribution equals 22% of the month income
- there is only personal pensions

With the above made assumptions the DR for 1996 is 1,64 while for 2014 it has been predicted to be 1,54. These figures indicate the increase in the pensioners and not proportional increase in the workers. If the percent of the contribution remains fixed for the period 1996-2014 RR will decrease from 0.361 for 1996 to 0.338 for 2014. The comparison between predicted value of the replacement ratio (0.361) for 1996 and the real one (0.32) shows that according to the assumptions, pensioners should receive higher income than actual one. The reason is that not all contributions in practice are based on the average wage. As a matter of fact, the pensioners would receive even lower income if pensions are not funded from other social security sources in addition to the pension payments contributions. The sources are state Budget and the Unemployment Fund.

The movement of the DR over the years shows how the number of workers 'paying' for the single pensioners changes. The lower it is the higher the percentage of the pension installment should be.

3. The Influence of the Arrears in Social Security Fund

A more realistic forecast should reflect the existing discrepancies between the incomes and the expenditures of the Social Security Fund resources.

First, the considerably small contributions⁴ coming from the private sector will significantly influence the forecast. Some figures shows that the ratio between the average wage in the public sector and the minimum wage for the country is 3:1 for the year 1996. The number of the ensured employees (by their employers or self-ensured) in the private sector are 36% of the total number of people in the private sector. And most of them calculate their contribution on the lowest income limit.

Second, the arrears of the public sector totaled to 27% of all contributions it should pay.

With the above consideration the RR should be 0,172 which is much lower than the RR with the assumption that all working people make installments proportional to their income. In the last case RR should be 0.361. The difference in the above figures shows that if the person is motivated to make regular contributions the pension resources would be much higher with the same installment level.

Aging stricture worsens the pension system. In order to keep the level of the average pension the part of the contribution in the income should increase from 22% to 23,5%.

4. Investigation of the Effect of Possible Retirement Age Increase

One of the possible solutions to the negative effects of the aging structure of the population is the raise of the retirement age from 55 to 60 for women and from 60 to 65 for men. If the increase is evenly distributed over the years (retirement age increases by one year every year) the transition period will be from 1998 to 2008. The DR would improve considerably in this case.

If we keep the assumption that all workers pay all due contributions of 22% of the average wage, the pension level when the reform completes (in 2008) would be 0.503 of the average wage and 0.475 in 2014. If the level at 0.361 of the average pension should be kept, the part of the contribution in the income should change from 22% in 1996 to 15,8% in 2008 and to 16.7% in 2014.

When the forecast reflects the distorted flow of fund in the Social Security Fund, the change in the part of the average pension would be from 0.172 of the average wage in 1996 to 0.239 in 2008 and 0.226 in 2014.

The increase of the pension age will have medium-term effect if the aging structure continue. Another possible solution to compensate the negative impact of the aging structure is a constant increase in the taxes. It is important to stress that it will not increase neither the motivation of the worker nor the motivation of employer to change their behavior.

5. Problems of the Social Security System

In the light of structural reforms the reform in the social sector plays important role.

A global social security reform is under way not only in countries in transi-

³DR - the ratio between working people and pensioners.

⁴Due to the use of the minimum wage contribution calculation and the big arrears

tion but also in developed countries. The main reason for reforms is the collapse of the state pension systems.

The reform in the social security is a whole set of structural reforms on labor market, financial markets and public sector.

At the moment the pension reform is a central part of discussions in many countries. The main issues of the discussions are : what kind of pension system to be adopted: pay as you go (PAYG) or fully funded (FF). Should this system be run by the government or should be private?

5.1 Bulgarian Pension System

There is a PAYG system in Bulgaria. That system has many negative sides which in combination with the expected aging of population will be a real problem in the near future.

3 473 526 people have been insured at Social Security Fund in 1996. Only 359 271 persons insured themselves at their own expenses (23% or 32%).

The Social Security Fund's deficit amounts to 5206. 8 mln. BGL and is covered by the Ministry of Finance. The nature of an old PAYG system is such that it could not be financially balanced.

Spending on pensions increases exponentially as population ages. In some countries pensions are above 15% of GDP. In Bulgaria - 6.7 % of GDP.

5.2 Problems

There are two general problems, closely related.

The first problem is the decrease of the dependency ratio (number of people, which make contributions to pensioners). That problem is related from one side with the aging of population and from the other side with peoples' unwillingness to contribute to the fund. The deterioration of the dependency ratio, which is expected in many Western Countries, leads to extension of losses of PAYG system, when contributions and pensions remain the same.

