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Garabed Minassian[1]

BULGARIA IN THE EU: THE CURRENT ECONOMIC STATE AND SHORT-TERM OUTLOOK

The confidence crash in the major financial institutions, the disastrous consequences of the discretionary monetary policies of the BNB, as well as the dramatic depreciation of the national currency created the preconditions for the search and the enforcement of a radical solution – namely, the adoption of the currency board arrangement (CBA). The outcome of CBA is connected with the appreciation in the real effective exchange rate. The only economic adjustment implies that the production should look for ways to keep and increase its competitiveness mainly along the line of higher efficiency and better quality.
Bulgaria's current account has been negative for almost all the period since 1990 (more than 11% in 2005). The good news is that the international foreign exchange reserves of the country have been steadily going up. Bulgaria has managed to keep remarkable budget discipline after the adoption of the CBA. Recently, in search of incentives for economic growth there were some experiments with various tax structures.
In the conditions of Bulgarian economy the importance of the institutional factors for social and economic progress outweighs the others. The macroeconomic forecasts provide conditional projections – as a consequence from adopting one or another line of macroeconomic policy, or a given exogenous influence (for instance the dynamics of the domestic energy prices, of the major foreign exchange rates etc.), i.e. they study problems of the type "what – if". The employed simulation model is used within the framework of the LINK project.
JEL: E61; E63

Bulgaria has lived through some quite hard and controversial years of transition to market economy after the end of the 80s of the XXth century, the way most of the Eastern European countries have. Seventeen years later the country is a member of the EU (since 01.01.2007) and its economic future starts getting clearer and the outlook more welcome.

Economic activiities in Bulgaria have undergone substantial and dramatic collisions (mic activities came to 14.5%!

The deep social and economic crisis was overcome by the forced resignation of the government and holding pre-term parliamentary elections. In the spring of 1997 a clearer and more favourable social and economic outlook began to take shape. Thanks to the active suppport, given by the IMF, the long-delayed restructuring of the economy was given a start, which as a rule was felt painfully and moreover, far from unanimously acclaimed by some strata of the society. These reforms, however, had a healing effect on the economy and over the following ten years Bulgria has managed to maintain steady and relatively high rates of growth. These have proved even more valuable in view of the lower economic growth rates of the

[1] *Garabed Minassian is Dr.Econ.Sc. Senior Research Fellow I degree in Institute of Economics at BAS, department Macroeconomics, phone: +359-2-9875879, fax: +359-2-9882108.*

EU (for instance three times lower), which became a major economic and commercial partner of Bulgaria.

Figure 1). The early 90s were spent in the process of gradually shedding off all inefficent output inherited from the socilaist period which went along with substantial shrinking of GDP (for 1990-1993 the official statistics recorded a drop of 24% in GDP)! By the middle of the 90s of the XXth century there emerged some positive expectations as well as timid signs of recovery. At the end of 1994 the parliamentary elections were won by the Bulgarian Socialist Party (which had inherited from the former Bulgarian Communist Party). The latter, however, had kept some essential stereotypes of thinking and behaviour of the past despite the qualitative radical change in the economic environement and conditions. Meanwhile, the accumulated social and economic contradictions during the first years of the transition which were unsettled and changing in every respect, became ever more glaring. The governing party elite did not manage to think over the processes taking place and went on appying methods of macroeconomic management which proved inadequate to the specific conditions in the country.This intensified the crisis further more, stirring up an unprecedented financial crisis in all the spheres of social and economic life. In 1996 Bulgaria experienced a record deep slump in GDP(of –9.4%), whereas for 1996-1997 the overall shrinking of economic activities came to 14.5%!

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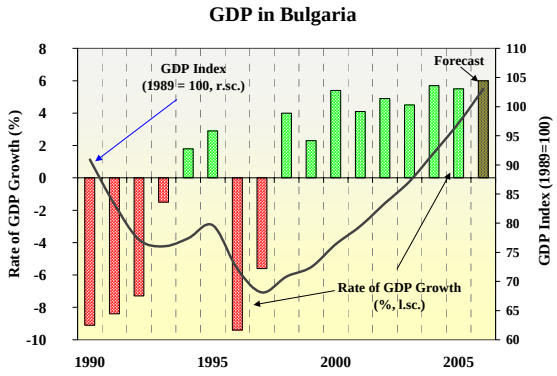
Figure 1



[2] For an overall assessment of the IMF performance you might see for instance in Минасян Г. – МВФ и страны Черноморского региона. "*Вісник Академії економічних наук України*", № 1 (5), 2004, 71-79с.

The devastating financial crisis, Bulgaria went through in the mid-90s of the last century, cleansed in a way the financial and economic structures and created the prerequisites for a new start. In the early 90s Bulgaria adopted a freely floating exchange rate but kept on having the Bulgarian Central Bank (BNB) actively intervening on the domestic foreign exchange market. The discretionary behaviour of the BNB distorted the real proportions and diluted the existing financial strains. Disparities went on accummulating and the inevitable blowing up of the seeming equilibrium was postponed indefinitely in time. Finally it really happened – in the early 1996 the exchange rate was about 70 BGL/USD, and 14 months later it went up to 3000 BGL/USD (25 times an annual depreciation of the national currency!).

The confidence crash in the major financial institutions, the disastrous consequences of the discretionary monetary policies of the BNB, as well as the dramatic depreciation of the national currency created the preconditions for the search and the enforcement of a radical solution. Actively assisted by the IMF, the transition to a new foreign exchange regime was prepared – namely, the adoption of the currency board arrangement.

There were two main options for the adoption of the reserve currency in the introduction of the currency board – the USD or the DEM. By the end of 1997 the prevalent economic conditions said pegging the national currency to the USD was necessary – at this time the prevailing part of the foreign trade settlements were denominated in USD (over 70%). What got the upper hand over it, however, was the political and economic outlook – the national currency was pegged to the DEM in the expectations to switch to the EURO a few years later without any change in the pegged foreign exchange rate. Time has proved that this decision was the right one, a decision promoting decisively the integration of the country to the European financial and economic structures. The foreign exchange composition of the foreign trade relationships underwent a substantial and consistent modification, with ten years later about two thirds of foreign trade and three quarters of the gross foreign debt of the country being denominated in EURO.

