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Sofia, 1463, 2 Khan Asparouh Str., Fl.3

Responsible: Nadya Yorgova
Copy Editor: Mariana Trifonova
Cover & Body Design, Prepress: D.Bojanov
Print: DEMA Print

This publication contains shortened and revised versions of the presentations delivered within the conference “The Competitiveness of the Bulgarian Economy during the Crisis Consequences and Perspectives”, organized by the Economic Policy Institute (EPI), Sofia and the Hanns Seidel Foundation, Bulgaria on November 26, 2009 in Sofia. Short articles or reviews of the topics covered at the event are also provided by EPI team members.

The current issue is made possible thanks to the kind support of the Hanns Seidel Foundation, Bulgaria. The findings, interpretations and conclusions here are those of the authors and do not necessarily reflect the views of the Economic Policy Institute, the Hanns Seidel Foundation, Bulgaria. The estimations, comments and remarks belong to the authors and they do not necessarily reflect the views of the organizations and the institutions they represent or those they are connected with.

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ISBN 978-954-9359-41-1

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INTRODUCTION

In the Global Competitiveness Report 2009-2010, prepared by the World Economic Forum, Bulgaria remains 76th out of the total 134 countries. That is the lowest position, occupied by an EU member state.

A quick review of the new EU member countries' advantages is useful for finding points for improvement of the Bulgarian competitive positions. The new EU member states, losing positions in comparison with the previous edition of the Report, are the Baltic states. But the reason for their worse positioning is the deterioration of the macroeconomic environment as a result of the crisis. Nevertheless, the Baltic States keep their leading position due to well performing institutions and markets, and rapid improvement of technologies. From the group of newest EU member-states, most distantly from Bulgaria stands the Czech Republic taking 31st position. Significant improvement of the institutional environment, market efficiency and technological progress establish Czech leading position within the group of new EU member-states. Poland has moved most significantly (ranking 7 positions up) among the new member-states to 46th position. The advantages of strong Polish education system, the significant improvement of Polish public institutions' quality and the increased trust in transparency and efficiency of the officials are among the keys to the Poland higher ranking. Factors like EU membership and rising GDP growth rates during the last years stimulated and provided resources for pursuing these reforms.

The infrastructure, innovations and institutional environment are areas where Bulgaria must make efforts to improve the competitiveness of the economy. Weaknesses that must not be ignored are the lack of workforce qualification, significant lagging behind innovations, insufficient scale of cooperation between science and business. They demand extra investments comparable with the level reflected by the investments in education and training index for those new EU member-states,

far ahead in the ranking. Concentrating the governmental policy in this direction would rapidly raise the competitiveness of the Bulgarian economy to another qualitative dimension.

Issuing the current publication, the Economic Policy Institute aims at providing a wider ground for a follow-up of the discussion within the conference on the competitiveness of the Bulgarian economy, held on November 26, 2009. That was the second 2009 edition of the conference. We hope that the information provided, the ideas shared and discussed will give an impulse of new researches and further discussions. We will be pleased if the collected information could serve also a source for the governmental decision-making process.

Ivanka Petkova

Chairman, Economic Policy Institute, Sofia

WELCOMING ADDRESS

Traycho Traykov

*Minister of Economy, Energy and Tourism
of the Republic of Bulgaria, Sofia*

The competitiveness issues have always been important. And now when the "economic puzzle" is mixed up and it is going to be rearranged in accordance with the new priorities, the competitiveness seems to be even more topical when it comes to comparing Bulgaria's position to other countries and raising the questions what could be done in this direction.

With regards to the competitiveness, our task as representatives of the executive is on the one hand, to create conditions, to maintain and improve the environment and on the other hand - to create and apply tools that we have at our disposal when it is necessary.

Concerning the economic environment - I think that sometimes we do not fully recognize how many things have already been done and what level of development we have already reached. Bulgaria is one of the three low-risk countries in Europe; the balanced budget we keep has to ensure a financial stability and to guarantee that there are practically no financial risks within the state. In the same time, despite the inevitable restrictions, Bulgaria has managed to preserve a favorable taxation with low and predictable taxes. The engagement for reducing the insurance burden is being fulfilled; the administrative procedures are gradually improving as well. The possibility for setting up a company with a token nominal capital only within four days is other factor for attracting more and more foreign investors to start their business in Bulgaria. Each of the above mentioned measures have been already taken and we work in order to make them even better. The concrete instruments for that are also different and it is very helpful when they are presented and discussed which allows us to see what the feedback from their implementation is.

Operational Programme “Competitiveness” is one of the most powerful tools of the Ministry of economy, energy and tourism of Bulgaria. With its almost EUR 1.2 bln. the Programme could make difference and could support many firms' policies. For this reason, the new team in the Ministry of economy, energy and tourism puts the Programme among the first priorities since it stepped into office. So far, we undertook all the possible and rational actions to make the management and the implementation of the Programme effective indeed. There will always be a debate on whether the state could actively support a given industry, sector or even a company, or whether the market should be given the freedom to expand to a certain level before the state intervenes. If the second scenario is to happen, certain pre-conditions are definitely needed and we work on reaching them. Firstly, a fundamental analysis of the specific needs has to be made to provide the basis and the current state and only then to evaluate periodically the conditions and the developments, which will make it obvious where exactly do we are and what could we do for a better performance of the economy. I could assure you that within the field of responsibilities of the Ministry of the economy, energy and tourism the business will receive a maximum support; we will remain open to any constructive ideas and the best of them will be integrated in our policy. Our team will try to define the optimal allocation of the resources which are limited by default. Finally, I wish success to the initiative!

WELCOMING ADDRESS

Bogdan Mirchev

*Representative of the Hanns Seidel Foundation in Bulgaria,
Sofia*

Since the previous conference on the competitiveness of the Bulgarian Economy in March 2009 till today many challenges have been met and many important decisions have been made - a big number of changes occurred, including fundamental political changes. The main focus of the current conference is the consequences of the crises and the perspectives for future development of the country's competitiveness. After the deep crisis situation of growing budget deficit in the summer of 2009, in the autumn the first effects of the anti-crisis measures such as lowering the budget deficit and its movement towards a surplus, a growth of the export, etc. are visible. Although, it is clear that the situation remains severe and many challenges are still ahead. The initiative for holding a series of conferences aims at exchanging views, strategies and positions among the government, business and NGO representatives on the policies that foster the competitiveness. As a result of these conferences, Hanns Seidel Foundation (HSF) in cooperation with the Economic Policy Institute (EPI) issue a publication containing the lecturer's presentations given within the particular panels.

Hanns Seidel Foundation is a German political foundation related to the Bavaria's ruling conservative party Christian Social Union. The political foundation as a term is related to foundations close to the main political parties in Germany and their activities are financed by the Federal Republic. The activities abroad are funded entirely by the federal budget. These activities are to be checked by the Bundesrechnungshof - the German Federal Audit Office. Although the foundations are closely associated with a certain political party, they remain independent and autonomous non-governmental organizations which

are open to every citizen and they work mainly in the field of promoting the democratic values and processes. Since its establishment in 1967, the Hanns Seidel Foundation has already implemented more than 90 projects in more than 50 countries. Eastern Europe lies amongst the main priorities of the foundation. It has offices in Sofia, Belgrade, Tirana, Bucharest, Zagreb, Prague and Kiev. The main activities of the Hanns Seidel Foundation are related to expert cooperation for consolidation of the integration process in the new member states such as Hungary, Czech Republic, Romania and Bulgaria. Hanns Seidel Foundation has a representative office in Bulgaria since 1994. Until now our main activities aim at implementation of projects in the three major fields: politics, administration and economy. Economic Policy Institute is one of our main partners in the field of economy.

CHAPTER ONE

NATIONAL POLICIES FOR FOSTERING OF COMPETITIVENESS

Kalin Marinov*Executive Director,**Economic Policy Institute, Sofia*

The arguments in favour and against the involvement of the government in the national economy have always been a matter of disagreement among the economists but the participation of the central authorities in overcoming of the economic downturns seems to be inevitable and even necessary. The other side of the coin is the government's set of mechanisms for enhancement of the competitiveness, especially during an economic crisis. Looking through the possible anti-crisis measures and their impacts on the national competitiveness the following sub-question will arise: is it possible for a country to take advantage of the crisis and to gain competitiveness? The positive answer is obvious since the crisis affects each country through different channels and the adequacy and effectiveness of the government policy could not only result in limiting the impacts but also in improving the comparable mood. However, in the case of Bulgaria the answer is related to the given economic parameters the existence of a currency board, decreasing value of the FDI, increasing unemployment rate and contracting of the GDP growth rate.

In the first months of the crisis, when it was still hard to forecast its impacts, the alerted governments implemented a set of policies based predominantly on the increase of the volume of the government expenditures and the focus was not on whether this is the right approach but on the allocation of the financial packages. Stimulating the national economy with funds from the national budget would have positive impacts in case of large economies as the central authorities have the financial resources to interact on several sectors and sub-sectors. The pouring of national funds into business organizations in small open economies proved to be unfounded endeavor since it faces constraints to be an effective anti-crisis measure. The available financial stimuli are usually limited and could not influence an essential part of the economic sectors. Such measures in small economies would have exclusively short-term impacts and could lead to imbalances in the business relations between the entities operating in different sectors.

The worsening trends of the economic indicators gradually brought under consideration another type of government policy which is not based on an increase in the expenditures but on institutional and regulatory reforms as well as on sharp striving for effective absorption of the financial resources. The small economies were first to face the contracting revenues to the national budgets which was also one of the reasons for the reversal of the nature of the government policies.

The implemented government policies in Bulgaria in the last year and a half are following the general characteristics of the decision-making process mentioned above - expanding the volume of the government expenditures and initiating institutional and regulatory reforms. There is no doubt that the implementation of large infrastructural projects is favourable for the competitiveness of the national economy as they could attract FDI, but the commencement of the work on an infrastructural project by itself does not automatically lead to its completion. However, the lack of clear priorities in terms of the selected infrastructural projects for implementation and the inadequate financial planning of the national funding are becoming obstacles for the completion of these projects and they are contributing to the accumulation of budget deficits.

Overcoming the budget deficit was one of the main priorities of the Bulgarian Ministry of Finance in 2009. On the one hand the achievement of this goal will send to potential foreign investors a positive signal and a proof of macroeconomic stability in the country. On the other hand the low deficit will give to the country a better point of departure in the negotiations over the accession in the ERM II and in the Eurozone. Suppressing the budget deficit will be also one of the main priorities in 2010 as the tax revenues are expected to contract further as a result of the decrease in the internal consumption, import and export. The fiscal instruments are often used as mechanisms for fostering the economic growth and competitiveness but in the case of Bulgaria this option seems to be depleted. The corporate tax rate and the income tax rate are already lowered to the levels

of 10 % and the decreasing of the social insurance payments is the only rational mechanism to be used during the crisis period in order to keep larger share of the financial resources on the disposal of the economic entities. The Bulgarian government took the cautious commitment to decrease slowly the social insurance payments by 5 % starting with 2 % from the beginning of 2010, which allows the financial authorities to plan national budgets with clear further decline. Similar scheme of planned gradual decrease of the tax rate was widely used by the European countries in terms of the corporate tax (for example Baltic states). Although, Bulgaria would not become a member of the Eurozone at least till 2013, the country should have optimal fiscal framework before the accession to the monetary union as afterwards all the maneuvers with the instruments of the fiscal policy would have to be subordinated to its stability.

The alteration of the VAT conception is also one of the eventual scenarios for the future fiscal policy. The changes are possible both in terms of the tax rate (decreasing, increasing and differentiation) and the tax basis. The VAT tax was firstly implemented in Bulgaria in 1994 at the rate of 18 %. The rate was increased to 22 % in 1996 and lowered to its current level of 20 % in 1999. There is only one differentiated VAT rate in Bulgaria and it is on the level of 7 % for the hotel accommodation when it is part of organized trip. Bulgaria is one of the countries with the most limited differentiation of the VAT rate in the EU. There are three other countries which use one flat VAT rate (Denmark, Germany and Slovakia). In March, 2009 the member-states of the EU reached an agreement for the implementation of differentiated VAT rates in several concrete services and goods areas personal and home care aides, restaurant entrepreneurship, small repair activities, hairdressers' services, book sale, construction and fur trade. However, the agreement is not mandatory and the countries are allowed to set their own fiscal policies.

