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THE “BULGARIAN PARADOX” – ECONOMIC GROWTH WHICH GIVES RISE TO NO OPTIMISM

This paper challenges the formulation of the paradox "there is growth, but it gives rise to no optimism". The thesis that economic growth stirs up no optimism, because it does not lead to raising the level and quality of life of low-income groups of the population is defended. Its macroeconomic indicators are interpreted not only from the standpoint of the average Bulgarian, but also in terms of the income distribution in decile groups.

In an attempt to answer that question, there have been formulated 6 hypotheses, the fifth of which is "the dynamics of social inequality and the loss of social status during the years of transition". It is the most reliable, but is poorly justified and has been ignored in the discussions. This article gives some of the viewpoints on those issues.

JEL: D33; A14

In the annual report titled "An Optimistic Theory of the Pessimism of Transition"¹ of the not-profit association "Global Bulgaria Initiative", where eminent sociologists, economists and entrepreneurs, belong significant conclusions were made on the basis of a representative sociological survey, working hypotheses and well-formulated scientific issues. That and especially the accompanying commentary of the discussion do feature a certain number of suggestions, too. The report and the discussion provoked my desire to express satisfaction with the analysis, and challenge some of the replies to the question why economic growth does not match expectations and optimism, which could multiply growth. My train of thoughts is based on its macroeconomic indicators, among which there must be the indicators of the dynamics of the level and quality of life, not just for the average Bulgarian, but rather for all decile groups.

Table 1 shows what the share of the ten percent of the population in the aggregate income is, arranged in decile groups - the first - the poorest 10% and the tenth - the richest 10%. The relation between the share of the income of the tenth group and the first was 7.7 in 1992, which shows how many times the income of the richest 10% exceeded that of the poorest. In 2002 that relation rose to 10.5. Therefore income differentiation continued at a growing rate. The Gini index in Bulgaria is 0.41 and is considerably higher than those of EU countries, where it is approximately 0.28. Such a picture of income distribution, which accompanies growth, does not lead to optimistic expectations. It causes pessimism, something the association is looking for an explanation of.

¹ In the block under the headline in the supplement of the newspaper Capital of 10-16 April 2004, there are given the names of the members of the Association and the Institutions they represent.

Table 1

Decile Groups Income Percentages (%)

Decile Group	1992	2002
First	3.3	2.6
Second	5.0	4.4
Third	6.0	5.6
Fourth	6.9	6.5
Fifth	7.8	7.5
Sixth	8.9	8.7
Seventh	10.2	10.1
Eighth	11.9	12.1
Ninth	14.6	15.3
Tenth	25.4	27.2

The report defines the problem using data from reliable sources - the National Statistical Institute (NSI) and BBSS Gallup International. Although details are not so important, when comparing the average growth rate of per capita GDP (4.5% for the past 6 years), we must not forget that the number of people is in the denominator of the relation, and during that period there was massive emigration, the inflow of revenue into the country as a result of the latter was comparable to the inflow of foreign investments. If we leave that detail unheeded, the graph of the comparison of the trend of GDP and that of optimism for the period 1998-2003 explicitly raises the question of what some authors call "the Bulgarian paradox" - there is a considerably higher GDP growth than that in Western Europe, but the pessimism of economic agents is on the rise (Fig. 1).²

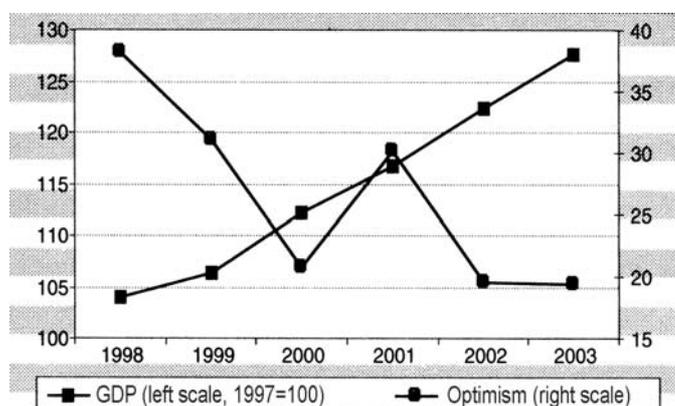


Fig. 1. Gross Domestic Product and Optimism in Bulgaria, 1998-2003.

² See the Capital newspaper, 2004, iss. 14. The GDP data is provided by the NSI, that on optimism - by BBSS Gallup International. Yearly data based on monthly averages. The survey features the percentage of affirmative answers to the question "Is Bulgaria Changing for the Better?"

The comparison with other economies makes "the paradox of the Bulgarian transition" stand out even clearer. In the USA the fall of the positive expectations for the future is a major indicator of economic recession and vice versa - the rise in optimism leads to economic growth and increases the political support for the government. "In EU countries and those of Central and Eastern Europe economic growth is also accompanied by an increase in positive attitudes towards the future", write the authors of the report and cite data from a study by "Eurobarometer" concerning the "satisfaction with life" in 13 EU membership candidate countries, in which Bulgaria ranks last - 50% of the Bulgarians think that now they live worse than 5 years ago.

This is not surprising, having in mind that only 19% of the Bulgarians trust Parliament, the government and the political parties. Growth in GDP alone cannot give rise to optimism. It does not automatically set a standard of life. It is subject to redistribution and only then it does turn into social consciousness, not without the help of trust in a well-arranged economy and its public sector. Small wonder there is no optimism - in the process of the "arrangement of the economy" there are also privatized sectors which cannot be profitable if they are denationalized, because they are socially important and subsidized even in the developed countries. From an economic viewpoint it is necessary first to analyze some details of the contents behind the indicators of economic growth in Bulgaria and the countries with which this comparison is made. The National Statistical Institute reported that 2003 saw the real economic growth of 4.3%, which was less than the projected one in the macroframework of the budget. The Minister of Finance reminded us that even though it stands at 4%, it is "one of the highest in Europe and creates conditions for achieving even higher growth in 2004".

In order to explain why that growth gives rise to no optimistic expectations, we need to analyze the individual contributions of the sectors which created it. The meaning of a unit of growth in tourism, the games of chance, the clothing industry (95% of which is customized production) and in high-tech production, which have a token share (1-2%) in the creation of the gross value added. Besides, any comparison with developed Europe is incorrect. It is as accurate as comparing the rate at which the number of teeth of a child increases when the child has only one tooth to the time when his molars are cutting. Behind a unit of GDP growth in the developed countries there lies not only a greater marginal utility, but also higher quality of the structure of the aggregate product.

