Bulgaria in the Process of Systemic Transformation
An Overview

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1. Introduction

Bulgaria is located on the Balkan Peninsula together with Albania, Greece, Romania, the former Yugoslavia, and part of Turkey. This region with its great diversity stands as a bridge between Europe and the Middle East. The geographical location and the complexity of the area have always played a significant role in the history of the Balkan peninsula and the Bulgarian people which has repeatedly been sucked into a cultural, economic, and historical vortex. The country is one of the oldest European states. Founded in 681 and one of the first political formations in Eastern Europe, it turned into a monarchy in 1887 and has been a republic since 1946.

Before the break-down of communism in 1989, Bulgaria’s economy was centrally planned, hierarchical, and highly monopolized. Concerning its industry, the country has tried everything except a market economy. It has only been modified by administrative/incentive attempts at improving the planning mechanisms. After the failure of the communist system, an extremely complex political, economic, and social situation has surfaced. The situation is very unstable, increasingly chaotic, and explosive.

Bulgaria is certainly not one of the success stories in Eastern Europe. Not very much has been accomplished in the country from a reform point of view. It is not among the countries advanced in the transition to a market-based economy. Bulgaria belongs to the group of countries that are at an intermediate stage of transition. This group also includes Albania, FYR Macedonia, Romania, and most of the CIS (EBRD, Transition Report, 1996). Especially after 1994, the reform pace slowed down visibly and 1996 can be described as an economic disaster. Bulgaria did not apply a shock therapy, but it did not undertake a policy of careful balancing structural reform, growth, and social welfare either.

Six years after the beginning of the political and economic changes in Central and Eastern Europe, Bulgaria is in a deep crisis. In a state of significant changes, the “going-back-to-zero rule” (Barker, 1992:140; Luthans & Lee, 1994:7) seems to illustrate well the starting point of the transformation. The conditions in the transition period are extreme. The drama of changing the centrally planned economy involves the break-down of institutions, a severe economic recession, and heavy social problems. Clear results are the negative growth of the GNP compared to 1989[1], increasing inflation, organized crime, rapid depreciation of the national currency, incoherent economic policies, and fear of “a bread and grain crisis”. The resource balance is missing and the budget is in bad shape. Economic forecasts about the economic development of Bulgaria are not made, and no macroeconomic models are developed which could form the basis for economic restructuring programs.

Other negative tendencies are social alienation, social conflicts, growing aggressiveness, crime, and corruption. The fall in living standards for 90% of the population in the country is visible. Since 1990, Bulgarians have lost what is the equivalent of more than 65% in their real income. Unemployment rates are increasing, domestic demand is falling, and demographic trends are alarming[2].

The present paper gives a descriptive overview of the transition processes in Bulgaria although it does not analyze these processes in-depth. As a background, a short overview is given of Bulgaria’s past socialist economic development with focus on its key feature, the central planning system (Section 2). The political situation in the first years of transition is then looked closer at in Section 3. Stabilization and liberalization measures are discussed in sections 4 and 5. Section 6 focuses mainly on the

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[1] Poland is the only country in the region to have surpassed the 1989 level of GDP.

[2] Bulgarian population has been declining ever since 1990 and following the projections, this trend will continue if the country’s economic and social development does not improve. Decisive factors

privatization process which is one of the most essential parts of institutional and enterprise restructuring in the transitional countries. While in the West, privatization became an issue of importance in the late 1970s, it is a new phenomenon for the ex-socialist countries. The paper outlines the privatization process as it took place in the period 1992-1996 although a few indicators are also from early 1997. Post-privatization management is not addressed although it is a controversial issue. Section 7 discusses restructuring within the context of stabilization, liberalization, and privatization.

2. Bulgaria's Economy before 1990: Central Planning

In Socialist Bulgaria, the main economic sector was built on the principle of *public ownership* of the means of production in *state-owned enterprises*. Strong emphasis was put on *industrialization* with the aim to overcome the relatively slow development process from a rather traditional agrarian society. The country used the *classical Soviet economic model* and was heavily involved in the intra-bloc division and specialization philosophy practiced in the CMEA countries. The economic environment was stable and predictable. Concentration on *heavy industry* gave rise to the development of large-scale bureaucratic organizations, supervised by the ruling party's political elite, exercising control over companies and their activities. The high degree of *industrial concentration* in the manufacturing sector did not open up for any competition. In most industries, an almost *monopoly-like* situation prevailed as a result of the socialist principle "More of the same".

The key element in the Communist doctrine which prevailed for decades in all socialist countries, including Bulgaria, was the *central planning mechanism*.[3] Balicki (1983) describes an economy as being centrally planned when the authorities both design a plan and how its objectives are

that have contributed to the unfavorable demographic situation are falling birth rates, increasing mortality and emigration.

to be reached. He points out that "this special way is firstly based on the fact that every producer receives an individual strictly defined and separately to him addressed production task which is part of the global plan. Secondly, it is based on the fact that the refusal to execute this instruction (or its acceptance and non-execution) is stipulated by a number of formal and informal, legal and illegal sanctions far exceeding afflictions of financial nature" (op.cit.:9). In the shape of five-, three, one-, half-year and even three-month, and monthly plans directives were given from the top of the ruling party's political hierarchy to enterprises. While the top was interested in maintaining administrative command over economic activities, the enterprises aimed at reaching a production result which reached the plan objective in quantitative terms. "Storming" (the concentration of efforts at the end of the month to meet the indicators set by the plan) was a common and wide-spread practice.

The planning practice is called "planning without facts" by Drewnowski (1982:79), i.e., planning without information or based on inadequate and limited information[4] which automatically leads to wrong decisions. This caused enormous coordination difficulties and problems in the central planning system. Furthermore, the state plan is an ideological rather than an economic program - it was called "a second Party program". Rigidities in the central planning system had some well-known and inherent contradictions: stagnation in production, permanent shortages and dissatisfied consumers, disequilibrium between supply and demand, shoddy quality, wage equalization, and economic mismanagement.

However, to explain the socialist economic development only within the framework of the central planning system in the years prior to the start of transition would be a simplification. Besides the widely used model of

[3] The practice of developing five-year plans was introduced in the Soviet Union by Stalin in 1928 and widely transferred in the East European countries and China in mid-1940s.
[4] Naughton (1990) has cited a Soviet economist who has calculated that a fully balanced, checked and detailed economic plan for the next year would be ready, if using supercomputers, in 30,000 years.

formal central planning, the socialist economy allowed the development of *parallel informal networks and structures* known as the "shadow economy" ("second economy", or "underground economy"). The "second economy" as a contrast to the "first (state sector) economy" is defined as "income-producing activities, legal, tolerated, or illegal, of households that occur outside employment in the organizations of the state sector" (Stark, 1989:137). This is an important consideration bearing in mind that it not the entire socialist system has collapsed in late 1989 - the first years of transition have legalized part of the former shadow economy. From an institutional point of view, the underground economy has at least three features that make a significant contribution to social change processes. First, it allows and gives space for private initiatives. Secondly, it gives subordinate groups more room to defend or improve their standard of living. Third, it limits the state-party officials in their freedom to act, and it provides fertile ground on which new institutional forms can grow (Mars & Altman, 1983; Shlapentok, 1989; Grancelli, 1993; Peng, 1994).

It is interesting that the idea of central planning was developed as a counterreaction against what was seen as the basic weaknesses of the capitalist economy - the tendency to have a permanent supply disequilibrium with all its negative consequences such as unemployment and crises related to surplus production. The idea of central planning was thus the dream of reaching equilibrium. However, there has been a critical difference between these expectations, and what happened.

First, in the years of industrialization, the socialist system reached full employment. This was maintained in a simple, but purely administrative and inefficient way: the central authorities offered work places (not jobs) until unemployment had been eliminated. Thus, full employment only existed according to the official statistics. Secondly, the centrally planned economies never experienced crises in terms of surplus production. However, they suffered from repeated shortages. Ultimately, central planning replaced one type of disequilibrium with another, and the dream has not thus come true. State socialism was not able to provide a constructive and workable alternative to capitalism. As pointed out by Stojanov (1992:21), the process of socialist modernization was transformed into "an active negation of the significant other [capitalist order], into a destruction of the structural pattern of capitalist modernization which is the particular mark of the integration of that society being striven for".

3. The political situation

Economic reforms in Bulgaria have been heavily politicized. As stated by Rock (1994:20), "Without a political understanding of the reform process, some changes would appear economically illogical, or even irrational. There appear many easier, probably more effective, mechanisms to achieve certain economic goals, but not, however, if one seeks to achieve economic changes *and* political retribution" (emphasis added). The following section gives a general picture of the political development in Bulgaria of the last few years.

Formal and representative state power are concentrated in the presidential institution in Bulgaria. The first free presidential elections in Bulgaria took place in 1992.[5] Leader of the UDF (Union of Democratic Forces, the non-communist opposition) was Zhelyu Zhelev at that time. Being one of communist Bulgaria's few dissidents, he was elected president in 1992. In late October 1996, the first round of the second direct presidential elections took place. There were 13 candidates competing. In the second round in November, 1996, the candidate for the UDF Peter Stojanov won by a close to 20% margin over the socialist candidate, replacing Zhelyu Zhelev. The vote demonstrated the disappointment and disapproval of the Bulgarians with the way the country had been governed. This was the poorest poll since 1990 - about 60% of the eligible voters turned out on

[5] 21 pairs of bidders for the presidency competed in the first direct presidential elections held in 1992.

election day compared with the 1992 elections in which more than 75% took part. The newly elected president Stojanov, a relative political newcomer, took over in late January 1997.

Bulgarian politics is a complicated affair.[6] The political development of the last six years has been dominated by the bi-polar model - the Socialist Party and the Democratic opposition occupied the political stage of the country. The instability of the country is closely connected to the complete lack of continuity and consensus on essential questions, such as *what* should be done, *who* should do it, and *how* it should be done. The fight between the political groupings is tough and often destructive. Political competition is often understood as confrontation. Bulgaria has had some of the most unstable governments in the region. With the recent introduction of parliamentary democracy, the country has had seven governments in the period from 1990 to early 1997, five of which have been controlled by the Bulgarian Socialist party (BSP), (Table 1). None of the governments have been able to work out a mature and powerful policy program to govern the country through the difficult and painful transition process. Demagogy and political games have prevailed and created a very negative image of the ruling political elite.

