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# Municipal Elections October '99

**Dr. Krassen Stanchev**

October general elections took place at the mid-term of the current democratic government. This is the most efficient government the country have ever had since the outset of reforms. It sticks to international agreements and especially to those with IMF. Elections speak about credibility in the government. What exactly?

Results

There is a need for some general information. Elections are based on full party lists system. In 1997 - 1999 fiscal relations were centralized: pension, unemployment benefits, healthcare and education costs were streamlined towards the central government from where municipalities receive a subsidy. New 28 districts were established in March 1999, they are similar to French prefectures; district governors are not elected but appointed by the cabinet. Usually, election turnover is 60-70%. This time it was 52%. The distributions is as shown in the following table:

| Political party | Votes | Seats in municipal councils |
|---|---|---|
| UDF (government) | 30.27% | 30.37% |
| BSP and allies (opposition) | 25.01% | 30.31% |
| Others (opposition and odds) | 44.73% | 39.32 |

Source: Central Electoral Commission

### What happened?

The government party chose a wrong campaign model. The message was: "we are in charge in the center, we have the district governors, financing is centralized, we will be in charge on the spot, if you elect our people we would help, if not you will suffer". The rhetoric was softer but strong enough. In addition, the prime minister (who is the head of the government party as well) sent all the members of the cabinet and his parliamentary faction to run the campaign in selected "tricky" constituencies.

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**IME Balance Sheet as of 31 Deecmber 1998 (in '000 BGL)**

| | 1997 | | 1998 |
|---|---|---|---|
| **Assets** | **106374** | | **92249** |
| I. Fixed Assets | 30295 | 78879 | |
| Depreciation | -10524 | -19574 | |
| **Net fixed assets** | **19771** | | **59305** |
| **II. Current assets** | **86603** | | **32944** |
| 1. Materials | 6 | 7 | |
| 2. Work in progress | 7 | | |
| 3. Future period expenses | 1426 | 5762 | |
| 4. Debtors | 19295 | 17109 | |
| **5. Finance assets** | **65869** | | **10066** |
| - in cash | 6878 | 2614 | |
| - in bank accounts | 57678 | 6139 | |
| - inaccessible finance assets | 1313 | 1313 | |
| **Current liabilities** | **1993** | | **269** |
| I. Taxation and social securities | 1993 | 269 | |
| **Net current assets** | **84610** | | **32675** |
| **Total assets less current liabilities** | **104381** | | **91980** |
| **Funds** | **104351** | | **96118** |
| 1. Permanent endowment fund | | | |
| 2. Other restricted funds | 104351 | 96118 | |
| 3. Unrestricted funds | | | |
| **Prior year income (loss)** | **1583** | | **31** |
| **Current year income (loss)** | **-1553** | | **-4169** |
| **Total funds and income** | **104381** | | **91980** |

**IME Income Statements as of 31 December 1998 (in '000 BGL)**

| | 1997 | | 1998 |
|---|---|---|---|
| **INCOME** | **203792** | | **259830** |
| **I. Ordinary income** | **152419** | | **253614** |
| 1. Economic activity income | 671 | 3763 | |
| 2. Increase work in progress | 1153 | 4336 | |
| 3. Donations and grants | 150595 | 245515 | |
| **II. Financial income** | **50876** | | **6216** |
| 1. Interest income | 749 | 823 | |
| 2. Gains from exchange rates fluctuation | 50127 | 5393 | |
| **III. Extraordinary income** | **497** | | **/** |
| **EXPENSES** | **205345** | | **263999** |
| **I. Ordinary expenses** | **181580** | | **251275** |
| 1. Expenses of materials | 10721 | 32312 | |
| 2. Expenses for services | 114928 | 163843 | |
| 3. Personal expenses | | | |
| à) salaries | 18739 | 10665 | |
| á) social securities | 8038 | 5716 | |
| 4. Depreciation | 1618 | 9989 | |
| 5. Other expenses | 27536 | 28750 | |
| **II. Financial expenses** | **23439** | | **12344** |
| 1. Bank charges | 1289 | 1386 | |
| 2. Losses from exchange rates fluctuation | 22139 | 10958 | |
| 3. Interest expenses | 11 | / | |
| **III. Extraordinary expenses** | **12** | | **380** |
| IV. Taxes | | | |
| 1. Income tax | 314 | | / |
| **INCOME LESS EXPENDITURE** | **-1553** | | **-4169** |

**Yordanka Gancheva, Finance Manager**
**Krassen Stanchev, Executive Director**

**from p. 1**

The government party lost elections in 100% of municipalities where top leaders took the things in their hands. More educated and younger voters did not go to poll stations at all. Besides this, the government party improved its municipal presence by 5% compared to previous local elections. It also won in traditionally "red" constituencies of North West Bulgaria, leaving to the local to run the show.

The summarized response of the voters was: "we would like to decide on our own, we want a majority election system; we won't obey".

## What is next?

Local election in Bulgaria are very different from general ones. However, being frustrated the government party fired some local leaders. And decided to start power sharing talks with key non-Socialist opposition parties. This move could make sense as a preparation to the next general elections due in mid-2001. The talks hardly make a difference in terms of rebuilding credibility. None of the odd parties presented in the parliament has its own light, values or constitutes an alternative to the government. Most of them have ridiculous approval rates. At the best case scenario they would support some of the anyhow firmly parliamentary backed policies of the government at the price of less transparent decision making. In the worst - they would attract voters out of the government coalition. The real way to convert voters back to the reform oriented government is trusting them, disclosing information, skipping administrative and monopolistic harassment, and deregulating bureaucratic presence in the economy. Not understanding this, sends a worrying signal: the government may kill its own still excellent prospects to have full parliamentary majority for second mandate.

# Foreign Trade Liberalization

Instutute for Market Economics

## Prosperity and Foreign Trade

An element of the globalization process is obvious in the recent development of Bulgaria's foreign trade. But there are no signs of regional integration accompanying increased globalization.

Tables 1 and 2 (all tables in the text are attached as a Supplement) show a positive trade balance with Balkan countries, and an increasing share of non-Balkan partners in Bulgaria's foreign trade.

