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A supplement with selected macroeconomic indicators

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Impacts Of Yugoslav War On Bulgaria

Dr. Krassen Stanchev

The institute is monitoring economic and political developments on the Balkans for five years. It maintains large network of professional contacts in all the countries, and in the days and weeks preceding the war IME researchers and I myself have been visiting all countries and provinces of the region working on a project Balkans In 2010.

Thinking the Unthinkable

Just started and with unclear resolution, the war in Yugoslavia is difficult to measure in terms of impacts on neighboring economies. It is not clear how long it will take, what is the likelihood of different post-war scenarios, and whether the war will be repeated in some form again. Assessments of provisional impacts are complicated by purely domestic factors that impede competitiveness and increase costs.

Short-term war, i.e. the government of Serbia to accept Ramboillet conditions, is almost a miracle. For the time being, the probability of a longer war seems greater. It well may be that there is a war which proceeds with interruptions lasting between 6 months to 2-3 years. These could be periods of delayed wars taken by the parties to prepare for the next step of desired solution.

Humanitarian disaster and ethnic cleansing in Kosovo, the current *casus beli*, emanate from deeper processes on the Balkans. The background driving force of a long-lasting warfare must be found in the formation of nation-states in the region, a process which in other parts of Europe had been proceeding between 17th and 19th centuries.

• Albania is undergoing such formation.

• Led by Milosevic and his clout and backed by the Serbian identity at home and abroad, residual Yugoslavia is defending its national pride and territory. At least it is the bold underlying perception of the people and politicians in Belgrade.

• Macedonia, with its recently gained independence, faces a challenge of defending itself.

• Montenegro is likely to embark on nation-state path in the nearest future.

Needless to say, whatever the national aspirations the genocide and ethnic cleansing can not be neither excused nor accepted as a tool of achieving them. The problem is that it is difficult to eradicate memories of the past violence when there is no shared vision of a common future and prosperity.

Yugoslav "Economic Options"

There is no information about the financial situation of Yugoslavia. From a recent interview of ex-governor of the central bank, Mr. Abramovic, it is known that forex reserves are about $ 80 million. Sources mention that a week before the war the country had a difficulty $ 1.2 million payment for gas-transits through Hungary. During the first week of the war the exchange rate did not change significantly. Since mid-March, informal mar-

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ket rate has reach the level of 50% higher values but currently the trade has virtually stopped. (Official central bank rates are 10.9 DIN/US$, and 6.2 DIN/DM while informal have freezed in the first days of April at 16.3 DIN/US$ and 9.2 DIN/DM.) .) Currency seems substituted. There are reports that the central bank of Yugoslavia blocked all commercial banks accounts. Official inflation figure for March is 3.5%. Informal subsistence to household budgets and barterization keep the societal fabric together. Another factors might well be "expropriation" of Kosovars' home savings. The production of food-stuff and basic goods seems self-sufficient, for the time being. This situation is not sustainable. If there is no aid from friendly governments, the rulers in Belgrade have no choice but printing money. It will be some sort of repetition of previous inflation history of the country. The likely outcome eventually is interruption of the warfare; in order to either rehabilitate the economy to fight again or to skip the violence path and take the cooperation, prosperity, and integration rout. If the latter, the instability factor may not be in the Serbian politics but outside the country. With the time passing, the international community will recognize these option and will probably bear some "containment" costs.

Table 1: Relative share of exports to some groups of countries

	1996 USD m.	share	1997 USD m.	share	1998 (6 month) USD m.	share
EU	1,912.5	39.1%	2,128.7	43.3%	1,083.8	49.7%
Other OECD	554.0	11.3%	661.7	13.5%	249.0	4.7%
EFTA	49.5	1.0%	44.3	0.9%	15.5	12.0%
CEFTA	94.8	1.9%	137.1	2.8%	119.9	4.8%
Balkan countries	514.2	10.5%	291.9	5.9%	397.6.	5.4.%

Table 2: Relative share of imports from some groups of countries

	1996 USD m.	share	1997 USD m.	share	1998 (6 month) USD m.	share
EU	1,780.3	35.1%	1,823.1	37.3%	1,044.9	48.8%
Other OECD	275.4	5.4%	343.8	7.0%	227.1	8,9.%
EFTA	86.4	1.7%	86.8	1.8%	34.0	1.7.%
CEFTA	159.9	3.2%	231.7	4.7%	120.0	6.0%
Balkan countries	163.3	3.2%	95.2	1.9%	68.4.	1.8%

Politics in Bulgaria

What about Bulgaria? I think, it would rather stay away of these developments. It will live in a heated political debate on what is good and what is bad, on how to keep peace with neighbors not breaking with EU and NATO community, and who is guilty for setbacks in either direction. This natural debate will not have a direct impact on the reform orientation and policies of the current government. Though not decisive, its ability to tackle different public attitudes towards Balkans will be a factor in the local elections of 1999, and in the general elections of 2001. There is almost no danger of direct Bulgaria's involvement in any Balkan war.

Worst-case Scenario

In 1998 Bulgaria signed an agreement with CEFTA which was expected to double the trade with Central Europe. By December it amounted to 5.4% of the total trade, growing by 51% for the year. The war will most likely endanger this exchange. But so is the entire trade.

So, the worst-case scenario must be taken into account as a bench-mark of further attempts to draw a realistic picture of the provisional impacts. Such scenario would mean:

- closed Bulgarian trade with West;
- no replacement with new trade-routs;
- no revenue from trade and transport.

Bulgaria's export to EU, CEFTA and EFTA amounts to 63% of the total export. The imports from the same countries is at the level of 52% of the total import. The average import dependence of Bulgarian export for the last four years is approximately 80%. Under these circumstances, the worst-case scenario would mean US$ 2 billion current account deficit.

Immediate Impacts

Immediate impacts are to be identified in the following areas:

- higher transport costs,
- lost tourism revenues,
- lost markets,
- less foreign investment,
- costs of refugee accommodation.

The most easy to calculate are the cost of refugees. Direct increases in transport costs are more or less known. Tourism revenues are difficult to predict in terms of impacts of the war. Lost markets are virtually impossible to take into account. Foreign investment must be discussed separately.

Bulgaria, according to ratified conventions, is obliged to accommodate 5,000 refugees. Total cost were correctly calculated by Cash weekly. They would amount to almost to 582 thousand per month, or 0.1 of nominal 1999 GDP. However, the risk of receiving this number of refugees is rather low.

Bulgarian firms have long been active in international motor carriage. Due to the international nature of the competition, prior to 1989 these firms operated more efficiently than was typical of firms in other industries in the region. Their adjustment to market shocks in the 90's has been relatively fast and smooth. The different of the current from previous shocks is namely in the physical closure of Yugoslavia (during the UN embargo lorries were crossing Bulgaria's Western neighbor cutting time and informal taxes).

It is possible to assume that informal transport costs (time spent on border crossing, informal taxes etc.) would be the similar to those of the time of the UN embargo, adding up to 50% to the formal costs. Currently, all carriers report 1.5-2 million losses a day. With the time passing real losses of road carriers will go down due political pressures to reduce informal payments and other institutional adjustments. The cost of speditiing a rail-way cargo through Romania are US$ 3-4 per ton of freight, and the time is four days more. Long-term transport hurdle will come if the high-way bridge Danube near Novi Sad will be destroyed.

Lost markets are expected to mostly in the EU and CEFTA area. There is a possibility for compensatory adjustment through regained positions in Russia and Former Soviet Union. This reorientation will rescue some immediate trade losses but is likely to have negative institutional consequences for firm-level strategies. The problems here are associated with lost competitive pressures which would later result in longer-term inability to compete in sophisticated markets led by enlightened demand.

Tourism losses are not clear due partially informal nature of the sector. Family hotels are those accommodate both winter and summer tourists from Macedonia and Yugoslavia. They are not more than 8-10% of all tourists. Competitiveness of the tourist sector is rather an internal matter: prices are comparable to Greece but quality of the services is much lower.

Domestic Hurdles

Similar to tourism all above mentioned direct an internal institutional impediments.

