



Republic of Bulgaria  
ECONOMIC  
AND SOCIAL COUNCIL

**OPINION**  
**OF**  
**THE ECONOMIC AND SOCIAL COUNCIL**  
**ON**

**“THE BULGARIAN ECONOMY UNDER THE GLOBAL FINANCIAL  
AND ECONOMIC CRISIS – PROBLEMS, CHALLENGES AND  
OPPORTUNITIES”**

**(developed on own initiative)**

The Economic and Social Council of the Republic of Bulgaria included in its Action Plan for 2009 the development of an opinion on

“THE BULGARIAN ECONOMY UNDER THE GLOBAL FINANCIAL AND ECONOMIC CRISIS – PROBLEMS, CHALLENGES AND OPPORTUNITIES”

The opinion is developed on the own initiative of ESC and its development was assigned to the Standing Commission for Economic Policy and the Standing Commission for Labour, Incomes, Living Standard and Industrial Relations.

With a decision taken at a joint meeting of the two commissions were appointed:

- a rapporteur – Mr Bojidar Danev – ESC member from group I – employers;
- an external expert on the opinion – engineer Silviya Todorova – Director of “Industrial Development” Department at BIA.

The draft of the opinion was drawn up and adopted at a joint (full) meeting of the two commissions on 10 July 2009. Representatives of the MLSP, NSSI, NRA, Agency for Economic Analysis and Forecasts, Employment Agency, Centre for Economic Development were present at the meeting and took part in the discussions of the draft.

The plenary session of ESC adopted this opinion on 22.07.2009.

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## **ACRONYMS**

GDP – Gross Domestic Product

GVA – Gross Value Added

BNB – Bulgarian National Bank

SIB – Supplementary Incentive Bonus

SSS – State Social Security

EC – European Commission

EU – European Union

ICT – Information and Communication Technology

ESC – Economic and Social Council

IMF – International Monetary Fund

ILO – International Labour Organisation

SME – Small and Medium Enterprises

NRA – National Revenue Agency

NARI – National Agency “Road Infrastructure”

NHIF – National Health Insurance Fund

R&D – Research and Development

NSSI – National Social Security Institute

NSI – National Statistical Institute

EIA – Environmental Impact Assessment

BIR – Base Interest Rate

FDI – Foreign Direct Investments

## *I. Conclusions and recommendations*

1.1 The current world financial and economic crisis proved to be an important indicator for disclosing the presence of significant structural problems in the Bulgarian society and economy. The high sensitivity of our economy to the world financial and economic shocks, reinforced by macroeconomic imbalances and distortions in the economic structure, pose challenges, which we have to deal with in times of crisis by carrying out transformations in the national economy.

The engine of this change are the technological development, education, qualification, changing qualification on the one hand, and a change in the attitude towards labour and behavioural culture on the other. In **both cases** in order to achieve good, sustainable results a significant transition period is required.

1.2 It is necessary to stimulate the government's policy on fast and large-scale structural optimization and technological modernization of the economy. Measures, necessary for the rapid increase of the share of medium and high-technology products in the structure of production and export, should be adopted.

The current economic slump, regardless of its severity, should not be a cause of postponing the measures for improving the economic competitiveness, including measures for fighting climate change. **The crisis may and should be considered as an opportunity.** Once we manage to overcome the recession we should head in a different direction.

1.3 The structure of production and consumption should change towards low energy consumption and low material consumption and lowering greenhouse gas emissions.

Some productions should disappear, while others should develop and enlarge. This will result in loss of existing jobs, but along with that new jobs will be created. The required skills and knowledge have changed and are still to change. These changes involve large investments.

1.4 The anti-crisis plan and the growth opportunities for the economy, the development of production and activities with higher value added should take into consideration the alternatives for more ecology-friendly economy. It is necessary to integrate the efficient utilization of energy and other natural resources in the economic growth. This should be achieved by taking into consideration the three pillars of sustainable growth – economic, ecological and social – without forgetting the growth and jobs goals.

1.5 Among the recommended measures to be implemented are:

1.5.1 Capitalization of Bulgaria's geostrategic location through accelerated construction of diversified modern transport infrastructure. This can be achieved with changes in the legal base, guaranteeing overcoming the problems related to the nationalization of the necessary land for community needs and through quick completion of the digital land cadastre.

1.5.2 Separating the state from the direct management of commercial partnerships, especially the monopolistic ones, but preserving fair competition and observing the public interest.

1.5.3 Liberalization of the energy market in compliance with EU requirements and regulations.

1.5.4 Development of market mechanisms stimulating land consolidation, increasing the percentage of arable land and improving the technological culture in agriculture.

1.5.5 To preserve the viability of the competitive sectors and productions it is necessary to accelerate and simplify the insolvency procedures and those on clearing debts between companies.

1.5.6 In order to improve the transparency of the monopolistic suppliers of public services as well as for all other state companies, requirements for disclosing information, similar to those applied for public companies, should be introduced.

1.5.7 The potential of ICT should also be utilized through building a broadband internet access.

1.5.8 To prepare a register of punctual tax payers and there should be an accelerated refund of tax credit on VAT for them.

1.5.9 Urgent initiation of negotiations for sale of emission rights under the Kyoto Protocol (AAU) in order to secure revenues of minimum of €1 bln., similar to the activities of the Czech Republic, Slovakia and Hungary.

1.5.10 The sales revenues from emission quotas under the scheme of emission trade should be directed straight towards investments and R&D in the sphere of climate change and energy saving.

1.5.11 The great opportunities for education and training, especially life long learning, so that anyone can get adapted to the changes in the models of production and consumption.

1.5.12 We recommend a change in the social welfare system for certain groups with full working capacity and part of the payments should be granted according to the income criterion and also according to the put in labour and improved qualification.

1.5.13 Renewing the work of the anti-crisis council under the Prime Minister with the participation of the social partners, where the effects of the crisis should be discussed and the anti-crisis measures coordinated.

1.5.14 The government should require that the line ministers undertake the development, along with the social partners, of branch anti-crisis programmes.

1.5.15 The civil society and the social partners should participate actively in the large-scale efforts for restructuring the economy. ESC expresses its willingness and desire to take part and do what is within its powers.

1.6 Guaranteeing the stability and sustainability of the pension system requires equality between the state (in its role as an employer) and the other employers and it should start to pay the whole contributions for those who it secures socially, taking into consideration the category and term of receiving the pension. To achieve equality between all types of secured persons it is necessary to raise the minimum security income of the self-securing persons to an amount which can guarantee them that they receive at least the minimum pension for a security length of service and age, including through the implementation of a differentiated minimum security income in terms of basic professions and strengthening

the control over the received incomes and paid contributions by the respective persons. It is also recommended that the amount of the minimum security income of agricultural producers be increased to the amount of that of the self-securing persons.

1.7 The bank institutions should not change unilaterally the terms and conditions on credit contracts, including interest rates, security, repayment schedule etc, and they should introduce transparent base interest rates, such as LIBOR, EURIBOR, BIR etc.

1.8 After carrying out a comprehensive analysis of the bottlenecks in the administrative services, part of the activities should be outsourced to private contractors.

1.9 A considerable decrease in the number of regulatory regimes, liquidating the illegally administered ones, accelerating the administrative services, including through their electronisation, social monitoring of deadlines and introduced fees. Relating the fee size to the expenses made on providing the administrative services.

1.10 Pulling together the efforts of the administration dealing with the management of absorbing the pre-accession, structural, cohesion and agricultural EU funds for improving their utilization as a compensating flow to lower the inflow of FDI and external lending. Simplifying and relieving the rules and procedures for applying under separate schemes, including in the field of preventing corruption practices, fraud and misappropriation.

### *General characteristics*

## *2. Introduction: Bulgarian economy after the start of the crisis*

### **Macroeconomic situation: financial and physical flows**

#### **2.1 Gross Domestic Product**

According to the results from the second half of 2008 and the first half year of 2009 it becomes obvious that Bulgaria has also been hit by the world crisis and it has affected all economic sectors, serious problems have arisen in the real sector, the financial sector and the social sphere. Up to the third quarter of 2009 Bulgaria had

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entered a recession, accompanied by an increase in unemployment and freeze in investment programmes. Although the Bulgarian economy is open and small, the accumulated reserves and stability of the financial system determine another direction of crisis development – from economic slump to a possible financial crisis. Regardless of the fact that the incentives for initiating the current processes were the events happening in the world financial markets and the recession in the developed countries, the strength and degree of this impact are also related to domestic reasons among which are the imbalances in the economic structure.

The initial psychological expectations in the country were that the crisis will be over and the broad investment programmes will continue without incurring any big losses at the expense of available reserves. This formulation was the basis for attempting to continue the economic development without any serious corrections to the political methods, the strategic plans and the budget. The world crisis, the withdrawal of capital and the decrease in orders for the industry called for the need for change in the macroeconomic policy and altering the budget for the current year.

