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## **THE WAGE POLICY DURING THE 90'S: CONDITION, EFFECTS, AND LONG-TERM PERSPECTIVE**

The article does an overall analysis of the income policy during the 90-ties. Because of the fact that income is one of the main macroeconomic stabilising factors, the implemented policy has predominantly restrictive character. The Bulgarian economy entered into a deep and prolonged income crisis, as a result of the restrictions and of the unfavourable internal and external economic environment.

The measurements of the income crisis are identified and investigated. The deepness and the scope of this crisis are expressed by a considerable decrease of the real incomes, an increase of the differentiation of earnings, lagging of minimal wages in respect of inflation, formation of unfavourable income structure and others. The economic and social effects are connected with a wide expansion of poverty, decrease of consumption and savings, demotivation of the labour force, a weak dependence of the working salary on economic results, stimulation of the informal economy and others.

On this basis, conclusions and proposals for changes of the income policy are made, so as to solve the accumulated problems and answer the challenges of Bulgaria's accession to the EC.

JEL: E24; E64

The model for transition to market economy, realized in the 90's, defined the incomes as one of the basic stabilizing macroeconomic factors. The liberalization of prices and economic activity, carried out in conditions of monopolistic structures and non-market behavior of the economic subjects, implies the application of regulative measures on the incomes in the public sector.

In the beginning of the 90's, as a result of the conducted restrictive policy and the unfavorable internal and external economic environment, the Bulgarian economy entered into a deep and enduring crisis of incomes. The profoundness and the duration of its presence generate clearly expressed social and economic negative effects.

The objective of this article is to identify and analyze the dimensions of the crisis of population's incomes and its social-economical effects. On this foundation and on the basis of the accomplished macroeconomic stabilization stands the need of change in strategy. This change is expressed as eradication of the restrictions. For this purpose the article analyzes few priorities that have long-term impact and are directed toward the solution of the accumulated social problems and the challenge of Bulgarian EU accession.

### **Priorities and Instruments of Salary Policy in the 90's**

The wage policy during the last decade has the following distinctions:

- The basic parameters are formed in close relationship with the international financial institutions (the International Monetary Fund and the World Bank). In this respect it is a unique compilation between the ideas of the Bulgarian government and the policy of IMF. The evaluations of the role of IMF in shaping the Bulgarian wage policy are ambiguous. However the important thing is that this influence has a disciplining character.

- It is aimed mainly at short-term goals and solution of current problems, which would have stabilizing effect. The resolution of strategic and long-term impact problems is postponed for indeterminate period of time, despite the impelling need for their solution;

- The regulative functions with outlined restrictive character predominate. The limitations subside or increase according to the current situation.

Three major priorities dominate in the wage policy: *achieving a non-inflation income growth; associate the incomes with the economic and financial results and social purpose in the context of the existing budget restrictions*. In the last two years one more priority is added: *increasing the real salaries in budget organizations*.

1. *Securing a non-inflation income growth* is a priority that has been in the base of the conducted policy for the entire period of transition. Different administrative and economic instruments and mechanisms have been used. The progression of nominal incomes does not have a sharply expressed pro-inflation inclination even in the periods when real income growth exceeds the growth of labor productivity (mainly in 1992, 1998, and 1999). This effect is due to the very low purchasing power of the incomes and in fact indicates loss of opportunities for their more adequate compensation without any impact on the inflation.

Despite the achieved non-inflation income growth, the pace of inflation remained too high until the introduction of the monetary council. Obviously the major sources, which furnished inflation in that period, are out of the domain of incomes. This questions the effectiveness and the purpose of the conducted firm restriction of incomes.

2. *The formation of incomes according to the economical and financial results* is a priority, which is premeditated in the mechanism for regulation of salary in the public sector. Despite frequent changes in the parameters of this mechanism, close relation with the efficiency of economic activity has not been accomplished. In many economic organizations from the public sector the salary grows independent from the poor results. This is characteristic for almost all monopolistic and financially supported

branches and activities, in which the low efficiency combines with high working remuneration.

3. *The social direction of wage policy* is related to the effective protection of the population of low social status. The aim is to accomplish even distribution of the reform burden. It is difficult to give a definite positive or negative evaluation of its realization. On one hand, the poor stratum becomes highly marginal, because of the substantial drop of all social benefits behind the mean salary. On the other hand, the limited financial budget capacity does not allow more effective passive protection of this portion of the population. In this field remain numerous unsettled problems, related mainly with the low level of social benefits and active struggle against poverty.

4. *The increase of the real salaries in the budget organizations* aims at rising the living standard of the employed in this field and at decreasing the fragmentation of labor remuneration. It is realized through more substantial increase of the salaries in the field and through budget surplus (giving additional labor remunerations in the form of 13<sup>th</sup> salary).

During the past decade the wage policy is carried out with the help of a set of economic and administrative instruments and mechanisms. The administrative measures predominate, because restriction is a major component of the conducted policy. The main instruments and mechanisms are based on straight fixing of the minimal and the average salaries in the budget area; binding the salaries in the budget sector and some social benefits to the minimal salary; levying taxes on the surplus revenues for salaries in the public sector and ordering indexation of all kinds of incomes.