Time period	**Prime minister**	**Government controlled by**
June 1990 - Nov. 1990	Andrej Lukanov	BSP
Dec. 1990 - Oct. 1991	Dimitar Popov	BSP + UDF
Nov. 1991 - Oct. 1992	Filip Dimitrov	UDF
Nov. 1992 - Sept. 1994	Ljuben Berov	BSP and MRF [7]
Oct. 1994 - Dec. 1994	Reneta Injova	caretaker government
Jan. 1995 - Dec. 1996	Zhan Videnov	BSP
Since January 1997	Stefan Sofianski	caretaker government

Table 1: Overview of the governmental changes since 1990

[6] Appendix 1 looks into the party-political reality in Bulgaria until 1990

[7] Movement of Rights and Freedoms, most of the members of which are people belonging to the Turkish ethnic minority in Bulgaria.

The BSP won the elections in June 1990, and Andrej Lukanov who was later gunned down in October 1996 was head of the government. The UDF[8] refused to participate as a coalition partner under the leadership of BSP. Under the pressure and as a result of demonstrations and strikes, BSP was forced to resign from power at the end of the same year. A transitional coalition government consisting of socialists and members of the UDF was formed in December 1990. It was led by the politically independent Dimitar Popov, and its office term was scheduled for one year until the next elections were to take place.

In October 1991, parliamentary elections were held and won by the UDF won slightly margin ahead of the BSP. The UDF then formed a government supported by the MRF. The UDF leader Filip Dimitrov became prime minister in November 1991. In June 1992, a major government "reshuffle" announced. Some months later, in October 1992, after the MRF withdrew its support of the UDF, the government resigned before its term in office had expired. The "government of technocrats and experts" led by the independent Ljuben Berov took over. This government was supported by the BSP, the MRF, and some other minor parties and groupings. In September 1994, Berov's government resigned because the mandate given to it by the parliament ran out. The president officially authorized the opposition to form a UDF government. The opposition coalition rejected to form a government within the existing parliament. Reneta Indjova took office as a prime minister, forming a caretaker government until the next elections were to be held.

The BSP won the 1994 parliamentary elections and in January 1995, the country's socialists returned to power. On the one hand, this was a reaction of disappointment on behalf of the electorate. On the other hand, the population was looking for more stability at the cost of resisting radical changes still believing that the transition period could be less painful and faster than expected. The three-party Democratic Left coalition (BSP, left-wing agrarians, and ecologists) gained a majority in the National Assembly, and a Socialist government headed by Zhan Videnov was established. The prospects and hopes associated with the new government were rather optimistic in the beginning of this government's term in office. Two main considerations contributed to the optimism of the Left at that time - the relative unity in the Socialist Party and the

[8] The UDF was set up in late 1989 shortly after ex-communist leader Todor Zhivkov was ousted from power. The Union was formed as a coalition of informal organizations established already at the time of the communist regime. Currently there are 17 parties and organizations in the Union. The UDF is the main formation within the united opposition. The other two formations are Moser's Bulgarian Agrarian National Union and the Movement for Rights and Freedoms.

absolute Socialist majority of 125 seats (43,5% of the total number of seats) in the parliament.[9]

About one year later, the picture had dramatically changed - the economic situation in the country had become much worse than it had been in the previous years. No substantial reforms had been undertaken, and the Socialist party became fragmented and was exposed to heavy criticisms. Mr. Videnov's authority was strongly undermined, and his policy was flawed. A plenum of the BSP supported the government in November 1996 although a confidence vote showed that the actual support was very limited (87 for and 69 against Videnov). In the end of December 1996, after an extraordinary (held two years ahead of schedule) congress of the BSP, this socialist government stepped down. The resignation was passed at an extraordinary session of the parliament December 29, 1996. Following the constitution, the president allowed the Socialist party to form a new government. The forty days of mass demonstrations which required a caretaker government headed the opposition and new parliamentary elections in 1997 instead of 1998 showed that the situation in the country was extremely difficult and explosive. The decision to follow the president's advise and not accept the mandate was taken on an individual basis by the person who was appointed to be the next socialist prime minister. The decision was not taken by the Socialist party as such. A new UDF caretaker government came into office in January 1997 and will be in power until the elections have taken place in April 1997.

The transition period has consequently been very difficult from a political point of view. At least three problematic issues are worth mentioning in the context.

One is that the political parties in the Parliament do not agree on the kind of reform that is needed. The second problem is a logical consequence of the first one and shared by all the various political parties. How can public support be gathered behind the reforms? As such, attempts at achieving national consensus on how to introduce the market economy and what strategies to adopt have failed. The third issue has to with the fact that political decisions in Bulgaria have been highly influenced by the advice of foreign institutions and experts. Although these have provided a way to transfer knowledge and expertise, they have often been contradictory in their nature and

[9] The rest of the seats was distributed as following:
69 seats (24.23%) for the UDF;
18 seats (6.51%) for the People's Union Coalition;
15 seats (5.44%) for the MRF;

inappropriate for the Bulgarian specificity. In this sense, the imitation of models and strategies implemented in other countries has not worked very well and often had drastic and negative consequences in both economic and social matters. However, it might also be argued that in the recent situation, exactly the non-following of the requirements of the international economic institutions (World Bank, IMF) or at least the lack of consistency in the relationship with them, has led to the deep crisis in the country (see especially Section 6).

The fact that a single person could occupy both the position as party leader and prime minister has not turned out to work very well under the conditions prevailing in the complicated transition process.[10] Bulgaria's political development in the last few years has proved that there has been not been sufficient respect for the formal positions and that full identification between the positions and the person occupying the positions has predominated (see Kristeva, 1991). Consequently, it would be more appropriate to keep politically influential positions separate.

4. Stabilization

After the start of the transition, the economy of the country is *no longer coordinated by central planning mechanism, but matured market forces have not developed* to act as its alternative. There are no strong forces able to make the dramatic transformation down to the road of market-driven mechanisms possible. This state of *vacuum* is certainly not a favorable ground for introducing and developing a successful market economy. Several points should be kept in mind when evaluating the present economic situation. First, as in the other countries in Central and Eastern Europe, Bulgaria was hit hard by the break-down of the Comecon trading bloc known because of its distorted trade structures unrelated to comparative advantages. The *loss of ex-socialist markets* led to a deep crisis in the production systems of all the ex-socialist countries, but in Bulgaria this was even more clear, because the country has been *very dependent upon the former USSR*. 75% of Bulgaria's trade was with the CMEA countries, and 55-60% of this was with the USSR (Dobrinsky et al., 1995:213).

1990 was a turbulent year in political terms, but there was not much done in order to progress economically. Gradualist reforms were on the agenda, but the results were far from satisfying. The *gross foreign debt* reached 10 billion USD although it was high already before the start of the transition. It mainly accumulated in the period between

13 seats (4.73%) for the Bulgarian Business Bloc.

[10] At the extraordinary congress of the BSP in late December 1996, these two positions became separated by electing a new chairman of the party.

1986 and 1989. Following Dobrinsky et al. (1995:214), one of the main reasons for the rapid growth of the foreign debt was the deterioration in the terms of trade after 1984, following the decline in the world price on oil (oil products based on Soviet oil were a substantial share in Bulgarian convertible currency exports). On the other hand, the ruling elite was reluctant to give up ambitious and prestigious investment projects. The result was an increasing deficit on the trade balance which was financed through heavy international borrowing from foreign commercial banks.

The foreign debt became one of the most problematic issues in Bulgaria's transition. By the end of 1992, the foreign debt had reached 12.95 billion USD, which was 152% of the GDP and 296% of export revenues (News Bulletin of the Bulgarian National Bank, 1992, 9). In 1995, the debt reached 11.9 billion USD, out of which 2 billion USD were held by official creditors. In March 1990, a moratorium on repayment of the foreign debt was declared. This measure meant that Bulgaria became financially isolated which had a highly negative impact on foreign investors' confidence in Bulgaria's creditworthiness. In 1995, the *gross foreign exchange reserve* of the Bulgarian National Bank increased with 383 million USD from 899 million USD to 1,282 million USD - the highest number during the last few years. The number varied depending on the time of the foreign debt service payments. In January 1996, Bulgarian foreign debt Brady bonds registered record high levels on the international debts instruments market.

The *foreign trade* broke down and the industrial output fell by nearly 40% during 1990 alone. 1991 was marked by the announcement of shock therapy. The years starting from 1991 could however be better described as "shock without therapy", to use Kolodko's (1996:12) terminology. GDP declined substantially for four years and increased for the first time in 1994.

The stabilization program was launched in Bulgaria in February 1991 - the year when some of the most significant changes took place in the country. The program was coordinated by the International Monetary Fund and included restructuring of state-owned enterprises, liberalization of the prices, of foreign trade, of interest rates, and the establishing of a floating exchange rate. In 1991-1992, a number of *new laws* were passed and implemented such as the Commercial Law, the Law on Foreign Investment, Restitution Laws, the Privatization Law, the Law on Bulgarian National Bank, and the New Labor Code.

The *tax system* is inefficient and inequitable. The demand that everyone liable to taxation should pay up does not function. A tax reform was introduced in 1991 and in 1993, the Tax Administration Act was passed. In February 1996, the parliament passed additions and revisions to the 1993 Act which were returned for re-consideration by the president. The amended Act makes the establishment of a national service on the prevention and detection of tax evasion possible. However, creating the legal taxation framework is not enough to increase the efficiency of tax collection. The Treasury's approach to tax debtors is far not harsh at all, and there are no proper institutions to deal with these matters. Corruption in those institutions that are supposed to take care of these issues are already widespread.

Part of the stabilization program of 1991 was *the introduction of a floating exchange rate* and making the *Bulgarian currency internally convertible*. For first time, Bulgarians were granted the right to possess foreign currency accounts in Bulgarian commercial banks. Export companies were allowed to keep their foreign exchange earnings in foreign exchange deposits, and import companies obtained the right to purchase foreign exchange from commercial banks in the amounts they needed.

Another stabilization measure was the *introduction of credit ceilings*. The purpose of this measure was better control with the money supply. The various commercial banks had the right to individually determine the credit ceilings, and if the respective bank exceeded the limits to the commercial loans, it had to respond to higher reserve requirements.