In 2008, underlined by strong domestic demand, real estate trade growth, rise in financial intermediation, construction and the related sectors, Bulgaria's GDP grew by 6%, reaching 40.1% of the average for EU GDP per capita in line with purchasing power standards. The slowing down in the economic processes and the subsiding growth became apparent in the second half of 2008 (Table 1). In real terms GDP for the first quarter of 2009 showed an economic drop by 3.5% compared to the respective period of the previous year as a result of limited demand and decreased domestic and foreign investments. In nominal terms GDP in the first quarter of 2009 compared to the fourth quarter of 2008 is by 5%. The drop in the fourth quarter of last year compared to the third quarter is 1.6 per cent. Registering negative growth in GDP for two quarters in a row means that the Bulgarian economy is in recession, according to statistics.

**Table 1: Basic macroeconomic indicators for Bulgaria: end of 2008 and first quarter of 2009.**

Forecast period	Institution	Forecast for 2009		
		GDP growth, %	Inflation, average for the period, %	Current account, % of GDP

Forecast period	Institution	Forecast for 2009		
		GDP growth, %	Inflation, average for the period, %	Current account, % of GDP
April 2008	EU	5,6	5,9	-20,9
	IMF	4,8	6,0	-18,9
	BNB	6,5	4,7	-20,3
October-November 2008	EU	4,5	7,9	-22,3
	IMF	4,2	7,0	-21,5
	BNB	4,9	5,4	-21,1
January-February 2009	EU	1,8	5,4	-24,0
	IMF	1,0	4,7	-15,3
	BNB	2,4	3,0	-18,3
April 2009	IMF	-3,5	3,3	-12,0
	BNB	between 0,6 and -2,0	between 2,5 and 1,7	between -17,2 and -13,8

Source: BNB, EC, IMF

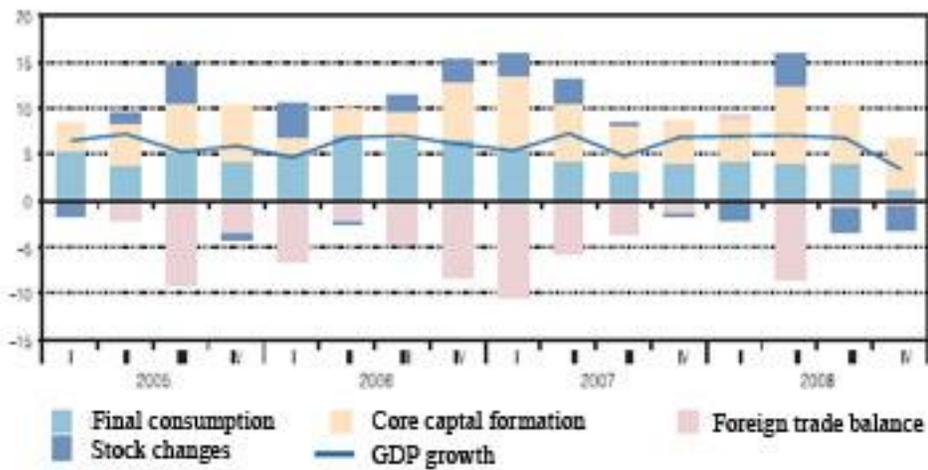
The main channels through which the international crisis penetrates into Bulgaria are the limited opportunities for export of Bulgarian goods and services; the drop in the inflow of foreign direct investments; limiting the access to loans and raising their price; reducing the transfers from Bulgarian citizens abroad; a decrease in the revenues from foreign tourists; limiting the revenue from transportation services.

The positive tendencies in the Bulgarian economy can be expected not earlier than six months after registering the first signs of steady recovery of the big economies in the European Union.

## 2.2 Investments, including foreign direct investments

The tendency over the past years was for investments in core capital to have the highest share in the GDP growth and it lasted during 2008. For the year on average the gross formation in core capital increased in real terms by 20.4%, contributing with 6.1 basis points to the economic growth. During the fourth quarter the investment activity remained high – the physical volume of investments increased on yearly basis by 15.8%, and its contribution to the growth was considerable, 5.4 basis points (Chart 1).

**Chart 1: Contribution by components to the growth of GDP under the method of final use (by quarters, %, percentage point compared to the respective period of the previous year)**



Source: NSI, BNB

In the sector structure of foreign direct investment with accumulation at the end of 2008 the main share belonged to the following sectors: *property and business services* (22.8%), *processing industry* (18%), *financial intermediation* (17.5%) and *trade and repair* (14.3%). The trends in the investments inflow by economic sectors at the end of 2008 showed a slowdown in almost all sectors, while these sectors preserved their importance in the net inflow. For the first five months of 2009 the slump in investments

in comparison with the respective months of 2008 was more than a half – by nearly 54%. (Table 2).

**Table 2: Foreign Direct Investments inflow in Bulgaria by type of investment (million €)**

	2008 г.					
	I	II	III	IV	V	I-V
<b>Total</b>	<b>329,2</b>	<b>344,9</b>	<b>528,0</b>	<b>722,1</b>	<b>519,7</b>	<b>2443,9</b>
Capital participation	163,8	189,0	130,3	205,5	186,9	875,4
Other capital	124,2	114,7	356,6	472,8	288,9	1357,2
Reinvested profit	41,2	41,2	41,2	43,9	43,9	211,3

	2009 г.						Difference
	I	II	III	IV	V	I-V	2009-2008
<b>Total</b>	<b>295,9</b>	<b>141,0</b>	<b>313,4</b>	<b>212,9</b>	<b>170,4</b>	<b>1133,6</b>	<b>- 1 310,3</b>
Capital participation	99,2	151,4	234,4	173,9	136,7	795,6	- 79,8
Other capital	167,3	-39,7	49,6	9,6	4,3	191,0	- 1 166,2
Reinvested profit	29,4	29,4	29,4	29,4	29,4	147,0	- 64,3

Source: BNB

In terms of attracting foreign capital the economy has returned to 2006 levels, at least. In the following half-year periods there will be stronger reticence in foreign investors as to investing their capital in our country as a result of an overlap of three crisis - economic, financial and gas. The likely political crisis could additionally worsen the alarming situation.

### 2.3 Foreign trade balance

The foreign trade balance still had negative contribution to the real GDP growth in 2008. In comparison with the previous years this contribution was smaller (-2.3 basis points). From the middle of the year both export and import slowed down their annual growth and in the fourth quarter both indicators decreased in nominal and real terms in comparison with the last quarter of 2007.

The drop in import is closely related to:

- Drop in export since it is characterised by high import consumption;
- Decrease in investments;
- Collapse of oil and oil products prices;
- Decrease in financial transfers from emigrants.

In the first quarter of 2009 the assessment of the index of physical volume of goods and services export registered real decrease by 17.4%, while the import index of goods and services registered a decrease by 21.1%. This tendency affected favourably the size of the foreign trade deficit, but it brings along long-term risks for the economy, the balance of payments of the country and the revenue account of the state budget. The revenue account from duties, fees, excise duties and value added tax is given in Table 3.

**Table 3: Spreadsheet of the revenues from duties, fees, excise duties and value added tax for the period January – April 2008 and 2009 in BGN**

Indicator	I-IV.2008	I-IV-2009	Difference	%
1. Excise duties	1 133 843 687	1 070 354 856	-63 488 831	94%

2. Duties	64 704 158	49 856 617	-14 847 541	77%
3. VAT from deals within the country	1 233 093 221	1 264 461 609	31 368 388	103%
4. Refunded VAT on import	-2 012 529	-7 760 665	-5 748 136	386%

Source: NRA, National Customs Agency

The aggravation of the global economic crisis has led to contraction in the foreign demand for Bulgarian goods during the current year. The worsened international market situation, the insecurity in terms of investments and the more expensive and difficult access to financing will affect adversely the investment plans of the enterprises. The slack construction activity will also contribute to slowing investments during the year. It is expected that there will be lower income growth and a slump in employment, which will restrict domestic consumption. Due to the high import component of investments and consumer spending the import volume is expected to decrease faster than that of export.

Nearly 80% of our export is directed towards developed economies – the most strongly affected part of the world economy. Any type of fluctuation in the economic activity in these countries will influence our export to them. The opportunities for restricting these consequences are limited since the causes are external.

The currency devaluation in Russia, the Czech Republic, Slovakia, Ukraine, Turkey, Serbia, Macedonia, Romania, Hungary etc by 35-50% will exert pressure on the economy in terms of the currency and the capital account alike.

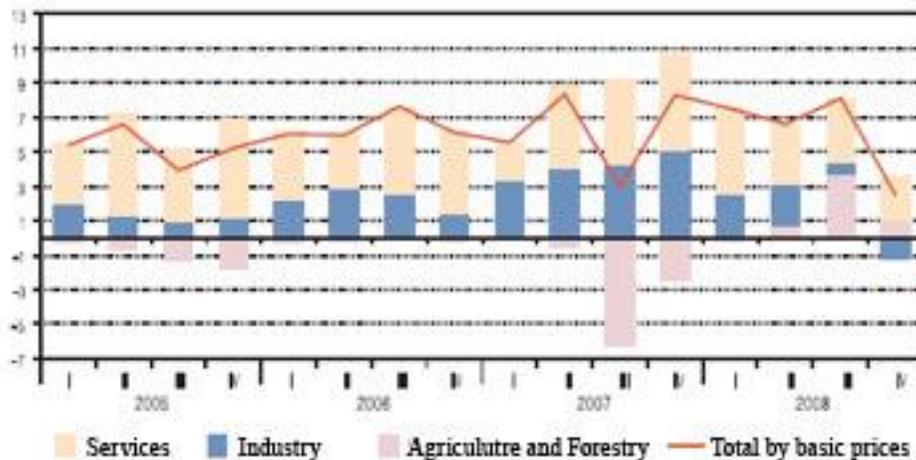
As a result of weaker foreign and domestic demand there will be a drop in the degree of using companies' production capacity and the expected rate of economic growth will be considerably lower than the potential one.

