

# Newsletter

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## In this issue

**Krassen Stanchev**  
on the Union of  
Democratic Forces  
Conference  
on p. 1

**IME Team**  
on cost of licensing  
on private business:  
study of selected  
sectors  
on p. 2-11

**IPED (Warsaw)**  
**team**  
on the impact of for-  
eign  
investment on Polish  
economy  
on p. 12-15

## Also Inside:

A supplement with  
selected  
macroeconomic indica-  
tors

Regional Conference on  
the Southeast Europe  
Trade Initiative (SEETI):  
Tentative Agenda

Desk editor:  
**Latchezar Bogdanov**

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# Democrats Go Populist

**Dr. Krassen Stanchev**

The Union of Democratic Forces (UDF), the backbone of the ruling coalition in Bulgaria, United Democratic Forces, as well as their junior coalition partner, the Democratic Party (DP), held simultaneously their party conventions last weekend.

The Democratic Party congress elected a young leader, a lawyer with ten years of political experience. It succeeded in voting a program based on neo-conservative values. As October 1999 elections demonstrated, it is attracting UDF voters but it is relying on the same pool of people. DP (as a partner of the Agrarian Party in a smaller coalition, the People's Union) has power sharing agreement with UDF. It seems secured for the time being.

Voters expected especially from UDF:

- to reflect on the results of the last (October 1999) municipal elections, deriving relevant lessons (see for comments, IME Newsletter, 1999, No 9-10, p.1);
- to point out and replace disappointing leaders (all of them already sacked from the cabinet and sent back to the parliament), thus answering corruption allegations;
- to discuss and explain to the citizenry what is the actual direction of reforms and what economic steps the government visions to undertake in order to ensure growth and prosperity, after ten years of reforms and pleading a new electoral victory in 2001 and a second mandate.

UDF conference delegates failed to respond to any of these expectations. They were interested in the second topic, although not to the extent to the initiative but rather waiting for an instruction from the leaders. Leaders, including the chairman of the party and the prime minister, Mr. Ivan Kostov, had to be elected as well and did not risk internal fights. They even issued a collective report which carefully avoided all issues related to the responsibility of those who were or still are in charge of running both the party and the country.

The ruling party failed to respond to the major public concern, namely to the allegations of corrupt practice and clientele favoring behavior. To compensate for this obvious omission, the report focused on local elections and anti-corruption rhetoric, blaming such "weaknesses" as: feudal mentality of the leaders and "incomprehensible leap of the family living standards" of the leaders; substitution of the work with voters with business and privatization; embezzlement; nepotism, "oriental partisan attitude", etc. At the same time, Mr. Kostov dismissed corruption allegations, referring to the fact that corrupt practices were introduced by previous governments.

Missing discussion on economic policies and prospects prevented debates on systemic sources of corruption, including those sustained from the past and "invented" by the UDF government. A case was made against preferential privatization to insiders, though such deals rose three to four times since UDF came into office. And this policy was, in fact, sanctioned by the previous forum of the same people. Thus, the calls "to free the top party line from discredited politicians with low public morals" were doomed to fail.

Economic ideas, to the extent they were shared in the deliberations and the resolution of the conference, made little sense. In the best cases they resembled poorly-read Keynes but more often desired to seek rents, soft loans and subsidies from the European Union. Three speakers had ideas to use EU pre-accession fund to help the poor, to enhance standard of living, and for the involvement of the youth in economic development. The prime minister pleaded for deregulation and privatization of natural monopolies "but without increases in the energy prices". He also underlined that "UDF is a people's party, not a party of the rich". The ex-minister of justice promised that a law to confiscate properties and assets of those "who can not prove where the money comes from" will be passed ("in accordance with the Constitution") "not now, just before the end of the mandate", before next elections.

The conference demonstrated that UDF suffers from a lack of right-wing criticism. It suffers from its loneliness in power, from its unsuccessful fighting with its own mentality. It is obvious that the only correction to UDF populist temptations can come from two sources, the creditors and the independent market oriented opinion of economic and political observers.

# Licensing In Retail and Wholesale Trade and Commercial Road Transport

Institute for Market Economics<sup>1,2</sup>

## Introduction: How does licensing affect economic growth?

Most governments set requirements for entrepreneurs to start operating in a certain market. The justifications of state regulation vary from protection of human health to quality, national security or "public interest". Fulfilling these goals through government regulation however, has an opportunity cost, i.e. the procedures and requirements that entrepreneurs should follow are costly both in time<sup>3</sup> and money, and some businesses probably never get started because of this. All such regulations that pose entry requirements to a certain market, be they licensing, certification, approval, registration or testing, have one common impact - they reduce competition and increase cost of doing business in the respective sector. Both reduce efficiency of markets and consequently growth.

In Bulgaria entry costs and transactions costs in general have never been studied in detail. The only measurement attempt<sup>4</sup> was initiated by IME in mid-1996 when we surveyed small and medium private firms. The survey indicated that for a sole proprietor to open a cafe or set up a small workshop the time needed to collect only these permits was at least four weeks. Submission of the permits to the local government office did not mean that the license would be issued by a provisional deadline, but a delay did not stop the applicant from operating the business. The smaller the venture, the less likely it was that the local government office would issue the license immediately; but meanwhile the entrepreneur could operate freely.

There is littler evidence that situation has changed

drastically since 1996.

In the period 1997-1999 the number of licenses doubled. In addition, most of the licensing requirements imposed in 1998 and 1999 were justified by the harmonization of legislation with EU directives.

On the other hand, both the general public and the government have become increasingly aware that high entry barriers impede competition and reduce economic growth. In 1999, the Bulgarian Foreign Investment Agency, a branch of the government, commissioned a study on administrative barriers to investment in Bulgaria to the Foreign Investment Advisory Service (a joint facility of the World Bank and the International Finance Corporation). A working group under the Ministry of Industry (now Ministry of the Economy) was established to review existing licensing requirements and ways to reduce their burden on the business. The FIAS team is focused on the general administrative procedures that businesses face. The working group of the government will review the reasoning behind each of the studied licensing regimes.

IME task in this situation is to provide some empirical evidence on how specific licensing requirements affect businesses. The goal of the study is to collect data on procedures related to obtaining all necessary documents for entry into certain markets. It should outline:

1. The transparency of the procedure.
2. Costs of licensing in terms of time, money and other problems.
3. The variance of licensing costs and related problems according to localities.
4. Major bottle-necks in the process
5. Institutional and legal arrangements that lead to costly licensing requirements.
6. Possible solutions that will reduce entry costs

## Selection of sectors for study

We chose to survey retail food trade, wholesale trade and freight road transportation. The reasons behind this selection are the following:

- Retail trade is the most widely spread business activity; according to National Statistical Institute (NSI) data, 159,384 out of 447,714 registered private companies in 1997 were involved in retail trade. The start-up capital needed is low, and it does not require highly specialized knowledge to operate a retail shop. On the other hand, retail trade with food requires additionally a wide range of documents that are related to health safety standards, such as sanitary and veterinary per-

**Table 1: Number of activities requiring license or permit explicitly mentioned in laws**

Year	Newly enforced licensing requirements	Total licensing requirements in place
Until 1989	2	2
1989	4	6
1991	3	9
1992	1	10
1993	5	15
1994	6	21
1995	21	42
1996	13	55
1997	10	65
1998	21	86
1999	20	106

Source: IME calculations

mits, etc.

- Wholesaling is an institutional issue; it is an important link between production and consumption. Licensing for wholesale trade includes all site development permits required for retail trade, but might additionally include a license by a central institution, i.e. National Commission for Commodity Exchanges and Commodity Markets

- Freight Road Transport must be treated as an institutional issue as well as an issue which is an important factor for transaction costs in domestic and international exchange. It is an interesting case, because freight transportation does not imply any direct health or safety hazard on the society, and licensing requirements are based on other presumptions. It is almost entirely regulated by central institutions.