*The minimal salary plays extremely important role in the wage policy during the 90's.* Beside its social and economic function, it is predestined to play the role of factor of economic stabilization. The latter is done by using it as base when determining salaries in budget organizations and some social benefits. Because of that it is placed under strict control and very often is used as an effective instrument for regulation of the incomes in the public sector. Very often the regulative function was blocking or irregularly increasing the minimal salary. For example, during the entire 1992, in order to control the public expenditures the government kept the minimal salary unchanged. As a result all the related payments fell behind the mean salary and the inflation. It should be stressed that during the past period more attention was paid to regulative functions. Principally the minimal working salary does not prevent the workers and those who receive social benefits from poverty.

Since the beginning of 2000 the changes in the mechanism for modeling the minimal salary has limited its capacity to be used as a mean for regulation of income. This way its social and economical functions were reinstated. The purpose for binding the average salary to the minimal for the country is to first compensate to a certain degree the substantial suspension,

and second to achieve a stable synchronization and constant proportion to the average salary.

*The formation of the salary in the budget sector* is based upon the minimal salary and the coefficients for the respective position. From economical and social perspective this is not the best of solutions, but from the aspect of regulation it appears to be an effective instrument for control.

This correlation has unfavorable consequences for the growth of the minimal salary and respectively for undergoing the discrepancies between them. Since 1999 this dependence of the budget salaries on the minimal salary has terminated. Since then the salaries in budget organizations have been directly determined. This decision is a step toward reinstating the basic functions of the minimal salary.

*The mechanism for regulating the salary* in the public sector is one of the fundamental instruments of the wage policy in Bulgaria. It is based on taxation of the surplus revenues for salaries. Its necessity, effectiveness, and ways of determining it have been a subject of active disputes and discussions during the entire decade. The fact is that the mechanism applied up to 1997 generated more problems than it settled. In general it limited the growth of salaries in the effective economic organizations and thus did not motivate working power. The changes in the mechanism for regulation, applied since 1997, are directed toward stimulating the salary growth in the efficient companies<sup>1</sup> and limiting it in the inefficient ones. This mechanism is not very effective since great part on the unprofitable companies do not apply it.

*The indexation as an instrument* of the wage policy had been applied until the introduction of the monetary council. In conditions of high inflation its major purpose is to compensate the population's incomes, but in conditions of inflation shocks this mechanism does not assure full compensation. The accomplished in 1994, 1996, and the beginning of 1997 undoubtedly supports this deduction.

### **Dimensions of the Crisis of Incomes**

Since the beginning of the reform the Bulgarian economy entered a deep and enduring crisis of the incomes. Its dimensions can be summarized in the following basic points:

1. *Sharp decrease of the real quantity of all kinds of population incomes.* During the 90's the population incomes lost substantial part (more than half) of their purchasing power. Compared to 1990 the real income of a member of a

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<sup>1</sup> Through free negotiation on the base of the achieved economic and financial results without applying administrative restrictions on the growth.

household<sup>2</sup> dropped with more than 60% (Fig. 1). The minimal payments (minimal salary and minimal pension) collapsed even more rapidly.

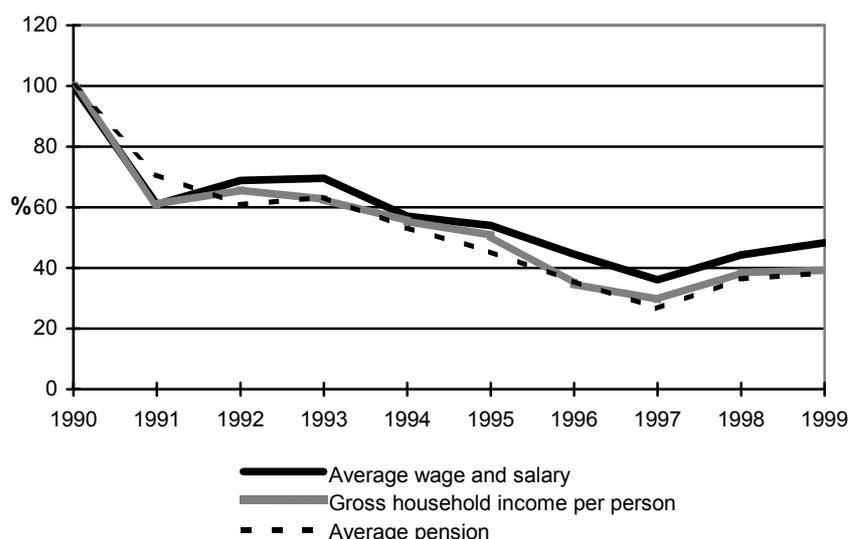


Figure 1. Dynamic of Real Population Incomes, 1990-1999 (Index 1990=100)

This substantial decrease of real income is not steady during the years. It is a direct effect from the price shocks and the incomplete compensational policy in 1991, 1994, 1996, and the beginning of 1997. For example the salary in 1991 decreases with nearly 40%, in 1994 with another 18%, and in 1996 and 1997 with 18 and 19% respectively. The growth accomplished in 1992 and 1993 cannot neutralize the lost of purchasing power in 1991.