The second problem is aging of pension scheme, which is caused by deteriorated demographic structure. These are the main reasons for State Fund's deficits. Such deficits create press for growing subsidies from the budget.

The need of reforms is determined by the huge and growing deficit.

5.3 Solutions

There are two approaches:

5.3.1. Reconstructing the existing system

a) increase of contribution rate

The increase of contribution rate is a measure which will not face public support. According to the data in Bulgaria

the contributions are very high Therefore such variant is inapplicable.

b) restructuring of payments

Restructuring of payments could be made by creating a separate Pension Fund, Health Insurance Fund and expenses for rising a child, motherhood and etc. should be undertaken by the State Budget. Such a dividing will lead to transparency and will motivate people to make their contributions. At the moment the amount of pensions is lower than people's expectations.

The question how that Pension Fund should operate remains questionable.

Positive and negative sides of private and public insurance will be further discussed.

c) Increase of the age of retirement by 5 years step by step

The burden on the working population of PAYG system depends to a considerable extent on the dependency ratio. An alternative strategy to cutting down the level of pensions promised to be paid, is to rise the age of retirement. According to the information the idea of increased age of retirement is well accepted in many Western countries. Such kind of programs should be implemented in connection with changes in the labor market and other programs like the unemployment insurance. The application of this program may give rise to unemployment, hence, many people will not be able to contribute and to receive pension in the future.

The results from increase of the age of retirement in Bulgaria were described above.

d) Mixed variant

According to the mixed variant, the State should provide a minimal pension on the base of the period of contributions or the length of service and to leave a possibility for employees to contribute to a private funds.

Such a mixed system exists in England. State pension is only 50% of pensioner's income, and around 23% are from private pension funds.

At the moment in two-tier system is under the discussion in Hungary. All employees will be obliged to contribute 1/3 of their installments to private pension funds. The newcomers in the labor force should adopt the new system immediately. Currently working people should also contribute to private funds.

It is clear that private pension funds are able to operate successfully if there is economic and financial stability. Financial and capital markets are not very well developed in Bulgaria, which creates many obstacles for private pen-

sion funds. Therefore the need of radical pension reform is obvious.

5.3.2. Privatization of Social Security

There is an alternative to the PAYG system - Fully Funded (FF) system.

5.3.2.1 Positive and negative sides FF and PAYG systems

a) A PAYG is a mandatory social contract of transfers from workers to pensioners. A FF system provides a close link between workers contributions and benefits, which implies that the FF system is a fair one. It leads to changes in the labor market and creates a motivation for old age saving.

Under the FF system the average return on old-age saving is determined by the market interest rate, while a PAYG system provides a real return on contributions equal to the real rate of growth of the wage bill, which is lower than real return on capital. Therefore PAYG provides lower rate of return in comparison with the FF system.

b) Under the PAYG system it is possible for powerful groups to secure generous pensions from the political establishment. (Professional Trade Unions)

c) Due to the expectations for small pension under the PAYG system, a great number of people are shifting into informal labor markets, where payments for social security, as well as taxes could be easily avoided.

Here are some of the main features of a private pension system :

- individual accounts
- decentralized private management
- rivalry, individual choice
- strict supervision
- annuity or possibility for withdrawing of accrued sum

5.3.2.2 A transition from PAYG to FF pension system.

There are some opinions that the change of PAYG with FF will increase savings, will eliminate distortions on labor market and will sustain growth in a long run.

The transition from PAYG to FF is a long process of reforms.

a) structural changes

Privatization of social security has three elements

- workers contribute to a personal retirement's accounts, rather than to a common pension fund
- the government should create a plan to finance the transition
- the government specifies portfolio allocation, tax, bequest and withdrawal rules, which regulate the individual accounts.

WE have to take into account that there are two kinds of pensions, which

should be paid:

1) pensions to the current pensioners

2) pensions, which should be paid in the future to those, who have been contributed to the PAYG.

A problem arises in family couples, with one working member. In such cases the accrued sum should be divided between them. A similar approach should be implemented in a case of divorce. Therefore the necessary laws should be created.

5.3.2.3 Financing of the transition

The main question is how to finance the transition.

a) debt financing

A straightforward way to finance the transition deficit is by issuing new government debt. According to Corsetti and Schmidt-Hebbel (1995) a debt financing implies that national saving and capital stock are only marginally affected.

b) tax financing

The second possibility to finance the transition deficit is by rising taxes which is equivalent to the combination of pension reform and contractionary fiscal policy.