In the agricultural sector the gross value added (BNS) in 2003 was lower in comparison with the preceding year by 1.3%. In industry it was growing at 7.1% - a rate which was higher than the growth rate of the GDP. However, in 2000 that indicator was 11%, and for the next two years below 4%. Its fluctuations during the entire period under study did not attest to steady growth, but rather to cyclic recovery, generated by situational factors. In an article entitled "The devil is not in the details" from the same issue of the *Capital* newspaper we read that in the GDP in 2003 "the share of correctives is growing, the item including the revenue from

customs duties, excise taxes and VAT, from which the estimated services in the financial sector are subtracted indirectly". This shows that the increase in the share of correctives in the GDP "is at least partially due to the increase in some taxes".

Each market economy follows a cyclic line of development - recovery and boom, crisis and depression. The phases of the upward and downward stages are sometimes "blurred". It is normal for the upward trend to last longer, and the "fall" to be below "the peak" of the recovery in the previous stage. After 1989 the law of cyclic development did not manifest itself very clearly in Bulgarian economy because of the many deformations of the market mechanism, caused not least of all by the chaotic economic policy. If we accept the evaluations of the European Commission, the World Bank and the IMF, that Bulgaria has "a functioning market economy", its recovery had to turn into a boom, projected by both governments after 1997, which, however, never scurred. Currently we are having a recovery, but will it turn into a stable growth, which could really generate optimism and business activity?

The Recovery in the Real Domestic Sector

Industrial sales in 2003 had grown by over 20% in comparison with the preceding year, export sales by 32% and domestic market sales by 3.6%, but the gap in the balance of trade has not been filled up yet. The consumer expenditure on a yearly basis has risen by about 6%, which shows that household income is on the increase. Last year, too, there was a deflation of commodity prices but it stopped because of the price rise of electric power and central heating. That affected the mass consumer, who had no other chance of restructuring the family budget, but disconnect the central heating and reduce the consumption of electricity. The energy regulation agency announced the next scheduled rise in the prices of electricity, including that of the threshold limit of 75 kwh. It is possible to argue quite convincingly that this is unavoidable. However, expecting the higher prices of those goods to generate optimism, is absurd. A cold home can stir no optimism among people with minimum income. Prices of clothes and shoes keep a steady deflationary trend, but pensioners and people whose income is below the poverty line as a rule buy such commodities on the second hand market. Prices of widely consumed services have been steadily rising.

Here is yet another detail in the explanation of "the Bulgarian paradox". Inflation is nearly at a zero level, but that is not the result of recovery in the real economy, but thanks to the rules of the currency board. If the price level were formed by the demand and supply correlation, it would be considerably higher as a result of the low income and the high production costs per unit of gross product. Measured by the consumer price index, in the past few years inflation had been fluctuating around 5%, which is advantageous to company planning, but did not boost the dynamics of consumer demand, because households

disposable income is at a level, that does not induce demand for high-quality consumer goods. However low, the rate of inflation also mixes up the household budget of low-income social groups, who are usually consumers of medicines and other goods featuring nonelastic demand towards price.

Pessimism in respect to employment is high, despite decreasing unemployment. Permanent unemployment is rising, which shows that the decrease in the latter is due to the increase in temporary employment. None of those who are out of job, whether permanently or temporarily, induce any social optimism. If we add to those people their families, we will have a pretty broad basis of pessimism about the economic development. There is a great difference in unemployment rates by regions - approximately 32% in the town of Targovishte and 4% in Sofia. The improvement in the employment indicator is a result of the temporary employment, rather than stable investment factors. The average number of unemployed people, competing for a vacancy is 16. Statistics shows a reduction in the rate of unemployment by several percent. This is some evidence of economic recovery, but it is not due to stable factors, which is why it gives us no grounds to expect accelerated and steady growth over the next few years. Reduced unemployment is partly due to the emigration flow and the large number of students on paid education at higher education institutes.

The GDP increase over the past five years is about 4%, but that is far below the level needed to overcome poverty and the distance between the level of income in this country and the EU. In order to bring the two levels closer we need a growth rate of over 8% for a period of twenty odd years. With the current economic policy, however, that is impossible during the following years, because the necessary production investments have not been made. We should not forget that the GDP produced last year was approximately 80% of what it was in 1989 and it is not correct to explain the pessimistic attitude towards growth with the post-inflationary 1997 as a more reliable benchmark. Sociologists may pick the benchmark, but each age group and each income group chooses how to make the comparative rating of their level and quality of life on their own.

Whatever the basis we use to make the comparison, pensioners, students and potential emigrants will always remember the way life had been like before they disconnected the central heating, before the prices of public transport discount tickets went up, when they had a job and so on. Sociologists give an aggregate appraisal of optimism and pessimism most often within the social, professional, age and other groups, but again it includes the individual rating, which depends on the status of the individual. In macroeconomics there is a popular aphorism stating that the individual estimates the economy as prosperous if the prices of the goods he sells rise, while those of the goods he buys fall. It is stagnant, if his friend loses his job, and is there crisis, when he, too, loses his job. No matter how pedagogical it may sound when explaining the difference between micro- and macroeconomics, this aphorism gives us an idea of how the expectations of the individual are formed and how he is accommodating to reality - adaptively or rationally.

The Recovery in the Foreign Sector of the Economy

The deficit in the current account of the Balance of Payments has exceeded for 1 bln USD, it amounts to 9.8% of the GDP and cannot be compensated by increased consumption. According to data provided by the BNB in January 2004 it was 1.2% higher than its projected level, whereas direct foreign investments dropped by 50 mln Euro in comparison with January 2003. The deficit in the balance of trade is disturbing, because it is due not so much to the import of investment goods, but rather to the increased import of consumer goods, financed by the boom in the consumer credit. In 2003, for instance, there were imported passenger cars to the value of 450 mln USD from the EU. The import of production capacities was considerably lower, something which in a longer term could raise the technological level of production, its competitiveness and also generate optimism.

The greatest share of the blame for the Balance of Payments deficit goes to the passive balance of trade. The only item on the current account, which marks progress are the current transfers - the revenues from pre-accession funds and non-governmental remittances. The payments on state securities, dividends paid to non-residents, the revenues from foreign assets and the private sector debt have deteriorated. The balance in the services item is also getting worse despite the increased net revenue from tourism. The amount of the attracted foreign capital from non-privatization deals is increasing and the currency deposits of commercial banks in foreign financial institutions are decreasing. The dynamics of the main elements of the Balance of Payments after 1998 features great fluctuations, but at a stable trend of deterioration.