With the introduction of the monetary council in the middle of 1997 and the decrease of inflation begins the overcoming of the real income drop. The accomplished of positive growth of all incomes, sensible in 1998 and 1999, compensates the decrease after 1996.

The loss of purchasing power was accompanied with extremely low level of incomes. In the entire 90's the average salary converted in US dollars<sup>3</sup> did not exceed 120 USD monthly, and the average pension – 40 USD (Fig.2). This fact places Bulgaria in an unfavorable position in the negotiations for EU accession. Overcoming this backwardness may prove to be one of the major directions and priorities in the wage policy.

<sup>2</sup> Calculated on the base of gross income.

<sup>3</sup> In current USD on the base of the mean annual exchange rate.

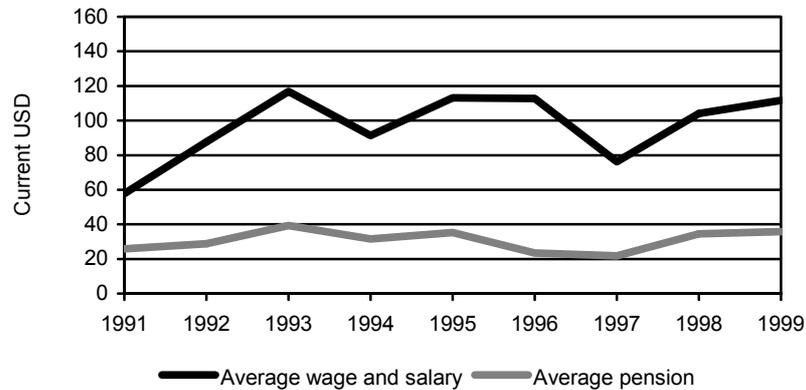


Figure 2. Dynamic of Incomes in USD, 1991-1999

There is an important difference, which should be stressed. The decrease of population income's purchasing power does not correspond to the contraction of GDP (Table 1). The real salary decreases nearly twice as much as the reduction of GDP. This immense abrasion of salary shows that it is more like a consequence of the price shocks and the inadequate wage policy, rather than an effect of the deterioration of economic results.

Table 1

Dynamic of GDP and Real Work Salary, 1990-1999  
(Index 1990=100)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Real GDP	100.0	88.3	81.8	80.6	82.1	84.2	75.0	69.5	71.9	73.7
Real salary	100.0	61.0	68.8	69.6	57.1	53.9	44.5	36.1	44.3	48.3

Source. Statistical Yearbook, NSI, 2000.

2. *Increasing differentiation in labor remuneration.* The development of market relations and free economic enterprise in the 90's reflected on the rapid increase of remuneration differentiation. The differences mounted between the distinct social groups as well as between the branches of economy, between the public and the private sector, and between different categories of employees. If the raise in labor remuneration growth is in accordance with the principles of market economy, it should not be regarded as negative phenomenon or as an element of the crisis of incomes. In our country the situation is different, because most of the differentiation is not a consequence from the economic and financial results of the economic subjects, but a consequence of their subventions and monopolistic position.

The fragmentation of working force in the public sector is regarded from two aspects: 1) between the salaries in the budget and real sector, and 2) between the salaries in the different branches and activities.

The salaries of the employed in non-budget organizations from the public sector exceed the remunerations of those involved in budget organizations. For the 1996 period the difference had increased over 10 times (from 7% in 1990 to 74%<sup>4</sup> in 1996). Here the special thing is that the substantial advantage of the first is not related to increase of efficiency. Obviously the restrictions implied in the budget sector are much stronger and effective than the mechanisms for regulation of salaries in the economic organizations.

During the past two years differentiation between salaries in the budget and salaries in the real sector is tending to decrease. While in 1996 salaries in the real sector (including the private) exceeded budget salaries with more than 57%, in 1998 the difference reduced to 28%. The decrease in 1998 is particularly evident (with 22.5 percentage points). There are different kinds of reasons, but the fundamental ones are the financial difficulties of the economic organizations and the preferential increase of salaries in organizations supported by the budget.

Similar problem emerges in the fragmentation of salary between different branches of industry. The breach between labor remuneration in monopolistic and subsidized branches (energy production, coal production, petrol industry, etc.) and the rest of the branched enlarged, but in the last few years it subsided.

3. *Backwardness of minimal payments from the salary.* The use of the minimal salary as a mean for regulation of incomes in the budget sector leads o its irregular indexation to inflation. This has a negative social effect. It substantially dropped behind the inflation and the mean salary (Fig. 3) and did not fulfill its economic and social function.

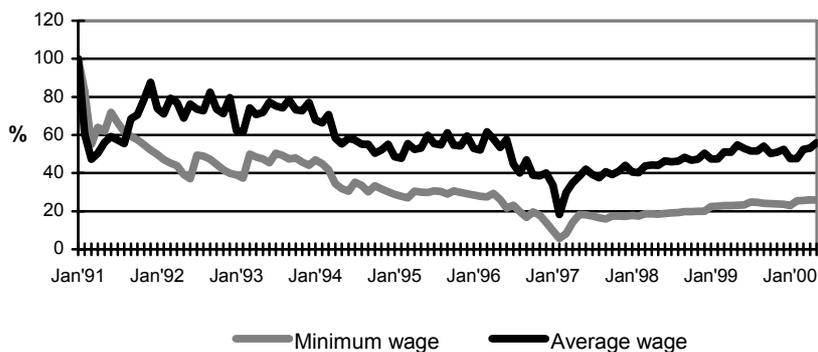


Figure 3. Dynamic of Real Quantities of Minimal and Average Work Salary, Jan.'91-May'00 (Index Jan.'91=100)

<sup>4</sup> Excluding the private sector.

