Garabed Minassian, Professor, Dr. Ec. Scs.

MACROECONOMIC POLICY: RULES VERSUS DISCRETION

The article discusses the fundamental principles of macroeconomic policy. It traces the development of macroeconomic policy ideas, and, particularly, the transition cycle from adhering to strictly defined rules to free discretion and vice versa – back to restricting the freedom of implementation of macroeconomic policy instruments. The article analyses the advantages and disadvantages of discretion as compared to the management that follows strictly defined rules. The special focus is on Bulgarian practice and tradition. The article proves that throughout history Bulgaria's governing elite has failed to take advantage of discretionary management and it has been rather the norm for the government to abuse (deliberately or not) the right to a greater management freedom. On the contrary, when macroeconomic management has had to adhere to specific imperative restrictions, positive results have prevailed. Bulgarian practice has confirmed the theoretical statement that the losses resulting from poor discretionary national macroeconomic policy are much greater than the benefits resulting from a well-defined policy, carried out consistently. The nature of and changes in monetary policy during the 1990s and the introduction of the currency board arrangement are a telling contemporary example of this statement. The recent policies of the governing elite have been focussed on fiscal policy, bringing about continuing attempts for large-scale economic experiments, in spite of the lack of clear estimation of the possible consequences. The article's analysis outlines some suggestions and recommendations, which are based on the adherence to clearly defined rules in fiscal policies and focuses the efforts of the state on establishing and developing adequate market institutions.

JEL: E6; E61; E66

Development of Economic Theory

Up to the world economic crisis of the late1920s and early 1930s, world economy was managed according to clearly defined rules and regulations. In general, the rules required adhering to the gold standard in monetary policy and keeping the budget balance in fiscal policy. Any exceptions to the rule were connected with a sharp rise in unproductive expenses, i.e. during prolonged military activities. This was the situation in Bulgaria by the beginning of the wars of 1912.

The world economic crisis necessitated a radical change in macroeconomic management ideas and brought about the first breakthrough towards a more selective implementation of discretion. In search of a more effective anti-cyclic policy J. Keynes proposed and established the active budget policy principle. The budget balance ceased to be the peacetime imperative for governments any longer and they began to use fiscal policy levers in order to encourage sustainable and consistent economic growth instead.

The need for new policy options in macroeconomic management became even more acute after the collapse of the gold-dollar standard at the beginning of the 1970s. The Bretton-Woods system of 1944 laid down the foundations of the IMF and succeeded in maintaining the international financial and currency stability, based on the gold backing of national currencies, relatively stable. The complete abandonment of the gold standard resulted in the crash of the second major obstacle on the way of adopting discretion – the freedom of carrying out an independent and unrestrained monetary policy.

The countries could thus relatively freely operate with the macroeconomic instruments available. Hard-line macroeconomic policy's landmarks collapsed. Budget deficit and state debts were no longer a scare for politicians, who discovered the unlimited resources provided by the issuing of money and regulation of money circulation. The age of monetarists began, who followed the principle "*Whoever manages the money he will manage everything*".[1]

Delivered from the chains of the budget in balance and the gold backing, macroeconomic and political elites enjoyed a sudden freedom in social and economic management. Discipline gave way to imagination, the control over the budget and finances – to frivolous populist ideas and increasingly corrupting red tape practices.

The free use of the macroeconomic tools reinforced further the division of the world. Those societies that were better organized (and richer) managed to impose effective means of control over their governing elite and this resulted in positive outcome. In other areas, dominated by poor discipline, weak control and traditions of prevailingly dictatorship-like style of governance, this led to marginalization. War conflicts multiplied, financed by unrestrained money issuing and accompanied by an ever-increasing poverty; inflation rates in these countries rose to unexpected levels even during peacetime periods. In the case of Bulgaria market prices during the extremely hard and catastrophical years 1912-23 (during the war and after it) were estimated to have risen 30.5 times; in comparison, the same estimation for the peaceful last 10 years of the XXth century was 2100 times! The end of the XXth century was a period when the inflation rates' record was broken in various corners of the world (for example in Latin America, Yugoslavia).

As a rule, changes in economic conditions result in shaking the government foundations. Principles have long-term implications, whereas particular government methods and styles are transient. After the ecstasies over the "*free management*" there came the time for a deeper rethinking and search for counter actions aimed at stabilization. It was time for differentiating between the tools of management – sustainable economies, that had managed to create enough effective instruments for control, could make use of the carefully assessed opportunities provided by discretionary management, whereas other countries would be better off if they adhered to regulations-based management.

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[1] Similarly, when analyzing the political struggles around the Bulgarian National Bank throughout Bulgarian history, R. Avramov concludes: *"… the one who controls the Central Bank, controls the state as well*" (*Аврамов, Р.* Неосъщественият консервативен манифест в България. - В: *Ст. Бочев.* Капитализмът в България. Sofia, 1998, p. 44).

The preferences for discretion in macroeconomic management do have eligible theoretical foundations. In 1977 J. Meade (who was a close friend to J. Keynes and shared his views) was awarded the Nobel Prize in economics for his "*contributions to the theory of international trade and investment flows*". In his fundamental works he outlined three major goals of macroeconomic policy[2]: (1) Maximum employment possible; (2) Acceptable inflation rates; (3) Balance of international payments. Furthermore, in accordance with *Tinbergen's rule*, stating that for every goal of economic policy there should be a corresponding action as an element of economic policy, J. Meade broadly defined three types of interacting economic policies. ***Firstly***, to achieve maximum employment implies to carry out adequate monetary and fiscal policies, which will subject the money supply, tax burden and state savings to an overall and rational use of internal financial resources. ***Secondly***, the achievement of acceptable inflation rates requires the exertion of control and regulation of salaries in accordance with labor productivity. ***Thirdly***, to prevent deficit in the balance of payments and to provide for the competitiveness of exports, the currency exchange rates should be controlled and regulated. As a whole, J. Meade's economic philosophy implies and requires discretion for almost every specific macroeconomic policy.

M. Friedman – another influential economist of the 1970s, is a staunch supporter of the liberal view of non-intervention of the state in the economy. This thinking is in line with the so-called doctrine of the "*least intervention*", going together with *"… the widespread belief that the best macroeconomic policy is to do nothing, or to follow a rigid monetary rule, which is almost the same thing*".[3] According to the apt comment of F. Von Hayek this doctrine "*is not an argument not to do anything, it is an argument to do little and what's more to do it step by step*". In spite of the fact that he was an active supporter of the monetary economic theory, he was firmly convinced that "…*fiscal policy won't work and active monetary policy will deteriorate the business cycle and raise inflation rates*".[4]

M. Friedman's analysis leads to the conclusion that discretionary monetary policy is too often thought of as leading to undesirable and unfavorable results. This is mainly due to the fact that there are many and prolonged time lags between, on the one hand, current economic problems, and, on the other hand, the moment when the change in money supply begins to influence economic processes. Three such time lags have been found out: (1) The Central Bank needs time to identify the economic problems; (2) The real change in money supply implies certain distance in time from the moment when the decision is taken; (3) The impact of whatever change in money supply on real economic processes

[2] *McCarty, M.* The Nobel Laureates. McGraw-Hill, 2000, p. 290.