The low growth rates in the EU and the fall in interest rates have had an adverse impact on the foreign sector. In the total volume of exports the greatest and constantly increasing share is that of raw materials, prime materials and consumer goods. But none of those commodity groups induces growth conditioned by investment. Geographically, the greatest contribution to the increase in export in 2003 belonged to the USA, Romania and Croatia. There was a certain improvement in the import structure after 2001 because of the rise in the share and the volume of investment goods. However, by its dimensions, the change was induced by the features of the imported consumer goods, for which our economy has the capacity, but their production costs are high and make them non-competitive.

The gross foreign debt (GFD) of the country in USD has grown and in the end of June 2003 reached 12,141.9 mln USD. One third of that increase is a long-term debt. The receipts of the international financial institutions are also rising. Some of the debt indicators in the end of 2003, compared to their values of 2002, show a certain improvement: GFD/GDP has fallen from 69.4 to 64.2; GFD servicing/export of goods and non-factor services drops from 20 to 13.8, whereas the short-term debt/currency reserves - from 33.8 to 40.4. At the same time the short-term debt/GDP ratio increases from 8.8 to 11.8, the short-term debt/GFD -

from 12.6 to 18.4. There may actually be no problems in the servicing of the debt, but the average Bulgarian would be right in posing the question *What is the point of smooth debt servicing, if it doesn't lead to a higher level of prosperity, it is difficult to get a job and the standard of living is getting worse ?* For him it is difficult to understand the result of the restructuring of the debt, as a result of which the fixed interest rate debt was 37%, there were changes in the ratio of the part denominated in Euro and USD, the IMF agreed that the next agreement would have a preventive character.

The country's balance proves the recovery of import and export, but there are no signs of a steady growth, as its deficit is rising. Our foreign trade partners give no indications that they will be the engine of the Bulgarian economy in the following years, as well, because they are still under the influence of stagnation. During the second quarter of 2003 the EU reported zero growth, while the countries in the Eurozone reported a negative GDP growth of 0.1%. The quarterly interest rate in the end of the six month period reached a record low of 2.1%, while unemployment rose to 8.9%. US inflation in 2003 fell below 1.9%, but unemployment rose. The macroeconomic indicators for the countries of Central Europe also fluctuate near levels, characteristic of stagnant economies. Monthly unemployment in the Czech Republic is within the range of 9.5 - 10%, in Hungary it is steady - over 6%, while in Poland, despite a certain decrease at the beginning of the year, it is now steady around 18%. In 2003 only Russia had stable growth and prospects were optimistic in all five key sectors: industry, agriculture, construction, transport and trade. In confirmation of the thesis that the determining factors on optimism and pessimism are the real dimensions of the level and quality of life, not as an average quantity but rather at consumer level, there come the ratings of expectations not only in the developed countries but also in the fast developing economies.

Fiscal Restrictions or Stability of the Sluggish Growth

The comparison of the changes in the volume and structure of the consolidated budget after 2000 shows tightening up of fiscal restrictions. The rates at which taxation revenues have been growing over the past three years are higher than the growth of the gross value added. During the second quarter of 2002 in comparison with the same period of the preceding year the profit taxes increased by 0.3%, and in 2003 - by 8.7% compared to 2002. The income taxes of natural persons during the second quarter of 2002 fell by 24.2%, and in 2003 rose by 4.1%. VAT during the first period fell by 1.4%, while during the second it rose by 25%. Since the beginning of 2003 the revenues from indirect taxes have constantly been increasing their share in the total amount of taxation revenues - from 18% during the second quarter of 2001 to 20.2% for the same period of 2003. That is the trend of revenues from natural persons' income tax, although at a lower rate compared to that of total taxation revenues.

In the consolidated budget there can be seen changes in the structure of expenditures - an increase in non-interest expenditure. That improves the budget's fiscal position, but worsens investment incentives and the entrepreneurship environment. There is an increase in consumption expenditure, which causes an increase also in indirect tax revenues, but that reduces the investment resources of banks. Restrictive in effect is also the refusal of the IMF to go along with the idea of using approximately 570 mln leva from the fiscal reserve of the country in government investment (capitalization of activities from the sphere of public services - highways, forestry, power engineering, environment, agriculture). The fiscal reserve, whose purpose was to guarantee the servicing of the foreign debt, was imposed by the Fund along with the introduction of the currency board. Its legally fixed minimum is 2.7 bln leva. In the end of February it amounted to 3.7 bln leva. The IMF imperatively insisted on using its methodology when calculating the budget deficit, which should not exceed 0.4%. The percentage planned, using the methodology of the MF - 0.7%, however, turned into 2.2% according to the methodology of the Fund, and this is contrary to the intention of the government to spend money from the fiscal reserve. In this particular case the IMF seems right, having in mind how the government spent money from the fiscal reserve ineffectively and irresponsibly in order to fund state projects on the eve of 2003 local elections.

Credit Expansion

During the past two years credit activities were great, suitable conditions for which were created by the demand for credit on part of both entrepreneurs and households. Another prerequisite was the growth in mortgage-secured and consumer credits, which, however, are not proper forms of transforming financial capital into productive capital. Competition among commercial banks also contributed to a certain degree. Something else also contributed to the credit expansion - the reduced returns of deposits in foreign financial institutions, which initiated the outset of accelerated restructuring of the assets of credit institutions. The reduction in the foreign assets of commercial banks increased the resources, which could be directed to domestic crediting. In the end of 2003, the credits lent by the commercial banks exceeded 10 bln leva, the greater part of which went to non-finance enterprises. The expansion changed the proportion in the increase of cash aggregates and activated the deposit multiplier. The recovery in the real sector of the economy had a favourable effect on the state of the banking sector. It was not just crediting that is expanding, but depositing, too. Both of them raised the profitability of banking operations.

"The permanently lowered profitability of investments in foreign financial institutions, as well as the favourable environment for credit activity have contributed to the reduced bank deposits on account of credits", reads the review of BNB for the second quarter of 2003.³ The expansive crediting of enterprises from the real sector

³ BNB. "Economic Research and Forecasting" Department, 2003, p. 27.

compensated the reduction in interest receipts from financial institutions. The recovery in the economy was observed also in the indicators of profitability of the banking system, which show that the trend towards improvement continued. However, that raises the question of how much time is needed for the recovery to turn into a boom to generate lasting business optimism. There can be given many examples in different countries which show an interruption in the recovery, before it turns into a boom. There was a similar situation in our economy with the recovery during the period 1994 - 1995, which stopped and there followed the crisis which led to the introduction of the currency board.