Similar drop behind the mean salary can be observed in all other minimal payments of social benefits (social pension and basic minimal income). This reflects in increase of income inequality among population with low and average incomes. The lowest proportion between those quantities is recorded during the crisis of 1997 (Table 2). The improvements, which emerged in the past two years, are a positive sign for the desire of this population stratum for better social position, but they are not big enough to settle its problems. The level of guaranteed minimal income (GMI) and social pension does not exceed 20 % of the average salary. In conditions of very low salaries this predestines the one who receive such benefits to misery.

Table 2

Proportion between Soma Social Benefits and The Average Work Salary

Proportions	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999*
Min. salary/ average salary	43.1	54.2	35.9	38.3	35.7	32.6	27.4	23.9	24.6	31.2
Min. pension/ average salary	27.2	35.3	22.0	23.5	23.0	20.6	16.8	15.6	17.4	17.5
GMI/average salary	18.5	33.9	19.4	23.9	21.0	18.7	16.4	13.6	14.9	18.2

\* - Preliminary data.

Calculated on the base of data from Ministry of Labor and Social Policy.

4. *The unfavorable restructuring of incomes.* In the past period restructuring of the basic sources of incomes is recorded. This restructuring is unfavorable from the perspective of market relationship development. The major tendencies are: *decrease the portion of salary, increase of incomes from small private farming and slight increase of the portion of incomes from independent economic activity.*

- *The portion of the salary in gross household income* is substantially reduced. It drops from 70% in 1989 to 38% in 1997 and increases again in 1999 to 42%. This negative trend is a consequence of the combined action of numerous factors: reduction of the number of employed, limitation of salary's growth, increase of the incomes from independent economic activity, dividends, interests, etc.

In this general tendency clearly distinguishes the increase of the portion of incomes received through irregular and additional employment. The low level of payment from the major occupation encourages employees to search for additional sources on income through partial additional employment, temporary labor contracts, etc. The portion of this source of income increases more than 11 times (from 0.4% in 1990 to 5.3% in 1999).

- *The increase of the portion of incomes from small private farming* is a feature, which characterizes the neutralization in economy. This definitely is a natural reaction of the population against the inflation, but it effectively impedes the

development of market mechanisms in economy. This way the households are inclined to preserve and compensate the level of consumption in conditions of high inflation and largely unfavorable economic environment. As a direct result of the low inflation in 1998 and 1999 the portion of this source of income decreased. Despite its drop with about 7 percentage points, the portion remains relatively high (17.7%).

- *The portion of incomes from independent economic activity* (enterprise and ownership) changes according to the development of the private sector. According to the economic situation its level changes from rapid enlargement in 1990-1994 period (from 0.4% to 3.7%) to steady increase (5.2% in 1999). Because this are incomes from average and small private enterprise, their development has a positive impact on economy and transition to market relations.

5. *Not declaring actual salaries in the private sector.* The regular concealing of the actual level of salary in the private sector is one of the elements of the income crisis. Many of the private companies (mainly small and average) declare level of payment close to the official minimal salary. Meanwhile they give much higher remunerations. The purpose for the employers to do this is to minimize the price for working force in order to decrease the taxation and insurance burden. The effect of this activity has three dimensions: 1) unrealistic statistics for salary; 2) direct losses for the budget and the social funds, because of low installments; and 3) insurance on the base of the minimal working salary leads to lower pensions.

The official statistics for salary indicates substantial differences between public and private sector (Table 3). In the first the average salary is about 39-40% higher in 1997-1998. This difference dropped to 21% in 1999.

Table 3

Average Monthly Work Salary in the Public Sector, 1997-1999

	1997	1998	1999
Mean salary in the public sector in denominated levs	142	208	221
Mean salary in the private sector in denominated levs	102	148	183

Source. Statistical Yearbook, NSI, 2000.

### Social and Economic Effects of Income Policy

The described unfavorable tendencies in population income development during the 90's have clearly expressed economic and social effects. In the social aspect predominate the expansion of poverty, fragmentation of working force, and social conflicts. In economic aspect the side effects of the crisis of incomes are the decrease of motivation for work and labor productiveness, reduced supply and demand, and expansion of economy in shadow.

1. *Increase of economic inequality and poverty.* A direct consequence of the crisis of incomes is the social polarization of population and the expansion of poverty. During the 90's in the Bulgarian society formed a bipolar model of social stratification. The greater part of population received low incomes, a small part received average incomes, and an even smaller part – high incomes. The household disproportion, measured by the coefficient of Gini, has a tendency of increase up to 1995; after that it slowly decreases. For 1999 the coefficient of Gini was 0.31<sup>5</sup>, which is closer to the one in countries with developed market economy.

