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**EVALUATION OF THE POST-PRIVATIZATION
MONITORING SYSTEM IN BULGARIA**

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EXECUTIVE SUMMARY

The recommendations and conclusions below are drawn from a CASE¹/IME survey based on in-depth structured interviews with 11 companies (eight privatized by the Privatization Agency (PA), three - by the Ministry of Industry (MI); four management-employee buy-outs (MEBO), five bought by domestic investors, and two by foreign investors) One of the companies was sold in 1995, four – in 1996, and six – in 1997. We also had access to and studied thoroughly the privatization contracts of these companies, and we conducted structured interviews with seven senior privatization officials and one ex-executive director. The research was carried out between October 1999 and January 2000. It is not fully representative but rather has explanatory value.

We believe that the recommendations, findings and conclusions will contribute to the public debate on the role of the government within the concluding stage of the privatization process. We believe they will also reflect upon and will improve the operation of privatization bodies, according to the previously expressed commitments of the leaders of the country and the government.

Recommendations

The idea of post-privatization control is that the government retains a means to interfere. This philosophy needs to be reconsidered. If controls are to be retained, they must follow clear and transparent rules. Privatizing agents must rely on the use of predominantly “open” procedures – auctions and public offerings (not just for detached units but also for company-sales). The expected positive implications are:

- ✍ faster procedures.
- ✍ greater transparency within the process.
- ✍ higher revenues, paid more quickly (as the price will be the only criterion for buyer selection).
- ✍ encouragement of capital market development (valid for the public offering scheme).

When tenders or negotiations are used, the evaluation criteria should be exhaustively listed in the Decision for Privatization; quantifiable and comparable to each other; and they should have evaluation weightings, which should be preliminary announced to the candidates. This will: 1) reduce the possibilities for discretionary evaluation, and 2) help the candidates submit business plans consistent with their actual business intentions.

We recommend also that non-price future commitment must be avoided in privatization contracts. This recommendation could be applied to existing contracts, if a unified amendment procedure is used upon application. The lack (or significant decrease) of future commitments should result in the absence (or significant narrowing) of the control activities of the privatization authorities. Should this be taken into consideration, we think the following results are likely:

- ✍ the encouragement of enterprise restructuring, leading to improved competitiveness and increased productivity;
- ✍ reduction of the time and direct costs that companies spend on reporting to the privatizing agent;
- ✍ more efficient use of the privatizing bodies’ staff, as the monitoring activities will be minimized;
- ✍ friendlier environment for foreign companies entering Bulgaria via privatization.

Background

Tenders and negotiations, i.e. procedures which allow for inclusion of non-price future commitments, have been, and still are, the prevailing practice of privatization bodies. The main feature of these techniques is that offers are ranked not only by price, but also through evaluation of the business plan,

¹ Center for Social and Economic Research, or CASE Research Foundation is one of the oldest economic think tanks in European transition countries, originally chaired by Leszek Balcerowicz. It is currently working on *Support for Economic Reforms in Bulgaria Project*, funded by the Open Society Institute, Budapest.

which every candidate is obliged to submit. These business plans usually have a complex structure, of which main components are the employment levels and investments for the projected period.

As no formal rules define the principles of the *selection of procedure*, the choice of privatization scheme is entirely dependent on the individual discretion of privatization bodies. Presumably, the main motive behind the prevailing use of “closed” procedures is that they allow for a better selection of buyers, because evaluation of different offers is made on the basis of more than one criterion (e.g. the price). Also, as a rule, “closed” privatization techniques require commitments from new owners regarding number of work places and future investments, as a minimum.

Findings

Several types of non-price future commitments were common for all of the surveyed companies, regardless of the type of procedure (tender or negotiations) and the type of buyer (management-employee company, or another type of domestic investor, or foreign investor). The following are findings related to some of these commitments. The *employment* commitments deal with average numbers of staff for a future period, as well as, in certain cases, the level of wages. As the average number of staff is one of the components of the business plan submitted by the candidates, it becomes a future obligation when the buyer is selected. In the case of PA and MI deals the most frequent obligations are those to keep or gradually increase the average number of employees. The period for which this type of commitment is applicable, is five years for the PA, and between three and six years for the MI. Business plans consist of both time-schedules and types of *future investments*. After the buyer is selected the volume of investments of his/her business plan becomes one of the future commitments. Sometimes the proposed time-schedule of investments is included in the privatization contract, which specifies the volume of investments for each of the following five years. All new owners that we visited were obliged to maintain the *scope of activity* of the privatized company. A standardized clause to *protect the environment* according to the environmental laws was also included in their contracts. They were also obliged to keep their *stakes* in the companies equal or above the contract-specified-percentage.

Besides these generally applicable commitments we learned of a number of specific non-price future obligations. Some of them have been applied to a limited number of deals, others, however, are common for a large group of companies, which have a common feature. For example, the repayment of debts is included in all contracts for indebted state-owned companies. The following is a list of these commitments:

- ✂ repayment of debts
- ✂ preservation of trade marks
- ✂ lower level below which the minimum wage should not fall
- ✂ maintenance of the state reserve and the war-time stock
- ✂ ban on capital increases
- ✂ ban on company's legal liquidation
- ✂ ban on sale of the new owner's shares
- ✂ ban on the sale of long-term tangible assets
- ✂ obligation to stick to the contracts, signed before privatizing the company
- ✂ obligation to satisfy additional restitution claims

The usual period for such commitments is five years.

A number of findings are related to the monitoring of the contracted commitments. No regulation requires disclosure of information by privatized companies. The practice may violate both the principle and the letter of commercial confidentiality. Standard privatization contracts require companies to send reports to privatization bodies on annual basis. At the end of each year privatization bodies send individual letters to companies telling them which reports are required. The standard deadlines for the submission of reports are either 31 January or 31 March of the following year. As the standard letter sent by the MI reads, the deadline at the MI is 31 January. Since the PA also requires accounting reports, which according to the Accounting Act are due March 31, the deadline for these documents is apparently 31 March. Since companies privatized prior to 31 December 1997 enjoy five

years corporate tax preference, the tax office requires a verification document by the privatization body that obligations related to employment and investment laid down in the contract are fulfilled. Companies that enjoy that preference should send reports in order to receive a verification by the seller.

Once received, reports are checked by the respective “Control” departments. They make sure that reports are complete, correct, and comply with regulations (including for tax exempted companies). Site audits are rare. The PA makes inspections under three major preconditions: in big companies where both size and variety of investments is huge; in case it is notified by a third party (including labor unions and press); in case the report is missing or incomplete. The MI makes site audits in cases when the report is missing or incomplete. The discretionary power of privatization bodies to initiate site audits therefore is substantial.

After reports are received and reviewed by “Control” units at the privatization bodies, the latter send warning letters to the companies that failed to meet the obligations. These letters acts as formal notification that the company should pay sanctions. Standard privatization contracts read that “sanctions are due in 30 days after the seller notifies the buyer”.

If a buyer fails to pay the sanctions as provided in the contract, the PA files a court claim against the debtor. At present, PA has 40 cases in court. The head of the “Control” department complained they have no flexibility imposing the sanctions. The Chamber of Accounts closely monitors their activities and does not allow the PA to relieve or delay imposition of sanctions or court claims. On the other hand, the Ministry of Industry does not have a single court claim.

Conclusions

1. In general, the institutional set-up for privatization control seems to be already established. However, it is far from perfect. At least it is clear who is responsible for what. The “Control” department in the PA remained unchanged under the rule of four executive directors. Since the PA is a relatively new institution with new functions, the current staff actually participated in the very design of privatization control. No complaints for lack of qualifications can be justified. At the same time, privatization bodies are overwhelmed with paper work, and given the limited human resources the control remains formal.

2. Control procedures *per se* do not cause an excessive burden for companies. Reasonable applications for contracts to be amended have a chance of success. Therefore, privatization control cannot ensure the perfect execution of all contracts, neither can it stop lay-offs if business conditions require them. Its only remaining function is as a tool of government intervention in already privatized companies.

3. Most of the reports submitted to the Privatization Authorities are to prove that assigned obligations have been completed. But companies submit also accounting reports, not directly related to those obligations: these rather disclose information on the general activity and the financial situation of the enterprise. Thus, post-privatization control operates in a broader sense than its presumed main function - namely, to monitor accurate performance of privatization commitments.

4. Due to the fact that the privatization bodies themselves created an enormous number of obligations, which they now have to monitor, it has become impossible to impose effective controls with available resources. Government bodies fail to react promptly to company requests. The MI “Control” unit is “overwhelmed with applications for amendments”, says an MI representative. Those who seriously plan to amend their contracts have to go to great cost and effort, even making direct contacts with representatives of the seller. This casts a shadow on the transparency of the process.

5. Most requests for amendments appear to be demands for reductions in the number of work places. Putting obligations for both investment and increases in employment numbers in privatization contracts at the same time is a result of inconsistent policies at the privatization bodies. The simultaneous increase in employment and investment can only happen when the market in question is

expanding fast; other things being equal, improvement in technology leads to reduction of labor needed.

6. The reporting requirements for buyers are a perfect example of self-perpetuating administrative discretion. The privatization bodies have the absolute power to establish what information companies are bound to submit. Moreover, reporting obligations pretend to be based on contractual obligations, and not by any superior position of the privatization bodies. In other words, buyers are not “forced” by the government institutions (sellers) to report, but rather they have “voluntarily” agreed to do so by signing the contract. If privatization bodies believe they need a specific report to verify fulfillment of obligations they can explicitly mention this report in the privatization contract.

INTRODUCTION

The Center for Social and Economic Research (CASE Research Foundation) is currently conducting the project "Support for Economic Reforms in Bulgaria". It is funded by the Open Society Institute, Budapest. The aim of the project is to assist, in co-operation with Bulgarian counterparts, in implementing structural reforms in the Bulgarian economy. At the request of the Bulgarian authorities, the assistance involves developing and carrying out reform programs and evaluating their results in priority areas of structural and institutional reforms, with particular reference, among others, to the process of the ownership transformation. This includes the privatization and post-privatization monitoring system.

This component of the project was undertaken by the CASE Research Foundation and the Institute for Market Economics (IME), Sofia, following a consultation with the Chairman of Economic Policy Committee of the Bulgarian National Assembly², Mr. Nikola Nikolov. It is hoped that it will contribute to the public debate on the role of the government within the concluding stage of the privatization process. The research was carried out in autumn 1999.³

Rationale

There are two factors to justify the work undertaken for this report: the final stage of the privatization process in Bulgaria, and the diverse experience, in terms of new economic players and their commitments, introduced through this process.

Since 1989, privatization in Bulgaria has taken three main forms: restitution of land and urban property; cash sale of State and municipal assets; mass privatization, or voucher privatization. The restitution of land and urban property is regulated by four 1992 and one 1998 'Restitution Laws', the 1991 'Land Restitution Act', as well as by implementing provisions. The existing legal framework allows for some 5% of all State-owned assets to be set aside for restitution claims. The 1992 'Transformation and Privatization of State-owned and Municipal-Owned Enterprise Act' (hereafter 'Privatization law') regulates the other methods, and by-laws contain provisions on the different procedures for cash sales. There is no privatization method used in other transition countries which is not applied in Bulgaria.