The increased profitability in the banking sector has been the result of the lowered profitability of commercial banks deposits in foreign financial institutions, their transfer to the Bulgarian banking system and through it - to the real economy, although at a higher risk. For the time being the credit expansion has not worsened the quality of the banks' portfolio. The share of the regular receipts of banks exceeds 92%, whereas those qualified as "losses" are about 2.55%. Despite the fact that banks were urged to restructure their assets under the influence of external factors, their functioning as proper financial intermediaries has prevented the global economy stagnation from moving into this country. Their conduct is to some extent a factor for the recovery described here. Last year for the first time since the beginning of the transition their profit was not formed under the influence of once-only factors, such as the rate differentials.

Some Conclusions from the Analysis of the Economy's Recovery

Analysis shows that the potential of the credit expansion is running low. In the end of 2002 the ratio of credits over the deposit funds was about 43%, and now it is over 55%, a fact which the banking practice views as satisfactory. This means that in order to continue the expansion, the banks will have to attract additional resources in long-term deposits, since the available resource is predominantly short-term. Only a few banks possess long-term liquidity. During the past two years capital adequacy was diminishing gradually, although it kept within the legal limit of 12%, it is far below the levels of about 40% during the period 2000-2002. Consequently, banks are depleting their credit potential because of the insufficiency of available resources of their own, whereas "the easy gains from revaluations, rate differentials and currency transactions are history". The credit expansion worsens the conditions for the functioning of small banks and raises the issue of their acquisition by the large ones or their consolidation.

Conclusions on credit expansion and the state of the banking system cast a shadow over the prospects of accelerated economic growth, too, because there arise limits to investment activities - the proper basis for stable business optimism. The privatization sources of investments funds are also running low. During the past two years direct foreign investment fell from 8 to 3% of the GDP. At the same time there was no chance for a change in the global economy, which could feed the capital flow to Bulgaria, and the investment risk level in this country remained high.

The situation gets less optimistic by the increase of company indebtedness. In 1998 the total amount was 16.676 bln leva, in 2000 it rose to 27.156 bln, and today it is in excess of 45 bln leva. If we add the national debt and that of households, the prospects for accelerated growth become even gloomier. The shadow of growth from the period 1993-2003 will bind us for a long time to rates typical of the stage of recovery rather than the push towards the desired rates of 7-9%, unless economic policy changes towards a short-term strategy, aimed at generating investment activity.

For that period the average annual GDP real increase in percentage in comparison with each preceding year for the EU candidate countries was: Poland - 4.4, Estonia - 4.2, Slovenia - 4.0, Slovakia - 3.8, Hungary - 3.1, Latvia - 2.5, the Czech Republic - 2.1, Romania - 1.7, Lithuania - 0.8, Bulgaria - 0.8.⁴ On the basis of past rates of real growth in GDP per capita, the research Unit of the Economist magazine - the Economist Intelligence Unit, has made a forecast according to which at the rate of 3.8% Bulgaria will reach the average European GDP level in 63 years, and with the other two less favourable variants - rates of 2.8 and 2.6%, in 85 and 92 years respectively.⁵

In the set of indicators on the transition from recovery to accelerated growth we need to include also the business environment, on the basis of which entrepreneurs take decisions based on the expected return on capital invested and the investment risk. The state of the judicial system, intercompany indebtedness, the unpaid wages of workers, that of municipalities to the budget, of households to the NEC, the country's internal and foreign debts, as well as the demonstrative executions of "businessmen" do not induce favourable entrepreneurial climate and social optimism.

The Vicious Circle of the Poor Economies

The report of the "Global Bulgaria Initiative" association groups studies in three models - economic, mass media and Bulgarian national psychology. The first - the income determinism, replies: "we are pessimists because we are poor". The ruling circles are seeking the source of pessimism in "the conspiracy of the media" - "people are pessimists because they are manipulated by the media". The third model was built on national generalizations - "we are pessimists, because we are Bulgarian". Having completed the modelling of explanations the authors have formulated six hypotheses. The first seeks the foundations of pessimism in atypical aspects of the country's historical development; the second is focused on the influence of socialism; the third emphasizes the importance of the democratic system; the fourth lays the emphasis on the media "distortion" of postcommunist publicity; the fifth draws the main reason from social inequality and the loss of

⁴ Capital, 21-27 June 2003, p. 18.

⁵ See the Economist Intelligence Unit, quoted from Capital, 2003, iss. 24.

social status; the sixth sees the generator of pessimism in the egalitarian and integrating function of pessimistic talk.⁶

The authors' professionalism in the area of Sociology has allowed them to formulate trustworthy hypotheses and to use them well. It seems to me, however, that the interpretation of "the economic model" and the state of macroeconomics over the past 15 - 20 years, are not reliable enough, which distorts the arguments about their impact on public awareness.