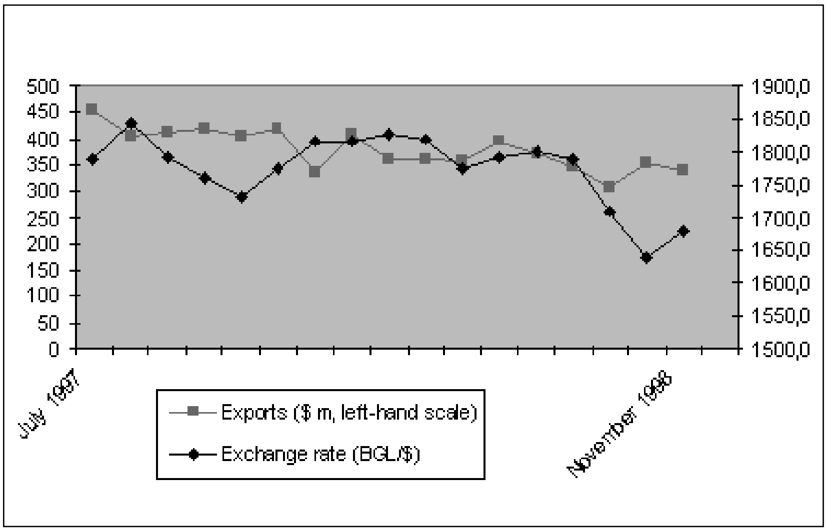
Rail-ways cargoes are more expensive. But the problem is also in the fact that it is difficult to find alternative routs. For instance, Bulgarian ports of Varna and Bourgas charge fee comparable to the Aegean port of Thessaloniki but three time higher than the neighboring Romania port of Konstanza.

A previous (1995-1996) research of IME and the American University in Bulgaria led by Prof. Richard Beilock reveal transport cost which Bulgarian carriers, ports and State Rail-Way Co. failed to reduce.

Movements in the Black Sea are more costly per kilometer than in Western Europe. The magnitude of the difference is surprising: a rate-distance gradient for movements in the Black Sea of $2.56 per kilometer ($2.20 + $.36), compared to $.36 per kilometer for movements in the Mediterranean. The high cost may be due to operational inefficiencies. An alternative explanation is that the high distance-rate gradient is due to capacity constraints which, admittedly, may be the result of inefficient utilization). The rate for crossing the Black Sea is comparable to the costs implied in the model of taking the land route. Due Black Sea freight and port rates, Danube barge costs rates would go up to the cost of the alternative (if the river is open for navigation).

Competitiveness of Bulgarian products is hampers by domestic factors as well. According to IME estimate, private sector companies have average 30% higher productivity than state owned. However,

Graph 1: Merchandise exports and exchange rate after the introduction of the currency board



state owned enterprise (especially monopoly structures) investment is not taxed while private sector is taxed. Electricity and gas monopolies are effective creditors of the state sector: their effective (quasi-fiscal) subsidy for 1998 is more than DM 900 million. In other words, it is ¼ of the worst case scenario losses, and in annual terms is higher than or equal to most pessimistic 1999 scenarios for the current account deficit (see below, the note on macroeconomic impacts).

Foreign Investment Losses

The Yugoslav war-related risk of provisional loss of foreign direct investment would rather depend on the size and attractiveness of privatization deals, the prospects for green-field investment and the size of the markets (including foreign) for Bulgarian products.

Envisaged amount of 1999 FDI's is DM 420 million cash revenues from sales of state owned enterprise, and DM 580 million green-field, joint-ventures and reinvestment. Both figures are rather modest. The cash component is to exceeded due the sale of Bulgarian Telecommunications Co. alone. The second component is up 50% investment in the power sector which has contracted electricity export agreements with Turkey, and the bulk of this investment is secured through a joint venture between the power monopoly, National Electric Co. (NEC), and Entergy Power Group.

Bulgarian economy still have number of "holy cows": NEC, Bulgargaz, roads, utilities, etc. Concession regulations hamper both green-field

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Bank Privatization in Bulgaria: Still Forthcoming

Assenka Yonkova, IME

The most significant delay in the privatization schedule adopted in Bulgaria seems to be in the banking sector. At the same time Bulgarian banks are suffering a lack of efficiency, effectiveness, and competitiveness. This is why it appears to be important for Bulgaria to attract serious foreign investors to buy the largest Bulgarian banks, and thereby provide fresh money inflows, to increase the investment potential of the banking system, to improve banks' management (including staff technical skills) and to make these banks competitive and profitable.

The Situation

Since the bankruptcy of approximately one-third of the banking system in 1996-97, the banking sector is lately composed of 33 banks (including the State Savings Bank and branches of foreign banks), most of them small and private.[1]

At the beginning of 1997 there were six state-owned commercial banks: Bulbank, United Bulgarian Bank (UBB), Expressbank, Bulgarian PostBank, Hebros Bank and Biochim Commercial Bank. Their major shareholder was the Bank Consolidation Company (BCC), which is in charge of bank privatization (see table 1).

At the end of 1997, state-owned banks accounted for 67.1% of total bank assets in Bulgaria (see table 2).

At the end of 1998 there were four state-owned banks,[2] and their share in total bank assets was 70%.

Regardless of the reforms that have been performed in the banking sector since 1997, there are a lot of problems to be overcome. Among the primary ones are:

• the small scale of the banking sector: the total assets of the banking sector in Bulgaria equal about 35% of GDP, which is far below the standards in developed countries (where this proportion is more than 100%).

• low quality and poor variety of bank services;

• a lack of sufficient confidence in banks;

• inadequate profit from bank activities;

Table 1:
The BCC's shares in state-owned Bulgarian banks at the end of 1997

Bank	Total face value of bank shares* (BGL, millions)	Face value of BCC's shares (BGL, millions)	% of total capital
Biochim	16,758	16,639	99.29
Bulbank	15,126	14,822	97.99
Hebros Bank	10,401	10,149	97.57
Expressbank	3,566	3,493	97.94
Bulgarian PostBank	2,421	1,894	78.22
Total	48,272	46,997	97.36

**IME's estimate*

• lending is still considered to be a very risky activity, because the business environment has not improved significantly and the execution of creditors' rights is slow and banks face problems in collecting on non-performing loans;

• a low level of competition among banks;

• a lack of typical investment banks and mortgage banks operating in Bulgaria;

• a lack of major international financial institutions on the Bulgarian market to improve the quality and availability of financial services, increase competition, and provide modern banking skills and technology;

• a lack of sufficient skills on the part of bank staff;

It is obvious that bank privatization with the decisive participation of foreign investors as efficient competitors is the most appropriate solution for most of the above-mentioned problems in the banking sector. Additionally, the entry of international capital in the domestic banking system would lead to a corresponding entering of foreign investors (including portfolio investors) in the real economy.[3]

United Bulgarian Bank - The First Deal

The first privatization deal in the banking sector was finalized in July, 1997. At that time the BCC sold the second-largest Bulgarian bank, United Bulgarian Bank. As a result, 35% of bank's shares were acquired by the EBRD and 30% by the American company Oppenheimer & Co. The remaining 35% are in the possession of the state-owned Bulbank. According to the stock purchase agreement, there was a provision for the recapitalization and financing of the bank in the amount of US $48 million. Actually UBB was sold for BGL 5.3 billion, which meant 25% of the face value per share.

As a result of its privatization and consequent increase in capital, UBB came to the top of the list of Bulgarian banks, ranked by equity in 1997. It reported the most significant return on assets: 14.79% for 1997 (see table 3).

Recently UBB has reported a 75.3% capital adequacy ratio. Its capital base is BGL 106.5 billion.

PostBank - Privatization in Progress

On August 14, 1998, the BCC signed an agreement for the sale of 78.23% of the share capital of Bulgarian PostBank The buyers were American Life Insurance Company (ALICO) and the Greek Consolidated Euro-Finance Holdings. They acquired the PostBank shares for US $38 million. In August, 1998, they paid 10% of the total amount. The deal was officially finalized in November, 1998. Bearing in mind that the stock capital of PostBank is BGL 12 billion, it turns out that the shares are being acquired at price 6.5 times higher than their face value. According to the agreement the new owners of the bank are obliged to increase the bank's capital by US $20 million within 12 months. The first increase in the bank's capital by US $10 million must be made by May 11, 1999. There is a special provision in the agreement prohibiting the sale of shares for seven years after acquisition.[4] Potential new shareholders can have access to PostBank only after additional approval from the Bulgarian government. The government will receive some portion of the bank's profits for the coming five years.

The Bulgarian Telecommunications Company (5.03%), Bulgarian Posts (5.03%), the State Insurance Institute (5.03%), the State Savings Bank (5.03%) and the National Palace of Culture (1.65%), all of them still state-owned, remain minority shareholders in PostBank, with the indicated stakes.

On the whole, the privatization of PostBank took a long time. Most of the obstacles to an efficient privatization process became clear. Some of the participants in the tender blamed the BCC for a lack of transparency, non-adherence to the announced deadlines, and unclear criteria for selecting the winner.