## Methodology

For the purpose of the report "**license**" and "**licensing**" will mean simply a document needed for the operation of the business, and the process of obtaining this document, respectively. Definitions used in Bulgarian legislation recognize "license", "permits", "certificate", "approval", etc. The economic meaning of all those is similar - they mean a requirement, provided in government regulation and obligatory for the performance of certain activity, to hold a formal document issued by either the government or a private institution. We have deliberately left aside documents required by the Law of Environment and Waters Protection related to Environmental Impact Assessment (EIA). The reason for this is that EIAs are regulated by a specific law, and a comprehensive list of investment projects that should go through EIA procedure is provided by International Law, applicable to Bulgaria.

This report is based on interviews with managers or owners of companies in retail trade with food products, wholesale trade and commercial road transport, as well as with government officials at the respective agencies involved in granting documents necessary for business operation in the above mentioned sectors. The interviews were conducted by professional interviewers of the Agency for Socio-economic Analysis (A.S.A.), using two standardized semi-structured questionnaires, one for the companies and one for the public officials. Answers were coded reflecting all categories mentioned in the interview record.

The sample of companies consisted of 82 firms, randomly chosen from the Yellow Pages directory of the respective location. All the companies employ less than 50 workers. The interviews took place in October 1999. We interviewed 27 firms in Sofia, 32 in Rousse (middle size town), and 23 in Dupnitsa (small size town). The sample includes 35 food retailers, 29 wholesalers and 18 freight carriers. About 29.5% of the firms have been in business for 3 years or less, about 36% - for between 4 and 6 years, and the remaining 34.5% have operated for 7 or more years.

## 1. Licenses required and institutions involved

The findings of the study will be better understood if a brief overview of the legal framework related to licensing in these three sectors is provided.

## 1.1. Legal foundations for licensing

### *Retail and wholesale trade*

As far as retail and wholesale are concerned, two distinct type of licenses are issued: licenses (or registrations) for commercial units, or shops, which are provided by the respective municipalities; and licenses for organized commodity markets as defined in art. 14 of the Law on Commodity Exchanges and Markets (State Gazette 93, 1 November 1996, last amendment SG 153, 23 December 1998). Additionally, separate licenses for the sale of tobacco and alcohol should be obtained from the respective municipality if a company intends to make such sales.

The authority of the municipalities to license commercial sites originates from art. 22 of the Law on Local Self-governance and Local Administration (State Gazette 77 of 17 September 1991). The Law generally allows local authorities to apply their own regulations when local problems are at stake. The box below

### Box 1: Commercial sites registration in Rousse municipality

Excerpts from Ordinance 5 of Rousse Municipal Council

Art. 3 The registration of fixed premises in trade, tourism, services and small industrial enterprises is carried out by the "Trade and Tourism" department after the following documents have been presented:

1. Property title (a notary act) for existing estates, or permission for use for newly built or reconstructed premises, issued by the Regional Directorate for National Construction Control - Rousse, or the "Territorial Development and Construction" department of the Municipality - Rousse.
2. Sanitary permission for the opening of the premises, issued by the Hygiene-Epidemiological Institute (HEI) - Rousse, as set out in art. 28 of the Rules for Implementation of the Law of Public Health.
3. Veterinary-Sanitary permission from the State Veterinary-Sanitary Control - Rousse for sale of goods with animal origin.
4. Document for company registration<sup>5</sup>.
5. Certificate for work as defined by Council of Ministers Decree 35 of 1987.

describes the licensing procedure for commercial activities and sites laid down by the Municipality of Rousse.

In fact, sanitary and fire safety certificates are required in accordance with the Implementation Rules of the Law on Public Health, and Ordinance I-61 of 12 March 1999 of the Ministry of Interior on Certification of Objects for Compliance with Fire Safety Requirements, respectively.

Council of Ministers Decree 35 of 1987 established opportunities for small business before the reforms started. It basically outlines how citizens can start activities in retail trade, handicrafts and services. It was finally repealed by the government on 9 November 1999. This indicates that for more than a decade municipalities have implemented a regulation from the socialist period.

The box shows a mixture of central and local institutions are involved in the licensing procedure, with local regulations mostly duplicating the requirements of national law.

A license for sale of wine and liquors (hereinafter called "Alcohol license") is required by the Ordinance on the conditions for production and trade with wine, alcohol and alcohol products, issued by the Council of

Ministers on 19 April 1996. The procedure set out in the Ordinance provides municipalities with the authority to license alcohol retail and wholesale

traders. Documents required include a document for company registration from the court and tax administration, a document verifying the balance of taxes due, a sanitary permission for opening the premises, issued by Hygiene-Epidemiological Institute (HEI), in accordance with art. 28 of the Rules for Implementation of

**Table 2: Documents and institutions mentioned in interviews**

Document	Institution involved	Level of authority
<b>Retail and wholesale</b>		
<b>1. Registration of sale store</b>		
Company registration	Municipality	Local
Sanitary permission	Court	Judicial
Water Supply & Sewerage permission	Hygiene-Epidemiological Institute	Central, with local offices
Electric company permission	Utility company	Local
Fire safety certificate	National Electric Company	Central, with local branches
Veterinary-Sanitary permission	Fire Safety department of the Ministry of Interior	Central, with local offices
Property document	State Veterinary-Sanitary Control	Central, with local offices
Social security certificate	Municipality	Local
Standardization certificate	National Social Security Institute	Central, with local offices
Rent contract	Institute for Metrology	Central
Permission of the Architecture Department in the Municipality	Landlord	Private person
Permission of the neighbors	Municipality	Local
Certificate for current legal status	Neighbors	Private person
Certificate for paid taxes	Court	Judicial
	Territorial tax department	Central, with local offices
<b>2. Registration of cash machine</b>		
Passport of the cash machine	Territorial tax department	Central, with local offices
Invoice	cash machine vendor	Private person
Contract for maintenance	cash machine vendor	Private person
Certificate for installation	cash machine vendor	Private person
<b>3. Certificate for "patent" activity</b>		
	Territorial tax department	Central, with local offices
<b>4. Tobacco and alcohol sale licenses (optional)</b>		
Sanitary permission	Municipality	
Certificate for paid fee for license	HEI	Central, with local offices
Protocol recently completed tax revision	Municipality	Local
	Territorial tax department	Central, with local offices
<b>5. Milk product sale license (one case only)</b>		
	Municipality	Local
<b>6. License for commodity markets (only)</b>		
	National Commission for Commodity Exchanges and Commodity Markets	Central
<b>Transport</b>		
<b>1. License for international transport</b>		
Clean criminal record	Ministry of Transport	Central
Clean driving license	Court	Judicial
Driving license for the respective type of vehicles;	Auto Police	Central, with local offices
Certificate for Professional Competence	Auto Police	Central, with local offices
Health certificate	DAI	Central, with local offices
Certificate from a psychiatrist	Polyclinic	
Receipt for paid road tax	Polyclinic	
Certificate for technical inspection of the vehicle for the respective year	Territorial tax department	Central, with local offices
Third-party liability insurance	Auto Police	Central, with local offices
Certificate for the vehicle for transportation	Insurance company	Private
Registration papers of the vehicle	DAI	Central, with local offices
	Auto Police	Central, with local offices
<b>2. Permission for local transport (in Rouse only)</b>		
Similar to those required for international transport	Municipality Transport Department	Local

Source: Survey

the Law of Public Health, and any other documents that the municipality requests from commercial site owners. The license is valid for 1 year.

Similar legal provision is found in the Rules for Implementation of the Tobacco and Tobacco Products Act issued on 21 February 1994 by the Council of Ministers. The municipal authorities should issue a license for sale of tobacco and tobacco products (hereinafter called "tobacco license"). Documents that municipal authorities should request are: a company registration document from the court and tax administration, verifications for the amount of tax due<sup>6</sup>, draft working time, approval by the "Technical Department" of the municipality and any other documents that the municipality requests from commercial site owners.