In the period 1993-1994, there was not much stabilization measures implemented stabilization, especially because of the political instability in the country. The Bulgarian currency collapsed, and the exchange rate crisis extended. In 1995, Bulgaria experienced some progress in terms of macro-economic stabilization. The best macroeconomic indicators in five years gave reason for optimism. The country experienced economic growth, a slowdown in inflation,. and a substantial trade surplus. GDP grew by 2.6% in 1995, totaling 852,000 million leva. However, throughout 1995, Bulgaria failed to reach the fourth standby agreement with the IMF,[11] the major obstacles being the crisis in the banking system and lack of tangible steps towards implementing structural reform. Table 2 lists the key indicators characterizing the economic situation in the country in the period 1994-1996:

Key indicators	**1994**	**1995**	**1996***
GDP (%)	1.8	2.6	-9.0
Inflation %	96.3	62.0	220.0
Industrial production (%)	7.8	8.6	-12.0
Unemployment (%)	12.8	10.5	10.4
Exports ($m)	3,935	5,110	4,500
Imports ($m)	3,952	4,683	4,000
Current account balance ($m)	203.0	281.0	300
Budget balance (% of GDP)	-5.8	-5.7	-8.9
Gross debt ($ billion)	10.3	9.4	9.5
*Sources: JP Morgan, EIU, WIIW, EBRD * projection*			

Table 2: Key economic indicators in the period 1994-1996
Source: Business Central Europe, December 1996, p. 41

As the table shows, the economic progress of 1995 was not sustained in 1996. The governments' objectives of lowering inflation while sustaining economic growth were not realized, and the country went into a grave economic recession. GDP declined considerably. The foreign debt to the London Club, the IMF, the World Bank, and the EU-countries surpassed 1,34 billion USD and a sizable share of the budget (52% in the first half of 1996) went to service external and internal debt. Some 900 million USD were paid on the foreign debt in 1995, and more than 1,000 million USD by the end of 1996.

Ceilings on the annual percentage increase in the *wage bill of state enterprises* have been imposed by the government since 1991. In 1990, the government, CITUB (the Confederation of Independent Trade Unions in Bulgaria) and the National Employers' Union signed an agreement, setting up a tripartite commission for the coordination of the different and often conflicting interests.[12] One of the concrete tasks of the commission has been to negotiate the wage policy and liberalization in order to prevent heavy social contradictions (CITUB, 1993). Wages in the country do not keep pace with inflation although a regular wage indexation in the public sector takes place compensating for a certain percentage of the price increases. In 1995, the average public sector worker in Bulgarian earned about 103 USD a month. In the period 1992-1995, wages increased by an average of 7.6% per annum, in USD. It is worth

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[11] This agreement is connected with extending of the FESAL loan by the World Bank that has been negotiated for more than three years.
[12] Regarding the labor relations and unions' participation in the economic reform in Bulgaria see Dittrich & Haferkemper, 1995

mentioning that wages and salaries, excluding the wage component in self-employment income and royalties, make up nearly half of average household income in Bulgaria (see Hassan & Peters, 1996:632).

The Bulgarian currency remained extremely weak. In the first two months of 1996, the Bulgarian lev depreciated by 8%. In the previous year of 1995, it had taken twelve months for the lev to depreciate by the same margin. The country's very limited hard currency reserves and the difficulties in servicing the external debt are part of the reasons behind the national currency crisis. The Bulgarian lev depreciated by 600% against the USD in 1996. The *exchange rate* started from leva 75 to the USD in April 1996 and reached Leva 313 in November 1996. In December 1996, the lev was traded at 500 to the USD (the government's ambition was to keep at the level of 150 leva for 1996) and in January 1997, the USD was sold and bought on the cash and inter-bank market at 910/960 leva and 950/1,000 leva respectively. This tendency was gaining in strength, and projections included a 10% depreciation of the national currency per day. In February 1997, the USD reached the record-high levels of 3,000 leva. As the second half of 1996 demonstrated, keeping high interest rates for deposits in national currency is only a short-term measure which cannot really influence the exchange rate dynamics. Additionally, the high rates impose a barrier to economic and investment activities.

In early November 1996, IMF officials proposed to introduce a currency board in Bulgaria to take over the monetary policy and apply strict rules to its implementation. Under the currency board, the commitment to a fixed exchange rate would be enforced by the full backing of domestic currency with foreign currency reserves. The currency board is an extreme measure which is considered to limit the country's room for maneuver. At the same time, the currency board seems to be the last resort for the country's stabilization and therefore one of the very few options as a way out of the current deep crisis. The tasks of the board would be to reduce inflation, keep the exchange rate at a certain level, and restore the confidence in the national currency.

The introduction of a currency board is less risky than the high interest rates and the monetary and budget restrictions and does not necessarily require special legislation. However, there are at least three significant premises for the successful functioning of the board. First, there has to be full consensus amongst all major political forces about the need for such a board. Secondly, it has to be supported by wide public confidence (which is closely associated with confidence in the IMF) and third that the foreign exchange reserves of the country and the financial resources exceeding the external debt payment are sufficiently supported by the IMF.

5. Liberalization

The *legal system* is a significant part of the environment in which economic activities fail or succeed. The legislation in Bulgaria does not provide consistency and clarity. It does not serve as a technical basis to sustain the reform. By distinguishing between passing laws/acts and implementing/enforcing them, on could say that the inefficiency of the legal rules in Bulgaria is not related to the fact that there are not enough laws/acts, because rather that these are poorly administered or implemented. Actually, the legal framework is well developed, “not discriminating between domestic and foreign investors and imposing few constraints on creating a range of investment vehicles and security instruments” and whereas the implementation/administration of these is “reasonably well administrated and supported judicially, although that support is sometimes patchy” (EBRD Transition Report, 1996:14).

Price liberalization started in 1990. The prices of the consumer goods increased by over 400% in 1991. By the end of 1992, 16% of the prices of all goods were controlled. From the beginning of the price liberalization until January 1997, the prices has increased with 30,595% (or 306 times). Many of the prices (46% in 1995) remain under the administrative control of the state. The Price Law (passed in 1995) allows the government to introduce further price controls at its discretion. Post and telecommunications, energy products, and tobacco products have fixed prices. Recently, certain formulas have been introduced to adjust the centrally administered prices of telecommunication services, the railway system, and urban transport, fuel, electricity, and heating to cost-recovery levels.

The situation within the *banking system* is highly unstable. The terms “banking mafia” and “credit millionaires” are widely used in the country. In 1991, the number of the state-owned banks was 73. The first private bank in Bulgaria (First Private Bank) was founded in 1990. The number of private banks reached 23 by the end of 1994 but dropped to 19 in 1995 (total assets of the private banks comprised about 16% of the total Bulgarian bank assets). In the beginning of 1995, 45 state-owned and private banks operated in the country. Their current losses are of the order of 4-6% of the GDP, and the aggregate negative capital of the banking system is 11-12% of the

GDP.[13] The Bulgarian banking system comprises more than 12 branches and subsidiaries of foreign and jointly established banks.

There is a national bank in Bulgaria called the State Saving Bank (SSB). The SSB is considered a leading financial and lending institution - it has between 60 and 70% of the national bank market. The SSB is mostly attractive to small depositors, but their confidence in this bank has also been shook - citizens started withdrawing their savings from this institution too. 600-800 million USD were drained out of the entire banking system in the country. The main concern is that the SSB refinanced several cash-strapped commercial banks, some of which face liquidation.

In March 1996, the government approved a *bank rehabilitation and restructuring* program. ZUNK bonds (internal government debt bonds or bad-debt bonds) worth 400 million USD were issued to initiate the process. The program included the following measures:

1) a consolidation of banks through mergers with majority state interest and banks with different form of ownership.[14] The consolidation had to be completed by January 1996 by the Bank Consolidation Company. The latter was established in 1992 and became the sole holder of all public shares in the commercial banks;
2) restructuring and privatization of some of the banks through the sale to local and foreign investors of the share packages held by the Bank Consolidation Company;
3) declaring insolvent and liquidating loss-making commercial banks, as well as compulsory floating of shares of inefficient and loss-making banks.

The financial situation of many Bulgarian commercial banks deteriorated and in 1996, the banking system has self-destructed in a disruptive liquidity crisis. It has become obvious that the banking sector cannot serve as an environment for private and institutional savings. In the last few years, instead of providing stabilizing measures for economic activity, the commercial banking system concentrated much more on short-term activities and extending bad loans to loss-making enterprises. The introduction of a scheme guaranteeing deposits prior to the final adjustment of this sector is seen by IMF's experts as the main mistake. Another factor that has contributed to the deep crisis is the excessively high costs the private and state-owned banks in Bulgaria have.

[13] The numbers are from the document "Macroeconomic Aspects of the Restructuring Program" drawn up by experts of the Economic Development Ministry, cited in Weekly News Bulletin, October 11, 1996.
[14] Seven mergers of banks were effected by December 1995.

Additional factors for the current urgent situation in the banking sector are the lack of financial discipline and non-appropriate behavior.

The mobilization of the banking system is a premise for an effective allocation of domestic savings. It is to a great extent connected with the structural adjustment of the public sector and increasing the pace of privatization. However, it is difficult to achieve concrete positive results in the banking reform after the confidence in the banking system was completely lost and after Bulgarians used their lev deposits to buy hard currency.

In May 1996, the Bulgarian government passed a bank bankruptcy law which was the main prerequisite for the implementation of the three bank restructuring steps listed above. The Deposits Protection Act was also adopted in May 1996. In September 1996, nine banks were closed. This, besides all other effects, caused problems for the buyers in the privatization deals. The Deposits Protection Act was amended in October 1996 and concerned about 800,000 depositors who had money in these nine banks. Following the act, personal deposits were guaranteed 100% and those of companies and legal persons only 50%. The withdrawal of deposits gave citizens 30 days and companies and legal persons 60 days after the bankruptcy decision.

There is no *national capital market* operating in Bulgaria although it is in a process of being establishing. Two stock exchanges came into existence in early 1992. Their number increased to 40 in 1995. The Bulgarian stock exchange was created as a consortium of several regional stock exchanges. It needs to be modernized and its operations improved so that portfolio investments can increase.[15] The unsatisfactory state of the stock exchange is linked to the delay in the mass privatization program and the loss of confidence in the capital market due to the so-called financial pyramid games. As recently as in 1995, around 150,000 Bulgarians lost their savings in such financial scams mainly because of loopholes in the legal framework and overconfidence on part of the investors. The recovery of the capital exchange is associated with launching cash privatization using the exchange and the appearance of the shares acquired in the process of mass privatization on the market (see Section 6.3 on privatization process).

[15] Throughout 1995, the stock exchanges in Bulgaria showed an aggregate turnover of only 6 million USD (the number for the Budapest stock exchange only for the first six months of 1995 was 123 million USD).

6. Privatization

While privatization became an issue of importance in the late 1970s in the West, it is a relatively new phenomenon in the former socialist countries. Privatization is considered to be one of the fundamental tenets of transition economics and crucial to the attainment of a market-based economy. Its primary objective is “to subject enterprise managers to pressure from owners that have a direct economic interest in the financial performance of the companies” (EBRD Transition report, 1996:10). It is assumed that privatization is the core process in institutional and enterprise restructuring in Central and Eastern Europe, it improves corporate governance and increases productivity as a whole.