The significant depreciation of the national currency at the start during the introduction of the currency board arrangement let the real sector gradually and steadily adjust to the changing conditions. The overall price level in the country lagged substantially from that in the EU, due to which domestic inflation exceeded that in the EC too. In 1997, for example, prices in Bulgaria accounted for about 30% of those in the EC whereas some ten years later this proportion attained 40%. The engine of the higher inflation rates is both the growth in the prices of non-tradable goods (the Balassa-Samuelson effect), and the gradual convergence of the lower prices of tradable goods in Bulgaria to those of the EU.

As the logic goes the outcome of the currency board operation is connected with the appreciation in the real effective foreign exchange rate (Figure 2). The latter is a phenomenon observed in all the countries of Central and East Europe. The economic implications are manifested in several ways:

(1) Exports begin to feel a growing pressure in terms of higher production costs;
(2) Imports get increasingly more accessible and domestic consumers redirect their consumption from home goods to imported ones;
(3) Foreign tourists start finding the country less attractive from the point of view of providing them with relatively cheap (of undermined prices) tourist and any other kinds of services;

(4) <u>But:</u> The international evaluation of labor in the country goes up – people's income grows faster in international terms (EURO, USD) than their real income.

There arises an inflationary tension in production structures which is not fully reflected in consumer prices. Over the last three years (2003-2005) for instance, the average annual rate of the producer price index (PPI) exceeded that of the consumer price index (CPI) – 5.9% against 4.4%!

The only economic adjustment implies that both production of goods and supply of services should look for ways to keep and increase their competitiveness mainly along the line of higher efficiency and better quality of the goods and services offered. This is the logic of economic prosperity – people might feel better well-off in comparison with other countries only when the economy is performing better (and more efficiently!).

Figure 2

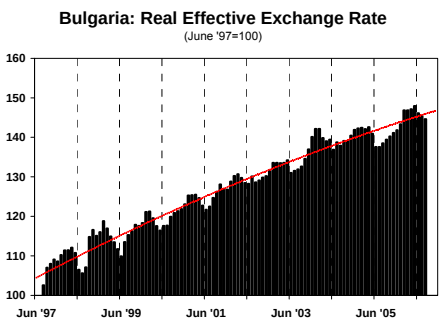
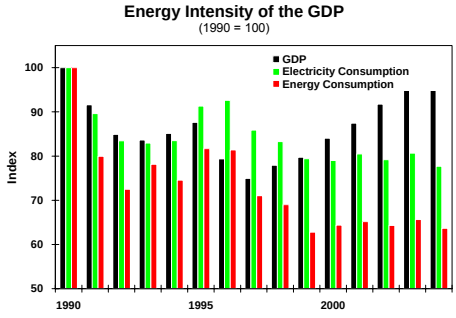


Figure 3



The business has managed to meet the challenges of the steadily appreciating local currency in real terms and consumption reacted to the adjustments in relative prices too. A telling example is given on Figure 3 where one can trace the energy intensity of GDP. In the first half of the 90s the structural reforms went sluggishly and the change in energy intensity was rather imaginary. The situation has changed over the second half of the 90s and onwards. Administrative pressure on energy prices has gradually lessened and thus changed the attitude of economic agents and the people to energy resources. So the positive results have appeared quickly – GDP has recorded significant positive rates of growth at almost the same energy consumption. A certain amount of the overall reduction in energy intensity of GDP can be accounted for by the intrastructural production readjustment which can also be assessed positively as far as a progressive model of production activities is being imposed.

The changed attitude to energy resources made realizing a significant volume of electricity exports possible without an increase in energy generation.

A vivid example of the potential of the real sector to overcome difficulties caused by the really appreciating local currency is the intensive development of exports of goods and services. In 1999 exports of goods amounted to USD 4 billion, whereas in 2005 the latter were three times higher (an average annual rate of growth for the six-year period in current USD of 20%)! There was a similar situation with receipts from tourism (a growth of 2.6 times in nominal USD terms for the last six years!). Such a development would have been illusionary in the recent past. The altered conditions have enabled Bulgarian economy to find ways for a significant increase

in the exports of goods and services despite the suppressing impact of the more expensive local currency.
The consumer has felt the positive economic development in terms of their growing real income, and the favorable influence of the appreciating national currency – in terms of the growing international evaluation of domestic labor. Imported goods and services are getting more accessible for the Bulgarian citizens mainly due to the overtaking growth of domestic revenues in international currency (EURO). The latter has contributed to integrating the country into the European and global structures too.
The findings (in a negative context) about the (relatively) high inflation rates in Bulgaria should be discussed constructively. By means of its higher inflation rates Bulgaria is preparing for its membership in the Euro-area. The general price level is rising and the system of relative prices is changing. All this is taking place in adjusting to the European economic stance. Overtaking inflation rates will continue until the country gets completely ready to join the Euro-area.
Keeping a deficit on the current account of the BoP is a typical feature for the transition counties. Bulgaria's current account has been negative for almost all the period since 1990. The only exception with a positive current account was in 1996-1997 due to the observed dramatic depreciation of the national currency[3]. However, statistics revealed a systematically increasing gap in the trade balance followed by an intensifying negative impact on the current account, which has ever more been attracting the analysts' attention.
The causes for the deficit of the current account are comprehensible but still worrying. The accelerated integration of the country into the European financial and economic structures demands and implies interweaving financial and economic interactions, and the initial effect is always negative on the current account.
One can see the structure of the current account of Bulgaria in the beginning of the twenty first century on Table 1. Traditionally, the trade balance is a negative value, which is offset (partly) by the other aggregate elements of the current account. Services (with tourism as the main positive component) help alleviate the trade deficit. Another positive influence comes from the net current transfers, whose main component are the private current transfers. The latter are formed predominantly from remittances. Lately (in 2006), the share of the income (compensation of the employed) in working out the current account has been reevaluated (statistically). Using an updated methodology, the income in forex of Bulgarian citizens working temporarily abroad – mostly within the three months allowed in the EU countries, was reevaluated for 2004-2005 especially, (to start with). The difference proved to be significant – while the estimate according the old methodology of the earned income stood at about EURO 50-60 million annually, the stricter recording of reality raised this income to over a billion EURO![4]
The sources for the higher deficit in the trade balance lay both in the current account and the financial account. For 2004-2005 for instance, it was calculated

[3] Actually, the Bulgarian situation with the current account in 1996-1997 could be quoted as a case example (though to a certain degree in grotesque forms) of the healing effect of currency depreciation under a deep financial crisis.
[4] The analytical estimates stated the actual remittances through this channel as twice more (Ratha D. – Remittances: A Lifetime for Development. "*Finance and Development*", IMF, December 2005, 42 p.).

that there came about two billion EURO on an average annual each year (nearly a tenth of GDP!), earned by the Bulgarian citizens abroad (official emigrants and visiting workers) – half of the remittances on the one hand and visiting workers on the other. The flow of forex through the Bulgarians working abroad (the EU), and the remittances might be assessed as an indirect material support most of all by the EU. This money contributed to a great degree to forming the trade deficit of three to four billion EURO.