A tax financed transition hurts transition generations and benefits future generations and in the same time encourages higher saving and capital formation, which leads to the increase of growth in the long run.

As it was pointed out FF system eliminates labor market distortions, but creates tax distortions. Tax distortions are permanent if the transition period is debt-financed. (we are considering only general taxation, not payroll one). In the same talking Kotlikoff, Smets and Walliser (1996) asserts that the most appropriate tax is tax on consumption. (when one's wealth is spent on consumption, a tax should be paid).

It should be mentioned, that the pension reform is a part of our efforts to liberalize the economy.

As it was described the Bulgarian pension system is in crisis. It is better to undertake a radical reform, than to reconstruct the PAYG system, which will deteriorate the problems, having in mind the aging of population.

Literature:

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Improvement of the mass privati -

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The success of the governmental stabilisation programme depends mainly on the rapid restructuring of the ownership in the real and the bank sectors, including the mechanisms of the mass privatisation. Thus, the acceleration of this process is very importance for achieving a consequent sustainable economic growth.

This presentation attempts to review in brief the progress of the mass privatisation process in Bulgaria and to propose some necessary legislation amendments that will facilitate the free trade of shares. Such amendments are:

- removing the ban on acquiring more than 34% of the assets of a privatised enterprise;

- removing the ban on the free trade with the acquired shares in the first 6 months after the last auction session.

The progress in the mass privatisation process: the Bulgarian experience

Until now the progress in the mass privatisation process in Bulgaria may be characterised as extremely slow, overregulated and with low transparency. The Privatisation Law was adopted by the National Assembly in April 1992, while the necessary amendments in this law, setting the main rules for the implementation of the mass privatisation campaign, were adopted not before June 1994. One more year was needed to elaborate and pass the Mass Privatisation Programme (October 1995), defining the list of enterprises and the share of their equity capital to be privatised, as well as the terms of the campaign. In the period December 1995 - April 1997 other normative acts concerning the mass privatisation were adopted (the Rules on the Mass Privatisation Campaign, the Law on Privatisation Funds, etc.). Until now the first two auctions have taken place. The third auction is to take place by September 1997.

Practically, the first wave of the mass privatisation will need at least five years and a half, or 65 months, to be accomplished. This very prolonged period eliminates one of the main advantages of the mass privatisation - the rapidity with which state enterprises are being sold. An example may be given with the implementation of the mass privatisation in the former Czechoslovakia, which model was to a great extent applied in Bulgaria. The first wave of the mass privatisation process in Czechoslovakia was carried out for only 14 months, including the registration of the participants, the licensing of the privatisation funds and the carrying out of the 5 bidding rounds. Thus, on average, one large and three medium-sized enterprises were privatised per day in this period, which undoubtedly is a significant achievement. From the very beginning of the privatisation in 1993 (the sale of „Carevichni producti“ - Razgrad) till February 1997, 5430 Bulgarian enterprises were privatised, but these were mainly small municipal companies.

The other main advantage of the mass privatisation, namely its large scale, was also eliminated. In the Czech Republic about 40% of the state-owned fixed assets were privatised through the mass privatisation, while in Bulgaria this number is about 20% of the state-owned fixed assets. The intention of the interim government (and probably of the next one) is to accelerate the privatisation process and to privatise till the end of 1997 about 40% of the of the state-owned fixed assets. This could be achieved through two ways: selling more big stakes of large state-owned firms (but this requires a relatively longer period), and accelerating and expanding the mass privatisation process.

The implementation of the mass privatisation campaign has been inadequate so far despite its long preparation. Only about 45% of the citizens, eligible to participate in the voucher scheme, bought privatisation vouchers. The fee for these vouchers was only about 6% of the average monthly wage in the first quarter of 1996. In the former Czechoslovakia about 80% of the citizens, eligible to participate in the mass privatisation, paid registration fees which were equal to about 25% of the average monthly wage in the country.

The reasons for the failure of the registration campaign are: 1) the crash of the financial pyramids in the summer of 1995. Most of the people related it to the mass privatisation process; 2) the undeveloped capital market. Practically, until now the people have not shown significant interest in investing in corporate securities. The stock exchanges failed to lay the beginning of the capital market in Bulgaria. This was mainly due to the inactivity of the state authorities which did not pass the necessary legislation and did not licence the players on the capital market; 3) the delayed licensing of the privatisation funds. They had to carry out the advertising campaign of the mass privatisation. The best of them was licensed shortly before the end of the registration period.