The “classical efficiency argument” for private ownership assumes that the assets will also generate the highest discounted present value of net returns from a societal point of view when assets are owned and controlled by those individuals in the society who value them the most highly (Kuznetsov & Kuznetsova, 1996:1173). As a part of the broader process of establishing autonomous profit-oriented and competitive economic units privatization is a pre-requisite for remodeling the economic environment in the countries in transition.

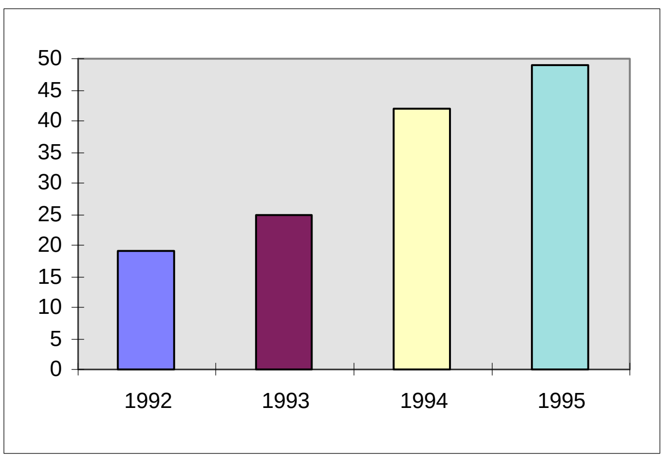
Income from the transfer of ownership may cover part of the lack of financial resources both on the government budget and in the reserve of the Central Bank (which was the case in Bulgaria in 1996). Privatization is one of the auspicious methods for recapitalization of the banking sector. Additionally, income from the privatization process may finance budget deficits to a great extent. In Bulgaria, revenue generated by privatizing state-owned companies goes to finance the largest part of the budget deficit in 1997. The grave economic crisis in Bulgaria meant that increasing the speed of the privatization process was given higher priority than proper enterprise valuation. Privatization is also necessary in the process of attracting foreign direct investment and thus foreign currency to Bulgaria. In the current economic climate, Bulgaria needs as much foreign currency as possible.

6.1 The State of Privatization

Bulgaria is not among the countries in an advanced state of transition, especially because of the slow pace of the privatization process. One of the specific and clearly expressed features of the economic development and the privatization process in Bulgaria is that it has been linked to strong political considerations. According to Rock (1994:20), the Bulgarian privatization process is “the outcome of continuing political struggles. It has taken place in the context of a revolutionary change in political power in which antagonisms have deep roots and where many politicians appear more focused on self-vindication, on just punishments of past collaborators in totalitarianism, or on outright revenge.” The privatization process was a part of the political programs of all governments that have ruled the country in the last few years. Three governments declared themselves “governments of privatization”. However, concrete positive results still lack. The two poles at the political stage, the Bulgarian Socialist Party (BSP) and the Union of Democratic Forces (the non-communist formation, UDF), agree on the need for privatization as a tangible step toward a dynamic and modern market-based economy. However, the concrete way in which the private sector should be developed is still a matter of dispute.

When economic reform began in 1991, the private sector share of GDP was 6.4%. As illustrated in Figure 1, this share increased steadily. In 1995, the output of the private sector rose by more than 25% compared to 1994 and made up about one-third of the Bulgarian GDP. Private entrepreneurs were most active in the food processing industry where production rose by 45%. This sector was ahead of mechanical engineering, electrical engineering, and electronics, that had a 23% growth rate. The share of the private sector in the Bulgarian GDP is nudging 50% at present. This is a positive indicator in the pessimistic picture of the entire economic situation.

Figure 1: Private sector share in GDP (%)



Source: National Statistical Institute, quoted in Bulgaria: The Investment Opportunities, Privatization Agency Bulletin, 1996:2

It is hard to estimate the exact contribution of new private companies, state-owned enterprises being privatized and foreign investment in the growth of the private sector. The proportion of these factors varies over time. For example, because of the delay of the enactment of the Privatization Law and the lack of real interest of several Bulgarian governments to privatize, growth in the private sector was rather limited until 1995-1996 and somewhat bigger in 1996. Statistics concerning the number of people employed in the private sector are different and often contradictory (see Frydman et al., 1993:23), mainly because of inconsistency in the recording of numbers.

It should be mentioned that it is not very clear how the development of the private sector is going to be influenced by the recent crisis in the banking system.

With fast changing governments, nobody has really had sufficient time to implement the announced promises and make privatization a central element in the transformation process. Because of this lack of continuity and missing consensus regarding economic reform, the privatization process was considerably delayed. Additionally, most of the big and profitable deals were prevented from being closed for several months, including those that were just about to be signed.

6.2 The legal framework for privatization

The legal framework for privatization in Bulgaria was drawn up before the privatization process began. The *Privatization Law* (the *Transformation and Privatization of State and Municipal Enterprises Act*) was passed in April 1992. The law concerned only market (capital) privatization by introducing techniques such as open-tenders, auctions, management buy-outs, etc. The *Privatization Funds Act* and the *Securities, Stock Exchanges and Investment Companies Act* are the two other significant instruments that form the legal framework for the privatization process in Bulgaria. The restitution of real estate and enterprises expropriated in the past was legally regulated by the *Restitution of Immovable Property Act* passed in 1992.

At present, enterprises in specific sectors such as water supply, sea ports, railway transport, extraction of minerals, and mining are not subject to privatization. In July 1993, the Parliament imposed a three-year moratorium on the privatization of enterprises of the military-industrial complex which expired in July 1996. In September 1996, the then government's program for increasing the speed of privatization included the sell-off of 62 out of 86 enterprises in the defense industry.[16]

The country's legislation provides preferential treatment to employees in cash and mass privatization. In cash privatization, the eligible staff will acquire up to 20% of the government-owned assets of an enterprise paying 50% of the purchasing price of each share. In the mass privatization program, the eligible staff will acquire 10% of the assets to be privatized by vouchers free of charge. These free shares shall be acquired off the voucher book. The legal framework allows foreign creditors to participate in the privatization through payment of up to 50% of the negotiated price with Brady

[16] Until 1989, Bulgaria used to earn 900 million USD and 2,500 million transferable rubles annually from arms and materiel sales. These earnings barely added up to 50 million USD in 1991-1992. The Bulgarian military complex recovered to a certain extent in 1994-1995, selling 390 million USD' worth of weapons and military equipment. The projections for 1996 were for a profit of some 450 million USD (BTA weekly news bulletin, October 22, 1996)

bonds (municipal enterprises are sold for cash only). There are no liabilities for paying interest envisaged in the budget and the use of Brady bonds therefore decreases the pressure on the budget. That is why this way of paying is not preferred by the National Privatization Agency. The issued “Bradies” have a maturity of 25 years with a 5-year grace period. Another alternative to cash payments in the privatization deals are the ZUNK bonds (internal government debt bonds or bad-debt bonds). Since late 1994, when the regulations to govern the debt swaps in privatization were adopted, the major deals were paid by external and internal debt bonds.

In 1996, the National Privatization Agency introduced significant tax incentives for domestic and foreign investors in enterprises where over 66% of the assets are privatized. Privatization investors can obtain a discount on the purchasing price, going all the way up to about 30%. Another key incentive offers privatization investors a “tax holiday” - 100% relief for the first three years after the acquisition and 50% relief for the subsequent two years.

6.3 Institutions involved in privatization

The state authority which organizes and supervises market privatization in the state sector is the *National Privatization Agency (NPA).* It draws up the annual privatization program and its annual report. The NPA is financed on the government budget. Its head office is located in Sofia and regional offices are all over the country. The NPA carries out the privatization of state enterprises with book value of long-term assets of more than USD 1 million.

The municipal privatization is carried out by the *municipal councils*. 6 *ministries* and 4 *committees with ministerial status* have the right to privatize smaller enterprises. The *Center for Mass Privatization* together with the *Council of Ministers* take care of privatization through investment bonds. The *Government* and the *Parliament* approve the programs for cash and mass privatization. The responsibilities of the different institutions involved in the privatization process are clearly demarcated. However, sometimes their coordination efforts fail because of the incompatibility of legal rules.

More than 120 *privatization funds* were established to act as financial intermediaries in the mass privatization program (the figures projected by experts were between 30 and 50 funds)[17] where small shareholders can invest their shares. The establishment of the funds is not a result of the restructuring of state enterprises. Their functioning is associated with the second stage of the process of mass privatization. Public organizations, state-owned and private companies, trade unions, and political parties meeting all legal and financial requirements are allowed to establish their own privatization funds.

The decisions for licensing the privatization funds are taken by the *Commission on Securities and Stock Exchanges*. 92 out of the 120 investment funds have been licensed to carry on business in a privatization-fund capacity. 11 of them failed to collect enough vouchers. The 81 funds are expected to be among the key players in the mass privatization process. With 2.8 million shares, the Doverie Privatization Fund has acquired the largest number of shares among the privatization funds. It is followed by Petrol - 2.4 million shares and Moultigroup - 2.3 million. The Doverie Fund has also acquired shares in the largest number of enterprises, 90, followed by the Bulgarian-Dutch Privatization Fund[18]- 74 and some others.

6.4 The privatization process

Transferring formerly state-owned enterprises into private hands is a part of the entire reform picture. It has been one of the most pressing issues in Bulgaria, and at the same time the process has been considerably slowed down. According to government plans, privatization was supposed to start in 1991. In reality, the first step in the privatization process was considerably delayed.[19] As mentioned above, the privatization law was passed in April 1992, and the NPA was established in the autumn of 1992. Restitution, cash privatization, worker-manager buy-out, mass privatization, and municipal privatization are the instruments of denationalization in the country (see the sections below). Although there has been recent progress made in the cash and especially mass privatization programs, the process of transferring ownership is rather slow in general. The first stage of denationalization of the Bulgarian economy involved the cash privatization launched in 1993. The initiation of the auctions of the mass privatization in 1996 started the second stage of the process.

The success of the privatization process depends to a great extent on the transparency of the information related to it. Rules for advertising the participation conditions and procedures should be made known as broadly as possible, and they have to deal fairly with all participants. The participation needs to be more active in order to create real

[17] The number of privatization funds in Bulgaria is considerably smaller than in the Czech Republic (450) and Russia (600).
[18] The Bulgarian-Dutch privatization fund was set up by Bulgaria's Post Bank and the ING Bank of the Netherlands. Altogether, 15 of the funds have foreign participation.

[19] The so-called "wild" (or "quiet") privatization started already in 1990 when experienced managers in state-owned companies transferred assets to their owned businesses at very low prices. The so-called "small privatization" started in 1991 by selling small enterprises through open, publicly announced auctions or through a tendering process (see Rock, 1994:22-26).

possibilities to sell the enterprises for the best price. People need to believe that companies are sold fairly, impartially, and highly priced.