In February, 1998, the BCC adopted a resolution strategy for the privatization of state-owned banks in which the key principle was to appoint investment advisors for the disposition of the BCC's interest. The focus of the privatization strategy shifted to one of selling the best banks first, in order to attract additional capital and expertise.

According to the government's agreement with the IMF, by end-October 1998 tenders for Expressbank and Bulbank had to be issued, and expectations were that these two banks would be sold during the first months of 1999. At the beginning of November 1998, a postponement was negotiated in the terms for the banks' privatization. According to it, a tender for the sale of Expressbank must be opened by March 31, 1999, and one for Bulbank by June 30, 1999.

Expressbank -Next in the Pipe-line

The privatization of Expressbank looks like it will be complete in the immediate future. Investment advisers HSBC Investment Bank plc. and Deloitte & Touche began working on the privatization of Expressbank in August, 1998. Their mission is to find one or more strategic investors[5] for the purchase of the majority package (67-80%) of the BCC's share in Expressbank's equity (97.94%). There is a scenario in which some portion of the bank's shares may be offered for sale via the Bulgarian Stock Exchange. Some portion of the shares (between 3% and 10%) can be sold to managers and employees of the bank. The World Bank's International Financial Corporation and the EBRD have declared their willingness to buy minority packages of Expressbank's equity if there is strategic buyer for a majority share of the bank. At the end of March BCC announced that three candidates are included in so-called short list and that their offers are expected. It is anticipated that the bank is going to be sold until July.

Expressbank's profits in 1998 are estimated to have been BGL 27 billion. The return on the bank's equity capital is 157.7%, which is the best of any of the state-owned banks. In 1998, Expressbank increased the amount of credit granted in leva denomination by BGL 65 billion. The bank's operations are oriented mainly toward a specific group of clients: shipyards, ports, sea resorts, etc. It is expected that the buyer of Expressbank will have options to cash in on the state guarantees for the outstanding debt of the Varna shipyard, as well as to buy part or all of the shipyard's credit exposure.[6]

Table 2: Bank Assets Structure

	State-owned banks	Private banks	Foreign banks
October 1996	84.8%	12.6%	2.6%
November 1996	85.2%	12.2%	2.6%
December 1996	86.3%	11.1%	2.6%
January 1997	88.3%	8.8%	2.9%
February 1997	89.0%	7.8%	3.2%
March 1997	88.4%	7.8%	3.8%
December 1997	67.1%	14.8%	18.0%

Bulbank - the Biggest Deal

The crucial test for the BCC, and for the Bulgarian government, will be the privatization of the biggest and most prominent Bulgarian bank, Bulbank.[7] As has already been mentioned, it is expected that Bulbank will be offered for privatization in June, and that it will be sold by the end of the year. The BCC's share in Bulbank is some 98%. In November, 1998, Bulbank's assets stood at BGL 2,230.9 billion, which was some 30% of total assets of commercial banks in Bulgaria. For the period January 1998- November 1998 the bank reported the biggest profit, BGL 27.5 billion, and the most significant capital base, BGL 231.5 billion (see table 4).

Table 3: Some Financial Indicators of Bulgarian State-Owned Banks, as of year-end 1997

Bank	Equity (BGL, billions)	Assets (BGL, billions)	Loans* (BGL, billions)	Profit (BGL, billions)	Return on Assets (%)**
UBB	221.267	812.484	276.083	120.133	14.79
Bulbank	213.332	2,412.404	1,648.603	162.393	6.73
Expressbank	43.764	361.853	109.545	15.526	4.29
Biochim	35.157	480.515	160.872	0.991	0.21
Hebros Bank	23.932	276.193	90.501	4.306	1.56
PostBank	21.736	430.858	229.289	14.287	3.32
SSB	94.113	881.224	403.609	59.891	6.80
Total	653.301	5,655.531	2,918.502	377.527	6.67

* including receivables from non-financial institutions plus placements with banks and financial institutions;

** based on profit/total assets ratio

Bulbank's privatization will be accomplished with the advice of a consortium between CA IB Investmentbank Aktiengesellschaft, Credit Suisse First Boston and Arthur Andersen. The privatization strategy foresees a combination of the sale of a majority of Bulbank's equity to one or more strategic investors, the sale of some portion to the managers/employees, as well as the registration and sale of some portion of equity via an international stock exchange (most probably London). The EBRD has declared its readiness to buy a minority package of Bulbank's equity.

Meanwhile, Bulbank has begun procedures for the sale of its shares in other Bulgarian banks. Bulbank holds 35% of the Central Cooperative Bank, 99.95% of the Corporate Commercial Bank, 35% of United Bulgarian Bank and 49% of HypoVereinsbank-Bulgaria. The bank has already sold its share (45%) of Eurofinance Financial House.

Hebros Bank - the Next One

Hebros Bank (whose assets equal approximately one-tenth of Bulbank's assets) is the next bank listed for privatization. In July, 1998, experts from the Bank Supervision Department of the Bulgarian National Bank and BCC's advisors from Barents Group completed an enhanced supervisory audit of Hebros Bank. The BCC prepared a bid package to be submitted to potential strategic investors interested in the bank, and if there are serious investors, the BCC will commence the bidding procedure. If there is no serious investor interest in the privatization of Hebros, the company will appoint a privatization intermediary to carry out a marketing program and to suggest a short-list of potential strategic buyers.

In October, 1998, Hebros Bank reported BGL 15.6 billion in profit and a capital base of BGL 29.4 billion.

Those Remaining - Biochim and SSB

Biochim was placed under a Management Agreement with a British management team from Glendeil Consulting Ltd. in September, 1998. The purpose of the contract is to perform operational restructuring of the bank, stabilization of its operations, implementation of a necessary balance sheet, and finally preparation for privatization. According to the Memorandum on Economic Policies of the Government of the Republic of Bulgaria, the privatization of Biochim must be completed by the year 2000.

According to the agreement reached with the IMF and the World Bank, the last Bulgarian state-owned bank, the State Savings Bank, should enter a privatization procedure by 2001. In November, 1998, the process of transformation of the SSB into a commercial bank began. Recently the SSB has been restricted in its lending capacity (loans to enterprises should be no more than 75% of its capital), in order to prevent its portfolio from deterioration. The bank is still prohibited from taking deposits denominated in foreign currency. The SSB is the only Bulgarian Bank with a 100% government guarantee on its deposits.

The current obstacles

One of the most serious problems concerning bank privatization (and privatization in Bulgaria in general) is that the supply of Bulgarian banks is still higher than the demand. A possible explanation for that circumstance could be that the political environment and investment climate in Bulgaria are considered hostile because of corruption, criminalization, the lack of an efficient legal system and the small domestic market. In principle Bulgaria is not well known, and it is not considered to be an attractive country on international markets. Moreover, the BCC to some extent has bureaucratic and slow procedures for accomplishing the privatization process. Most investors consider that there is no clear procedure or criteria for the selection of candidates. Other obstacles are a lack of transparency in the process and non-adherence to announced deadlines.

In conclusion, there is consensus among the government officials, privatization authorities and analysts that the process of bank privatization in Bulgaria must continue. Becoming more flexible and market oriented is a decisive condition for the final stabilization of the bank system and the restructuring of the main Bulgarian banks into efficient, competitive and reliable credit institutions.

Table 4:
Main Balance Items of Some Bulgarian Banks, as of 30 June 1998

Items(BGL,thousand)	PostBank	Bulbank	Hebrosbank	Biochim
Cash	85,957,764	225,694,485	43,383,975	72,132,121
Claims on banks and other financial institutions	134,598,451	1,172,090,994	36,786,301	66,746,589
Claims on nonfinancial institutions	49,265,395	412,846,158	67,665,699	66,249,057
Attracted resources	367,645,835	1,796,507,414	197,917,729	328,114,656
Own capital	12,000,000	276,732,473	38,106,083	45,687,800
Reserves	9,736,325	37,849,134	13,518,616	18,400,174
Profit	4,464,446	71,763,179	14,186,347	10,530,469

1. In January 1998 Credit Bank went bankrupt. This bankruptcy didn't have a significant effect on the banking system because the bank was comparatively a small one, and there were clear signs that the bank did not work properly and that it was a matter of time before it would be closed. Most of its depositors managed to withdraw their deposits, and the remainder of deposits were covered by the Deposit Guarantee Fund.

2. Bulgarian PostBank was privatized in 1998.

3. Although this is not the only precondition.

4. This restriction is not adequate from an economic point of view. But according to the privatization authorities, such a provision serves as insurance that the investor is 'strategic,' regardless of whether it increases the transaction costs of the buyers (also see footnote 5)

5. According to the Bulgarian privatization authorities, "strategic investors" are those who buy a company (in this case a bank) with the intention to manage it, rather than to sell it after short period of time. It is assumed that such a "strategic" investor will buy a majority package of the bank's equity.