### ***Transport***

Prior to 1 January 2000, licensing for road transport carriers used to be regulated by Ordinance 3 on the International Road Transportation of Passengers and Freights of the Ministry of Transport (State Gazette, 113, of 2 December 1997). No regulation required domestic carriers to apply for a license. The new Law on Road Freight Transportation (State Gazette, 82, of 17 September 1999) establishes that all carriers (domestic and international) must be licensed by the Ministry of Transport. The requirements set in the new Law are identical to those that were applicable to international carriers before the Law was passed: "reliability; professional competence, financial stability, and travel reliability of the vehicles". The fulfillment of the requirements must be verified with the following documents listed in Art. 8 of the Ordinance:

1. company registration documents (court, tax office, BULSTAT);
2. documents confirming financial stability - bank guarantees, financial reports, registered share capital or other;
3. document issued by the court showing the manager has a clean criminal record;
4. two letters of recommendation regarding the reputation the manager from clients, spedition companies, etc.;
5. professional competence certificate issued by the State Automobile Inspection (DAI)
6. proof of psychological health issued by a medical doctor;
7. receipt proving payment of the requisite fee;
8. rental contract or property document for garage space for the vehicles;
9. copies of registration documents of the vehicles and certificate for annual technical inspection;
10. certificate for compliance with customs requirements for cargo carriers;
11. rental contract for the vehicles (if not owned by the company).

The license issued by the Ministry of Transport is valid for one year and should be renewed under the same procedure.

The new Law on Road Freight Transportation

requires that the Ministry of Transport issues an ordinance to establish the necessary documents and procedures for licensing. By the end of 1999, no such ordinance exists.

## **1.2. Licenses and institutions involved as seen by entrepreneurs**

We asked entrepreneurs about the types of documents required before starting an operation, about the institutions that are involved in providing these documents, and the major steps of the procedures they had to go through. The companies we interviewed provided different answers, and it is doubtful that they represent the entire variety of documents required in all possible situations. We can summarize the results in the following sections.

### ***Retail and wholesale trade***

For retail trade the necessary licenses are:

- license (formally named "registration") for trade site (premises) issued by the municipality;
- license for trade with tobacco and alcohol (optional);

Obtaining each of the above is not an easy task. Companies mentioned 18 documents that were required by their respective municipalities to grant the license. Some of them were documents related to general company registration, such as documents for court registration, tax registration, social security registration, etc. Others were documents to be issued by another government institution, which itself has separate procedures and requirements for granting documents. Typical examples are hygiene and sanitary permits, and fire safety certificates. Obtaining each of them involves both compliance with standards and requirements set in laws and regulations as well as presenting new documents again. The process is multi-stage, prior to getting a sanitary permit health certificates must first be obtained for the employees.

Seventeen institutions are mentioned as being involved. Utility companies such as Water Supply and Sewerage and National Electrical Company, are also included since documents issued by them are also required during the procedure.

The procedures related to licensing of wholesalers are similar, with the exception of organized commodity markets and exchanges, which need a special license from the State Commission on Commodity Exchanges and Markets.

### ***Transport***

Licensing in transport remained unclear after the survey was conducted. Legislation that was in place at the time the survey was done<sup>7</sup> stated that the Ministry of Transport issued license for international carriers only.

The documents required for international carriers included: a clean criminal record from the court; a clean driving license from the Traffic Police; a driving license for the respective type of vehicles; a certificate of the manager's professional competence (from DAI); the manager's health certificate; a certificate from a psychiatrist for the manager, a receipt for paid road tax; a vehicle's technical inspection certificate for the respective year; third-party liability insurance; a certificate for the vehicle for transportation by DAI;

registration papers of the vehicle. However, our findings prove that in Rousse the local authorities license on their own domestic carriers. The procedure is roughly as described in Box 2.

On the other hand all the ten interviewed carriers in Dupnitsa stated that they didn't need a special license for transport activity and that they operate as any other company under commercial legislation.

This proves that the level of discretion at municipal level is extremely high, and municipalities can establish their own licensing requirements.

## 2. Costs

There are various costs related to obtaining all necessary documents for a business operation. The first economic cost related to licensing is access to information about the requirements that should be followed.

The question we asked was: How did you get informed about the existing permits, licenses, certificates, and other papers of the kind needed for your business (sources of information)?

Table 3 summarizes the answers received.

The very fact that both the instructions available at the respective institution and advice from colleagues are major sources of information means that procedures are neither clear nor easily accessible to potential applicants. Moreover, 48.8% claim that they had to make personal inquiries with officials working for the particular institution involved proves that entrepreneurs do not rely upon written rules. Official publications in State Gazette come in fourth place as source of information.

The costs directly related to the licensing procedures are basically money spent on obtaining necessary documents, time spent during the procedures, and visits to

**Table 3: Source of information on necessary documents**

Sources of information on necessary documents	Total %	Retail	Whole sale	Wholesale and retail	Transport
Samples inside institutions providing permissions/documents	62.2	74.3	58.6	67.2	44.4
From colleagues	54.9	62.9	37.9	51.6	66.7
Received after a demand from the institutions	48.8	57.1	48.3	53.1	33.3
State newspaper	43.9	28.6	51.7	39.1	61.1
Other information sources (lawyers, own experience, etc.)	13.4	11.4	6.9	9.4	27.8
Not used	2.4	2.9	3.4	3.1	0

Source: Survey

**Table 4: Costs related to licensing**

	Cost in BGN			Time cost in man-weeks			Number of visits to institutions		
	Median	Max	Min	Median	Max	Min	Median	Max	Min
Total sample	176	1690	1	7.5	125.0	0.5	14.0	128.0	5.0
Retail food	187	1000	1	9.0	52.0	0.5	17.5	75.0	5.0
Wholesale	120	1690	25	6.0	53.5	0.5	12.0	128.0	5.0
Transport	200	700	116	5.5	125.0	3.5	12.0	42.0	5.0
Retail food in Sofia	350	1000	105	18.0	52.0	4.0	19.0	75.0	5.0
Retail food in Rousse	192	883	10	8.0	28.0	2.0	15.5	47.0	9.0
Retail food in Dupnitsa	138	660	1	5.0	32.0	0.5	15.0	20.0	5.0
Wholesale in Sofia	285	1690	100	12.0	53.5	3.0	12.0	128.0	9.0
Wholesale in Rousse	82	905	25	7.0	13.5	0.5	13.5	24.0	9.0
Wholesale in Dupnitsa	100	1500	35	4.0	20.0	1.0	9.0	25.0	5.0
Transport in Sofia	600	600	600	7.0	125.0	5.0	13.0	42.0	10.0
Transport in Rousse	172	460	116	5.5	13.0	3.5	11.5	21.0	5.0
Transport in Dupnitsa	450	700	200	4.5	4.5	4.5	-	-	-

Source: Survey

**Table 5: Institutions that create biggest problems**

Which institution have created greatest problems for you?	Total%	Retail	Whole sale	Whole sale and retail	Transport
Municipality	23.2	25.7	20.7	23.4	22.2
HEI	20.7	25.7	27.6	26.6	0
Municipality Architecture Department	13.4	25.7	6.9	17.2	0
Territorial Tax Department	8.5	8.6	6.9	7.8	11.1
NEC	6.1	11.4	3.4	7.8	0
Fire Safety Department	4.9	8.6	3.4	6.3	0

Source: Survey

institutions. Table below summarizes the answers received:

Table 4 reflects costs reported by entrepreneurs; this does not mean that these were actual costs. The time of licensing varies significantly and direct conclusions cannot be drawn. However, the table provides some important indications that characterize costs of licensing:

- The average cost in money (measured in statistical median) for all licensing procedures is BGN 176, with transport companies paying BGN 200 on average. Variance in monetary costs is significant, however. Companies pay more in Sofia than in other cities; retail and wholesale traders in Sofia pay 2.3 times more than those in Rousse and 2.7 times more than those in Dupnitsa. Variance within locations is also huge, cost of licensing for retail traders in Sofia varies from BGN 105 to BGN 1000.

- Costs in time are also not equally spread among businesses and locations. The amount of time spent is positively correlated to the size of the city. Also, the time spent by retail traders is higher than in other businesses. Variance among individual companies is high; retailers in Sofia reported time costs of between 4 and 52 weeks.