6.4.1. Restitution

The restitution process restores the property right on real estate that was nationalized in the period 1946-1962 by the totalitarian regime. Until October 1996, around 87% of all municipal and state-owned entities that went into private hands were privatized through restitution (22,000 out of 25,300). Restitution claims are met by part of the government assets in the cash and mass privatization processes.

Land restitution proved very complex and costly and was hindered both by legal and financial problems. The process of handing over land ownership did not yield the expected results. About 60% of the land was returned to its owners, 20% is still pending restitution, and the technical procedures about another 20% have not yet started. The majority of the privatized farms are tiny (averaging only 1.2 hectares), most of the existing machinery is designed for large-scale farming, and 45% of the farmers do not intend to farm their plots themselves. Following Wyzan (1993), "the result has been a resurgence of producer-type cooperatives of various types, which may not prove to be viable in competing on the world market; indeed, they may not even be able to compete against imports on the domestic market" (cited in Miller, 1995:68).

6.4.2. Cash privatization

Cash privatization requires legal analysis and evaluation based on current market prices. Therefore, the costs for conducting an evaluation for cash privatization is considerably higher compared with this for mass privatization. The evaluation differs from case to case which delays the privatization procedure.

The first privatization deal in Bulgaria was completed on May 12, 1993 when the Belgian company Amylum bought 81% of the shares of the Bulgarian maize processing plant "Tzarevichni Producti"-Razgrad. Privatization in 1993-1995 did not accelerate as expected. In December 1995, the then Bulgarian government approved a list of about 70 enterprises to be privatized. This number is part of a total of 467 companies of its 1996 market privatization program. Poor coordination between the responsible ministries and the NPA kept down the pace of cash privatization. The cash privatization program was unrealistic, involving heavy bureaucratic procedures and was not completed. Additionally, no large enterprises were put on the list for cash privatization. The requirement of the World Bank towards Bulgaria for 1996 was cash privatization of a minimum of 5% of the long-term tangible assets of state-owned companies.

The push in the cash privatization process in 1996 was caused by the urgent economic situation in the country, a deep crisis in the banking system, disappointing economic indicators, and large amounts of money not being circulated. The lack of money was by large covered by revenue from cash privatization. The list of the so-called accelerated privatization was made, and the procedure for cash privatization for some of the enterprises on the mass privatization list was approved in October 1996.

The results of cash privatization during the last four years is not positive measured on the basis of the decisions taken for opening procedures, the number of deals, and the amount of financial income generated. However, most of the deals concerned the privatization of detached enterprise units and did therefore not really influence ownership restructuring.

6.4.3. Management-employee buy-outs

As far as insider privatization is concerned, we should bear in mind that although it favors the employees to a greater extent than any other type of privatization, it is mainly the managers that gain and exercise control over the privatized firms. An important factor in this process is "the degree the formal and de facto ownership rights have been given to the employees both in the period prior to the revolutionary change and in the transitional period before privatization is implemented" (Mygind, 1995:200). Before 1989, employees in Bulgarian companies *formally* had certain rights. In fact, they were relatively limited or not sufficiently used by the workers, and the actual rights were in the hands of the enterprise managers. Around 1988, the Bulgarian Communist Party initiated "workers' self-management" and the act of "transmitting ownership from the state to the people working with and managing it" was initiated. However, this was a purely administrative act and had nothing to do with ownership transformation, increasing the influence of employees. The enterprises remained state-owned. At that time, the idea of changing their legal status was too far from economic and legal reality.

When the economy is too centralized, decisions concerning what and how much to produce as well as what and how to sell was not up to the individual enterprises and their managers. Instead, they were taken by state bureaucrats and Communist Party officials in the respective municipalities and in the case of enterprises of strategic significance - under the supervision of the central party-political institutions. The party apparatus had more rights than any other group. Even internal tasks and processes were subject to confirmation from above. Being faced with the dilemma “where they want to go and where they feel they can go” (Graves, 1986:155), managers in socialist enterprises were limited to a great extent in their decision-making and ability to act.

By the end of 1989, the change of the political system became a key challenge for Bulgarian companies, influencing their staff and management directly and tangibly. The business environment had changed dramatically and influenced the economic entities forcing them to operate as market actors. At the same time, the effects of stability and stagnation in the period prior to early 1990s created a climate of social distance, of anonymity, and organizational apathy. Therefore, the lack of motivation for change from the part of both employees and managers was not surprising. At a later stage, the management teams turned out to be the “dominant coalitions” (Kanter et al., 1992), taking initiative and participating actively in the pre-privatization and privatization process.

No definitive conclusions concerning the participation of employees and managers can be drawn until the various privatization funds start selling the shares they have bought. Only after this process is at a more advanced stage, it will be clear who the real owners will be. What can be expected is however that the forthcoming start of the mass privatization process will stimulate part of the management-employee deals and the sale of detached units.

By the beginning of September 1996, a total of 203 deals were concluded as worker-manager buy-outs. About 200 enterprises are envisaged for MBOs for 1997. These are mainly small and medium sized companies, and even bigger financial preferences compared to the present ones are projected to be introduced for the personnel to buy them.

6.4.4. Mass privatization

The process of mass voucher-based privatization was the preferred method for large-scale privatization. The BSP and the international financial institutions insisted on the implementation of the voucher-based privatization method. Even though the UDF took a stand against this form of denationalization, the participation of the population was highest in the cities where the opposition performed best in the local elections in October 1995. The Mass Privatization Center was assisted and consulted by a PHARE-European Union Consortium set up in August 1995 in legal and organizational matters. The consortium consisted of three institutions: Credit Commercial de France (one of the biggest banks in France), Omniul International (a large French agency working in the field of economic and financial information and advertising) and the British Denton Hall legal firm.

The mass privatization scheme was passed in December 1995, and the process was launched on January 8, 1996. The scheme envisaged that every Bulgarian above the age of 18 is entitled to 25,000 investment leva in a voucher book. The registration fee was 500 leva (a relative small amount of money even at that time), but students, senior citizens, and conscripts only had to pay 100 leva for their voucher books. Orphans received their investment books free of charge. Voucher books were available at more than 3,000 post offices in the country. They can be transferred to relatives and exchanged for privatization funds shares. Foreign investors were directly able to participate in the process of mass privatization in Bulgaria through the establishment of privatization funds.

According to the statistics of the Mass Privatization Center (BTA weekly news bulletin, 5-11 February 1996), an average of 40% were scheduled to use investment vouchers in the privatization process. The price of land on which the enterprises are built and which is their property is included in these companies' assets. By enterprise size, the percentage of the shares set aside to be traded for investment vouchers breaks down as follows:

- 25% for 180 large and profitable enterprises. The state will retain control over the rest of the shares of these companies;
- 60-80% for medium-sized enterprises which comprise the majority of enterprises scheduled for mass privatization.
- 80-90% for 355 small-sized enterprises.

The remaining shares will be used for cash privatization and meeting restitution claims.

The first centralized auction was scheduled for October 1996 involving the sale of 11% of all state enterprise assets. 32 million shares (42% of all offered interest) were purchased at the first session of the auction. Of the 968 enterprises offered at the first session, the privatization funds acquired shares in 578. They have bought out 3, in 55 the individual participants controlled the funds, and 390 have been sold to individual bidders alone. A second round will follow in 1997. The centralized auction includes three bids each with a duration of three months. The mass privatization of 1050 enterprises is expected to generate private ownership control in 911 entities with the government controlling a maximum of 33%.[20] Six months after the last auction, the shares of the newly privatized enterprises and of the privatization funds are freely available on the Stock Exchange.

[20] According to World Bank criteria, enterprises with such a ownership ratio are considered private.

Although it is stated that “Bulgaria has moved substantially ahead” with the process of mass privatization in 1996 (EBRD Transition Report, 1996:22), it is not a big success in terms of popular participation. Despite the massive campaign in the national media, Bulgarians were not in a hurry to become owners of investment vouchers (wait-and-see-approach). A month after the process started, only 4-5% of entitled citizens had registered to take part, contrary to the expected 17%. Many waited until the last moment to obtain their voucher books. The initial deadline for the registration expiring on April 8, 1996 was extended. The initial expectations were that about 70% of the population would take part in the mass privatization process. In reality, around 3 million eligible citizens signed up through privatization funds or independently out of the 6.5 million Bulgarians that could take part.

Mass privatization in Bulgaria was called “mass privatization without the masses”. What are the main reasons for the low interest and participation in this process?

The public had in fact no real information about the actual financial performance of the enterprises on the list for mass privatization. The Confederation of Independent Trade Unions in Bulgaria (one of the country’s most influential amalgamations) set up a Labor and Property Association to exercise civil and trade union control of the process of mass privatization. The aim of the association was to protect citizens against state bureaucracy and pyramid financial schemes by providing them with information about the enterprises put on the voucher privatization list and yet, the lack of essential information was one of the main barriers for broader participation. Misleading advice such as to invest in enterprises in the region where citizens live was another factor. The procedure according to which citizens were to take part in the process was actually not clear either.

The majority of the population did not believe they could profit from the mass privatization program. The intensive media campaign tended to focus on explanations as to why participants would not lose by participating in the mass privatization program. Bearing in mind that the Bulgarian currency is highly devaluated, but that the purchasing power of vouchers is high, it was cheap to participate. However, the alienation of the population was difficult to overcome. The most active group appeared to be the pensioners who comprise around 20% of the population.

The low participation can also be explained by the general attitude of many Bulgarians that the state uses the mass privatization program as a way of getting rid of unprofitable enterprises. According to the study conducted by experts of the Economy

2000 Club,[21] the 1,200 enterprises put on the list perform quite poorly. 53% of them showed losses at the end of 1994 (BTA, Weekly News Bulletin). According to the same source, the fixed capital of these enterprises is worth an aggregate of 90,000 million leva. However, this assessment was made in 1992, and since then it has not been adjusted to the 300%-plus inflation. The explanation that potential investors did not have to accept responsibility for the debts incurred by privatized enterprises did not help a lot.

Part of the Bulgarian population was not interested in participating in the mass privatization program, because they saw the investment of their vouchers in the privatization funds as being similar to investing in the so-called financial pyramids. As recent as in 1995, around 150,000 Bulgarians lost their money in such financial schemes; mainly because of loopholes in the legal framework and overconfident investors. Although the legal framework provides sufficient guarantees against misappropriation in the privatization funds, it is difficult to overcome such suspicion.