6. Expressbank offered to wipe out $10.2 million of the Varna shipyard's debts in exchange for ownership of one or two ships currently are under construction there. The idea is that the bank will fund the rest of the ships' construction and then sell them.

7. Due to Bulbank's special position in the Bulgarian banking system (its assets are 30% of total banking system assets), it is believed that its privatization is going to be difficult from a political point of view.

Bulgaria and Europe: Rhetoric of Bulgarian Media

Zora Blagoeva, IME

This overview of articles from several Bulgarian daily papers, live shows on Bulgarian National TV, CNN and Russian Television and Radio Channel for March 1-30th does not claim to be thorough. The idea is merely to initiate debates.

Prosperity Through Integration for the Sake of Bulgarian National Interests

Right at the beginning of the Balkan political crisis, Bulgarian Prime Minister Ivan Kostov appeared on National TV and appealed for the initiation of a general discussion over national interests (namely future integration in EU and NATO). Basically, his idea was to try to preserve Bulgaria's identity through incorporating Bulgarian social and cultural values in with European ones, to get actively involved in global economic turnover, to nourish world peace, and to participate in competition for investment and employment. There is some confusion in the wording of Kostov's ideas, between the prerequisites and consequences: we want integration in order to support our development; EU wants us first to prosper, and will let us join only after reaching a certain level of development.

Therefore, a debate started in the Bulgarian press, among those who are tired of awaiting new adventures to be invented for the candidate-conqueror; sporadic opponents of integration as a whole, and expressed EU position of being reluctant to suffer the enlargement process.

What Was Released In March

What led to the intensification of the debate? At the beginning of March, the Prime Minister granted an interview to Reuters, wherein he explained his position on several interrelated problems: the political crisis in Kosovo, NATO's ideas on solving the problem, expectations for progress in EU-Bulgaria dialogue[1], subsequent challenges facing economic reforms and the political will to best solve them.

Unlike in previous months, when words like EU, accession, Euro-integration, Euro, *acquis,* etc., appeared in the Bulgarian press once a week, during the first week in March journalists made the Interview into "hot issue," both inside and outside the country.

As expected, opinions varied. During the first week, all Bulgarian journalists were practically united, denouncing Mr. Kostov's manner of statement, not his ideas. Were left-oriented commentators too embarrassed to accuse Westerners of neglecting us? Were right-oriented commentators afraid that hurting Europe's feelings would prolong accession negotiations? A clash of interests arose. Integrating Bulgaria into Europe is no doubt a political issue, though arguments behind the problematic negotiations are economic. The two partners unintentionally became opponents: our Prime Minister, along with senior politicians, considers accession as a means to stimulate reform. An explanation could be that our restructuring strategies and schemes are prepared by means of Western experts' knowledge anyway, so why not get to use structural finds too. The EU, having to sponsor considerable CEE transition expenses, surrounds itself with more barriers, thus converting the fulfilment of an *acquis* from a prerequisite for integration into an award.

In mid-March the debate split in two different directions: the Kosovo crisis and how (or whether) to get involved in it; and the pending vote on the energy strategy. Thus real news about Bulgaria-EU developments was relegated to secondary importance. And was there any news? Not much. Although it is not well known in CEE, the EU's existence is becoming more and more problematic. Internal turbulence over the financial and political future of the Union occupies the mind of Euro-integration strategists. The public's attention has re-oriented toward the disclosure of European Commission financial maneuvers.[2] In the meantime, NATO concepts about how to solve the Kosovo situation split. It is quite normal that we shove aside abstract promises of future well-being while the house next door is on fire.

In mid-March the debate split in two different directions: the Kosovo crisis and how (or whether) to get involved in it; and the pending vote on the energy strategy. Thus real news about Bulgaria-EU developments was relegated to secondary importance.

The majority of Bulgarian publications outline the following: we realize that our achievements are insufficient, our performance imperfect. A problem appears: people become unmotivated (based on opinion polls), expectations for EU accession have receded from the year 2050 to 2080. Some quantitative assessments of accession have begun to appear on the radio and in daily newspapers; evaluations vary from a firsthand necessity of $10 billion to more modest strategies for absorption of promised Euro 500-540 million each subsequent year for the period 2000-2006. What we will receive is Euro 3 billion, two-thirds of it through PHARE and SAPARD infrastructure programs.[3]

Any development with the "Schengen" list? Not much — Bulgarians still need visas to travel west. Was it enough that the EU interceded on our behalf to Poland, Hungary and Czech Republic not to impose visa regimes at least until May?[4]

Requirements and Pledges

Germany's Foreign Minister Joschka Fischer assured us, quoted in the ruling party's newspaper, that his country now chairing EU is "fully supportive of our accession, recognizes [our] advancement and contribution to stability in the region." At the same time, Germany is fighting hard to decrease its installments to the EU tax purse. Is it because one of the successful countries in the Union is tired of financing less prosperous members, such as Spain and Greece? Or is Germany amassing funds for candidate-members? What we really need is help to improve our *image*[5] set by international donor organizations; assistance in advocating our advancement toward meeting integration conditions to the World Bank, EBRD, EIB, etc.

Actually, it is the constantly increasing budget expenses for the war machines of any NATO member that need justification. The most articulate way is by calling it involvement in a 'humanitarian' mission — although one not approved by the UN Security Council. The reasons behind this are also economic. The appropriate question is not "who will win from another embargo?," but rather, "who will lose more?"

A while ago, the European Commission announced its decision to accelerate the acceptance of Bulgaria and four other candidates. A German-owned paper reported the British Minister of Euro-Integration's amazing statement: "The EU is ***obliged*** to approve [them] all." Qualitative *acquis* are being supplemented by quantitative ones (the Corfu, Essen and Madrid summits, after setting lists of criteria in Copenhagen and Maastricht). It is logical to oppose enlargement, the CEE public understands, because resources are limited, and funds within the EU would have to be distributed among more countries.

How Much Has Been Accomplished

By the end of the day, the EU statement[6] was: when and only when the candidate countries have fulfiled the provisions (grouped in major fields on 80,000 pages) — only then will they be invited to harvest the fruits of integrational development.

Where We Stand: officially, Bulgaria has almost met the political *acquis*; and is on its way to switching to a market economy; shows some advancement in establishing means to withstand competitive pressure, and is lagging behind in the introduction of harmonized regulations, standards and norms.

Explanation: the pace of mass privatization is far slower than expected, both by Bulgarians and prominent international experts; corruption has not been eradicated; no corporate governance practice is used; our financial system might be fully independent from politics because of the Currency Board, but due to the Board system it has become dependent on IMF. Are Bulgarian politicians correct in complaining openly that Bulgaria receives less structural assistance than first-wave-candidates, thus limiting our chances? Yes, to a certain point it is provable that reform failure is not our fault alone.

The Hindrances: for instance, one comparatively competitive sector in Bulgaria — agriculture — is facing CAP; moreover, now even our standards for ecologically clean food do not correspond with European ones — according to recent publications, we appear to be "short" of nitrates. It is calculated, and nobody denies it, that PHARE alone has poured around Euro 750 million into Bulgaria since 1990, and an additional 100 million is expected. However, no one gives an account of what portion of this aid is going back to the EU due to regulations requiring recruitment of external experts; how much is allocated for their honoraria, conference fees, necessary literature…

Kosovo: Policy Stemming From Economic Interest. Whose?

What is going on in Yugoslavia? People are bewildered, Bulgarian press carefully restricts itself from radical judgment.

Aggression or just usury

Prior to NATO's official decision to try to stop the "humanitarian disaster in Kosovo" from spreading, the president of the United States declared on CNN that the only thing he wanted was for "our children [not specifying from which continent] to have a prosperous, undivided, integrated and free Europe." In his address he also explained to his fellow Americans that in order to prosper, they need to keep the conduction of global trade unrestricted by "the turmoil in the Balkans." From the position of certain prosperity, it is easy to get involved in international politics, and even to try to influence the global political environment. Only, it is curious to ponder how many millions of Euro and USD NATO will have to pay as honoraria to highly-qualified personnel involved in this mission. Also, are the Italians being reimbursed for military sites provided? It is controversial as to whether the Kosovars are innocent victims of ethnic cleansing. But even if so — who will finance the rebuilding of their houses, destroyed by accidental humanitarian missiles?