[3] *Hahn, F., R. Solow.* A Critical Essay on Modern Macroeconomic Theory. The MIT Press, 1997, p. 150; "*The state as the night-watch*" is yet another universal well-known saying, defining the functions of the state. (*Шумпетер, Й.* История на икономическия анализ. Book II, Sofia, 2001, p. 43).

[4] See *Блаут, М.* Големите икономисти след Кейнс. V. Tarnovo, 1998, p. 299; *Pressman, St.* Fifty Major Economists. Routledge, 1999, p. 158.

also lags in time. In addition, experience has proved that there is too great a dispersion around the precision and adequatness of discretionary decisions. Thus monetary policy does not bring about the expected and desired efficiency. Often the decisions made do not correspond anymore to the specific development by the time these decisions are able to have a real impact.

The analyses of monetary policy practices have resulted in the definition of the famous rule for fixed increase of the money supply even in sustainable leading economies. M. Friedman appeals for "*tiding the hands of central bankers*" and maintaining a rate of 3-5% yearly growth of the money supply.

Later on, M. Friedman's assumptions and suggestions were backed analytically by the school of rational expectations. Using econometric techniques, R. Lukas, the most eminent representative of this school, proved that monetary policy "*… is ineffective in raising and stabilizing output*". The only thing it can stabilize is the long-term price trend and that is what it can be used for. The response of the school of rational expectations was definitely negative too, when it came to the possibility of programming and smoothing short-term variations by means of discretionary decisions.[5]

R. Lucas went beyond these findings. He went on formulating some specific recommendations of principle for macroeconomic policy. The latter should be predictable, in order to (1) minimize uncertainty for the people and economic agents when it comes to the behavior of the governing elite and the future effects from their decisions, and, (2) reduce macroeconomic management's ineffectiveness, resulting from making too costly managerial mistakes.

The followers of the school of rational expectations strongly question the advantages of large-scale discretionary macroeconomic policy. They share the idea that the rational response of economic agents and the public in general may weaken the effects of macroeconomic policy, and may even influence its impact, channeling it to unexpected and unforeseen directions. R. Lucas's logical final and compact (and impressive!) conclusion is that "*the correct policy for business cycles is no policy at all*". This conclusion stems mainly from the hypothesis for the neutrality of macroeconomic policy.[6]

The development of economic ideas led naturally to the theory known as *constitutionalism*. J. Buchanan is an eminent representative of this trend in economic thought. He broadened the requirement for enacting and imposing rigorous rules in macroeconomic management to go beyond the monetary policy and reach fiscal policy as well. The role of the expert in political economics was identified as the art of defining some proper rules for behavior and management and the ability to explain their benefits to the various members of society and to society as a whole.

[5] *Niehans, J.* A History of Economic Theory. The J. Hopkins University Press, 1990, p. 515.

[6] *McCarty, M.* Op. cit., p. 156-157; *Blaug, M.* The Methodology of Economics (Or How Economists Explain). 2nd Edition, Cambridge University Press, 1992, p. 203.

J. Buchanan justified imposing effective rules (as an antipode to discretion) with the necessity of limiting excessive expansive political activities[7]. In principle constitutionalism stands for the enacting of some restrictions, which eventually affect free choice opportunities. This delicate point of economic theory has both individual and collective implications. The predominant view (shared already unanimously?!) of economists 240 years after A. Smith's "*The Wealth of the Nations*" is based on the concept of the free choice of the individual. This position correlates in a natural way with the free functioning of market forces and mechanisms, which in turn secure effective growth.

Individual freedom in contemporary economic theory reaches as far as the so-called "*instrumental freedom*", defined by A. Sen[8]. He thinks the various manifestations of individual freedom and economic progress are inextricably bound up. According to A. Sen the instrumetalism of the category in hand means preconditioning and causation.

From the managerial point of view it is worth going into prioritizing the various types of freedom. A. Sen put first *Political freedoms*, which guarantee the unrestricted right of the individual to evaluate and publicly comment the actions and choices of macroeconomic elite, and moreover, to do this from the viewpoint of his/her private selfish interest. *Economic facilities* provide free choice of the type of work and economic activities, corresponding to individual preferences. The main point here is the unrestricted use of accumulated individual economic resources, provided it does not infringe on the rights and interests of others. *Social opportunities* guarantee equal and unrestricted access to education, health care and so on – freedoms, connected to the human right of pursuing a better and happier life. *Transparency guarantees* provide the transparency of information and accessibility of economic and community interactions. The absence of this freedom results in increasing corruption, shadow economy and financial offences. *Protective security* guarantees a system of protection against the exclusion from civil structures and marginalization when caused by factors, going beyond individual powers.

These freedoms are both a prerequisite for (a cause) and a consequence of economic development. Higher standards of living go together with better conditions (and the requirements are higher as well) for guaranteeing greater freedom. The opposite is also true – the absence of guarantees for the fundamental human rights and freedoms is an obstacle to economic development. In other words, an underdeveloped economy indicates inadequate human rights guarantees. Economic prosperity is unconceivable without the respect for fundamental human rights and freedoms. Macroeconomic discretion can bring about positive results only given the imperative precondition of effective human rights guarantees.

A contemporary article of Fraser Institute, Canada, has empirically supported the concept for the instrumental nature of human freedoms. The

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[7] *Buchanan, J., R. Musgrave*. Public Finance and Public Choice: Two Contrasting Visions of the State. The MIT Press, 3 rd printing, 2000, p. 107.

[8] *Sen, A*. Development as Freedom. Anchor Books, 1999, p. 38.

economic freedom of 123 countries has been estimated[9] in the article. The authors have found out a very strong correlation between the economic freedom index and the gross disposable income per capita according the PPP estimation.

The principle of respect for human rights and freedoms sounds differently when it comes to collective behavior. The ideal for complete concurrence between individual and collective value systems remains purely theoretical and unattainable. Collective choice is determined and made by individuals, based on their personal motivation. Due to their collective action it is more or less an expression of the individual choice and interests of the managing elite. Thus the enforcement of rules for governance and behavior is being interpreted as a guarantee (insurance) for protection of the collective interest.

J. Buchanan analyses in detail both the opportunities for and the practice of actual discrimination of minorities by the dominating majority. He quotes the various solutions to this problem, suggested by the Swedish economist K. Wicksell. He holds the idea that the change in the majority principle in putting important issues to the vote towards a better representation of the will of minorities (the hypothetical goal being complete unanimity) will increase (not decrease) the effectiveness of collective choice.

To incorporate the principle of plurality in economic management regulations as an element of its management system will undoubtedly provide the means for restricting dubious and problematic discretion and will transform the decision-making mechanism. The dominating party-like dictatorship practice will have to give way to far better grounded arguments as means for persuasion, as well as to the necessity of taking the interests of the minority into account. This will also be a kind of school in the art of politics and management, requiring the ability to recognize and respect the interests of various groups at various times. This is especially true Bulgaria, where the traditional behavior of parliamentary elections winners has been characterized by arrogance and disrespect for the rights of the losers.