Voucher privatization is the most serious privatization effort in Bulgaria so far. It is considered as the quickest way to increase the private sector share of the economy and to develop the secondary market in the country. One of the long-term objectives of the mass privatization process is the creation of a normally functioning stock market. However, mass privatization leads to little corporate governance. The low participation means that financial value of enterprise assets which are up for mass privatization is distributed among a smaller number of investors. Another consequence is stronger competition among the privatization funds in terms of attracting voucher books and profiting from the process of mass privatization. Experts projected that some of the enterprises subject to mass privatization may be profitable in 1997, but this is rather unlikely bearing in mind the difficult context in which they operate.

6.5. Privatization in Bulgaria - numbers and figures

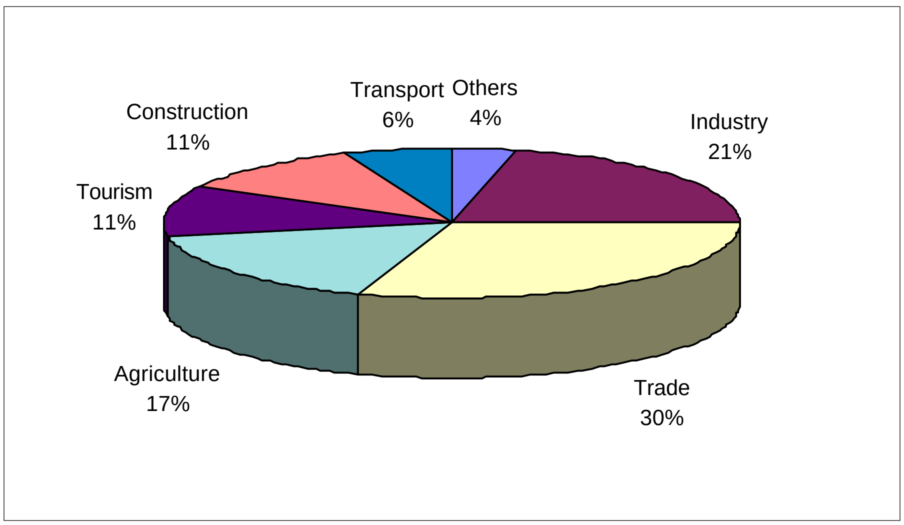
The general privatization model adopted in Bulgaria combines cash payment, in most transactions covering debts, and an obligation for additional investments in the projects, as well as the preservation of a minimum number of working positions for a certain period of time. By the end of 1995, the NPA had realized 13 transactions with foreign investors worth approximately USD 356 million. Sale of state property raised only USD 133 million compared with the planned USD 200 million (this is below the 1994 figure of USD 180 million).

[21] The survey was based on the balance sheets of the enterprises and reveals both their financial state and the return on capital employed.

In 1995, there were 309 privatization deals, down from the 584 target and double the 1994 figure. The highest percentage was reported in the field of agriculture (25%) ahead of the food processing industry (14.4%) and construction (13.5%). There were fewer deals in transport and mechanical engineering. 305 out of 309 units that went into private hands were bought by domestic investors, and only 4 deals were signed with foreign investors. 20 of the companies privatized in 1995 were municipal. 32 privatization sales paid in Brady bonds were finalized in 1995. An amount of USD 123,400,000 has been written off the external debt by the partial payment of privatization sales in Brady bonds.

Figure 2 illustrates the shares of the different sectors in terms of privatization results:

Figure 2: Privatization results by sector (by number of transactions, up to 08.11.1996)



Source: Bulgaria: Heart of New Markets, Privatization Agency, 1996:9

For 1996, there were 460 enterprises on the priority list. A total of 1,366 privatization deals were closed by October 1996, with a total financial result of 78,530 million leva. Table 1 lists the largest Bulgarian privatization deals in 1996, the year in which the strongest privatization push was made:

Table 1: Largest Bulgarian privatization deals in 1996

Company	Buyer	Sector	Share	Price
Aroma	Astera (BG)	cosmetics	67%	USD 9mln
Instrument	Plansee (A)	machine tools	75%	USD 4mln
Avangard	ABB (S/CH)	generators	67%	USD 2mln
Vitamina	TKM (BG/Gk)	food-canning	60%	USD 0.1mln
Hemus	MEBO *	stationery	55%	USD 3mln
Plama	Euroenergy (BG)	oil refinery	75%	USD 310mln

Eltos	Sparky Trading (D)	electric appliances	55%	USD 8mln
Interpred	MEBO *	office space	70%	USD 32mln
Sheraton	Daewoo (South Korea)	hotel	67%	USD 22mln

** Management-employee buy-out*

Source: Whitford, 1996:38

The data of the NPA only appear positive if one does not take into account the harsh devaluation of the Bulgarian currency. At the present exchange rate, the above amounts are far from satisfactory.

7. Bulgaria in a process of restructuring: why and how, if at all

Stabilization, liberalization and privatization are all elements of the creation of a competitive market environment which, in turn, is a prerequisite for macro economics and enterprise restructuring. There is a serious lack of structural changes transforming the Bulgarian economy and Bulgarian enterprises or these changes have at least not been extensive enough - they do not adjust to the changing market environment. The strongest evidence is that the structure of the country's economy has remained unchanged since 1989. At present, 52% of the state companies are making a loss.

7.1. Foreign investment as a factor for economic restructuring

Since there is a vital link between sustainable economic development and the integration of the countries in transition into the world economy, one of the direct factors for restructuring the economic systems is foreign investment. It plays a crucial role in the process of transition from a centrally planned to a market economy by changing the market structure and introducing competitive market-based interactions. Foreign investment provides technical and financial expertise, know-how, modern management policies, and practices as well as access to international capital markets. Private investors concentrate on financial returns and profitability, and government investors focus on the impact their projects will have on the scope and objectives of the transition.

Bulgaria's attractiveness lies mainly in the strategic geographical location of the country (a cross-point between Western Europe and the Middle East) combined with a relatively cheap but highly qualified and skilled labor force [22], cheap resources and tax incentives. A main obstacle for foreign firms wishing to enter the Bulgarian market is the shortage of hard currency. The large foreign debt (see Section 4) and the lengthy payment delays pose significant barriers. Major structural are low productivity and

[22] 40% of the work force hold university or higher vocational diplomas. Another 29% hold full secondary school qualifications.

inefficiency - "per capita labor productivity is reported to be only 15-20% of that of most developed countries" (Buckley and Ghauri, 1994:12). Although the legislation in FDI is effective, it is not sufficient for attracting investment. Privatization, establishment of joint-ventures with a domestic partner, building an enterprise from scratch (greenfield construction) represent various ways in which to invest in the country. The latter possibility is rarely used because of the market's immaturity. Other alternatives include different forms of cooperation, licensing and concession agreements. Table 4 shows the legal and regulatory framework for FDI.

	Legal & regulatory environment for foreign investors
Foreign Investment Laws	The Law on the Business Activity of Foreign Persons and on Protection of Foreign Investment Law of July 1991 (last amendments in 1996)
Restrictions on Activities	No restrictions on business activities except the following: license or permission required for production of military equipment, banking, insurance, activities obtaining immovable property in certain geographical regions.
Profit & Capital Repatriation	No restrictions on after-tax profit or capital repatriation
Tax Treatment	Tax rate on profit for state budget is 36% (respectively 26% if the profit is up to 2,000,000 leva) while the tax rate on profit for municipalities is 6.5%. Equal treatment of local and foreign investors - tax holidays.
Participation in Privatization	Foreign and local investors have equal rights in participation in the privatization process. Privatization procedures are effective after the authorization from the relevant ministry but if the mount of assets exceeds leva 70 million - authorization from the Privatization Agency is required. The Privatization Law was amended in 1994, 1995 and 1996 to include and regulate voucher privatization. Holders of Bulgarian Brady Bonds obtained in exchange for rescheduled Bulgarian debt may use them in privatization with their normal price (for DISCS) and half of their nominal (for FLIRBS), despite their purchase price.
Property Law	Ownership Act (1990), last amendment in 1996. Law on Ownership and Use of Agricultural Land (passed in 1991, last amendment in 1995), State Ownership Act (passed in 1996), Municipal Ownership Act (passed in 1996). Foreign persons acting in the capacity of local persons (registered under Bulgarian Law) may acquire land, although not arable land. They may acquire real estate and land after permission from the Bulgarian Ministry of Finance. Legal entities with foreign participation may not hold ownership rights on arable land, regardless of the share of the foreign participation.
Contract Law	The Law on obligations and Contracts (1951, amended 1993) regulates civil transactions. The Commercial Code (1991, last amendment in 1996) regulates commercial and company law. The Law on Securities, Stock Exchanges and Investment Companies (1995) provides for the issuance of securities and the transactions with them, the activity of the stock exchanges, the investment intermediaries, the investment companies and the government control over them.
Bankruptcy Law	The new Bankruptcy Law came into effect in July 1994 as a chapter in the Commercial Code. By the banking and Lending Act (amended in 1996) the legislator introduced legal regulations concerning bank insolvency. The Law regulates bank positioning under specific surveillance in danger of insolvency, insolvent procedures and bank liquidation.

Anti-trust Law	The Act on Protection of Competition of 1991 regulates monopolies and unfair competition and establishes a special controlling body. The Commission for Competition.
Company Law	The Commercial code (1991, amended 1993, 1994, 1995, 1996) provides for joint-stock companies, limited liability companies and three types of partnerships. Rigid management is imposed on limited liability companies.

Table 4: The legal and regulatory framework for foreign investment

Source: "Current Foreign Investment Climate in Bulgaria", Foreign Investment Agency, 1996:19-20

Governmental approval for investment proposals is not required. Profits can be repatriated, and the IMF Agreement of July 1996 specifies that there will be no currency exchange controls.

One of the popular attitudes in Bulgaria is that the participation of foreign investors in the privatization and eventual purchases will lead to the "selling out the country". There is a general fear of Bulgarian property being sold out to non-nationals at low prices. This fear certainly has its grounds, but it imposes a barrier for realizing some appropriate investment chances. Bearing the modest size of the domestic financial market in mind, foreign ownership is an appropriate option. The total cumulative value of all state-owned enterprises by far exceeds the savings of the population, which means that a lack of foreign investment will delay the process of privatization. Many Bulgarian companies will be unable to improve their performance without foreign investors who have the ability and the capital to restructure and modernize production. The shortage of capital and not least the shortage of qualified managers can partly be overcome by foreign partners with the ability to improve the production side on the one hand and to provide a well developed network of outlets that can stimulate sales and marketing activities.

The most attractive sectors for foreign investors are the food industry, transport,[23] textile industry, agriculture, the pharmaceutical industry, tourism. These are branches in which some of the Bulgarian companies had favorable positions on the international market before the collapse of the socialist system. It is small businesses rather than large companies that find the investment climate in Bulgaria favorable.