The process of polarization was transferring incomes from low-income and average groups to high-income ones. Very indicating for that process is the decrease of the relative portion of income of the lowest income group and increase of the portion of the highest. The proportion of household income from the endmost deciles groups (the 10% with highest and with lowest incomes) increased from 7.8 in 1992 to 11.9 in 1995 and dropped to 8.9 in 1999.

Despite the lack of officially adapted poverty line, numerous surveys show a substantial increase of the poor. In the past seven years (1990-1997) the portion of population with incomes under 50% of the mean income nearly doubles – from 7.9% in 1990 to 12.2% in 1997<sup>6</sup>. The situation is similar when using other indicators for measuring poverty. For example, the portion of population living under the line of poverty, measured through the living salary, increases from 49.7% in 1992 to 63% in 1996.<sup>7</sup> Despite the fact that the discussed data depends on the method of definition and measurement, they clearly indicate a tendency of deterioration and expansion of this phenomenon.

2. *Fragmentation of working force.* The process of fragmentation of working force is presented since the beginning of the reform. As was previously mentioned, it embraces on one hand the employed in the budget and non-budget sector, and on the other the employed in the different sectors of economy. Moreover, the income disproportion increases for those involved in the market of labor, as well as for those outside it (unemployed, retired, and others receiving social benefits).

3. *Decrease of consumption.* The most considerable effect from the crisis of incomes is a significant decrease of the population's living standard. A model of consumption, specific for the countries with low living standard, was formed in the 90's. It is characterized with the following three tendencies:

- *Drastic decrease of personal consumption.* During the whole period of transition the real consumption of the population largely decreases (see Fig. 4). For the 1990-1999 period the consumption expenditures of a household member decrease with about 65%. After the initial collapse in 1991, a more significant

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<sup>5</sup> Budgets of Households in Bulgaria, NSI, 1999, p. 13.

<sup>6</sup> For more information see Poverty in Conditions of Transition: Supporting Formulation and Implementation of Policies and Strategies "anti-poverty". ILO-UNDP, 1998.

<sup>7</sup> Ibid.

decrease is presented in 1994, 1996, and 1997. The level of consumption in 1997 is 25% of the one in 1990.

The achieved economic stabilization and relatively high growth of incomes in 1998 had a positive impact on purchasing power of the population and respectively on the level and the structure of consumption. During this year the amount of household consumption expenditures reached its highest growth since the beginning of the 90's. The actual gross expense of a household member increased with 31.2% in comparison with 1997. The consumption growth after the crisis of 1997 is close to the 1996 level.

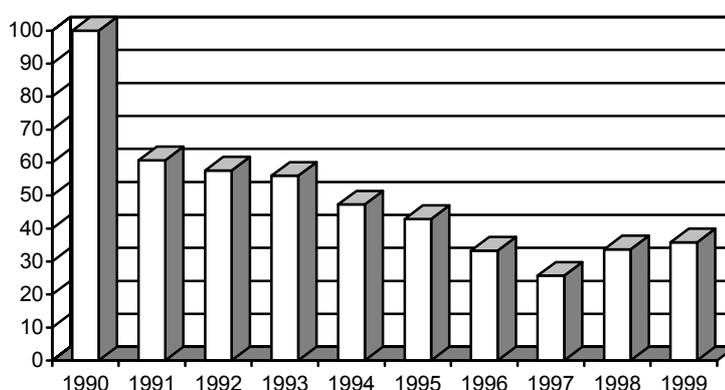


Figure 4. Dynamic of Real Gross Consumption Expense for the 1990-1999 period.  
(Index 1990=100)

- *Naturalization of consumption.* In order to preserve the level of consumption in conditions of high inflation and low incomes the households increased their consumption in kind. In the years of crisis aggravation the portion of consumption in kind in the gross expense increased with about 5-6 percentage points over the usual level (10-12%). This reduction of market consumption on behalf of the consumption in kind has a direct negative effect on the economic growth. The limited role of consumption market lead to inefficient production and depress of investments. In Bulgaria the perspectives for substantial decrease of the role of consumption in kind are not considerable, because of the years-long tradition and the role of small private farming in nourishing the Bulgarian household;

- *Restructuring of consumption expenses.* The decrease of real consumption is accompanied by extensive restructuring of consumption expenses. The tendency is toward increase the portion of expenses for satisfying the basic, vital needs of the population and respectively toward limiting the expenses for commodities for long-term use, education, and leisure time. The expenses for food, housing, and

energy, which are basically the urgent needs, compose 64% of the household budget in 1997 and 51% in 1992. In 1999 the positive income and consumption growth reduced this portion to 59%. However it remained high. The structure changes in the expenses for food are especially drastic. The relative portion of expenses for food in the gross consumption expenses increased from 36% in 1990 to 55% in 1997 and decreased to 44% in 1999.

The second substantial change in the structure of household expenses is related to expenses for electricity, heating, and other energy sources. Due to the regular increase of the energy prices, disproportional to the incomes, their portion in the gross expense increased. For the 1992-1999 period the portion of expenses for energy raised from 8.2% to 13.9%. This reflected in decrease of the portion of other shares in the household budget, including the expenses for food.