The principle of following some strict rules for macroeconomic management is applicable not only to the monetary, but to the fiscal policy as well. M. Friedman has developed such rules for monetary policy. He thinks that governance should aim at achieving a steady and continuous growth of the money supply and should give up the so-called *fine tuning* policy (i.e. a policy, which constantly brings macroeconomic measures in conformity with temporary fluctuations, trying to outwit nature).[10] Another rule, that is significantly more severe, is the adoption of a currency board arrangement. It actually implies a non-intervention in the money supply, accompanied by a number of restricting rules in other spheres. The system of European monetary union (EMU) is yet another non-discretionary approach to national money supply management.

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[9] *Gwartney, J., R. Lawson.* Economic Freedom of the World: 2002 Annual Report, June 2002. (Internet: www.fraserinstitute.ca); Bulgaria scores 97th together with Cameroon and Nigeria.

[10] According to J. Schumpeter *"… fine-tuning does not look like real regulation*" (See *Шумпетер, Й.* История на икономическия анализ…, Book II, p. 483).

J. Buhanan goes further, standing for a strict regulation of the fiscal policy as well. Such an example is the requirement for maintaining the budget deficit at zero, or, generally, to maintain the national budget in balance regardless of the condition of the economy. Deliberately containing the growth of the national debt by means of fixing its limit (keeping the debt/ GDP ratio within certain limits) is yet another example of management based on rules and not discretion.[11] Practice itself requires enacting certain key rules in fiscal policy, although these are not always viewed as such. Beyond these rules, however, opinions vary and often the unwillingness for discretion is viewed as managerial weakness (as being inactive).

Theory still contemplates how sustainable the effectiveness of a combined macroeconomic management (i.e. regulating certain activities and leaving others to discretion) can be. The question is to what extent such a type of management is able to pursue and achieve its long-term goals. This issue has to be structured in terms of scale and international status. Things are not the same in Bulgaria and the United States for example. Processes in large-scale and stable economies are far more inert; traditions there also play a stabilizing role. When it comes to Third World countries in transition to free market economy, where economies are of higher instability and structural interactions are not clear, a combined policy can lead to unpredictable and unexpected results.

Effective governance no doubt requires that there should be coordination between the various elements of macroeconomic policy, and those of the monetary and fiscal policy in particular. The ideal combined policy would be the one that matches the advantages and security of regulated management with the active positive influence of discretion. This ideal match, however, is hypothetical and goes astray from real life. Theoretically, certain elements of discretion may reinforce the stabilizing influence of regulated management; however, the opposite is true as well – discretion may shake (completely or in part) the economy, which has already been stabilized by regulated management. Under certain conditions it would be inappropriate to allow for discretion which could have destructive impact on financial and economic stability. The crisis in Argentina in the beginning of this century was a demonstration how the licentious undisciplined effect of discretion prevailed over the restrictive, disciplining influence of regulations.

Another analogical problem is to what extent a market economy can exist or function in a country, where market relations do not dominate all spheres of economic life. This has been the situation in Bulgaria since the beginning of this century. There is enough evidence to say that the market has been dominant whenever it comes to goods, services and even labor. Capital markets, however, have not been functioning normally. The interest rates of three-month financial instruments (basic interest rate) issued by the Bulgarian Ministry of Finance in order to finance the budget deficit in the year 2000, were lower than the

[11] Art. 10 of the National Debt Law, adopted by Parliament on 17 September 2002,reads: "the relation between the outstanding part of consolidated national debt and GDP by the end of each year should not exceed the same relation from the previous year provided, is greater than 60%".

corresponding ones in Germany. Economic common sense would have us conclude that financial risks as a whole have been lower in Bulgaria than in Germany – and this would be economic absurdity. The problem here is that such a situation makes it possible to manipulate financial markets (incl. the market of deposits and credits) and distort market indicators and interactions.

The strength of a chain depends on the strength of its weakest link.

The Case of Bulgaria

The principle of restricting discretion in carrying out macroeconomic policy is especially relevant in the case of Bulgaria. Bulgarian tradition in macroeconomic management both during the period of transition towards market economy (since 1989) and as a whole (during the last 120 years) has proved that macroeconomic and political elites systematically abuse of their power over national wealth.[12] Bulgarian contemporary history has been most indicative of this fact – in the mid 1990s Parliament passed a number of amendments to the national budget that had all aimed at drastically expanding direct credits given by the National Bank. After the introduction of the currency board and the adoption of the Law on the Bulgarian National Bank in 1997, an effective ban was placed on BNB's direct or indirect involvement in operations, resulting in financing of the budget deficit.

Bulgaria's relations with the IMF have introduced a specific type of regulations in fiscal policy. These regulations are not imperative by nature; i.e. it was Bulgaria itself that has declared its willingness to cooperate with the IMF. Central European countries for example (Hungary, the Czech Republic, Poland, and Slovakia) preferred to discontinue their relations with the IMF as early as the second half of the 1990s and managed to do it. In the mid-1990s the Bulgarian government, headed by J. Videnov declared that they also directed their efforts towards paying-off Bulgaria's debt to the IMF. The macroeconomic team of the government claimed they had the knowledge, skills and abilities to handle the country's economic problems themselves, without having to conform to the IMF experts' supervision. Their venture lasted no more than a year and a half and was followed by a dramatic economic crash. Since then Bulgarian governments have been prudently following the advice of the IMF and experience has proved that the possible and probable failures have been evaded. The IMF institution dictates the rules, even though within some limits of admissible discretion.[13]

Modern Bulgarian history does not offer many examples of successful political and economic governance in the cases when the leading elite has acted independently, without foreign supervision. During the few years at the beginning

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[12] R. Avramov has exhaustively and consistently analyzed this process in his publication *Аврамов, Р*. Стопанският XX в. на България. Sofia, 2001.

[13] Bulgaria's relations with the IMF might have been contraversial at times and sometimes even got negative evaluations, but as a whole they influence positively the social and economic adjustment to market economy (See *Минасян, Г.* Финансова стабилизация и икономически растеж. Sofia, 2002, ch. II).

of the 1990s, when the political elite acted independently, Bulgaria was at the edge of catastrophe (for example the spring of 1990 when complete moratorium on foreign debt repayment was prematurely decreed; another example were the mid 90s). Earlier, during the years after World War II, Bulgarian economy and society was developing under USSR's dictate. Still earlier, during the 1920s and the 1930s, when the country's financial system was significantly reformed (the BNB was reformed, the national budget was consolidated and restructured, both with the help of the so-called Stabilization loans) this was done under the strict supervision of the UN and foreign creditors.[14] The tragic consequences from the Balkan wars at the beginning of the XXth century were the result of independent Bulgarian discretionary policy, unsanctioned by foreign supervisors.