The cumulative decrease in export by volume and prices will most strongly affect our export sectors. The effect will be felt along the entire chain of economic relations and will be felt in the decrease in manufactured BDS, drop in the sales revenues, laying off workers, lowering tax and security revenues. Particularly alarming are the difficulties that the business experiences in servicing inter-company debts, accounts payable to banks, budget, social security, payments to their own staff etc. (116 billion BGN at the end of 2007). According to our expert evaluation at the end of 2008 their debts amounted to approximately 160 billion BGN.

## 2.4 Value Added

During the first quarter of 2009 the gross value added, created by the sectors of the national economy, amounted to 11,607 million BGN in current prices. In comparison with the first quarter of 2008 the gross value added in real terms decreased by 3.6%. For the second quarter in a row the value added in industry registered negative growth and the effect is reinforced by the negative growth in agriculture.

**Chart 2: Value added growth and contribution by sectors (% , percentage point compared to the respective period of the previous year)**



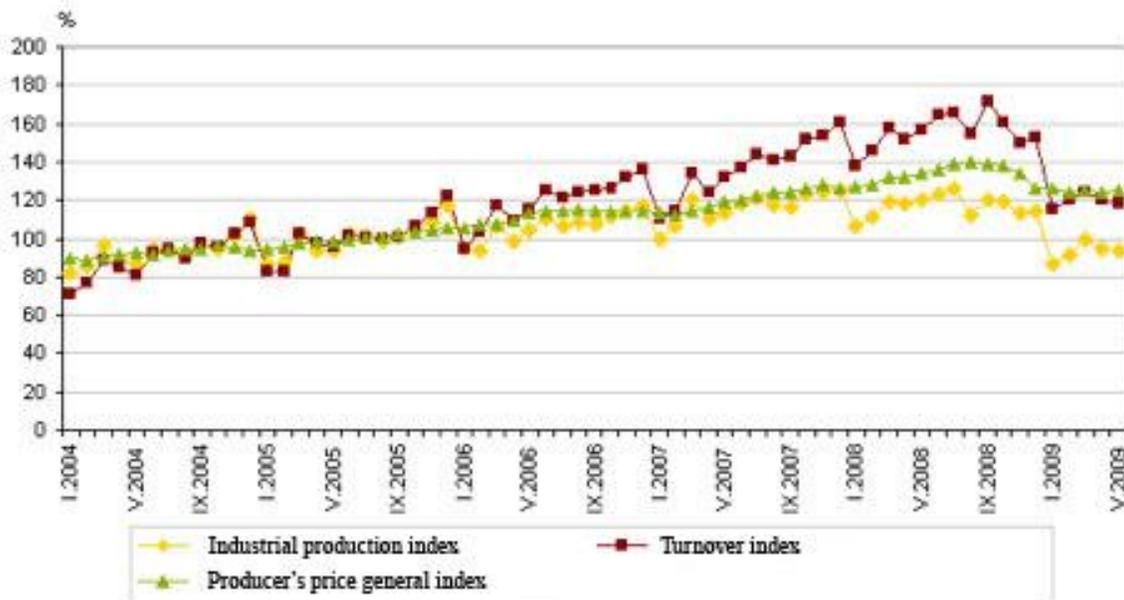
Source: NSI, BNB

During the fourth quarter of 2008 the real sector marked the beginning of a decrease in the manufacturing and investment activity in most economic sectors. The deterioration in the foreign economic situation, the complexity and the difficulties related to receiving leverage financing led to cutting down production plans and investment programmes. Projects for reorganising big companies have been stopped, payments have been delayed, demand has dropped, prices have gone down.

There is a slump in foreign demand and a considerable part of metallurgy and other energy-oriented productions cut the volume of their output. The strongest price

shock was felt by enterprises in the metallurgical and chemical industries, where the prices in the three autumn months fell 1.5 – 2 times. Construction business, retail trade, tourism started to experience difficulties because of tighter credits, also including a slump in consumer lending. The growth in prices of output of these sectors, which was observed in the previous years, was caused by the flow of cheap money in the economy. To a certain degree this growth also was seen as an inflating “bubble”. As a result one of the first reactions in the real sector was the sharp drop in the prices of output.

**Chart3 : Dynamics of industrial output and industry turnover (year 2005=100)**

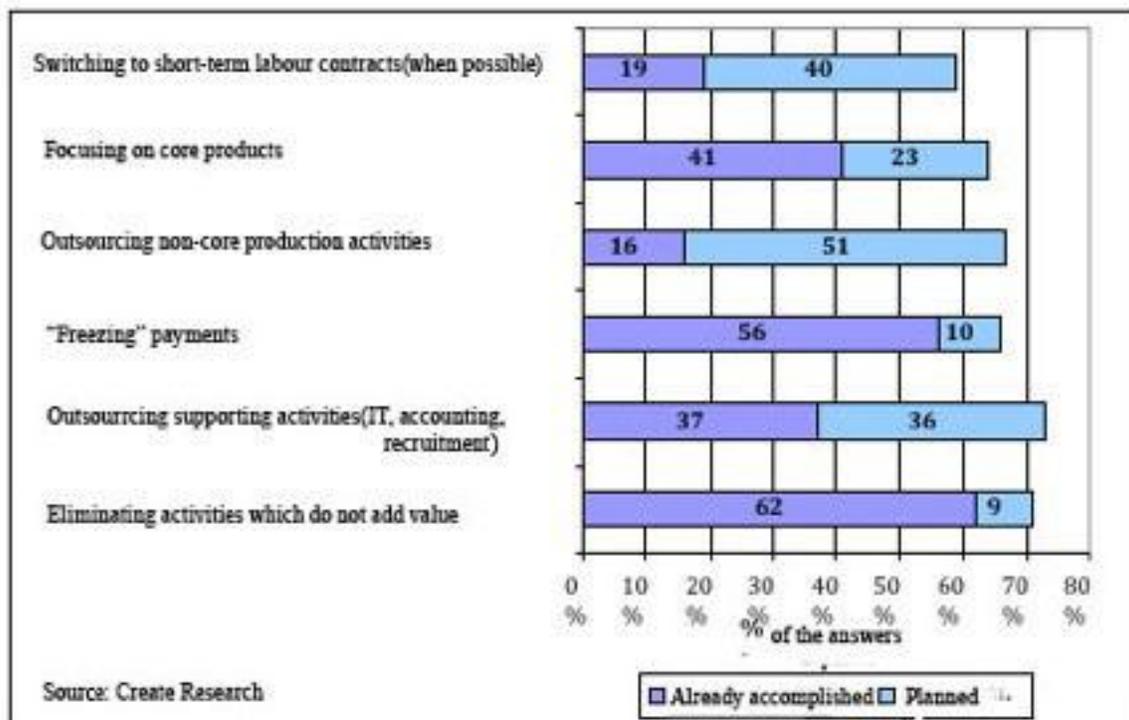


Source: NSI

What can be expected from enterprises under the conditions of decreasing demand for their production. Judging from the surveys among company management, they are ready

to cut costs, prices, salaries, as well as reducing the production volume. Issues related to significant business reorganisation are for the time postponed, despite the fact that it is this reorganisation that has to guarantee the after-crisis development.

**Chart 4: Undertaken actions and entrepreneurs' intentions for softening the effects of the crisis**



A significant confidence crisis arises. Interest rates on all types of loans go up. Acute problems are related to the collapse in payments on supplies, insufficiency of working capital, increase in corporate indebtedness. Expectations related to staff layoffs rise, actively terminating a number of not business-like, and sometimes even business-like expenses.

Over the past years of transition the economy has been performing inefficiently. This inefficiency has been financed by the inflow of finance directed to the speculative market of property. That is why, under crisis, more funds are needed in order to revive the economy, to recover it, including the strengthening of its efficiency.

### **2.4.1 Industry**

The unfavourable development in foreign demand and the slump in export prices affected the export of Bulgarian enterprises in the second half of 2008 and in the first half-year of 2009. Because of the high share of export in the output of processing industry this sector started to experience the adverse influence of the economic crisis in the third quarter of 2008, and in the fourth quarter the value added in the processing industry dropped in real terms by 5% on yearly basis. As a result of the negative growth during the second half of the year the real growth in value added in the processing industry in 2008 slowed down by 1.9%. The data about output and turnover in industry during the first four months of the year show that the sectors providing materials and raw materials for the construction business have also started to experience difficulties.

The drop in GDP during the first quarter of 2009 is mainly due to the decrease in value added in the industrial sector, which is by 12.2% less than that in the first quarter of 2008. This also affects the decrease in the relative share of value added in the industrial sector – 30.3%.