4. *Decrease of the inclination toward savings.* The decreased purchasing power of the incomes reflected negatively on the level and structure of population savings. During the entire period of the 90's there is a specific tendency toward reduction of savings. It is most clearly expressed in the years of high inflation and aggravation of the economic crisis. The low level of savings is accompanied by additional loss from the negative actual interest.

The fact that in some years from the considered period (1991, 1994, 1995, and 1996) the average monetary expenses of a member of household exceeded the monetary incomes is very indicating. It is obvious that the difference is covered by current savings and loans. This is a typical practice for the low-income groups. Despite all that, the tendency in the inclination toward consumption (respectively savings) can be perceived on the basis of the gross income of a household member (Table 4).

Table 4

Average and Ultimate Inclination toward Consumption of a Member of Household on the Base of Gross income, 1995-1999

	1995	1996	1997	1998	1999
Average Inclination toward Consumption	0.70	0.81	0.75	0.75	0.77
Ultimate Inclination toward Consumption	-	1.01	0.74	0.74	1.22

Source: Bulgarian household budgets, NSI, 1999.

The data shown in Table 4 clearly outlines a tendency toward decreasing the savings. The high inclination toward consumption in 1996 and its decrease during the crisis of 1997 is unusual. Despite the nominal and real increase of the incomes in 1998, the inclination toward consumption does not change compared to the previous year. The reasons are probably complex. On one hand, the extremely low level of consumption in 1996 and 1997 stimulates its restoration. On the other hand, the low interest from bank deposits does not encourage saving.

5. *The weak relation between salary and labor productivity.* Viewed in the context of decreasing real salary the restrictive wage policy has another significant economical effects. Most substantial is the consequence for productivity and economic efficiency. It has two major forms: 1) decrease of motivation and increase of absents among the workers, and 2) weak relation between salary and labor productivity.

The decrease of real salary since the beginning of the 90's with nearly 50% inevitably had a negative impact on the motivation for work. The absence among the workers from all economic sectors rapidly increases during the entire period. This is confirmed by the increase of time for additional working activity and the incomes received from it. As was previously mentioned, the relative portion of those incomes rapidly increases.

The level and development of salary in almost all economic sectors vaguely correlate with the production and financial results. On national level it is expressed in discrepancies in the development of real salary and gross added value (GAV) of an employed person (Fig. 5).

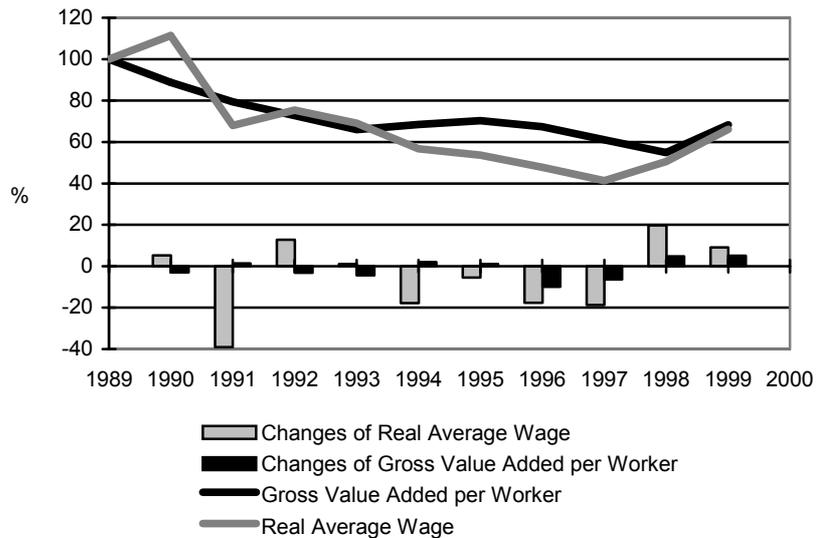


Figure 5. Dynamic of Average and Real Work Salary and Productivity,\* 1989-1999 (Indexes and rates of increase)

\* Measured as gross value added per worker.

Lack of correspondence between the real salary and labor productivity is most clearly presented in the 1993-1997 period. At the end of that period the real salary is 20 percent points less than productivity. Beside this the increase rates have opposite signs and very different absolute values. The rise of salary over the

level of productivity in 1998 and 1999 compensates the difference without affecting inflation.

Between the salaries and the results on branch level exists even higher inconsistency. This is very characteristic for industry branches, where mechanisms of negotiation and indirect regulation of salaries are applied. The facts show that better economical results in profitable branches do not lead to higher remuneration, and the opposite – in unprofitable branches are played higher than the average salaries<sup>8</sup>. From here is the conclusion that labor productivity is not a factor for determination of the short-term salary adaptation. For example, during the entire period after 1991 the nominal payments in the financially supported and low productive companies grow even faster than those in the effective ones. The major reason for this is the applied till 1998 mechanism of obligation (through the formula for taxation of revenues for salary). Through this mechanism is attempted to centrally impose the desired proportions.