- Another indicator of the costs related to licensing requirements is the overall number of visits than owners/managers had to make to the institutions involved. The significance of this indicator partially stems from the fact that sources of information available are mainly instructions posted on message boards at the institutions or direct advice by public officials (see table 2). The numbers prove that the average number of visits that entrepreneurs pay is about 14; the bigger problem seems to be the extreme cases where respondents reported 128 or 72 visits. It is obvious that these numbers do not reflect the actual number of visits; however, they reflect the frustration generated by the amount visits to institutions. To summarize, the survey did not prove extraordinary high cost of time and money. On the other hand, procedures seem to vary significantly between locations, and more importantly, between individual companies. This proves a high level of uncertainty in implementation of generally prescribed procedures, it also reveals huge discretion by administration on case-by-case basis.

### 3. Major problems faced by companies

The six institutions that create biggest problems are presented in Table 5.

The answers generally suggest that procedures related to site development, i.e. verifying that a certain shop meets all the safety and urban planning requirements, seem quite burdensome. The responsible institution is the technical (architectural) department of the Municipality. The procedure in brief is like this: the firm prepares its own design for the site, then all the utility companies and other institutions (such as HEI, fire brigade) should approve this draft design. With the collected approvals, the firm goes back to the architect of the municipality, who should approve the design. The architect should, in general, approve that a certain property can be reconstructed and used as a shop, café

or the like. Then, after the premises are built or refurbished, the same procedure is repeated. Not surprisingly, retail and wholesale companies report having visited the architectural department more than 6 times on average. The period for getting the permit is the highest reported by retail and wholesale, averaging at more than 7 weeks. Asked which institution created major problems, 17.2% of retailers and wholesalers

#### Box 2: Licensing requirements introduced by Municipality - Rousse

First, a health certificate and a certificate by a psychiatrist for the manager should be prepared. Second, the owner should enroll in professional training courses organized (only) by the regional State Automobile Inspection (DAI) in order to receive a certificate for professional competence. At the same time the vehicle(s) is registered, all necessary technical audits are made, insurance and road tax are paid. Then DAI issues a certificate for transportation for the vehicle. After that the owner makes a registration for "lump taxation" at the tax office and together with all other documents he goes to the Municipality. It issues a license for transportation activity. Every 6 months the company has to present a current legal status of the company issued by the court.

reported "the architectural department", the third highest after HEI (26%) and the Municipality as a whole (23%).

Apart from the frequently expressed complaints about delays and bureaucracy, here are several quotations from answers to an open-ended question on major problems faced in licensing:

- The Municipality Architecture Department delayed the approval for 6 months;
- The Water Supply & Sewerage company demanded that costly water meters should be installed;
- The National Electric Company delays approval for connection to the electrical grid;
- HEI and the Tax Office ask for bribes;
- Enrolling in the professional competence training course with DAI is difficult; there are big delays;
- The Ministry of Transport required 32 documents;
- HEI asked for written consent by all neighbors for tobacco and alcohol license;
- The company is required to transport the inspectors from the HEI and Fire Brigade to make the site audit;
- You have to go to Kyustendil (district center for Dupnitsa) to get certificates from DAI, HEI and Fire Safety<sup>8</sup>;
- You have to apply for new license from the Municipality each year.

These problems can be more easily understood if a brief picture is given of what the institutions are entitled to monitor. Box 3 provides excerpts from what companies believe that institutions check:

These brief quotes alone provide a general idea of the scope of activities the respective institutions are expected to maintain. Most of the rules and technical requirements to be imposed date back to the 1960s and 1970s, when technology was different and there was no diversity of private business. In 1989, there were about 24,500 registered private companies. In 1997, their number exceeded 447,000. In retail trade alone, the registered companies were about 160,000. Road transport companies in 1997 were about 32,000. These figures roughly illustrate the increased scope of



duties government agencies are obliged to perform. Administration has to either increase its efficiency by 10 to 20 times, or decrease the quality of service it provides, with rules to implement remaining unchanged for decades. This survey proved that the latter "possibility" prevailed.

Another huge problem seems to be the ambiguous relations between licensing institutions and private companies involved in the process. Particular cases are found in Dupnitsa. One firm reported the requirements of the local HEI to sign contracts with private firm for extermination of rats, of pests, and maintenance of freezer windows. Several firms reported that scales are also certified and maintained by a private company. There are two problems with this: first,

Dupnitsa, together with all permits by HEI, Fire Brigade, DVSK, utility companies, etc. is sent (actually, delivered personally) to Kyustendil regional construction control (this should be part of the Regional Administration, an extension to the central government). The latter issues permission for start of operation, which is then returned back to the Dupnitsa municipality to register (license) the shop. Companies from retail and wholesale in Dupnitsa reported that they were "asked" by the respective institution to provide transport for the inspectors who had to visit the shop.

#### 4. Changes in regulatory framework and problems for businesses

Interviewed companies reported on average an 4,43 changes of regulatory framework related to licensing during the lifetime of their operations. Problems that arise from frequent changes in regulatory framework can be classified in several categories: Time costs; Monetary costs; Application for new license; Reconstruction costs; Paperwork, Miscellaneous. Selection of quotes is provided in Annex 1. They prove that the impact of changing regulations might be immensely diverse. In many cases details are really what matters; they might seem reasonable to most entrepreneurs and be extraordinarily expensive to a selected few. The survey also shows that whatever the effort, administration cannot provide streamlined requirements and procedures that match all possible occasions in life, in other words one-size-does-not-fit-all when it comes to regulation of a dynamic market. And again we are faced with the problem of administrative discretion that comes to solve the ambiguities found in written rules.

#### 5. Biggest bottlenecks and possible solutions

##### *Retail trade*

In any respect, getting approval from the Architectural Department of the municipality for reconstruction of property into commercial site (shop) and sanitary permit by HEI seem to be most troublesome.

Health safety of consumers is probably a largely accepted goal, and this provides grounds for tough requirements by the government agency entitled to ensure it. The problem with this is that due to the variety of economic agents, products offered at the marketplace and technology improvements, it is difficult to design a simple set of rules that should be followed. The result is a complicated system of requirements that is not published or made public in any way but direct inquiry with the local HEI office. As a direct consequence decisions are often discretionary - over 65% of interviewed retailers reported that a subjective assessment by the HEI inspector was crucial during the procedure. In Dupnitsa, the regional HEI required one retailer to sign contracts with private companies as a necessary condition to grant the permit. Another hurdle is the weird procedure of two-stage permission procedure, i.e. the draft project design is approved by the HEI, and when the shop is ready, the HEI checks again and issues the sanitary permit.

The only possible solution IME finds includes the following:

#### Box 3:

##### Sanitary Requirements

Meat should be stored separately. An electric boiler, basin and cleaning disinfectant are required (Sofia) Shelves are required. There should be no dust, The freezer windows should stay closed (Sofia) Expiration date of goods, the environment they are stored in, proof that goods are suitable and safe for use (Rousse, Sofia) Indoor plumbing (Sofia) Invoices for the goods offered, the way goods are stored (Sofia) Health certificate (for the employees), separate shelf for tobacco goods (Rousse) Separate storage of different types of goods (Rousse, Sofia, Dupnitsa) Package of goods should be untouched (Rousse)

##### Fire Safety Requirements

The position of the electrical board, the position of the wall-plugs (Sofia) Availability of fire extinguisher, the door should open to the outside (Sofia) The working order of the electrical installation (Sofia, Rousse, Dupnitsa) The buckets should be full with water (Dupnitsa) The working order of the electrical devices (Sofia, Rousse, Dupnitsa) The electrical board should be in a metal box, separate from the goods. A working fire extinguisher should be available (Rousse)

these private providers have virtually monopoly power granted by the respected institutions, and second, the local HEI did not monitor the compliance with certain health standards but rather the existence of formal contract. The government institution in fact ceased to perform its original functions to take care of consumer safety; moreover, the company that complained to have been forced to sign contracts with pest exterminators and other "service providers" reported that such companies had never showed up and performed the service.

What is also found in the survey is that retailers and wholesalers have to apply for a new license at the municipality each year. The purpose of this requirement seems quite odd, since the municipal license (registration) requires a mere compilation of necessary permits from other agencies. The latter are the factual control bodies, they impose requirements and follow implementation. But the fire safety certificate for example is valid for 3 years. The question is why the municipality should require the same documents to be brought at their office each year to issue a new license. The impact of this provision is increased costs for entrepreneurs.