Bulgarian privatization has evolved to a stage where it is nearing completion. By the end of 1999 it was expected that about 2/3 of assets subject to privatization (i.e. all industrial and service sector enterprises, except those in the area of "natural monopolies", telecommunications, roads and railroads) would be sold to private owners, and this target was actually met.⁴ In mid-1999, parliamentary and media debate on the future of the process and its institutions (Privatization Agency, line ministries, and municipal privatization agencies) focused a great deal of attention on the issue of the government's role and its provisional monitoring tasks. The prevailing opinion was that necessary amendments to the regulations should only take place after a profound reflection on the experience accumulated so far.

² This report does not reflect the views and positions of the Committee members and chairman.

³ Two complementary research techniques have been applied in the study:

- first, interviewing members of the Boards of privatized companies (or, alternatively, the owners or their representatives) and officials from the privatization bodies in charge of post-privatization monitoring;
- second, analyzing the regulatory framework for privatization related to the topic under investigation.

11 companies have been surveyed, including eight companies privatized by the PA, three - by the Ministry of Industry; among them four management-employee buy-outs, five bought by domestic investors (other than management-employee companies), and two by foreign investors; one of the companies was sold in 1995, four - in 1996, and six - in 1997.

⁴ See: Privatization in 1999, Annual Report of the Privatization Agency to the Bulgarian National Assembly, February 2000.

At different moments, the available methods have been used simultaneously and in various combinations. At present, all of them are being applied to assets still in public ownership. They are also being applied as a method of controlling commitments related to recently sold assets. A key feature of the privatization law (adopted in April 1992) is that it allowed for a wide degree of discretion in the selection of potential buyers. Cash privatization, in particular, could and can be carried out according to different procedures: tenders, direct negotiations, public offerings of shares, or auctions. Institutions in charge of individual privatization deals decide on a case-by-case basis which sale procedure to apply. Direct negotiation is the least regulated method and, yet, it used to be the most frequently applied to sell government assets, at least in the period before 2000⁵. The privatization law (especially amendments to it in 1994-1996) introduced a special regime for management-employee buy-outs (MEBO) of cash privatization deals. In particular, a preferential payment system allows management-employee buyer companies to provide a down payment amounting to 10% of the price offered, whilst scheduling the remaining 90% through installments over a period of ten years. Available estimates indicate that between 1993 and 1998, 44.3% of all sales of whole companies were made to management-employee buyer companies. (At the same time, 20% of the shares are reserved for insiders.) Figures isolating such percentage for 1998 only, however, indicate a considerably higher percentage of 73.4%.⁶ In 1999, MEBO's won one third of all privatization deals.⁷ MEBOs are not a phenomenon typical of given sets of governments; in particular, of socialist-led governments. Under the current government, believed to be center-right and reform-minded, the recourse to this preferential system is predicated on the grounds of accelerating the divesting of state's assets.

This framework necessitated a closer look at post-privatization commitments in the sale contracts, which were signed previously. Such scrutiny was particularly necessary because of two features of the experience: the tradition of negotiations with strategic buyer *vis-a-vis* open auctions, and the involvement of MEBO's.

Because of the complexity of the entire process and the relation between the privatization agents, the report focuses on the deals conducted and monitored by the Privatization Agency. Municipal privatizations have been left aside. Nine municipalities have established local privatization agencies, which operate through structures mirroring the central Privatization Agency, though they tend to have larger supervisory boards⁸. In other cases, municipal governments are responsible for privatization. All the issues raised with reference to central government privatization also apply to local governments, including the extensive recourse to MEBOs, the appointment of privatization intermediaries, and the ultimate authority of the mayor regarding the biggest deals.

Although, in the case of municipal-owned enterprises, the local authority is the 'principal' in the privatization process, the (national) Privatization Act regulates the allocation of revenues⁹. In other

⁵ According to available data (especially the report on Privatization in 1998, and interviews taken by Krassen Stanchev and Luisa Perrotti in March 1999 in relation to the below mentioned research), in fact, the percentage of auctions against the total number of deals contracted by both the Privatization Agency and line ministries in 1998 amounts to a mere 6%. It may be interesting to contrast this figure with those concerning the application of 'open' privatization procedures Hungary, where they account for nearly 70% of all the deals. See, Maria Dezserine, *Accessibility and Transparency of the Public Procurement Process in Hungary, Albania and the Slovak Republic*, Budapest, FME, 1998. In Bulgaria, there is a regularity that for bigger enterprise, the auctions are more frequently used in privatization procedure, but not more than 20% of the sales through the Privatization Agency, while "selection of a strategic buyer" tend to prevail in smaller deals conducted by line-ministries and principals. For details, see: Luisa Perrotti, Krassen Stanchev, *The role of the core executive in the privatization process: Country Report on Bulgaria* (restricted circulation report for the OECD/SIGMA and World Bank training courses, March 1999).

⁶ Privatization Agency, *Privatization Strategy and Programme*, no date (1999), p. 1. (actually, 1998 Annual Report of the Privatization Agency).

⁷ See: Privatization in 1999.

⁸ For instance, there are 13 members of the Board of the Sofia's municipal privatization agency, nine of which are appointed by the local Council, and four are appointed by the mayor.

⁹ These provide that 9% of revenues should be allocated to expenses arising from the privatization process, 5% to a local environmental fund, and 86%, to the local budget. Of the latter share, 35% must be employed in investments in long-term assets; 30% in a portfolio comprising short-term financial instrument; 18% be allocated

words, although the municipalities are formally in charge of the process, their ‘autonomy’ is constrained by extensive central regulation. In all privatizations, the Privatization Agency has a “methodological” lead. So, in the report we discuss the role and practice of the line ministries and Privatization Agency, but, of course, not exclusively.

Goals and Topics

The goal of the project component is to evaluate how privatization bodies have monitored and enforced non-price requirements set in privatization contracts. This report is a component of the CASE Support for Economic Reforms in Bulgaria Project, mentioned above, which addresses the following issues, amongst others:

- ✍ A review of legal issues affecting non-price conditions and commitments applied in privatization deals. This relates especially to the ways that privatization procedures are selected and the methods underlying the application of the commitments.
- ✍ An assessment of the types of future commitments that have most frequently been included in privatization contracts. The presence of non-price requirements has been a widespread practice since the very beginning of privatization in 1993. The main motive behind the using the vast variety of future commitments is misconception among government officials about the very concept of privatization. The acceleration of privatization substantially increased the number of privatization contracts, which include future commitments. In addition to preparing and conducting sales, there is a need to ensure that there are enough staff and resources in privatization bodies to deal with the monitoring and enforcement of the contracts.
- ✍ A review of the institutional framework for post-privatization monitoring and procedures applied by the major privatization bodies. Even though the institutional set-up for post-privatization control has been established in practice, there are no appropriate regulations stating how privatization bodies should perform control functions and if they should do this at all. Besides, this has created a contradiction between the roles of the privatization bodies as governmental institutions, and as part of the privatization contracts.
- ✍ An assessment of the system for reporting on the fulfillment of commitments, the enforcement of sanctions, and the amendment of privatization contracts. An introduction to commitments in privatization contracts encourages the privatization bodies to introduce special reports, verifying the fulfillment of obligations by the buyers. A breach of commitments in privatization contracts requires the enforcement of sanctions. In order to avoid sanctions, the buyers, at least formally, can apply for re-negotiation and amendment of their privatization contracts.
- ✍ An assessment of the impact of commitments undertaken by buyers on the business strategies of new owners and privatized companies. New owners usually face problems inherited by privatized companies from the past, which require radical and fast restructuring measures. Many commitments impede the process of restructuring the privatized companies, and some of them could make it in practice impossible.

The concluding section summarizes our findings and draws up recommendations oriented towards policy change.

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The core team on this project included Assenka Yonkova, Georgi Stoev, Latchezar Bogdanov, Svetlana Yanakieva, and Tzveta Dimitrova from the Institute for Market Economics. The final compilation and editing of the report was done by Julian Pankow (CASE Research Foundation) and Krassen Stanchev (Institute for Market Economics).

TYPES OF PRIVATIZATION PROCEDURES

Legal Framework

The Privatization Act¹⁰ outlines the possible methods for privatizing state-owned and municipal companies. There are six possible procedures for selling majority stakes in whole companies:

- ✗ Auction.
- ✗ Competitive tender.
- ✗ Direct negotiations with potential buyers.
- ✗ Public offering of stocks on the Stock Exchange.
- ✗ Centralized voucher auctions.
- ✗ Sale to insiders without tender or auction (as per Art. 35 of the Privatization Act).

The act treats preferentially the participation of insiders as it allows for deferred payment (up to 10 years) when the selected buyer is a management-employee company. In addition, managers and employees may buy up to 20 per cent of the shares of the company which they work in, at preferential terms

Four of the above mentioned privatization procedures, namely auction, tender, sale as per Art. 35, and centralized voucher auctions, are specifically regulated by ordinances. The ordinances focus on the basic features of the concrete privatization schemes. The two procedures that allow for the inclusion of future commitments are tenders and negotiations (no ordinance regulates the technique for negotiations). They are often quoted as “closed” procedures vs. the “open” procedures - auction and public offering.

The Ordinance on tenders¹¹ specifies the mechanics of selling state-owned shares in companies via competitive tender. According to the ordinance, the decision for privatization via tender procedure¹² should include *conditions* of the tender, such as:

- ✗ keeping the purpose of the enterprise (i. e. the activity of the company) unchanged;
- ✗ keeping or increasing the number of working places;
- ✗ the volume of future investments;
- ✗ saving and augmenting the environment;
- ✗ the terms of payment;
- ✗ the period, for which the new owner may not sell the enterprise (i. e. the shares).

The Ordinance allows for the inclusion of additional conditions, as well as for the prioritization of the conditions by the privatizing body.

Virtually no regulation (neither general nor internal for any of the privatization bodies) treats the *selection of procedure* by the privatization bodies. The Privatization Act says that state-owned shares in a joint-stock companies may be sold in any of the following five ways: auction, tender, negotiations, public offering, and centralized voucher auctions. In addition, state-owned stocks in a limited-liability company may be sold via any of the following three procedures: auction, tender, and negotiations.

Practices of the Privatization Bodies

We were convinced that the privatization authorities use a kind of matrix (although not formally approved, even not written) for the selection of procedure, which is the following:

- ✗ *auctions* are used for minority stakes in companies and detached units of companies;

¹⁰ The formal title is Transformation and Privatization of State-Owned and Municipal Enterprise Act. It was adopted on 8 May 1992.

¹¹ Adopted with a Decree of the Council of Ministers No. 155 of 14 August 1992.

¹² The Decision is issued by the respective state body in charge of privatizing the company.

✗ *tenders* tend to be used for majority stakes in companies with “clear files”, which means no debts, no open court cases, etc.;

✗ *negotiations* tend to be used for majority stakes in companies, for which files are “unclear”.