The acceleration of the mass privatisation depends mainly on the readiness of the government to reduce the period for the implementation of the process and to expand the range of the assets to be privatised. However, some new amendments in the existing legislation are needed.

Removing the ban on acquiring more than 34% of the assets of the privatised enterprises

The privatisation funds cannot acquire more than 34% of the assets in one company under article 30, paragraph 1 of the Law on the Privatisation Funds.

It is hard to judge what stood behind this decision of the legislative power. One of the possible motives may have been the prevention of the privatisation funds from acquiring majority stakes in the firms. Probably, there were fears that the founders of some funds would try to initiate their

artificial failure and to transfer the assets to related companies. This argument is not justified. Moreover, the restriction threatens the success of the privatisation process.

The main argument of the opponents of the mass privatisation is that it does not improve the efficiency of production. First, the fragmentation of the companies' capital may cause inefficient control over the activities of the privatised enterprises, especially when the key shareholders do not have the necessary skills to manage the firms in a competitive environment (this is most likely in cases of management-employee buy-outs). Second, the fragmentation of the capital may reduce the abilities of the key investors to take decisions, which will complicate solving the main problems of the privatised enterprises in the post-privatisation period, such as undercapitalisation; large liabilities to banks, deliverers, state budget and employees; out-of-date technologies and equipment; poor management.

The ban on acquiring more than 34% of the shares in one firm not only does not remove the main deficiencies of the mass privatisation, but even reinforces them. Moreover, we should have in mind the notorious order of the Ministry of Industry, according to which the main decisions about the management of the post-privatised enterprises may be blocked by the residual stake of the state (in some cases 10%). This order aims at keeping the state influence in companies that are over 50% private.

The privatisation funds were really restricted by this ban in their participation in the first auction. They bade far above the minimum acceptable prices. As a result, about 68% of the vouchers were used for the privatisation of 41% of the offered assets on the first bidding round. One of the reasons for this are the undervalued fixed assets, because of the prolongation of the period between the inventory of the assets and the first auction. The second reason is that the privatisation funds most probably strove to acquire the maximum allowed stake of shares in particular firms. Thus, they were forced to offer relatively higher prices.

Many of the firms whose shares were entirely sold on the first auction

have been a strong competitive target for the funds. Some of the companies with the highest biddings are: „Leyar Complect“ - Sofia, where PF „Doverie“ and PF „Petrol Invest“ have acquired the maximum allowed stake of 34% of the capital; „Unipac“ - Pavlikeni, where few privatisation funds bought almost all offered stake (67%) - PF „Severcoop Gumza“ (26%), PF „Neftochim Invest“ (25%), „Central Privatisation Fund“ (8.75%); „Lead-Zinc Complex“ Kurdjali, where the minority stake (25%) was distributed between 4 privatisation funds, etc.

According to the data about the participation of 57 privatisation funds in the first auction session (the total number of the funds is 81), in about 30% of their approved offers they have acquired more than 30% of the capital in the companies. This indicator may underestimate the real efforts of the privatisation funds to acquire the maximum allowed stakes because:

1) many of the firms (especially the largest ones, which are most attractive for the investors) are included in the mass privatisation programme with minority (25% or 60%) stake. Thus, acquiring a 34% stake is a very difficult or impossible task for the privatisation funds;

2) the privatisation funds have an opportunity to increase their stakes on the second auction, when the residual shares will have lower acceptable prices;

3) some of the privatisation funds are established to participate in the mass privatisation of particular firms which commonly have low offered stakes. Such examples are: PF „Slunchev bryag“, PF „Nicotiana“, to some extent PF „Multigrupelite“, etc. In all cases, the stakes, acquired through the mass privatisation process, are below 20%;

4) co-operation between two or more privatisation funds. Thus, although each of the privatisation funds has acquired below 30% of the shares of a particular company, they hold together a stake of the capital which exceeds 30% and even 50%. A typical example in this respect is the co-operation between PF „Semeen“ and PF „Industrialen“, which made offers for the same companies.

It may be concluded that the privati-

sation funds have been striving to acquire the maximum stake of the capital in many companies. The privatisation funds, which are an exception from such a behaviour, are PF „Aktioner Favorite“, PF „Bulgaria“ and PF „Golden lev“. If the ban is not removed soon, there are two ways for evading it: 1) co-operation between the privatisation funds. Such attempts are already observed; 2) acquiring shares of other privatisation funds, joint or merger of privatisation funds.