The Balkans have no market identity per se. The trade picture of the region as viewed from other Balkan countries is similar to that as viewed from Bulgaria. According to the UN ESE,[1] the respective Southeastern European share for different countries in 1997 was as follows: for Albania: 7.13% of exports and 5.6% of imports; for Bosnia and Herzegovina: 60.2% of exports (Croatia's share is 57%) and 20.1% of imports; for Croatia: 18.6% of exports and 2.6% of imports; and for Macedonia: 16.3% of exports and 22.4% of imports (half of this trade being with Yugoslavia). These figures suggest that geographic and background factors still play a key role in commercial exchange within the southeastern corner of Europe.

For Bulgaria, regional trade could not be worse.

Recent theoretical ideas focus on the channels though which free trade links foster growth (Grossman and Helpman 1989, also Krugman 1990).[2] According to their assumptions, free trade stimulates innovation of production because international trade provides access to international markets, and hence to advanced technology. Therefore, it leads to economies of scale and faster growth. Vamvakadis'[3] assumption focuses on the evidence that the size of the domestic market is important to a closed economy, whereas trading with developed countries fosters economic growth for small open economies.

For the time being, there is little evidence that Bulgaria has benefited from openness and regional integration. Recent theories of international economics assume that a country that is open to free trade will perform better. Willingly or unwillingly, such was the assumption behind Bulgarian foreign trade regulation in recent years, as is the commitment to liberalize further in the years to come as agreed between IMF and the Bulgarian government.

## Openness of the Economy

The guiding principles of free trade are: liberalism (no or minimal restrictions on international transactions) and openness of the economy to international markets. Opening the economy and the liberalization of foreign trade are interdependent. Gains in and degree of liberalization are difficult to quantify and estimate. However, some general indicators are in use for measuring openness. The traditional measurement of openness is (exports + imports) / GDP – trade share of import and export in total turnover, growth of exports and imports.

Table 3 in the Supplement depicts the dynamics of trade openness in Bulgaria. It has a high value of the trade index, it is basically higher than Switzerland's. Foreign trade is an important factor in the formation of GDP. In 1998, the index reflects losses in market shares in Russia and lower export volumes to other markets.

The decrease of the share of turnover in GDP is due to ongoing structural reform and low domestic demand. Jeffrey Sachs and A. Warner[4] construct in their work variables of openness, based on four dimensions of protection: average tariffs at rates higher than 40%, non-tariff barriers that cover on average more than 40% of total imports, black/informal market premium, and the role of the state in the economy. According to their criteria the Bulgarian economy may be characterized in the following way:

1. With regard to the criterion "average tariffs at rates higher than 40%": the average tariff rate in Bulgaria is less than 40%. Since 1991, customs tariffs have been changed several times (1991, 1992, 1993, 1997) and were basically adjusted to the requirements of the Harmonized Customs Tariffs. The average tariff was 11.4% in 1991, 15.4% in 1992, 17.5% in 1993 and 17.2% in 1995. According to the Customs Tariffs Act adopted in 1997, the average tariff rate is 17.8% (for the Ist column), and 16.2% (for the IInd column), and the average tariff of General Customs Tariffs amounts to 57.7%. The average weighted tariff for agricultural products is 21.23%, while that for industrial products is 9.29% (this evaluation is only for ad-volume tariffs). In 1998, the average tariff for industrial products was 16.7%, and 25.9% for agriculture products. Since January 1999, a new Customs Code has been introduced, based on the EU Customs Code. According to the new Customs Code, duties on a significant number of industrial products have been reduced. The average rate for these goods is 12.58%, with respect to Most Favored Nation Treatment agreements. It is expected that up to January 1, 2000, the average tariff on industrial products will reach 12%, and 24% for agriculture products, while starting from 2002 they will decrease

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further, and the average tariff on industrial products will be 10% and that for agriculture products 22%.

2. With regard to the criterion "non-tariff barriers cover on average more than 40% of total imports": most non-tariff barriers have already been eliminated, except those under bilateral agreements with EU countries for numerous products.

3. With regard to the criterion "black/informal market premium exceeds 20%": in Bulgaria, the exchange rate is fixed. There has been no parallel currency market since 1991.

4. With regard to "the role of the state in the economy": in Bulgaria, the privatization of major exporters began in 1997. Some progress has been achieved in terms of restructuring and privatization of the large, state-owned foreign-trade enterprises. On the whole, the structural reform in foreign trade has been delayed. At present, privatization of these enterprises is ongoing. In 1998, of a total of 37 foreign trade enterprises 14 were sold, four will remain state owned and the others are still under privatization or liquidation procedures.

One of the weak points is the fact that foreign trade activity has been de facto demonopolized. This has been an institutional incentive to lobby for control over foreign trade. Under the pressure of international financial institutions (IFIs), such efforts seem to have been thwarted.

***A major disadvantage of the Bulgarian transformation was a constant macroeconomic imbalance, from start of reforms in 1991 until 1997, and the dependence of Bulgarian production on imported inputs from traditional partners, such as Russia.***

## Towards Foreign Trade Liberalization in Bulgaria

There is a positive relationship between the liberalization of foreign trade and achieving sustainable economic growth, as trade balance and external debt are basic macroeconomic indicators for output recovery. Important factors for growth are the opening of the economy and introduction of export-stimulating measures. A common feature of countries in transition is a U-shaped response to output dynamic (a sharp decline in output, followed by recovery). Therefore, foreign trade liberalization is used as a tool for the improvement of aggregate demand when market-oriented reforms start. All countries in transition follow a similar model of transformation; what is different is the speed of progress in market reforms. Bulgaria undertook measures toward price liberalization and reduction of tariff and non-tariff barriers, simultaneously with implementing a variety of other policy reforms – fiscal, monetary, financial regulations, and reduction of government intervention.

A major disadvantage of the Bulgarian transformation was a constant macroeconomic imbalance, from start of reforms in 1991 until 1997, and the dependence of Bulgarian production on imported inputs from traditional partners, such as Russia. A typical feature of the Bulgarian economy is a low rate of GDP growth. Positive GDP growth has been achieved in the short term, not the long term.

Bulgarian foreign trade turnover suffered from the international embargo against Serbia and Montenegro. The Kosovo conflict disrupted the regular transport link with Western countries and was a cause of the balance of trade deficit registered for the first six months of 1999.

