Republic of Bulgaria

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Legal and Administrative Environment of SMEs: Bulgaria

The idea of this presentation is to demonstrate the complexity of SME policy frameworks refereeing to the experience of one country – Bulgaria.

The experience of the institute I have the privilege to manage leave little doubt that there were and still exist similar challenges through-out the Black Sea region.

The situations and lessons, described below reflect IME research, findings and analysis conducted in a period of ten-eleven years. This experience is the following:

- 1994 – 1997 Parallel Economy and Quasi-Fiscal Subsidies in Albania, Bulgaria and Romania;
- First transaction costs survey for Bulgaria 1996;
- Management Costs in State Owned Enterprises – 1996 and 1997 (The same survey repeated for enterprises privatized via voucher schemes);
- First Compliance Costs survey for Bulgaria 1999;
- Since 2000 weekly surveys, costs benefit analysis and publications on ad hoc issues; monthly tax bulletin and annually drafting an alternative state budget at 10% tax;
- Shifted research interest on incentives, e.g. for economic informality in Bulgaria; -Romania and Serbia (in 2003) and for Bulgaria migration (in 2004 and 2005);
- Assisting business reforms in Bulgaria, Bosnia and Herzegovina, The Balkans, Kyrgyz Republic, being part of the EU debate.

Some inappropriate policies and constellations

One of the key barriers in the area of SME policy frameworks in Bulgaria was the uneven treatment of the entry barriers in different sectors of the economy, policy decision benefiting different political constellations.

In 1989 – early 1992, the establishment of financial intermediaries, commercial banks in particular was relatively easy. There was need to get a permit of the prime minister (who was obliged to consult the governor of the central bank) and it was possible to set a bank of borrowed money, from the central bank itself or at state owned enterprises. That was the way of mushrooming private banks before first free elections of June 1990. Then, they collected saving of the public and to extend credits to shareholders plus government enterprises (in order to qualify for central bank refinancing).

Bankruptcy regulations were adopted in 1994 but were not applied to loss-making government owned enterprises 1998. Creditor rights remained poorly protected (e.g. foreclosure process could take 19 months, if the system worked properly). Central bank "cured" the system via financing the government and refinancing banks and through "measured" issues of notes; the results: hyperinflation, privatization of profits and nationalization of losses, which costs were at the level of 14% of 1996 GDP. The banking system collapsed in 1996-1997, during one of the most expensive banking crisis in the history of post-war Europe. [1]

In a contrast to lacking or delayed prudential regulations in the financial sector (they properly implemented only in 1997-1998), private enterprise has been, during most of the reform years, heavily regulated.

Business registration in the period preceding the 1997 crisis was around 70 days. In addition to slow formalization, there were significant increases of other entry barriers, like preliminary controls, licensing and permits. The most significant increases of such barriers coincided with changes in the government: end-1994 – 1995, in 1997 and 1998.

In 1997, the government has abandoned discretion in monetary (and macroeconomic) affairs but kept it on microeconomic level. Recently, new government regulations are explained by EU accession, but, whatever the reason, they retain interference in private transactions.

In 1999, private sector's compliance costs were 12% of GDP, and it was 2.5 times cheaper to operate if one does not comply with regulations.

In the period between 1991 and 2000, the fifteen key laws regulating taxes, companies, social welfare, accounting and statistics were amended 198 times.

During the period in question, using taxpayers' money was also far from prudent. Rules of compiling government budget were adopted in 1996 and applied fully in 1998. Public procurement was put in order in 1999. Government debt statistics become public in 1999,

The first consolidated budget was published in 2000.

Lack of regulation served to hide realities behind sizable budget deficits of above 6% for the entire period of 1990 – 1997 and 1996 and behind redistribution of public funds via off-budget accounts (on average at the level of 7-8% of GDP in 1992-1996 and of 15% in 1997).

Regulation and taxing of labor used to be quite problematic as well.

On every 100 units of wage, the total employer and employee's transfers to the state budget (in line with income tax, pensions, healthcare and other relevant laws) grew from 56% in 1991 to 78% in 1996, and 75% in 1999; 2001 – 2004 roughly 70%.