A decrease in the VAT rate of 1 to 2 % would not lead to the same growth in the household incomes as the companies would absorb

it and transform it into a net profit. At the same time any decrease in the VAT rate would have strongly negative impacts on the revenues of the national budget especially during the economic downturn and will have no direct impacts on raising the competitiveness of the economy. In 2010 it is envisaged that the revenue volume accumulated by VAT would be approximately BGN 6.8 bln. In the nutshell we could conclude that the decrease in the social insurance as direct taxation would be more reliable measure to ensure growth in the household incomes. Although, if there are positive trends in the national economy the government still have the intention to decrease VAT to 18 % in its fiscal policy agenda for 2010.

In November 2009 was implemented an important positive amendment in the legislative framework of the VAT, which is envisaged to ensure better liquidity of the business entities and improvement of their investment planning. Thus, the VAT reimbursement from the government authorities is now reduced to 30 days instead of 45 as was till then. An additional guarantee for the implementation of this reform is the introduction of penalty interest rate.

One of the measures for the increasing of the competitiveness of the Bulgarian enterprises and fostering their export capacity was the additional capitalization of the Bulgarian Development Bank in the second quarter of 2009. Gradually, this financial instrument which was envisaged to raise the export orientation of the Bulgarian business was transformed into anti-crisis measure, which allowed companies with low or no export capacity to receive access to the provided credit lines. Furthermore, the financial package granted to the Bulgarian Development Bank was not at the needed volume to create a downward pressure on the interest rates on credits provided by the commercial banks and the interest rates on loans to non-financial companies with volume of up to EUR 1 mln. were between 10.5 and 13.5 % as of the end of 2009. The forecasts for 2010 are that the credit rates will decline slightly by up to 1.5 %. One of the indicators which hides a certain risk for the stability of the banking sector

in the country is the share of bad loans in the total volume of the credits. It is expected to reach its peak for the crisis period in the second half of 2010 at the level of approximately 10 %. The Bulgarian National Bank reduced sharply the levels of the base interest rates as part of its policy portfolio aimed at restoring the credit activity of the commercial banks. In December 2010 the base interest rate was fixed at 0.55 %.

The Operational Programme “Competitiveness of the Bulgarian Economy 2007-2013” and the Operational Programme “Regional Development 2007-2013” are the main government mechanisms to interact in the national economy and foster its competitiveness. However, they are still not implemented to their full potential and the absorption rate is low as it could be concluded from the following reports in the current chapter.

The discussions over the anti-crisis measures in Bulgaria inevitably lead to the debate in favour or against the maintaining of the currency board and the missed possibilities for the national economy to gain competitiveness on the basis of floating exchange rates. Although, the Bulgarian producers in several sectors experience the price pressure by the competitive enterprises, importing production from the neighboring countries, the currency board remains a necessary prerequisite for preserving the macroeconomic stability and suppressing any upward inflation trends that would prevent Bulgaria from entering the ERM II.

Ivan Kapitanov

Senior Expert, Ministry of Finance of Bulgaria

Herewith I will try to focus your attention on the main measures of governmental support towards the economic agents to minimize the negatives from the current economic and financial crisis on them. As you know more than a year has already passed since firms and households started suffering from the crisis. It also impacted negatively on the public finances. The decreasing trend affected both the revenues and the total budget execution. Most of our efforts were put into preserving the national economic stability without allowing the expenditures to prevail over

the revenues, which is a feasible goal so far. In the same time, the Ministry of Finance does not underestimate the necessity of actions towards stimulating business activities. Currently, one of these steps is to relieve the insurance burden which will positively influence the companies.

A further helpful tool is the set of measures of the Bulgarian Development Bank. We will try to provide it with resources for encouraging the small and medium enterprises (SMEs) or eventually to fund them through commercial banks in 2010.

Another measure which is being discussed is to reduce the volume of debts on behalf of first-level spending units to their contractors. Since these amounts are sufficient, we expect their paying off to revive the markets and to reduce indebtedness between the economic operators. The Ministry of finance already works in this direction and we hope it will be done soon, which will positively influence the current status of all the economic units.

Furthermore, the Ministry is concentrated on the informal economy. The unregulated imports caused considerable losses which hindered the development of local producers. For that reason, the Ministry will do its best to restrict the size of the informal economy and unfair competition, thus contributing to increasing the incomes of local entrepreneurs and consequently the budget revenues as well.

Since the government still experiences difficulties caused by the continuous crisis, main tools for supporting SMEs will be the Operational Programmes' funds. Therefore, a higher attention will be paid to the effective adsorption of funds. We expect an increase of absorbed funds from all beneficiaries including municipalities, SMEs, non-governmental organizations, in view of the fact that the administration performs well in managing the Programmes. This will undoubtedly improve beneficiaries' market positions. Despite the uncertain situation and the lack of explicit positive outlooks, we do expect to observe a recovery of the Bulgarian economy by the middle of 2010 and even to witness an overfulfilment of some budget revenues.

Beside the measures mentioned above, the Ministry of Finance works on a number of others, but at the moment all the efforts are directed towards achieving a balanced budget and maintaining economic stability which currently is the main focus of the Ministry.

Julieta Hubenova

Adviser on European Programmes in the Ministry of Economy, Energy and Tourism of the Republic of Bulgaria

In terms of competitiveness, Bulgaria ranks amongst the worst performing countries in EU before as well as after its accession to the Union. The experience of small and medium enterprises in Bulgaria does confirm it. Most of them were indeed not ready for the challenges of the single market. This logically leads to the idea of a better development of our national economy with the support of the EU Operational Programmes funded mostly by the EU budget (85 %) and co-financed by the national budgets (15 %).

Unfortunately, 2008 was marked by the spreading global financial and economic crisis. Bulgaria was supposed to be an isolated island but naturally this proved to be a wrong perception. The firms' feedback pointed in the first quarter of 2009 a decrease in their turnover up to 25-30 %. Why is that? If they are export companies the demand for their goods is decreasing. If they work on the domestic market, in most cases their contractors rely on export, so the above-mentioned decline indirectly impacted on them. Thus, by the end of the year the total decrease reached up to 50 %.

Less affected appeared to be the enterprises in the food processing industry. Some of them even registered an increase in their turnovers. Only in the beginning of 2009 an insignificant decrease occurred due to media campaigns over a supposed bad quality of the traditional white cheese and the frankfurters. Another reason for the aforementioned decrease is the difficult access to financial resources. Trade banks suspend the over-

draft payments to firms which were approved to get such and they respectively cannot pay for the big quantities of raw materials they import. Because of this, the production is decreasing and consequently their turnovers as well.

Below, I will give you more information about the main goals the Operational Programme "Competitiveness" supports: mainly, to develop a dynamic competitive economy on a European level and more specifically to encourage innovations and to improve the enterprises' efficiency. As you know, the main indicators of positive development of a given enterprise in terms of the crisis are the innovations and the value added. Another main factor is the business climate improvement.

The Programme consists of five priority axes which seek to fulfill of the abovementioned main and specific goals. The **first** axis aims at development of a knowledge-based economy and innovative activities. 21 % of the total Programme budget is allocated to this priority axis. The **second** axis refers to enterprises' efficiency and promoting of supportive business environment. The greatest share of the total Programme (51 %) is allocated to this axis. Financial resources for enterprises' development are set under the **third** priority. This is the JEREMIE initiative. The **fourth** priority has to strengthen the international market positions of the Bulgarian economy.

Enterprises are the main beneficiaries within the first two priority axes managed by the Bulgarian Small and Medium Enterprises Promotion Agency as an intermediate body. The annual procedures, the annual calls for projects within the Programme and their approval are duties of a Monitoring Committee. Projects under five procedures only are received in the period 2007-2009 whereas 13 procedures are to be implemented during 2010. According to the European Commission, the development so far is not appropriate at all but the main goal of the whole team working on the Programme is that all granted funds will be absorbed effectively by the Bulgarian economy.

The status of the five priority axes is available at **Table 1.** below. It shows how much of the funds are absorbed, how many contracts are signed and how many of them are active. The total amount of EUR 192 mln. includes signed and effective contracts with small and medium enterprises as well as contracts with institutional beneficiaries of the Ministry of economy, energy and tourism. A contract, due to be signed with the European Investment Fund, will pave the way for management of the JEREMIE holding fund. The main goal of JEREMIE is to provide financial resources to the SME through intermediate units.

Table 1. OP “Competitiveness” status as of 30.10.2009.

Priority	Total budget (EUR)	Number of contracts signed	Total amount of the signed contract's grants (EUR)	Number of contracts in execution	Total amount of the grant (EUR)
Development of knowledge and innovation-based economy	246 500 000	40	16 146 726	36	15 590 590
Support for startups or existing enterprises with innovative potential		30	4 629 996	27	4 219 784
Support for implementation of innovative products, processes and provision of innovative services		10	11 516 729	9	11 370 806
Increasing efficiency of enterprises and promoting supportive business environment	593 837 780	698	130 717 214	581	113 912 748

Priority	Total budget (EUR)	Number of contracts signed	Total amount of the signed contract's grants (EUR)	Number of contracts in execution	Total amount of the grant (EUR)
Improvement of technologies in small and medium enterprises		296	73 877 012	225	58 603 453
Improvement of technologies in large companies		42	49 667 174	41	49 185 958
Introduction of internationally recognized standards		360	7 173 028	315	6 123 337
Financial Resources for Developing Enterprises*	200 000 000	1	200 000 000		
Strengthening the international market positions of Bulgarian economy	87 011 870	6	37 778 258	6	37 778 258
Promoting the investors' advantages of Bulgaria		1	10 945 892	1	10 945 892
Promoting the internationalisation of the Bulgarian enterprises		1	14 007 644	1	14 007 644
Improvement of quality infrastructure and of the services offered by the Bulgarian Institute of Meteorology a factor for increasing the competitiveness of Bulgarian enterprises		1	6 502 845	1	6 502 845

Priority	Total budget (EUR)	Number of contracts signed	Total amount of the signed contract's grants (EUR)	Number of contracts in execution	Total amount of the grant (EUR)
Consolidation of supervisory and control bodies within the state Agency for Meteorological and technical supervision as an element of the national quality infrastructure		1	2 939 370	1	2 939 370
Access improvement for accreditation services		1	1 109 601	1	1 109 601
Elaboration of the standardisation system in Bulgaria		1	2 272 906	1	2 272 906
Technical assistance:	34 865 901	7	24 861 024	7	24 861 024
Total:	1 162 215 551	751	409 503 222	630	192 142 620

Source: Ministry of Economy, Energy and Tourism of the Republic of Bulgaria

The latest data show a decrease of the real GDP growth by 4.2 % during the first half of 2009. The value added in the industrial sector went down by 11 %, the agricultural one by 6 % for the same period. The consumer prices declined too and deflation reached 0.2 %, the unemployment rate reached 7.88 % in August 2009. The households' consumption was also reduced by 8.2 % in the period April-June 2009. In July 2009 the industrial production contracted by 18.9 %, the turnover by 24.5 %. Within the period January - July 2009 a decline in the international trade was also observed since the export decreased by 30.6 % and the import by 35.1 %. The foreign direct investments within the same period reached EUR 1.88 bln. (5.6% of GDP) in comparison to EUR 3.95 bln. (11.6 % of GDP) for the period January - July 2008.

What are the anti-crisis effect and role of the Programme? The main priorities set are an efficient response to the challenges, overcoming of the consequences of the global crisis and application of measures for raising the public trust. The latter concerns the small and medium enterprises since they cannot see how the Operational Programme works for them and how it supports their activity. As a result, the trust in the Programme on behalf of the business dropped considerably.

What are the direct and the indirect effects of the Programme? Many of the measures to be implemented are related to promoting supportive business environment for the SMEs, pro-active export policy, improving the effectiveness and efficiency of the business. Such measures aim at giving the business an opportunity for investing in new machinery, equipment and technologies because Bulgaria ranks among the last in terms of economic productivity. The Programme provides also support for transition to a knowledge-based economy, promotion of innovations created by SMEs and encouraging the cooperation between them and the academic circles. The Programme also stimulates "intelligent" investments, e.g. investments in technologies such as import of patents and know-how.