Exceptions are possible and we have visited companies, at which the files were not that “clean”, but were privatized via tender. Also sometimes, negotiations are viewed as a compulsory procedure when the company is “of structural importance”. Furthermore, a shift from one scheme to another is possible, e. g. from tender to negotiations, during the privatization of a company.

SHARE OF DIFFERENT PROCEDURES IN THE PRIVATIZATION OF WHOLE COMPANIES (ALL STATE BODIES) 1 JAN 1993 – 30 NOV 1999

Procedure	Share (%)
Auction	6
Competitive tender	43
Direct negotiations	42
Sale as per art. 35 (without tender or auction)	8
Public offering on the stock exchange	1
Centralized auctions	0
<i>TOTAL</i>	<i>100</i>

Source: PA

SHARE OF DIFFERENT PROCEDURES IN THE PRIVATIZATION OF DETACHED UNITS (ALL STATE BODIES) 1 JAN 1993 – 30 NOV 1999

Procedure	Share (%)
Auction	7
Competitive tender	22
Direct negotiations	22
Sale as per art. 35 (without tender or auction)	49
<i>TOTAL</i>	<i>100</i>

Source: PA

Tenders and negotiations, i. e. procedures which allow for inclusion of non-price future commitments, have been and still are the prevailing practice of privatization bodies (see tables above). The main feature of these techniques is that the ranking of offers is not only made according to the price, but also to the evaluation of the business plan, which every candidate is obliged to submit. The business plan has usually a complex structure, of which the main components are the number of work places and the amount of investments in the projected period. Thus, there are several criteria for buyer selection, unlike auctions, where the price offered is the only criterion.

Analytical Remarks

The Ordinance on auctions¹³ postulates that the *selection of buyer* in privatizations via auction is made only on the basis of the price offered, eliminating the discretion of public officials. However, no clear rules for buyer selection are outlined in the Ordinance on tenders, where Art. 11 states that “the selected buyer should be the one, whose offer best satisfies the tender conditions”. Neither can such rules be found in the case of direct negotiations as no specific regulation treats this procedure at all. This makes it the least regulated, and respectively, the most highly discretionary method.

As no formal rules define the principles of the *selection of procedure*, the choice of privatization scheme is entirely dependent on the personal discretion of privatization bodies’ officials. The main motive behind the prevailing use of “closed” procedures is that, according to the privatizing authorities, they allow for the better selection of buyer, because the evaluation of different offers is made on the basis of more than one (the price) criterion. Also as a rule, “closed” privatization techniques require commitments from the new owner regarding, at least, the number of working

¹³ Adopted with a Decree of the Council of Ministers No. 105 of 15 June 1992.

places and the amount of future investment. This means there is a period of post-privatization control over the already privatized company. As one of the public officials stated: “the privatization is not just a sale; it aims at the development of the given company.”

Obviously the weight of the selection criteria, when tender or negotiation schemes are used, varies for the privatization of different companies. In the Decisions for Privatization these criteria are usually quoted in two groups: priority criteria and other criteria. Nevertheless, the practice for announcing the exact weighting of each criteria in the evaluation of the offer is rarely met.¹⁴ The results of this vicious practice are:

- ✗ the privatization procedure loses its transparency;
- ✗ the candidates are led into a blind competition, which forces them to submit business plans (i.e. future commitments if they buy the company) which are hardly achievable.
- ✗ there are differences in the access to information for insiders and for outsiders.

¹⁴ We were told that the MI announces the weightings to the candidates but this practice is quite recent.

TYPES OF FUTURE COMMITMENTS

Generally, privatization contracts include two type of obligation for the new owner: 1) the price and the conditions of payment, and 2) all other obligations, named in this report “non-price future commitments” or “non-price obligations”. The non-price obligations can be divided into two subgroups, namely financial (such as the investment program) and non-financial (such as employment commitments). In the section below we focus on the non-price future commitments, as they are a necessary condition for the post-privatization control itself.

Generally Applied Commitments

Several types of non-price future commitments were common for all the companies that we visited, regardless the type of procedure (tender or negotiations) and the type of buyer (management-employee company or another type of domestic investor, or foreign investor). These are the following future obligations:

- ✍ *maintaining a certain average number of staff*
- ✍ *making a certain volume of investments*
- ✍ *preserving the company’s previous activity*
- ✍ *keeping the stake of the new owner unchanged*
- ✍ *developing environmental protection*

The period, for which the commitments should be met, was five years after signing the privatization contract, for all companies visited. The only exceptions were two deals with foreign investors, where the obligation to keep the new owner’s stake equal or above 70 % was applicable only for three years.

The *employment* commitments concern the average number of staff in the future period, as well as in certain cases the level of wages. As the average number of staff is one of the components of the business plan submitted by the candidates, it becomes future obligation when the buyer is selected. Cases, most frequently met among the deals of PA and MI, are obligations for keeping or gradually increasing the average number of staff. Obligations to keep the average number of staff below the pre-privatization levels are exceptional. The period, for which that type of commitment is applicable, is obviously five years for the PA, and between three and six years for the MI. In some cases the average number of staff for the whole period (five years) should be observed, and in others it is the average number of staff for each year of the five-year period.

The business plan also consists of a time-schedule for and types of *future investments*. After the buyer is selected the volume of investments set in his business plan becomes one of the future commitments. Sometimes the proposed time-schedule of investments is included in the privatization contract, which specifies the volume of investments for each of the following five years. In one of the companies visited, the types of investments (certain tangible assets) were included in the investment time-schedule. Prior to the beginning of 1997, when the economy suffered a hyperinflation shock, it was possible to contract the investments in either domestic or foreign convertible currency.

Total Volume of Investments Committed (in the deals of all privatization bodies)

Year	1993	1994	1995	1996	1997	1998	1999*	Total
m USD	59	202	152	171	891	389	781	2 645
% of total financial effect*	45	46	46	29	59	38	52	48

*First seven months.

*Total financial effect includes cash payments, liabilities undertaken, and investments committed.

Source: PA

Additionally, all the new owners that we visited were obliged to keep the *scope of activity* of the privatized company. Also a standardized clause to *protect the environment* according to the environmental laws was included. Finally, all new owners had to keep their *stake* in the privatized companies equal or above the percentage, for which the privatization was contracted.

Specific Types of Commitments

Besides these generally applicable commitments we learned of a number of specific non-price future obligations. Some of them were applied to a limited number of deals, others, however, are common for a large group of companies, which have a common feature – e. g. the repayment of debts is included in all contracts for indebted state-owned companies. The following list of specific commitments is obtained from our interviews with 11 companies. It is not exhaustive, but gives a clear picture about the variety of post-privatization obligations:

- ✍ *repayment of debts*
- ✍ *preservation of trade marks*
- ✍ *the minimum wage in the company should not fall below certain level*
- ✍ *maintenance of the state reserve and the war-time stock*
- ✍ *ban on capital increases*
- ✍ *ban on company's legal liquidation*
- ✍ *ban on sale of the new owner's shares*
- ✍ *ban on the sale of long-term tangible assets*
- ✍ *obligation to stick to the contracts, signed before privatizing the company*
- ✍ *obligation to satisfy additional restitution claims*

The usual period for such commitments is five years. However, when the new owner is a management-employee company a ten-year period for deferred payment of the price is possible. When such a scheme is used, the shares in the company are used as collateral of the payment before the respective privatizing authority. This makes the ban on the sale of share valid for the period of the deferred payment, which could be up to ten years.

Usual Periods Applied to the Future Commitments

TYPE OF COMMITMENT	USUAL PERIOD
Generally applied commitments:	
<i>Maintaining a certain average number of staff</i>	5 years
<i>Investments</i>	5 – 7 years
<i>Preservation of company's previous activity</i>	5 years
<i>Keeping the stake of the new owner unchanged</i>	3 – 5 years
<i>Environmental protection</i>	5 years
Special commitments:	
<i>The minimum wage in the company should not fall below certain level</i>	5 years
<i>Repayment of debts</i>	Depending on the credit terms
<i>Preservation of trade marks</i>	5 years
<i>Maintenance of the state reserve and war-time stock</i>	5 years
<i>Ban on capital increases or decreases</i>	5 years
<i>Ban on company's legal liquidation</i>	5 years
<i>Ban on sale of the new owner's shares</i>	5 years
<i>Ban on sale of the long-term tangible assets</i>	5 years
<i>Obligation to satisfy additional restitution claims</i>	not fixed
<i>Obligation to stick to the contracts, signed before privatizing the company</i>	Term of contract

A milk-product company, located 130 km away from Sofia, was privatized via negotiations. The new owner, a management-employee company, decided to use the ten-year deferred payment scheme. One of the future commitments that the buyer undertook for the following ten years was to create a gas installation in the plant. However the city, where the plan is located, has no gas transmitting network, which makes the creation of a gas installation senseless.

Analytical Remarks

Among officials at the privatizing bodies, there is a prevailing perception of privatization as a process which aims at *developing the company*, i.e. their job is not just transferring the property, but also finding the “good” new owners and committing them to “develop” the companies. This naturally leads to the vast variety of non-price future obligations. The preservation of company’s previous activity guarantees that the company will continue to operate. This commitment is often combined with a ban on the company’s legal liquidation.

“We insist on investments when the company’s equipment is very old, and the company is not competitive”- one public official told us. Obviously the privatizing authorities consider investments the primary source of companies’ development. In the preliminary evaluation¹⁵ of the company (which has to be made before the offers are submitted) a minimum volume of necessary investments is included, which becomes a reference threshold for the evaluation of offers. In certain cases, specific machines and equipment are even included as commitments in the privatization contract in order to confirm that the buyer has actual intentions to invest.

Only social reasons – i.e. the high level of unemployment – were mentioned as being behind the employment-related commitments. However this commitment is persistently present in contracts for companies located in regions with negligibly low level of unemployment, e. g. Sofia city. Also it is not clear why in certain cases the employment commitments touch the issues of wages and collective labor contracts. Although we are not aware of any direct pressure imposed by the trade unions upon the privatizing bodies, their officials claim to be “a kind of buffer in the policy conducted by the government.”

Keeping a majority stake in the hands of the new owner is a necessary condition for post-privatization control, i. e. the undertaking of whatever other commitments are made before the privatization body imposes, at least, this additional commitment. In the bulk of privatization cases, both management-employee buy-outs and deals with outsiders, this future engagement was combined with one or more of the following commitments:

- ✍ ban on capital increases or decreases;
- ✍ ban on the sale of the new owner’s shares;
- ✍ ban on using the shares as collateral.

The ban on the sale of new owner’s shares is, according to the Privatization Act, applicable to all cases of management-employee buy-outs on deferred payment. In such cases the management-employee company is obliged to secure its payment using collateral or mortgage. The recent practice of the privatizing bodies shows that the shares, as well as the long-term tangible assets in the privatized companies, have been used as collateral. This has naturally imposed 1) the ban on selling or using as collateral new owner’s shares, and 2) the ban on the sale of the long-term tangible assets.