In Dupnitsa, which is municipal, but not regional, center, the procedures seem even more complicated. When a commercial site should be registered, the design approved by the architect in the municipality of



1. The HEI, and the government in general, should not be responsible for all possible health safety hazards. The variety of economic agents makes it impossible for the HEI to regulate the market in the present fashion. The obligatory requirements should be simple and limited to the very basic safety conditions.

2. All obligatory requirements should be published and no additional ones should be introduced at discretion of the administration.

3. Sanitary permits should be replaced by *post factum* inspections. This would mean that a shop is open without having a sanitary permit in advance, but the HEI inspectors can check the compliance with the above mentioned set of rules. If violation of the requirements is found, then and only then the company should be punished.

The problem with reconstruction of property and obtaining respective approval by the Architecture Department of the Municipality is of slightly different character. The problem there seems to be with the unfinished urban zoning plans, the out-of-date urban planning rules and the lack of automation in the local offices. Getting approval takes approximately 2 months and 7,8 visits to municipal service. Apart from the complicated procedure inherited from the past, the problem might be also generated by the lack of capacity within the institution. A survey of Access to Information Program/A.S.A. on access to public registries by citizens showed that only 15,7% of the interviewed reported that officers at the Technical Service of the Municipality (which in some municipalities includes the Architectural Department) used computers preparing the answer to the inquiry. The Technical Service ranks second after the Citizens' Registration Administrative service in number of inquiries with 25,6% among all local institutions, the survey shows. The situation is even worse in bigger cities, where inquiries at the Technical Service are at the top with 36,4% of total number of inquiries made.

All these suggest that the procedure needs to be substantially redesigned to match institutional capacity with responsibilities. Also, the goals of urban planning should be reconsidered. At present, any change of use of property or any reconstruction requires a change in the urban development plan, i.e. explicit permit by the municipality. It is doubtful whether transforming a garage into a food selling shop would harm the public interest of the neighborhood; therefore the required approval by the architecture of the municipality can be abolished. If negative externalities occur, the interested parties should rely on the court system.

Another peculiar finding of the study is that about 11% of the retailers complain about the National Electrical Company creating problems. Even though the only thing that the NEC should do in the process is to allow connection in the electrical grid, entrepreneurs face problems and probably delays. This problem however is typical for monopoly utilities not only in Bulgaria; the possible solution is fast deregulation of the market.

#### **Wholesale trade**

Two groups of wholesale traders should be distinguished: licensed commodity markets (by the National

Commission for Commodity Exchanges and Commodity Markets) and wholesalers that operate under the general regulation of trade and commerce in the respective municipality. As far as the first group is concerned, it does not seem that the licensing procedure for organized commodity market is of particular significance. The procedure at the National Commission for Commodity Exchanges and Commodity Markets basically requires that the applicant presents a specified list of documents.

Both groups however should go through the general licensing procedure for commercial sites. It seems that sanitary permit is difficult to obtain, with 27% of the wholesalers complaining about HEI creating problems during the licensing procedure. On the other hand, other institutions, and especially the Architectural Department at the municipality, are "low" in the complaints. There might be two possible explanations: first, wholesale trade is usually a larger business than retail shop, and owners probably hire separate persons to deal with administrative procedures; second, most of the wholesale markets (or warehouses) at present use the premises of the former state-owned wholesale enterprises, which already have most of the permits.

On the other hand, the interview with the National Commission for Commodity Exchanges and Commodity Markets revealed another quite specific problem for wholesale commodity markets that apply for license at the Commission. The Fire Safety Department issues fire safety certificates for each separate premise in the marketplace; this means sometimes up to 100 separate certificates. Even though the fee for one certificate is not excessively high at approximately 150-200 leva, the total cost becomes significant.

#### **Transport**

Commercial road transport is a perfect example of the suspicious attitude of the government towards the private sector, which was brilliantly described in the Administrative Barriers to Investment in Bulgaria Report<sup>9</sup>. The requirements that either only international (by end-1999) or all private transport companies should meet reflect a "government-knows-best" understanding of how economy functions. There is no rational argument for a government to require managerial abilities of transport company owners or directors. Nor should it require proof of "financial trustworthy" by the applicants. The situation became even more ridiculous after the new Law on Road Freight Transportation, which allows the Minister of Transport to suspend new applicants' licensing or to void previously issued licenses (art. 4). This could be done if a crisis in the transport market occurs; crisis is defined in the Law as: "*existence of substantial and probably long-lasting surplus in the supply of transport services compared to the consumers' demand, which presents serious threat to the financial standing and survival of substantial number of carriers*". If a government agency is responsible to achieve such goals, then the means would probably lead to excessive bureaucratic burden and irritation. One carrier complained he was asked to present 32 documents. Carriers are also obliged to enroll in DAI training courses to prove "professional competence". The waiting period is long, an entrepreneur complained of

waiting 6 months to start the course. It is dubious that DAI tutors know the market best; what is important here is that their monopoly in training induces costs in both time and money for potential transport entrepreneurs.

The second major finding related to transport is that local authorities in Rouse have introduced their own, local licensing for domestic carriers, even though it was not required by the legal framework by the time. It is a good example of how local authorities can in fact increase the entry barriers for entrepreneurs and that administration in fact functions according to the principle: "we can decide what to do unless we are explicitly prohibited by the law".

The reason for licensing cargo transportation cannot be supported by rational argument. It serves neither to protect human health, nor does it prevent a negative effects spilling-over onto a large number of individuals (such as the Fire Safety Department does). As for the technical safety of vehicles, there are general regulations that ensure that all vehicles are regularly and properly checked (such as annual or semiannual technical checks by Traffic Police).

Therefore, we strongly recommend that licensing of freight transport services be abolished. This would mean a change in the Law on Road Freight Transportation, i.e. nullification of Chapter 2 "License", Art. 6-16.

### General conclusions – policy recommendations

1. Administration shifts costs to private sector. As the number of private companies grows and the complexity of business increases, the tasks of the government institutions which issue "licenses" or other documents also become more sophisticated. This inherently increases the administrative costs of implementation, requiring additional taxpayers' money to be spent. Problems related to lack of capacity have two possible types of solutions: simplification of procedures or shifting of part of the costs to the private sector. There are numerous examples showing that the latter option is generally accepted by government institutions. Here are several types of cost-shifting that occur:

- Government institutions require private companies to provide information that is already available at other institutions or registries. The fact that a company is registered, for example, can be checked at the commercial registrar maintained by the courts. In fact, companies are forced to make dozens of copies of their company registration documents and present them at all institutions involved in providing some kind of document, certificate or license. The problem is that different agencies within the administration or the court do not communicate with each other. It is cheaper and easier for them to shift the entire cost of verifying certain facts upon the private sector. The solution is to impose a legal ban on the administration, forbidding it from demanding information that already exists in other public registries or other agencies.
- Several cases revealed a vicious practice of forcing private companies to pay for the transport of inspectors when a site audit is required. This is particularly

true in Dupnitsa, which is not a district center and for which the regional offices of many government institutions are located in Kyustendil.

- There is a complete mixture of responsibilities between institutions. For example, HEI is obliged by national law<sup>10</sup> to issue sanitary certificates for commercial sites. On the other hand, the local authorities usually require that a retail or wholesale trade applicant for license presents a sanitary certificate. The only possible explanation is a general lack of trust between institutions which makes each institution introduce its own procedures.