There are expectations for accelerating and aggravating the crisis processes on the economic activity in the country. Among the sectors, affected by the crisis, are the construction business, ore output, ferrous and non-ferrous metallurgy, chemical industry, machine building, timber processing industry, electrical engineering, cement industry, manufacture of other building materials, textile and shoe subcontract manufacturing, domestic and international transportation, tourism and related to them activities (Tables 4 and 5).

#### **Table 4: Industrial output indices and industry sales (IX – XII. 2008)**

Months	Industrial output index		Industry sales index	
	To the previous month	To the respective month last year	To the previous month	To the respective month last year
June2008	103,1	104,2	102,9	105,0
July2008	103,1	104,4	101,9	104,2
August2008	87,2	94,0	87,0	94,6
September2008	108,5	102,5	111,0	103,3
October 2008	100,3	97,7	96,4	94,9
November 2008	94,5	90,7	91,8	88,3
December2008	101,7	91,7	99,6	89,2

Source: NSI

**Table 5: Industrial output indices and industry turnover<sup>1</sup> (I – IV. 2009)**

Months	Industrial output index		Index of turnover in industry	
	To the previous month	To the respective month last year	To the previous month	To the respective month last year

<sup>1</sup> The index is used to assess the average change between two time periods. The turnover includes all sales revenues of the enterprise invoiced over the reporting period, plus all taxes and fees on the products without VAT.

January 2009	76,2	81,6	75,3	83,3
February 2009	105,6	82,4	104,4	82,9
March 2009	108,0	83,1	103,7	79,0
April 2009 г.	95,3	80,0	96,2	79,3
May 2009 г.	99,0	77,9	98,4	76,0

Source: NSI

The crisis and the related sharp drops in the prices will influence import favourably, especially the import of energy sources. Along with that they will influence unfavourably export by lowering sharply the prices of raw materials, initially processed materials and the goods with low value added which prevail in our export.

#### **2.4.2 Agriculture**

Agriculture had considerable contribution to the high dynamics of value added during 2008. After the contraction of the manufacture output in 2007 under the favourable climatic conditions in 2008 the sector registered a recovery in the output volumes. For 2008 the value added growth in the sector was 26.7%, while in the first quarter of 2009 there was again a real decline of 3.1%.

The expectations for poor harvest in 2009 further strengthen the general negative trends in the economy. The bad management, including the careless work of customs administration, led to slowing down in vegetable production, fruit production etc over the past years. Animal husbandry has dramatically lagged behind both in terms of technology and in output volumes necessary for satisfying domestic demand, including demand in the tourist industry.

#### **2.4.3 Services**

The service sector increased by nearly 6% in real terms in 2008 and the main contribution of 3.6 points belonged to financial intermediation. During the fourth quarter the annual real growth of value added in services slowed down to 3.8% (6.8% for the first nine months of 2008), and during the first quarter of 2009 in comparison with the same period last year the real value added growth in the service sector was 0.9%. The biggest

part of the total value added during the first quarter of 2009 – 65.3% belongs to the service sector.

The slower rate of growth in consumption of households at the end of 2008 influenced the value added growth in trade and it slowed down from 5.6% for the first nine months of 2008 to 1.6% for the fourth quarter.

Construction and real estate deals and business services preserved the high growth rates in 2008 – 8.5% and 5.5% respectively. During the last quarter, however, the annual growth slumped to 4.4% and 0.6% respectively.

Regardless of the growth the service sector has been developing mainly to meet the demand in the domestic market. With the exception of transportation services the share of services directed towards foreign markets and the share of services with high value added is negligible.

## **Human resources**

### **2.5 Labour force**

The social aftermaths of the economic crisis for the time being are weak and fragmented. The crisis has gone through consecutive phases, which are not closely related to the social situation: drop in the stock market, deficit in bank liquidity, drop in the prices of Bulgarian export output. It is only when the crisis enters the final stage or when there is a decrease in goods and services output, as well as when there is a significant local budget deficit, that the direct consequences are felt, such as a decrease in employment and incomes and consequently the decline in the level of social guarantees.

An alarming fact is the decrease in the number of employed people, who according to statistical data only for the period from September 2008 when the first definite signs of the crisis were felt until the end of March 2009, dropped by more than 82 thousand people. Serious concern is caused by the dynamics and mainly the rapid concentration of the problem in separate sectors, regions and towns. A considerable decrease in employment (including the transition to shorter working week, asking people to take an administrative leave) has been registered in metallurgy, chemical industry, coal mining, machine building, construction business as well as the service sector (financial sector, consulting services etc.). With the development of the current trend in these particular sectors and regions the rate of general unemployment can reach 40 – 50%, and in some towns with one dominating industry– even higher indicators.

The expectations are for lasting strengthening of the tendency towards decreasing the number of employed in the coming months because of the time lag in the development of the crisis processes and the execution of contracts and orders in industry and services, which were signed last year. Further deterioration of the indicator is expected since a significant part of our fellow countrymen working abroad is expected to return. This also affects the volume of transfers which emigrants used to send to Bulgaria (Table 6).

**Table 6: Unemployed, unemployment rate and employed**

Index	2008					2009				
	<i>Jan.</i>	<i>Febr.</i>	<i>March</i>	<i>April</i>	<i>May</i>	<i>Jan.</i>	<i>Febr.</i>	<i>March</i>	<i>April</i>	<i>May</i>
Unemployed people - thousands	273,3	268,8	251,6	241,1	229,1	240,8	247,8	254,9	260,7	262,1
Level of unemployment	7,38	7,26	6,79	6,51	6,19	6,50	6,69	6,88	7,04	7,08
Change in the level of unemployment on the basis of previous month –p.p.	0,47	-0,12	-0,46	-0,29	-0,32	0,23	0,19	0,19	0,16	0,04
Change in the level of unemployment on the basis of previous year –p.p.	-2,29	-2,22	-2,12	-1,87	-1,64	-0,88	-0,57	0,09	0,53	0,89
Employed persons on labour or service	2 430	2 437	2 450	2 477	2 487	2 438	2 428	2 413	-	-

contract - thousands										
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Source: Employment Agency, Monitoring of enterprises - NSI.

When evaluating the actual unemployment rate, besides the registered unemployment we should take into consideration the bigger part of the so called discouraged people (permanently unemployed above the age of 15, who are not looking for a job because they have assumed that they cannot find one). Currently according to data provided by NSI their number exceeds 160 thousand people, which brings about an increase in the unemployment level by not less than 4%. In line with this approach the relative level of unemployment (taking into consideration the definitions and methodology of ILO and EC) probably exceeds 10 – 11% of the labour force to which the discouraged people belong too.

In the *sociopolitical sphere* there is a growing tension in relation to the accounts payable at all levels, expectations are changing and even the values of different social groups.

The crisis has already affected the national budget. As a result of the slump that can already be seen in manufacture there are a number of budget items which do not receive enough revenues.

Unemployment has started to grow, the number of vacancies is decreasing and job applications by unemployed people in the labour centres are increasing, but for the time being employers prefer to switch to part-time employment. There is increasing indebtedness in terms of remuneration. Enterprises switch from 3- and 2-shift regime to one-shift. Workers are asked to take an unpaid leave or partially paid one, shorter working week is introduced or other forms of part-time employment are applied.

Most world crises begin by deteriorating consumer expectations, cutting back consumer spending and after that there is faster growth in hourly payments than the growth in hourly output. This leads to an increase in the comparative labour expenses, a drop in the profit margin, which has been observed in our economy over the past years including the faster growth in wages than the growth in output, which partially compensates the trends in the years of transition.

Among the reasons, standing out in relation to the inflow of cheap money in the Bulgarian economy, is the greater demand of households stimulated by the supply of consumer credits as well as the transfers made by immigrants.

## 2.6 Administrative capacity

The task of each administration is to provide services to the citizens. From 2001 until the end of 2008 the number of employees in the “Government: mandatory social security” sector increased by 37%<sup>2</sup> but this has not led to any evident improvement in the quality and quantity of services, provided by the administration.

There is a pressing need for optimising the work of administration, having in mind the fact that the implementation of electronic government requires increased efficiency, reducing part of the work resulting from the introduction of electronic information and organising it in registers which should be easily accessible and will not require the employment of a great number of employees with overlapping functions.

Regardless of the moderate layoffs in administration in 2008 in comparison with 2007, more drastic measures for reducing the state and municipal administration by 10 – 15% are to be taken in 2009, along with improving qualification and lowering staff turnover for those on service contracts.

Another indicator of the need for changing qualification is the general increase in the share of administrations, which have attracted external experts to perform specific tasks related to their activities.

Every year there is an increase in the administrative structures giving additional payments to employees, which act as supplementary incentive bonuses (SIB). In 2008 the supplementary payments given by the administrations to their employees amounted to 22.5% of the total amount of the gross salary. The biggest amount of supplementary payment given is that in the administration of state commissions where as a supplementary incentive bonus in 2008 money amounting to 60.9% of the total amount of the gross salary was paid out. It is accepted that administrations rely on their own revenues for giving SIB to their staff. In most of the cases these revenues are collected through fees collected from citizens and the business and are not in line with the principle

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<sup>2</sup> According to data provided by NSI about the average list roll number of people employed on labour and service contracts in “Government, mandatory social security” sector in 2001 was 95,825, and in 2008 – 131,575 people.

for calculating fees in accordance with the real expenses for providing this particular service. A conflict of interest arises.