The fourth priority axis, managed by the Bulgarian Small and Medium Enterprises Promotion Agency, foresees pro-active export measures as promotion and support to SMEs for participation in exhibitions, fairs and trade missions as well as providing them with more detailed information about external markets. SMEs need to know what their position on the international scene is. Therefore, it is encouraged the organization of different information campaigns for the business as well as issuing of a catalog with the Bulgarian firms whose products and services could be attractive to foreign business. The axis also aims at optimization of the tasks and the activities of the economic and trade services provided by the Bulgarian embassies abroad as

well as promotion of export credits and multiplying the activities for export insurance. For the sake of sustaining the innovation activities and for promotion of “intelligent” investments, innovative start-up enterprises, commercialization of innovations and improvement of R&D personnel's potential are supported. All these measures referring to the pro-innovative structure of the economy are to be triggered in 2010 and are meant to create new and to further develop already existing pro-innovative infrastructure, to modernize the R&D equipment and to establish a national innovation network. In order to create new jobs, to save energy and to foster investments in green technologies which will contribute to the low carbon sectors, we will support investments in key future skills and in rising energy efficiency.

Which are the specific initiatives for counteracting the global economic crisis? We do increase budgets of future grants (e.g. 40 mln. instead of 20 mln.) by ensuring the possibility for advance and intermediate payments. When the Programme was launched such payments under the given procedure did not exist. On the other hand, beneficiaries encounter difficulties in obtaining a bank guarantee indeed. For this reason we initiated meetings with the Bulgarian Development Bank to negotiate what kind of a guarantee tool could be created as the Bank holds most of the capital of the Guarantee fund and it could help SMEs to receive the advance payments. Meetings with the Association of the Bulgarian banks are also in progress. We also increase the intensity of our assistance. For example, if it is up to 50 % for small and medium enterprises, there is an option for the assistance to be raised up to 70 %. The intensity of the assistance within the next calls has been already increased. Most of the efforts are focused on the execution of the JEREMIE initiative. The negotiations with the European Investment Fund

on all legal acts are already in their final phase, the investment strategy of the Holding Fund is already determined and we expect the Fund itself to be established by the end of 2009. From 2010 on it will be possible funds to be directed to SMEs through financial institutions. A review of the processes for accelerating the execution of the Programme will also be done. We have formed a few working groups to determine what the obstacles were for the Programme to work better and for the funds to be adsorbed more effectively by SMEs. Measures are undertaken for at least half of the proposals not to be rejected for administrative reasons yet in the first phase and to continue in the approval process with easier and quicker procedures. All these problems are already being solved. The manuals are already improved. We are doing our best for the funds to reach the SMEs.

These are the forthcoming procedures already approved on November 25, 2009 at a meeting of the Monitoring Committee. The total amount of the funds to be provided to the small and medium enterprises is about EUR 500 mln.

Anitsa Ruseva

Chief Expert, Ministry of Regional Development and Public Works of the Republic of Bulgaria, Sofia

Operational Programme “Regional Development” (OPRD) which is executed by the Ministry of Regional Development and Public Works is an infrastructure programme, which contributes mainly to improvement of Bulgarian municipal and regional competitiveness. OPRD is funded by the European Fund for Regional Development. The total amount of its budget is EUR 1.6 bln. or

more than BGN 3 bln., including a national co-financing amounting to EUR 240 mln. On November 5, 2007 the European Commission approved the “Regional Development” Operational Programme. The main strategy of the Operational Programme consists of few goals: to make living and working conditions in the regions and municipalities of Bulgaria more attractive by reducing the socio-economic differences both within the country and between Bulgaria and the other EU member states; to improve regions' access to different networks (communication, information and energy supply ones). By mentioning this it should be taken into account also the urban and industrial environment; the access to main services; the social, cultural and ecological environment.

The specific goals of the Programme are to build sustainable and dynamic urban centres and to connect them with the less urbanized surrounding areas; to provide better transport, information, communication and energy supply connections within the regions. Another objective of the programme is to improve the tourism potential, which could add value to the sector, to encourage regional cooperation and to merge local and regional cooperation capacities on national and European level.

OPRD pursues its main strategy goals through four priority axes, the **first** of them is a sustainable and integrated urban development. This axis is due to receive the greatest share of the total funding and emphasizes on the attractiveness and competitiveness of metro areas; their development; providing of better living conditions and access to public services by preserving the ecological potential of the regions at the same time.

The **second** priority axis is Regional and local accessibility. It is meant to rise and improve the connectivity between the regions in the larger metro areas and includes 86 municipalities on the territory of Bulgaria, which are defined within the Operational Programme's analysis. The first and the second priority axes spotlight on the urban agglomerations since they are considered to be centres of development and growth for their surrounding

areas. The Regional and local accessibility aims at improving roads and transport connections, building energy connection infrastructure as well as upgrading information and communication technology networks and gas supply infrastructure.

The **third** priority axis is sustainable tourism development. It is also a national priority and seeks to improve the regional tourism potential. The specific products from a given region have to be developed by adding value for the region which will influence positively the sector and the national sustainable development.

For the **fourth** priority axis of key importance is the local development and cooperation. Beneficiaries of funds within this axis are the municipalities, located out of the urban agglomeration areas and more precisely - those needing small scales of investments for a significant improvement of their competitiveness. Recently, the evaluation of projects on landsides as small-scale investments in small municipalities was completed within the current axis. Another direction of the axis is the interregional cooperation among EU regions (including Bulgarian) to focus on sharing experience in the field of OPRD. Beneficiaries are the municipalities, regional areas, district administrations, any kind of European regions and non-government organizations as well.

The last, **fifth** priority axis supports Technical assistance. It exists in all the Operational Programmes. Its share of the overall funding is 3.8 %, which amounts to a EUR 54 mln. It focuses mainly on improving the managing body's and beneficiaries' capacities for a better implementation of the Programme. Managing body for Bulgaria and a beneficiary in the same time is the Directorate General “Regional Development Programming”.

The first grant scheme was opened on 1 November 2009. The approval decision of the Programme was taken by the EC a few days later. The official opening of the Programme in Bulgaria was accompanied by events in Sofia and other second level

cities where the Directorate General is presented by territorial divisions. Parallel conferences announcing the start of the Programme were also held.

The amount available for the 21 opened calls is approximately 1/3 of the total Programme. According to the latest information as of 30 September 2009 a few projects are already in a process of evaluation. 539 project proposals are approved. Since many of the projects are in their final phase of execution, the current trend shows an increase of the transferred amounts. The contracts between beneficiaries and managing bodies include the option for subsequent execution and assignment of construction works and service supply by Bulgarian firms. In terms of crisis such a measure could contribute to the adsorption of funds anyway stipulated for Bulgaria. The funds stipulated in Bulgaria in accordance to the Operational Programms exceed the pre-accession funding several times. But these funds need to be adsorbed for the membership into the EU to have indeed a positive effect on the Bulgarian municipalities, regions and the whole economy.

European funding is also a tool for supporting the Bulgarian entrepreneurs executing public procurements. It encourages the economic activity and creates new jobs. The infrastructure activities within OPRD on municipal level could improve competitive living and tourist conditions, and could encourage economic activity in the regions also. For that reason, all the stakeholders need to strictly observe the rules and requirements established, to implement projects with the smallest possible delays, if any. Seeking optimization of the processes based on analyses, the EU requirements are improving and reflect the regulations of Structural Funds. Despite such a general optimization, the managing body in Bulgaria works on internal optimization of the control and management systems, including the Structural Funds Manual.

An increase is observed in the trend of transferred amounts from the managing body for the period November 2008 - November 2009. This is mostly valid in the last months. The overall increase was almost double in September 2009 compared to July 2009. Moreover, some final payments on projects under OPRD have been already made.

OPRD through its priority axis supports the social environment within the prerogatives and the territory of different municipalities, which include kindergartens, crèches and schools. The main beneficiaries of the Programme are municipalities as they are considered to be the main actors for regional development that could contribute to enhancing of local potential.

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The mission of the Bulgarian Development Bank (BDB) is to facilitate the implementation of government's economic policy in the field of export by SMEs and the access to funding. The tools for achieving that, as reflected in the Law for the Bulgarian Development Bank, consist in loans, guarantees and risk assets. The risk assets, scheduled to be involved in a risk capital fund subsidiary of BDB, were not in the focus in 2009.

The activities of BDB could be divided into two groups. The first group includes short-term pre-export lending and long-term investment lending. The main purpose of BDB is not to compete with the commercial banks but to complement their activities. In our activities portfolio prevail the investment functions. Another feature of BDB is the way of fundraising. It is focused in attracting external financial resources from different international financial institutions, mostly Europe-based (e.g. corresponding development banks), instead of using accumulated deposits. Another point is the fact that BDB is the only state-owned bank - the Ministry of Finance holds 99,9 % of its assets.

Since 2000 our international partners are the European Investment Bank, the Council of Europe Development Bank, the European Investment Fund, etc.

Despite BDB's specific characteristics and functions, it is obligated to act in accordance with the regulations valid for any other commercial bank. It complies with the state aid provisions and enjoys a strong support on behalf of the major shareholder. BDB increased its funds by more than 10 times during the last year. Our performance has been successful - we gained a profit of BGN 9 mln. in the first three quarters of 2009. The evaluation of our capital adequacy ratio is also very positive. To be mentioned is the shift from direct financing to on-lending - BDB provides financing to commercial banks which offer lending to SMEs. Such an on-lending is due to another feature of BDB - its headquarters are in Sofia and one more branch is based in Plovdiv while commercial banks have good country coverage which makes their services more accessible to SMEs.

In 2009 BDB has also a certain anti-crisis function. A share of assets, originally meant for capitalization of BDB was relocated to commercial banks in order to make the access of SMEs to funding easier. Within the last year we stipulated external resources for the SMEs amounting to EUR 103 mln. which is 150 % more than the resources in the ten-year history of the bank.

In times of crisis it is understandable that commercial banks encounter obstacles in providing loans to SMEs. Due to a risk increase and a more expensive price of free resources, the options for funding SMEs are even more limited than they used to be before the crisis. As a result, small and medium-size business becomes much more vulnerable. Secondly, the limited funding leads to investment cuttings and reducing of activities. Most affected appear to be the construction and metallurgy sectors, tourism, trade and services sectors. In many European countries including Bulgaria the access to loans is crucial for the economies to recover.

Clients of BDB are small and medium enterprises. According to statistical data, they amount to 282 615 and hold BGN 3 bln. fixed assets along with the corresponding incomes for 2007. They employ approximately 1.6 mln people. Products of BDB designed for SMEs are long-term loans (up to 10 years); loans under relieved security requirements; short-term export and pre-export loans and loans co-financed by the structural funds.

80 % of the Bulgarian Development Bank portfolio consists of investment credits, 96 % are one-year credits and 55 % are for a period exceeding 5 years. In terms of sectors, the manufacturing one prevails. However, the bank seeks a risk diversification by sectors. If the portfolio is considered according the planning regions, the leader is the Sofia region which reflects the concentration of economic activities and the territorial allocation of SMEs in Bulgaria.

Beside the direct funding, BDB provides also a targeted financing to commercial banks - the so called anti-crisis measures which started in 2008 and continued in 2009 as well. There are two programmes which are sought to facilitate the access to funding. The first target is SMEs and the second one - the farmers. An amount of BGN 375 mln. is stipulated within the first programme for providing long and medium-term loans. Because of liquidity difficulties short-term loans were added to the same programme. BDB has 14 partners within the two programmes. The beneficiaries number to 1216 for both programmes and the jobs created and preserved are respectively 1828 and 5926. The total amount of the assigned funds is BGN 460 mln.

While the partner commercial banks provide loan rates to their beneficiaries up to 7 or 8%, BDB interest rate is limited to 5 %. Another limitations concerns the maximum costs for taxes, commissions and administration fees which must not exceed 0.7 % of the total loan amount.

Depending on the given commercial bank's policy the loan collateral for a SME could be an estate, equipment or facilities. For the sake of lowering the risk in terms of crisis the commercial banks increase the required guarantees. However, according to statistics, SMEs do not obtain considerable amount of fixed assets. Of course the difference in their location, the depreciation and their technical specifications should be taken under consideration.