2. Administrative discretion over what to regulate is indefinite. There are several ways in which government agencies increase their power to regulate:

- They introduce new licenses, as is the case for transport companies in Rouse. In such cases we suppose that the municipality claims fall within the provisions of art. 22 of the Law on Local Self-governance and Local Administration. In essence, this allows local authorities to regulate matters of local significance.<sup>11</sup>
  - They demand documents that are not explicitly required by the law. The typical provision to be found in Bulgarian laws is "[the government agency may demand]... other documents if needed". Findings of the survey proved the administration makes a great use of such provisions. HEI in Dupnitsa requires service contracts with private pest exterminators to be signed; one carrier complained the Ministry of Transport required 32 documents.
  - There are no borders on local authorities that prevent them introducing new regulations. In fact, local authorities can introduce whatever criteria they see fit to license food shops; there is no law that prohibits this. This means that a municipality has full discretion to regulate activities "of local significance".
  - There is also evidence that some institutions try to regulate activities that are completely out of their competence. The example of a tax inspector who required a wholesale trader to sell only Bulgarian goods eloquently shows that some public servants still feel "responsible" to maintain total control over the private sector.
3. Renewal of licenses. One of the most ridiculous findings of our survey was that most licenses should be renewed after certain period of time, usually one to three years. There is no rational justification for that; presenting copies of the same documents on an annual basis serves no purpose. This is especially true of municipal licenses for commercial sites. The only thing the municipality is authorized to do is to verify that the applicant holds all necessary certificates and documents. If municipal officials are concerned about the validity of all documents, they may randomly make site inspections and see if all papers are present. The system seems even more ridiculous if we consider that a Fire Safety Certificate is valid for three years. There is no answer to the question why a company should present one and the same document again and again over these three consecutive years. A possible solution is to make the period of validity for documents longer (or even indefinite). New documents should be required only if changes in the circumstances have occurred in

the meanwhile. If the regulatory institutions have to ensure safety standards they can always revoke the license or the permit when violations are found.

The survey revealed problems that are not unique to the three sectors. It also outlined some general problems created by inefficiency of the administration, high transaction costs imposed by regulations on the private sector, and some anecdotal experience from the day-to-day life of entrepreneurs. In conclusion, we think that there is hardly a solution that would make the present licensing system more efficient and less costly. What we generally suggest is the following:

- Government regulation should be limited to protection of human health, social order and national security; all regulations that go beyond this goal should be abolished.
- Licensing regimes should be introduced only by law, in which all necessary and sufficient requirements should be explicitly enumerated.
- Laws should strictly define the scope of regulation by the administration. There should be no provisions that allow administration to impose requirements other than those explicitly listed in the law.
- The Draft Normative Acts Bill should be changed to require preliminary impact assessments of proposed regulations. Regulations that aim at preserving human safety and health also impose cost of compliance to the businesses involved. Therefore, cost and benefits of proposed regulation should be assessed and compared before the legislation is passed.
- When licensing is justified as a means of regulation, it should follow at least two principles: first, licenses should be granted for unlimited periods of time, provided the regulatory authorities can revoke the license if the rules are violated; second, institutions should be prohibited by law from demanding the same information from citizens more than once, i.e. they should be forced by law to exchange information at their own effort and expense.
- Local self-governance should be more clearly defined

and art. 22 of the Law on Local Self-governance and Local Administration should be revoked. The law should instead establish explicitly the areas in which local authorities can interfere and limit them to local road traffic, recreation areas, locally financed activities, and the like.

#### Annex 1: Merchants quotes on problems created by changes in regulations

##### 1. Time costs.

"No one can recover the time I have lost in the endless reading of legislative changes" (wholesale trader, Rousse)

"Loss of time; permanent irritation: they don't allow me to forecast and plan the development of my business even in the short term." (wholesale trader, Rousse)

"I cannot work while I don't have a license. Instead of working I have to go to the Municipality and waste time." (retailer, Sofia)

##### 2. Monetary costs

"High state fees and foregone profits" (retailer, Rousse);

"My expenditures on drugs increased due to increased pressure; instead of working calmly I am constantly aware of deadlines; the almost permanent site audits from different institutions cost me a lot because I have to close to shop during inspections." (retailer, Rousse)

"I had to hire a lawyer for pre-registration, this cost me \$150." (retailer, Sofia)

##### 3. Application for new license

"It is difficult to plan activities; one has to apply for a new license or a prolongation of the old one each year, which costs a lot of time and money." (retailer, Dupnitsa)

##### 4. Reconstruction costs

"Because of new sanitary requirements of HEI I had to reconstruct the shop." (retailer, Dupnitsa)

"They asked me for a new architectural design of the shop, including a new sketch, separate drainage and water meter, and a separate electricity meter, because using the ones installed in the house was not allowed." (retailer, Dupnitsa)

##### 5. Paperwork, accounting, other "Change in reporting documents" (wholesale trader, Sofia)

"The major problems are related to pre-registration, in fact, the same documents are required, but new state fees are to be paid." (retailer, Sofia)

"The requirements of the tax office to sell only Bulgarian goods..." (wholesale trader, Dupnitsa)

"I had to buy a new cash machine" (wholesale trader, Dupnitsa)

1. The survey analyzed in this paper was commissioned by the World Bank office within the Regulatory Reform Roundtable Project. Materials related to local regulations were collected within the project "Municipal Entry Barriers: Retail Merchants and Services", supported by the Open Society Institute, Budapest. It was made possible with the invaluable contribution of Mr. Joel Turkewitz, who participated in drafting the survey goals, outline and the questionnaires.

2. IME team included: Assenka Yonkova, Yordanka Gancheva, Georgi Stoev, Latchezar Bogdanov, Krassen Stanchev. Latchezar Bogdanov coordinated the entire project; Krassen Stanchev is responsible for putting this report together.

3. An experiment by Hernando De Soto proved that in Lima, Peru, in 1983 it took 289 days of full-time work by a team of researchers to go through all the legal steps to obtain all the permits necessary to open a small textile firm, without paying (many) bribes or using political connections. See: Hernando de Soto, *The Other Path*, (1989)

4. The survey was conducted in April and May 1996, and is representative for private enterprises in Sofia, Plovdiv, Varna and Silistra.

5. Company registration is done at the district court which keep commercial registries

6. A formal document issued by the Territorial Tax Office that shows the amount of tax and other state claims due by the taxpayer at a given moment.

7. Ordinance 3 of the Ministry of Transport on the International Road Transportation of Passengers and Freights, State Gazette, 113, of 2 December 1997.

8. Central government has regional offices in the 28 district centers for the purposes of licensing and control; Dupnitsa is located within Kyustendil district.

9. See: *Administrative Barriers to Investment in Bulgaria*, Foreign Investment Advisory Service (a joint facility of the World Bank and International Finance Corporation), February, 2000.

10. See: *Implementation Rules of the Law on Public Health*

11. See: art. 22 of the Law on Local Self-governance and Local Administration

# The Impact of Foreign Investment on Polish Economy

Institute for Private Enterprise and Democracy, Poland

*The text is a part of the report Strategies inductive to growth and prosperity, prepared for the Conference Conditions for Long-term Growth and Prosperity in the Balkans, held on 21 October 1999 in Sofia.*

## Introduction

The foreign investment had a significant impact on Polish economy in 90-ties. They not only resulted in important increase of manufacturing output in the area of consumer goods but also balanced negative foreign trade balance. The Institute for Private Enterprise conducted two important researches on the role of foreign investment on Polish economy. The first research was carried in 1996 and presented the role of foreign investment in the Polish economy in the first part of nineties.

The second research was started just after the collapse of financial system in Russia and neighbouring countries in 1998. As the result the report was prospered presenting the main threats for economic development in Central Europe. This research contained econometric forecasting model for growth of Polish economy and simulation models of changing the policy patterns. Below we present results which could have an important meaning for policies inductive for growth and prosperity.

## Positive effects of the foreign investment

The research carried by the Institute for Private Enterprise and Democracy shows that direct foreign investment has a key impact on the economic development of Poland. The main task of our research team was to estimate the numerical relationships between the size of foreign investment and basic macroeconomic aggregates. The results enable us to state that there is a positive statistical correlation between foreign investment and Gross Domestic Product. From 14 linear and non-linear equations of Gross Domestic Product it is possible to confirm that a variable "foreign investment" always influences GDP.

The results show that one million US dollars of direct foreign investment in Poland resulted in 10,885 million zlotys in GDP growth (at 1990 prices). If we take into consideration the 1990 average exchange rate (9,500

zł/1 US dollar) then we perceive that one dollar of direct foreign investment resulted in 1,14 dollars of GDP growth.

Another estimate shows that a 10% growth in foreign direct investment causes an increase of 0,31% in GDP. A 1% growth in GDP is accompanied by an average increase in foreign investment of 4,19%. The results also show that foreign investment has an impact on Poland's exports. An increase in foreign investment of 1 million US dollars is accompanied by 6,27 million PLN of exports. In parallel, an increase in reinvested profits of 1 million US dollars is matched by an increase of 34,96 million PLN in Polish exports.