Removing of the ban on the sales of shares 6 months after the tenders

The shares acquired on the mass privatisation auctions may be transferred only after publishing of the first balance sheet of the privatised company but not earlier than 6 months after the end of the last central auction session, according to article 51a of the Privatisation Law. Thus, the acquired shares of the privatised firms may not be traded before early 1998, under the present schedule. If the restriction in article 51a of the Privatisation Law is removed, the shares can be traded after mid-1997.

The hypothetical motive of the legislator was the desire to avoid the extra-supply of the shares of privatised firms immediately after their acquiring, which could cause a sharp decrease of their prices, and hence the undervaluation of the shares of many enterprises. This would favour the big investors with large investment potential. However, the delay in the free trade of the privatised shares can not cope with this problem but can only postpone it with some months.

The earlier start of the trade with the acquired shares would have a great impact on the development of the capital market in Bulgaria. The Bulgarian Stock Exchange practically stopped its activities in the end of 1995. The appearance of many small investors is an important condition for its successful future development. The interest in the trade with the shares from the mass privatisation, as well as with the preferential shares for the employees will result in interest in the overall trade of corporate securities. This will enable other companies (state or private), not included in the privatisation process, to use this source of financing their activities. Until now, the sources of addition-

al funds for the firms are commercial banks and other companies. The citizens may consider the corporate securities to be an attractive way to invest their savings.

The permission of free trade immediately after the balance sheet of the privatised firm is published will allow the large investors to consolidate their stakes as soon as possible. It may contribute to the improvement of the control and management of these enterprises in the post-privatisation period which will remove the main deficiency of the mass privatisation.

The delay in the free trade of shares will also have a negative psychological impact. The small investors (the citizens) will continue to consider the acquired shares of enterprises or privatisation funds more as vouchers (papers with unclear economic characteristics) than as real securities. They will consider the mass privatisation more as a game, than as a real process of property transition. At present, the main attractiveness of the vouchers for the people is their liquidity, but not the expected increase of their profitability in the further period. An indicator for that is the sales of voucher cards (despite the illegality of these transactions) for prices which exceed considerably the value of the registration fee. If the ban will be held, the shares will remain non-liquid for a long time and it will decrease the interest of the citizens in the whole privatisation process. In the last, the main goal of the mass privatisation is the privatisation, in itself, but not its mass or the idea of equitable distribution of state property.

There is an existing opinion that only the trade with the shares acquired from the citizens should be allowed, while the free trade with the shares of the privatisation funds, as well as with the acquired by them shares in the enterprises should be banned.

Such a decision would avoid the extra-supply in the very beginning after the last auction session. On the other hand, the privatisation funds would be protected against the eventual sharp decrease of the prices of their shares because of the expected negative financial results in 1996. The founders of the privatisation funds would not be able to take advantage of this under-

valuation because the privatisation funds will operate as closed funds in the first 5 years of their activity under article 4, paragraph 1 in the Law on the Privatisation Funds.

The main deficiency of this proposal is that the majority of participants (about 85%) would not be able to trade their shares in the privatisation funds. The privatisation funds will have little opportunity to pay dividends in order to attract and preserve their shareholders. The privatisation funds are faced with serious problems because of the lack of financial resources in the form of dividends by the privatised enterprises. The government, led by Mr. Jhan Videnov, decided to transfer all profits of the privatised firms for 1996 to the state budget. The citizens will not enjoy immediate gains from their vouchers, which may decrease their interest in the privatisation process. On the other hand, the lack of financial resources (one of the few possible sources is the free trade with shares) will limit the future investment projects of the privatisation funds.

The mass privatisation is a way for rapid restructuring of a relatively large portion of the state-owned property. The political will and support are the main conditions for its successful implementation. Their lack caused the delay and prolongation of the mass privatisation process, as well as of the privatisation process as a whole. However, a hidden privatisation took place and its participants remained generally unknown to the society. Probably, this is the reason for the strong resistance to the privatisation process.

The mass privatisation may create a large class of new owners. It may encourage popular support for the whole privatisation process. It may promote the development of the capital market in Bulgaria. The task of the state authorities is to make use of its advantages (mainly the rapid transfer of ownership from the state to individual shareholders) and to reduce its inherent vice.