It should be also taken into account that the most of the newly established entrepreneurs do not own enough fixed assets to guarantee a loan, which raises a need of guarantee schemes. BDB has signed an agreement with the European Investment Fund (EIF) in 2003 amounting to EUR 42 mln. Currently the bank has another guarantee line of EUR 60 mln. which allows further loans to be raised up to this amount.

What does a relieved collateral requirement mean? For example, if a given loan requires collateral of 100 %, BDB is able to decrease the percentage to 80 %, on the basis of the guarantee line provided by the EIF. This represents a decrease by 20 %. The requirements to the beneficiaries are as follows: the beneficiary should be a SME; the loan could be long-term or at least 18-months; the loan could be up to EUR 500 thsd. and the total amount of the exposure to a given entrepreneur must not exceed EUR 1 mln. Usually such loans are funded under the BDB programme. Basically, BDB and EIF share the risk and if a given loan is bad, the two institutions will also share the loss in the proportion based on the credit portfolio of loan guarantees. After the overall recovery of the bad loan, BDB restores the share assigned to EIF.

The National Guarantee Fund (NGF) was established a year ago and is 100 % owned by BDB. It is competent to issue guarantees of collateral supplements for SME loans, granted by commercial banks. Ten contracts with commercial banks amounting to BGN 76 mln. have already been signed. The number of collaterals issued as of 30.10.09. equals to BGN 3 mln. but there is still a

room for improvement. The possibilities for a NGF development are significant. If we assume a leverage of 3-4% over the BDB capital, which is BGN 80 mln., the issued collaterals could reach up to BGN 320 mln. Naturally, the usage of these funds and the above mentioned funding scheme depend entirely on the given bank's policy and its risk estimations. The highest amount of the guarantee for investment loans is BGN 500 thsd. and for turnover loans - BGN 250 thsd., taking also into consideration that the expenditures on collateral issuing could not reach more than 1 %. We work on improvement of the collaterals as well as on increasing the number and the amounts of the contracts.

CHAPTER TWO

BULGARIA AND THE EUROPEAN FRAMEWORK OF COMPETITIVENESS

Prof. András Inotai

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Firstly, let me mention that in some parts of Europe, the competitiveness in the last period has got not only a positive but also a negative evaluation. It is the same when we talk about reforms. We are talking about reforms and when we want to introduce some of them, we experience a lot of opposition from different social groups. And then there is a certain reform fatigue. And that is to some extent what we see also in the European Union - a competitiveness fatigue in the last period. So, competitiveness by a large number of people is more and more considered to be a pressure of constant adjustment. And if there is a constant pressure for adjustment to a new situation, it always hides lots of risks; it is connected with personal and social costs. And this has been emphasised instead of keeping on stressing on the chances the crisis is offering and not only the risks and the additional costs.

The global map is characterized by the emergence of new countries. We have much more competitors both on a country level and even more on a company level and we have a number of new factors of competitiveness. If we look at the number of different competitiveness rankings we have - from the Institute for Management and Development in Lausanne and the World Economic Forum, etc. If one takes a look at all these surveys it becomes obvious that they have become more and more comprehensive in the last ten years than they have been before. At the beginning they have included just some economic factors. Then later they started to include good governance, institutions and in the last years - even social behaviour. If you look at one of the latest comprehensive reports both produced by the Bertelsmann Foundation - one on the Transformation Index and the Sustainable Governance Index you can see that there are more than 100 factors and there is a very clear shift from the status oriented economic factors towards longer term factors like investment in education, health, the appreciation of the human

factor and how the societies are working - to what extent the societies are able, capable and willing to adopt and to support some reform measures. And that is extremely important if you look at the crisis and particularly at the potential post-crisis situation.

Which countries will become winners of the post crisis situation? To a high extent it is not dependent only on the economic policy of the countries. It is dependent to a growing extent on how the societies are able to perceive the chances and not to oppose all the adjustments saying we have some vested interest we would like to protect what we have achieved and the less we can protect, the more we try to protect it - that's very human. And that is my first point.

The second point is that some of the traditional competitiveness factors do not work anymore. One of them was of course cost-price or the price competitiveness. That is a very old theory that if you have low labour costs then you will attract a lot of foreign direct investments. If the low labour costs had been the main attracting factor of international investments, today 95% of international investment would be in Sub-Saharan Africa, which is not the case. Of course, low competitive labour costs are important but there are a number of other factors. For instance, in technology-driven economies, the labour costs have a fraction of 2 to 3 % of the total costs. Much more important are the innovative capacity, physical infrastructure, good governance, etc. The second old element that used to be factor of competitiveness is the exchange rate policy. That was a wide-spread experience in the 1970's, 80's, even in the 90's. Main idea was that if a country started devaluating its currency (that is the East Asia model with competitive devaluations at that time), then you can get additional competitiveness; you will be able to explore new markets; to increase market shares, etc. What we see today is that particularly in globally opened economies, which are operating with a number of transnational companies; if your exchange rate is depreciating it does not bring much more market share because generally your exports have very high import content. So, if you devalue then immediately the import value is increasing and the only theoretically positive impact you can

perceive of devaluation is the value added. If you have a very low value added (8-10 %) of the total exports then the negative impacts may outweigh the potential positive ones. We have also seen that there are three Central European countries - Poland, the Czech Republic and Hungary that have depreciated their national currencies by about 20 % in the last year. And none of them was able to compensate at least partially the collapse of the international trade. One explanation is that the collapse was so dramatic that even a 20 % potential benefit in the exchange rate did not help or it did help in some countries but not in direct exports. It "helped", for instance to all the three countries but via the latest EU member-state - Slovakia in a way that Slovak citizens are not buying in Slovakia at all - all of them are shopping in Poland, in the Czech Republic and in Hungary. That has of course repercussions in the domestic economy. And then the role of the exchange rate has been revitalized because these countries are members of the EU and they are striving to become members of the Euro zone. For that they have to take into account the Maastricht Criteria and convergence towards these criteria, which keeps the exchange rate policy very much constrained even if the exchange rate is free floating.

Another traditional element used to be what I would call regulatory competitiveness. It was used by the latest EU members before their accession and they have made a broad use of this instrument. They were attracting foreign companies with very low taxes, holiday taxes with a lot of additional support. And this is not anymore possible because of the competition rules of the EU. So, you have to be very careful what kind of attraction is allowed by Brussels and what is not allowed.

Next point is very important. Recently Mr. Trichet - the president of the European Central Bank emphasized on the connection between the external and internal dimensions of competitiveness. It means that infrastructure, transportation costs, technological development and last but not least - intensive competition on the domestic market is a pre-condition of external competitiveness. The more the country is closed, the

more the domestic market is maintained for domestic producers and the less competitive these firms would be on the international market.

The next point is specialization. There has been a change and there is a constant change among the individual countries. There are three different specialization patterns. One is what we call factor-driven, that depends on labour costs, primary education, macroeconomic stability, institutions, and infrastructure. The second is efficiency-driven that is goods and labour market efficiency, financial markets sophistications, technological readiness, higher education and training. And the third one is innovation-driven. Now we can see in which stage the individual countries are and which countries are in transitional stage between factor-driven, efficiency-driven and innovation-driven competitiveness. One case is not very well known - China is between factor-driven and efficiency-driven competitiveness. It is far not only factor-driven as many people say the Chinese commodities are produced at a very low labour costs and they have only that competitive advantage. But if you look at the Chinese export to the EU more than 50 % of the Chinese exports contain medium and high-tech products. Whether the high technologies come from Chinese or from European or American or Japanese multinational companies working in China is another issue. But it is by far not cheap, low-quality, labour intensive goods. And these 50 % of the Chinese export is by about 40 % more than the total EU exports to China.

One more point here is the static versus the dynamic element of competitiveness. It is quite clear that in future the dynamic elements will be appreciated, upgraded. It means not only relying on prices and costs and maintaining the old structure that at a certain time used to be competitive on different markets. It's the capacity of the companies and governments, to learn to react rapidly to the challenges and to innovate. The capacity of permanent modernization of technology and of management has become and will become the key element of international competitiveness even more in the post-crisis situation.

And the last point here what is expected to change is the governments - not only the good governments, but also efficient governments as well. It is not by chance that the OECD has published a book recently - "Government at a glance, 2009" emphasizing the importance of efficient government policies in preparing the member countries of the OECD to the post-crisis challenges of international competition.

Another point is how is the competitiveness related to the crisis? I have two more remarks here. One is that as the negative growth was accompanied for the 1st time after the WW2 by the dramatic collapse of international trade in a short term seems that countries with large domestic market did suffer less than those which are absolutely open. However, in the post crisis situation it is quite clear that small open economies with a high level of flexibility will be again the winners. So, don't be deceived, don't be diluted in your judgement by the importance of the large domestic market. The large domestic markets are not closed markets either. In the EU everybody in the internal market can go to the large domestic market of Germany, France and the other countries. The second remark which is much more important is how the anti-crisis measures may have influence on the future competitiveness of the European countries.

The impact may be positive and negative. It is definitely positive if the anti-crisis measures have been focused on restructuring of the companies, or the banking sector that has been supported, and if these anti-crisis measures contributed or have been contributing to the creation of future-oriented competitive jobs. Unfortunately, most of them were taken by those European countries that were in a position to take such measures on a large scale, they have supported structural rigidities. Most of the bailing out - be it banks, be it the car industry have not been connected with restructuring. We will bail out the banking system; we will bail out the car industry, we will keep 10 000 of jobs (mostly uncompetitive jobs) for the future. But that is certainly not the way. In the European Union several countries will be facing a lot of problems including the budgetary constraints because of the huge indebtedness in the next period.

The last point is concerning the vulnerability - competitiveness and vulnerability especially in the small new member countries and what can we do in this case in order to increase our competitiveness. Firstly, the financial vulnerability - that was the case in Hungary particularly, the EU was suffering very much from the financial vulnerability. Here the tasks are quite clear - solid fiscal policy, higher savings, a lower interest rate, a lower margin between the domestic interest rate and the Euro interest rate. These are mainly domestic tasks. Concerning the trade vulnerability all countries have been suffering from the trade vulnerability. The answer is not closing down like some populist politicians used to propose because the country is too much open and it should close down. But how could you do so if you are a member of the EU? The answer is not to close down. The answer is: try to diversify your export structure to dynamic markets. As it in fact happened - most of these dynamic markets are outside the EU. But if you are on the company level - the companies have niche strategies. There are very dynamic niches also in the European market even if the total EU market is not growing at all.

The other vulnerability is the sector vulnerability - specialization vulnerability. What kind of industry did you specialize on? Was it the car industry, computers or electronics; was it food industry, textiles, labour intensive goods? In fact, those countries that have specialized on higher tech industries - machinery, cars, electronics, and telecommunication equipment, they seem to suffer more at the moment. Because we have to buy bread every day, we don't have to buy a car every year; we don't have to buy a new computer every half a year. But, again - the answer is not to specialize on other sectors such as shoe industry. Would you like to compete with Vietnam? You can do it, if you have Vietnamese wages, but will have to tell the society that in the next twenty years they will have Vietnamese wages. So, are you satisfied with it or not? Then the answer is - deepen the sectoral specialization and increase the value added to your domestic production.

There is a structural vulnerability as well. It is expressed in the duality of the production structure - you have a very competitive transnational sector, and you have the enterprises generally small and medium size and they are generally lagging behind, not competitive, etc. In the EU where there are a number of programmes to help the small and medium size enterprises - in small countries like Hungary, but I would say also in Bulgaria also, there should exist two very important criteria for those SMEs, allowed to get EU funding. First is that they have to prove that they are also competitive outside the domestic market it can be that you are a sub-contractor to multi-national company in your country but even more are able to export at least to the neighbouring countries. Such an export capacity has to be developed. And the second criteria for receiving funding are that if you have a brilliant idea, you should also indicate the spill over or the multiplier effects of your project. It is not enough to have a good idea. You have to specify - it will create additional labour or jobs, it will contribute to regional development, it will improve the physical environment, it will have some innovative ideas also for the other sectors, etc., etc.