From the point of view of the size of foreign investment, Bulgaria is outside the world business map. In the period 1990-1993 the total Western investments in Bulgaria were

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[23] The geographical position of the country explains the fact that the share of foreign investments in the transport sector has the third position in the total foreign investment in Bulgaria after industry and trade and is larger than in the other countries of Central and Eastern Europe.

only 167,5 million USD. The respective numbers for the same period are 500 million USD for Romania, 2 billion USD for Poland, and 5 billion USD for Hungary. At the end of 1995 total foreign investment in Bulgaria was approximately 830 million USD. The Ministry of Economic Development did not realize its intention to create favorable conditions in order to increase the inflow of foreign investments by setting up a task force of Bulgarian experts and foreign businessmen who had already been operating in Bulgaria.

1995 registered a slowdown in the process of foreign direct investment. According to the report from the Agency for Economic Coordination and Development on "Bulgarian Economy in 1995 and Prospects for 1996-98", foreign investment in Bulgaria totaled approximately 101 million USD in 1995, which is less than the 1994 figure (Pari Newspaper, March 19, 1996) by about 133 million USD. The decrease is partly compensated for by the considerable growth in indirect investment (32 million USD) and the so-called other investment (100 million USD). The report stresses that the average investment is very modest mainly because of legal irregularities, uncertainties and instability.

According to the National Statistical Institute, foreign investment in Bulgaria in 1995 reached 452 million USD. Industry absorbed 44.3% of the investment, transport 25.9%, and trade 20.1%. Germany still tops the list of foreign investors accounting for 32.2% of the total in 1995. Next came Britain (16.2%), the US (7%), Greece (6.3%), Belgium, Luxembourg and France. More than half of the foreign investment in 1995 was in the form of foreign currency, 15.6% in leva, and 4.2% in machinery and equipment (Bulletin of weekly news, October 17, 1996). For the entire period, starting from 1991 up till the first half of 1996, the structure of the foreign investments by countries is as illustrated in Table 5:

Country	**% of total**
Germany	33.97
Netherlands	10.18
Greece	7.08
Switzerland	7.02
Belgium	6.73
USA	6.24
Austria	5.30
UK	4.47

Russia	3.73
France	2.47
Others	12.82

Table 5: Structure of foreign investments in Bulgaria by countries

Source: Current Foreign Investment Climate in Bulgaria, Foreign Investment Agency, 1996:34

In the period January-September 1996 the foreign investment increased 2.19 times in comparison with the previous year. Over 210 million USD were invested during the first nine months of 1996. According to the National Statistical Institute, in the majority of the enterprises - 95.3%, the invested funds came from one country, in 4.2% - from two, in 0.4% - from three countries, and as few as 0.1% of the enterprises investments were distributed among more than three countries. In terms of profit reinvestment, Greece comes first, followed by Ukraine, the US and the UK. Foreign investments were mainly concentrated in the territory of the Sofia district - they amounted to some 60% of total foreign investment in Bulgaria.

Among the companies which have invested in Bulgaria are Interbrew (Belgium), Philip Morris Companies Inc. (USA) through Kraft Jacobs Suchard (Switzerland), Lifton International A/S through Breakers A/S (Denmark), Nestle S.A. (Switzerland), International Spedition Willi Betz GmbH (Germany), Heineken N.V. (the Netherlands) through Brewinvest S.A. (Greece), Rover Group (UK), Luxcraft Trading Ltd. (UK). The Irish-Bulgarian company Bimak Ltd., a company extracting and processing non-ferrous metals was announced Foreign Investor of 1995. It was established 6 years ago, invested 20 million USD and created 100 new jobs. The three largest deals in 1996 were made with Westdeutsche Allgemeine Zeitung which bought 168 Hours Ltd., with Daewoo which acquired the Sheraton Hotel and a joint venture between Fayans in Kaspichan and Laufen of Switzerland.

7.2. Corporate restructuring

According to Frydman et al. (1993:35), the corporatization of state-owned enterprises is “the process by which firms are converted into commercial companies with a structure familiar in the capitalist system”. The main assumption when talking about enterprise restructuring as a part of the transformation processes is that corporatization may reduce costs and increase profitability. By 1995, the formal process of corporatization of the state-owned sector had been almost completed in Bulgaria (Dobrinsky, 1996:391) - the governments reclaimed the actual ownership rights over the state-owned enterprises by changing their legal status. These enterprises were transformed into joint-stock companies or limited liability companies.

Besides the change of the legal status of the enterprises, there have been no serious efforts to strengthen competition and corporate governance. The insufficient results of corporate restructuring in Bulgaria is one of the reasons for the lack of economic growth. The increasing trade deficit can also partly be explained by the lack of enterprise restructuring. As described by Dobrinsky (op.cit.:393), the program for financial restructuring in Bulgaria constituted "a swap of bad enterprise debt in the balance sheets of commercial banks for government securities coupled with the cancellation or rescheduling of debt in the company books". In the period 1992-1994, there were several rounds of bail-out and there are expectations of further ones.

The stabilization measures undertaken in 1991 created additional pressure in terms of stagnation because of the failure of state-owned industrial enterprises to adjust to the new conditions of the rapidly changing environment. The stabilization program did not take into account serious barriers that have hindered its realization. Among these factors are the imperfection of the domestic market, total lack of competitive behavior and experience, lack of market-oriented management knowledge and skills, as well as strong resistance to change. According to the Bulgarian National Bank (the central bank of the country) and some other sources (EIU Country Report), the *inflation rate* was 334% in 1991, 80% in 1992 and 60% in 1993. In 1994, it rose again to more than 90%. In the first three months of 1996 inflation was approximately 2.5%-3.0% per month, but it reached 20.3% in June because of the drastic devaluation of the Bulgarian lev in May 1996 and remained at the level of 20% in September adding up to a total of 153% in the period since January. In July 1996 inflation was at its highest since the price liberalization in 1991: 81.9% in the first seven months of 1996 and further 113% in August.

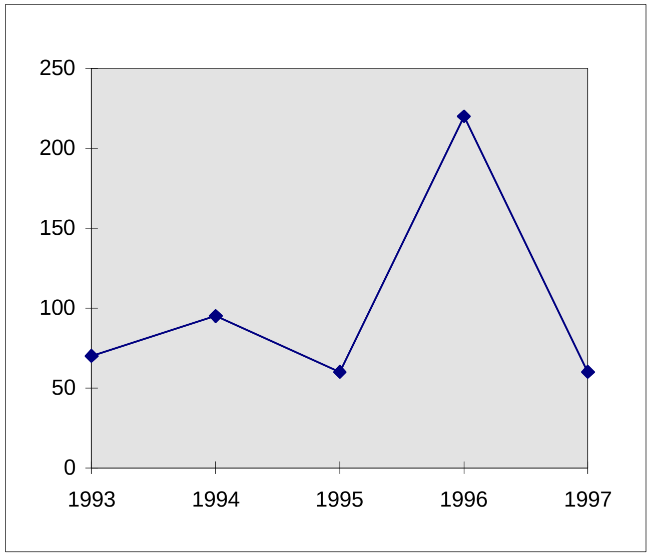

Figure 4: Annual inflation

Source: EBRD, IMF, quoted in Business Central Europe, The Annual 1996/1997, December, 1996:41

The agreement with the London Club from 1994 assumed a 5% inflation growth for 1996. This is far from reality. It can hardly happen in 1997. 12% of the annual inflation in 1996 was due to the exchange rate which was 6.6 times higher at the end of 1996 than at the end of 1995. One fifth is due to the direct impact of the electricity and fuel tariffs. Among other causes of the inflation are the decreasing production (around 5-7%), the poor crop, the increasing prices of the goods controlled by the government and the falling domestic demand. The chronic budget deficit and the floating exchange rate are other important factors responsible for maintaining the inflation at a very high level. The accumulated high inflation potential means that even if the currency board is introduced, the inflation will not decrease substantially. As a temporary measure against high inflation and as an effort to stabilize the foreign currency market and the banking system, the Central Bank drastically raised the central interest rate.[24] Later, in October 1996, the Central Bank reduced the base interest rate from 300% annually (25% monthly) to 240% annually (20% a month).

The beginning of the changes in late 1989 resulted in an abolishment of the employment guarantee which was typical for the socialist society. Bulgaria has the highest *unemployment* rates in the group of transitional countries in Central and Eastern Europe. The National Statistical Institute (NSI) estimates the country's labor force at 3,552,000. According to data from the National Employment Service, in January 1996, 11.6% of the economically active population was unemployed.

However, both institutions base their figures on the records of the job centers which register less than half of the actual unemployed.[25] Therefore, it is very difficult to claim that the data in this area are exact. Following estimates of the EBRD, employment in manufacturing fell by 7-18% every year in Bulgaria during 1992-1995 (Transition Report, 1996:24).

The social safety net in Bulgaria is financed by payroll taxes of 35-50% as well as by transfers from the state budget and is a crucial source of income in low-income households. The net consists of pensions, unemployment benefits and maternity, child and family benefits. The pensions system is not sustainable. The ratio of pensioners to contributors was 86% in 1994, as a result of overly generous entitlement criteria, an aging population and the early retirement of redundant workers (EBRD Transition Report, 1996:144). Expenditure on social protection constituted more than 13% of GDP in 1992 and represented 11% of GDP in 1995, but the real benefit levels were extremely low. The entire social safety net does not function sufficiently and the cash benefit system is widely considered to be both ineffective and not affordable (Hassan & Peters, op.cit.:640).

The disintegration of the Comecon-market caused significant changes in terms of *Bulgarian exports*. The introduction of trade in convertible currencies at world market prices caused a completely new and highly unfavorable situation for traditional Bulgarian exports (such as products of the manufacturing industry). According to surveys conducted by the Bulgarian Trade Ministry, at present, two-thirds of Bulgarian exports are received by risk markets, such as the Arab countries and the CIS (Bulgarian Telegraph Agency Weekly News, various numbers) and the ex-Soviet Union has remained Bulgaria’s largest trading partner. Products within the same industrial branch vary a great deal in quality according to their respective place of production being either Western or Eastern countries. This makes it difficult to reorient the trade flows from the Eastern to the Western markets. Such a process is possible only if serious changes in production technologies, production processes and

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[24] Since most prices in the banking sector are directly linked to the central interest rate, the latter is a powerful financial tool in the country.