Table 1

Bulgaria 2000-2005: Current Account (m EURO)

	2000	2001	2002	2003	2004	2005
Current Account	-761	-855	-403	-972	-1131	-2531
Trade Balance (goods)	-1280	-1778	-1878	-2426	-2954	-4369
Services	548	331	505	553	693	667
Income	-345	30	404	288	238	247
Current Transfers	316	562	566	613	891	925

Table 2

Bulgaria 2000-2005: Balance of Payment (m EURO)

	2000	2001	2002	2003	2004	2005
Current Account	-761	-855	-403	-972	-1131	-2531
Direct Investment (net)	1100	893	951	1827	2244	1856
Growth of the Gross External Debt	1036	52	-1166	-128	1882	1803
Public External Debt	481	-178	-1738	-913	-619	-1290
Private External Debt	556	231	572	784	2500	3093
Others (net)	-1186	333	1335	-97	-1594	-559
Reserves and Related Items	-188	-425	-717	-630	-1400	-569

The current account was worsening all the time but it was being financed by the inflow of forex through the financial account (Table 2). Over the last two years the new issues of external debt of the private sector have had a decisive contribution to the overall positive balance. In 2005 the net receipts of FDI were not able to cover the deficit on the current account and there was a significant leakage of forex resources linked with the reduction in the external debt of the pubic sector. The shortage of forex resources, for replenishing the international forex reserves of the country including, was covered by the attracted foreign financial resources of the private sector. The point is whether such a situation might induce tension and risks on the macroeconomic level and how much or many these will be.

The transnational movement of capital flows is reflected in the financial account of the BoP. In 2004-2005 for example, the average annual net inflow of forex was about three bullion EURO. The main part of this amount came as foreign investments or as issued external debt of the private sector. The last indicator describes mainly the financial relationships between the local enterprises along the line of FDI, and the respective organizations abroad, on the other hand. In both cases the inflow of capital in the country was meant to develop the production sector, i.e. it involved imports of machines and equipment. The detailed calculations revealed that the predominant part of this in-coming capital left back the country to pay for imported raw materials, machines and equipment within the same current year, i.e. they did not remain in Bulgaria. The BoP registered an almost constant turnover of forex through foreign investments and issued gross external debt. Only a small part of these financial resources stayed in the country in the way of domestic expenditure.

There is one more component of the BoP which brings confusion in assessing the deficit on the current account. It is a question of the item *"Errors and omissions"*. It reflects undistributed transnational forex (net) flows. In 2006 the BNB undertook some consistent measures to redistribute this position by which key financial indicators were altered. There are grounds to believe that a substantial part of these *"Errors and omissions"* are connected with the current account.

The good news from the analysis of the structures in the balance of payments is that the international foreign exchange reserves of the country have been steadily going up. This, finally, demonstrates that the pegged fixed exchange rate has been successful in its disciplining function and is still forcing business to look for opportunities for a gradual and apt adjustment to the evolving environment.

Under the currency board arrangement in operation (a fixed exchange rate) and fully liberalized balance of payments the only efficient macroeconomic instrument to counter the high deficit in the current account (more than 11% in 2005) is the budget policy. Economic theory has manifested (in compliance with the consequences from the Mundell-Fleming model) the performance of the so called impossible trio – under a fixed exchange rate and liberalized balance of payments it is impossible to pursue independent monetary policy. Under the currency board the BNB is, as a matter of fact isolated from the possibility to practice monetary policy (presumably), but the fiscal policy might carry out some elements of the monetary policy. The options touch on the budget deficit management – the sterilization of the input foreign exchange flow presumes taking away all the money supply in circulation (in terms of revenue exceeding expenditure in the government budget), which is to be maintained as the so called fiscal reserve[5] with the BNB.

Bulgaria has managed to keep remarkable budget discipline after the adoption of the CBA (Figure 4). It appears still more important on the background of the economic situation in the EU (Figure 5).

Figure 4

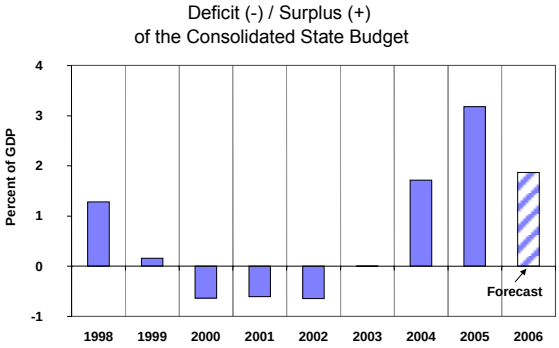
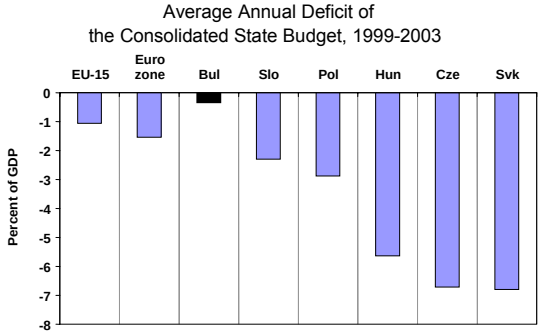


Figure 5



Source: World Economic and Social Survey 2004 (Trends and Policies in the World Economy). UN, DESA, N.Y., 95 p. and my own estimates;

[5] The purpose and design of the *fiscal reserve* is to provide for sufficient financial resources for unimpeded servicing of the external debt. In the near future major debt principals are due for repayment (most of all connected with the issues of global bonds), whereas privatization has almost exhausted its potential. The assessment of the fiscal reserve should be made in perspective, not from the point of view of today's cravings.