And the last which is probably the most important issue in the future - the social or the mental vulnerability. All our countries are vulnerable in this sense. The question is how much social cohesion, how much insurance, how much crisis awareness and crisis management capacity is available in the country. Not only on company level. Not only on the level of public administration, on the level of societies. To what extent the societies are open, adjustable, flexible, and future-oriented, instead of going back to the past. And here I could make two final remarks for our region; unfortunately I don't know how we could change them. All the Central and South Eastern European societies after 20 years of transformation are characterized by prematurity, if you want - early born consumerism instead of saving. Without much higher savings, and it is not financial but behavioural question, to what extent the society is able and ready to invest into the future rather than to consume all that has not been produced. Unfortunately, last 20 years because of this catching-

up process and the demonstration effect coming from Western Europe were characterized by this early born consumerism. It is very difficult to change that. And the last is how to create social capital, solidarity, small community cohesion, families and future-oriented networks, long-term education and health issues, etc. investing into the human capital. Tallentum is a London-based research institute. It has produced a list based on the performance of 104 countries according to the innovative capacity, macroeconomic stability, education, health, etc. Hungary holds the 27th place. The Czech Republic is 25th, Slovenia 20th. But in all the indicators except one Hungary is fluctuating between 21 and 30 which is good in average. There is not much discrepancy from the 27. But there is one indicator that the country occupies place 92 out of 104. And that indicator was social capital.

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Bulgaria is the EU member state with the lowest production costs. Another competitive advantage remains the favourable tax environment for the corporate sector and even more favourable after introducing the 10 % flat taxation of individual incomes. For an exception could be given the social insurance payments that are among the highest in Central and Eastern Europe (CEE). Even though, the tax environment could be defined as one of the most favourable in CEE. Bulgaria is considered by the foreign investors a gateway to the Western Balkans markets and the Black Sea region. The key location of Bulgaria and its closeness to the Western Europe countries gives the country additional competitive advantages. This is even more important in the context of unequal competition with India and China, for example, which are offering much lower labour costs than Bulgaria does. Unlike them, the country has the potential to produce limited series of products with lower transport costs and deliver them relatively faster. Besides, the proximity to Western Europe is an encouraging factor for Western companies to enter the Bul-

garian market, because the closeness appears to be important for the branches' effective management. According to World Bank estimations, Bulgaria obtains one of the most flexible labour markets compared to all new EU member countries with emerging economies.

In regards to the international trade specialization, Bulgaria obtains competitive advantages in the traditional labour-intensive goods and products from sectors such as food and drink producing, clothing and textiles, furniture sector. Moreover, the country keeps good market positions in producing intermediate products like metals and chemicals. Bulgarian industry and economy are also high energy-intensive. The low-technology manufacturing industries with insignificant value added are predominant. The relative share of high- to semi-technology products in the total exports is approximately 20 %. In comparison with the CEE countries like the Czech Republic, Hungary and Poland the same indicator values at 40 to 55 %.

If we use Michael Porter's theory on economic development stages, it could be concluded that the Bulgarian economy is in the transition stage between the *factor-driven stage* and the *effectiveness-driven economy*.

The first stage is specific for states depending entirely on access to production factors (mostly cheap labour force and natural resources). The companies within this first stage of development are competing entirely on a price basis of offered goods and services and the economy specializes in producing low complexity goods, mostly extraction of raw materials and producing intermediate goods. The low productivity characterizing this stage also determines the low wages.

In the *second, efficiency-driven stage*, the countries focus gradually on implementing more effective production processes and on improving the quality of goods and services. The economy gradually makes a transition to producing goods of higher complexity. Consequently, one can observe an increase in pro-

ducing semi- to high-technology goods such as durable and investment goods. Main characteristic of the companies in this development stage is their willingness to invest not only in physical capital but also in high quality workforce. Therefore, the competitiveness of the countries in this stage of development progressively depends on the higher quality of education and qualification of the workforce, the effective functioning of markets and the flexibility of the labour market, and on companies' access to new technologies as well as their readiness to take advantage of them. At this stage, the existence of well developed financial markets is extremely important for guaranteeing that the savings will be located to the best entrepreneurs' projects proposed for funding.

What are the main challenges towards the transformation of the Bulgarian economy from the factor-driven to effectiveness-driven? If we take a look at the Global Competitiveness Index (GCI), Bulgaria lags behind the rest new EU member-states in three main pillars. Namely - the Institutions, Infrastructure and Financial market sophistication.

The quality of economic institutions is important because they determine the stimulus of the economic operators which is the main tool for influencing economic operators. Moreover, the institutional environment influences the investments in human capital and new technologies and thus also the organization of production processes. The institutional environment reflects not only the total economic growth potential of each country but also the effective allocation of resources within the economy. It also has a leading role in the process of distributing public benefits and bearing the costs needed for economic modernization. Therefore, the institutional importance is far not limited only to drawing the legal framework or in other words defining only the "rules of the game". The governmental attitude towards the freedom of market and its effective functioning is crucial. According to GCI, Bulgaria is far beyond the levels reached by the CEE countries and those considered acceptable in the field of fight against organized crime; legislation effective-

ness; independence of judicial system; prevention of misuses of public funds; bringing back the public trust in politicians; equal rules for all companies and entrepreneurs in regards to the decision-making process; restrain the wasteful spending of public funds; protection of property rights; and the barriers put in front of the business from the number of regulations.

The quality of education and healthcare are also fundamental for the competitiveness and productivity improvement. That is extremely valid for the Bulgarian competitiveness aiming at modernization and reduction of labour-intensive and low technology sectors with low value added in favour of sectors offering highly paid jobs and producing high technology products.

Unfortunately, GCI indicates Bulgarian education is inadequate for what the business demands. CGI also estimates the flows of brain draining; the qualification of personnel; the quality of management schools' tuition and the extent to which the companies are adsorbing new technologies as disappointing, which underlines the need of urgent and deep reforms in these areas.

The balance between increasing labour costs on the one hand and improvement of business environment on the other will shape the evolution of competitiveness sources and at the end - how successful Bulgaria would be in its efforts to restructure the economy. This definitely means that the country needs to speed up the reforms towards improvement of institutions, including healthcare and education similarly to the CEE countries. In perspective, the evolution of the Bulgarian competitiveness has no other alternative, because the current low labour costs are source of competitiveness only in short term. Such a source simply cannot exist along with China and India. Moreover, the low labour costs oppose the national ambitions of reaching the incomes and standard of living in EU.

Simeon Semov

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What is the linkage between competitiveness and the stock exchange? The Bulgarian Stock Exchange (BSE) is the place where admitted shares and securities are being dealt with. The connection to competitiveness consists in the fact that the stock exchange gives the chance to good ideas for given business development to congregate with free individual or institutional funds. They are to be invested through the stock exchange in those companies estimated by the analysts to be the best performing. Thus, the most competitive companies will receive the best financial support. There is a direct relation between the stock exchange and the national economy - one big stock exchange could not exist in a small economy. So, the stock exchange is a reflection of the national economy.

BSE has strengthened its role in the field of financial intermediation. Many experts say that funding through the stock is a bank loan alternative. The truth is that the stock exchange meets operators with a lack of resources with those who need funding. For an economic operator to receive funding through the stock exchange is necessary to meet certain requirements - to own a joint stock company, to keep a number of specific functions; to be listed in the public register of the Financial Supervision Commission; to obtain a public status and only then the economic operator could deal with its shares on the stock exchange.

Public funding through the stock market has become a good alternative of bank loans from 2004 till recently. The investments in stock market financial instruments have increased significantly. Unfortunately, an indicative fact is that there is not a single initial public offering during 2009. The process of privatization is another option for the stock exchange to be successfully involved. A privatization through the stock exchange is among the most transparent ways to privatize a company. If such decision is taken, the government can get the highest price for the deal

and it will be done transparently, in accordance with the specific requisites for the process. On the other hand, the investor who acquires ownership of the public company will not be engaged in preserving jobs, fulfilling plans, etc. which are required according to the other ways of privatization.

Main principles in stock exchange trading are the equality of all players and irrevocability of the transactions. Bulgaria was obligated to harmonize its legislation to the European directives and that was made very quickly but unfortunately in the easiest way - by copy-pasting the directives in our legal acts, instead of trying to cope with them but in accordance with our national specifications. Main European directive, treating investing through stock exchange trading is the Markets in Financial Instruments Directive (MiFID). The main benefit of that document is related to the so-called MiFID passport, which gives a firm once authorised, the right to use the MiFID passport to provide services to customers in all other EU member states.

What are the injuries caused by the financial crisis to BSE? The foreign investors stepped back in the end of 2008. While in 2007, 43 % of the foreign assets were invested through the Bulgarian Stock Exchange; in 2008 they decreased to 15 %. Some of the planned IPOs were postponed and part of them did not take place at all. The listed banking institutions limited also their activeness. Institutional investors like large funds and predominantly pension funds are extremely cautious. Unfortunately, we experience an extremely low liquidity and turnover and as a result almost all small investors (individuals) withdrew from the stock exchange.

BSE reached its peak in October, 2007 followed by a big crash. The trade intensity fell down to its levels from the end of 2004 and the beginning of 2005.

What is next? After considerable drop in the indexes, we observe a hesitant stabilization as well as a hesitant increase, though,

it is still too early to be concluded that these are signs of an overall improvement. The interest in the stock market as an alternative source of funding for the business gradually comes back. Anyway, it should be clear that everyone seeking funding through the capital market should be at a certain economic development stage for being able to pay the price for issuing shares. It needs to be mentioned also that the price for being issuer on the Bulgarian Stock Exchange is among the lowest world-wide. The government has also declared willingness to trade shares of the state monopolies using the platform of BSE

Among our main priorities is to provide an active support to public companies. The BSE team is ready to consult them on any issue in case to back their activity. We organize events like round table discussions for promoting and provoking the enterprises to be listed at the stock exchange and to issue stocks. The BSE has become popular both among people and business circles. The first step towards integration within the developed EU markets have been made by promoting the worldwide electronic securities trading system Xetra "Exchange Electronic Trading" based in Frankfurt, Germany. It is also used in Austria, Ireland. Xetra is used as a base in China, Shanghai.

It could be concluded that the CEE countries' potential remains high. Bulgaria could again obtain the position of attractive place for investments, including those attracted at the stock exchange. Furthermore, the country has positive perspective for turning into a regional financial center.

Micho Chipev

Exhibition Director, German-Bulgarian Chamber of Industry and Commerce, Sofia

Among the tools for real-time definition of competitiveness and for market positioning of the Bulgarian products on the international markets is the participation in fairs and exhibitions. One of the priorities of the German-Bulgarian Chamber of Commerce

(GBCC) is to provide support to the German, Bulgarian and firms from third countries, interested in the German-Bulgarian bilateral relations.

How is this priority realized? We help the German firms coming to Bulgaria to participate in exhibitions. The chamber also represents a few German fairs in Bulgaria. More precisely - our organization represents six of them and the rest are represented by German companies, which have Bulgarian offices. There are less than 1 000 companies from Bulgaria manufacturing products which could be presented at international fairs. These are the Bulgarian export companies. In Germany they reach 400.

One of the main mistakes made by Bulgarian companies while participating in a fair is the lack of goals to pursue. The main indicator of competitiveness for a given company remains its ability to buy and sell. For this purpose it must either produce goods (services) or hold free capitals. When the company is able to trade, then it becomes an object of interest on behalf of the other economic operators. The main idea of fairs consists in meeting those companies offering their production with the ones willing to buy it.

Along with the export, the import is also determinative for the overall competitiveness. If a company holds free capitals, this is a sign that it is well performing. On the other hand, the fairs and exhibitions give total information about the products: did they gain market positions and what exactly are those positions. The distribution is also a crucial link in the whole process of selling a product. Unfortunately, in the general case the Bulgarian companies can only use their local distribution networks. This definitely prevents them from succeeding on the European markets. In this regards, the fairs and exhibitions give good perspectives for establishing and strengthening positions abroad.

How could the government choose fairs in certain country and how could the government encourage Bulgarian firms to participate? The only (or at least the most imperative) criterion is

the volume of the export. That reflects the last years' trends. The same concerns the import, respectively the gross product.