6. *Stimulating the informal sector of the economy.* The low level of payment in formal economy has definitely contributed for the expansion of the informal sector. The stimulation is mainly done in two ways: through incomes and through consumption. The tendency toward earning additional incomes through secondary employment compels work force to search for employment wherever there is. The most favorable field is the informal economy, which offers advantageous conditions of payment (without taxation and insurance). The other way for stimulation is the personal consumption. The low living standard forces the population to search for the cheapest markets, which as usual are the “black markets”, namely those where the prices are lowest, because excises, customs, duties, taxes and others are not paid.

7. *The population incomes are not major source of inflation.* The main positive effect from the conducted during the 90's wage policy is that the incomes do not turn to prime source of inflation. This statement can be supported by numerous circumstances. First, the population incomes significantly drop behind the development of prices. The comparison of monthly pace of inflation with incomes shows that the level of salaries does not correspond to inflation trend and in many of the periods they have opposite direction. Second, the level of real salary in almost the entire 90's is under the one of productivity (fig. 7). Third, economic surveys of the dependency “inflation- salary” confirm the hypothesis for weak cause-and-effect relation between them<sup>9</sup>. More likely inflation determines salary.

### **Long-term Perspectives for Wage Policy**

Income policy in the coming decades would be formed entirely under the influence of the following two circumstances: Bulgaria's EU accession and

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<sup>8</sup> For more information see *Tzanov, V., D. Vaughan-Whitehead*, Macroeconomic Effects of Restrictive Salary Policy in Bulgaria: Empirical Evidence for 1991-1995. In: *The Bulgarian Economy: Lessons from Reform during Early Transition*. Jones and Miller, Ashgate, 1997, pp. 99-126.

<sup>9</sup> *Ibid.*

resolving instant problems with long-term impact. The actions of the government should be directed toward satisfactory solution of the major problem – sustaining the income crisis and elimination of the accumulated negative economic and social effects. This can be achieved through reformulation of the main priorities in wage policy and construction of adequate mechanisms that will assure the functioning of market relation in this field.

Having in mind these prepositions the following most essential priorities of wage policy can be formulated:

- *Protection of all kinds of incomes and their progressive enlargement according to the available resources;*
- *Struggle against poverty through developing determined programs and actions;*
- *Obliging the salaries with the economic and financial results;*
- *Decentralization and extension of the negotiations on branch level.*

*The stress of wage policy should be on protection of all kinds of incomes and their progressive enlargement according to the available resources.* The low level of incomes and the forthcoming EU accession imply that this priority should be of main importance in the coming years. This requires conducting a policy such that would distribute more incomes according to the scarce resources.

The major aspects are 1) protection of all kinds of income from future decrease, and 2) progressive restoration of incomes from the erosion during the 90's. The realization of the first aspect is based upon application of adequate mechanism for indexation according to the expected inflation. The second aspect can be achieved only in conditions of economic development. It should be a consequence of the economic growth and re-distributive policy.

In the process of negotiations and preparations for EU accession Bulgaria should not commence unrealistic tasks concerning increase of salary and all other incomes. For such a short period it is impossible to get closer to the EU standard. The objective should be to create conditions and mechanisms, which would guarantee increase of incomes for all population strata as a result of the economic growth. The creation of favorable environment depends on reconsideration of the mechanism for formulation of the minimal salary, for negotiation of salaries in the real sector, for determination of salaries in budget organizations and state administration, and for social aid.

The changes that appeared in the mechanisms for formulation of minimal salary in 1999 were aiming exactly at these areas. The minimal salary is no longer a base for determination of salaries in the budget field, but the mechanism for its increase is related to the average salary.

The reform in the system of remuneration in the budget sphere is closely related to the reform in state administration. The complex character of that reform implies actions directed toward seceding the minimal salary from the initial salaries in budget sphere, toward creation of a new system for determination of salaries,

toward reduction of unemployment, toward increasing salaries and improvement of the distorted structure of remuneration.

*Struggle with poverty should become one of the most important priorities of wage policy.* The substantial expansion of poverty during the past decade implies the need for developing and adapting a new national program for measures against poverty. An active policy for struggle against poverty should be intended for definition and determination of an official line of poverty and developing a strategy and programs for reduction of poverty. The conducted surveys in this field<sup>10</sup> suggest a wide range of methods, evaluations, and proposals for the solution of long-term problems.

In Bulgaria, like in other countries, poverty is regarded as a multifaceted phenomenon, which includes absolute poverty (lack of means for satisfying the vital needs), as well as relative poverty (lack of proper human possibilities for dignified living). The strategic course of actions should have as its objective combination of those complement notions for poverty. In this respect, the field and direction of the struggle against poverty should not terminate only with wage policy. It requires decisive actions and policies in numerous aspects of social life (economical growth, employment, education, social protection, etc.).

The strategic goal of struggle against poverty is economic growth, directed toward the poor. In other words, a growth such that would assure higher employment and incomes for all categories of population. For example, more extensive aid for agriculture, small and middle-sized companies, and particular economically underdeveloped regions would make the growth beneficial for the poorest population groups. The efforts should be based upon correlation between the economic and social policy.