Actually, it is the constantly increasing budget expenses for the war machines of any NATO member that need justification. The most articulate way is by calling it involvement in a 'humanitarian' mission — although one not approved by the UN Security Council. The reasons behind this are also economic. The appropriate question is not "who will win from another embargo?," but rather, "who will lose more?" Some admissions have begun crawling into the Western press, acknowledging that firsthand Yugoslav trade partners would suffer a bigger part of their turnover than United Europe. Not to mention destroyed infrastructure nets, production capacities, etc. Naturally, economic losses will have to be reimbursed. Cases of reimbursement being performed by donations are rare. Usually it comes in the form of loans; interest is due, principle is paid back by taking even more loans. Bulgaria received no compensation for the first Yugo-embargo[7] during the conflict with Bosnia. It is doubtful that we will be compensated now.

Neighbors scared or cautious

Countries neighboring Yugoslavia are concerned about the fate of victims of the air strikes. But they also are afraid for themselves; distances are negligible, for the slightest deviation of a missile, no matter whether it is NATO-'peace-making' or Serb-'defending,' can harm people who are not quite sure whose side they are on. Material and ethical collapse is contagious — people are emotionally biased and the troubles make them ineffective even in daily routine.

Broken trade routes (due to disturbed transport[8]) lower demand, diminished demand in turn reduces production, decreased production lessens supply — this is not a vicious circle, it is a downward spiral.

The first indirect attack by Milosevic appeared to be the mob of refugees headed towards Albania and Macedonia. World media uses live coverage for propaganda. For those who go southwest it is clear; they wanted a sovereign motherland, and finally arrived in one. But what living standards can Albania provide them with, and how is this going to alienate them from the advanced European environment? Macedonia is closer, life is easier there, and thus, if time is needed before the conflict ends, it is a good place to wait in. More than Euro 40 million is reported to have been spent to date for medical aid and nourishment in Macedonia, Kosovo and Montenegro, and more has been negotiated.

But how does this escalation of social tensions reflect on a receiving country? Bulgaria officially declared accommodation readiness for taking maximum 5,000 refugees, and for no longer than week, in order to prevent social problems. Is this a smart move on the part of our logisticians — will we be able to require financial aid from developed countries for each person exceeding this number? Aid in Euro or USD; aid without interest due, without an expiration date. While the conflict develops, quotations in the Western press modestly confirm this will be very hard to achieve.

No matter how sophisticated the weaponry used, some concerns exist of side-effect damage to the surrounding countries' economies. Is there really no threat that computer technologies of attacking 'the mind' of the enemy's armor could affect, for instance, banking systems, civil aviation and hospitals? Could this turn into a disaster worse than the 'year 2000' computer bug?[9]

Patronizing or shame-faced

Moscow's immediate reaction was of clear contradiction - all representatives in international organizations withdrawn, demonstrations against NATO military campaign, storing arms, volunteer conscript is underway.[10] Why do the Russians support the Serbs? Two types of explanations are put forward. Economically, because traditional trade channels have been demolished; politically, Yugoslavia seems to be the only CEE country that has not declared intentions to integrate with the West, and history does not forget wartime allies.

How costly is fraternal support for the Slav tribes, Orthodox Christians? Has someone assessed how much a simple demonstration costs, in buildings and cars ruined, police force involved, social tension raised? The mighty new generation of American and West-European weaponry is widely reported in scientific magazines. The Russian arsenal is only presumed to be at least equal. Not long ago, the world was watching live coverage of the systems' first proving themselves in the Persian Gulf. Do others feel like they need a demonstration too? In tumultuous times the economy responds fast.[11] The Serbs managed to come out of one war, albeit with carved up territory — surely they will survive another. Could this be an example of mobilizing effort for development.

More careful and yet firm, countries like China and India have joined the opposition. "How come?," Serb supporters ask at demonstrations. They too have problems — Tibet and Kashmir — and tend to address them as local. No doubt there will be a strong reaction if smart weapons come into action.

Whose Side Bulgaria is On

The Bulgarian one, is the consensus in the general public, though nobody quite understands what this means. If we leave aside politicians and their party platform declarations, it is not clear what portion of the population in the Balkans/CEE comprehend the NATO and EU objectives.

Apparently, Bulgaria it trying to please (or at least not to anger) both sides. Peace-keepers do not hear judgment that differs from their own, although everybody realizes current situation hampers the whole region. And, following threats from Milosevic and Sesel about spreading NATO propaganda, Bulgaria declared neutrality. After all, economic and cultural exchange with Yugoslavia is more significant (in volume and meaning) than that desired with the distant United States. As the crisis developed, it unfortunately appeared that our politicians are not as welcome in Belgrade as they expected, the opposition party newspaper pointed out. Now, by expressed consensus, they are "determined to change the regional environment in order to preserve our national interest in the best manner."

Apparently, Bulgaria it trying to please (or at least not to anger) both sides. Peace-keepers do not hear judgment that differs from their own, although everybody realizes current situation hampers the whole region. And, following threats from Milosevic and Sesel about spreading NATO propaganda, Bulgaria declared neutrality. After all, economic and cultural exchange with Yugoslavia is more significant (in volume and meaning) than that desired with the distant United States.

So why are we appealing for a peaceful solution — it cannot be only because of the innocent victims, there must also be a reflection of an economic notion. The press quotes not only likely causalities but damage and losses that will be imposed upon fragile Balkan reforms. Wouldn't it be more effective to invest in economic development (surfeit are gentle), than in a war machine? Trade with Yugoslavia and Macedonia will shrink, initial losses are reckoned at $150-200 million; diminished investment and tourism due to political instability will affect the trade balance, sovereign debt management, exchange rate stability, etc. It is too early to have precise figures, but when the bill comes we are sure to choke on it.

Now, there are still expectations and hope of proving again that Bulgaria is a source of stability (ethnic, religious, political and economic) in CEE. Analysts shall recall in their own considerations about making risky, but low-risk, investments, that we need a hand in our way through transformation. Independent experts declare we have achieved much — inflation is under control, the currency is stabilized, interest rates lowered, market transparency provided — so responses like, "Brussels finances candidate countries according its own appraisal as per their needs and does this impartially" are neither satisfactory nor justified.

Kozloduy: We Will Guard it from the EU *and* from Missiles

What do Europeans want from Bulgaria — for it to close the nuclear power station down as soon as possible, since its reactors are not safe enough. On the other hand, nobody in the Western press is discussing the danger and damage caused during the incidents that have occurred in the past few years within the EU. It would have been cheaper, easier and faster to help by contributing to the modernization and reconstruction of the two power units to be left operational. Agreed upon in both the leftist and rightist press is the fact that what we need is either $3-4 billion for closing down blocks 1 through 4, or at least 15 years to amass this kind of money ourselves.

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The prime minister's insistence on placing Bulgaria in "the second wave of integration"[12] has provoked dissent even with regard to voting on our energy strategy. Internally, the opposition initiated a crossfire about the provisional costs of energy production, but when the question came to the nuclear issue, the votes were united in defending the independence of the power sector. Outside the country, experts discover in random opinion polls that the issue of the Kozloduy NPS is considered to be and treated as a matter of *national stand-point*?! Europe showed a will to cooperate and extend deadlines. Speculations appeared that the "nuclear debate" is brought up only at moments when the EU decides to collect and distribute money for the technological renovation of the European power sector. Has the French and Greek position (in our case opposing Kozloduy's existence) weakened? Bulgarian daily papers quoted Mr. Gordon Adam on the European Parliament's willingness to assist, sketching a realistic time-frame for closing the plant (even be it after year 2004), schemes to finance refurbishment, even helping in provisional negotiations with the EBRD. In a financial newspaper Deputy Prime Minister Evgenii Bakardzhiev mediated the Government's answer by inquiring about the chances for amending the agreement, chances for negotiating an annex to let us secure a means to meet internal consumption and face power export commitments.

Is the Kozloduy NPS indeed safe and sound? The Ministry of Defense answered on National TV and major papers, "YES, we do not even fear missile attack." What more could the public want?

What Do We Need to Read in the Next Few Days

One of the Bulgarian press peculiarities for the past 10-15 years appears to be its ability to deeply affect and influence Bulgarians' minds. Or is this a peculiarity of the Bulgarians themselves? It is commendable that our papers succeeded in restraining themselves from publishing sensational news during the first days of the Kosovo crisis and spreading panic in the population. What we did not get to read was not only where bomb shelters are located and what status they are in, but when and how Euro-tales will become Euro-deeds. We hope never to have to know the first, and to be gratified by the second answer.

What else do we want to hear, other than:

- we are lent low-interest credits for modernization of our energy sector;
- peace negotiations are coming to a successful end (is there a 'win-win' game?);
- NATO has agreed to let us in; and Russia allows us to, after all discrepancies being solved;
- the EU quits fortifying itself with quantitative and qualitative obstructions to Euro-integration;
- Bulgarian politicians succeed even more often in reaching consensus on issues of national interest (really, isn't it all about our common good)?