Another important point is the definition of interests. A weak point of the Bulgarian economy is the definition of sectoral interests and interests of group of companies. You are probably familiar with the fact that it is difficult for industrial and trade chambers to examine the interests of their members, let alone to reach unification. The definition of group interests itself is very important but hard to be achieved in the case of Bulgarian strong individualism. Efforts in this direction could have a positive affect on country's competitiveness.

The governmental policy should not focus on increasing the companies' competitiveness. That is definitely not governmental mission but responsibility of the companies. The only thing government should do is to create conditions for the companies to exist, to produce and respectively - to contribute to the budget revenues. It is totally wrong policy if the cabinet chooses which the priority branches will be. From strategic point of view this leads to distortion of competition and wrong market positioning, experience shows. The government obtains tools for stimulating certain sectors. For example it could set public targets and the companies to compete for the adsorption of the earmarked funds for public purposes. That would indeed improve the competitiveness.

The business indicator prepared by the National Statistic Institute in Bulgaria measures the expectations for development of the Bulgarian business from 1997 onwards. Another available data is those extracted from the Bulgarian-German turnovers which could be considered representative (covers approx. 8-10 %) for the total Bulgarian turnover. The correlation between both indicators definitely exists - the business expectations are involved in direct subordination with the traded volumes between the countries. Any change in the attitude leads to a fluctuation in volumes.

Having available the import and export in and out of Germany along with the number of Nuremberg fair visitors in Germany, a comparison between them could easily be made. The main conclusion is that the top 10 visitor countries are those having highest trade volumes with Germany. This makes it clear that even the highest willingness is unable to make a difference in a chart order. There are certain actual parameters and given economic limitations which makes it impossible to switch positions without firstly improve them. This is completely valid for Bulgaria. Countries from the EU are among the top 10 trading partners of Bulgaria. A diversification it the trade contacts with the second and the third tenth partner countries could be positive.

The governmental policy allowed another weakness in 2009 e.g. the funds through the Bulgarian Small and Medium Enterprises Promotion Agency were exhausted yet in March 2009 and there are not even estimations for such funds in 2010. While any given country participation in such a fair demands preparation exceeding a year or year and a half. Therefore the government and all the interested parties need to reconsider the possibilities for Bulgarian companies' to participate more actively in fairs and exhibitions, which would reflect on their overall competitiveness.

CHAPTER THREE

PERSPECTIVES FOR THE DEVELOPMENT OF THE BUSINESS CLIMATE IN BULGARIA

Tsvetan Simeonov

*President, Bulgarian Chamber of Commerce and Industry,
Sofia*

General Indicators for Business Climate Assessment (Positive Impacts)

- Banking system - stable;
- Monetary system - no currency risk (fixed exchange rate), low inflation;
- Political environment - functioning democracy;
- Effectiveness of the judicial bodies - signs of improvement;
- Labour market - increased unemployment rate (opportunity for expert selection).

General Indicators for Business Climate Assessment (Negative Impacts)

- Banking system - high interest rates;
- Monetary system - currency board in Bulgaria and currency devaluation in neighbour countries (Romania, Turkey, etc.), cost raise of Bulgarian goods and services compared to the other countries in the region;
- Political environment - division and disagreement between the ruling party and the opposition on all matters (lack of national consensus on strategic issues);
- Effectiveness of the judicial bodies - slow reforms, disuse of arbitration and mediation;
- Labour market - lack of sufficiently qualified labour force (despite growing unemployment/ wage increases for those who remain employed).

Specific indicators

- Tax burden;
- Administration and Regulations;
- Access to financing;
- Public procurement transparency;
- Shadow economy rate.

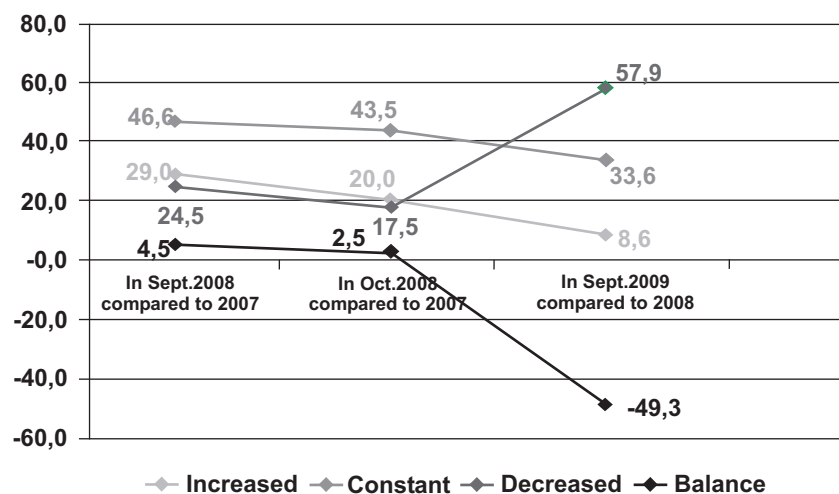
Perspectives for the Business Climate

- Good perspective compared to other countries, if tax stakes remain unchanged - they will stimulate investors;
- Fight against corruption preconditions sends positive signals to foreign investors;
- Stable budget with no deficit also has a long-term positive impact on investment intentions as it does not suggest further internal increases to treasury liabilities.

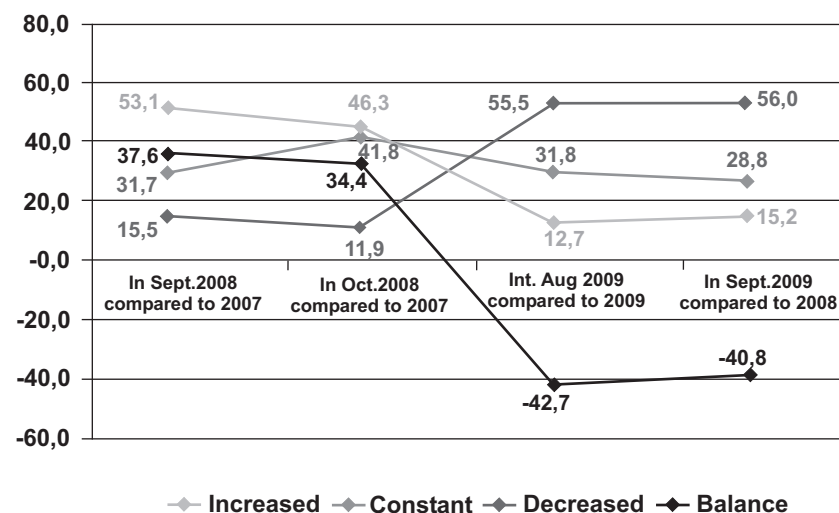
Necessary Actions

- Attention must be paid to further administrative functions optimisation by:
 - Computerisation of all activities (breaking the chain client-clerk)
- This will allow administration reduction and cuts in the budget expenses.
- Focused and prudent advertising campaign of Bulgaria and its business; advertise the good framework for business and Bulgaria's attractiveness - messages must be conveyed to the companies and persons with investment interests.

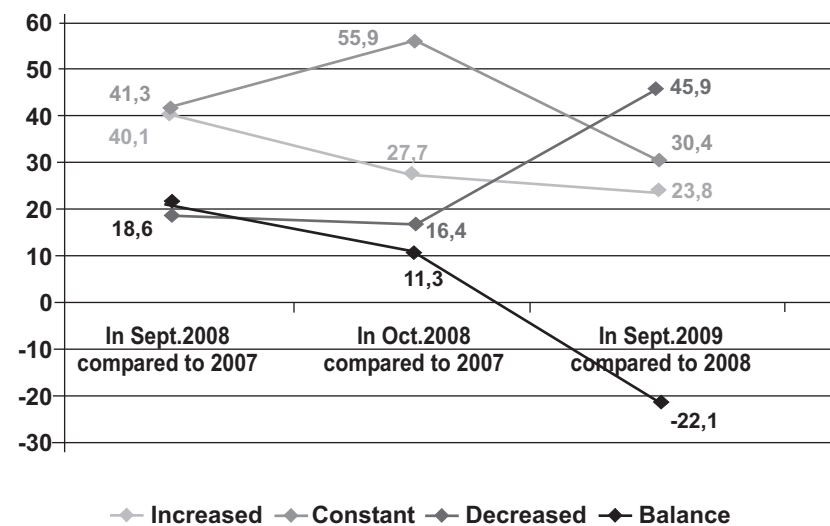
Enterprise assessment (in %) for business conditions in 2009 compared to the previous year 2008



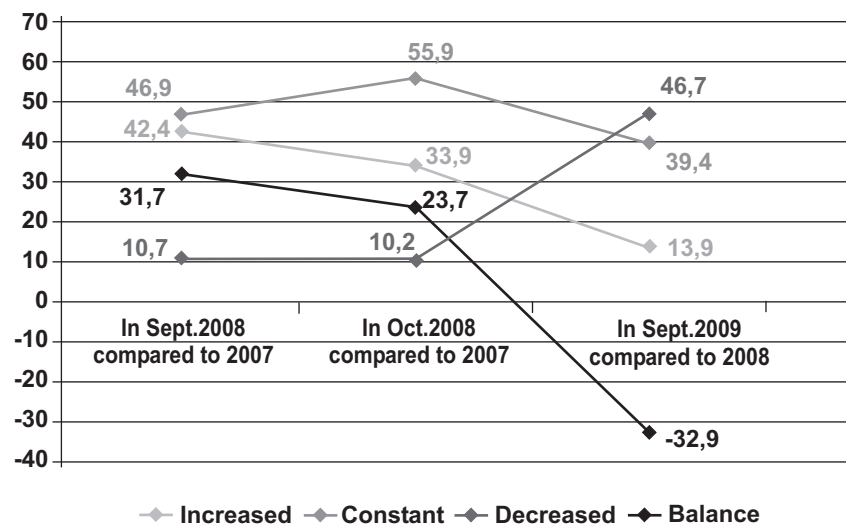
Enterprise assessment (in %) for sales revenues in 2009 compared to the previous year 2008



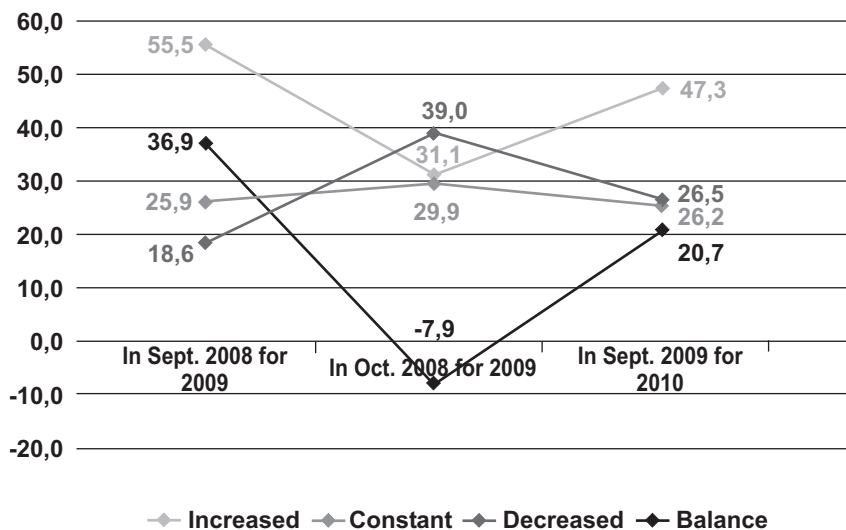
Enterprise assessment (in %) for export revenues in 2009 compared to the previous year 2008



Enterprise assessment (in %) for investments in 2009 compared to the previous year 2008



Enterprise forecasts (in %) for business conditions in 2010



Dr. Evgeni Evgeniev

Private Sector Development specialist, World Bank¹

The World Bank regularly prepares analytical studies and provides policy recommendations to the Bulgarian government that are also discussed in public. In the dawn of the global financial crisis one of these reports was the Bulgaria Investment Climate Assessment published in three volumes in autumn 2008². It includes an extensive study of numerous factors that affect the investment climate in Bulgaria. To a large extent this report is still up-to-date (in particular the analysis and the recommendations for business climate improvements). In the regulatory reform field, the World Bank prepared four reports on Bulgaria since 2006 and two more are to be released by April 2010³. The specific goal of this expose is to direct attention to the regulatory reform which turns out to be the key for better business climate. Answers to three important questions shall be pursued, namely: (i) why is it crucial nowadays to put regulatory reform on top of Bulgaria's priorities?; (ii) what is the current state of the regulatory environment in Bulgaria compared to other countries in the region?; and (iii) how to achieve more favourable business climate in Bulgaria through the regulatory reform priority areas for the near future?