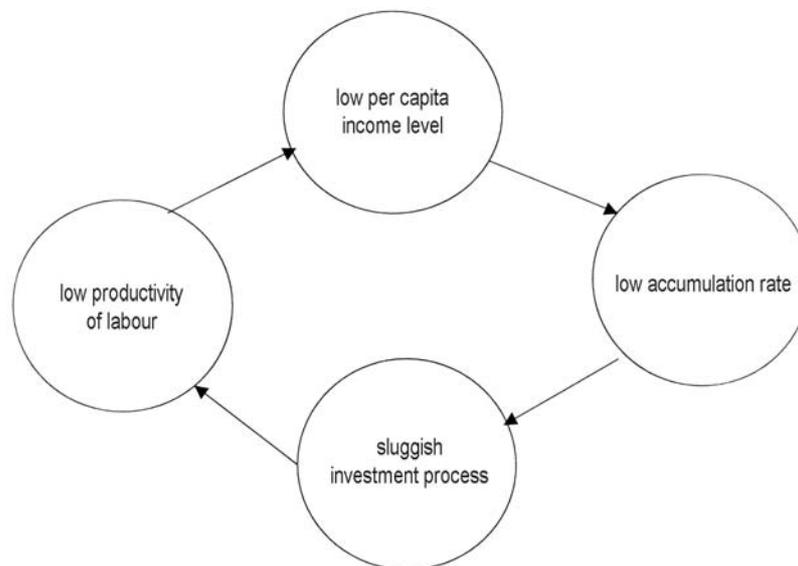


Fig. 2. The vicious circle of the poorly developed economy

We do not need any proof of the insufficient development of our economy despite the GDP over 4% increase during the past few years. At such a growth rate the distance to the average European level is growing. The problem is how to we get out of that scheme of simple reproduction having in mind that our resources are scarce not just in principle, but also in practice. Bulgaria is deficient in ores and minerals, water supplies, human capital, developed infrastructure, financial capital, technology and entrepreneurial skills. Nevertheless in those lines we have considerable reserves of underutilized resources - not less than 30% of those are idle. Suffice it to mention the figures for waste land, the five hundred thousand unemployed, the seven hundred thousand able people, who have emigrated, and the tens of thousands of potential emigrants, who are not motivated to

⁶ An Optimistic Theory of the Pessimism of Transition. - Capital, 2003, iss. 14, p. 2.

work hard. No country could prosper if one third of its production factors are underutilized. Therefore the way out of the vicious circle of poverty presupposes the existence of a short-term strategy, on the basis of which domestic resources should be used and by improving the entrepreneurship environment foreign investments could be attracted. If the mechanism of full utilization of resources we have at our disposal does not start operating, the capital we have attracted will also withdraw. Some strategic investors started to pass us by and the competition to attract them in neighbouring countries will increase.

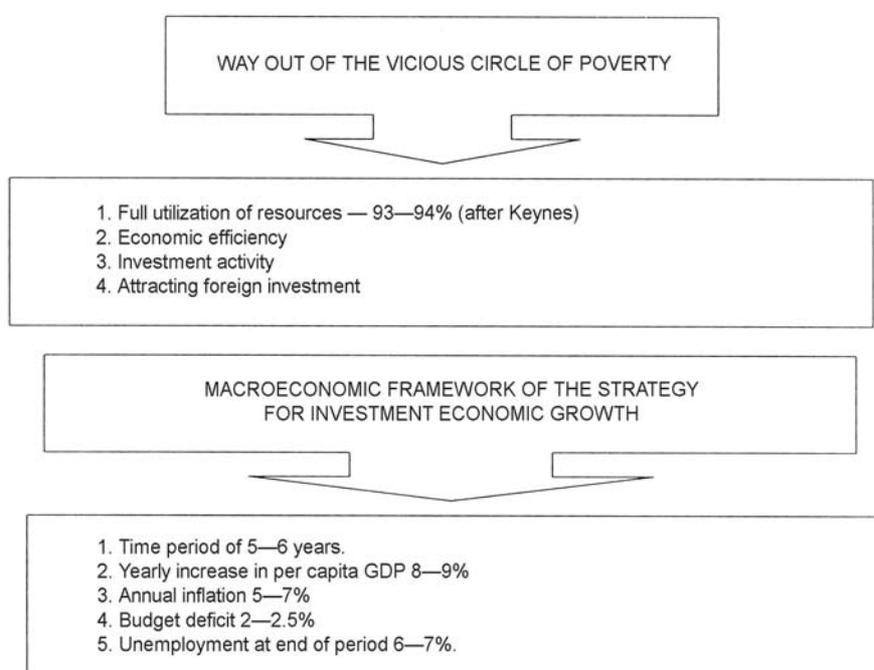


Fig. 3. Short-term strategy for economic growth

The achievement of the parameters described above cannot be made, without activating and modernizing the principal areas of the country's economic policy and the behaviour of entrepreneurs through targeting the respective forms of economic policy.

Structural Policy

This instrument for the implementation of the strategy of investment economic growth has a wide coverage and is integrated in almost all the rest of the policies and above all in the investment policy. Its immediate

embodiment are the criteria for change in the ingredients aggregate product grouped according to several criteria as to their origin, purpose and character of inherent utility. In the short run the subject of the structural policy should be the industrial, technological and regional structure of the GDP. In the first area the starting point is what has been contracted at the negotiations with the EU and the comparative advantages the country has had. In some of the closed chapters - Agriculture, Environment, Industry, Services, the parameters of the priority types of production have been set. For instance it is known that the directives on the environment oblige us to build capacities for the processing of waste, waste water purification stations and incineration equipment within specified deadlines. Also known are the obligations we have assumed to comply with European standards, which require investments by the billions, in order to ensure placement niches on the European market.

The country's resources that are well known, our comparative advantages have been tested not only under market conditions (during the transition), but also under "non-market" (socialist) conditions and it is not difficult for priorities to be reliably arranged. The classification of the technological level of aggregate production is as follows: low-tech - 35-40%; resource-intensive - 45-50%; medium-tech - 10-15%; high-tech - 1-3%. That can easily be checked also using the data on the technological and industrial structure of import and export - aggregate and by region.

The adverse technological and industrial structure of production leads to low productivity of labour and great fluctuations in the real average wage level, as a rule with a minus sign. Labour productivity in Bulgaria, compared to its 2002 index and the new members of the European Union, in relation to the average level of the fifteen EU members is lowest (see Table 2).

Table 2

GDP Index of purchasing power parity per person employed, 2002
(EU = 100)

Country	Index	Country	Index
Cyprus	74.92	Bulgaria	28.46
Slovenia	72.70	Romania	30.73
Hungary	65.20	Turkey	36.25
Czech Republic	55.96	Latvia	37.00
Slovakia	52.30	Lithuania	41.70
Poland	45.40	Estonia	43.20

Source. Eurostat.

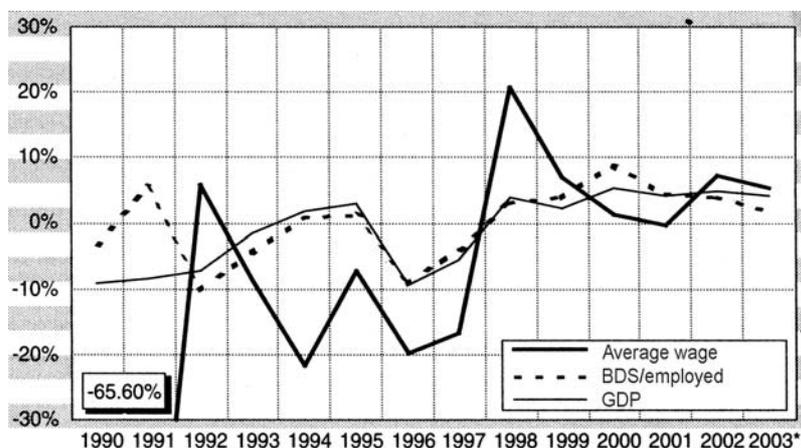


Fig. 4. Dynamics of the average real wage level, productivity and GDP, 1990-2003 (%)

NSI data. See Capital, 2003, iss. 50, p. 22.