Regarding the preservation of trademarks, public officials in the PA convinced us that this commitment was imposed only upon the buyers of state-owned breweries. The motive behind it was the preservation of the domestic beer market from monopolization. This fear felt by the privatizing authorities was born from the fact that several breweries, holding different trademarks, were bought by one and the same foreign beer producing company, which could have substituted the several different marks with one common trademark.

Maintaining the war-time reserve is a commitment, which is extracted from the legal framework treating military issues.¹⁶ The companies with such commitments are obliged to maintain certain quantities either of the inputs they use, or of their produce. Commodities, which were mentioned as

¹⁵ The preliminary evaluations are made by experts approved by the respective privatizing body. According to the Privatization Act such valuations are obligatory when the negotiation is chosen as the sale procedure (including negotiation as per Art. 35). Obviously insiders could influence this preliminary evaluation since they provide the primary data for it, however, this is not the focus of the current research.

¹⁶ It is probably regulated in the Ordinance on the State Reserve and War-time Provisions (adopted with a Decree of the Council of Ministers No. 315 of 24 December 1998), of which contents are secret.

part of the war-time reserve, include: sugar, oil, salt, tin, etc. Since the regulations treating the war-time reserve are secret, we can only wonder whether such clauses in privatization contracts repeat or complement the general legal regulation of the issue.

The environmental protection commitments seem to be present in every privatization contract either as concrete engagements (e. g. the building of a water-cleaning station) or as standard abstract clauses, which state “protecting the environment according to the environmental laws”. The privatization authorities told us that standard clauses for environmental protection are put in the contracts “in order to remind the buyer to respect the environmental laws”. We do not consider this kind of clause, which merely repeats a general regulation, to be a privatization commitment clause. This might be the case also with the war-time-stock clauses.

POST-PRIVATIZATION CONTROL

Institutional Framework and Practices

Privatization bodies maintain specialized control units. In the Privatization Agency (PA) there is a “Coordination and Control of Privatization Process” department. The Ministry of Industry (MI) has “Privatization” department with a specialized “Control” unit. The “Control” department of the PA consists of nine people, while the “Control” unit at the MI employs 13 people.

Privatization control is conducted according to a methodology of the PA, which is an internal document, issued as an order by the Executive Director of the Agency¹⁷. The first methodology was approved in 1995, and a new methodology has just recently been approved by the PA’s Supervisory Board. However, PA representatives claim that their department has been working with the new draft methodology for over a year. As it is a government body which should provide methodological guidance to all other privatization bodies, the latter are generally using the same methodology as the PA.

The PA monitors about 400 privatization contracts, and the MI monitors about 650¹⁸. Given that the average size of a company report is about 100 pages (together with all required copies and attachments) it seems that the control units are overwhelmed with work.

In both privatization bodies we studied how experts from the control units participate in the preparation of deals. They check all draft contracts and work on the provisions that they will have to monitor later. This is called “pre-privatization control”. The PA representatives claim that they make corrections in 90 % of the draft contracts. They also claim that PA follows standard provisions on buyers’ non-price future commitments that allow more efficient control. But, PA representatives generally admit that the pre-privatization control in the other privatization bodies is inefficient which undermines future control efforts.

The new buyer becomes a party to the contract, and is therefore responsible for the fulfillment of all obligations in the contract. However, the non-price commitments actually refer to the way the privatized company will be managed, and their fulfillment depends on the economic performance of the company. Therefore, the privatization bodies, in fact, monitor the performance of formerly state-owned companies, while at the same time keeping responsibility with the new owners. This seems to cause some misunderstanding among both privatization bodies and the new owners.

No law states that companies (and buyers, in fact) should disclose information to the privatization bodies after privatization. The Statistics Law states that companies are obliged to provide statistical information to “statistical agencies” only when the data required is explicitly listed in the Annual Program of Statistical Surveys. Nor does the Privatization Act require any type of reporting by privatized companies.

On the other hand, standard privatization contracts require companies to send reports to privatization bodies on an annual basis. Also, in most contracts we found a standard clause that “the buyer is obliged to provide access to all necessary data needed by the seller”. At the end of each year privatization bodies send individual letters to companies to describe required reports. The PA uses four different sample letters depending on types of commitment in each individual contract, while the MI sends uniform letters to all companies. These letters include deadlines for submission of reports, a list of reports to be provided, a list of documents that should be copied, and contact persons at the privatization body. A spreadsheet on investments, which companies must fill out, is attached to the letter.

¹⁷ For the time being, IME is refused access to this methodology.

¹⁸ According to representatives of the PA and MI

The standard deadlines for submission of reports is either 31 January, or 31 March of the following year. As the standard letter sent by the MI reads: the deadline at the MI is 31 January. Since the PA requires also accounting reports, which according to the Accounting Act are due March 31, the deadline for these documents is therefore 31 March. At the same time, companies privatized prior to 31 December 1997 enjoy a five-year corporate tax preference (see section on reporting requirements). The tax office requires a verification document by the privatization body that obligations related to employment and investment laid down in the contract are fulfilled. Since the annual tax return is due March 31, companies that enjoy that preference should obviously send reports on employment and investment by 31 January in order to receive a verification by the seller.

The PA seems to be involved in the very process of preparation of reports by companies. According to the head of the PA “Control” department, experts from the department help some managers to compile the reports. The reason seems to be the vague definition of “investment”. The Foreign Investment Act provides a comprehensive definition for foreign investment; on the other hand the provisions in the Accounting Act are considered insufficient by the PA. Therefore, PA itself provides a definition of investment for the purpose of privatization contracts. Moreover, contracts signed up until 1994 had different wording of employment obligations, i.e. “new jobs” instead of the present expression “average number of employed”.

Once received at the privatization bodies, reports are checked by the respective “Control” departments. Priorities for control are, first, to make sure that reports are complete, and second, to issue the documents required by the tax office for tax exempted companies. At the PA experts make arithmetical checks on the accuracy of calculations, based on attached copies of invoices or other documents.

Site audits are made rarely. This is something we learned from both the privatization bodies and the interviewed companies. The PA makes inspections under three major preconditions: in big companies where both size and variety of investments is huge; in case it is notified by a third party (including labor unions and press); in case the report is missing or is not completed. The MI makes site audits in cases when the report is missing or not completed. The MI “Control” unit makes about five to six site audits per annum. The discretionary power of privatization bodies to initiate site audits therefore is substantial.

Interviews with companies provided no evidence on how privatization bodies decide to go for a site inspection. Out of 11 companies, three reported to have been visited by experts from the respective “Control” departments. Two of them are located in Sofia. One of them, owned by a foreign investor, was visited once for approval of investment equipment. No amendment has been signed. The other has been visited five or six times by representatives of the MI during the last two years. The company has negotiated one amendment for reduction of employment. At the same time, the privatization of the company had been problematic: the present owner - a local investor - won the company through negotiations in 1993, but the Ministry of Industry refused to transfer the ownership. A second procedure – competition – was opened and in 1997 the same buyer won again. The roots of the scandal remained unknown to the authors; this very fact, however, might be the reason for the frequent audits. The third company - owned by a management-employees company - that reported site inspections is located outside Sofia. Three audits have been made by the PA, one of them directly related to amendment of the employment obligations.

A specific type of site audit is conducted in big companies with huge investment commitments. The PA pointed to one case where the foreign investor had committed to invest over DEM 30 million in five years. The number of separate investments was huge, therefore the PA did not require copies of all invoices and documents but only those for considerable amounts, together with a list of the remaining. Then a group of control experts went to visit the plant and made random checks of the equipment mentioned in the list.

After reports are received and reviewed by “Control” units at the privatization bodies, the latter send warning letters to the companies that failed to meet the obligations. These letters act as formal

notification that the company should pay sanctions. Standard privatization contracts read that “sanctions are due in 30 days after the seller notifies the buyer”.

If a buyer fails to pay the sanctions as provided in the contract, the PA files a court claim against the debtor. At present, PA has 40 files at court. The head of the “Control” department complained they have no flexibility imposing the sanctions. The Accounting Chamber is closely monitoring their activities and does not allow the PA to relieve or delay imposition of sanctions or court claims. By contrast, the Ministry of Industry does not have a single court claim. This might be either because all companies are fulfilling their obligations (or pay sanctions on time) or because of a lack of internal control by the Accounting Chamber.

Analytical Remarks

The very idea of privatization control was a “spontaneous” invention; there is no single legal provision reading that privatization bodies should execute control functions. The basis of privatization control is the Contracts and Obligations Law, in other words, the general civil law. Thus the state, via the PA and other privatization bodies, turns itself into a mere party to bilateral contracts. Therefore, no limits to administrative power are possible; privatization bodies can establish the rules of the game, the procedures, and the sanctions, in the same way as any individual party to a contractual agreement can do. Privatization control is also an example of mutual self-creation of administrative authorities. The Profit Tax Act of 1996 established tax preferences for newly privatized companies which were applicable only for those holding a certificate by the privatization bodies for fulfillment of privatization contract. This is a *prima facie* argument for the existence of privatization control.

The reporting requirements for buyers are a perfect example of self-perpetuating administrative discretion. According to a clause in the standard contract: “the buyer is obliged to provide access to all necessary data needed by the seller”. Furthermore, the privatization bodies have absolute power to establish what information companies are bound to send. This is a formal excuse for privatization bodies to require whatever documents they see fit (see section on reporting requirements). We noted, for example, that the PA requires a copy of the annual accounting report, and the MI does not. Moreover, reporting obligations pretend to be based on contractual obligations between the buyer and the seller, and not on any superior position of the privatization bodies. In other words, buyers are not “forced” by the government institutions (sellers) to report, but rather they have “voluntarily” agreed to do so by signing the contract. If privatization bodies believe they need a specific report to verify fulfillment of obligations they can explicitly mention this report in the privatization contract. Each deal establishes concrete commitments by the buyer; therefore, reporting requirements can be projected in advance. Also, it remains unclear why the privatization bodies would require information already collected by other government institutions. The PA, for example, requires annual accounting reports. This seems quite strange since they cannot verify the fulfillment of any obligations, and what is more, they are already collected by the National Statistical Institute.

The above mentioned observations question the ground for the very existence of privatization control. The idea that a government institution must have a say when an investor is planning his activities for the following five years lack economic rationale. Understandably, the legislator has provided no explicit provision that would allow privatization bodies to monitor the performance of privately-owned companies. The “invention” of privatization bodies to organize post-privatization control therefore might be explained only by their efforts to maintain state interference in the economy.

However, many still believe that the market and private entrepreneurs cannot be trusted. In general, this belief suggests that unless the government makes sure that companies are “properly” run, the private investors will lead them to bankruptcy. This is not the place to discuss a claim that has never been proven by either economic theory or practice in the real world. But the facts prove that privatization control fails to serve this goal. It does not monitor whether companies are properly managed. It is an impossible task *a priori*, and would require a new *planning committee*. The observations below prove that the actual activities of the privatization bodies are mostly concentrated

in following administrative procedures, completing paper work correctly, and “waving the big stick” when an investor tries to behave in a way, not in line with the political mood of the day.