### **Social Security System**

2.7 There is a long-lasting tendency towards raising the minimum security thresholds, raising the average social security income and increasing the collectability of social security contributions in the SSS fund. As a result of the crisis in the investment markets the results from the activity of the pension and social security companies in 2008 were negative<sup>3</sup>. This leads to making the pension scheme face a moderate risk.

For the first 4 months of the year the revenues from contributions to the SSS funds decreased by 5% from what was planned in the budget, which implies a deficit of about 200 million BGN for the year. There is an alarming tendency towards a decrease in the number of secured people – solely for the first 4 months of 2009 they are by 140,000 people less (Table 7).

<b>Indicator</b>	<b>First quarter 2008 г.</b>	<b>First quarter 2009 г.</b>	<b>First quarter 2009 / 2008</b>
SSS secured people, number	2 819 147	2 684 096	95,2%
Monthly social security income for the country, BGN	464,52	535,55	114,1%
Social security payments expenses, BGN	1 424 617 460	1 712 828 866	120,2%
Registered unemployed entitled to benefits	62 207	80 194	128,9%
Expenses for unemployment	25 417 964	41 969 209	165,1%

<sup>3</sup> 2. The Financial Oversight Commission for the first time has recorder a negative profitability of the management of the net assets of the funds for 2008 (on average):

- Universal pension funds – minus 20.15%;
- Occupational pension funds – minus 23.13%
- Voluntary pension funds – minus 24.71%

<b>Indicator</b>	<b>First quarter 2008 г.</b>	<b>First quarter 2009 г.</b>	<b>First quarter 2009 / 2008</b>
benefits,BGN			

Source: NSI

The reduction in the number of socially secured people is caused along three channels:

- Terminating social payments as a result of the fact that part of the economy shifted in the grey economy sector.
- Increasing the number of unemployed.
- Retiring part of the employed, including premature retirement.

### **Gross financial indebtedness and liquidity**

**2.8 Financial sector.** The upsurge in the Bulgarian economy between 2001 and 2008 was mainly based on financial services, construction and property sector and some reserves of labour force, which secured conditions for high growth rates at low accumulation rate. This led to the accumulation of considerable reserves, lowering significantly the government debt, but it was also related to a certain extent to the increase in corporate indebtedness.

Recognising the necessity for modernisation is not supported by the pragmatic combination between private business and institutional development. A considerable part of the equipment, which was implemented during the 80ies and 90ies of the last century, will exhaust its resource in the near future. This fact, along with reducing labour resources, necessitates the significant increase in investments into the modernisation of the country's economy.

The time for creating instruments for developing and strengthening the market of corporate bonds (the stock exchange) as a whole has gone.

Instead of implementing the financial markets model directed at the developed countries and realising the real problems in the country, a system for export of foreign direct capital was created, for accumulating state reserves and borrowing portfolio capitals. The main share of foreign indebtedness belongs to the private corporate debts (Table 8).

**Table 8: Gross Foreign Debt for the period January – April 2009**

<b>Gross foreign debt</b>	<b>I.2008</b>	<b>IV.2008</b>	<b>I.2009</b>	<b>IV.2009</b>
<i>(million €)</i>				
Gross foreign debt	27 407,4	31 354,9	36 445,2	36 554,9
Public and publicly guaranteed foreign debt	4 056,9	3 905,9	4 047,0	4 045,3
Private unsecured foreign debt	23 350,5	27 448,9	32 398,3	32 509,6
Net foreign debt	11 398,3	14 588,9	19 334,9	19 863,1
Short-term debt/gross foreign debt (%)	32,0	33,1	36,2	36,1
<i>(% of GDP)</i>				
Gross foreign debt	83,7	91,9	99,4	107,8
Public and publicly guaranteed foreign debt	12,4	11,4	11,0	11,9
Private unsecured debt	71,3	80,5	88,4	95,9
Short-term foreign debt	26,7	30,4	35,9	38,9
Net foreign debt	34,8	42,8	52,7	58,6

Source: BNB

One of the main imbalances lies in the fact that the savings in the nonfinancial sector are less than its foreign indebtedness. Until the middle of 2008 this imbalance was financed by the flow of speculative capital from foreign markets, but then its withdrawal

began. As a result problems in the bank system arose both in terms of liquidity and in terms of lending. This means that the “accelerated growth” model applied in the country during the past years has been exhausted.

The unsolved problems in the development of the financial system exerted their influence and effects at the time when the country was drawn into the crisis. As a whole, Bulgaria entered the world financial crisis with significant state reserves and banks owned by foreign juridical entities mainly from the EU.

The opportunities for attracting funds for financing investments in core capital sharply shrank, while the risks in project financing considerably increased. The financial turnover directed to the inflow of cheap money did not stimulate the search for alternatives for its efficient utilization, determined a fast growth of mechanisms servicing the speculative turnover in comparison with the mechanism servicing the turnover of goods and investments in core capital. As a whole this facilitated the inflation of “bubbles” in the Bulgarian economy and the import of “bubbles” accumulated in the world financial system.

2.9 The beginning of 2009 is characterized by a decrease in the financial inflows in the revenue budget account. The decrease is primarily the result of financial inflows which form the basic revenue budget account, VAT revenues, duties, excise duties (Table 9).

**Table 9: Implementation of the republican budget up to 31 May 2009 (million BGN)**

INDICES	(mln BGN)				
	Report May 2008 r.	Law 2009 r.	Report May 2009 r.	Fulfilment to 2008 r.	Fulfilment to law 2009 r.
Total revenue and aid	8 019.9	20 955.0	7 312.4	91.2%	34.9%
Tax	6 937.4	18 916.0	6 072.7	87.5%	32.1%
Direct	2 154.4	4 903.5	1 975.3	91.7%	40.3%
Indirect	4 702.8	13 795.8	4 019.1	85.5%	29.1%
Other taxes	80.2	216.7	78.3	97.6%	36.1%
Non-tax	1 020.7	1 899.6	1 126.9	110.4%	59.3%
Aid	61.8	139.4	112.8	182.5%	80.9%
Expenditures, transfers and contributions to EU budget	5 647.3	20 466.1	7 206.6	127.6%	35.2%
Interest free	2 539.0	10 053.4	3 280.2	129.2%	32.6%
Current	2 190.6	7 402.8	2 600.4	118.7%	35.1%
Capital *	348.4	2 650.6	679.7	195.1%	25.6%
Interests	329.0	632.4	312.6	95.0%	49.4%
Foreign Loans	246.4	474.2	230.3	93.5%	48.6%
Domestic loans	82.6	158.2	82.3	99.6%	52.0%
Emergency and contingency reserve		590.0			
Transfers to other budgets	2 455.1	8 258.3	3 270.2	133.2%	39.6%
- Contributions to EU budget	324.2	931.8	343.7	106.0%	36.9%
Budget balance	2 372.7	488.9	105.8		

\*Incl. net growth of government reserve

Source: Ministry of Finance

There is still registered budget surplus, which is at the expense of restraining capital expenses. There are long-lasting disturbances in the revenue budget account of NSSI, NHIF. The worsened budget liquidity, along with the planned implementation of the 90% expenses rule, which for April was announced as a planned check of budget expenses by 20% will lead to problems in the budgets of all who are in charge of budgets, including municipalities, the National Agency “Road Infrastructure” (NARI) etc.

2.9.1 The slack economic development (slump by 3.5% of GDP for the first quarter of 2009) will be further accelerated as a result of a slowdown and restrictions in payments financed by the budget, tightening tax credits, increasing fees. The high corporate, including inter-corporate indebtedness, is another adverse factor and the **low business liquidity** will block part of the input turnovers. The situation is aggravated by the worsened liquidity of the financial system, including banks, licencing companies etc. An accurate gauge of the **deteriorated liquidity of the bank system** is the significant increase in the deposits with interest rates of 10 – 12.5%, the decrease in the credit flows towards business and the higher price of the credit resource. The volume of bad credits is growing, although at a slow rate.

An indirect indicator of the negative trends related to the business liquidity is the increasing number of restructured credits. The same worsened liquidity can be seen with

physical persons too. This trend can be strengthened by the increased unemployment and the return of a great number of emigrants.

**2.9.2 The mutual influence of the poor liquidity** of the budget, of the financial system, and business and population can drive the country into a **liquid spiral**.

An indicator of such an event, without mentioning the remaining factors (current account deficit, decreased FDI, transfers by emigrants etc), is the significant decrease in the country's reserve. Over the past months it has been going down at a very high rate from 29 billion BGN at the end of last year to 23 billion BGN. This rate is alarming and in case that the reserve reaches 15 – 18 billion BGN some important issues arise concerning the financial stability of Bulgaria, including the stability of the Currency Board.

2.9.3 Along with these processes there can be observed an increase in the revenue from income taxes of physical persons by 9% during the first half year of 2009 in comparison with the same period of 2008 and a decrease of 21% in corporate tax revenues. This supports the conclusion that the crisis first affects the corporate income and then the consumer spending with a significant decline in consumption (Table 10).