In analyzing contemporary Bulgarian practice, one should not fail to examine the historic retrospective, which establishes a kind of tradition. D. North makes a special mention of informal restrictions as a limiting factor for society's development, when trying to explain "…*how the past influences the present and the future*".[15] Even before World War II in Bulgaria "*the confrontation of the state and Bulgarian capital had been most dramatic when it was governed by people considered the most enlighted reformers".*[16]

Large-scale macroeconomic experiments have continued in modern Bulgarian practice. The currency board has frozen the desires to toy with monetary aggregates, but the politicians and governing elite have shown special appetite for playing with fiscal policy. Radical changes have been made in fiscal regulations, without being preceded by precise consideration of the short- and long-term consequences and moreover, based on questionable assumptions. Typically, short-term goals dominated over long-term ones.[17] How could young and qualified people choose to commit themselves to the teacher's profession, given the miserable (and not only materially) living standard of teachers? Yet it is in the primary (and later in the secondary) school where human conscience has its spiritual and civil foundations established! Bulgarians have already got used to looking for high quality higher education abroad; well, will the time come when they will have to look abroad for their secondary education as well? The problem is that when the significant deterioration of the quality of education becomes evident it will take at least 10 years to reverse the deterioration trend.

The problem with education goes far beyond intellectual development - it has purely economic effects. The term *human capital* is widely used in economic

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[14] See *Иванов, М.* Политическите игри с външния дълг (български сюжети на стопански кризи и възход, 1929-1934 г.). Sofia, 2001, ch. I.

[15] See *Норт, Д*. Институции, институционална промяна и икономически резултати. Sofia, 2000, p. 12.

[16] See *Аврамов, Р.* Неосъщественият консервативен манифест…, p. 27.

[17] R. Avramov has successfully introduced the expression "*macroeconomic short-sightedness*" or "*macroeconomic theft*" (Ibid., p. 51).

literature as a factor determining economic progress.[18] Economic growth rates through history can't only be attributed to the growth of physical factors (population, cultivated land, natural wealth). Technological innovations are a significant factor for growth, when combined with the opportunities for their adequate exploitation. Innovations require educated population as an element of the production process. What is more, the use and implementation of technical innovations that have already been introduced elsewhere also require adequate educational and intellectual schooling. One of the important characteristics of good education is that it cultivates the appropriate social and economic attitudes, which are vital for further progress. These arguments have been supported by a complex econometric analysis of education's impact on economic growth.[19]

It is worth mentioning that foreign investors in Bulgaria (during various governments' term of office) seek their employees among those best educated, skilled and qualified. Often (if not always) they employ at key positions individuals that have been educated abroad (and/or worked abroad as well). In the meantime domestic enterprises keep employing low-paid and relatively poorly qualified individuals. This practice raises natural barriers between local and foreign investments, resulting in many unfavorable long-term consequences. If macroeconomic shortsightedness allows the situation to deteriorate to the point it becomes a nation-wide problem, the solution would have to take years of single-minded efforts.

Macroeconomic management is a complicated activity that combines in a peculiar way interests and responsibilities. The famous saying of A. Smith that selfish interest is the engine of progress is valid for macroeconomic management as well. Once at a top governmental position, individuals endeavor to show their worth with the clear awareness for the unique chance they have been given. It would be difficult to make impression and gain recognition if you lead a passive policy of following the regulations. An active position, especially when successful, is the one that would guarantee admiration. At the same time, however, responsibility outlines become vague. Contemporary governmental mechanism is based on collective responsibility, thus assimilating the personal one and diminishing the unfavorable consequences for wrong individual behavior.

The selfish interest of individuals at governmental positions is a good first approximation in the search of explanation for the processes, which could even develop into a working hypothesis, but not more. C. Kindelberger claims that successful governance needs something more – it needs certain self-restraint, voluntary compliance when planned forceful measures won't work and most of all "*active economic responsibility on behalf of the system as a whole*".[20]

J. Schumpeter believes that the explanation of economic events and phenomena should go further – it should search down the chain of causation until it

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[18] *Becker, G.* Human Capital (A Theoretical and Empirical Analysis with Special Reference to Education). The University of Chicago Press, 3rd Edition, 1993.

[19] *Edison H. et al.* International Financial Integration and Economic Growth. IMF WP/02/145, August 2002, p. 16.

[20] *Kindleberger, C.* Comparative Political Economy (A Retrospective). The MIT Press, 2000, p. 429.

reaches a non-economic cause.[21] Macroeconomic decisions are made and applied by the cabinet, but are voted by deputies in Parliament. At this highest level of authority a conflict of interests takes place that is not only economic in nature (for example stabilizing the power positions).

Macroeconomic management in Bulgaria since the beginning of the 1990s has been characterized by a dominating governing majority in Parliament, electing its own cabinet. As a rule the majority has obediently followed their party's instructions, since the nomination of deputies and the climbing of party and professional ladders have depended on the party leaders' approval. The result has been that bills, submitted by the government and the party establishment have often been voted for, completely ignoring the opposing position and arguments of the minority. This has made it possible for each new government to impose discretionary decisions of large-scale experimental nature, aiming at gaining the voters' feelings with original solutions, attractive from the viewpoint of required time, efforts and burden.

Bulgarian Parliamentary practice abounds with decisions, voted for solely by deputies from the governing majority. The negative consequences of this practice are extremely grave when discussing and voting bills of great importance for the country and population (for example the law for the national budget). This practice is abusive of the democratic principles of governance since the interests of a dominating croup are being achieved at the expense of the minority thanks to a formally democratic vote.

There are yet other dimensions of this problem. In the 1990s, for example, Parliament voted a number of restitution laws of a shady nature. Later, when deputies turned out to dispose of unexpectedly large and hard to justify financial resources, they based their defence on restitution. Statistical data shows an insignificantly low percentage of the population that has made use of restitution laws and a significantly high percentage of majority deputies that have done so. One can say that the ruling parliamentary majority votes laws that serve their own interests.

During the last years a new expression has become popular, and with good reason – *political corruption*. It illustrates the fact that the ruling majority vote in line with their group and party interests only passing amendments whose sole purpose is to secure (or prevent) particular political appointments at key positions. After such an appointment is done, it is completely logical for the individual appointed by the "people's vote" to obediently follow the will of the Parliamentary majority, i.e. of the ruling party establishment. This is yet another ostentatious abuse of the democratic principle, subjecting decision-making to the will of the majority. The enforcing of more severe requirements to the decision-making process would limit the possibilities for abuse in the best interests of society.

The addition of stricter requirements for the decision-making process is a movement from discretion to rules. The curve of Laffer depicts the effectiveness of

[21] See *Шумпетер, Й.* Теория экономического развития. Moscow, 1982, p. 59.

the decision-making mechanism and gives an insight into the search for the optimal solution. The principle of the majority vote (only of the ruling one?!) is far from being flawless. The other end of the scale – unanimity – is not effective enough (being close to the impossible). The optimum would have to be somewhere in the middle – more than half of the votes (i.e. 60%, 65%, or 75%).

The IMF practice when voting for issues of great importance is to require 85% unanimity of the votes. This requirement allows for protection of the interests of the majority of the IMF member countries in an area very delicate for the developing countries – international economic relations. For over 50 years of experience so far, this requirement has not brought about a stumper in the IMF. The Security Council of the UN requires unanimity when it comes to decisions of great importance, but the IMF decisions are much more closely related to particular national interests and do not serve mainly a propaganda effect.