Ambiguities stemming from unclear definitions of “investment” and “new jobs” create reporting problems; there were enterprises which under-reported investment due to lack of understanding. The general practice of the PA in such cases is to contact the management and to go through the documents once again. In numerous cases, the PA representative claimed, the “companies didn’t know what exactly is considered investment”. There were isolated cases when experts from the PA worked together with the company management to prepare the reports. There is no rational reason why a bureaucrat would do excessive paper work other than to develop the importance of his position.

Moreover, problems can hardly be blamed on institutional chaos. In general, the institutional set-up for privatization control seems already to be established. This is far from saying that control departments do a perfect job; it rather means that it is at least clear who is responsible when privatization contracts are to be monitored. Also, the staff of the “Control” department at the PA remained unchanged under the rule of four executive directors. Since the PA is relatively new institution with new functions, the current staff actually participated in the very design of privatization control. No complaints for lack of qualifications can be justified.

As mentioned earlier, the average size of a report submitted to the PA is about 100 pages (the size largely depends on the number of documents and invoices copied). There is no evidence that in other privatization bodies the reports are shorter. According to the head of the PA “Control” department, these checks consume almost entirely the time available to the department. At the same time, the head of the MI “Control” unit complains of perpetual inquiries by the National Statistical Institute which require huge effort and time to answer. The overall impression is that the privatization bodies are overwhelmed with paperwork to audit. Given the limited human resources, control remains formal, i.e. the numbers are checked for arithmetical errors rather than for economic rationality.

Privatization control therefore turns in mere formal procedure and a possible tool for harassment when needed. Site audits are rare, most reports are collected and stored for evidence, and only total numbers are checked for reconciliation. Sometimes controlling agents help companies prepare the reports. It turns out that control procedures *per se* do not cause excessive burden for companies. Moreover, it seems that reasonable applications for amendment of contracts may well come to success. Therefore, privatization control cannot ensure perfect execution of all contracts, neither can it stop lay-offs if business conditions require them. The only function that remains to it is to be a tool of the government for intervention in economic affairs; a tool in a game of *carrot-and-stick*.

REPORTING TO THE PRIVATIZATION AUTHORITIES

Documents Verifying the Fulfillment of Commitments

Privatized companies submit reports to the Privatization Agency (PA), and respectively to the Ministry of Industry (MI), once a year. Usually, the reporting period for a given year ends on 31 January, or on 31 March of the next year.

There are exceptions to the obligation for annual reporting to the privatization authority. For example, the privatization contract for one of the surveyed enterprises, of which the buyer is a big foreign company, stipulates that reporting on fulfillment of investment commitments should be **twofold** in a span of five years. According to the contract, the investments should be made in two tranches. The reports are to be submitted after each tranche is accomplished, and not as in the common case - annually. The management of the enterprise in question does not submit any other reporting documents to the Privatization Agency. The privatization contract of another company stipulates, that besides reporting annually to the Privatization Agency, to verify the fulfillment of the investment program and other commitments, the company should also submit a report on the average number of employees **every three months**.

Apart from the reporting documents defined in the privatization contract, companies are obliged to submit extra papers, requested by special letters from the PA or MI.

The reporting requirements concern the buyers. The duration of the reporting process before the privatizing authorities is defined in the privatization contract and usually coincides with the terms of fulfilling assumed non-price obligations. In most of the cases this period is five years. When a given enterprise is bought by its employees and the legally-set preferential terms of payment are applied, the period for paying off the company, and respectively for reporting, is ten years.

In one of the surveyed enterprises, the buyer (MEBO) paid the full contracted price after 11 months instead of the envisaged ten years. Nevertheless, the buyer must still report for the whole period of 10 years.

Documents verifying investment absorption:

- ✍ Report of committed investments. There is a standard form which includes numbers and dates of invoices, suppliers and/or executors, contents of deliveries and/or installation works, etc.
- ✍ Certified copies of all primary accounting documents - invoices, standing orders, customs declarations for consigned investments directed for fixed assets, bank statements, etc.
- ✍ Certified copies of all documents related to the investment program contracts, protocols, Act 19 (for carried out installation works and for site' value), etc.
- ✍ Declaration as per § 9 of the Temporary and Concluding Provisions of the Privatization Act. This actually means that enterprises should declare the origin of and grounds for ownership of investment funds, as well as to submit a Declaration of taxes paid.

When investments are in the form of large machinery and equipment, entered into the enterprise as capital, their value in increased capital is assessed according to conclusions of an expert appraisal. In these cases, there are few more documents to be submitted:

- ✍ Expert Appraisal of the investment performance, certified by three experts.
- ✍ A Court Order approving the Expert Appraisal.

In addition to the above-listed documents proving the commitment of investments, in cases when the specific investment is paid into the company as a contribution to capital, a further requirement is added:

- ✍ A declaration of non-disposal of fixed assets imported into the company's capital.

Documents verifying the retention of business activity:

Most of the enterprises sent to the PA (or respectively to the MI) a **Declaration of continued retention of business activity**, signed by the Executive Director of the company. Other documents that are obligatory, and also have the power of proof are:

- ✍ Copy of the last court registration.
- ✍ Copy of the Certificate for the company's Current Status.

Documents verifying number of employees retained:

Retention of the average number of employed is proved by an ***Average Monthly Number of Employees Report*** for the specified period. This report follows a standard form and is certified in the respective regional bureau of the National Statistics Institute.

Documents verifying the retention of stocks and shares ownership:

- ✍ Copy of the Shareholders Register (applied for the joint-stock company).
- ✍ Declaration of retaining Lots of shares (applied for the limited-liability companies).

Documents verifying the fulfillment of obligations on the conservation of the environment:

In fulfilling regulatory requirements, or those obligations for conservation of the environment assumed with the privatization contract, enterprises have to include an appraisal from environment experts in the form of:

- ✍ a Protocol or written Statement from the Regional Inspectorate for Environment and Waters Protection (RIEWP).

Accounting Report:

Apart from the documents listed above, which prove that the non-price commitments assumed with the privatization contract have been fulfilled, most of the companies submit the following accounting reports to the PA:

- ✍ Balance Sheets and respective annexes (e.g. references on fixed assets, on receivables, liabilities and loans, financial assets, etc.).
- ✍ Income and Expenditures Accounts and respective annexes (reports on cash-flow, on equity, on employed and wages, etc.).

Companies for which annual reports are verified by a Certified Public Accountant have to submit to the PA (or respectively to the MI) an:

- ✍ Auditors Report from a Certified Public Accountant.

Other specific documents:

In some cases, apart from the standard documentation requested by the PA and the MI, some privatized companies must submit other papers and declarations reporting specific obligations assumed with the privatization contract. Thus, some enterprises send to the PA a *Manufactured Output Report*. In other cases, additional documentation requested includes duplicate declarations of other documentation submitted for reporting purposes.

These specific documents are:

- ✍ A declaration, verifying the fulfillment of non-price commitments included in the privatization contract.
- ✍ A declaration of the legitimacy of data enclosed in the Yearly Report. This declaration is standardized and is sent by companies to the PA.

DOCUMENTS VERIFYING FULFILLMENT OF NON-PRICE COMMITMENTS

<i>Verifying:</i>	<i>Reporting documents:</i>
Investments	<ul style="list-style-type: none"> ✍ Record of investment expenses committed; ✍ Certified copies of invoices, standing orders, customs declarations, etc.; ✍ Certified copies of Contracts, Protocols, Act.19; ✍ Declaration of origin and the grounds for ownership of invested funds; ✍ Declaration of paid taxes; ✍ Experts appraisal of the investment performance, certified by three experts; ✍ A court order approving the experts appraisal; ✍ Declaration that fixed assets imported into the company capital (xxxaport installments) have not been disposed of.
Company's business activity	<ul style="list-style-type: none"> ✍ Copy of the last court registration; ✍ Copy of Current Status Certificate for the company. ✍ Manufactured Output Report

Average number of staff	☞ Average Number of Employed Report for specified periods.
Retained ownership on stocks and shares	☞ Copy of the Shareholders Register; ☞ Declaration of retaining Lots of shares.
Environmental protection	☞ Protocol or written statement of the RIEWP.
General fulfilment of the non-price commitments	☞ Accounting Report. ☞ Declaration verifying the fulfilment of commitments included in the privatization contract; ☞ Declaration of legitimacy of data enclosed in the Yearly Report.

If the specified reporting documentation is not submitted in time, the privatization authority assumes that contract obligations have not been performed, and sanctions are imposed. Usually, if a company does not submit a report or if the latter is incomplete, the privatization agent undertakes a site inspection.

Direct Costs and Time Needed For Report Preparation

There is no standardized amount that companies are forced to spend in the course of reporting to the privatization authorities. Expenses are related mainly to verifications of primary accounting documents, certification/verification of copies, excerpts, experts' appraisals, or protocols. According to the management of some companies that were surveyed, verification expenses amount up to 50-200 BGN. Companies, which have to report on their environmental conservation obligations, have to pay a 200 BGN annual fee to the RIEWP for ecological expertise. Other enterprises pay monthly fee to the RIEWP amounting 50-60 BGN.

But some managers do not consider reporting to the PA or MI as a direct cost. There are different estimations of the time needed for preparation of the necessary reports. There are also enterprises whose management does not evaluate time as an expense using the explanation that these documents are produced anyway for the company's operational use.

Some of those surveyed claimed that reporting took significantly more time during the first year than during the years that followed. This can be explained with the quantity of documents required by the PA (respectively MI), but also with lack of personnel experience. In these cases, employees devoted two to six weeks for the preparation of reporting documentation. In the subsequent years, the reporting process became a routine, diminishing time expenses.

Analytical Remarks

There is no clear (or at least transparent) rule why some companies have to submit reporting documents by the end of January, while others – by the end of March. Probably the second deadline is necessary if companies are obliged to submit to the Privatization Agency copies of their Balance Sheets, Income and Expenditures Accounts, and other related financial statements, whose preparation is associated with the annual reporting period.

Most of the reports submitted to the Privatization Authorities prove fulfillment of assigned obligations, stipulated in the privatization contract. But accounting reports, not directly related to these obligations, are also submitted. These, rather, present the general activity and financial status of the private enterprise. This could indicate that post-privatization control in Bulgaria has a somewhat wider aim than that which should be its main function - to monitor accurate performance of privatization contract commitments.

In practice, accurate reporting to the PA and MI is important for companies, not only in relation to sanctions. Most of the privatized companies are granted tax preferences according to the Profit Tax Law of 1996. In fact, privatized companies do not pay 100% of income tax for the first three years after the date of privatization, and 50% for the fourth and fifth years. In order to qualify for these preferences, enterprises should receive a certificate from the PA, demonstrating immaculate

performance of assumed obligations (i.e. fulfilling obligations related to investment and employment, etc.). This is achievable only if all reporting documentation is properly submitted to the PA and accepted by it.