Well, spring has come and it ***is time to sow what we want to harvest*** in the future: ***prosperity***.

1. The schedule for association agreement discussion promotion was argued over — the Government wants the EU to hurry up; 10-15 years is too big a horizon for the population to comprehend, and too uncertain for a politician's future. The other controversial point was the future of the Kozloduy Nuclear Power Station.

2. Articles published influenced Bulgarians' notions that the EU itself is not quite ready to accept us; negotiations on amendments to Agenda 2000 were prolonged; the whole accession process was postponed from 2003 or 2004 to beyond 2010.

3. How does this aid contribute to structural reform - after evidence of misuse of funds, donor-organizations started specifying methods of fund absorption; a requirement was introduced to co-finance through state and local projects (up to 25-50%) as an effective way of influencing quality outcome.

4. Increased efficiency of border control, fight against organized crime, restriction of illegal immigration, visa regimes introduced for the list of "risk-imposing" countries - all were acknowledged. Leftist papers inquire: were we, too, not diligent?

5. Image in French means not only 'appearance,' but also 'similarity.'

6. Fragments of the Commission's Enlargement Report were presented and elucidated in most economic newspapers in Bulgaria throughout 1998.

7. Because of that embargo, disrupted trade routes cost Bulgaria an increase in its external debt of $9 billion.

8. Some estimates have been made of damage to exports and imports (reduction by 45% and 50%, respectively) due to hampered trade routes; the Transport Minister declared that during the first week of conflict we endured over $4 million in losses. And more is expected.

9. Iraq realized some $4 billion in debt from pending state credits, company liabilities, clearing, and construction sites; an additional $10 million remain blocked in U.S. bank transfer accounts.

10. A RTR broadcast stated that the North Sea navy is alerted, and open discussions on political and military support have started.

11. The Russians have officially complained of economic losses due to UN Resolution #1160, forbidding the supplying of weapons to the region, while "the Kosovars were being equipped for quite a while."

12. Which automatically limits resources, efforts, and assistance at our disposal.

Aspects of Bulgarian Privatization

Georgi Stoev, IME

History of Privatization in Bulgaria

Privatization in Bulgaria started at the beginning of 1993. Since then, a total of 1,371 state-owned whole companies and 1,384 detached units of other enterprises have been sold. During the period 1993-1998 the Privatization Agency (PA) contracted 525 deals (19%), of which 58 are with foreign investors, the biggest such purchases being the chemical producer Sodi Devnya (US $160 million), the copper producer MDK Pirdop (US $80 million) and the cement producer Devnya Cement (US $45 million). The total revenue of the PA from foreign investors is about US $620 million, which is a significant portion of foreign investment in Bulgaria for the period 1993-1998 and is 38% of the total privatization proceeds.

In late 1998 the IMF approved a three-year extended fund facility (the so-called 'three-year agreement') for Bulgaria. In the memorandum supplementing the agreement, the government of Bulgaria promised to complete the privatization of 70% of state-owned fixed assets by the end of 1999 (50% should be sold by the end of second quarter). Therefore, there is another reason to hurry up with the privatization – every tranche from the IMF is approved separately on the basis of the goals reached so far, including the privatization goals.

Actually, the official projections of privatization revenues for 1999 - US $554 million – do not include proceeds from the 'cash privatization.' The latter includes the privatization of the most profitable companies, such as the Bulgarian Telecommunications Company (BTC), Bulgartabac Holding, KZM-Plovdiv and OZK-Kurdzhali. Only the 51% stake of BTC was pre-estimated by the agent Deutsche Morgan Grenfell at about US $600 million.

No significant revenues are expected from the privatization of the other big companies to be offered in 1999 — the oil refinery Neftochim, the isolated steel producer Kremikovtsi, Balkan Airlines, Stomana, etc. All of them, as well as most of the huge state-owned companies, are either deeply indebted or loss-making due to their productive inefficiency, and most often both. Nevertheless, they account for the bigger part of the state-owned fixed assets and their privatization or eventual liquidation will fundamentally change the structure of Bulgarian industry.

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Table 1: Bulgarian Privatization since 1993

	1993	1994	1995	1996	1997	1998	Total
Total Number of Privatization Deals	**62**	**165**	**309**	**515**	**590**	**1,114**	**2,755**
All Ministries	51	129	240	369	506	935	2,230
Privatization Agency	11	36	69	146	84	179	525
Direct Financial Effect(mln USD)	**72.185**	**232.810**	**181.919**	**416.573**	**607.997**	**637.953**	**2,149.437**
Payments Contracted	44.233	144.252	113.702	184.764	571.828	587.870	1,646.649
Corporate Liabilities Undertaken	12.702	32.956	57.553	218.297	35.040	50.083	406.631
Corporate Liabilities Paid	15.249	55.602	10.665	13.512	1.129	0	96.157
Investments Contracted(mln USD)	**58.971**	**201.738**	**151.914**	**170.561**	**891.346**	**390.912**	**1,865.442**
Total Financial Effect(mln USD)	**131.156**	**434.548**	**333.833**	**587.134**	**1,499.343**	**1,028.865**	**4,014.879**

Source: PA

Introduction

Privatization, being a key component of structural reform in Bulgaria, has become a major concern for the current government after the loss of a lot of precious time during the early years of transition. Six years after the beginning of the privatization process in the country, just over 30% of state-owned assets have been privatized. The year 1999 seems to be a crucial one for structural reform, and thus for the economic future of the country, since the most radical structural changes are planned for this year; the biggest privatization deals and liquidation of the huge loss-makers still lie ahead. In this article some of the institutional and technical obstacles to the privatization process are outlined, the main idea being to promote their conceptual understanding and how they could be overcome.

Generally, there are two obstacles to any privatization process:

• lack of investor interest, and

• technical and institutional obstacles to the process.

In the case of Bulgaria, four concrete technical and institutionally determined obstacles to privatization have the most negative impact on the process. These are:

• the prevalence of closed procedures;

• the lack of clear rules in the selection of a buyer;

• the shortness of the legally determined terms for submitting offers; and

•the functional gaps between different institutions.

Those obstacles could hamper privatization in two ways:

• by narrowing the circle of potential buyers, and

• by slowing down the process of property transfer.

In this article these four types of technical impediments to Bulgarian privatization are described, as well as the kind of effects they impose.

Table 2: Privatization Expectations of the Government in 1999

Expected Number of Deals	
Privatization Agency	155
Other State Bodies	928
Total	1,083
Expected Proceeds (millions of USD)	
Privatization Agency	339
Other State Bodies	215
Total	554

Source: 1999 Privatization Program of the Government.
Exchange rate BGL/USD = 1,800

Type of Procedure: Closed Means Slow

There are seven types of legally outlined procedures for selling state-owned and municipal stocks and shares under the Transformation and Privatization of State-Owned and Municipal Enterprise Act (Privatization Law) of 1992:

1. Auction,
2. Competitive tender,
3. Direct negotiations,
4. Public offering of stocks on the Stock Exchange,
5. Centralized Voucher Auctions,
6. Preferential Sale of up to 20% of the state-owned or municipal stake to insiders, and
7. Sale without tender or auction to insiders as per Art. 35.

Every procedure is regulated by a separate provision[1], which outlines the main terms and selection criteria. The auction and public offering procedures are the fastest, most transparent and most effective, since the only criterion when selecting the buyer is the price offered. These two procedures I call open, as they give the best possible chances to an unrestricted number of potential buyers to compete for a given object.

Tender procedures include several more criteria; e. g., future investment, new jobs, etc., and the selection is made on the basis of this complex set of parameters. Thus the administrative discretion is much greater, and transparency and speed correspondingly lower.

Direct negotiations are the least regulated type of procedure for privatization, and therefore have the highest possible administrative discretion. Moreover, they are technically slow because they usually include several waves. But, as described below, negotiations are the favorite procedure of the Bulgarian privatization authorities.

Finally, Article 35 of the Privatization Law gives insiders and their companies the right to buy the entire state-owned or municipal stake in the company at a price equal to its pre-evaluation. The pre-evaluation is made by representatives of the privatizing authority.

A recent case proved that auctions are much more effective (in terms of revenues) and faster than any other privatization procedure, other factors being equal. The sea-coast-situated tourism company Roussalka was bought by the Bulgarian holding company AKB Corporation, when the latter won the auction by offering just over US $2 million. It was the second procedure in a row for Roussalka, after the management-employee buy-out company failed to buy it for the symbolic price of US $200,000 even competing with itself in 'the negotiations with potential buyer.'