The wage policy, concerning the struggle against poverty, is an outcome of the economic policy, which is a basic instrument for generation of incomes and employment. For this purpose more concrete measures may be used. Measures for increasing employment among the poor and guarantees that the component income, on which the poor rely, will not drop behind the common economical growth. The more concrete directions and measures for generating employment and incomes can be summarized in the following:

- Preferring policy, which leads to more significant growth of incomes;
- Encourage a faster increase of minimal incomes. The wage policy should secure correspondence in the increase rates of minimal incomes (minimal salary, pensions, and guaranteed minimal income) and average income;
- Use of an official limiting line of poverty as a base for the policy of social benefits. Determining an official limiting line of poverty, which would cover the basic

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<sup>10</sup> Scrutinizing all questions related to the methods for evaluating poverty, its spread, mechanisms for social benefits and proposals for administrative and financial governance of the system under the auspices of ILO and UNDP: "Bulgaria: Poverty in Conditions of Transition. Supporting Formulation and Implementation of Policies and Strategies 'anti-poverty'", ILO, 1998.

needs of a household, is a major element in the reform of wage policy. On this base should develop the programs for struggle against poverty and system for social protection.

*Associating the salary with the economic results should be a priority, embraced on all levels of wage policy.* This way their pro-inflation influence would automatically decrease and there will be no need for special regulative measures. The problem is on what level this correlation should be done and what instruments should be used. The practice shows that an effective connection cannot be achieved on the base of centralized method and mechanisms. It should be done on micro-level through the mechanisms of cooperative labor negotiation without the implementation of regulative measures.

The free formation of salary in Bulgaria, which is based on cooperative labor negotiation and market relations, depends on the creation of favorable economic environment where the need for regulation of salary would expire. In this environment the economic subjects would have rational behavior in formation of salaries. The stimulation of remuneration and labor motivation should be done through mass implementation of modern systems for remuneration (share of the profit, share ownership, etc.).

The exchange of central regulation of salary with system for direct negotiation can prove an adequate measure for achieving non-inflation growth of salaries without applying restrictions. Such a policy is based on direct negotiation with the social partners on different levels. The increase of the salary is fixed in the context of social agreement on national level (between the state, the employers, and the syndicates). The achieved agreements are either proposals or obligations on lower levels (e.g. companies). This policy is proved efficient in some countries in transition (Hungary and Poland) and some western countries (Italy).

The problem about its implementation in Bulgarian conditions is in the insufficient development of collective negotiation on branch level. Increase of the role and the importance of collective negotiation on this level is required for the accomplishment of a larger social and economical effect.

This can be done through *gradual decentralization of wage policy and of the state from direct or indirect regulation (determination)*. In the current conditions the presence of the state in this sphere is very perceivable. It determines minimal salary, salaries in budget sector, almost all additional remunerations, mechanisms for regulation of salaries in the public sector, taxation and insurance, etc. Obviously, the state intervention in determining the incomes is too extensive for a market economy.

The directions of decentralization should not be regarded as a total withdrawal of the state from wage policy. The incomes should be fixed according to the particular circumstances and conditions. For example, on the current stage a proper strategy for decentralization is the abandonment of central regulation of salaries and restrictions over them, as well as determination of additional remuneration. The latter should be successively settled on branch level. In the

current situation the total decentralization of the minimal salary is not convenient. The state should determine an obligatory minimal size of salary. Otherwise there can occur situation, in which the level of minimal salary in many branches and activities (mainly in the private sector) would happen to be below the line of poverty, and this would generate social tension.

The discussed priorities should be regarded in the context of a more universal set of actions and reforms directed toward equaling the conditions and wage policy in EU countries. This can be realized through skillful combination of uncontroversial instruments and mechanisms, which would assure a more efficient wage policy. Definitely the efficiency would depend on decisive changes in legislative, institutional, and economical area.

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The restrictive wage policy conducted in the 90's has in a wide respect contributed to the crisis of incomes and its effects. The domain and the range of this crisis are expressed as a definite decrease of real incomes, increase of the differentiation of remuneration, a symbolic meaning of social benefits, and creation of unfavorable for the development of market relations structure of incomes. The economic and social effects are related to wide expansion of poverty, decrease of consumption and savings, discouragement of the working force, weak association of salary with economic results, stimulation of informal economy, etc.

The development of these negative trends and the achieved financial destabilization put the existence of this policy under question. It needed a greater precision and determination in setting priorities, strategy, and instruments. This is required for maximizing social and economic effects in conditions of limited opportunities.

The fundamental solution of the crisis of incomes is directly related to the accomplishment of a real economical growth. In the current conditions the main objectives of wage policy should be directed toward improving the effectiveness of social protective mechanisms, and meanwhile to be tightly connected with the financial capacity of the budget and the social activity. It is logical for such a policy to be based on the following priorities: protection of all sources of incomes and their progressive enlargement according to the available recourses; determined actions against poverty; association of salaries with economic results and decentralization and expansion of branch cooperative negotiation.

These priorities are related to a set of reforms with long-term impact. The reforms can be based upon concrete actions directed toward reconsideration of the role, the functions, and level of minimal salary; change of the mechanisms for determination of social benefits and salaries in the budget sector, development of mechanisms for associating the salary with the efficiency of the economic organizations and labor productivity.