The reporting requirements, as fixed in the privatization contracts, allow for the indefinite and absolute discretionary increase of the volume of documents and information wanted by the privatizing bodies. Reporting by the new owners is virtually the disclosure of private information before a public institution; but at the same time the only legal grounds for this disclosure is the private contract between the new owner and the privatizing agent. We could not find any clear-cut difference in this respect between the functions of the privatizing agent as a public institution on one hand, and its actions as a party in a private contract on the other. We think that this problem could be overcome, at least partially, as the reporting clauses in the contracts become *exhaustive lists* of the documents required.

AMENDMENTS TO PRIVATIZATION CONTRACTS

Practices and Procedures

Out of 11 companies we visited, two have signed amendments to their contracts (one company has three amendments signed and one under negotiation), five have initiated negotiations for amendments, and one has only thought about possible amendments, without making any further steps. Three companies claimed they had never even thought of amending their contracts. One of the companies has negotiated amendments related to the manner of payment, reduction of employment, and changing the type of investment. It is now negotiating an amendment which will eliminate an obligation for gasification of the plant. The other company which has already amended its contract has negotiated a reduction in employment. Three of the other companies also requested a reduction in employment, one is in negotiations to restructure its debts and its investment schedule, and one has started informal negotiations on the reduction of employment, while it has abandoned the idea of reducing the amount it must invest. One company was considering a reduction in employment, but has not taken any further steps.

Companies, included in the survey, which:	Number
have signed amendments	2
have started negotiations	3
have only thought of amendments	4
have never initiated amendments	5

The commitment which has most frequently been subject to negotiations is the level of employment. Two of the companies we visited have already achieved amendments which allow for reduction of the number of employed, and another four have initiated negotiations for similar amendments. Companies claimed two major reasons for reduction of employment: a contraction of production and sales, and new equipment. The first factor is in a way a demand for higher flexibility in employing labor; it has to do with the basic understanding that entrepreneurs would be in favor of more freedom on the labor market.

A milk producing company, owned by a manager-employee firm, managed to sign three agreements. The first one occurred in late 1997 about a year after the deal was signed. It allowed 75% of the remaining payments to be made in government bonds. Thus the buyer paid the entire amount, instead of delaying the payments for 10 years. The second annex of March 1998 allowed for reduction of workers by approximately 10%. The major reason was a fall in the amount of milk to be processed, increased competition by other producers in the region, and the installation of new equipment. As evidence for the fall in the amount of milk processed, the company had to present the supply sheets where individual milk supplies are recorded. The third annex of December 1998 allowed them to change the types of investments laid down in the contract. Sometimes, the investment commitments include not only size but type of equipment as well, which in this case turned into a barrier - the buyer had already invested three times more money during 1998 than it was scheduled to. At present, the company has initiated negotiations to remove a commitment to install a natural gas supply in the plant. Since this advance can only be made after the national gas network is extended to the city where the dairy is located, the imposition of such an obligation on the company seems weird, to say the least.

Those companies that did not make any efforts to amend their contract provided interesting reasons for this decision. A foreign investor claimed that his company “has no problems related to investment and employment commitments”. Another company abandoned the idea of negotiating reduction of investments when it realized that “only the time frame but not the size of the investment were negotiable”. “An amendment that delays the investment time schedule also extends the period of government control over our enterprise”, said the manager, which was a good enough reason to give up the idea. Another manager claimed that “the PA is a bureaucratic structure, it is easier for them to follow strictly the contracts, and any change annoys them; that is why they will try to prevent any amendment”.

Standardized privatization contracts include a provision that notification between the parties must be made in written format only. So, the buyer should write a formal letter to the privatization body accompanied by the rationale for any demanded change. However, companies that we visited reported that they not only wrote letters, but contacted representatives of the privatization bodies in person. Some of the managers told us that they preferred to bring letters directly to Sofia, and not to use the mail. The reason for doing so, according to one of the interviewed, was that “if you send the letter by mail it will take a lot of time before it is received by the person in charge of dealing with it, due to the huge bureaucracy in the Privatization Agency (PA)”.

Time costs devoted to negotiations seem significant. One manager claimed that the engineers had to prepare a motivated proposal for changing the type of investment which took them up to two months. The process of exchanging letters is also considered slow. The companies reported that, on average, it takes two to four months to reach an agreement. One company complained that they received no answer for more than three months. At the time of the interview they were still waiting for a reply. Managers are often invited to meet the privatization bodies in person, and these meetings occur several times before they get an agreement.

We are not at this moment aware of any written rules that determine the PA or MI criteria for allowing amendments. The procedure, described by representatives of privatization bodies, is the following: The requested amendment is studied by a group of three experts who propose a motivated decision to the Executive Director (PA) or the Minister of Industry. Most of the amendments at the PA have to be approved by the Supervisory Board. The rule of thumb for investments is that the revised size should not go below the bid of the second-best candidate during the privatization procedure. The general principle also seems to be that investment can be postponed but not reduced. Regarding employment commitments, the principle seems to be that labor unions in the respective company should support the reduction. According to senior MI official responsible for privatization control “if labor unions agree, reductions in employment commitments happen much more easily”. The same official also calculated that one out of five applications for amendments is approved.

Analytical Remarks

Although the privatization bodies themselves induced the enormous number of obligations that need monitoring and controls that are impossible to perform with the resources available, they fail to react promptly to any requests made by companies. The MI “Control” unit is “overwhelmed with applications for amendments”, says an MI representative. Therefore, those who seriously plan to amend their contract have to put in a huge effort, including the use of direct contacts with representatives of the seller. This puts at least a shadow on the transparency of the process.

It seems that most requests for amendments demand reduction of employment. This is a direct consequence of the inconsistent policy of privatization bodies to put both investment and the increase in employment in privatization contracts at the same time. The simultaneous increase in employment and investment can only happen when the market in question is expanding fast. All other things being equal, improvement in technology leads to reduction in the amount of labor needed.

The PA recognizes that the business environment is changing fast and unexpectedly. The war in FR Yugoslavia is now considered as major factor, together with last year’s shock in Russia. The PA therefore accepts some flexibility that allows for the amendment of contracts signed during different economic conditions. However, the standard clause that envisages “extraordinary events, such as war, natural calamity, etc.” and that provides an excuse for changing the obligations of the buyer, has never been used so far.

At the same time, the PA complains of permanent checks and audits by the Accounting Chamber. The latter attacks any initiative that “harms” the interest of the state budget. On the other hand, there is a strong political pressure to keep contracts as initially signed.

The major feeling from meetings with PA and MI officials is that they understand the necessity of flexible privatization contracts. They claim that any motivated application for an amendment that will improve the overall performance of the plant would be approved. They seem to understand that employing too many workers above a certain threshold might threaten the very existence of the company, thus even further increasing unemployment. A PA representative referred to a case of a company, which is at present violating its employment clause, and is forced to pay penalties. "Had the company ever applied for amendment, we would have granted one", said the PA official.

It seems that privatization bodies are called to do quite difficult and inconsistent tasks. On the one hand, there is a deep-rooted understanding that the State can and should retain control over the economy through privatization contracts. This is particularly true about investments and employment. The PA, when preparing a privatization procedure, does an assessment of the investment needed in the enterprise, in a desperate attempt to do some planning. Employment commitments are understood to be a major tool of the government's social policy.

However, the privatization bodies, and the government as a whole, recognize the impossibility of this "social engineering mission". They seem to understand that, first, owners are the ones who can best take decisions related to the effectiveness of a given company, and second, that market conditions are changing, and no one is able to predict the future five years ahead (The MI claims that after 1998 all commitments in privatization contracts last for only three years). Therefore, amendments become more and more easy to negotiate. So the reasons, be they political or social, behind putting future commitments in contracts, become futile. The message sent to potential buyers is, therefore: "We will verify that you *deserve* the enterprise by your business plan. Be sure that you follow your promises, otherwise we will make you pay or we will take away you tax preference. But on the other hand, we, and only we, can provide you with amendment in case you are in trouble."

SANCTIONS FOR BREAKING COMMITMENT CLAUSES

The common conclusion from the interviews with the eleven companies is that buyers, fearing sanctions, prefer to compromise with their company's strategy rather than pay forfeits. And this completely coincides with the initial idea behind setting sanctions – “These are designed as an incentive for the Buyer to keep to the obligations assumed.”

Sanctions imposed in cases when the Buyer has failed to fulfill his obligations are more or less standardized in contracts signed with the PA and/or the MI. This is because they are regulated by the Ordinance on Tenders, and also because both the PA and MI follow one and the same methodology for post-privatization control.

Types of sanctions and ways/reasons to dissolve a contract

All contracts have a clause committing the buyer to a specified volume of investments, as well as to maintain an average number of employed in the privatized enterprise, with respective sanctions arrangements in case the obligations are not fulfilled. Other obligations assumed by enterprises are negotiated separately for each specific case, although the sanctions remain similar. For any breach of obligations, sanctions can be:

- ? forfeits for breach of obligations, and/or
- ? dissolving the contract (the ultimate sanction).

The above two types of sanctions are inter-related. The Ordinance on Tenders stipulates that contracts may be dissolved unilaterally by the Seller if forfeits have been calculated for more than 45 days. If the contract is dissolved, the Buyer owes the suspended income tax according to Art. 58, Section 7 the Corporate Tax Law (adopted in 1996). It appears that such a peculiar sanction stimulates Buyers to fulfill the assumed obligations. There is an option, by which the Buyers can avoid being sanctioned when the breach of obligations is due to *force majeure*.

The practices of the PA and the MI assume that an enterprise has not fulfilled its contract obligations when the stipulated reporting documentation is not received in time. It is possible that a particular privatization contract includes a clause referring to (***non***)***respect of reporting deadlines***. For instance, some of the contracts stipulate that if the Buyer delays the submission of its report on committed investments, a forfeit is imposed amounting to 0.1% of the basic interest rate for the period on each overdue day till March 1st of the current year. After this period, the Seller (in these particular cases - the PA) has the right to dissolve the contract.

According to the Ordinance on Tenders, when the ***price*** is not paid (or the first tranche is not transferred) within seven days after the contractual term is expired, the seller may dissolve the contract unilaterally. Additionally, the Buyer owes interest (according to Law on Interest Over Taxes, Fees and Other Similar State Claims) on payments postponed. In some contracts a clause, similar to the reporting deadlines clause except for the determined sanction, the Buyer's due payments are burdened with interest of 0.1% per overdue day. If the delay continues for more than 45 days, again the Seller has the right to unilaterally dissolve the contract.

When a breach of obligations for ***maintaining the average number of employees*** of the privatized enterprise occurs, the Buyer owes a forfeit amounting 150 % of the average wage¹⁹ for the country per each work place not provided. As mentioned above, the contract can unilaterally be dissolved by the privatizing authority if forfeits have been calculated for longer than 45 days.

Privatizing authorities have introduced some amendments in specified contracts, e. g. in the clause stating that (quoted as in the privatization contracts):

¹⁹ We were told in one of the surveyed companies, that the sanction according to their privatization contract is calculated on the basis of the minimum wage. We take this statement on trust as no contract was shown to us.