The temptations to introduce macroeconomic solutions that would "*encourage economic growth*" and bring about (especially) "*quick results*" are neither few, nor weak. They often lead to questionable macroeconomic decisions with vague consequences. A similar decision was the BNB's refinancing of the commercial banks with currency at the beginning of the 1990s. The idea was clear, comprehensible and as if self-realizable. Why investing Bulgaria's currency reserves in foreign assets abroad if they could (at least in part) be allocated to domestic commercial banks, which would credit the real economy and thus spur investment processes? Currency was allocated to commercial banks and the result was (by the middle of 1997) 126 mln levs worth of bad loans (close to $80 mln). Another attempt for providing "*economic growth stimuli*" was BNB's policy of maintaining relatively stable currency exchange rates without taking into account economic and other developments during the second half of the 1990s. BNB did succeed in this respect for the years 1991-93 and 1995; however, this success turned out to be at the expense of periodical drastic and uncontrollable devaluation (1994, 1996-1997), that eventually stultified BNB's policy and caused even greater mistrust and uncertainty.

Playing with tax rates was another "*obviously successful policy*". The ideas here were borrowed from the so-called *supply economy* without having the needed insight and without having made the obligatory consideration of international experience and domestic environment. The contemporary interpretation of the *supply economy* is connected to a wide range of structural reforms, dealing with the correlation between output, costs, technology and effectiveness of the organization. L. Klein warns against being too quick to reduce this idea to the popular concept of tax cutting and deregulation that is often done as an end in itself.[22] In addition, it should be noted that the empirical evidence for the negative

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[22] *Klein, L.* My Professional Life Philosophy. - In: Eminent Economists. Their Life Philosophies. Ed. M. Szenberg. Cambridge University Press, 1992, p. 186. L. Klein was awarded the Nobel Prize in economics in 1980.

correlation between tax rates and economic growth is "*much weaker than expected by theory*" and is mostly valid for underdeveloped countries.[23]

To carry out any macroeconomic measures it is necessary to take into account and consider various ethnic and even cultural characteristics, that predetermine the outcome since (according D. North) "*… one and the same formal rules and/or establishments imposed on other societies produce different outcomes*".[24] Reducing tax burdens for the richer part of the population, for example, (reducing the maximum tax rate by 10%!) at the beginning of the 21st century was justified with the apparently logical hypothesis that thus financial resources would be redirected to investments in production. Experience, however, has proved that this "*good*" hypothesis does not work in Bulgaria. Macroeconomic policy results in redistribution, which makes the rich even richer while in the meantime the major part of the Bulgarian population gets poorer and poorer. We have to agree with J. Schumpeter that *"simplifying things might turn to become a caricature. And the latter might be ideologically biased*".[25]

Here again, it is worth referring to the past experience, which has turned into a tradition. As far back as 70 years ago St. Bochev stated that *"… accumulation of capital in our country often is used to having the characteristics of ungrounded transfer of resources, from the business point of view, from some people to other people on the same location, in the same community*".[26]

The taxation's nature and philosophy are presently reinforcing stratification based on property status as well. The tax burden is being increasingly laid upon indirect taxes at the expense of direct taxes. The justification of this policy is the argument that indirect taxes are easier to levy than the direct ones. Improving direct taxes levying requires a more intelligent tax system and administration, hence better professional skills and organization, which are not easy to achieve. Major confronting interests meet here as well, most often resulting in corruption. At the same time, however, indirect taxes are being unfair to the various strata of society. The poor, living on social securities and the rich owner of a castle both pay the same tax on bread, for example. The result is that the rich are provided luxury living at the expense of the rest of the population, forced to privation.

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[23] *Tanzi, V., H. Zee*. Fiscal Policy and Long-Run Growth. IMF "Staff Papers", Vol. 44, N 2, (June 1997), p. 187.

[24] See *Норт, Д.* Op. cit., p. 56. One can make an analogy with F.von Hayek's words: *"… it is unacceptable for an economist to borrow a method just because it was successful in another field*" (See *Шумпетер, Й*. История на икономическия анализ. Book I, Sofia, 1999, p. 77).

[25] See *Шумпетер, Й*. История на икономическия анализ. Book II…, p. 381. G. Minassian has made a detailed analysis of the consequences of this particular macroeconomic policy in *Минасян, Г.* Обезпокоителни тенденции в общестевените финанси. - Банки, Инвестиции, Пари, 2002, N 3, p. 9-17. R. Reagan's supply-side policy implemented in the 1980 in the USA was analyzed by *Hess, P., C. Ross*. Principles of Economics. An Analitical Approach. West Publishing Company. 1993, p. 518-526.

[26] See *Бочев, Ст*. Капитализмът в България. - In: *Бочев, Ст*. Капитализмът в България. Sofia, 1998, p. 100.

The increase of luxurious, showy type of consumption, expressed mainly in an exclusively expensive construction of offices and residential buildings is quite a telling example. In other words, financial resources, freed from taxes, are not going into production, but into consumption, which reveals that theses have been accumulated relatively easily (easy money). It is a typical fact of Bulgaria that expensive and luxurious buildings take extremely short time to construct, whereas small residential buildings and improvements of vital importance for their owners take years.

The behavior of people that suddenly became rich due to a quick (and somewhat unexpected) increase of their wealth is not a novelty for economic studies. T. Veblen analyzed this issue in detail more than a century ago and formulated the so-called *cultural theory of consumption*. His analysis makes it clear that when the culture of production (and society) is at the beginning of its development *"… unproductive consumption was a mark of human prowess and dignity*". In such societies top consumers do not use their abilities to enlarge their economic powers, but to impress others and make them envious.[27]

There is yet another explanation of poor investment activity in the field of production. J. Keynes places a special emphasis on the feelings of uncertainty. If a given individual has some doubts about the successful development of political and institutional processes in the future, he/she " *… in their confusion, might embark on a greater consumption and less investment*". J. Keynes states that "*the act of individual savings means … not to have lunch today*"[28] and if tomorrow's lunch were not secured, it would be better to have lunch twice today. In a way investment activity is an indicator of investors' trust in the real and declared intentions of the macroeconomic elite. Behaviour regulations in the form of laws represent a stable and rational foundation to set one's trust upon.

The entrepreneurial economic agents from neighboring Greece have made their own assessment of Bulgarian economy and the appetites of the new wealthy elite. A consortium of Greek companies and local governmental agencies, known as Procom, is now building a large commercial center close to Bulgaria's south border in order to make it possible for individuals and small companies from the South Balkans to buy all kinds of consumption goods without having to travel more than several kilometers[29]. Bulgarian population as a whole, which lacks consumption capacity to stimulate Bulgaria's own cheap production, is willing to pay much more for goods from neighboring Greece. Individuals and organizations, which are able to afford such a luxury, are no doubt outside the company of average Bulgarians; they belong to the leveraged wealthy elite.

Statistical data logically confirms the fact of the growing stratification of the Bulgarian population. According to the World Bank the Gini coefficient for Bulgaria

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[27] *Pressman, St.* Fifty Major Economists. Routledge, 1999, p. 89.

[28] See *Кейнс, Дж.* Обща теория на заетостта, лихвата и парите. Sofia, 1993, p. 185, 240.