The improved possibilities to finance the budget items have enabled a considerable growth in the financial resources available to the government and the fiscal reserve, in particular. Its record high values at the end of 2004 whetted the appetite of politicians to defend the *"national interests"* by means of spending the money accumulated without paying enough attention to its functional composition and purpose. These desires have been cooled down (with the IMF's assistance including).

The possibilities to realise a substantial budget surplus went along with the considerable surplus in the revenue side of the government budget. For 2003-2005 the revenues in the central government budgets were exceded by 12% on an average annual! Along with the natural satisfaction with the higher revenues obtained (planned reserves!), anxiety about the undesired consequences is getting higher. The already traditional model of monthly allocating expenditure from the budget follows a clearly terrace-like structure[6]. The cyclic recurrence thus obtained reflects on the monthly growth of the fiscal reserves too. The year starts from low levels of budget financing which rechannels resources to the fiscal reserve. Gradually, in the course of the year the reallocation of financial resources increases to reach a record high in the last month. A simiilar monthly distribution of expenditure is very convenient for the MF people in charge of the budget but it is highly undesirable in the context of harmonious economic development. There is a striking resemblance to the cyclic monthly development of the real income of a household within the year – in the beginning of the year it is typically marked by low real income which grows to reach a record high level at the end of the year.

There is a direct correlation between the monthly distribution of income observed, and the monthly development of inflation, on the other hand. A similar monthly cyclic recurrence describes the consumer price index too. Such sharp variations tend to create social tension and the specific time structure of income has a reflection on the irrational use of consumer resources available, i.e. they remain underused and ignored as structural elements to raise consumer satisfaction.

The quality and assessment of consumption is not lacking in variations in terms of income distribution over the year – at one and the same level of annual income its relatively more even monthly distribution increases consumer satisfaction, the feeling of social justice respectively. Improving the time structure of income received in the direction of balancing and smoothing the significant monthly variations raises their consumer value, i.e. represents an additional reserve to raise the positive social effect from the improved economic performance.

Although the possibilities of macroeconomic management of change in income are relatively limited (up to the impact on the income of employed in the public sector), the behavior of the government exerts an influence over the principles of management in the private sector. And what is more, it is a model to copy from the private sector. That's why the approach of the macroeconomic elite to planning the monthly structure of expenditure in the government budget, respectively the time

[6] There are two models of budget performance and budget accounting discussed in professional readings – on a *cash basis* and *accrual basis*. What is being practiced in Bulgaria is cash budgeting. The OECD countries are redirecting themselves to accrual budgeting, which is being recommended by budget analysts to the transition economies as well (Diamond J. – Budget System Reform in Emerging Economies. IMF Occasional Paper N 245, 2006, VI). The latter, however, requires purposeful technical and administrative training.

structure of income within the year, is important for the overall process of income regulation.

Recently, in search of incentives for economic growth there were some experiments with various tax structures. The outcomes observed are not simple, as well as those observed from similar experiments in other countries. The idea to leave a greater part of income in the business in order to promote higher economic activities is so tempting that it rouses suspicion. What is evident on the surface is that there is a positive economic performance but also that social stratification and differentiation is intensified. So it is questionable to what extent the positive economic development witnessed is the outcome of the changed structure of taxation and to what extent it follows its logical positive development. A considerable part of the reduction in the tax burden is to the benefit of the more well-off and the latter pretend to prefer to increase their ostentatious consumption and invest in non-productive accumulation (spacious houses). Macroeconomic management has not made any attempt so far (neither shows that it perceives the problem) to restrict non-productive accumulation at the expense of the productive one. The wide-spread policies in the world in this respect are for instance to apply progressive taxation which makes it freezing financial resources in real estate for consumer purposes inefficient.

At the same time key activities connected with the normal performance of the state remain underfinanced. This is the case too with some long-term activities of the state to which it seems to have turned its back. Education and healthcare, that should firmly and constantly be in the focus of government attention, suffer from vague and diluted management decisions, all of them keeping up the marginal status of the employed in these sectors. The status quo thus established creates the prerequisites for the search of unregulated additional income and whenever this turns impossible – it leads to accumulating and mounting social tension.

In the conditions of Bulgarian economy the importance of the institutional factors for social and economic progress outweighs the others. In fact all EU criticism to Bulgaria at the moment is addressed at the unsatisfactory performance of national institutions. Corruption, crime, the quality of the legal system and many other pending problems (economic by nature – in the end) are the outcome of the poor performance of the institutions.

Building working market institutions is a process requiring consistent and purposeful efforts of long standing. Price liberalization, interests and exchange rate arrangement might be altered literally overnight, large-scale privatisation requires a much longer period and preparation, whereas institutional building implies and involves a change in the dominant way of thinking. When building up the necessary institutional environment personal, group and party interests come in collision, and this delays and postpones economic progress. Institutional change affects most intimately and in the long-term both personal and group positions, due to which its realization is a painful and difficult process. It is a question how to think those mechanisms which would provide a long-term economic and social prosperity and attack the reasons for the poor performance of the economy (not the consequences) on this basis.

It is hard to evaluate the quality of institutions in quantity terms. However, there might be individual indirect macroeconomic indicators which provide information about the way economic players and the people assess the complex overall

institutional structure and its impact on the behavior of economic players and the people on the other hand.

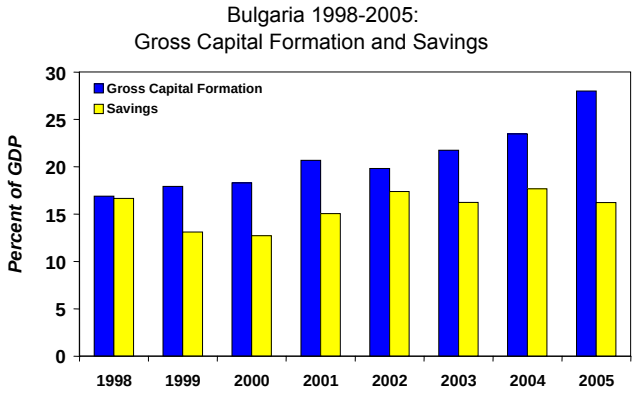
The growth of gross capital formation ratio and savings in Bulgaria after 1998 is shown on nt in order to draw investment.