Despite this unfavorable external environment, Bulgaria made progress in foreign trade price liberalization, the foreign exchange regime and reduction of tariffs on imports and exports. A specific feature for Bulgaria is that economic growth is driven mainly by domestic demand, imports rising faster than exports, especially during the last year.

Foreign trade liberalization has been a case of market reform success in Bulgaria. The liberalization process took place gradually. The foreign trade regime was changed several times, towards decreasing tariff barriers.

The foreign trade liberalization process may be divided into the following periods, according to the extent of trade liberalization and EU integration progress:

First period: 1991-1995. In 1991, trade liberalization started with price liberalization and the introduction of internal currency convertibility. As a result of this internal convertibility, the gap between domestic and international prices decreased. Non-tariff barriers and export subsidies were eliminated. Despite the liberalization measures, protection on import goods remained to enforcement of the new Customs Tariffs. The Customs Code (1992) did not influence trade liberalization, because import duties remained very high: 3-30% (first column) and 5-40% (second column). Customs Tariffs were changed in 1993 and some duties on imports of raw material decreased. Foreign trade regulations and restrictions changed very often, aiming at decreasing licensing procedures (import licenses, export permissions, etc.).

Second period: 1995-1998. The main feature of this period was the signing of the EU Association Agreement (EAA) and Bulgaria becoming a member of the WTO. In 1995, new Customs Tariffs were introduced. Macroeconomic instability and an inefficient export structure impeded the effects of foreign trade liberalization on output. Frequent changes to foreign trade regulations created uncertainty for economic agents. The foreign trade regime was changed several times. (Council of Ministers Decree N307/1994; Decree N 82/ 1995, amendments to decree N180 from 1993, Decree 226). All of the changes to the foreign trade regime reflected the measures included in the EU Association Agreement.

Third period: 1998-present. The progress of EU integration has been outlined in the pre-accession to the EU strategy and a National Program for Adoption of the Acquis (NPAA) was adopted in 1998. Commitment to EU membership is a stated priority of the Bulgarian government. A free-trade agreement between Bulgaria and the EFTA countries has been implemented. Bulgaria has unilaterally lifted customs duties on the import of textile commodities from EFTA countries, in view of equalizing duty treatment with that of the EU. In July of last year, Bulgaria signed an Agreement on Accession to the Central European Free Trade Agreement (CEFTA) and became a full member. In January of 1999, duties were reduced on 80% of the goods imported from CEFTA countries. Duties on CEFTA imports will be eliminated in January of 2002.

According to trade agreements with Turkey, 90% of trade is duty free between both countries. In July of 1998 Bulgaria signed a Free Trade Agreement with Turkey. Since January of 1999, duties on all industrial goods exported to the EU are free from tariffs. The decreasing of duties on exports improves Bulgarian access to the international market. The effect of the drop in duties on trade integration is significant, in case of higher profitability and competitiveness. However, Bulgarian products are not competitive and revenues from exports are low. For this reason there has been no significant effect from the reduction of export duties on production.

The new Customs Code was adopted in 1998. It provides for customs procedures similar to those in the EU. A process of computerization of the customs system started in 1998, aimed at covering the whole customs procedure, from the customs declaration to discharge of the debt. New institutions were established, aiming at the promotion of exports and further foreign trade liberalization, such as the Center for Export Promotion (founded as a separate part of the Ministry of Trade and Tourism in 1997), a Promotion Bank and the Agency for Export Insurance.

Starting this year, according to Council of Ministers Decree No271, 26.13% of all of the categories of commodities included in the Customs Tariff law are under a licensing regime, while 0.67% are under a permission regime. One of the obstacles to foreign trade liberalization was a 2% import tax (aimed at supporting country's balance of payments). In 1999, this surcharge tax on imports was eliminated. The current foreign trade regime reflects all existing bilateral and multilateral agreements to which Bulgaria is a party.

Liberal foreign trade policy in Bulgaria is a prerequisite for economic growth. Protectionist measures had a positive impact on production only in the short term, because distribution by the government could lead to temporary growth in GDP. In Bulgaria the positive effects of restrictions on producers were diminished, because the state supported unprofitable enterprises for a long period, delaying structural reform. Protectionist policies could be used for promoting the export-oriented sectors, especially in the short run. In the long term, protectionism deteriorates the terms of trade because of the increased difference between internal and international prices. Thus, implementation of protectionist measures will lead to declines in productivity of labor and capital, as well as investment flow. The gains from the liberalization of foreign trade up to now have not had an impact on economic performance, because of weak flexibility and adjustment to the domestic and international market on the part of economic agents. Perhaps in the longer term, benefits from trade liberalization will be achieved through enhancing the competitiveness of production and diversification of the export structure with profitable products.

## Dynamics of Foreign Trade

In 1991, Bulgaria lost more than half of its markets in the USSR, as a consequence of distortion of the Council for Mutual Economic Assistance (CMEA) market. The geographic structure at the beginning of the market reform differed from that at present. The instability of the region was a barrier to the development of regional integration. The main characteristic of foreign trade dynamics in the last two years has been a downward trend with the main partner, the countries of the former Soviet Union, and an upward trend with the EU countries. The problem regarding trade with Russia was tariff policy.

Key stimuli to further openness and liberalization were arrangements such as the EAA, participation in the WTO, CEFTA and free trade agreements with Turkey and Russia.

Since 1995 the downward trend with regard to exports has continued. The total volume of turnover last year was lower than that for the previous year, but imports from CEFTA countries rose (the value of foreign trade turnover in 1998 was US $8.9 billion, a decrease of 8.8% compared to 1997; exports decreased by 13%).

This is mostly due to the worsened competitiveness of Bulgaria's exports, resulting from structural reforms, and in particular their slow pace. Imports increased slightly in 1998, but are showing a sustained downward trend. The share of trade with Russia decreased. It was 18.6% in 1997 and 13.5% in 1998. Exports to Russia and other former Soviet republics declined significantly in 1998. Imports from Russia dropped by 27.4%. Nevertheless, Russia remained a main supplier of energy and raw materials.