- ✍ "The SELLER has the right to unilaterally dissolve the present Contract upon written notice in cases when the BUYER reduces the number of jobs by more than 30% within 45 days in contradiction of Art.... for the current year."
- ✍ "The SELLER has the right to unilaterally dissolve the present Contract, ..., if the BUYER reduces number of jobs by more than 30% in contradiction of Art. ..."

If the Buyer does not commit the *investments*, assigned by the contract, he/she owes sanctions of 50% of the non-performed investment, according to the Ordinance. In two of the enterprises we conducted interviews, we were informed that the sanction on non-committed investment amounts to 30% of the latter. Since no contract was shown to us, we cannot claim that this is valid. Like the clause described above on the number of employees, the privatizing authority has the right to unilaterally dissolve the contract when the forfeit has accumulated for more than 45 days. There is a slight variation however. The Seller has the right to unilaterally dissolve the contract if the Buyer does not commit 30% or more of the total volume of contracted investments for the current year.

Another standard obligation commonly assigned to Buyers is the *non-transference and/or use as collateral of shares* of the privatized company for a specified period - usually five years. If this obligation is not fulfilled, the Buyer owes sanctions for each transferred share, amounting 100% of share's value.

Likewise, a clause is included in some contracts referring to a "ban" on the sale of the long-term tangible assets (usually for a period of five years). A certain percentage of the entered property is commonly considered, whereas the amount of the sanction is either its market value or the value entered in the balance sheets - whichever is bigger.

Since most of the privatized enterprises were responsible in the past to maintain certain *war-time stock and state reserves*, these obligations are transferred to the new owners. Sanctions vary from 110% of the market value of the secured produce, to dissolving the contract.

Another obligation commonly presented to the Buyer is to *take over the liabilities* of the privatized company towards banks, the State budget and other enterprises. In this case, a separate agreement with the creditors is signed. If the Buyer does not submit such an agreement to the privatizing authority in time, the latter has the right to unilaterally dissolve the contract. Also, if payment of the liabilities is postponed, a forfeit is due amounting to 0.06% of the tranche per day.

Failing to fulfill the obligations to preserve the previous business activity, to protect the environment, etc. can cause the imposition of sanctions, which should be agreed by the parties and included in the contract clauses. Unfortunately, we are not in a position to determine these limitations.

According to representatives of privatizing authorities, the clause for the protection of the environment is included in order to 'remind' the Buyer to respect the Environmental Protection Act. Fulfillment of such clause is monitored (as well imposing sanctions) by the RIEWP.

Mechanisms of imposing sanctions

Having observed the failure of the Buyer to meet its obligations, the respective department of the privatization authority (e.g. Privatization Process Control in the PA, or Control Department at the General Department Privatization of the MI), sends a letter setting out the terms for the payment of sanctions (usually within 30 days). If this period is violated, a Court Claim follows. Contract disputes are solved according to Code of Civil Procedure regulations.

A foreign investor which bought an enterprise in the wood-processing industry is due to pay sanctions for the past three years for failing to perform obligations. But it is not paying. The PA has won one lawsuit against it, and others are in process. Another example of PA practice is a foreign investor who paid sanctions for two years after failing to maintain the number of employed. In the third year, when the amount due reached 300,000 BGN, the investor requested to sign an annex to the contract.

At present, the Sofia City Court is working on 40 claims submitted by the Privatization Agency. But, the agency's representatives admit that annulling a contract is procedurally difficult. There is no description of such a procedure in the Privatization Act. Transferring shares back should be done voluntarily. Even if the PA endorses these shares, it [the PA] has no money to cover them, because the Ministry of Finance disposes of the revenues from privatization.

The MI showed us a feasible scheme for solving the above problem (and it is used at present). If the MEBO buys an EOOD (a limited company owned by one person), a mortgage or the privatized company's shares are pledged in favor of the MI.

In this situation the new owner is impeded from applying for a bank credit, because there is no reliable coverage for the sources - no bank would extend credit (or if it would, then only under unfavorable conditions for the recipient) if the long-term tangible assets or shares are used already as a collateral.

The MI has not processed any cases or surrendered claims in the Court. Since 1997, ten enterprises privatized by the MI have paid forfeits, and ten more have their contracts annulled for non-payment of the price.

Analytical Remarks

While working on the project we found that people involved in post-privatization control at the PA and the MI differ to a large extent regarding the necessity of such a control and the imposition of sanctions. Some entirely renounced the need for control and sanctions. But a PA representative shared with us her viewpoint that control should be tightened, and forfeits should be regulated with a Law on State Claims in order to solve problems faster.

At this point a question arises: "Which are the leading grounds for determining sanctions in each specific case". When choosing mild or strict sanctions, it is important what state the privatized enterprise is in. The Buyer's good image is also important; and the company's capacity to negotiate more favorable conditions, or a mixture of these criteria. Other questions are: Has anyone in the privatizing authority carried out a preliminary analysis of the particular sector and environment? Are there rational grounds for each of the obligations assumed? What are the chances of failure because of *force majeure* obstacles? Only after considering all these peculiarities, should sanctions be set.

Buyers themselves recognize that sanctions are the biggest threat to them. Only one of the new owners surveyed was explicit: "I have no money for sanctions. If they [the privatization authority] do not like what I do - let them have back the factory."

Here arises the question why is it necessary to impose sanctions at all, if representatives of the PA and the MI are responsive enough to amend the contract clauses – if needed. In practice, Buyers do not make best use of the available opportunities to additionally negotiate contracts clauses. (It should be mentioned that the procedures for approval of pleas for clauses amendments are sluggish and bureaucratic.) On the other hand, as a representative of the privatization authority told us, some Buyers exaggerate when setting obligations, in order to acquire the enterprises, and problems follow.

PROBLEMS THAT COMPANIES FACE, STEMMING FROM NON-PRICE COMMITMENTS

Companies' View: Business Strategies vs. Privatization Commitments

The parameters of the business plans, proposed by the candidates themselves, usually become the new owners' non-price future commitments. These are mainly engagements regarding number of employees, investments, and in certain cases, concrete environmental commitments and commitments related to wages. In every company that we visited, privatized via tender or negotiations with more than one candidate, we found huge gaps between the actual business strategy of the buyer and the business plan submitted to the privatization body. The new owners shared with us that: "The business plans submitted to the respective privatizing body had nothing to do with the actual business prospects of their companies." Moreover, the public officials in the privatizing authorities are obviously aware of this practice.

We found out that every company included in the survey faces certain problems related to one or more of the non-price future commitments. The weight of these difficulties varies according to the case: in some companies the non-price commitments mean only additional costs (most often negligible) for reporting. But in others they threaten the company's existence. Nevertheless, in most cases (companies that we visited or we were told of by the PA and the MI) there was a conflict between the companies' business strategies and their privatization commitments. Also there is a positive correlation between the weight of the commitment-related problems and the hardness of the competition during the privatization procedure.

Problems Related to the Labor Commitments

From the socialist years Bulgaria inherited industry characterized by a phenomenon known as the "hidden" unemployment, meaning that companies were operating beyond the optimal level of employment. It was at the expense of the average productivity (and thus wages) and the cost-competitiveness of the state-owned enterprises. The structural change needed in the state-owned sector therefore presupposed reduction of the average number of staff in most of the companies. We are not certain that the privatization policy ultimately aimed at such structural changes, but in all cases the privatization authorities should have considered the staff releases in most of the companies as an absolute necessity.

We encountered problems related to labor commitments in virtually all of the companies that we visited. What is more, the privatization bodies' officials claimed that most of the requests submitted for contract amendments concern the employment clauses. Most of the companies, included in the survey, have faced or currently face problems maintaining the average number of staff defined in the privatization contract (in some cases the contracts stipulate not only maintaining certain number of employees but increasing the average number in the span of three or five years). Such companies claim that if there were no employment commitments they would have reduced the average number of staff between ten and 38 percent.

Another labor-related problem appears when there are trade unions represented in the company, which usually means that there is a collective labor contract. When a company has negotiated a "soft" kind of employment clause, i. e. maintaining the average number of staff at a certain level, lower than the pre-privatization level, the privatization contract allows it to dismiss some of the employees. However, when a collective labor contract exists, there are usually limits (defined as a percentage of the total number of employees, usually five percent), up to which employees can be dismissed. We encountered cases where the privatization contract is inconsistent with the labor legislation regarding cutting down the average number of staff, since the contract allowed for bigger releases of personnel than possible according to the collective labor contract.

Problems Stemming from Other Commitments

The second most frequently met problem, both in the companies visited and among the requests for contract amendments sent to the privatizing agents, stems from the *investment* commitments. Although the investment obligations are much more consistent with the companies' strategies than the employment commitments, it happens that during periods of weak sales the companies' expenditures can hardly extend beyond their operational costs. Additionally, due to the changing market environment in Bulgaria, commitments for investment undertaken at a given moment in a given business environment might have completely different dimensions and effects after four or five years. In such cases the new owners usually apply for postponement of their investment commitments. Problems for some companies stem also from engagements to invest according to a certain program, which includes specific types of machines and equipment.

In almost all of these cases, companies come up against problems related to the fulfillment of their investment commitments if the amount of future investment is denominated in foreign currency (most frequently, USD). In contrast, almost all of the enterprises, included in our case study, for which the privatization contracts stipulate investment in domestic currency, have not faced problems with the fulfillment of their investment programs. This is understandable, since most of the contracts were signed in 1996-1997 when Bulgarian currency depreciated by 624% against the USD, and there were several months (December 1996 - February 1997) of record hyperinflation.

Prior to 1999, there were periods when the import of machinery and equipment in the form of foreign investment was exempt from taxes and customs duties. Some companies made use of this opportunity and declared a five times bigger total value of investment. In these cases, the investment plan was fulfilled according to reporting documents and balance sheets, but the real value of the investment was considerably lower.

The *ban on using shares in the privatized company as collateral* seems to be the cause for a significant problem, although met only once in the survey. This commitment reduces the company's access to capital. However, an easy way out could be to establish a new company, via which the new owner acquires the privatized enterprise. Then it is possible to use the shares in the new company (and thus indirectly the shares of the privatized one) as collateral.

Management-employee companies that have used the ten-year deferred payment option, are usually obliged to report to the privatizing authorities during the whole ten-year period. When such a company has paid the whole price before the deadline (e. g. in the first two years), it is still obliged to report during the whole period defined according to the deferred payment scheme. It turns out that in such cases the owners should continue reporting beyond the expiration of both the price and non-price commitments.

There is no legal requirement for the state-owned enterprises to have "clear" files, i. e. to have no debts, no restitution claims, etc., before they are transformed into commercial companies and privatized. Restitution claims remained pending for the land of most of the companies even after their privatization. The privatizing agents normally keep minority stakes in the companies with the sole purpose of satisfying such claims with shares in the privatized company. We have encountered several cases, however, where the new owners are obliged to satisfy additional restitution claims, i. e. claims greater than the state-owned stake of shares kept for such purposes. The main problem in such cases stems from the lack of a land registry. In some companies the restitution claims submitted are for areas several times bigger than those owned by the company.