Figure 6. Economic theory and experience reveal that the levels of these indicators of the order of 15% and less than that are not sufficient for providing a modern technological renovation and acceptable rates of economic growth. This is exactly the level of savings in our country. No doubt, purely psychological motives are not to be ignored here. The readiness of people and economic agents to save is a kind of measure of the confidence in official institutions. If the future seems predictable and institutional behavior of the macroeconomic elite instills confidence, then people will tend to increase and invest their savings. On the contrary, if the institutional set-up of the society does not inspire safety and confidence, then they would rather use whatever has been earned to the full today [7].

The ratio of gross capital formation recorded a clear trend towards growth till about 25% at the end of the period, which should not be overestimated though. During this period there were finalized privatization deals of large state-owned companies and they attracted a lot of foreign investments. Over the last five or six years FDI in Bulgaria accounted for about half of the gross capital formation, i.e. the domestic sources of gross capital formation were at a lower level than the one shown on nt in order to draw investment.

Figure 6. In the near future, however, we have to only rely on the attractiveness of the economy and the improved institutional environment in order to draw investment.

Figure 6



One cannot ignore the massive investment of people in nonproductive capacities and activities (luxurious houses, ostentatious consumption etc.). The flight from

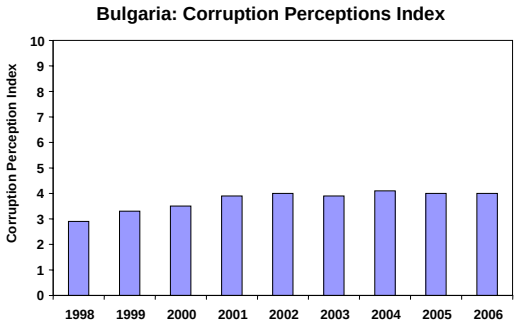
[7] There is a wide-spread simplified belief that the low level of savings is determined by the low level of income. This might be considered a delusion and an example of unadvised superficial conclusion. *First*, the notion of *"low income"* is hard to define in absolute terms, and *second,* there are savings, no matter what the size of income is. In addition, even J.S.Mill proved that *"savings do not reduce consumption*" (Й.Шумпетер – *История на икономическия анализ*. Том 2: 1790-1870. *Изд.* "*Прозорец*", София, 2000, 381 с.).

and reluctance for productive investment might be evaluated as a form of distrust in official state institutions too and as a result of the poor performance of government authorities. Production capacities are much more prone to various ways of actual expropriation than real estate of non-production purposes. Another thing not to be forgotten is the influence of inefficient capital and financial markets.

Corruption is a problem which has been attracting analysts' attention all the time. The unsatisfactory functioning of the institutions gives birth to and nurtures conditions for corruption, which undermines the possibilities for steady economic growth[8]. Figure 7 illustrates the insignificant progress of Bulgaria made in the way of fighting corruption[9]. It should be noted that this progress was made until 2001 and after that it actually kept that level of corruption with even a certain worsening. Figure 8 ranks the CEE countries by levels of corruption and the picture is hardly positive. There cannot be a positive attitude of people and economic agents to macroeconomic institutions in such an environment of "*steady*" corruption. If the latter does not improve significantly, economic outlook cannot be brighter.

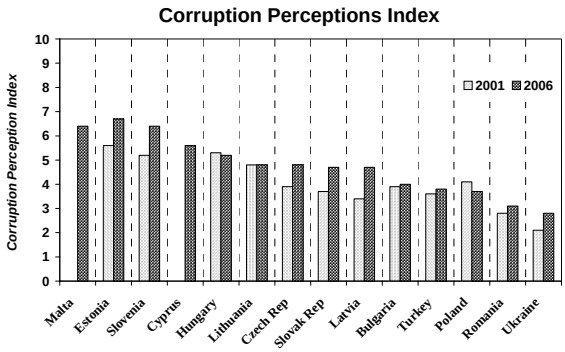
Bulgaria's transition to market economy began in the early 90s of the twentieth century and will most likely finish with the building up of institutional set-up of good quality. There, in the institutions (most generally) all dominant group and personal interests get interwoven. These cannot be changed by a magic wand in a few days (years!?). They demand persevering and consistent efforts aimed at achieving given principles.

Figure 7



Source: Transparency International (Internet);

Figure 8



Source: Transparency International (Internet);

As a rule the managerial elite does not realize the scale of negative outcomes and implications of the poorly performing institutions[10]. Consciously (because of vested

[8] "*The institutional environment, measured by the corruption level, …*" (Tytell I., K.Yudaeva – FDI in Eastern Europe and NIS. "*Beyond Transition*", Jan – Mar 2006, vol. 17, No. 1, WB, 23 p.);

[9] According to the international non-governmental organization *Transparency International* the highest mark is 10 and it corresponds to non-corrupted administration while the lowest one 0 means fully corrupted administration.

[10] Looking after its personal and group interests the managerial elite tends to go lobbying in drawing out the laws and not to think much about the likely (purely economic!) unfavorable consequences for society. This problem is studied in detail in specialist reading. See especially R.Coase who states that "*… the legal system will have a profound effect on the working of the economic system and may in certain respects be said to control it*" (Coase R. – Essays on Economics and Economists. The Uni. of Chicago Press, 1994, 11 p.).

interests) or unconsciously (because of ignorance) some unfinished laws, as well as lenient (or unscrupulous) abidance of legal requirements shape an environment of distrust and insecurity, which eventually erodes the principles and pillars of economy and society. The imperatives of today become predominant naturally and the painful adjustment is put off for better times. However, as experience has shown consistently times and times again, the more this is put off, the stronger the foundations even of short-term goals are undermined.

The most efficient way to leave lasting positive traces in national history is dealing with the painful problems of society. Bulgaria cannot continue to successfully go forward without well performing institutions. The macroeconomic elite (and the political one too) ought to find the strength and the means to build the necessary modern institutional environment. All other "*successes*" will be illusionary and transient.