Having in mind that the number of daily working hours the employed clock today, exceeds that in 1988 by 14%, it turns out that 14 percentage points of the growth in labour productivity are due to the extended working time. If we disaggregate the growth in 2002 by branches, agriculture turns out to be at the lowest level. The productivity of labour, measured according to the BNS per person employed, increased faster in the public sector, than in the private one - during the past seven years the latter lost 8% of its productivity, while the public sector productivity rose by 19%.⁷

During the period 1999-2001 the productivity of labour in all six economic regions of the country fell. As a percentage of the average level the downward dynamics of the ratio GDP per person employed in five of the regions in 2001 was within the range of 94.72 for the North-West to 74.76 for the Central South. In the South-West the ratio was 107.88, but in 1999 it was 118.10. The NSI data on "disaggregation" of the economic growth at regional levels does not call for any optimistic expectations either.

Industrial Policy

Bulgaria does not pursue a consistent industrial policy (in the narrow sense of that notion), the principal guidelines of which would be consistent with the tendencies in the developed market economies and the country's specific issues. Attention has been focused on privatization, whose normative has been changing

⁷ NSI data. See Capital, 2003, iss. 50, p. 22.

matter incessantly. Over a period of 15 years The Law of Privatization has been changed over 40 times and almost every major privatization deal accompanied by lobbying and corruption. If denationalization is unable to attest democracy as a political form of development, which results in tangible prosperity, public consciousness views economic growth not as an increase in wealth, but rather as a process of redistribution.

The industrial policy involves constant perfection of the corporate structure. Of all registered companies, around 95% are small, predominantly family businesses, preoccupied with survival, rather than accumulation of capital. A major element in the functions of state institutions in that respect is to create entrepreneurship environment, fair competition and strategy for encouraging the pooling and concentration of small business units. One of the strategies of international corporations is to transfer part of their activities abroad, to developing economies, the so-called outsourcing. This process has firmly penetrated into our economy also in the shape of jobbing. Generally, over 90% of the textile industry is engaged in customized production. However, this practice has both its positive and negative sides. Jobbing is also accompanied by pitfalls, in which some types of production get caught, and, what is more, our country loses some comparative advantages in the medium term.

With the outsourcing system, our companies cooperate with foreign companies, which allows the former to gain technological and managerial experience, there is a substantial improvement in the execution of intercompany contracts and a reduced number of incorrect payers. In the global economy that system enjoys a turnover of over 350 bln USD. According to the research company IDC, by 2007 outsourcing services in the sphere of information systems alone will have reached 100 bln USD. Even today they bring large profits to international IT companies. IDC claims these companies save approximately 40% of their annual costs. Many of them, however, transfer some of their activities to developing economies just because the workforce there is 4-5 times cheaper, compared to the situation in which the economic activity is carried out in the country which has placed the jobbing order. This condemns entire branches to stagnation and stimulates "competition" among underdeveloped countries trying to keep their wages low in order to attract outsourcing services. Thus their current comparative advantages in the price of the labour factor are turning into a precondition for even greater noncompetitiveness on the international market in future. That is why the aphorism "in order to choose what you can outsource, first of all you need to determine what you cannot", is a rational piece of advice to economies such as ours, although some large countries like China and India have reacted negatively to the discussion that opened in the USA in connection with its intention to limit outsourcing because of the large export of jobs.

Over the past 4-5 years the average wage in the tailoring industry in Bulgaria has been between 58 and 82 USD, which is for the time being its "comparative advantage" on the markets in Western Europe. However, there is no guarantee

that it will be retained because of outsourcing outflow towards Macedonia, Ukraine and Belarus, since those have greater "advantages". The low level of labour is one of the factors for increased export, which, in 2002, as compared to 2001, according to data provided by the Association of Exporters of Clothes and Textile rose by 21% to the EU, and by 42% to the USA.

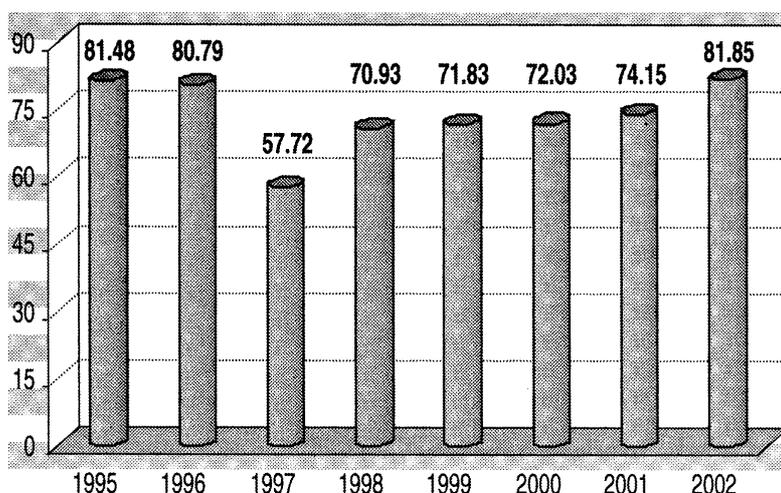


Fig. 5. Average wage level in the textile industry

Source. Federation of Independent Light Industry Syndicates in Bulgaria. - Capital, 31 January - 6 February 2004, iss. 4.

The trends of growth rates in some traditional types of production in this country also confirm the validity of "the Bulgarian paradox" - it looks as if there were growth, however, rise to no optimism, since it has not resulted in the well-being expected giving from transition.

Fiscal Policy

A working strategy for economic growth should take an inventory of the elements of the current taxation policy, which suppress or are neutral with respect to the investment activity, in order to justify changes in the maximum amounts and the differentiation of tax rates with a view to broaden the tax basis and promote the stimulating function of corporate tax, the VAT tax credit and the grace periods on the reinvested part of the profit. It is necessary that the strategy focus not only on the fairness of taxation, but also on its economic efficiency. Isn't it possible to try to get the real budget deficit close to 2-2.5%, instead of anchoring it at zero level? Isn't it possible to apply the Keynesian idea of fixed inflation - about 8-9% annually, which would bring unemployment

down to a one-digit level? This will boost entrepreneurship activities, and lead to increased income and a rise in the domestic demand. The considerations in that direction can also be justified through comparing inflation during the past few years to its level in the 15 EU countries.