Foreign trade turnover with Balkan countries dropped by 2% in 1998. Since 1995, exports to Balkan countries have been higher than the volume of imports.

The leading countries in Bulgaria's foreign trade are the following EU member-countries: Germany, Italy, Greece and Turkey. Turnover with them amounted to 50% of total turnover.

The Russian crisis, and low prices of some inputs on the international market in 1998, did not influence foreign trade. The share of trade with Balkan countries recorded its highest value in 1998. Trade surpluses were recorded with all Balkan countries (most significantly with Turkey, Greece, Macedonia and FR Yugoslavia).

The following conclusions can be made:

• Bulgarian foreign trade with CEFTA and EU countries will continue to increase, on the basis of the association agreements.

• By eliminating tariffs, trade with Macedonia will be further developed in the future. The data demonstrate that Bulgaria is becoming a partner in demand in the Balkan region. Meanwhile, Bulgarian exports to Balkan countries are higher than imports.

Bulgarian trade with Greece and Turkey is considerable, unlike that with Albania and FR Yugoslavia.

Bulgarian exports have significant import compo-

***Protectionist policies could be used for promoting the export-oriented sectors, especially in the short run. In the long term, protectionism deteriorates the terms of trade because of the increased difference between internal and international prices.***

nents, so a decrease in demand for exports influences import volume. In terms of import structure, imports of consumer goods increased by 22% in 1998 as compared to 1997, as a result of decreasing domestic output and liberalization of imports. In addition, growth of real salaries contributed to increased imports of consumer goods. Raw materials dominate in the import structure. Imports of investment goods increased in 1998, as a consequence of decreased duties on investment goods from the EU. Exports fell, as a result of internal factors — restructuring the main companies — and external factors — low prices on the international market.

This year, 1999, is claimed to be a special case due to the crisis in Kosovo. However, the picture is as follows. During the first three months of this year, effectively before the war, export industrial sales had already fallen by 26%. Domestic sales fell by 12% over the same period, and GDP went down by 1.2% as compared to the same period for 1998. So poor performance was already evident before the NATO airstrikes on FR Yugoslavia.

The immediate shock was perhaps most obvious in April of 1999, when exports dropped from $335.1 million[5] in March to $283.7 million in April. Imports went down as well, but at a much slower pace: from $453.7 million to $442.9 million. The aggregate decline in imports for the first half of 1999 was only 1%, while exports went down by 21.7%. This difference suggests that physically interrupted trade routes were not the lone factor in Bulgaria's worsened competitiveness; although there were delays in deliveries, the impact of longer transport routes was often exaggerated by the government.

***From the economic point of view, regional economic association brings immediate benefits and increases the welfare of participating countries, when they are at more or less comparable economic levels and have similar economic potential. In such a case, eliminating trade restrictions between the members of regional integration agreements brings benefits to all.***

## Commodity Structure

Bulgarian industrial exports are concentrated on clothing, textile materials, pharmaceuticals and ferrous and non-ferrous metallurgy products, as well as energy. Imports are characteristically industrial equipment, consumer goods, minerals, raw materials and investment goods. The positive trend shown in foreign trade turnover is the increase of the export volume of consumer goods, textiles, leather materials and clothing. Perhaps this is due to the fact that most enterprises in these sectors were privatized, and that in an unstable macroeconomic environment entrepreneurs sought markets with stable hard currencies. Foodstuffs are exported mainly to CEFTA countries and Russia. Bulgaria exports mainly leather materials, textiles, clothing, cement and chemical products to the EU; it exports foodstuffs, beverages, plastics, metals and minerals to Balkan countries.

Low prices of raw materials and chemical products on the international market have a negative effect on export revenues. Therefore, revenue from the export of energy resources decreased by 19% in 1998, compared to 1997. Exports of chemicals, plastics and rubber dropped by 30%; of fertilizers, by 40%; of steel, by 18.3%; and of copper, by 27%. Export revenues from metals decreased by 21% in 1998, compared to 1997.

## Integration With Balkan Countries

The greatest share of trade is with Greece and Turkey. Bulgaria has positive trade balances with Balkan countries. The share of exports to Albania accounted for 0.5% of total exports during the last year. In fact, however, the Balkan countries maintain import restrictions on exports such as food, textiles and steel. Bulgarian exports to Macedonia and FR Yugoslavia suffered from high duties resulting from the implementation of foreign trade restrictions. Differences in progress toward EU integration among Bulgaria's neighbors impose different dynamic effects on their production and economic welfare. Greece is a member of the European Union, while Romania and Bulgaria have signed association agreements and are included in the pre-accession strategy of the EU. Albania and Macedonia have not signed EU Association Agreements yet, which reflects on product specialization and foreign trade turnover.

There are possibilities for expanding trade between Bulgaria, Macedonia, Albania and other Balkan countries. This could be promoted by their signing bilateral free-trade agreements, aimed at abolishing trade restrictions and further opening their markets. This has recently happened with Macedonia, on the basis of a compromise which preserves the protection of Macedonian-made construction materials for the period of rebuilding Kosovo. Although not yet implemented, the Stability Pact for Southeastern Europe and the debate around it are built on two sets of beliefs:

- free trade areas foster a linkage between the demand of one country and supply by another via trade; and
- creation of such areas will be a first step toward regional integration.

In the case of the Bulgarian-Macedonian free trade agreement, it applies the Stability Pact philosophy because there is a general expectation that the Pact will somehow be implemented.

But policies towards regional integration in the Balkans are political, as well as economic, decisions. From the economic point of view, regional economic association brings immediate benefits and increases the welfare of participating countries, when they are at more or less comparable economic levels and have similar economic potential. In such a case, eliminating trade restrictions between the members of regional integration agreements brings benefits to all. In the longer term, it brings the enlargement of markets and the potential to attract investors.

One possible way to foster trade in Balkan region in the near future would be to sign preferential trade arrangements among Balkan countries. This would increase their manufactures' production, because of changes to the existing pattern of trade. This regional trade would lead to gains for production by coordinating their trade policies with respect to other countries. As a consequence of developing regional integration, market enlargement could be attained, which would allow Balkan countries to exploit economies of scale and develop a competitive product structure.