Modern institutional set-up implies a change in the way of thinking of both the managerial elite and the people. Finally, the accession to the European structures means above all enjoying similar lifestyles, environment assessment, attitude to given elements of social and economic life. What is needed here is to carry out education policies leaving out all kinds of populist elements, targeting these policies at both the people as a whole and the party structures.

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Macroeconomic forecasts are an important and necessary element in working out macroeconomic policies. This type of forecasts should not be taken to the letter. They do not intend to guess the future and in this was they differ substantially from (say) technological forecasts. They are meant to cultivate a certain flair, vision and understanding of the specific development of economic processes, to assist the researcher to *feel* the economy. The striving is to outline *some bottlenecks*, to predict the emergence of social and economic strains, to make the economic players get ready for some needed management policies to be carried out in the future (transparency).

Such forecasts are made periodically, at regular intervals today (quite often twice a year) by all international financial organizations as well as almost all governments. Deciding on the budget proportions at a national level is necessarily accompanied by an attempt to look further in the mid-term. Forecasts deviate from reality and are constantly to be adjusted. Still they are thought to be of great interest, they are looked for and expected by specialists.

In any case macroeconomic forecasts provide conditional projections – as a consequence from adopting one or another line of macroeconomic policy, or a given exogenous influence (for instance the dynamics of the domestic energy prices, of the major foreign exchange rates etc.), i.e. they study problems of the type "*what – if*". Conditionality is expressed too in the change in macroeconomic parameters at the moment when a given macroeconomic decision is being applied. The economy alters its configuration and the reaction of economic agents creates a new reality. The latter is known in economic theory as "*The Lucas Critique*" and in particular it says that "*…economic behavior will change in response to a policy change*"[11].

[11] Quoted from: S.Pressman – Fifty Major Economists. "*Routledge*", 1999, 195 p.

The specialist theory was aware of the specific features of macroeconomic forecasting as early as the 80s of the last century, although there are quite often some expectations and even requirements for working out unconditional macroeconomic forecasts (much more as inertia coming from the widespread meaning of the word *forecast*). Speaking about the experience of Norway of the second half of the XXth century in the field of macroeconomic forecasting L. Johansen explicitly pointed out that "*…the goal of such projections* (macroeconomic ones – note G.M..) *is to study the implications of one or another hypothesis, and not to describe the most porbabale trends of development*". The author paid special attention to the particularities of social systems where any forecasts might exert some influence on the people's and economic agents' expectations and bring about a change in the development of the specific processes. So, "*…the forecast might help alter the dynamics of the forecasted values themselves*" [12].

The very nature of macroeconomic forecasts defines them as a marginal estimate of specific management policies. There is no final objective in terms of a state towards which the society is striving, i.e. there are no ultimately desired parameters for macroeconomic theory to strive for in order to attain a given economic trajectory (the specific macroeconomic criterion for optimum performance is absent). If we follow F. Hayek we have to agree that "*life has no other goal but itself*". Each individual sets out their own goals which in a strange and spontaneous way combine at the social level[13]. The forecast is based on observed values and development and projects the impact of given management policies. This is what the marginal economic philosophy means anyway – an assessment of the new (adjusted) elements of economic policy, i.e. the value added of the specific social and economic policies. If it is a question of any optimization at this level at all, then this is maximizing the marginal effect of given managerial policies and this is in a way what the economist-researcher has assessed. The appearance of relationships which macroeconomic management viewed as unwelcoming should be avoided, or vice versa – one should think over very well what kind of economic policies would be able to generate acceptable social and economic outcomes. Thus projections into the future lead to the better course of action. Such a view of macroeconomic forecasting is getting it close to what H. Simon had in mind: "*Instead of always seeking the optimal, we get the best information we can for making the most practical choice, and then we stick with it*"[14].

The forecasts'convergence with reality is an indicator of the extent to which our own knowledge of economic interactions goes, as well as how powerful the probable domestic or outside shock effects might be. The clear and hidden application of some fundamental principles about the relationships and dependencies in the economy underlie any quantitative projections. M. Friedman, for instance, went further in claiming, that "*…there is no importance whatever if the*

[12] Л.Йохансен – Очерки макроэкономического планирования. Том 1, Изд."*Прогресс*", М., 1982, 153-154 с.

[13] F. Hayek – The Fatal Conceit: The Errors of Socialism. "*Отворено общество*", София, 1997, 179 с. This can act as a constructive element too of the so called *spontaneous row*, that F. Hayek is keen on keeping in an undeliberate and unplanned way (see the interpretation of S. Koeva – (The market as a spontaneous row. F.Hayek's contribution) Пазарът като спонтанен ред. Приносът на Ф.Хайек. Изд. "*Стено*", Варна, 2002))

[14] Quoted from: M.McCarty – The Nobel Laureates. McGraw-Hill, 2000, 33 p.

assumptions underlying the economy are realistic or not". What matter is "*… if these assumptions bring about fruitful suggestions which might be checked empirically and thus prove if they are valid or not*". How true and adequate a theory is, is proved by the degree to which it is able to predict the future[15]. The forecasts and their comparison with reality turn into an instrument for assessing the adequacy of the theoretical conceptions at the input. The more so that the in-built initial prerequisites all but too often overlap with the consequences from adopting them[16].

In this case, as well as in many others in economic (and in statistical) research, negative statements seem to be more forceful and sound much more assertive than the positive ones. This is what M. Friedman pointed out by emphasizing that facts and reality can never prove (M.F.) a given economic assumption or theory. What they can do is only refute it[17].

For the sake of thoroughness one should admit that there are alternative views in economic theory. The American economist W. Michel of the early XXth century is one of the representatives of the anti-theoretical thinking. He is critical of working out complex theoretical economic models to explain economic reality and suggests focusing on direct observation instead, whereby the latter "*…is not based on preconceived opinions but tends in particular to thoroughly measure the facts observed*". This stance has boosted the development of the so called "descriptive economic statistics"[18].