¹ Responsibility for all errors, omissions, and opinions rests solely with the author. This paper has not undergone the review accorded to official World Bank publications. The findings, interpretations, and conclusions expressed herein are those of the author and do not necessarily reflect the views of the International Bank for Reconstruction and Development/The World Bank and its affiliated organizations, or those of the Executive Directors of The World Bank or the governments they represent. The World Bank does not guarantee the accuracy of the data included in this work.

² World Bank (2008). *Bulgaria: Investment Climate Assessment*. Washington DC.

³ The reports are prepared within the framework of the Technical Assistance in the Regulatory Reform area between the World Bank and the Bulgarian government since end 2006. Main partners of the World Bank for this work are the Ministry of Economy, Energy and Tourism and the Directorate within the Council of Ministers Administration which manages, coordinates and controls the implementation of the Better Regulation Programme (2008-2010). The two World Bank reports that shall be completed by April 2010 are: (i) Report on the Administrative Barriers to Investment in Bulgaria; and (ii) Report for Post-Regulatory Impact Assessment of the Law on Limiting Administrative Regulation and Administrative Control on Economic Activities Act.

Why there is a need to put regulatory reform on top of the Bulgarian policy agenda?

In the first place, poorly designed and administered regulations impose major constraints to growth and productivity and create strong incentives for small businesses to remain in the informal economy. In this light, Bulgaria does not want to drive firms (small firms, primarily) into the informal sector, especially nowadays.

Secondly, the regulatory reform strategy must take a systemic approach. Regulatory and administrative barriers and policy inconsistency, as well as instability and unpredictability, are among the most significant impediments to both foreign and domestic investors. Hence, on the one hand, the current government needs to continue the successful reforms and good practices that have been put forward by the previous government in the area of regulatory reform, and on the other hand, the present cabinet needs to prepare the ground for the inflow of foreign and domestic investment after the global financial crisis is over.

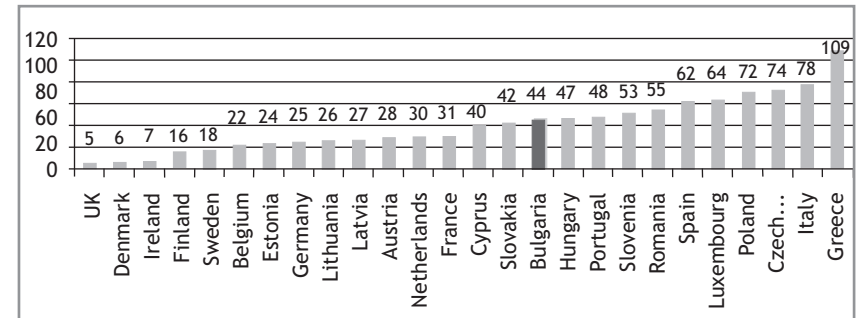
Thirdly, effective regulatory reform processes and institutionalization of the system for monitoring and control of the regulatory environment would improve the investment climate by reducing policy risks and cutting regulatory costs for the businesses. Thus, not only the business benefits from better regulation, but it is also the government that profits by cutting red tape and improving administrative efficiency.

What is the current regulatory environment standing of Bulgaria compared to other countries in the region?

Concrete regulatory quality indicators demonstrate the position of Bulgaria among other EU members. Figure 1 shows Bulgaria's ranking according to the Doing Business 2010 report of the World Bank. The ranking (which does not include Malta) suggests that Bulgaria obtains the "golden mean" compared to the other EU

members. Of course, one should bear in mind that the countries behind Bulgaria might be well developed or stem from a more developed regulatory environment where the need for reform change is not so pressing.

Figure 1: Regulatory environment standing of EU members



Source: *Doing Business 2010 report (World Bank)*.

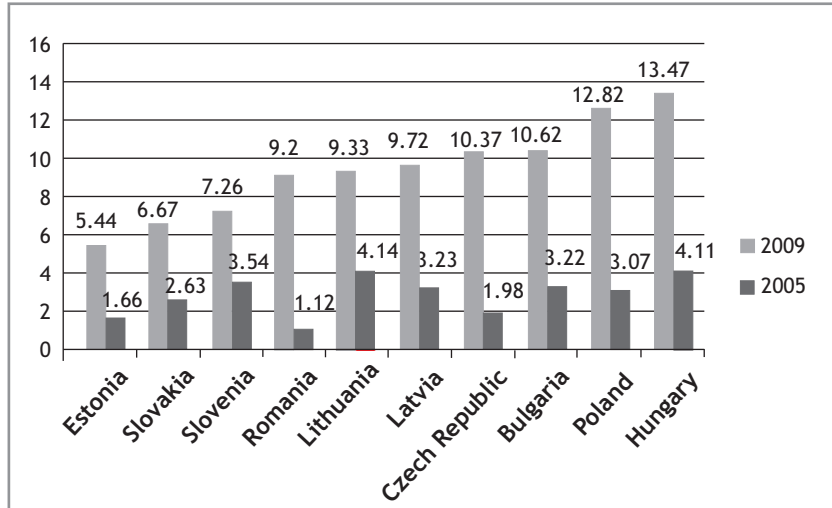
Actually, the report renders an account that Bulgaria concluded two reforms in the fields of starting businesses and registering property. In comparison, successful reformers in the field of regulatory reform are considered those countries that manage to conduct seven reforms per year, on average⁴.

Despite the undertaken reforms, Bulgaria still has some catching-up to do. The most recent Doing Business 2010 report marks the results up to June 2009, respectively, the Doing Business 2009 report reflects the results until June 2008. Therefore, the last report does not mention the reforms undertaken by the new government in respect to "Starting a Business", namely reducing the minimal paid-in capital for trade companies to BGN 2 and cutting registration period for firms to 4 days. The other indicator is "Closing business activities". In this area, Bulgaria clearly needs a change and this will be touched upon again at the end of the paper.

⁴ The whole Doing Business Index comprises ten indicators.

Comparative data with the EU-10 in the field of corruption, informal economy and regulatory quality, are shown below. These are taken from periodical World Bank Enterprise Surveys.

Figure 2: % of Bulgarian senior management time spent in dealing with requirements of government regulations in 2005 and 2009

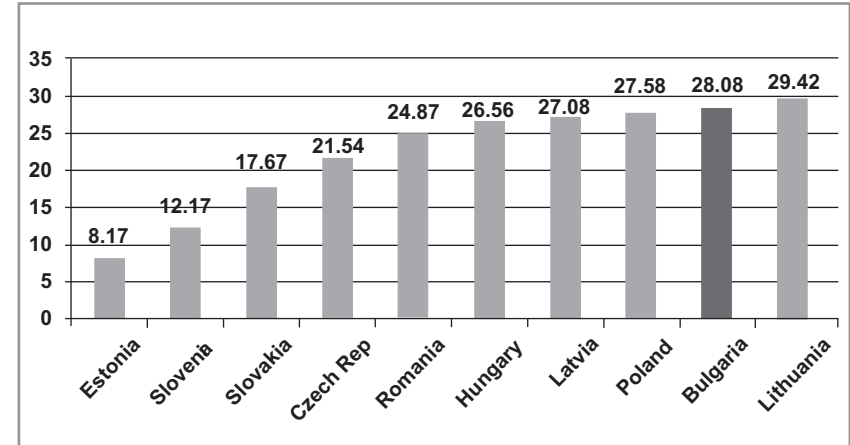


Source: World Bank Enterprise Surveys.

The high and often unpredictable burden of regulations is a major area of concern. In 2009, the World Bank Enterprise Survey registered in Bulgaria a serious increase of the time the average senior manager spends dealing with requirements imposed by government regulations (10.6 percent of their time (see Figure 2)), which, is comparatively similar to other new-EU member states from the region. However, this is a serious increase compared to 2005. This indicator demonstrates a regulatory burden which affects the regulatory quality.

It is widely considered that heavy and unpredictable regulations foster unfair competition and corruption. Indicators on that follow below.

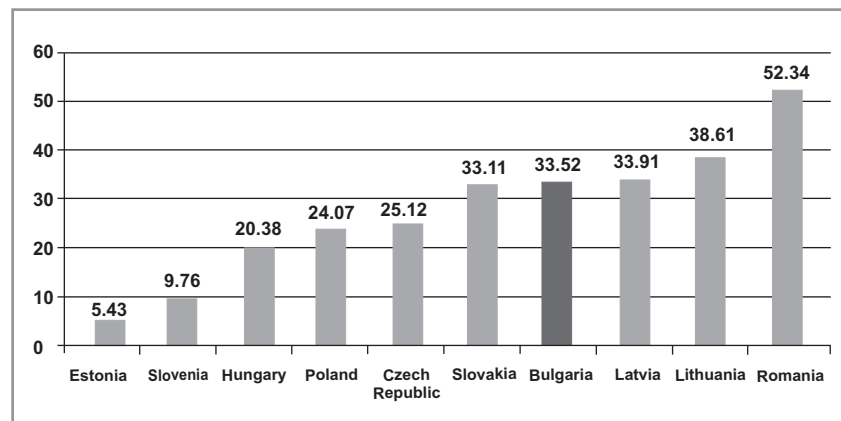
Figure 3: % of companies identifying unfair competition practices from informal business as major impediment (2009)



Source: World Bank Enterprise Surveys.

It is well known that the *informal sector* is both difficult to define and difficult to measure. As seen from Fig. 3, firms from Slovenia and Estonia do not see informal competition as a major constraint, whereas on average, the other countries' firm replies demonstrate that every fourth firm finds competition from the informal sector a major constraint. Many firms in Bulgaria identified in 2007 (as per World Bank Enterprise Survey) that the informal sector is impeding their business activities and this indicator took the third position (after corruption and policy instability) in terms of being firm's major constraint. In 2009, however, informal competition climbed to second place, after the indicator "access to finance". Little more than one out of five small firms and one out of four large firms in Bulgaria found competition with the informal sector as the first major impediment for their business activities.

Figure 4: % of companies identifying corruption as the first major impediment (2009)



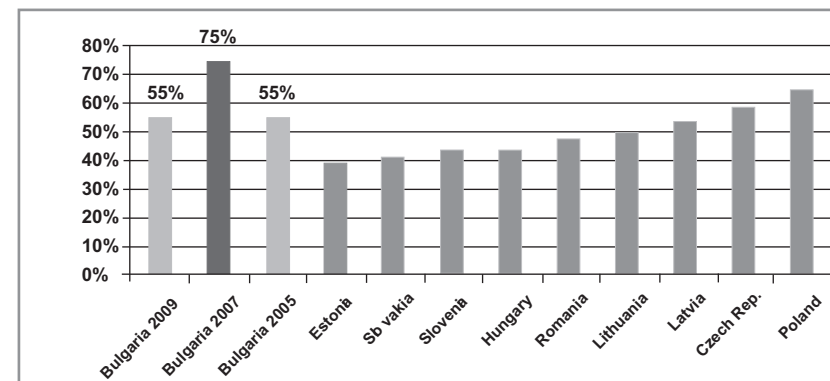
Source: World Bank Enterprise Surveys.

Most certainly, public sector corruption is a symptom of failed governance. Corruption is not manifested in one single form and it typically takes at least four broad forms (bureaucratic corruption; grand corruption; regulatory capture; and patronage, paternalism and clientelism)⁵. The World Bank Enterprise Survey at hand deals with bureaucratic corruption. Fig. 4 shows that Romania scores exceptionally high when firms are asked whether they identify corruption as a major constraint, whereas Estonia and Slovenia score exceptionally low. The other countries are more or less in one group. In Bulgaria, the level of corruption remains after all very high. While in 2007, over 45 percent of firm

⁵ As per Anwar Shah (2007). *Performance Accountability and Combating Corruption*. World Bank: Washington DC, the four types of corruption are: (i) *Bureaucratic corruption*. Isolated transactions by individual public officials who abuse their office by demanding bribes and kickbacks; (ii) *Grand corruption*. The theft or misuse of vast amounts of public resources by state officials-usually members of, or people associated with, the political or administrative elite constitutes grand corruption; (iii) *Regulatory capture*. The collusion by private actors with public officials or politicians for their mutual, private benefit; and (iv) *Patronage, paternalism and clientelism*. This is when officials use their official position to provide assistance to clients or colleagues with the same geographic, ethnic, or cultural origin so that they receive preferential treatment in their dealings with the public sector.

manages in the Enterprise Survey said that corruption is a serious problem for their firm, two years later the percentage remains very high - each one out of three firms reports that corruption is a major obstacle.