**Table 10: Corporate tax revenue, income tax of physical persons and value added tax, in BGN.**

Periods	I-VI.2008	I-VI.2009	Difference 2009-2008	2009/2008, %
Income tax for physical persons	946 399 177	1 031 564 242	85 165 065	109%
Corporate tax	1 427 927 705	1 130 400 135	- 297 527 570	79%
Value Added Tax on deals in the country	1 838 777 921	1 913 768 760	74 990 839	104%
Refunded VAT on import	-2 654 502	-8 092 185	-5 437 683	305%
Social and health	2 404 328	2 478 950 548	74 622 039	103%

security*	509			
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Source: NRA

\* “The social and health security” item does not include the social security and health contributions payable by the liable persons, which are at the expense of the republican budget.

## **Crisis characteristics and anti-crisis measures**

### **2.10 Consistency of the global crisis**

The majority of the world economy crises are related to inflating “bubbles” in different markets. Currently in global markets and in particular in the financial and raw materials markets there are “bubbles” too. The scale of these “bubbles” has not been evaluated yet and they have not disappeared yet. The risk of further collapses in the global economy is high enough. This is the main factor for the unspecific character of all forecasts.

From its very start the global crisis has looked consistent. Just for a few months there were much more serious changes in the financial systems of the western countries than during the previous 20 years. The rigid regime in which the western economic cycle functioned after the 1974 – 1975 crisis has begun to become more flexible.

It is not certain whether the spread of protectionism will be stopped. What number of countries will be hit by the current events is not clear either. Iceland, Hungary, Ukraine, Estonia, Latvia, Lithuania, Pakistan had negative annual growth of GDP for 2008 – this is not the entire list of countries.

As a whole, the idea that we still have not reached the bottom of the crisis leads to the fact that the assessment of potential losses and additional losses should be reconsidered. What affects the respective growth of the budget “holes”.

For the time being we do not have answers to the following general questions:

- In what direction will the crisis in USA and EU develop? Has the lowest point been overcome or more slumps and collapses are to be expected? What will the centre points of these slumps be?

- In what way will the competitive advantages of the national manufacture industries depending mostly on export or the export-related ones change under the crisis? To what extent will the slumps in the world economy affect the Bulgarian one?
- Which factors of the crisis in the Bulgarian economy having external, not internal, character have not operated yet – in the sphere of social and political liabilities, in the area of business regulation, related to serious corruption, low market efficiency etc.?

When will the “bottom” of the crisis be reached – has it been touched or it is expected to happen at the end of 2009, which forces will be the engine of the consequent modernization of the economy, the legal system, the state sector in the economy?

It is important to point out the fact that we cannot pinpoint the position of the national crisis in the dynamics of the development of the world economy. There are two different in principle alternatives when describing the ongoing processes. The more widely spread approach suggests that the current economic crisis is part of the regular cyclical development of the economy when the recession stage turns out to be deeper and longer than usual. In such cases the active policy to maintain demand and prevent the irreversible losses in industry (complete stopping of production, disturbing the production cycle, dismantling equipment) will give the chance for preserving the production capacity.

The alternative viewpoint results from the long-term character of the crisis, which changes the nature and structure of consumption in the entire world economy by shifting to more economical consumer model. In this case any attempts for state regulation of preserving the former demand levels can have only short-term effect resulting in the long term in spending the limited resources. In this case the focus should be on “softening the landing” of the economy and accelerating its adaptation to the new conditions.

### **2.11 Risks of anti-crisis measures**

The peculiarities of the forecasts under crisis are their “active” nature. Their values are in close relation to the efficiency of the undertaken anti-crisis measures as well as of those that are to be taken. We may naturally assume that all necessary decisions are reasonable, adequate to the demands of the bank system and the real sector and will have at least average efficiency.

The general logic of the activities lies within the combination of system measures and decisions, which have quantitative characteristics.

On the turn between 2008 and 2009 there is a “branching out” in the anti-crisis regulatory measures. In their “co-ordinates” on the one hand, there are clearly indicated risks of government regulation, on the other – we can see the dependency of the frameworks of the after-crisis economy on the contents of the anti-crisis programme. Both “axes” circumstances have a general character.

The anti-crisis regulation is contradictory, driven by inertia (i.e. draws from sources of inspiration post times) and it is structurally determined (it is determined by the economic and political interests and motivation of groups representing the units of the existing sectoral-branch economic structure). Mostly working under an emergency regime, it increases the risk of structural immobilisation, “drop” in the potential of the required and imminent structural changes. An important characteristic of the anti-crisis programme is the tuning in of the regime of functioning of “regular” market institutions. The insufficient financial support leads to their weakening.

The first risk assessment, from the point of view of investors (respectively the post-crisis capital inflow), is seen in lowering the long term and short-term credit rating of Bulgaria (Table 11). This is one of the areas, which is of interest to creditors. In case there is a tendency towards decreasing rating, owners can be asked to repay their foreign corporate loans ahead of schedule.

**Table 11: Long-term credit rating**

Agency	Date	Foreign currency		Local currency	
		Long-term	Prospects	Long-term	Prospects
Standard & Poor's	05.06.2008	BBB+	stable	BBB+	stable
Fitch	15.08.2008	BBB	negative	BBB+	
Moody's	25.09.2008	Baa3	stable	Baa3	
Standard & Poor's	30.10.2008	BBB	negative	BBB	negative

Agency	Date	Foreign currency		Local currency	
		Long-term	Prospects	Long-term	Prospects
Fitch	10.11.2008	BBB-	stable	BBB	
Moody's	20.03.2009	Baa3	stable	Baa3	
Fitch	30.04.2009	BBB-	negative	BBB	

Source: Ministry of Finance

Bulgaria's credit rating was changed and lowered several times for the last half year of 2008 and the first half year of 2009, but still remains within the "investment" scale.

### ***3. Macroeconomic imbalances and social factors determining the high economic sensitivity to the world financial and economic shocks***

Along with the myriad of quite positive changes we witnessed over the last 20 years – society democratization, transition to market economy, joining the North Atlantic and European values, the Bulgarian society still goes on and will go on paying a very high price for some negative effects of the socioeconomic transformations. Today these negative effects are essential since the political elite lacks strategic thinking and has limited managerial skills.

#### **3.1 Labour quality**

3.1.1 The democratization and opening of our country stimulates a **great many people who belong to the labour force to emigrate**. These stimuli were strengthened as a result of accumulated imbalances in the planned economy, including general labour productivity, remuneration, pricing etc. These imbalances were not corrected by the democratically elected governments, irrespective of the conducted significant economic reforms. The privatisation, which was performed too late and too badly, the closing down of high technology industries, scientific and manufacturing, project, development units broke the chain of reproduction of highly qualified labour resources. Receiving much higher remuneration abroad than in this country, including for both qualified and unqualified workers led **to demotivation and lower qualification of human resources in the country**.

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3.1.2 These distortions have existed for many years and have led to **ideas among young people of denying education**. The “financial” motivation that without education considerable amount of money can be earned has led to considerable changes in the value system of the young generation. This is one of the main reasons for undermining our educational system. As a result of all that today we have more than 300,000 illiterate and a great number of people with low qualification. Nearly every local and foreign investor encounters serious difficulties in finding qualified labour force. This phenomenon plays a restrictive role on production and activities with high value added. Even under crisis and increase in the rate of unemployment in the country the **shortage of qualified staff** will still be an issue.

3.1.3 The extremely complex situation in the Bulgarian labour market will get further complicated by the fact that more and more **Bulgarian emigrants (mostly with low qualification) start to come back to their country** forced by the bad economic conditions in the country where they have worked and lived. Unfortunately, it is not only that a powerful financial inflow is being terminated, money that is earned in a foreign economy, but also these people and their families will join the Bulgarian social security system. Over the last 20 years not a single government did manage the migration processes. Not only did they not manage them, but they did not even monitor them. Neither qualification nor the age structure of these groups of people who emigrate were clear, nor the countries where they emigrate so that the process could be controlled, analysed and managed.

The negative consequences from the low qualification of the labour force in the country under the economic crisis will further aggravate the negative phenomena and will considerably slow down the recovery period in the economy.