Due to the above considerations using sophisticated mathematical apparatus will not be able to improve forecasts. Along with all the other difficulties this apparatus will only contribute to render the process of finding out the final outcome much more vague and bring about some mysticism (the computer says so?!). Actually, whatever the methodology, the specific forecast will always be personal and not impersonal (a computer one). Responsibility respectively (however conditional) will be personal, too. Macroeconomic forecasts always bear the print of the subjective factor, they are the product of man although the qualities of the methodological apparatus are not to be neglected at all. By applying one and the same methods and apparatus, various specialists can construe differing forecasts. These differences will reflect the theoretical concepts and hypotheses set in the forecasts, as well as the degree of specialist training of the research team.

What is advisable in working out the complex methodological tools is to resort to relatively compact behavioral functions and at the same give up any claims for maximum scope in terms of formal functional dependencies. The technical work in the number of options should not be very time-intensive by enabling the researchers to focus their attention exceptionally on how adequate, admissible and

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[15] Quoted from : Р.Гилпин – Глобална политикономия. Изд. "*Д.Яков*", С., 2003, 82-83 с.; Т.Бухолц – Живи идеи от мъртви икономисти. Изд. "*Христо Ботев*", С., 1993, 272 с.

[16] P.Samuelson said that "*…the distinction between assumptions and predictions is never very clear; what counts as an assumption and what counts as the consequence of some assumption is quite arbitrary*" (S.Pressman – Fifty …, already quoted., p.163). Analysing the assumptions underlying the production functions R.Dorfman, P.Samuelson and R.Solow pointed out that "*…perhaps economists would not have gotten into the habit of making this assumption so glibly if they had realized what, and how much, they were assuming*" (R.Dorfman, P.Samuelson, R.Solow – Linear Programming and Economic Analysis. Dover Publications, Inc., 1958, 203 p.).

[17] M.Friedman – Essays in Positive Economics. The Uni. of Chicago Press, 1953, 9 p.

[18] Quoted from: В.Леонтиев – Есета по икономика. Изд. "*Христо Ботев*", София, 67 с.

reasonable the outcomes are, i.e. on the most important features of the projections. The methodological apparatus is supposed to be able to generate (copy) various possible and probable combinations of macroeconomic parameters, and the final estimate of how reasonable the various options, and how probable the emergence of the potential social and economic strains, should lie on the economist – researcher.

Table 3

Bulgaria: Main Economic Indicators

	2002	2003	2004	2005	*2006*	*2007*	*2008*	*2009*
	Real Data				*Forecast*			
Aggregate Demand (current m BGN)								
Individual Consumption	24823	26846	29325	33067	*35934*	*38562*	*41156*	*43912*
Collective Consumption	3247	3469	3898	4097	*4217*	*4552*	*4882*	*5235*
Gross Capital Formation	5909	6694	7969	9971	*12284*	*13613*	*15536*	*17959*
Export	16706	18500	22192	25506	*31419*	*33954*	*36384*	*38958*
Import	19065	21779	26115	32449	*40799*	*37842*	*39264*	*40211*
Gross Domestic Product	32335	34547	38275	41948	*45991*	*50577*	*55172*	*60166*
Aggregate Demand (2001 m BGN)								
Individual Consumption	23791	25480	26729	28707	*29798*	*30930*	*32106*	*33326*
Collective Consumption	2978	3067	3272	3344	*3497*	*3651*	*3809*	*3973*
Gross Capital Formation	5881	6699	7603	9048	*10093*	*11226*	*12455*	*13820*
Export	16949	18305	20685	22174	*26010*	*27311*	*28676*	*30110*
Import	19333	22290	25433	29147	*32787*	*32802*	*33946*	*33769*
Gross Domestic Product	31165	32505	34358	36247	*38348*	*40497*	*42699*	*45025*
GDP Growth Rate (%)	4.9	4.3	5.7	5.5	*5.8*	*5.6*	*5.4*	*5.4*
Balance of Payments (current m USD)								
- - Export --								
SITC 0 - 1	605	626	837	986	*1070*	*1132*	*1198*	*1267*
SITC 2 + 4	357	462	620	740	*825*	*884*	*961*	*1029*
SITC 3	559	623	1004	1796	*1973*	*2126*	*2277*	*2455*
SITC 5 - 9	4171	5830	7386	8218	*9025*	*9665*	*10352*	*11087*
All goods	5692	7541	9848	11740	*12892*	*13808*	*14788*	*15838*
- - Import - -								
SITC 0 - 1	374	484	698	856	*918*	*995*	*1050*	*1128*
SITC 2 + 4	370	560	822	1157	*1348*	*1508*	*1666*	*1846*
SITC 3	1425	1708	2223	2667	*2740*	*2635*	*2489*	*2298*
SITC 5 - 9	5117	7307	9747	12459	*14012*	*15152*	*16211*	*17403*
All goods	7287	10059	13491	17139	*19018*	*20289*	*21417*	*22676*
Trade Balance (E-I)	-1595	-2519	-3643	-5399	*-6126*	*-6482*	*-6629*	*-6838*
Key Economic Indicators								
Exchange Rate, Annual (BGN/USD)	2.08	1.73	1.58	1.57	*1.56*	*1.55*	*1.52*	*1.49*
Exchange Rate, Annual (BGN/EUR)	1.96	1.96	1.96	1.96	*1.96*	*1.96*	*1.96*	*1.96*
CPI, Annual Average (%)	5.8	2.3	6.1	5.0	*7.1*	*5.1*	*4.3*	*4.2*
GDP Deflator, Annual (%)	3.8	2.4	4.8	3.9	*3.6*	*4.1*	*3.5*	*3.4*
Labor Force (Th.)	3315	3283	3250	3250	*3255*	*3260*	*3260*	*3260*
Employment, Annual Average (Th.)	2979	3021	2996	3047	*3086*	*3105*	*3118*	*3150*
Registered Unemployment (Th. As of 31.12.)	603	501	451	383	*327*	*323*	*298*	*276*
Unemployment Rate (%)	16.3	13.5	12.2	10.7	*8.7*	*8.3*	*7.9*	*7.0*
Labor Productivity (Th. 2001 BGN)	10.5	10.8	11.5	11.9	*12.4*	*13.0*	*13.7*	*14.3*
Annual Average Wage (current BGN)	3720	3957	4300	4572	*5116*	*5646*	*6180*	*6724*
Money Supply M1 (current m BGN)	6696	8030	10298	11652	*12775*	*14049*	*15325*	*16713*
Money Supply M2 (current m BGN)	13854	16465	20302	24675	*27806*	*31610*	*34482*	*37604*
Money Supply M3 (current m BGN)	13857	16566	20394	24925	*28087*	*31930*	*35186*	*38371*

The simulation model used by the author of this paper to make the macroeconomic forecasts for Bulgaria in the mid-term within the framework of the LINK project[19], follows the principles set out above. On Table 3 one can track the changes in the key macroeconomic indicators for Bulgaria, arrived at by means of the simulation model.