Figure 5: Public authorities' interpretation of laws and regulations in Bulgaria remains unpredictable and inconsistent



Source: World Bank Enterprise Surveys (2005, 2007); Survey on Administrative and Regulatory Costs, conducted by AFIS Agency, ordered by Directorate at the Council of Ministers Administration, using a methodology provided by the World Bank (2009). Note: 2005 data are provided for all other new EU member states.

Public authorities' interpretations of laws and regulations in Bulgaria are unpredictable and inconsistent. 75 percent of businesses in Bulgaria either strongly disagreed or tended to disagree with the statement that laws and regulations are interpreted consistently and predictably. This is higher than in the other EU entrants and higher than in 2005. In a recent survey, conducted by AFIS Agency on Administrative and Regulatory Costs in Bulgaria, the indicator came down to 55 percent, coming back to the 2005 levels, which is still very high.

How to achieve better business environment through regulatory reform priority areas for the near future?

The business in Bulgaria continues to be overloaded by non-compliance with the provisions of the law, regarding application of regulatory regimes. The Limiting Administrative Regulation and Control on Economic Activities (LARACEA) Act was adopted in 2003. The Act was intended to reform the regulatory environment by providing incentives for the business in simplifying administrative regimes and administrative control. However, the implementation of the Law does not function well, despite its 16 amendments - there are still too much irregular regulatory regimes, primarily introduced by municipalities in order to collect fees, issuing superfluous regulations that burden the business in terms of cost and time⁶.

The non-compliance with the LARACEA Act is burdensome particularly for small and medium-sized enterprises in Bulgaria.

Exit procedures for firms are relatively time consuming. Speedy closure of businesses is especially important in times of crisis. The estimated time required to resolve a bankruptcy in Bulgaria is 3.3 years (on average) as per latest data from the Doing Business 2010 report. This is about eight times as long as in the most recent best practice EU country (Ireland, 0.4 years). The cost of the proceedings in Bulgaria was about 9 percent of the estate in 2008, which is about twice the level of the best practice country in the EU (Finland, 4 percent). But, as bankruptcy proceedings take long time to complete, the assets depreciate considerably during the process (successful out-of-court mechanisms for dispute resolution, known in the international practice, could be considered an alternative).

⁶(2009). Analysis of State Fees, Administered at the Central Level and Proposals for Undertaking of Measures, Draft report of Working Group under the Ministry of State Administration and Administrative Reform; World Bank (2008). Bulgaria: Investment Climate Assessment. Washington DC.

The business is additionally overloaded by the state fees regime, which is unsystematic, unfair and non-transparent. State fees made up BGN 850 mln. for the state budget in 2008⁷. The increase of state fees between January 2005 and November 2008 has been substantial 60 percent (without the calculation of the Ministry of Health Tariff, the increase of which has been the greatest)⁸. A recent World Bank report noted that there is no policy regarding the setting of state fees in place one reason for the “wild” development of tariffs that include state fees⁹. There is still no such policy. The report further indicated that the legal framework is outdated the law is from the 50s of the previous century. There is weak institutional framework to monitor the setting and approval of state fees by executive agencies and ministries; wrong incentives are in place - there is a focus on the revenue generating function of fees and fines than on the legal requirements, namely the principle of cost recovery proclaimed by the European Commission when it comes to administration fees. An example could be given with the tour operator fee that remains ungrounded BGN 5000 (BGN 1000 for application processing and BGN 4000 for registration). Additionally, the regulatory regime for independent restaurants/cafes still exists although it is almost inapplicable worldwide. Neither the process to set fees nor to distribute retained fee revenues is transparent agencies are free to determine on their own and without clear criteria what budget to be put aside for additional bonuses for staff from those 25 percent, and sometimes even 75 percent of state fees revenues remaining in the agencies.

The Better Regulation Programme (2008-2010) was adopted by the Bulgarian government in April 2008 in compliance with the “Better Regulation Agenda” of the European Commission. Implementation of the Action Plan began soon afterwards. By now,

⁷ Ministry of Finance Report of the consolidated state budget as of 31 December 2008.

⁸ (2009). *Analysis of State Fees, Administered at the Central Level and Proposals for Undertaking of Measures*, Draft report of Working Group under the Ministry of State Administration and Administrative Reform.

⁹ World Bank (2009). *Bulgaria: Reforming the Regime of State Fees*. Document of the World Bank. June 2009. Available at www.worldbank.bg.

the Better Regulation Programme implementation has achieved progress: the Better Regulation Unit was created in the Council of Ministers Administration; the Government removed or simplified 25 regulatory regimes, as per broad public consultations; www.strategy.bg became a portal for the initiative. Furthermore, 181 illegal Municipality regimes were abolished; 14 Regulatory Impact Assessments (RIAs) were conducted for important legislation; over 250 bureaucrats were trained in applying RIAs; and a target of 20 percent by 2012 for reducing administrative burden for the business was adopted by the government¹⁰. However, the Better Regulation Programme needs to be supplemented and extended until 2013. Moreover, the RIA is currently not a mandatory tool, accompanying important legislation. And the new bill of the Normative Acts Law, which in fact introduces RIA as a mandatory tool, is still not in the pipeline of new legislation. Last but not least, satellite units for better regulation in all ministers are still lacking. Such units exist only in the Ministry of Economy, Energy and Tourism, as well as in the Ministry of Food and Agriculture.

To conclude, the improvement of the business environment requires consistent government measures in the regulatory reform area. Those countries, which continue to demonstrate engagement in this realm, would be the countries that would benefit the most from the inflow of investment after the global financial crisis is over.

Liana Uzunova

Expert-consultant, Economics and International Trade

Economic and trade missions abroad are undoubtedly taking significant part in improvement of companies' competitiveness. They contribute by establishing contacts with firms abroad, providing relevant information and consultations, and establishing

¹⁰ "Better Regulation Program" Report for the period April 2008-April 2009, prepared by the Strategy Planning and Governance Directorate of the Council of Ministers Administration, available at www.strategy.bg.

direct contacts with potential business partners. Trading missions' personnel selection issues and the follow-up assessment of their work become crucial, especially when their closing is needed. The competitiveness topic particularly in times of crisis is directly related to the effectiveness of the missions abroad. However, in order to make trade representations effective, they should be funded appropriately which will ensure the resources needed for participation in fairs and exhibitions.

In countries where rare languages are spoken it is often the case that deals do fail due to translation problems caused by Bulgarian firms that prefer to economize from professional translation services. In cases like this, Bulgarian companies could turn to country's trade missions abroad for even translation support in the negotiation process.

The Hungarian companies are traditionally interested in Bulgaria. That is obvious from the large bilateral trade turnover. Although the question remains to what extent the Bulgarian companies are able to meet the demands of that market? Often they are not pricing or technologically competitive, they lack for a certain production quality or partnership capacity. Usually such cases occur when multinational companies look for subcontractors, having high criteria and requirements. Then they usually turn to other partners in other countries.

Competitiveness depends not only on the imports but on the exports also. Certain misbalance exists within the Bulgarian-Hungarian commodity turnover. The overall Hungarian export surpasses the Bulgarian several times. Such a misbalance could be explained with the commodities comprising the exports of each country. While the Hungarian export flows are formed mainly from high technology and value added goods, the Bulgarian is mainly from low-priced goods, whence the misbalance occurs.

In terms of the volume of commodity turnover, Hungary ranks among the second tenth of countries trading with Bulgaria, which makes it a perspective future partner. Despite the nega-

tive trade balance, once could observe an increase in the Hungarian investments in Bulgaria as well as a higher number of Hungarian tourists. Only for the first eight months of 2009 the latter raised by 40 % which is also that is due to the work of the Bulgarian trade mission in Hungary. In the same period over 30 presentations of Bulgarian companies were made which partially compensated the shortage of funds for participation in fairs and exhibitions. All these facts do not suggest any need of closing down the Bulgarian trade mission in Budapest, Hungary but unfortunately that is exactly what happened recently.

Amongst the most important trade missions' partners are the embassies and the invest agencies. For example, the Hungarian invest agency is supporting for decades their national companies to participate in the International Fair held in Plovdiv, Bulgaria. Hungary was a partner-country in the critical 2009 with more than 60 companies; approximately 25 to 30 of them repeated their participation from previous years. This leads to the conclusion that participation in such initiatives is worthy and gives positive results. Unfortunately, although the Tourist Fair "Traveling" in Budapest influenced very positively the tourist flows in both directions, it remained the only one supported by the Bulgarian State Agency for Tourism.

The existence of bilateral chambers of commerce is extremely important in countries where trade missions are either closing or already have been closed down. The chambers are able to undertake some of the missions' functions because they are interested in both countries. For example, the newly established Hungarian-Bulgarian chamber of commerce consists mainly of Hungarian members which are permanently interested in the Bulgarian markets. Activities like that could contribute to preserving the bilateral economic and trade relations in future. Another option for cooperation is the companies owned by Bulgarians abroad that are always willing to keep in touch with companies and partners from Bulgaria.

Other immeasurable in numbers opportunity is municipalities to twin with each other. Thus, the personal contacts can develop in business. As a result of the twinning process during the last months, there were a number of inquiries from the Hungarian partners regarding possible partnership in projects within the EU Structural Funds. That is a potential which should be used in any cases, because for widening our horizons all we need to do is to slightly change our perceptions.

Diana Naydenova

Senior expert, Labour Market Department Confederation of Independent Trade Unions in Bulgaria, Sofia

Workforce is one of the main economic development factors, which brings an importance to syndicates' position. We are deeply concerned because even if funds and competitive advantages are available, they will not lead to good results if there is not enough qualified workforce. The previous and the current cabinet's anti-crisis measures contribute to a minimal extent to the balance on the labour market; to preserve the workforce or to open new positions. There are no new jobs opened that demanding high qualification, right on the opposite more and more of them are cut. Bulgarian government is making insufficient efforts for preserving the labour resource. The measures taken towards cutting the insurance burden will not lead to creation of new jobs, because in this way they make social funds thinner needed at the same time for unemployment compensation payments. These processes may cause such level of poverty, which may threaten our EU membership. This provokes urgent measures concerning the labour market to be taken.

Some of the labour market problems are the following. We are witnessing significant personnel cutting within the big, medium and small enterprises. Serious challenges in front of the labour market are yet to be faced. The processes within "Kremikovtzi" will continue to develop in 2010-2011, which will lead to a number of negatives for the ports, the Bulgarian National Railways and after all for the SMEs, which will be forced to cut their modest remaining personnel.

Another concern is the increasing number of permanently unemployed who haven't been working for more than a year and have lost work habits and qualification. It is important to pay attention to these people. But that's not done because it demands extra funding, the expenses for which are cut. Instead of the planned BGN 165 mln., the current amount is only BGN 65 mln. and just BGN 40 mln. out of them are spent for subsidized preserving of 38 thousands jobs which is considerably below the number of closed jobs each month. The measures towards easing the risk groups' labour (including up to 29 years-old and above 50 years-old along with invalids) are also reduced. From BGN 55 mln. in 2008 the funding in accordance with the National Programme "From social payments to employment" was reduced to BGN 15 mln. in 2009.

All the above mentioned are serious threats and trade unions are concerned that the population may start social protests, if appropriate measures for balancing the labour market are not taken soon. We mostly count on the Operational Programmes for human resources. Unfortunately, our country is not prepared accordingly to adsorb such funding. The main problem remains in the administration, which acts both as regulation and managing body in the adsorption process. The procedures are slow and heavy which is why personnel improvement measures must be taken within the institutions themselves.