However, there are benefits derived from the dynamic effect of enlarging the regional market. At present, the political and economic situation in FR Yugoslavia is not favorable for strengthening trade integration. An obstacle to the enforcement of cooperation among the Balkan countries is the fact that FR Yugoslavia is not a member of the WTO and has not signed trade agreements with the EU.

## Assessment of the EAA signed by Bulgaria

The EU Association Agreement is a crucial point of reference with regard to current political and economic developments in the Balkans. EAA membership is a prerequisite for active participation in the European integration process and intensification of economic relations with the EU.

In 1995, the European Agreement of Association (EAA) entered into force in Bulgaria, and foreign trade policy began to adhere to its requirements: elimination of non-tariff barriers and the gradual liberalization of trade with sensitive goods, such as textiles, chemical products and agricultural products. According to the EAA, the protection of "sensitive products"; the restriction degree would gradually be removed five years after implementation of the Agreement. The Bulgarian market, for some years, has been most open (i.e. imports) to EU member countries' commodities, unlike Bulgarian exports to EU market. At present, following the scheme of liberalization of trade, export tariffs on industrial goods have been abolished. Opening the domestic market to foreign products puts pressure on domestic producers who face high foreign competition.

Benefits of having signed the EAA are:

• access to EU markets, vital to the development of a market economy in Bulgaria;
• assistance in promoting economic and social reforms and improving economic and social cohesion;
• regulation of foreign trade corresponding to the requirements of Bulgaria's acceptance to the EU;
· assistance in improving the quality and competitiveness of Bulgarian products;
• fostering of restructuring and economic growth;
• increase of exports, based on development of comparative and competitive advantages;
• restructuring of commodity structure on the basis cost-efficient policy; and
• creation of bilateral free trade areas for non-agricultural products, abolishment of quantitative restrictions.

Reduction of trade restrictions contributes to trade diversification and improves the efficiency of resource allocation. In Bulgaria, this effect cannot be felt because of the stage of restructuring. Under the conditions of monopoly structures, any effects from decreasing tariffs on resource distribution are lower than in countries with well-developed property rights. The role of the capital market in the facilitation of foreign trade activity is substantial. However, the capital market is underdeveloped in Bulgaria, with low liquidity, and is not an efficient tool for the accumulation of financial resources.

## Foreign Trade Perspectives

For the past few years, Bulgaria has been in a pre-accession period. The expected positive effects of Bulgaria's association with the EU depend upon an interrelationship between restructuring the economy and trade policy. One of the ways to foster this process is by the creation of an internal competitive market and widening the export structure. The liberalization of foreign trade cannot be considered a means for fostering economic growth without significant structural changes of the economy. Bulgarian foreign trade is rather extensive. Its inefficiency derives from sub-products and low value added. Thus, revenues from Bulgarian exports are very low and do not lead to increased economic efficiency. Export products involve high input components, so Bulgarian exports have to modernize through innovation, improvement or diversification of the products and decrease the amount of sub-products and increase the amount of final products. Bulgaria's low competitiveness stems from high production costs. Export revenues are significant for maintenance of the external balance. Therefore, the Bulgarian government should outline a national export policy and its priorities.

***The expected positive effects of Bulgaria's association with the EU depend upon an interrelationship between restructuring the economy and trade policy. One of the ways to foster this process is by the creation of an internal competitive market and widening the export structure.***

We may summarize the following foreign trade priorities:

• improving the efficiency of Bulgarian exports and terms of trade through creation of an export-oriented long-term strategy, based on the branches' competitive advantages;

• creating free trade zones of zero tariffs with most Balkan neighbors;

• modernizing export structure, developing integration on the basis of internal trade;

• stimulating the production of capital-intensive final goods; and

• formulating an efficient export-oriented policy through diminishing economies of scale.

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1. Economic Survey of Europe, 1999, No. 2, p. 15.

2. See: Krugman, Paul, Geography and Trade, Cambridge, Mass., MIT Press, 1991, pp. 90-130.

3. See: Vamvakidis, Athanasios, "Regional Trade Agreements or Broad Liberalization: Which Path Leads to Faster Growth?", IMF Staff Paper Vol. 46, 1999.

4. Based on empirical analysis of industrialized and developing countries with different degrees of openness, Sachs and Warner find that open economies grow on average 1.5% faster than closed economies. The Sachs-Warner openness indicator is a zero dummy, which takes the value 0 if the economy is closed according to any one of the criteria mentioned. See further: "Economic Reform and the Process of Global Integration," NBER Working Paper Series, 1995.

5. March was an exceptionally good month for 1999 exports, the only month to equal the average monthly export volume of 1998; April represents the rough average monthly export for the first half of 1999.

# Where the prosperity comes from?

# The Marshall Plan and the Stability Pact

**Krassen Stanchev (IME),**
**Dessislava Kocheva (AUBG)**

Security, democracy and prosperity are the three pillars embraced by the signatories of the Stability pact. Prosperity is claimed to be the key element: without it low living standards would sustain animosities in South East Europe. For its accent on prosperity, an analogy is often being drawn between the post-Kosovo developments on the Balkans and those in Europe after the World War II.

It is obvious that the Stability Pact for the Balkans is different from the real Marshall Plan. But it is also obvious that political leaders do not pay proper attention to this fact. The best the Pact can do is to set up a round table, at which to negotiate constitutional and financial reforms of the region. Although it is called a "pact", the Pact is not an agreement, but a process of agreeing on the international security and economic exchange in South Eastern Europe.

## The longest economic growth period

Perhaps, the longest period of more or less steady economic growth and expansion in European history is attributed to the years after the Marshall Plan. In fact, success came from creating its own pattern of institutionalized, international economic interdependence. This is neither the pattern of a monetary system, nor the emergence of harmony between Western Europe and the United States. In much of the 'Atlanticist' literature, this harmony is depicted as a result of the postwar development. Nowadays, similar harmony is attributed to the future relations between the Balkans and the European Union by the same leanings. However, it seems a bit premature.