Interestingly, only 33% of the deals for whole companies contracted by the PA in 1998 were the result of either of the two open procedures, auctions or public offerings (see Table 1). The other state bodies followed the same practice, an even harder way — only 8%.

Who Is the 'Strategic Investor'?

Direct negotiations with potential buyers (35% of the PA's deals and 36% of the other state bodies' deals for whole companies, see Table 1) are defended as the best way of finding a 'strategic investor,' using the terminology of Bulgaria's privatization officials. Obviously, a 'strategic investor' is considered any company that: 1) does not have plans to sell the enterprise a short period after its privatization, and 2) does not have plans to liquidate the enterprise as a way of trying to get rid of its competitors.

Indeed, such division of potential investors into strategic and non-strategic is meaningless from both an economic and a financial point of view. First, even if an investor buys a state-owned company with a mind to its short-term speculative sale, the company does after all finally become the property of an investor who intends to maintain and develop the formerly state-owned enterprise. It is quite probable that this process takes less time than privatization through negotiations. Second, if an investor acts rationally, then why should he buy and liquidate his competitor? If his competitor, i. e. the state-owned company, is more competitive, he can use its competitive advantages and make his business more profitable — thus not liquidating the company. If the state-owned company is less competitive, it would not be any danger to the investor's original market, giving the investor either no reason to buy it or if buying it at all, no reason to liquidate it.[3] *Òhe search for 'strategic investors' is a result of the fundamentally wrong perception of privatization as a process of economic (or structural) adjustment conducted by the state. Actually privatization is just a political process of property transfer.*

Another motive supporting closed procedures is that the aim is to create efficient corporate governance. Actually, the state has never been as capable of creating anything efficient as the market is itself.

"Efficient ownership control can never be created by the state, not even in the process of privatization. Efficient ownership control emerges spontaneously and only under the pressure of market forces. Privatization can therefore be only the first step. It is the step which cuts the enterprises off from the state and initiates the beginning of the spontaneous market-oriented processes of a search for a good owner by means of finding the first owner…Transfers of property among private owners represent a more natural and efficient way to find good owners than any decision by the state on who the winner should be."[4]

The same motives, i. e. that of finding a 'strategic investor' or creating new efficient corporate governance, are prevalent in privatization via tender procedure (32% of the PA's deals and 53% of the other state bodies' deals for whole companies, see Table 1). According to the Tender Ordinance, the winner in a privatization tender is the one whose offer 'best satisfies' the following six criteria:

1. maintaining the original activity of the company;
2. maintenance or creation of new jobs;
3. future investment;
4. preserving the environment;
5. best terms of payment and period of property transfer (which should include the price offered); and
6. a minimum period for which the investor does not have right to sell the company.

Obviously, the price is neither the only, nor even the main, criterion. The 'best satisfaction' of six criteria can be determined only on the basis of a complex evaluation of each offer, making the procedure extremely complicated and therefore less transparent and slower. Moreover, it is doubtful that the expertise and competence of the officials permits them to make this complex evaluation, if such is possible at all.[5]

Privatization through offering detached units of companies is in a way easier, since no 'strategic investor' motive can be at the forefront when selling the fixed

Table 3: Closed Procedures Prevailed in 1998[2]

1998	**Privatization Agency**		**Other State Bodies**	
Whole companies	**No. of Deals**	**%**	**No. of Deals**	**%**
- auction	30	30	32	6
- tender	31	32	306	53
- negotiations with potential buyers	34	35	208	36
- negotiations as per. Art. 35	0	0	17	3
- public offering	3	3	10	2
Subtotal:	**98**	**100**	**573**	**100**
Detached units	**No. of Deals**	**%**	**No. of Deals**	**%**
- auction	2	3	4	1
- tender	0	0	137	38
- negotiations	1	1	77	21
- negotiations as per. Art. 35	78	96	144	40
Subtotal:	81	100	362	100
Total (whole companies and detached units):	**179**	**-**	**935**	**-**

Table 4: Basic Features of FLIRBs and DISCs

	FLIRBs	**DISCs**
Ownership form	Bearer	Registered
Maturity date	28 July 2012	28 July 2024
Principal payments	2003–2012: 21 equal half-yearly installments	At maturity
Interest payments	Every six months	Every six months
Interest rate*	1999: 2.50 %2000: 2.75% 2001: 3.00% 2002 – 2012: 6m LIBOR + 13/16	6m LIBOR + 13/16
Accepted value of 1 USD face value in privatization deals	0.5	1.0
'Sell' quotation (US cents per 1 USD) **	58.500	69.125

* The interest rates for the first four years were: 1995–1996: 2.00%, 1997–1998: 2.25%
** 23 March 1999

assets of a company (although sometimes their value is quite large, as with individual hotels, restaurants, mines, etc.). Nevertheless, 59% of those deals were concluded by the ministries and committees through direct negotiations or tenders.

The conclusion is that closed procedures bring practically no advantages, but rather only slow down the process of privatization by their complexity and high administrative discretion, which is a major institutionally determined obstacle to privatization. What is more, they narrow the circle of potential buyers with a lack of clear rules and increased transaction costs, thus diminishing the chances of a company's being privatized at all. In the section below it is described how it actually could further narrow the circle of potential investors, using the concrete issue of terms of payment.

Table 5: Gap in the Law in October 1997 - June 1998

Value of the fixed assets, below which the company is to be privatized by a line ministry or committee	
Period	Threshold (million BGL)
May 1992 – June 1994	10
June 1994 – October 1997	70
October 1997 – February 1999	350
Since February 1999	1,000
Value of the fixed assets, above which the company is to be privatized by the Privatization Agency	
Period	Threshold (million BGL)
May 1992 – June 1994	10
June 1994 - April 1998	70
April 1998 – February 1999	350
Since February 1999	1,000

Rules for Buyer Selection: Who is Happy in the Jungle?

The 1999 Privatization Program foresees US $554 million in revenues from privatization, with US $236 million of that total in cash payments and US $318 million in payments with 'other legally accepted instruments.' There are several types of other accepted payment instruments:

1. Investments vouchers accepted in mass privatization;

2. Compensatory Notes issued against claims for formerly nationalized property; and

3. Debt Instruments:

• Brady bonds,

• ZUNK bonds, and

• Other types of long-term government bonds.

What matters here are the debt instruments used in privatization or debt-equity swaps, since the vouchers and compensatory notes constitute a relatively small share of the expected payments with non-cash instruments.[6]

The types of Brady bonds accepted are discount bonds (DISCs) and front-loaded-interest-rate bonds (FLIRBs). They are described in Table 2.

Payments with these instruments in privatization deals are regulated by an ordinance of the Council of Ministers from 1997. It stipulates that:

1. only these two kinds of Brady bonds can be used for privatization;[7]

2. the DISCs and FLIRBs can be used only in the privatization of state-owned companies (i.e., not including municipal property);

3. no more than 75% of the price can be paid with FLIRBs, and no more than 50% with DISCs;

4. DISCs are accepted at their face value, and FLIRBs at 50% of their face value.

No financial logic can lead to a decision to pay with FLIRBs, since their 'sell' price (58.500) is higher than the accepted value determined by the ordinance (50.000), even when subtracting the interest payments. In this case only two things could change this situation: 1) FLIRB prices fall, and 2) the accepted value becomes higher. Therefore, we take only the DISCs into consideration.

DISCs can constitute up to 50% of the price in a given privatization deal. From the investor's viewpoint, when using this instrument a difference between the price offered and the actual cost occurs – about 15% of the price at the DISC's current price, ignoring transaction costs. In that case the investor would prefer to pay half of the price with DISCs, if only the price is considered when choosing the winner. But in the commonly used procedures, not only the price is considered (as noted in the section on procedures above). Moreover, no firm, publicly announced rules for the selection of buyers are known, which is especially true for the tenders, in which several criteria (including terms of payment) are examined. Normally, if the state follows rational financial logic, the cash offered should be more valuable than the DISCs. If the investors assume that such decision-making is likely on the part of state officials, then they should know how their cash or DISCs are evaluated. But 'rational' and 'logic' have never been compatible with the public officials' decision-making. Therefore, the range of investors that have interest in a certain deal narrows significantly. Only those who can and want to use additional resources in the informal competition for a certain object remain in jungle.

That said above is applicable to all the criteria used by the state bodies in their selection of buyers. No investor can be sure what weight is carried by the future investments or jobs included in his offer without clear rules.