## **3.2 Property market and construction business**

**3.2.1** The second interesting phenomenon is related to the process of democratization and our accession to the EU alike. It is not even the accession itself but rather the signs given to the world economic community that Bulgaria will become a member of the EU that have outlined ever since 1998 the fast rate at which the prices of property will go up. This phenomenon has attracted a huge flow of speculative capital. The speculative environment has distorted the banks’ credit portfolio, it has attracted huge for the scale of

our economy foreign resources from foreign parent banks, which have privatized our bank system. Our accession to the EU resulted in expansionary development of property trade, financial intermediation, construction and construction-related manufacture and services. This has caused serious distortions in the structure of our economy over the past ten years. The construction sector has drawn from the other sectors capital and labour force because of the high profit rate and created preconditions for high but unhealthy economic growth. **The deficit in strategic thinking hindered the understanding that attaching greater priority to this sector leads not only to sector imbalance but also to creating assets which do not yield value added on yearly basis.**

3.2.2 Along with this the fast development of construction business, financial intermediation and property trade, facilitated by the speculative policy of the bank sector, contributed to the spreading of grey economy in the country. A quick glance at the construction sector and property trade over the past years shows huge accumulation without the respective tax and social payments. Thus, through getting high incomes illegally, without levying them with the real taxes and social payments, a well-off stratum in the society was created with relatively high standard of living, which does not contribute adequately to the socio-economic system. The financial shocks in the western economies and the expected collapse in the construction sector forced the foreign parent banks to withdraw the speculatively channeled bank resources and cause problems with liquidity of the Bulgarian bank system. The interest rates on deposits grew and as a result the price of the credit resource limited the financing of the economy. Today, under the crisis and with an imbalanced sector economy, limited crediting and severely distorted labour market, the issue arises how to counter the economic and financial crisis which is coming at a great speed and brings across-the-border effects.

### **3.3 Energy market**

3.3.1 Unfortunately over the past 20 years not one Bulgarian government has solved the problem with providing an appropriate normative environment to set the price of energy in line with the prices in the European market. The low price of energy, in comparison with the price in the other European countries, predetermined the structure of our economy during the years of transition. Big foreign investments were channeled not only towards the financial sector and construction business, but also towards energy-guzzling production with low value added. When we consider the investments in the industry it becomes clear that the main investments were channeled towards extremely energy-guzzling manufacture, not towards science-related sectors, which contradicts the Lisbon strategy.

3.3.2 Over the past 20 years the Bulgarian economy has been based on two main pillars – low energy price and low labour price. With policies like that we cannot rely that we will attract investors in the production sector, which will shape the competitiveness of our economy.

3.3.3 Distortions in the energy sector have become more serious because on entering the sector the prices of the primary energy sources (coal, oil, natural gas) are set on a market principle, while on leaving it energy and heat are determined administratively, in most cases inadequately.

There are some indicative key parameters, which over the past 20 years have not been changed, such as the relationship – end energy consumption and primary energy consumption has been about 46%. For all EU members, including Bulgaria this indicator is 68 – 70% on average. This means that 54% of the energy losses are the ones in the Bulgarian energy sector, which makes energy itself the most energy-guzzling sector. Because of the price distortions the modernization of the energy sector has been slowed down.

3.3.4 The most efficient use of primary energy through gas supply has been blocked by management incompetence in Bulgaria. Only 1,5% of households use natural gas, while in Europe this percentage is 49%. In countries like the Netherlands, Hungary, Romania etc this percentage is from 56 to 85%. The share of natural gas in the energy consumption in the country is only 11%, while in the countries in the European Union it is 24%, which under the conditions of conducting climate and “green economies” policy holds serious long-term economic consequences for the country. This technological abyss has widened as a result of a distorted monopolistic government policy in the energy sector. There is lack of control over the execution of the concession contracts and the gas supply licences.

Unfortunately, in this sector there was also a significant deficit of managerial skills in all past governments. There is no long-term strategic thinking – the political horizon extends 4 years ahead at the most, the length of one term of office! The problem lies **in the unwillingness of the political elite to pay the political price of the respective reforms**. Energy and heat pricing is still widely used as an instrument for social welfare. Cross subsidizing of centralized heating systems, households consumption and other community needs of business leads to long-lasting unhealthy changes in the sector structure of the economy, to low energy efficiency, including buildings, to lack of stimuli for modernizing the energy sector. Another current example in this respect is the state monopolist “Bulgargas” PLC, which actually subsidizes not only heat production, but

also some other loss-making production industries, distorting the market environment and burdening the other natural gas consumers. This cross subsidizing can be seen also with consumers of natural gas at low pressure.

3.3.5 The conclusion is that government intervention in the management of commercial partnerships leads to further distortions in the economic structure, which will have long-lasting consequences. Using the majority stake of the government in the management of structure-determining commercial partnerships results in fast short-term putting out of social conflicts, but not to real problem solutions. To the contrary – they become even more serious.

The development of the crisis, the slump in energy consumption, the subsidized production of energy from co-generation (heat supply), the export collapse, the subsidized manufacture of energy from RES, the subsidized consumption of low pressure consumers (households and municipal), resulted in burdening the business with the imbalances that have emerged. A policy like that dooms the economy of the country to long-term slump, as a result of which there will be a further loss of jobs and faster bankruptcies.

### **3.4 Agriculture**

Another current example of deficit of strategic planning is the delayed by more than decade land consolidation which affects the land market and the quality of agricultural production. The plots do not have economic efficiency and are of everyday importance to their owners – they provide for the households.

The tendency towards pouring 160 million BGN into “tobacco production” sector (much less money for science, for example) keeps going on, knowing that the sector is doomed. We have created many problems and we are still creating more instead of trying to solve them!

### **3.5 Management crisis**

The economic crisis in Bulgaria is quickly turning into a management crisis.

**3.5.1 The decision-taking mechanisms created during the period of sustainable development and massive inflow of money from the property sector no longer function under the new conditions.** They were built on the system of increasing financial indebtedness the fulfillment of which motivated the economic agents, but as the

crisis developed the sources for covering such indebtedness shrank headlong, which gradually led to a growing conflict of interests among different groups of people.

Besides that the financial reserves are quickly exhausting. Judging by the rate of this process at the end of 2009 the country's reserves might considerably shrink and this situation requires that drastic short-term measures be undertaken. But we should clearly recognize the fact that at time of crisis all economic agents – the budget, the enterprises and the population – suffer colossal losses distributed extremely unequally by regions, by enterprises and by people. These losses are on a much larger scale than any compensatory government subsidy might provide.

On the strength of the outlined factors in the very beginning of 2010 it will become obvious that there is a crisis of the social contract based on stability. The conflicting tendencies in this crisis will emerge in the process of gradual decrease in social transfers, the increase in the number of unemployed, the marginalization of the population, the rise in crime, growing discontent.

**3.5.2 Under the conditions of growing uncertainty of the events development we lose track of the understanding about the priorities and tasks in terms of current and middle-term prospects.** Depending on how crisis events develop the ideas about the priorities and the ways of solving middle-term tasks change in a sufficiently wide range. The ideas about priorities in different community groups also become more discernible. **In this respect the Bulgarian society is already experiencing a crisis of values.** As a result decisions motivated by certain factors and events start to contradict the newly emerging circumstances, the solutions oriented towards some business and community groups contradict the interests of other groups. An impression of inexpedience, short-sightedness and inconsistency is created.

**3.5.3 The price of managerial mistakes goes up because as it happens under any crisis the need for “manual management” rises.** And vice versa, shifting to “manual management” creates opportunistic behaviour of economic agents and strengthens the spontaneity and the chaotic character in the entire system of government regulation. It often happens that there are deficits in the normal coordinating measures resulting from the simple reason that there are not people capable of taking decisions independently based on rational motivation. The bureaucratic elite is oriented towards preserving their positions and is incapable of responding quickly and taking independent decisions.

#### *4. Opportunities and propositions*

The economic crisis, regardless of the negative effect on the economy, creates also opportunities under reasonable management policy.

4.1 Gradual creation of conditions for development of balanced sectoral structure and effective utilization of the existing sectoral distortions (strongly developed sector of civil and industrial construction) **for capitalization of the geo-strategic location of Bulgaria** through accelerated construction of diversified contemporary transport infrastructure.

For acceleration of the processes amendments in the Law on organization of the territory are advisable, which can allow easier expropriation of terrains for construction of highways and other infrastructure of national importance.

Stimulation of demand through pro-active realization of the infrastructure projects. Enlargement of the execution of different infrastructure projects along the line will lead to a growth in demand of products in a number of other sectors. Thus simultaneously are solved the problems of increase in internal demand of production of different sectors, as well as of providing of employment in these sectors on the one hand, and on the other the state of the infrastructure, which influences the competitiveness of Bulgarian enterprises, will improve. Under the limited financial resources, in the absence of clear vision for the continuation of the crisis and for the perspective of the world economy coming back to previous levels of consumption and production it is necessary to put the stress firstly not so much on the increase of the infrastructure volumes relying on future increase of needs, but on bringing its volumes to a level corresponding to the current needs and for the improvement of its qualitative characteristics.

4.2 Development of anti-crisis programme, in compliance with the negotiated EU anti-crisis programme because the coordinated measures between member states give better results than the isolated national measures.

Inclusion in the anti-crisis programme of exact and realistic assessment of the situation at macro level as well as mezzo level by sectors, sub sectors even at micro level - enterprises.

It is necessary to take into account that the financial and social stability are equally important for Bulgaria and the burdens of the crisis and the anti-crisis measures should be shared in a balanced way by labour and capital. Giving support to economic units should be linked to their activity before the crisis and take into account the

difficulties, which they have as a result of the crisis. It is not effective to render support under anti-crisis programmes to enterprises, which were in a bad condition due to bad management, incompetence or other subjective reasons.