Contrary to the common opinion, when the Plan started (1948), no symptoms for an economic crisis were observed. The years after 1947 were years of growth and prosperity. The proportion of Western Europe's food imports originating in the dollar zone increases up to three times in importing various goods (such as maize, barley, and fats and oils) in the period of 1949-51 compared to 1934-38. In the second quarter of 1947, the level of industrial production (excluding Germany as the most defeated after the war) reaches 100% of the 1938 level. At the same time, gross and net domestic capital formation as a percentage of the national income are higher than in 1938. The only exception from this picture is the fall in gold and foreign exchange currencies in some countries associated with balance of payment difficulties. These difficulties resulted from the high output and employment rate in the years prior to the Plan. Payment balances suffer from dollar deficit on trade with the US. Trade deficit and low interest rates in Europe result from imports of capital goods by European countries, as part of their plan for a fast recovery after the end of the war. They did not manage to/could not finance their trade deficit with US through invisible earnings from the interest rates of foreign investment or foreign tourists.[1]

The trade and exchange crisis came from increased demand by Western Europe on a relatively constant supply of dollars and the high rate of flow of gold back into the US. The effects of outward movement of gold from America during the war have been annulled by the end of 1947.

## The policy of the US

The US tried to meet three main objectives:

1. return to the pre-war view of strategic self-interest, where the main threat to US and Western Europe comes from the Soviet Union;
2. prevent the breakdown in international trade and in payments mechanisms;
3. partly solve the problems in Germany, without the reconstruction of which, the recovery of Western Europe seems impossible.[2]

Germany is included in the recovery plan. Only through its reconstruction, Europe is also recovered. Germany, as a part of Western Europe, resolves the problem with the world trade equilibrium: without Germany, it is impossible neither to preserve the international trade, nor to form the payments mechanisms. The last two also regain equality of economic rights of Europe in the world. That is the essence of the European Recovery Program (ERP), i.e. the "Marshall Plan". The Plan actually pays for sustaining expansion economic and social policies in WE countries in order to prop up American interests against communists and the Soviet Union.

## Is there a foundation for economic growth in South Eastern Europe?

The Balkans are geographic and a political, but not an economic notion. They do not constitute a market.

The Croatian, Romanian, and Greek governments have their right to deny being Balkan states. The fist two as located at the periphery, while Greece is the only Balkan member of EU and NATO.

But most of the countries are not on the Balkans in terms of trade, and those who can separate its image from this "boiling spot of Europe" are trying not to be a political part of the Balkans as well.

Take, for example, Bulgaria's major trade partners. Table below shows a positive trade balance with Balkan countries, and increasing share of non-Balkan partners in Bulgaria's foreign trade. As IME discussion paper In Search For Growth: Bulgaria's Lessons and Policy Options, points out , in the last three and a half years Balkan countries decreased their share in Bulgarian trade to less than 5% (in the first half of 1999). Balkans have no market sense per se for Bulgaria.

But the trade picture of the region viewed from other Balkan countries is similar to that from Bulgaria. According to UN ECE[3] respective South East Europe share for different countries was in 1997 as follows: for Albania 7.13% of the exports and 5.6% of the imports; for Bosnia and Herzegovina 60.2% of the exports (Croatia's share is 57%) and 20.1% of the imports; for Croatia 18.6% of the exports and 2.6% of the imports; and for Macedonia 16.3% of the exports and 22.4% of the imports (half of this trade is with Yugoslavia).

These figures suggest that geographic and background factors still play a key role in the commercial exchange within the South corner of Europe. This means that the countries (or governments) have more incentive to seek rents from transit fee rather trading with one another. All countries have relatively liberal FDI frameworks. But they lag far behind other European transition economies, in terms of foreign investment. One of the reasons is to be found high economic and political instability. Equally important, however, is the fact that these economies are small individual markets with low rates of return. Their individual share in the global trade is declining. Fragmentation and diverse framework of doing business impedes expansion into neighbor's yard. Hence, they constitute no significant destination for investment abroad. On its turn, domestic investment is hampered by a constellation of factors, acting at national and regional level:[4]

at country level:

- company survival strategies;
- weak and/or unsophisticated demand;
- underdeveloped clusters;
- over-reliance on factor conditions;

and on regional level:

- poor trade and cooperation;
- diverse frameworks for doing business;
- underdeveloped information for economic policy and decision making;
- economic structures based on low value added and unskilled labor;
- lack of shared vision on growth and prosperity.

Thus, we have two major sources of growth - investment and exports - hampered and dependent on previous development paths or on stickiness of institutions and traditions.

## Stability Pact Preconditions

Marshal Plan had as an economic policy motivation an attempt to avoid then perceived dangers of

It is impossible to have common trade disequilibrium (even at a complete absence of the Balkan transition economies from the European or world market). It is unlikely to expect a common, commercially or economically motivated, action to "rescue" Balkans. In normal conditions, these economies exchange 3 to 4 times more with EU, EFTA, and CEFTA than among themselves. The level of their GDP, with the exception of Slovenia, is far below those of the years before the reforms have started. Expected 1999 joint economic performance of the Balkan countries' (excluding Yugoslavia) would be marked by overall GDP of decline 8%. Only Bulgaria and Croatia from the neighbor countries can mark a small-scale increase in GDP. No country from the region has regained completely the level of investments from 10 years ago; it is two times lower in Bulgaria. The aggregate level of investment as percentage of GDP in the Balkan transition economies is at average 5-6% lower than the same index in the emerging Central European markets.

| Level of GDP (1989=100%) | Albania | Bulgaria | Croatia | Macedonia | Romania | Slovenia |
|---|---|---|---|---|---|---|
| 1997 | 80 | 63 | 76 | 56 | 82 | 99 |
| 1998 | 86 | 65 | 78 | 58 | 76 | 103 |
| 1999* | 91 | 66 | 79 | 60 | 74 | 107 |
| FDI-inflows as a % of GDP | | | | | | |
| 1997 | 1.9 | 4.8 | 1.0 | 0.9 | 3.5 | 1.6 |
| 1998 | 1.5 | 2.8 | 2.9 | 3.7 | 4.7 | 0.8 |

Source: Transition report update. 1999 EBRD.
*Projected level

Yugoslavia, obviously, is a different case. According to the estimations of the Belgrade-based group of non-government economists, G-17, the gross domestic product of the Federal Yugoslavia (excluding Kosovo) in 1998 represented about 60% from the 1989 level, and the level in 1999 will be 40% lower than last year. Although the condition of Yugoslavia is important to the neighbor countries, (mostly to Macedonia, but also Kosovo - because of the interdependence in water supply and electrification), the FRY - contrary to Germany right after the war - is not a part of recovery plans for the time being. The neighbor countries will have to pay for this decision and will get some compensations and credits.