Two solutions to this problem are proposed here:

1. for open procedures to become the prevailing technique in the activity of the privatization authorities; and

2. clear and firm rules, which outline the priority criterion (or criteria) and the relative weight of all criteria in the selection of buyers, when using any procedure other than auctions or public offerings.

Relations Between Privatization Authorities: Catch 22

The Privatization Law introduced the different authorities responsible for the privatization process. Municipal enterprises were to be privatized by the respective municipality, and state-owned companies were to be privatized either by the Privatization Agency or by a line ministry or committee. The threshold that divided the state enterprises into two groups — 1) those to be privatized by the PA, and 2) those to be privatized by line ministries or committees — was the value of the fixed assets of the given enterprise. Since the Privatization Law was adopted, this threshold has changed three times.

During the period from October 1997 to April 1998 there was a controversial regulation that applied to this issue (see Table 3). With the amendment adopted in October 1997, the law stipulated that enterprises with fixed assets of a value below BGL 350 million should be privatized by a ministry or a committee (see the top of Table 5). Meanwhile, it said that all enterprises with fixed assets exceeding BGL 70 million should be privatized by the PA (as shown in the second half of Table 5). Thus nobody could tell who should privatize a company with, for instance, BGL 200 million in fixed assets. This controversy was overcome in April 1998, when the law was amended again. Nevertheless, the date introducing the new threshold of BGL 350 million was October 1997, and it should be considered the beginning of the second period.

Besides the above division of the state-owned enterprises, a list of companies[8] is determined by the Council of Ministers, whose privatization requires the approval of the Council of Ministers. In those deals no debt papers are accepted as payment instruments, so this kind of privatization acquired the common name 'cash privatization.' In fact, the Council of Ministers list for 1999 includes 25 of the biggest companies. The introduction of one more institutional player, i. e. the Council of Ministers, in the property transfer schemes can mean only one thing: slowing down of the process and increased chances of institutional gaps. Moreover, the privatization of Bulgarian Telecom (BTC) introduced another official body, the Interdepartmental Working Group for the BTC deal, lead by Deputy Prime Minister Evgenii Bakardzhiev. The result was that only one offer was submitted for Bulgaria's most attractive company, at a price which is surely several times lower than the expected US $1 billion.

The structure of the Privatization Agency alone gives enough opportunities for Catch-22 situations. By law, two separate bodies take the final decisions regarding the PA's deals: its executive director and its supervisory board. What happened during the negotiations for the privatization of Petrol, a state-owned gas-station chain, proved that either nobody is aware of his concrete functions or that lobbying in the PA can be quite destructive to the speed of privatization. Zahari Zhelyazkov, executive director of PA, proposed that 51% of Petrol be sold to the Russian company Yukos Petroleum, which offered US $52 million, but the supervisory board rejected the offer, revealing no clear reason.

Time Limits for Submitting Offers: Who Could Manage in Time?

The time limits for submitting offers include the period from the announcement in the State Gazette of a privatization procedure's opening to the deadline for applications. They are determined ad hoc by the decision of a separate privatization body, but can vary in limits set by the ordinances regulating different procedures; e. g., up to 30 days for tenders and auctions. Only deadlines for executing the right of preferential acquisition of shares are strictly set at 90 days and cannot vary. In the table below average time limits are given, covering both state and municipal privatization.

These figures show that limits were close to the ceiling set in the ordinance. Indeed, the ceiling seems to be quite low, especially when the procedure requires the preparation of a complex offer and making a huge deposit in a Bulgarian bank. Some municipalities imposed even shorter time limits (of 10 to 14 days) in 1997.

Besides the complexity of the activity that must take place during that period, short time limits are a sure source of corruption, as they make information extremely precious, and they undoubtedly narrow the circle of potential buyers. It is obvious that only insiders or investors possessing inside information can prepare well for a tender (or an auction). The solution lies in the legal introduction of minimum time limits, which could be 30 days, together with keeping the ceiling at higher level — 45 to 60 days.

Conclusion

Bulgaria has lost six precious years in wondering which way to choose for privatizing its economy: fast and large-scale transfer of property, or a slow and careful search for 'good' new owners. Time has proven that fast and open privatization, even if it is at any price, may be the only way.

The government should aim at the fast and open transfer of property, not at a search for imaginary 'strategic buyers.' A few simple steps that would lead to higher speed and transparency of the process are as follows:

Table 6: Time Limits for Submitting Offers Through the Years

Year	Preferential procedure	Tender or Auction
1995	90 days	n.a.
1996	90 days	a.a.
1997	90 days	20 days
1998	90 days	30 days

• Open procedures such as auctions and public offerings on the stock exchange should become dominant in the practice of privatizing state authorities;

• Clear and simple rules must be publicly announced, either generally applicable or for every concrete deal; and

• Equal access to the bidding for every company should be provided to every investor (which includes the time limits for submitting offers, which could be a physical obstacle to some of the investors).

All this, if implemented, would help the government in its effort to conduct structural reform as soon as possible; if not by attracting investors, at least by not chasing them away.

1. Different procedures are regulated by ordinances of the Council of Ministers; e. g., Auction Ordinance of 1992, Tender Ordinance of 1992, Ordinance for the Preferential and Free Sale of Municipal and State-Owned Stocks and Shares of 1994, Ordinance for the Sale Without Tender or Auction of Companies and Detached Units to Persons as per Art. 35 of the Privatization Law of 1994, etc.

2. Preferential sales of minority stakes to insiders are not included. No centralized auction took place in 1999.

3. Actually, only state producers of tradable goods that permit wide diversification and very low market elasticity, (e. g., ships) could be viewed as being in such danger. If such companies were the only ones privatized through negotiations, the percent of negotiations would have been negligibly low.

4. Vaclav Klaus, "A Short or Long Way to Privatization: the Czech Experience," published in An Austrian in France, 1997

5. It is hard enough to compare promised investments to cash revenues (price), since no common basis can be applied to these two criteria.

6. Vouchers can be used in the centralized auctions, where minority stakes (up to 5%) of some 160 companies are sold.

7. Bulgaria has issued three types of Brady bonds altogether – the above-mentioned two types and the interest-arrears bonds (IABs). The emissions were made in July 1994 and their nominal value totaled US $5.08 billion.

8. This list of companies is included in the yearly privatization programs of the government. By law companies could be only added to the list, and not taken off.

Impacts Of Yugoslav War On Bulgaria

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investment and privatization. Formerly public services in pensions and healthcare are poorly reformed. Banking sector privatization is underway.

For most of these sectors the Yugoslav war will mean cheaper price and lower green-field investment not only and not so much in 1999 but later.

A Note on Macroeconomic Impacts

Salomon Smith Barney survey of what the introduction of the EURO would means for Central/East European economies (quoted by *CEER,* February 1999) forecasts that movement in US$/EURO rate will have a large effect on Bulgaria's export competitiveness.

Graph 1 shows that there is direct link between export and exchange rate in recent eighteen months. The reasons must be found in institutional influences already mentioned above.

Table 2: Provisional Impacts of Yugoslav War on Bulgaria

Indicator	1999 risk	2000 risk
balance of payments	low	medium
current account deficit	medium	high
FDI	low	medium
markets	medium	medium
transport	medium	medium
tourism	low	low

This fact is important in two ways. First, it makes very difficult to prove to what extend external factors and the war itself hamper the balance of payment, most domestic factors are tricky to measure. And, second, it transfers the argument with creditors (IFI's) on provisional effects on the balance of payments in the area of structural policies, still the weakest segment of Bulgaria's economic policies.

The measurable risk is for the current account deficit. It is equal to the share of Bulgaria's foreign trade at risk, i.e. about 60%. In absolute terms it is likely that instead of the currently envisaged US$ 380 million the current account deficit can easily reach the level of 550-560 million. This would rather mean that 1999 balance of payments is endangered (other factors neutral).

The war may not mean contraction in 1999 GDP. 65% of the envisaged nominal growth is due to the central government investment program (mostly infrastructure). The risk here is in the difficult design of the program: it intention is to match private investment while the cabinet has little skills in co-financing and procuring out services. Anyway, 3.7% growth of GDP should corrected to 1.5-2%.

Conclusions

Going back to issue of the duration of the war and taking into account institutional factors, the "pure" provisional impacts of the Yugoslav war are likely to be the following.

These estimate should taken *con grano salis*: domestic impediments and institutional policies give room for maneuvering but hardly can compensate losses. There is another factor which is difficult to quantify: inactivity of the government due upcoming elections in 1999 and 2001, and the temptation to blame "the international constellation". Such factors we expect to be relatively neutral due cabinet's commitments under the IMF 3-year program. In an event of a miracle shorter war, the decisive force of domestic policies remains as desirable as always.

9 April 1999