Getting onto the trajectory of growth which brings prosperity requires a change in the fiscal centralization/decentralization ratio. The self-financing of municipalities as a fiscal model is able to change the structure of taxation and increase the investment orientation of the entire fiscal policy. The expenditure share of the budget during the past few years shows that the budgetary policy of the governments was strictly following the model "at the beginning of the term of office we should have strict budgetary restrictions, while towards the end of it - we should have a short-term loosening of the latter". Although such a policy has been practiced in countries that are mature democracies, it is not suitable for an underdeveloped economy featuring immature democratic institutions. Such a fiscal policy generates a "political business-cycle" and kills the long-term investment orientation of entrepreneurship activities.

In the theory of market economy, the issue of whether it is necessary to have fiscal police, which would guarantee tax collection, or not, is controversial. The alternative to such an institution is the effectiveness of the taxation system, which would shed light on the economy using market forces. Of the invisible economy, which is currently about 30-32% in relation to the GDP, more than half is the result of tax restrictions, burdening entrepreneurship. Part of it remains in the twilight zone, in order to survive, rather than to make a lot of money.

Monetary Policy

The short-term strategy may be oriented towards long-term objectives - adaptation towards full EU membership, and more specifically to the Eurozone, and the introduction of the common currency. Within the possibility to "pursue" a monetary policy under the conditions of a currency board, the strategy should be aimed at developing the functions of BNB as an autonomous institution, yet not indifferent to the policy of accelerated economic growth, that is, it should shift the emphasis from restrictions towards incentives of the function, saving - investments. Throughout its history BNB has always been involved with the economic development of the country, and not only with the currency turnover.

General areas in which monetary policy can be developed, to stimulate investment activities, are: operations on the open money market; improvement of the transmission between the financial and the real sector of the economy; management of currency turnover; influencing the dynamics of interest rates on deposits using market-oriented approaches with the purpose of turning the real interest rate on current deposits into a positive quantity. It is necessary that the bank manage the dynamics of the foreign debt

together with the Ministry of Finance. At this point the least suitable is the political cliché "financial stabilization", that is, the debt should be serviced "normally", its absolute value not rising or "crawling" in relation to the GDP. It is necessary that the servicing of the debt is done through net export revenues, rather than new loans.

The currency reserve must be managed effectively, and it should not be formed predominantly through proceeds from privatization deals, foreign investment and loans from the IMF and the World Bank, but rather from the net export. There isn't much use in a large reserve, serving solely as an insurance policy before the official creditors, if it does not generate investment growth. It is necessary that the monetary policy leave the rule named "macroeconomic financial stabilization". The existence of unpaid, even though earned wages, unpaid subsidies to municipalities, colossal intercompany indebtedness, a negative real interest rate on current deposits and a high interest rate on credits for fixed assets, a stable foreign debt, a financial collapse of the public health service, large social groups below poverty level (the share of those living below that level in 2000 was 35%) and zero annual inflation do not guarantee real economic substance of that category.

The IMF has reached agreements with the BNB on measures restricting the crediting activity of commercial banks, which, according to the leader of the Fund's latest mission, Mr. Flickenshield, is due mainly to the consumer credits, stimulating the import of goods. In 2003 the deficit in the balance of trade reached 8.7% of the GDP, whereas the percentage set in the macroframework was 5.4%. The agreements envisage "immediate" expansion of the basis, on which the mandatory minimum reserves are set. It will also include deposits with a term of two years and over, and the repo-deals. The mission thinks that structural reforms are no less important than macroeconomic stability, and in fact the former are greatly underrated in economic policy. It has found that a great share of imports are consumer goods and raw materials, from which those have been produced, and that a large part of investments are directed towards non-tradeable commodities - trade with fast-moving goods, which do not help the export orientation of the economy.

The findings of the mission are accurate and the criticism of the economic policy because of the financial stability not being bound to the structural reform is justified, however the measures, restricting the crediting activity, will also restrict the investment activity. The credits/GDP ratio in this country is a little over 30%, while in some developed European countries it is over 90%. The Eurobank executive director forecast that IMF measures will surely "lead to a rise in the prices of customers' credits, but not to reduced crediting".⁸

⁸ See Capital, 2004, iss. 15, p. 20-22.

Foreign Trade Policy

The analysis of comparative data on the openness of Bulgarian economy - import and export compared to the GDP, export and import of capital, transfers into the country of our workers and experts and the dynamics of the trade balance and the Balance of Payments after the introduction of the currency board, is a proof of the disequilibrium of the opening - more towards import, than towards export. Such a foreign economic policy, which stimulates predominantly one-sided openness, actually checks economic growth. The dynamics of the commodity and geographical structure of import and export after 1997 shows a low level of commodity concentration and a high level of geographical concentration. This is easy to prove through measuring the competitiveness of export by means of the changes in the indicator "terms of trade" under the influence of changes in the shares of commodity groups and geographical areas. The comparison of the indexes of interindustrial trade in commodity groups and countries shows that it is at a very low level for Bulgaria. The strategy of the foreign trade policy may work successfully, if it contains an assessment of the comparative advantages, which we have been losing and in whose types of production it is feasible to form new ones in middle-term, that is, when it is harmonized with the structural and industrial policy.

This gives rise to the necessity for an analysis of customs policy. Can we apply "dosed protectionism" - what means do we use to stimulate exports and protect local production? What are the reasons for the ineffective "export orientation at all costs" policy? How do we encourage the kind of production that is a substitute of import in branches for which we have the resources, in which we are able to form competitive advantages and create preconditions for the import of investment goods?

Institutional and Regional Development

The role of the state in the economy does not come down to maintaining a state sector in production. In all phases of the capitalist market economy even in the most developed economies it sets the rules to economic agents and sees to it that the former are observed. In economic theory Adam Smith's concept of the "invisible hand" is even today sometimes falsely interpreted. As Joseph Stiglitz says it is "invisible, because it is nonexistent". Market fundamentalism as an idea does exist, but it is not applied institutionally anywhere. The concept of institution does not fit into the narrow framework of its administrative embodiment. The institutional development is above all normative-legal regulation of ownership, its protection and the genetically encoded in it competitive behaviour of economic agents. Economic growth under Bulgarian market conditions requires strict rules of competition, without which neither the market, nor the political democracy can lead to the expected results.