[29] Prometheus Unbound. A Survey of Greece. *The Economist*, October 12th – 18th 2002, p. 8.

by the end of XX^{th} century was 41%, being the highest among countries in transition from Central and Eastern Europe (excluding the countries from the former USSR).[30]

The extent of income differentiation as an issue goes beyond purely sociological matters and correlates positively with economic growth rates. Economic studies provide analyses, proving that income differentiation causes social dissatisfaction and political instability, which in turn suppress investment activity and economic growth.[31] Creating and maintaining great income differentiation in the population is representative of poorly developed countries and societies. Worldwide practice has proved that intensive growth rates require bearable social stratification.

Contemporary Bulgarian life clearly demonstrates that the economic growth, as measured by the National statistics office is comparable to a zero-sum game – the economy grows, but by means of redistribution of wealth. A small part of the population becomes rich at the expense of the rest of the Bulgarians. Deliberately or not the discretionary macroeconomic policy in Bulgaria encourages this pattern of growth (in contrast to the game with positive sum, different from zero, where all participants win). According to a well-known paradigm in economic science economic growth should be Pareto-effective, i.e. it should result in an improved welfare for at least part of the society, but never at the expense of the other part of the society.

The fact that the redistribution of wealth acts as a formal source of economic growth in the transition economies has not remained unnoticed by economic experts.[32] The preferred alternative, desired and sought for is an economic growth resulting from the creation and introduction of technological innovations. The institutional vacuum that occurred immediately after the break up of the socialist social order allowed for the formation of informal economic and social structures, whose functioning was based on various redistribution processes. Official governmental policy, however, is supposed to forestall the opportunities for such redistribution, rather than tolerate them (deliberately or not), or even worse – encourage them.

Each new government in Bulgaria wins elections with certain promises. The greater and spectacular the promises are, the greater the probability to gain massive electoral support. The difficulties come later with the need to justify the commitments made. Often governments and macroeconomic elites try to launch various modifications, but eventually they are pressed to report to the people and are accountable for their promises. And they do this by implementing specific macroeconomic measures as part of an entire discretionary policy.

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[30] *Gupta, S., L. Leruth, L. de Mello, S. Chakravarti*. Transition Economies: How Appropriate Is the Size and Scope of Government? IMF WP/01/55, May 2001, p. 34.

[31] *Tanzi, V., H. Zee*. Op. cit., p. 200.

[32] *Campos, N., F. Coricelli*. Growth in Transition: What We Know, What We Don't Know, and What We Should Know. - Transition Newsletter, WB, July-August-September 2002, Vol. 13, N 4-5, p. 66.

Too often temptations to carry out "*significant*" measures prevail. Usually the problem is not identified correctly; then the measures implemented are unable to solve it. The wrong identification is less due to the lack of professional qualifications (and not always), but to a conflict of interests which cannot be resolved.

It is very common to draw the attention mainly to particular incentives for encouraging investments and the economy, such as reduction of tax rates, introduction of various tax holidays, reinvestment incentives and etc. There is a firm conviction that the state is obliged to find means of providing low-interest credits for various businesses, classified (most often with partiality, not objectively) as priorities. Various producers (in agriculture or the light industry) regularly and insistently raise voices to ask the state for help in the share of protectionist measures and direct subsidies. And governments yield to the pressure.

Such a discretionary policy places the state in the delicate position of a creditor of last resort. Producers know that if they ever get into great trouble the state will help them, because it has promised to do so. Such commitments involve the state in a vicious circle if not considered seriously enough. This was the situation of the BNB in the first half of the 1990s – it was almost unceasingly financing commercial banks in liquidity crisis, believing that the bankruptcy of one commercial bank may result in an undesired crisis of the entire system. As a result, tension in the bank system reached unexpected levels, until the only possible solution remained - a decisive surgical intervention.

There is a special term in economic literature (moral hazard) denoting the credit beneficiary's abuse when he/she is aware of the secure existence because of a last-resort savior. In that particular case the producers (mainly large state-owned enterprises) knew that the state could not and would not remain indifferent when faced with the possibility for economic tension to spill over into a social one. Knowing this, they passed on the production risks and failures caused by poor management to the state.

Here again it is worth making an analogy with the BNB's experience. This time after the introduction of the currency board, when the BNB's policy towards poorly managed commercial banks became firm and uncompromising. During the first years of the currency board the BNB closed down two commercial banks – Credit Bank and the Balkan Universal Bank. Other banks lost their illusions that they could rely on the BNB for financing in case of unjustified liquidity crisis; and so they started firmly adhering to the sound principles of banking.

Economic conditions for production in Bulgaria should have been described as better than those in the neighboring countries. Salaries in Bulgaria are the lowest not only in comparison with all the neighboring countries, but with all the countries from Central and Eastern Europe as well. In addition, the general price level (incl. that of production consumption) is also extremely low. Labor costs as part of overall production costs are relatively low; the nominal measure by expenditure items should also be lower and in spite of this Bulgarian production is not competitive internationally.

Astonishing as it may be, looking back in history one will find that the problem is far from being new; it is rather traditional. It is St. Bochev again who found out that in Bulgaria of the 1930s "*… whatever we produced, was produced by other countries too, but cost us more, although the general price level in our country was lower*". He also emphasized on the widely shared attitude that "*… all the state gives is or should be cheaper*". And, also, that the state justified granting cheap credits with the need to pursue social policy, however this "*… in its essence is most often purely party policy*".[33] Having said this, the "*new*" policies in Bulgaria in our modern history turn out to look like a mere repetition of worn-out and ineffective parochial activities, producing results that are quite away from those of the successful economic strategies of developed countries.

In the autumn of 2002, searching for "*effective*" means of encouraging the business by the state, the government announced new measures as part of an active macroeconomic policy. However, in their greater part, they were still questionable and unpersuasive. The measure that may be evaluated as the most inadequate was the decision to raise an investment fund using the resources of the so-called fiscal reserve. It was meant to provide investments "*in shares of developing Bulgarian companies*" as well as for the creation of an "*alternative to bank crediting that is nearly the only source of funding for the Bulgarian business*", as well as to contribute to the "*development of a modern financial industry*".[34]

This information is extremely confusing. The alternative to bank crediting, which this government claims to provide, sounds like a new state bank. What the government should provide is a real alternative for the small investor, i.e. a working stock exchange. The fact that the average depositor in Bulgaria has almost no other option than the commercial banks is a prerequisite for financial abuses. Commercial banks' deposit interest rates are extremely low (they are comparable to those in Germany and even lower) while a significant risk premium is calculated within credit interest rates. Thus a large enough spread is formed that makes it possible for banks to report acceptable financial results without having to involve in unnecessarily risky lending.

In addition, the management of the new investment fund runs the real risk of making once again all well-known and continually repeated mistakes in the economic steps made by the government so far.

The problems connected to the development of a modern infrastructure are quite different. The quality of infrastructure is directly linked to economic growth rates – something that (as worldwide experience has definitely proved) the state is obliged to contribute to[35]. There is a positive example in this respect at the

[33] See *Бочев, Ст.* Op. cit., p. 104, 122, 198.