The mid-term economic development of Bulgaria is likely to be favorable. There are all the prerequisites for the country to manage to keep up satisfactory rates of growth, which will enable it to gradually integrate into the European structures.

Of all the features of macroeconomic policies it is worth outlining at least three of them:

First, *Bulgaria is firmly set to continue operating the currency board arrangement with the exchange rate pegged to the EURO. The official paper entitled Strategy of the Bulgarian National Bank declares its commitment to act within the current currency board framework until its full Euro area and Eurosystem membership*". And moreover: "*The BNB supports the view of Bulgaria's joining the ERM II immediately after EU accession, and commits to maintain unilaterally the currency board until euro area accession at the fixed exchange rate of 1.95583 levs per one euro. The BNB will conform to the framework set by the EC and the ECB, which precludes unilateral euroization of an acceding country*" [20].

Second, Bulgaria will go on pursuing strict and conservative fiscal and budget policies. This might cause some tension in the National Assembly, as far as politicians tend to be ready to spend any money accumulated. In the spring of 2007 the seventh and last stand-by agreement (a precautionary one) with the IMF expires and it is likely to be the very last one. Since agreements with the IMF always specify the need for tight and conservative fiscal and budget policies, then during the preparation of the government budget there might be some voices claiming to have the budget restrictions alleviated. This government's term of office expires in 2009 and it is quite likely to have some claims demobilising the budget but it is hoped that the the IMF will successfully pass on the restrictive torch to the EC.

Third, the issue with inflation and keeping to adequate macroeconomic policies acquires some new dimensions with a view to Bulgaria's accession to the EU. The financial framework for 2007-2013 envisages that Bulgaria will obtain from the EU funds EUR6 billion for regional policies, EUR5 billion for the agrarian areas and agriculture and EUR500 billion for other policies[21]. The total inflow of financial resources along the lines of cooperation with the EU for this period is estimated at EUR11.5 billion. This money supply accounts for about 6-7% of GDP, or 15-16% of

[19] For more detail on project LINK see http://www.chass.utoronto.ca/link/meeting200610.htm

[20] Strategy for Bulgarian National Bank Development between 2004 and 2009. Sofia, September 2004, 7 p. The paper can be found on the Internet address: http://www.bnb.bg/bnb/home.nsf/fsWebIndex?OpenFrameset .
Bulgaria adopted the currency board arrangement on the recommendation of the IMF in the mid 1997, following a deep financial crisis. At that time the Bulgarian lev was pegged to the DEM as 1000 BGL/DEM. The BNB's Law of 1997 stated that upon the introduction of the EUR the Bulgarian lev will switch its pegging to the at the same ratio/proprtion as to the DEM. At he end of 1998 the relationship between the DEM and the EUR was set at 1.95583 DEM/EUR and the Bulgarian lev pegged to the EUR as follows 1955.83 BGL/EUR. In the mid 1999 Bulgaria denominated its own currency whereby 1000 old Bulgarian levs were replaced by one denominated lev, so the exchange rate was fixed at 1.95583 BGN/EUR.

[21] As the Minister of Finance Pl. Oresharski said (*The Standard newspaper*, 11.05.2006, 11 p.).

revenues in the government budget and a fifth to a quarter of the money in circulation[22]. Macroeconomic management will be faced with a serious challenge, linked with the rational management of a substantially increasing money supply. Anyway there will be a tangible pressure on the price level which should be alleviated and neutralized in a suitable way. It has to do with both the BNB policies and the fiscal ones. Most likely, however, the administration will not be able to absorb the resources provided to a degree high enough, which, everything being equal, will mean again a delay in the process of integration into the European structures.

*

Following a painful transition from a centrally planned to market economy, which was met with controversial estimates al the way through, Bulgaria now is set to record steady and sustainable social and economic progress. Over more than ten years in a row the country has managed to maintain relatively good and acceptable rates of economic growth. The key structural reforms have already irreversibly been carried out, with the private sector holding solid positions and economic future seems predictable. A satisfactory trend towards falling unemployment has also become noticeable.

Despite the ebbs and flows in the country's relationships with the international financial organizations it is no doubt necessary to emphasize unconditionally their overall positive impact. As a rule the domestic economic elite has been jealous of the requirements of the international financial institutions, but it is true, that it was not easy at all to carry out market reforms on their own, independently of them, and that more than once it was tempted to skid because of inconsistency or political advantage. The presence of the international financial institutions has even had, in psychological terms, a favorable impact on macroeconomic management as far as it enabled it to provide justifications and find an excuse for the painful for the people market reforms.

The major macroeconomic institutions – the Ministry of Finance and the BNB have become more stable and cautious in adopting policies of discretionary nature. However, populist calls and promises tend to crop up from time to time and people do not always react adequately. The fatigue from the transition and nostalgia for the secured past are easy to be exploited as well as put to use to serve personal and group political interests and such a behavior might prove disastrous for the country's future.

Bulgaria's accession to the EU and integration into the European economic and all other structures is looked for with satisfaction by the people. The issue now seems to be to rein in the excessive expectations for fast and unpainful social and economic progress. Here too, the political elite is at stake, since political rhetoric might exert a significant influence on the people and their expectations and these are often not used in disinterested way. In any case Bulgaria's future is inextricably bound up with that of the EU and the faster the country integrates into the European structures, the better.

[22] GDP for 2005 was BGN 42 billion, while the figure quoted corresponds to an average annual rate of growth of about 5 percent. Money in circulation at the end of 2005 in Bulgaria was estimated at about BGN 6 billion, with a growth of about a fifth an average annual for 2001-2005. In the next decade this rate of growth will most likely fall to about 15%, so that the net planned inflow of financial resources from the EU funds for 2007-2013 will account for nearly a fifth to a quarter of the money in circulation.