We also observe that a growth in foreign investment is accompanied by a decrease in inflation rate (Consumer Price Index). An increase in foreign investment of 1% is accompanied by a decrease of 0,11% in CPI.

## Educational effect

Apart from a large number of measurable effects like growth of GDP, foreign investment has a significant impact on various qualitative aspects in the companies concerned.

The educational effect is one of the most important qualitative effects of foreign investment. This is related to significant improvement in the skills of employees. The research reveals that the educational level of employees increased in over 60% of firms with foreign investment. Levels of professionalism, knowledge of foreign languages, responsibility and self-reliance also increase. The data show that the improvement of skills in firms with foreign investment is not associated with "a brain drain" away from Polish companies. We also observe an increase in the educational parameters in foreign investors' Polish competitors. There is a synergic increase of educational levels in both domestic and foreign companies, strongly determined by patterns and standards introduced by foreign investors.

### Foreign investment and transfer of modern technology

Foreign investment has a favorable effect on the transfer of modern technology. 85% of firms with foreign capital in Poland claim that their companies acquired technical equipment comparable to that of foreign companies. Modern machines and technology strongly motivate technical staff to pursue their own technical developments. In 1995 an average enterprise with foreign capital introduced 5 innovations of this kind. A high level of technical equipment and an improved level of education have an impact on product quality. According to the directors, in 37% of the companies quality is world class; in 58% at the European level and only in 5% at the national level. High product quality is also borne out by the low number of complaints. In

companies with foreign capital the percentage of complaints does not exceed 1,5%.

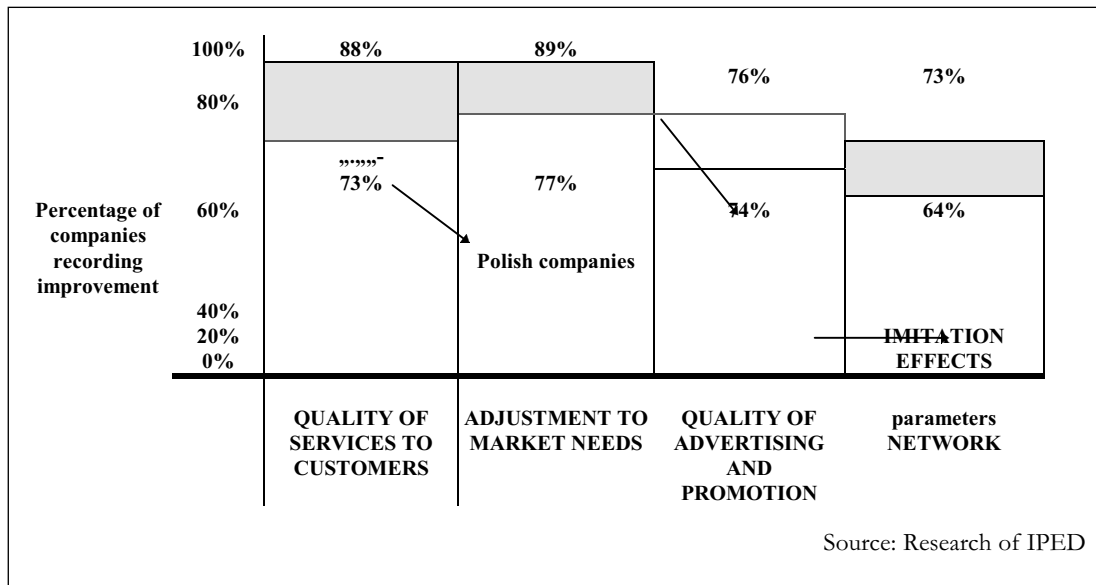
### Improvement of the management

One of the most important effects of foreign investment is an improvement in the quality of management. In over 80% of the foreign companies in Poland such elements of financial management as cost control and planning were improved.

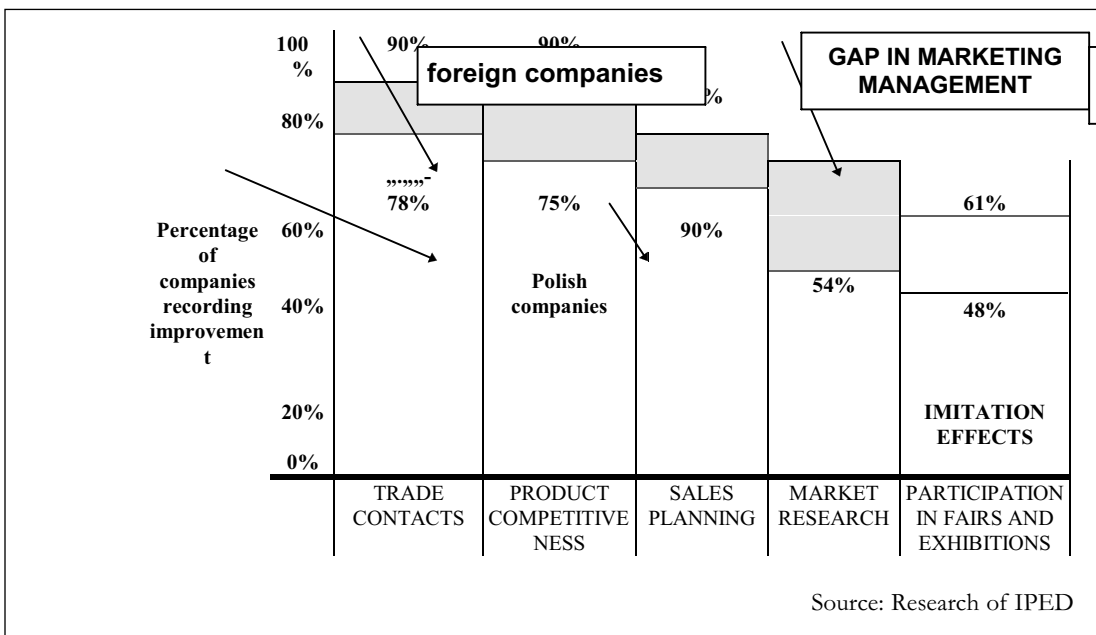
### Foreign investment and market strategies

The use of management accounting, effective receivables collection and tax payments improved on a smaller scale. Improvement is also observed in personnel management, especially in the field of motivation, staff selection and delegation of duties and

**Chart 1: Parameters of the management quality in foreign companies and imitation effects foreign companies**



**Chart 2: Parameters of marketing technology in foreign companies and imitation effects**



responsibilities to lower management levels. In parallel, we observe a strong imitation effect. Domestic competitors quickly adopt foreign standards. It is necessary to note that a difference of 20% in the number of firms which improved their management is observed between these two groups.

Foreign investment also brings fundamental changes in companies' market strategies. According to the results of the research, 82% of managers of foreign investment enterprises stated that the operations of

their firms had created patterns imitated by domestic competitors. Aggressive marketing practices by firms with foreign investment are connected with the spending of significant financial resources on them and by the evaluation of potential benefits. It also requires considerable engagement by company personnel. According to the data, 32% of all employees in foreign investors' firms work in sales and marketing. The companies described spend 5,6% of their annual budget on advertising and promotion. About 80% of companies