## The value of Marshall Aid

The Marshall Plan allows Western Europe to continue maintain a high level of investment, avoid the deflation raised by the further increase in trade controls as the only possible response to the crisis, and to maintain flow of dollar imports. The Economic Cooperation Administration (the body which administered Marshall Aid) never has had the objective to produce such deflationary policies in Europe[5]. It is essential, that the Plan finances increase in capital goods imports from the US. It raises alarm and makes Western Europe continue restrictive trade policies and seek a commonly accepted way to remain a self-dependent part of the international payments system.

Marshall Aid is directly of much more value to certain industries which are unable to attract private long-term capital investment for reconstruction or to finance their own investment policies (electricity, gas, coal-mining, steel industry)[6]. In its first year ERP means a large increase in national income for the majority of recipients and allows governments to widen the scope and forms of the advanced recovery process.

Marshall Aid, however, is not so great a political leverage as it is meant to. The limitations to the exercise of American power and influence through ERP are subtle, complicated, but always present and often narrow. The main issue limiting conferred by ERP power is the unwillingness of the European countries to offer most-favored-nation treatment to Germany, upon which the US insists. Another barrier is the demand the signatories to register and discuss any projected change in the exchange rate of their currency with the IMF prior to making the change. The program rests on the assumption, that productivity growth leads to decline in the political argument, and that investment is needed for productivity increase, which then results in economic growth, and hence political stability. Although the ideology of the ERP is basically acceptable and the growth of productivity of labor and capital of Europe to the levels of US is economically desirable, the program has not been committed because of trying to impose a set of particular human and economic values on European societies. The US sought extra political gain next to the economic ones in return for Marshall Aid. At the same time, gains achieved by the European countries are not as large as to shape the politico-economic future of Western Europe. The gains for the US can only be judged related to specific issues and specific countries.

## The Marshall Plan and international security

Marshall Aid resolves the crisis between Western Europe and North America, but by openly inviting European countries to go into the direction of an expansionist economic policy might drive them to a crisis among themselves. Naturally, when the countries are aiming at high productivity, output and expanding exports, they need to cooperate. The cooperation is to be coordinated by the OEEC (Organization for European Economic Cooperation). This attempt has failed, however, because the OEEC could not function effectively both politically and economically. OEEC is an example of the way in which the gap between ambition and feasibility has deprived American policy of all effectiveness in the period.

The reason the Western European countries to refuse the political implications of the American economic conception, is that it is based on imposing a risk against a set of political and economic ideas, they personally do not share. There are various barriers to this. The so-called Great Powers, often change their roles and make no decisions as in the period before the First World War. When it comes to a cooperative action, the different national interests of the European countries are emphasized. These are assumed too great to be resolved in an international organization. Another barrier to the American policy implementation is the high capacity of the two dominant states (UK and France) to ally against and resist it. At the same time, the chances of the US forming sufficiently strong and stable alliances with the smaller states to push through any parts of its policy are negligible. The US do not have the economic or political leverage to achieve such ambitions.

Comparing the period after the Second World War to the one of the 1990s on the Balkans outlines a few differences. The recovery of Western Europe after the World War II includes definite states, participating in the process of integration. This process on the Balkans includes states disintegrating into new nation states (Bosnia and Herzegovina, Slovenia, and Croatia in the first half of the 90s, and Kosovo and Sandjak in the second half of the 90s). The different neighbor countries have claims on different state of circumstances in the countries – Greece has claims on the name and national symbols of Macedonia, Hungary on the status of Vojvodina and the human rights in former Yugoslavia. Along with this, there are inner claims such as the one on cultural autonomy of the Albanians in Macedonia and the Hungarians in Yugoslavia. There is no homogenity of the issues such as to define one common direction to integration.

America exaggerates the weakness of European economies. It also overestimates the scope of political and economic action needed as well as the capacity of power and influence of the Marshall Aid. Actually, later only solves the technical problem of the crisis (the deficit with the dollar zone), but does not interfere with the expansion of these economies. The success of Marshall Aid itself is a major obstacle to the implementation of American policy7. The declared aim of the Aid is the recovery of the European economy. In such a case, the share of the American economy on the world market will decrease. If the US wants to conquer the European markets, the 'subsidies' must not be successful.

American attempts at integrating Europe by Marshall Aid and the OEEC ultimately produce not only a different path of European integration as a defense against America, but also strengthen the European motion of anti-Americanism. Such a reaction against American policy were the European Payments Union (EPU) and the European Coal and Steel Community (ECSC). Intra-Western European trade, the larger less restricted markets, as well as the decay of protectionism, the political objective of WE integration enabled Western Europe to survive in a worldwide multilateral trade and payments system without the need of dollar aid from the US[7]. Foreign trade is basis for further economic development and integration.

Foreign trade is the foundation of the integration after the Second World War, but it's not the case on the Balkans, where there are no such prerequisites. The Balkan economies potential has seldom been discussed. Whatever the American interest in the region, it is most unlikely that it is lead by economic motives. There are no symptoms of economic motives being leading for the EU' attitude to the Balkans too. The situation is characterized by the fact that the ideas for resolution are once again coming from 'outside'. In contrast to the period after the Second World War, there is no inner integration process in the region. In regional economies production with low added value prevails and the services are almost absent. The economic, monetary, and political instability in the few past years result in exports to the hard currency zone, and not into the region.

The collapse of the OEEC resulted positively in September 1949. For the commitment of the integration of the European economies, there is raised the need for other institutions to participate in the process. Ideas of a payments union are introduced, that later result in the European Monetary System and the Euro. Through removal of restrictions on foreign trade, the ECA tries to achieve these goals for the OEEC. The agreement on the EPU, however, signifies the defeat of all these future American hopes[8].