Some evidence of the institutional maturity of growth is the absence of regional ghettos of underdevelopment in the national economy. During the times of planned economy, towns by virtue of administrative rules drained resources from villages, the centre reigned over the periphery. Now in a "market" way the capital and the large towns buy cheaply the agricultural produce and "sell" to the rest of the country expensive communication, transportation, health and education services. Unemployment in Sofia is about 4%, whereas in some municipalities of the north-west it is over 44%.

Despite the lofty evaluation "a functioning market economy", the strategy of a stable investment growth should analyze the insufficient institutional maturity, the alarming level of poverty and the underdevelopment of municipalities which lose their population because of the lack of means of livelihood. For that purpose it is necessary to offer specific incentives for structural changes in the most needy regions, as well as a policy of sustained employment and social integration of minorities.

Entrepreneurship Environment and Market Culture

In that part, the strategy providing steady and optimistic economic growth, capable of leading the country out of the vicious circle of poverty, must be of a conceptual and analytical character as entrepreneurial environment and market culture are not created imperatively, but are rather a product of evolution. Some of its elements are part of the national psychology, which took centuries to develop. To some extent, they are encoded in the "life and mentality of the Bulgarian", in the words of Ivan Hadjiiski.

Within the macroframework of economic development in this country the influence of entrepreneurial culture is underestimated. It's time to give it due credit, by making a reassessment of the classical conception of basis and superstructure in the light of the relation traditional-modern. The entrepreneurship environment and market culture are the most important noneconomic factors, exerting a direct influence on the economic development. It is an embodiment of the expectations of economic agents when investors, bankers, stock exchange people and insurance companies make entrepreneurial decisions. Keynesianism and the marginal theory of the economy restored the significance of the factor of "expectations" when explaining such categories as interest rates, exchange rates, current value of financial assets. Rational economic thinking begins with the category of scarcity of resources and wealth, hence the ordering of priorities on the basis of marginal cost, marginal utility, alternative price, etc.

The characteristics of market rules - individualism, capital augmentation, innovative behaviour - traits which are embodied in the life of German people and the Anglo-Saxon model of market economy, have never been built into the national psychology of the Bulgarian. Deeply rooted in the entrepreneurial

thinking of the Bulgarian are: easy gain, agricultural mentality, paternalism, collectivism, wasteful use, prestigious consumption.⁹ The alienation from the state because of its adherence to the "overwhelming fiscality" which began during the middle ages and was reinforced during the Ottoman domination and the post-liberation years, is turning into the psychology of the Bulgarian, which manifests itself in the conformist grumbling against authorities.¹⁰

However, paternalism, egalitarianism and collectivism do not generate industriousness, motivated by the ambition to get rich, but rather preoccupation with survival. On that basis there arises the tendency to clam up in "the economy of natural self-sufficiency".

The co-operative is not an invention of the socialist TKZS or co-operative farm. In 1934 there were 4.8 thousand co-operatives with a membership of 836,742, which shows that capitalism did not satisfy the needs of Bulgarian merchants and producers. At the beginning of the eighties the "self-sufficient" auxiliary farms produced 40% of the meat, 28% of the milk, 55% of the eggs, 35% of the vegetables, 36% of the fruit. In 1973 there were distributed 540 thousand decars of land for private use, and there were created 5300 auxiliary farms to complement industrial enterprises. Neither capitalism, nor socialism, or the current transition towards market economy were able to undermine the "home-grown economy".¹¹

As early as the dawn of capitalism in the economic culture of the Bulgarian there were ingrained two groups of values, which have preserved their imprint even today. The first comprises the country's dependence on the geopolitical interests of the Great Powers. It explains why the preferences of our society are Russophile, Francophone, Austro-Hungarian, German (and now American). The second group consists of the influence of economic underdevelopment after the Liberation, the frequent changes in the legislation concerning institutions, the attitude of levelling the standard of life, the influence of traditionalism and the "spirit of catching up" with the developed European countries, which, by virtue of circumstances, is now in its zenith.

The conclusion is that the entrepreneurial culture in the national psychology of a major part of Bulgarian entrepreneurs is not adequate to the market rules, which must be observed in the EU. The illusion that the Euro-Atlantic euphoria will lead to a fast and easy adoption of the European way of thinking with regard to the market economy is hardly possible. But why not allow for other criteria, in line with the Anglo-Saxon ones, in which there may be reincarnated "the spirit of capitalism", praised by Max Weber.

The strategy in the social policy should be based on the idea that it stands close to the achievement of the goal and that through it there can be

⁹ See *Kolev, B.* Economic Culture. Sofia, UPH "Economy", 2002, pp. 111-125.

¹⁰ *Kolev, B.* Op. cit.

¹¹ *Ibid.*, p. 175.

achieved tangible results in the solution of paramount issues of our socio-economic development - unemployment, impoverishment, demographic crisis, disintegration of marginal social strata. The great differentiation between the richest and the poorest strata of the population becomes less and less tolerable.

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Careful analysis of "the Bulgarian paradox" on a reliable methodological foundation arrives at the conclusion that there is nothing "paradoxical" in it. The phenomenon "there is growth all right, but there is no optimism" is contingent on many factors - economic, historical, sociological, psychological. The question is which ones are dominant.

In the economic history of Bulgaria there had been optimism at times of lower economic growth rate, when the long-term trend had been stable. It is difficult to prove the decisive role of the national psychology of the Bulgarian, the inclination "to grumble against authorities". The expectations of economic agents (producers and consumers) are correlated not only with the current values of the macroeconomic indicators, but also with past situations. Friedman's concept of permanent income and Modigliani's concept of the life cycle of income are well-known. However, both categories are determined by the past, the current and the future income, that is, with equal other conditions by the dynamics of the long-term economic growth.

During the 15 years of transition growth had been neither steady nor did it have a high rate. The gap between two social strata - the poor and the wealthy, is growing. Approximately 40% of the population are below or close to the poverty threshold. Bulgaria is at a "honorary" distance from the income levels of the 15 EU member states. In this case we are not interpreting the reasons for that situation. As a measurement, neither the value not the structure of the growth gives rise to optimism. The exaggerated expectations from the political form of democracy have been equally important.

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