The outcome of the 1996-1997 crisis necessitated prompt privatization.

Often however, the privatization law outlined and regulated privileges for managers and employees of industrial enterprises. The most important of them was the possibility of 10% down payment in the privatization and re-scheduling remaining 90% over a 10 years period. Thus, this type of privatization constituted granting of the formerly government owned assets and the right to re-sell or use them - to managers appointed by the government itself.

In 1998, such deals were almost _ _ of all sales of state owned enterprises.

Privatization rarely went via auctions, negotiations (with no rules how to conduct them until 2000) with "strategic" buyers were used in 90% of the sales.

In 2002, the government adopted new rules to skip privileges make auctions a common practice but allow for non-privatization goals to lead the process, an innovation that eventually blocked the process and decreased transparency. In 2005, non-privatized state owned enterprises are handful in number in the power sector and gas (plus the tobacco monopoly).

Meanwhile, the government remains in control to significant still state assets, like land, forest, roads, etc.

Some macroeconomic and other policy conclusions

History of macroeconomic constellations

Indicators (average)	1990-1997	1998-2004	2002-2004
Inflation (%)	210.1	7.5	4.8
Inflationary tax rate (%)	57.7	6.9	4.5
GDP growth (%)	-4.7	4.4	5.0
GVA growth (%)	n.a.	4.0	4.9
Investment growth (%)	-8.8	18.2	11.4
Budget deficit/surplus (% of GDP)	-6.3	0.2	0.4
Government debt (% of GDP)	168	65.9	48.2
FDI (USD million)	168	1,253.4	1,867.7
FDI (% of GDP)	3	7.4	9.1
Subsidies (% of GDP)	n.a.	2.1	2.5

In fact, after 1997-1998 there is a new country. For Bulgaria, this is the longest historic period of sustained economic growth, although necessitated to a certain degree by the previous years of contraction of GDP and dis-investment.

The entire positive outcome is due to the limited government monopoly to print money. It was introduced by law in mid-1997 and this strict (fixed) exchange rate policy has brought about flexibility in all walks of economic life. This trend is particularly visible by the dynamics of the last five years.

	2001	2002	2003	2004	2005
GDP growth	4.1%	4.9%	4.5%	5.6%	5.5%
GDP per capita in BGN[2]	3,754	4,109	4,416	4,885	5,380
Investment / GDP	18.3%	18.3%	19.3%	20.9%	24.0%
Net savings / GDP	14.6%	14.9%	12.5%	16.0%	15.0%
Inflation	7.4%	5.8%	2.3%	6.1%	5.0%
Unemployment	19.7%	17.8%	13.7%	12.0%	10.0%
Current account / GDP	-7.3%	-5.6%	-9.2%	-5.8%	-11.9%
Government debt / GDP	73.6%	56.0%	47.8%	40.9%	32.3%

Lessons

Bulgaria is a typical, textbook case of both mismanaged economy and an economy that demonstrates clear gains from sound and simple policies.

In the period of 1990 – early 1997, the government of Bulgaria was ready and attempted to peak winners. The economic performance of the period after that year shows a mobilization of enormous resources to invest and grow every year is a result of the established sound money and the respective price stability.

For the period the sustained economic growth, there were negligible attempts to conduct earmarked financial SME programs, much rhetoric and almost no actual government effort to finance such efforts. This is because no government program can compete with the resources generated in the economy. The greatest deal of policy action needed is in the area of reducing barriers to business and improving the business environment.

It seems that countries try not to repeat Bulgaria's policy mistakes: Serbia and Montenegro, as a state union and alone, have made a remarkable reform in the area of business environment and entry barrier: World Bank ranked Serbia World's Best Reformer in 2005. Similar effort is visible in Georgia and to some extend in Armenia.

Bibliography

1. The crisis was related also, besides hyperinflation, to three time increase of the population under the poverty line, public discontent in the winter of 1997 and fresh elections in April 1997.

2. The exchange to Euro is 1.95.