After it has been severely affected by the American recession in 1950, Britain threatens to withdraw completely into the sterling area payments mechanisms, and thus to divide the world into two payments systems. For this reason, there is a drastic change in American policy by abandoning goals of integrating UK into a united Western Europe and the acceptance of the existence of the sterling area and of the UK as its pivot in the post-war world[9]. The US accept that its real interests are more affected by the world-wide ramifications of British and sterling area trade than by Britain's role on Europe.

South Eastern Europe is characterized by the process of currency substitution and by referent currency represented by the German mark. The process resembles the drawing of Britain in the sterling mechanism in so far as local currencies are not self-dependent and are not free-traded outside the respective countries. The difference from the development of the British sterling is that the currencies are substituted with the German mark and tend to be substituted with the Euro. That is why ideas for rational and freely chosen rejection of national currencies emerge naturally.

In this situation no durable reconstruction could have been possible unless the future terms of coexistence of the sterling area, Western Europe, and the dollar trading zone have been defined. The last is done by the EPU which creates a pattern of institutionalized interdependence; it is a multilateral payments network imposing certain restrictions on national policy choices to make it work. The success of this institutionalization of interdependence free from pressure towards integration is immediately seen in the way the EPU have coped with the very problem, which had proved most disastrous for the OEEC, the economic recovery of Germany.

In fact, Britain limits its participation in the process of European integration. The imports of West Germany increase. Germany appears to be a potential leader of any Little European economic association, which makes France to take its own initiative. The most dynamic sector of the French economy in 1949 is foreign trade and that is why ideas turn towards a more liberal framework for an integrated Little Europe as a solution to the problem of national security. Little European payments union is unacceptable, however, to the Dutch without the German participation, and the French government is not prepared to face the West German economy in so liberal a framework.[10] After January 1950 the only practically acceptable framework is to return to the concept of a regulated market.

The first step in this direction was the establishment of the European Coal and Steel Community (ECSC) as a result from the idea that any policy for harmonizing French and German reconstruction has to deal directly with the central question of coal and steel resources. As far as the customs union is defined as a common market, confined at first to those strategic commodities, no common market in those products could be created without the most complex agreements on its regulation. Here the Schuman Plan negotiations began on cooperation of Germany and France in Ruhr. As a result, the ECSC is founded, which contains large modifications to accommodate not only France and Germany, but also European countries and the US. These modifications, however, join together more strongly and intricately the framework of economic interdependence and political alliance on which the rest of the economic peace settlement is later erected. From the Schuman Plan, negotiations emerge an altogether more pragmatic process of integration which resolves the central political problem of Western Europe and becomes the pattern for the European Economic Community (EEC)[11].

Instead of a liberal unified Europe comes a closely regulated Little European common market. It provides simultaneously for French national security by containing West Germany and permits its members to continue to pursue a very limited range of common economic policies in a few specific sectors of economy, which would otherwise have become impossible. Parallel with this development, the whole of Western Europe by rejecting the economic framework for interdependence which the US seek to impose on it, is able to build an alternative framework. Although it may not have withstood the challenges of that time, it is certainly better founded than anything devised in the inter-war period[12] .

Western Europe creates an alternative pattern of reconstruction by a restricted institutional framework for economic interdependence, which has proved to be more effective than any previous peace settlement and in the end the best solution for the United States too.

The creation of institutions after the pattern of the experience and mistakes from the late 40s and early 50s in Europe seems impossible on the Balkans. What is possible, is the adoption of patterns of institutions and laws already created in EU or the international community (UN, NATO, IFIs, and G-8). This raises the basic problem of the natural origin of the legal and constitutional changes, which might emerge on the Balkans. As a consequence again arises the problem of security.

1. Data in the paragraph above is borrowed from: Alan S. Milward, The Reconstruction of Western Europe: 1945-1951, London, Mathuen & Co. Ltd., 1984.
2. Milward, Alan S., The Reconstruction of Western Europe 1945-51, Methuen & Co.Ltd, p.53.
3. Economic Survey of Europe, 1999, No 2, p.15.
4. The following two set of factors have been identified by a research, sponsored by the Worldbank Institute in five countries (Albania, Bosnia and Herzegovina, Bulgaria, Macedonia and Romania) on Competitive Advantage of Regions: Creating Competitive Clusters (the results were presented at a Senior Policy Makers Forum on September 15, 1999 in Vienna, Austria.
5. Milward, Alan S., op.cit., p.99.
6. The data which follows on this page is from: Alan S. Milward, Op. Cit., p.108, 114, 125, 195, 210.
7. Alan S. Milward, p.216.
8. Ibidem, p.473.
9 Ibidem, p.474.
10 Alan S. Milward, Alan S., p.475.
11 Ibidem, p.475.
13 Ibidem, p.476.

| **Institutions which emerged as a result to the Marshall Plan** | **Ideas of the Stability Pact** |
|---|---|
| 16 July 1947 CEEC Committee for European Economic Cooperation | June 1999 – Adoption of the Stability Pact for South Eastern Europe and drawing up of the draft for it. |
| 5 June 1947 ERP European Recovery Program | Regional table for South Eastern Europe which will coordinate the three working tables: (1)on democratization and human rights;(2) on economic reconstruction and reform; (3) on security |
| April 1948 ECA Economic Cooperation Administration | The Special Coordinator, appointed by the EU and responsible for the process of implementation of the Pact within and between the individual countries, will be supported by appropriate structures tailored to need |
| 16 April 1948 OEEC Organization for European Economic Cooperation | The Southeastern Europe Cooperative Initiative for economic and infra structure related regional cooperation will attract private investments to the region. |
| 7 July 1950 EPU European Payments Union | The process of establishing a framework for cooperation in the region in Royaumont will play a key role concerning civil society issues in the framework of the first Working Table of the Stability Pact. |
| 18 April 1951 ECSC European Coal and Steel Community | The Conference on the Adriatic and Ionian Sea region proposed by the South Eastern European Defense Ministers (SEDM) group will contribute to the security of the region. |
| 25 March 1957 EEC European Economic Cooperation | A donor/reconstruction conference for Southeastern Europe in order to launch a comprehensive and coherent economic development plan for |

Source: History of the Marshall Plan is reflected after Wexler, Imanuel. **The Marshall Plan Revisited. The European Recovery Program in Economic Perspective**.Greenwood Press. London 1983.