## **Business and Regulatory Environment**

4.3 We should not forget that every crisis has healing effect as well. Usually in a period of crisis the most viable and most competitive survive. Now it is time to make every effort to preserve those sectors, activities and production processes which are competitive in the framework of European and world economy. At the same time there is a real threat that the big corporate indebtedness (incl. intercorporate indebtedness) will cause chain bankruptcies. Due to this the **insolvency proceedings**<sup>4</sup> should be simplified and speeded up not to allow non-competitive enterprises to drag behind themselves in the spiral economic insolvency some viable companies.

Additional step in the right direction is the application of the system of mutual settling of intercorporate debts, which can considerably decrease this indebtedness.

4.4 Key question at present is the stabilization of trust in the bank system. When there is serious decrease in economy the latter is exposed to particular risk. The first symptoms of difficulties in repayment of credits are already visible. For this purpose the bank institutions should not change unilaterally the conditions in the contracts for credits, incl. interest rates, securities, repayment schedules and so on, as well as introduce transparent basic interest rate as LIBOR, EURIBOR, BIR etc. This will create stability in the business environment. Currently the response of the bank system is unpredictable. With these actions the bank system creates serious obstacles for the business to manage effectively its activity and to undertake investment initiatives.

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<sup>4</sup> EU encourages national authorities to establish quick and easy procedures for insolvency, going on for not more than a year: Regulation (EO) No 1346/2000 of the Council of 29 May 2000 on insolvency proceedings (OJ L 160, 30.6.2000 , p. 1-18); Communication from the Commission of 5 October 2007 "Overcoming the stigma of business failure-for a second chance policy. Implementing the Lisbon Partnership for Growth and Jobs" (COM (2007)584 final);Communication from the Commission of 1 October 2004 "Community guidelines on state aid for rescuing and restructuring firms in difficulty" (OJ 244, 1.10.2004, p. 2-17)

4.5 To analyze the bottlenecks of administrative services and, where possible, part of the activities to be outsourced to private contractors. Among the examples of administrative shortages are the concession permits that have not been issued or have been delayed, EIA, complex permits, construction permits, permits for change of agricultural land use and others, which blocks enormous amounts of local and foreign investments. The government should provoke local authorities to undertake similar analysis for abolishment of bottlenecks in providing services for business at municipal level.

4.6 The monthly number of the bank payment orders filled in by the companies for transfer of the social contributions and the income tax, exceeds 20, while a separate bank tax is paid for each. This hinders and makes more expensive the activity of the small- and medium-size enterprises. It is necessary **to accelerate the introduction of a single payment order for the transfer of the social contributions by the employers** and the allocation of the individual funds should be performed by the National Income Agency, of its own motion.

### **Investments and Innovations**

4.7. New technologies and innovations are coming into practice entirely through investments which are made in the households, enterprises and the public sector. Investments are necessary for the economic development and employment as well as for achieving the goals in respect to climate and energy. Investments require the presence of specific framework conditions. They cover stable economic frame, market demand and access to markets. Besides a good regulatory framework is required – stable and predictable, avoiding administrative and financial burdens for the enterprises. Only profitable enterprises can invest in technological development, innovations and introduction of new technologies. Consequently the presence of competitive economic framework is a prerequisite for achieving the goals in relation to climate and energy. When there is an appropriate political approach the policies in the field of climate and energy may generate growth and jobs as well.

4.8 The change is driven by the technological development on the one hand and by the change in attitudes and behaviour on the other hand. In both cases it takes time to achieve good and lasting results. The EU share in the co-financing of research and

development and innovation is a small one as compared to the resources in the EU Member States. It is of vital importance the EU Member State to increase the resources, including revenues from the emission allowances auctioning under the EU Emission Trading Scheme to support the scientific research and development as a whole and clean technologies in particular as well as to seek a critical mass and a leading role worldwide through efficient cooperation.

It is crucial to be established a State Investment Fund with a considerably greater resource than the fund, as foreseen by the budget, pooling the Scientific Research Fund and the National Investment Fund. The proposed fund will support public and public-private investment for applied scientific research, for establishing high-tech manufacture, export-oriented manufacture and high-speed Internet infrastructure.

4.9. The huge potential of the elaboration and implementation of the ICT should turn into a priority, including through establishing broadband Internet access in the rural and alpine municipalities, which shall allow the effective use of the information technologies by the farmers and rural communes.

4.10 Bulgaria should use all revenues from the emission allowances auctioning under the EU Emission Trading Scheme to support the investment in scientific research and development and technologies in the field of climate and energy. Still there should not be assumed that the greater the revenues the better the situation is. The transfer of big amounts from the enterprises to the State can jeopardise the investment.

4.11 A new vast State programme has been launched for improvement of buildings energy efficiency, while the cost of the energy saved following the buildings sanitation shall be re-allocated for sanitation loans repayment. To this end there should be leveraged fundings from the newly established European Fund for energy efficiency in the residential buildings construction (which amounts to EUR 8 billion altogether) and national co-financing, if necessary.

### **Social and Educational Aspects**

4.12 Another important measure is the change in the social security system. Part of the social benefits should be granted not only on income criteria basis, but also on length of service and improved qualification. There is great demand for education and training which will help enterprises, social sector services and labour force cope with changes. It

is more than imperative to foster among citizens willingness for education and career development.

4.13 In order to guarantee the stability and sustainability of the pension system without introducing any changes in the model of the pension-security system a number of measures need to be taken:

4.13.1 To secure equality between the state (as an employer) and the other employers – the state should pay the full amount of the contribution for those it secures socially after taking into consideration the category and period of receiving the pension. These funds should be deducted from the subsidy provided for NSSI by the State budget for paying pensions. This should clearly be recorded in the budgets of the ministries and the other administrative structures and respectively lead to bringing into light the public subsidy and the real government expenditures.

4.13.2. The minimum social security income of self-secured persons should be determined on the basis of annuities guaranteeing that the secured people will get at least the minimum pension for social security length of service and age. The measure should be closely related to the introduction of a differentiated minimum social security income (thresholds) by basic professions such as intermediaries, lawyers, notary public, medical doctors etc. along with tightening control over the received incomes for paying the respective contributions. The minimum social security threshold will provide that there will not be redistribution within the framework of “Pension” Fund money for guaranteeing the pensions of this group of secured people.

4.13.3 The size of the social security income of agricultural producers should reach the minimum monthly amount of social security income for self-secured persons. For agricultural producers receiving subsidies from the European funds and the complementary national direct payments the minimum social security income should be determined as a function of the subsidy since it represents a potential opportunity for receiving income.

4.14 The consumer models change over time and this leads to changes in production. According to studies done by ETUC, SDA, Syndex, ISTAS and Wuppertal Institute<sup>5</sup> the

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<sup>5</sup> The assigned by the DG “Environment” at the European Commission research of the climate changes and employment was carried out by a consortium presided by the European Trade Union Confederation (ETUC) and the Social Development Agency (SDA) where Syndex, ISTAS and Wuppertal Institute participated. The research can be found at <http://www.etuc.org/a/3676>.

employment net effect of the measures for decreasing the greenhouse gases emission by around 40% by 2030 is to a certain extent positive. However, there will be considerable changes in the jobs structure and qualification requirements. The conclusions drawn in the research refer to the fact that the changes will be more significant within the individual sectors than between the sectors. For example, a transfer of jobs is expected from energy production to activities related to energy efficiency, or jobs from the land transport to railway and water transport.

4.15 Since the changes will influence nearly all participants in the labour market, they will all have to have at their disposal the opportunity to be educated in order to be able to adapt to the changing requirements.

4.16 Education and training, including lifelong learning are the main precondition for accumulating knowledge and building knowledge economy in Bulgaria. Not long ago the European Commission proposed that forecasts for skills needed should be strengthened, which is of vital importance to securing the timely reaction on the part of education and training. The better forecasts, the improved correlation between demand and supply and the strengthened measures for lifelong learning are the natural part of the anti-crisis measures and the achievement of competitiveness of the Bulgarian economy.

### **Power Engineering and Monopolies**

4.17 A crucial anti-crisis measure is the real liberalization of the energy market and demonopolisation of the energy sector in compliance with the requirements and the regulations of the EU.

4.18 It is necessary to clearly separate the government from the management of the commercial partnerships but preserving fair competition and observing the community interest. It is especially alarming that the participation of the state in the partnerships has a monopolistic character.

In order to improve the transparency of the work of the monopolistic suppliers of public services and for all state companies requirements should be introduced for disclosing information similar to those applied in the public companies

### **Agriculture**

4.19 It is necessary to develop the market mechanisms stimulating land consolidation, increasing the percentage of arable land, improving the technological culture in agriculture, which will bring about an increase in the marginal productivity and yields per

unit arable land. The arable land is the longest frozen capital in the modern history of Bulgaria as a result of insufficiency of managerial skills of the political elite.

### **European Funds**

4.20 Using the money from the structural and the Cohesion Fund to compensate the shortage of fresh financial resources for the small and medium enterprises and the real economy.

4.21 Mobilizing the administration dealing with the absorption of the pre-accession, structural, cohesion and agricultural EU funds to improve their utilization as a compensating flow for the decrease in the inflow of FDI and foreign credits.

4.22 Optimizing the functioning of the schemes on the operational programmes through further decrease and simplification of procedures, which will allow faster access to resources of the European Social Fund, especially for SME.

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