**Table 1: Comparison of the results between continuation and intervention policy**

No. Name of forecasted economic aggregate	Forecast for 1999 (1998=100%)	Forecast for 2000 (1999=100%)
1. Exports in mln USD in %	32636.767 (115.73)	34659.317 (106.20)
Simulation	33384.60 (118.38)	35685.20 (106.89)
2. Imports in mln USD	52490.20 (112.64)	59248.20 (113.51)
Simulation	53407.70 (115.89)	60778,20 (113.80)
3. Negative trade balance in mln USD	-19853.433 (107.90)	-24588.883 (123.85)
Simulation	-20023.10 (108.48)	-25093.00 (112.32)
4. Negative trade balance as a % of GNP	12.87	15.05
Simulation	12.98	15.35
5. Payment balance Export incomes in mln USD in %	32032.12 (105.90)	34957.82 (109.13)
Simulation	32764.40 (108.49)	36814.70 (112.36)
6. Payment balance Import Expenditures in mln USD in %	47507.235 (108.18)	55026.775 (115.83)
Simulation	44726.90 (101.88)	53947.10 (120.61)
7. Payment balance level in mln USD in %	-15475.115 (113.23)	-20068.995 (129.68)
Simulation	-11962.50 (87.53)	-17132.40 (143.22)
8. Payment balance level as a % of GNP	10.03	12.33
Simulation	7.75	10.48
9. GNP in constant prizes in %	104.15	105.04
Simulation	104.42	105.14
10. State budget incomes in mln z <sup>3</sup> in %	151738.95 (113.55)	173955.30 (114.64)
Simulation	152751.80 (114.31)	179230.20 (117.33)
11. State budget expediencies in mln z <sup>3</sup>	157539.15 (112.72)	182190.64 (115.65)
Simulation	159898.30 (114.41)	182868.70 (114.36)
12. State budget balance in z <sup>3</sup>	-5800.20	-8235.34
Simulation	-7146.50	-3638.50
13. State budget balance as % of GNP	0.93	1.14
Simulation	1.15	0.502

Source: Research of IPED

modify their products and services to individual customers' needs. Companies with foreign investment on average participate 3 times a year in fairs as exhibitors and 5 times as visitors.

Marketing management parameters improve fast after the introduction of foreign investment. Polish competitors also react quickly, as can be seen from the following drawing:

It can be observed in the drawing that in some fields of marketing management domestic firms reach a higher level than firms with foreign investment which have created the patterns and standards. It is worth mentioning that in the opinion of managers of foreign firms, domestic manufacturers engage in a higher level of promotion and advertising (!!!) and more frequently participate in fairs and exhibitions.

### Foreign investment and quality of work environment

Foreign investment has also an impact on the quality of the work environment. The technical facilities available to employees, comfort of working conditions, and also, what is more important all kinds of compensation related to work are significantly improved. Nine out of ten employees stated that wages have increased. The average real increase, compared to the level in the previous employment was more than 69%. More than 50% of employees observed an improvement in other aspects of work compensation.

Positive results of foreign investment are observed also by consumers. The research proved that Polish manufacturers base the appearance, features, packaging and style of their products on the example of the foreign investors. The process of imitating products is fast and products made by companies owned by Polish capital which imitate the products of foreign investors appear on the market within a year. Products made by foreign investors improve Polish manufacturers and as a result the market shares of the Polish and foreign manufacturers are increasing at the cost of imported goods. As a result foreign investment substitutes imported products with goods made in Poland.

The results show that direct foreign investment has an impact on the economy at both micro and macro level. It influences GDP growth, develops exports and scales down inflation. On the micro scale it has an impact on the quality of management. Improvement in management produces examples which are imitated by Polish manufacturers. The positive results of foreign investment show how important it is to attract foreign investors to Poland.

### The growth in danger in late 90-ties

In the second part of 90-ties the following pattern of growth was observed in Poland:

1. Significant growth of GNP reaching 5-6% a year,
2. Rapid growth of consumption extending GNP

growth rate by 1-2% a year,

3. Decreasing inflation to 7-8% in 1999, mainly thanks to the very strict monetary policy of the National Bank of Poland

4. Huge trade deficits reaching 16 billion of USD in 1998,

5. Big inflows of foreign capital to consumer good manufacturing, banking and financial services

6. Significant invisible inflows of currencies to Poland mainly thanks to unregistered foreign trade, transfers of Polish workers from abroad and dirty money laundering.

7. The invisible inflows and inflows of foreign capital balanced the negative official trade balance.

8. Foreign currencies reserves were growing steadily, but the growth pace was significantly reduced in last 2 years. In 1998 foreign reserves of currencies governed by the National Bank of Poland amounted to 26,6 billion USD.

9. Foreign investment concerned more privatization project and less new grassroots projects. The foreign property increased rapidly in last 9 years. In many industries like in banking, paper, automotive, sweets, food oils foreign property is higher than domestic one.

10. Decrease of demand in NIS countries with regard to collapse of Russian financial system.

Such a growth pattern may lead to the financial crisis. Accordingly to econometric methods we decided to prepare a growth forecast for 1999 and for year 2000 including important interventions of the government. We assumed undertaking the following interventions:

1. Gradual devaluation of zloty from 3,8 to 4,5 at the end of 1999 and 4,8 at the end of 2000,

2. Decrease of the central bank interest rate from 16 to 12 at the end of 1999 and 10 at the end of 2000,

3. Imposing import tax at 2,5%,

4. The government increases governmental expenditures by 2% in each quarter in comparison to values forecasted in the normal model,

5. The government increases tax income by 2% each quarter more than the basic forecast,

6. Improvement of terms of trade 2% each quarter (with regard to domestic currency devaluation)

Table 1 presents the results of both forecasts: basing on the continuation of present tendencies and including intervention:

Presented data show that intervention proposed by part of the economist would bring only short term effect. Simple measures, like import tax or devaluation of zloty would not efficiently improve the conditions for growth.

## Southeast Europe Trade Initiative (SEETI): Business Across Borders

At the beginning of 2000, IME was contacted by representatives of USAID and MSI Sofia, with the proposal to consult the USAID Southeast Trade Initiative. The concept has been evolving since spring 1999.

The general idea of the SEE Trade Initiative (SEETI) is to stimulate trade and economic development in the region, through improving the trade policy/legislation environment and information within countries from the region and between them. Also, in a more practical sense to jointly organize business forums between the countries, giving them more and more opportunities to build up mutual trust as trade and co-operation partners. Partner countries are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Greece, FYROM, Romania and Turkey.

As a first step of the Initiative, we are trying to organize working groups in countries with USAID presence, that will develop country specific trade problems/barriers, which will lead into country specific action plans, to be implemented by all interested stakeholders.

To accomplish this goal, it is very important to organize working groups composed of representatives of the Government, think-tanks and business associations, so that problems are discussed from all points of view. Furthermore this mix of stakeholders will give the working group the necessary lobbying power for more efficient implementation of regional co-operation.

Taking into consideration the development process, each working group will develop an action plan for decreasing all the problems/barriers. Each country will elaborate on the five main problems/barriers for regional trade:

- Competitiveness - classification of country competitive goods and services for the last few years; key governmental and non-governmental incentives/disincentives for the competitive producers; comments on the possible regional cooperation in world competitive goods/services.
- Finance - country models of SMEs business plan, listing financing institutions and adequate schemes; comments on possible regional finance flow (e.g. banks with regional correspondent relations, exchange rates, etc.).
- Administration - structured information about administration's functions and procedures, means of communications, names, comments on the coordination of the administration bodies activity.
- Legislation - enlisting specific and substantial for the general and regional trade regulations; proposals for establishing an interactive communication between SMEs and Administration within and between countries.
- Information - identification of reliable local and cross-country sources of information for trade partners and most traded goods/services in the region; references to international and/or regional sources.

For each of these five, a task force will analyze, in detail, each problem and devise a concrete plan for improvement and activities. By compiling these action plans, a strategic plan for each country will be developed and eventually, as every country does the same, we will have a trade co-operation strategy for the region.

Each working group will then educate all stakeholders and disseminate information within their country and lobby for policy and legislative changes to improve the trade environment within the region. We are hoping that all of the working groups will eventually become a regional network for co-operation. In this way, they can depend on each other for information sharing and providing good and trustworthy partners.

The trade co-operation regional strategy and country specific action plans are to serve as guidelines not only to the Governments, but also to all Initiatives in the region. Our Initiative's goal is to make sure the efforts in the region are co-ordinated and not overlapping, so that the results are more effective.

The high-profile SEETI Regional Conference scheduled for 8-9 March, 2000 will be the kick off event of the Initiative and an excellent opportunity for all groups to meet each other and start the co-operation process. Despite the fact that each country has its own specific problems, there will be similarities and these offer a great chance for co-operation between the Ministries, business associations, think-tanks and Donors in the region.

**See also provisional agenda of the conference in the *Supplement!***