[25] Between 225,000 and 375,000 Bulgarians are working on the black labor market. According to figures calculated by sociologists of the Bulgarian Academy of Sciences, 6-10% of the active population work unprotected by the social safety net. These are mainly members of families who work unpaid and uninsured in their family companies. Some 150,000 pensioners earn money in the same manner. Nearly half of the working pensioners have not signed labor contracts. At least 35,000-40,000 of those who work without contracts are officially registered as unemployed. Some 6% of the people employed in the public sector take up additional jobs without signing contracts and paying taxes. (See “Douma” newspaper, December 13, 1995)

work force qualification take place. Changes in the latter require foreign direct investment on a large scale.

The financial results of Bulgarian companies operating in export-oriented industries are better than the average although the behavior of foreign exchange rates deter rather than promote Bulgarian exports. Chemicals, products of the ferrous and non-ferrous metallurgy, mineral products, machinery and equipment are among the highest hard currency earners and at the same time these are the industries that record the highest growth during the last years. In general, Bulgaria does not sufficiently use and take advantage of the possibility to create and improve its access to foreign markets. The policy of the 1995-1996 government was to limit the import of finished goods using the possibilities of the fiscal, customs and foreign exchange mechanisms.

One can hardly speculate on the fact that, at present, international financial institutions are the Bulgarian economy's basic real source of financing. Under such circumstances, there is limited choice for the country in terms of whether or not to comply with the conditions and requirements formulated by these institutions. The question remains, however, as to what extent and how speedily these requirements are implemented. In the spring of 1996, the World Bank determined that a country must have an agreement with the International Monetary Fund before the World Bank would agree to finance the country. The World Bank requires a strict and specific program for structural adjustment of the economy including acceleration of privatization, reform in the financial sector and improvement of the financial discipline in state-owned enterprises. Bearing in mind that the World Bank is interested in financing a country which undergoes a real process of restructuring and not simply slight and cosmetic changes, the institution does however, place strict market conditional requirements before providing credits. It had two main requirements towards the Bulgarian government - immediate close-down of 64 enterprises which detracted money from the economy[26] and isolation of 71 other chronically deficit-producing companies by putting them under a special regime which would not allow them to receive bank credits.[27] The companies in question have accumulated considerable amounts of bad debt. These "financial black holes" (Gomulka, 1994) were grouped according to their financial results and were meant to be restructured and possibly privatized. However, this can

[26] These 64 enterprises were responsible for one-third of the negative value added generated in Bulgaria in 1995.
[27] For a period of three years (1993-1995) the losses of inefficient enterprises have come up to 20% of the GDP (about 2,000 million USD) a year. The loosing enterprises in Bulgaria are 2056 with over than 180,000 employees.

hardly happen bearing both their technical and financial state in mind. The other option - to let these enterprises sink into bankruptcy seems to be the more likely outcome even though there are strong political considerations to be taken into account when taking such decisions and even though the social price will be significantly high - most of these companies are large and some supply whole regions with their industrial profile.

Liquidating money-loosing and non-competitive state-run enterprises turned out to be a difficult step for the Bulgarian government. Although it formally required the closure of most of the 64 enterprises, it preferred the rehabilitation of the enterprises to their liquidation. It was announced that fast privatization of the enterprises on the liquidation list would be preferable. The Privatization Agency sold some of them but in general, the financial system was not able to allocate existing financial resources for productive uses. The IMF suspended a 582 million USD stabilization loan to the country after the government failed to close these state enterprises.

The rehabilitation process of the companies in isolation is even more slow. According the provisional Law on the Financial Rehabilitation of State-Owned enterprises, there are certain procedures of drawing up the rehabilitation programs, their revision and approval, and finally implementation of the rehabilitation programs by the enterprises in question. Therefore, results of this process can not be expected to be available before 1998. Since rehabilitation measures have been deemed urgent in Bulgaria's case, this slow-down is disapproved by the IMF.

The implementation of a stronger structural policy in Bulgaria is hindered by the monopolist positions some of the enterprises have. As discussed in Section 2, monopolies have strong traditions in Bulgarian economy. Since enterprises were situated in a stable and non-competitive environment, they were not motivated to introduce innovations. It is difficult to expect that those enterprises will be willing to change even if they face a crisis. Companies are inclined towards inertia as a result of a combination of various factors and inertia promotes maintenance of the status quo, even if clearly dysfunctional processes are present. As pointed out by Murrell (1992:47), "the essence of the problem of macro economics stability during reform lies in the incompatibility between the new market environment and the enterprise behavior and expectations that are a heritage of the past. The old systems accommodated themselves to certain features of enterprise behavior, among them the tendency to disregard financial constraints in the face of seemingly more urgent real priorities. Given the stability of the old system over a number of decades, one might conclude that, within the constraints, such accommodation was successful in controlling or neutralizing those elements of enterprise behavior that had most immediate dysfunctional consequences".

8. Highlights and conclusions

The transition processes in Bulgaria so far support the view that the "Jump into the market" (Csaba, 1992) is not a textbook case from which solutions are easily available and transferable. The results of six years of transition look disappointing and pessimistic. From the previous sections we can conclude that the Bulgarian economy is in a state of collapse. The industries are declining, a large number of companies operate at a loss and the prospects for many others are bad. Many industrial enterprises reached the bottom line without being able to turn up again, others are "starting from below zero" (Sullivan, 1992).

The Madrid Declaration, adopted by the IMF in 1994, defined two main aims for economies in transition: integration into the international economy and laying the foundations of sustainable growth. Bulgaria has not taken any of these to heart. Other countries in similar situations had competent rulers who were able to overcome the transition problems by developing and executing long-term programs. Up till now, Bulgaria has not adjusted flexibly to the changes along the path of transition and doubts about the country's ability to meet the transformation targets are growing.

At the beginning of 1997, the country is more unstable than it was in the beginning of 1990. With regards to the reasons for the current crisis, it must be emphasized that there are several factors to be taken into account: Bulgaria started its economic transition under particularly difficult conditions, the introduction of structural transformation and privatization were delayed considerably, the banking sector collapsed totally, and the country did not succeed in attracting foreign investment. The most serious and pressing problems Bulgaria has to solve are related to the avoidance of a financial collapse and the speeding up of the process of economic recovery. The government is faced with the challenge of structurally reforming the economy but there is no substantial progress in the formulation and implementation of appropriate stabilization and structural adjustment policy. Structural imbalances are to be reduced. In terms of objectives, reduction of the budget deficit and a prudent monetary policy cannot be avoided. One of the conclusions that can be drawn on the basis of the facts presented is that substantial institutional changes in Bulgaria have been very slow and far from sufficient.

The macro economics imbalances as well as the price pressures being extremely high and unstable keep the living standards and quality of life at a very low level. There is no workable system for social protection. The unemployment rates are likely to rise considerably in 1997. Closing down deficit-producing enterprises, dismissing their personnel, in addition to reducing staff numbers in various budget organizations will be difficult to avoid. A major challenge ahead is the improvement of micro economic efficiency. The development of privatization in Bulgaria is of great importance to the transition processes in general. The commitment to transparency is relevant for winning public understanding, confidence and acceptance. The rules for advertising the participation conditions and procedures should be made as broadly known as possible and should be equal for all participants. Participation needs to be more active in order to create real possibilities to sell the enterprises at the best price. People need to believe that companies are sold fairly, impartially and at high prices.
As indicated above, foreign investments are crucial to the recovery and development of Bulgaria's economy. The perspectives do not look encouraging: the country does not look to be in a position to attract larger flows of foreign capital and it will remain in the periphery of foreign investors' attraction. It is not realistic to expect large capital inflows of foreign direct investment. Therefore, the country needs a new image based on real achievements. Despite the liberal investment laws that have been passed, a long-term security of the property rights of foreign investors is needed. Serious efforts are required to develop a reputation for honoring past implicit or explicit contractual commitments to foreign investors (OECD, 1997:1-2).

As stated by Whitley (1985:14), "the transformation of a command economy to a market economy clearly requires more than the sale of state assets to a private sector, not least because these assets are rarely organized into coherent units which could form the basis of independent economic actors. Thus, all former state socialist societies have to reorganize production units, manage inter-enterprise debt and reallocate resources if they are to develop viable firms for a market economy". Hirschhausen (1995:54) draws a similar conclusion: "Where reformers expected rapid privatization to guarantee immediate restructuring, it has proved impossible to convert socialist industrial structures to the new monetary environment by a mere change of ownership [...]". Therefore, privatization is not to be considered in isolation but rather in the context of the broader processes of economic restructuring.

Industrial restructuring goes beyond privatization of state-owned enterprises and their transformation into viable firms. It requires serious changes in market orientation, production technology and management / employee-behavior. A deeper integration in international markets, consideration of environmental issues and imposing motivating mechanisms to act competitively are only some of the concerns that follow from the above mentioned aspects of change. The lack of policy consistent as well as the lack of a longer-term strategy for restructuring were the main reasons for not progressing in economic terms. Restructuring requires enterprise-closures and this leads to employment losses as an unavoidable process in the period of transition.

The serious crisis Bulgaria faces is a force in its own right and can spawn a deep transformation. On the way “from ‘real socialism’ to ‘somewhere’” (Schmidt, 1995a:4) the complexities of the tasks facing the country require a growing national consensus on the resolution of key problems. In addition the process requires the constructive interactions and coalitions between the political parties in their concentrated efforts to overcome the current crisis. Under circumstances of disagreement on the solution to existing problems and a lack of commitment to pursue a valid solution, it is hard to implement a consistent and visionary reform program.

Appendix 1: The Bulgarian Political Reality until 1990

Communist Party 1918

Dominant party of the Fatherland Front organization which claims 800 000 members. Founded from a splinter group of the moderate left *Social Democratic Party* (1893). Renamed Bulgarian Socialist Party (1989).

Agrarians' Union 1899

Founded to protect farming and related industries. Main body continued as Stambouliisky's party when Draghyeff's party broke away in 1919 as a more moderate group, defending parliamentary methods in politics.

Democratic Party 1895

Founded as a group to reconcile differing parties with a centre policy. In 1906 *the Radical Party* split off, in support of co-operatives, radical tax reforms and a federation of Balkan states.

National Liberal Party 1920

United three small parties to rebuild post-war Bulgaria and gain a revision of the peace treaty. Stambouloff's *National Liberal Party* broke away in 1925.

Party of the Democratic Entente 1923

Moderate reform party committed to peace and strengthening of the law and the economy.

Bulgarian Socialist Party 1989

Formerly the Bulgarian Communist Party

Union of Democratic Forces 1989

A coalition of 16 opposition groups including *the Bulgarian Workers Social Democratic Party*, the *Citizens' Initiative Movement* and the *Ecoglasnost Independent Association.*

Movement for Rights and Freedom 1989

The Party of the ethnic Turkish minority in Bulgaria

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