[34] Kapital newspaper, 19-25 October 2002, p. 19.

[35] L. Klein has reported for the existence of an econometric demonstration *… for the considerable contribution of infrastructure capital to the non-infratsructural one in the nonlinear development of the Cobb-Douglas function*" (See *Клайн, Л.* Нова икономика? - Икономическа мисъл, 2000, N 4, p. 7).

municipal level – the cities of Sofia, Varna and Svishtov successfully issued municipal bonds and used the finances they earned for municipal infrastructure investment projects. Governments, however, haven't taken the initiative yet to attract investors for the improvement and development of national infrastructure, incl. by the use of state participation and guarantees.

Once again, the measures reported follow the stereotype – they contain various investment and tax concessions and conform to the good traditional supposition (well tried, but unfortunately unsuccessful) that it will result in a boom in this type of investments.

Putting Theory into Practice

What investment activities actually suffer from is not the lack of particular economic concessions, but the absence of a thorough economic and social environment instead, encouraging business. It is very difficult to talk about favorable business climate without having strong and effective social management.

When analyzing the German experience in developing the so-called social market economy, O. Schlecht repeatedly mentions the "*framework conditions*", created and provided by the government, as well as the "*economic constituting policy*" as the antipode of the *ad hoc* management. O. Schlecht considers the developments in macroeconomic policy and searches for an explanation of the retreat from the principles of global (total?!) management in Germany during the 1970s. He finds this explanation mainly in the fact that it is practically impossible to properly dose the influences of an active *ad hoc* policy, as well as in managerial failures, resulting in reforms that were an end in themselves. The conclusion seems evident – it is the reliability, consistency and sustainability of macroeconomic policy that determine the steady economic growth.[36]

There is a lot of convincing evidence that concessions are not sufficiently decisive and effective by themselves when applied as an element of an ad hoc policy. In Egypt, for example, there are significant tax concessions for foreign investors. Their income in the free zones (7 free zones so far, 2 more being planned) enjoys great tax concessions. Foreign investors, operating in key economic branches (industry, tourism) in the country's interior are granted from 5 to 15 years tax holiday. In spite of this, foreign investors are not numerous, the main reason being the unfavorable business environment.

A special research was done under the aegis of the UN on the effectiveness of foreign investment incentives in the countries of Central and Eastern Europe. The conclusion of the research was that long-term strategic investors were interested mainly in political stability, long-term convertibility of the local currency and secure repatriation of income. The peculiarities of the tax system, fair treatment of all investors, guarantees against administrative abuse were viewed as more important than various tax

[36] See *Шлехт, О*. Основи и перспективи на социалното пазарно стопанство. Sofia, 1997; p. 52, 89, 95, 100.

concessions. Tax concessions cannot compensate for the lack of security due to the system as a whole (which it can or is willing) to provide.[37]

A recent research of the World Bank, based on detailed questionnaires filled in by individuals from 10 000 enterprises (mainly small and middle-sized) in 80 countries,[38] found out that for nearly two thirds of the surveyed services provided by the government were ineffective. It took too much time for business executives to communicate with state officials. In half of the economies in transition companies resorting to corruption were those formulating the policies, laws and regulations to a great extent. In the case of Bulgaria it was estimated that it took 702 working days to start a business and provide the business premises (Romania followed Bulgaria with 634 days, whereas in Slovenia one needed only 75 days). Under these conditions any kinds of concessions lose their attractiveness and are being used mainly by shrewd profiteers aiming at getting rich as quick as possible.

The creation of a favorable and encouraging business environment is the responsibility of the government. The only way to do this is to establish effective modern institutions. The word institution used here (in contrast to organization) stands both for enacting a modern legislation and (especially) for abiding by it. It is this kind of institutional environment that creates the conditions needed to instill trust in economic players – and trust is the key prerequisite for the development of a long-term investment process.[39]

D. North clearly emphasizes the institutional problem as being both a prerequisite and an obstacle to finding the solution of particular economic problems, especially combined with the changes in East European countries during the 1990s. "*The existence of relatively efficient institutions … is a powerful impetus for change in a poorly functioning economy.*"[40]

The establishment of effective market institutions is a process that requires long years of consistent and purposeful efforts. It can take just a single day to liberalize prices, interest rates and exchange rates; it takes much longer and greater preparatory efforts to carry out large-scale privatization. The establishment of institutions, however, needs transformation of prevailing attitudes. Institutional establishment is a process that is accompanied by conflicts of private, group and party interests, that prolong and delay economic progress. Institutional reforms affect most and for longer periods both individual and group positions – thus the reforming process is painful and difficult. The problem, however, goes down to gaining insight into the mechanisms that could provide long-term economic and

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[37] Incentive and Foreign Direct Investment. UNCSTAD/DTCI/28, Current Studies, Series A, N 30, NY and Geneva, 1966, p. 42-43.

[38] *Prefferman, G*. Good Transition Needs Friendly Investment Climate – Some Lessons of Experience. - Transition Newsletter, WB, July-August-September 2002, Vol. 13, N 4-5, p. 1-4.

[39] *Lipschitz, L., T. Lane, A. Mourmouras*. Capital Flows to Transition Economies: Master or Servant? IMF WP/02/11, Revised 10/2/02, September 2002.

[40] See *Норт, Д*. Op. cit., p. 191.

social prosperity. This would make it possible to target the reasons for (instead of the consequences of) the economy's poor performance.

Economic theory does not simply deny or confirm macroeconomic management's ability to influence effectively (positively) economic processes. Economic experience world-wide clearly shows that sound and reasonable macroeconomic policy in small (and middle-sized) countries should comply with the following basic requirements: (1) it should abide by and impose well-established and well tested indisputable principles of macroeconomic management (for example securing the functioning of market mechanisms), and, (2) it should brook no deterioration of economic conditions due to hasty decisions, that haven't been thought out seriously enough. The first condition implies positive action; the second one excludes negative influence.

In terms of mathematics, one may say that economic theory defines: (1) the necessary conditions for providing economic prosperity; (2) the sufficient conditions for provoking an economic crisis. According to pure mathematics the two conditions should be equivalent. If one condition is necessary for providing for economic progress, its absence (the failure to fulfill it) should result in the opposite, i.e. to economic crisis. Real life, however, is much more complex than axiomatic mathematical diagrams. In between the two – the lack of economic prosperity and economic crisis – there is a wide variety of situations that are not at all insignificant for the state of the economy.

There are no indisputable precepts for macroeconomic policy that can secure continuously positive economic progress. Certain requirements are obligatory (for example the dominance of market principles in relationships and respect for human rights). However, they are not sufficient by themselves and have to be backed by other measures as well. There are other requirements that if fulfilled, are sufficient to cause a negative turn in economic dynamics (for example malfunctioning institutions or restricting the operation of market forces).