Analytical Remarks

Although officials at the privatizing agents are aware of the gaps between business plans submitted and actual strategies, there is little sign that they have changed anything substantial to rectify the causes of this disparity. The use of "closed" privatization techniques, i. e. tenders and negotiations, as well as the setting of unclear rules for buyer selection, have encouraged the exaggerated figures

(especially regarding the average number of staff) in the business plans, compared to the buyers' strategies.

Besides the non-price commitments resulting from the business plans, we encountered a bulk of commitments that have been suggested (or imposed) by the privatizing authorities, and in most cases have been accepted by the candidates (especially when there was a hard competition between the candidates). However, accepting these commitments in no way meant keeping consistency with the actual business strategies. When there was a hard competition for a company the candidates could hardly reject commitments suggested by the privatizing agent.

The actual business strategies of the new owners in most cases would include restructuring of the company, aiming eventually to achieve higher productivity and profitability. Commitments such as keeping the previous activity, maintaining a certain level of employment, and not selling fixed tangible assets, would obviously impede such intentions. It is worth noticing also that the fulfillment of future commitments by the selected buyer generally depends on at least two conditions, both external for the new owner. Namely these are:

- ✗ the privatized company's capacity as it was inherited by the private owner.
- ✗ The will of the other shareholders.

The problem of maintaining a (too high) average number of staff can be solved in several possible ways:

- ✗ amending the privatization contract – i.e. reducing the figure in the employment clause;
- ✗ reducing the average number of staff without amending the contract, and paying sanctions;
- ✗ reducing the average wages, whilst maintaining the average number of staff;
- ✗ making an informal agreement with the workers to take non-paid holiday (usually for several months), and so maintaining the average number of staff. In some cases workers on maternity leave (for example) are included in the list of average employment, so the average number of workers is bigger than the real number. Women on maternity leave receive money from the National Social Security Institute, not from their employer.
- ✗ operating within lower than optimal profit margins because of the increased labor costs.

Keeping a level of employment which is higher than the optimal generally means lower productivity and lower wages, as well as narrower profit margins for these companies (especially for those operating in highly competitive markets). We were convinced that if the companies succeed in their efforts to amend the contracts, the average wages in their plants would be raised (in some cases up to 40 %).

The executive director of one of privatized companies we studied argued that it would be better to pay a minimal wage to the extra staff to stay home instead of taking the risk of contract cancellation. An additional argument is the fact that the enterprise has embraced the above mentioned tax preferences according to the Profit Tax Law of 1996. In this case if the commitments stipulated in the privatization contract are not fulfilled, the enterprise should compensate for the income tax due but not paid during five years following privatization.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

There is a prevailing perception among the privatizing bodies' officials of privatization as a process, which aims at *developing the company*, i. e. their job is not just transferring the property, but also finding "good" new owners and committing them to "developing" the companies. This is the main motive behind the prevailing use of "closed" procedures, i. e. tenders and negotiations. According to the privatizing authorities, they allow for a better selection of buyers, because the evaluation of different offers is made on the basis of more than one criterion (the price). The results of this vicious practice are:

- ✗ the privatization procedure loses its transparency;
- ✗ the candidates are led into a blind competition, which forces them to submit business plans (i. e. non-price future commitments if they buy the company) which are hardly achievable.
- ✗ There are differences in the access to information for insiders and outsiders.

In addition, we believe that "closed" procedures decrease the potential amount of privatization revenues at least for three reasons:

1. there is a trade-off between the price and the other commitments.
2. the unclear rules of the game reduce the number of interested investors, which mean lower demand and lower price for the company.
3. the discretionary power, resulting from the unclear rules for buyer selection, in certain cases may not lead to the selection of the best offer.

Thus we consider the prevailing use of tenders and negotiation to have high opportunity cost in terms of missed cashflows to the budget.

The evaluation of candidates' offers, based on several incomparable (and some cases, not quantifiable at all) criteria, naturally leads to the vast variety of non-price future obligations. The most persistent among them are:

- ✗ *maintaining a certain average number of staff*
- ✗ *certain volume of investments*
- ✗ *preserving company's previous activity.*

The preservation of company's previous activity guarantees that the company will continue its operation. The privatizing authorities consider investments the primary source of companies' development. Finally, the employment clauses are supported by the social reasoning of the state officials, i. e. this is part of the "fight against unemployment". Besides the generally applicable commitment clauses, in our survey of 11 companies we encountered a number of specific commitments applicable only to particular cases. Some of the clauses refer to or repeat existing general norms or obligations stemming from other private relations. Such obligations include preserving the environment, maintaining the state reserve and war-time stock, and sticking to contracts with third parties signed prior to the company's privatization (including collective labor contracts). We consider the existence of such repetitive clauses legally unjustifiable.

The following non-price future commitments have the most negative effect on the privatized companies either by preventing the new owners from restructuring the company, or by jeopardizing company's current operation:

- ✗ maintaining a certain average number of staff.
- ✗ not selling fixed tangible assets.
- ✗ not using the shares in the privatized company as collateral.
- ✗ implementing an investment plan, fixing volumes of yearly investments and types of investments.

Furthermore, the use of the ban of the sale of shares has to certain extent prevented the faster development of Bulgaria's capital market.

The use of "closed" privatization techniques, as well as the unclear rules of buyer selection, have encouraged gaps between submitted business plans and actual strategies. The actual business strategies of the new owners, in most cases, would include the restructuring of the company with the aim of

eventually achieving higher productivity and profitability. Commitments such as keeping the previous activity, maintaining a certain level of employment, and not selling fixed tangible assets, obviously impede such intentions.

Besides the commitments resulting from the business plans, we encountered a mass of commitments that had been suggested (or imposed) by the privatizing authorities, and in most cases had been accepted by the candidates (especially when there was a hard competition between the bidders). However, accepting these commitments was in no way consistent with their actual business strategies. When there was a hard competition for a company the candidates could hardly reject commitments suggested by the privatizing agent.

The very existence of the non-price future commitments predetermines and justifies the post-privatization control. However, the basis of privatization control is the Contracts and Obligations Law, in other words, the general civil law. Thus the state via the PA and other privatization bodies turn into mere parties to bilateral contracts. Therefore, no limits to administrative power are possible; privatization bodies can establish the rules of the game, the procedures and the sanctions, in the same way as any individual party to a contractual agreement can do. This is a *prima facie* argument for the existence of privatization control.

It seems that most frequent requests for amendments to the privatization contracts demand reductions in the level of employment in companies. This is a direct consequence of the inconsistent policy of privatization bodies to define both levels of investment and increases in employment in privatization contracts. The simultaneous increase in employment and investment can only happen when the specific market is expanding fast; all other thing being equal, improvements in technology lead to reductions in the amount of labor needed. The major feeling, however, from the meetings with PA and MI officials, is that they understand the necessity of flexible privatization contracts. They seem to understand that employing too many workers above a certain threshold might threaten the very existence of the company, thus even further increasing unemployment.

Privatization bodies are called to do quite difficult and inconsistent tasks. On the one hand, there is a deep-rooted understanding that the State can and should retain control over the economy through privatization contracts. On the other hand, the privatization bodies, and the government as a whole, recognize the impossibility of this “social engineering mission”. They seem to understand that, first, owners are the ones that can best take decisions related to the effectiveness of a given company, and second, that market conditions are changing, and no one is able to predict the future five years ahead (The MI claims that after 1998 all non-price commitments in privatization contracts last for only three years). Therefore, amendments become more and more easy to negotiate. So the reasons, be they political or social, behind putting non-price future commitments in contracts, become futile. The message sent to potential buyers is, therefore: “We will verify that you *deserve* the enterprise by your business plan. Be sure that you follow your promises, otherwise we will make you pay or we will take away you tax preferences. But, we, and only we, can provide you with an amendment in case you are in trouble”.

One of the most peculiar facts about non-price commitments and their respective sanctions is that if employment is reduced below the negotiated numbers, the buyer has to pay compensation to the state, usually 150% of the average salary for the country. This does not seem to solve social problems stemming from possible lay-offs. The people who are laid off from a privatized company are the ones who suffer, not the state. It would be much more rational (or fair) that they received whatever compensation is paid by the new owner of the enterprise. The current situation implies that employers who reduce jobs harm the state, not those who lose their employment. This assumption justifies the further involvement by the government in corporate strategies related to labor and employment.

Privatization control therefore turns into a merely formal procedure and, when needed, a possible tool for harassment. Site audits are rare. Most reports are collected and stored for evidence, and only total numbers are checked for reconciliation. Sometimes controlling agents help companies prepare the reports. It turns out that the control procedures *per se* do not cause excessive an direct burden for companies. Moreover, it seems that reasonable applications for the amendment of contracts might

come to success. Therefore, privatization control cannot ensure perfect execution of all contracts. Neither can it stop layoffs if business conditions require it. The only function remaining to it is a tool of the government policy for intervention in economic affairs; a tool in a game of *carrot-and-stick*.

The above mentioned observations question the ground for the very existence of privatization control. The idea that a government institution must have a say when an investor is planning his activities for the following five years lacks economic rationale. Understandably, the legislator has provided no explicit provision that would allow privatization bodies to monitor the performance of privately owned companies. The “invention” of privatization bodies to organize post-privatization control therefore can be explained only by their efforts to maintain state interference in the economy.

Recommendations

We recommend that the privatizing agents start using predominantly “open” procedures – auctions and public offerings – not only for detached units but also for whole companies. This will have the following positive implications:

- ✍ higher speed of procedures.
- ✍ higher transparency of the process.
- ✍ higher and faster revenues (as the price will be the only criterion for buyer selection).
- ✍ fostering capital market development (valid for the public offering scheme).

When tenders or negotiations are to be used, the evaluation criteria should:

- ✍ be exhaustively listed in the Decision for Privatization.
- ✍ be quantifiable and comparable to each other.
- ✍ have evaluation weightings, which are preliminary announced to the candidates.

This will 1) reduce the possibilities for discretionary evaluation, and 2) help the candidates submit business plans consistent with their actual business intentions.

The very idea behind post-privatization control is that the government should have a means to interfere in the economy. In a market economy this assumption should be abandoned. We recommend that non-price future commitments, being a major impediment to companies’ eventual restructuring, should be avoided in privatization contracts. This recommendation could be applied to existing contracts through the adoption of a general regulation amending the contracts in this way. The lack (or significant decrease) of future commitments should result in the absence (or significant narrowing) of the control activities of the privatization authorities. Should this proposal be accepted, we foresee the following positive direct effects:

- ✍ encouragement of the restructuring process of formerly state-owned companies, leading to improved competitiveness and increased productivity;
- ✍ reduction in the time and direct costs that companies spend on reporting to the privatizing agent;
- ✍ a more efficient use of the privatizing bodies’ staff, as monitoring activities will be minimized;
- ✍ a friendlier environment for potential foreign companies entering Bulgaria via privatization.