According to the main principle of the games theory, the government should strive to restrict the negative consequences (especially the long-term ones) of its activities. Discretionary policy creates an illusion for active positive influence but the prevailing real outcome is actually unfavorable. What is more, as theory demonstrates and experience has proved, "*no simple model could determine with any precision the magnitude of the impacts of different measures on consumption and capital accumulation*".[41]

Experts are very cautious when analyzing the various types of macroeconomic policy, especially if they have to make universal statements. F. Hahn and R. Sollow have made the conclusion that it is not right to completely

[41] *Mackenzie, G.* Are All Summary Indicators of the Stance of Fiscal Policy Misleading? - In: How to Measure the Fiscal Deficit (Analytical and Methodological Issues). Ed. M. Blejer, A. Cheasty, IMF, 1993, p. 35. Meanwhile the dominating idea for 2.5 centuries now has been that *"… what each industry and trade need most is freedom and stability*" (See *Шумпетер, Й*. История на икономическия анализ. Book I…, p. 298).

ignore the choice of a particular macroeconomic policy, but its evaluation still remains questionable and unsure. They agree that a particular macroeconomic policy (i.e. discretionary management) that is able to improve all macroeconomic indicators may exist; however it is extremely difficult to define it. The issue eventually goes down to making an evaluation of the benefits from applying the right macroeconomic policy and the losses, caused by the wrong one.

The position of C. Kindleberger is similar, though much more reserved. His analysis of certain world events justifies discretion in extreme situations, mainly connected to significant external shocks (a war for example), when being passive is the losing strategy. Then the saying is true "*whoever hesitates, loses*". However, relying upon discretionary policy during times of crisis creates the danger of establishing rules, which may be applied wrongly later. Such an extreme effect is instituting a type of authoritarian government. What is more, there is no a universally valid precept for dealing with a given type of crisis, when the latter takes place in different countries at different times. One should not reject either the recommendation to "*Don't just stand there; do something*", or "*Don't just do something; stand there.*"[42]

The consideration of worldwide experience shows that the various monetary policies, as well as the more complex macroeconomic policies, lead to much greater losses in terms of sustainability and trust when wrong, than benefits when right. The bad news is that trouble never comes alone. The simulation of macroeconomic models shows that, once induced, macroeconomic unstability may bring about "*slipping*" into a macroeconomic abyss.[43] One should not ignore the real possibility that the sustainable (good!) balanced trajectory might be encircled by collapsing and almost uncontrollable trajectories. Thus even the smallest deviation from the current macroeconomic policy might provoke a catastrophe. The events in Bulgarian economy in the mid-1990s corresponded amazingly well to this logic.

"*Good*" macroeconomic policy should diminish unpredictability and at the same time the "*friction*" in the economy. Most of all it should decrease the cost of transactions. Excessive non-productive revolutions (great friction) decrease efficiency and lead to all well-known unfavorable consequences. State bureaucracy, as well as uncertainty and unpredictability increases production costs and reduces the possibilities for economic growth.

The type of macroeconomic management is also connected to the economic education of the public and economic agents, as well as to the cultivation of market attitudes. Changeable and ambiguous governmental economic messages are what nourish the illusion for easy and non-risky overcoming of obstacles. This is especially true of Bulgaria, where the traditional belief in the almost unlimited economic security provided by the state and its abilities of a savior (i.e. the national budget). has constantly been fed

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[42] *Kindleberger, C.* Op. cit., p. 478-480.

[43] *Solow, R.* Growth Theory. An Exposition. The Nobel Foundation, 1987, p. xiv.

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Economic theory does not provide indisputable and sure precepts for economic growth. There are various types of macroeconomic policies in the world, which lead to very different, sometimes even incompatible results. There is no single macroeconomic policy that is able to achieve by itself the desired positive results. Most possibly this is the reason, which makes macroeconomic management a combination of science and art. It is important to possess economic flair and ability to orient among the great variety of conditions and factors, exerting a number of impacts.

The working out of macroeconomic policy should take into account the complete set of genotype characteristics. Future is wrapped up in the present, but (for good or for bad) it also depends on the past. Ignoring certain traditional characteristics, even if done with a sincere motive for a faster and more effective movement towards the desired trajectory and level, may distort the results expected. This is especially true when expectations are based on illusive and over-estimated hypotheses.[44]

The aspiration to economic growth should be properly directed. The priority among the variety of tasks for Bulgaria at the beginning of the 21st century is to build an entire, logical system of working market institutions. It is these institutions that determine the quality of business conditions, which in turn determine investors' attitudes towards a given economic expansion. Getting round institutional imperatives by means of implementing superficially active macroeconomic policies is a way to deal with the consequences, not with the causes. Such an approach is not able to bring about a positive outcome.

It is of great importance to provide for the respect of all possible social and economic freedoms, since their contribution to constructive market interactions and creative entrepreneurship is crucial. If only certain freedoms were provided for (for example political freedoms), this might earn propaganda assets to the governing elite, but would not switch on the market engine of economic growth.

The managing teams should give up the illusion that there exist or easy magical solutions might be found out to difficult economic problems. This is the belief that lies at the roots of macroeconomic discretionary experiments in Bulgaria. It is a well-known principle of cybernetics that tough problems require hard solutions. Things become worse when people are prone to easily believe and accept the officials' arguments and promises, logically followed by frustration in the end.

Economic theory is not unanimous about the good and bad sides of discretionary macroeconomic policies. Yet, more clear signs have been observed recently for a redirection towards better considered, more reserved and restricted macroeconomic steps. This is especially valid for small (and even middle-sized)

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[44] "*Poor thinkers have perpetrated more crimes unintentianally than bad people premeditatedly*" (See *Фридман, М.* Немирството на парите. Sofia, 1994, p. 298).

economies and countries, since modern globalization implies a priori movement along certain rails.

The speed and unanimity with which the currency board arrangement was introduced and accepted by the public and the economic players in Bulgaria have been impressive. Trust in money aggregates has been restored to a satisfactory level. The population and economic agents as a whole have positively evaluated the enforcement of firm rules for monetary policy. Transaction costs have decreased greatly, investment planning (especially long-term one) has been relieved, and predictability of monetary processes has improved. All these developments have resulted in a better business environment.

Attention has now been switched to fiscal policy. The temptations for active fiscal policy in the context of the overall macroeconomic policy have become prevalent. At the same time long-term considerations are being ignored and current developments have remained unsatisfactory. The expectations of the governing elite are great but the responses of investors are reserved and are of the wait-and-see type. There are grounds to believe that this behavior leads to uncertainty and wavering rather than confidence in businesses. The rational expectations (visibly and invisibly) imply in investment calculations the reversing of the wheel, the restoration of the status quo, and thus make investors even more cautious.

The good strategy in macroeconomic policy is to adhere to highly predictable, firm and clear rules. The rules should require implicit obedience to market principles of management of all kinds of economic interactions. They should consistently cultivate risk-taking willingness among the people and economic agents in terms of economic activities, as well as willingness for assuming the responsibility for possible and probable consequences. The state should cease being a social guarantor for all possible economic failures in the country. It should obey clearly defined, written and announced functions, that have been formulated clear enough and well known in the theory of market economy.

The voting mechanism in Parliament, based on the majority principle, creates opportunities to abuse democratic principles. Bills that are of great or extreme importance should be adopted under greater requirements and wide approval. Political powers should be compelled to seek mutually acceptable solutions, since this would provide guarantees for respect of the economic interests of the nation as a whole.

25.X.2002