

IME Annual Report: 2002

2001-2002 Priorities

- ✓ Competitiveness: Sector Analysis, Case Studies and Study of Microeconomic Conditions;
- ✓ Decentralization, Regional Development, Private Provision of Public Services, Innovative Management Tools for Firms and Public Governance on Local level;
- ✓ Creation of a ITCC to promote Applied Economics Research, Improvement of Economic Information and Education in Decision Oriented Managerial Approaches;
- ✓ Regulation Impact Analysis and Legislative Corrections Studies;
- ✓ Growth and Prosperity in the Balkans: Initiation of Change, Monitoring and Advocacy.

Activities in 2002

Regional Development and IME Presence on Local Level

1. An IME led joint effort produced the first interactive information system, which incorporates the database of the official statistical office. The system was launched in 2002 in the region of Smolyan, South East Bulgaria. The ultimate goal of this effort (supported by the German Marshall Fund) is improved chances for wealth creation and development in this stagnating region. The approach adopted is knowledge transfer, particularly in terms of computer-based tools for decision making. The target group of the effort has been the local leadership that involves representatives of both the business sector and the local authorities, as well as other key regional economic actors.
2. IME elaborated the design of *Barometer of business expectations* intended to serve as a means for exchange of knowledge and expectations about the future between entrepreneurs. In 2002, the *Barometer* was successfully launched in two regions of Bulgaria by local business development NGOs; those were the regions of Varna and Blagoevgrad. The concrete methodology for calculation of the index is similar to the methodology of the *Business Sentiment Indices*. The *Barometer* however is a unique index in Bulgaria that presents the expectations of the companies, concerning the economic conditions at regional level.
3. An IME project in 2002 aimed at the successful introduction of a legal framework of Special Purpose Investment Vehicles in Bulgaria, i.e. that would allow for the tax transparent securitization of assets. The IME effort began in mid-2002 when a first draft of the Special Purpose Investment

Companies Act was already in place. Thereafter the IME team elaborated a number of alternative tax treatment regimes of the special purpose investment companies, that is draft of regulations that set rules how to treat ownership of tradable instruments as compared to direct ownership of assets. Meanwhile the work on the regulation included comparison of Bulgarian, EU and other legal frameworks. IME has done a promotion campaign of the law in order to improve public understanding and to avoid political misunderstanding and prejudice.

4. An IME led joint effort with Regional Development Agency, Smolyan Statistics Bureau and Algorita Ltd to produce the first interactive information system, which incorporates the database of the official statistical office and provides for regional and sectoral development potential. The system was launched in 2002 only in the region of Smolyan, South East Bulgaria but is replicable in other parts of Bulgaria and in other countries. The ultimate goal of this effort (supported by the German Marshall Fund) is improved chances for wealth creation and development in this stagnating region. The approach adopted is knowledge transfer, particularly in terms of computer-based tools for decision making. The target group of the effort has been the local leadership that involves representatives of the business sector and local authorities, as well as other key regional economic actors.
5. IME and two BARDA regional offices elaborated the design of *Barometer of business expectations* intended to serve as a means for exchange of knowledge and expectations about the future between entrepreneurs. In 2002, the *Barometer* was successfully launched in two regions of Bulgaria by local business development NGOs; those were the regions of Varna and Blagoevgrad. The concrete methodology for calculation of the index is similar to the methodology of the *Business Sentiment Indices*. The *Barometer* however is a unique index in Bulgaria that presents the expectations of the companies, concerning the economic conditions at regional level. The idea of this effort was to transfer knowledge to two BARDA offices and it is now possible that BARDA or any other interested organization keeps the effort going.

Applied research

Survey of Business Strategies

In 2002, in co-operation with *University of Michigan*, IME developed and successfully completed a study of the about 130 leading companies in Bulgaria based on the University of Michigan *Amadeus Database*. On behalf of IME, Pavlina Petrova and Svetla Kostadinova managed the research efforts.

The goal of this study was to better understand how firms in Central and Eastern Europe are changing some of their systems to work in a still-developing free market system. To date, few studies have been undertaken,

which analysed this topic. The first phase of this study was undertaken in Lithuania 2000-2001 and has resulted in business press publications in Lithuania as well as submissions to international conferences. This phase of the study was examining firms in Poland, Bulgaria, Lithuania, Ukraine, and Belarus. Upon completion of research in other countries, respondent will receive a copy of aggregated finding. The results will be published in Bulgaria's business press as well as in U.S. and European academic journals. The findings would managers run their firms more effectively and will increase Bulgaria's visibility to foreign partners.

Survey of Government Policies to Support Disabled

Since mid-1990 Bulgaria is attempting to pursue policies that pretend to compensate social disadvantages of physically challenged citizens. In mid-2002 IME was invited by the *Center for Independent Living* to analyze government policies towards disabled persons as a part of the Annual Survey of the Rights of Disabled in Bulgaria.

Besides involvement of numerous state bodies, objectives set in laws and regulations are hardly met. In many instances, but particularly in education and employment areas, the comparative position of these people is in fact worsened by official policies; while private initiatives to improve this position are often blocked. These are the key findings of the Survey.

We focused on both direct financial assistance and indirect economic incentives provided by the government in 2001 and 2002. It was the first comprehensive attempt, led by Krassen Stanchev and Latchezar Bogdanov, to study the impact of policies on the social integration of physically challenged people in Bulgaria from political and economic points of view. A side effect of the survey activities was an improved access to information from relevant government and quasi-government bodies (e.g. Ministry of Labor and Social Policies, Ministry of Education and National Insurance Institute - the pay-as-you-go pension fund).

Survey of business conditions in Croatia, Serbia, Slovenia and Kosovo

The survey was based on local consultants' expertise investigating existing barriers before foreign investors. The issues covered were those of: capital account liberalization, land prices and rents in big cities, procedures to buy land for industrial purposes, consumption structure and presence of big retailers on the market.

Final fact-findings, presented by Martin Dimitrov, reflect cross-country comparisons of conditions of doing business.

Land Tenure Data Base

On an assignment by FAO, IME's Diana Kopeva and a team conducted a national case study on the design and implementation of a land tenure database. It identified the currently collected data and outlined the provisional efforts to fill existing gaps.

Forwarding and Transport Companies Research

We conducted a research on penetration rates of forwarding and transport companies in the Czech Republic, Bulgaria and Romania. It consisted in revealing main participants and preparing lists with basic data on companies. Finally, the team led by Martin Dimitrov, have elaborated separate lists for the three countries with main contact information of relevant firms.

Regulatory and Business Environment

IME Work on Policy Reform and Advocacy Strengthening

1. In 2002 IME successfully accomplished further development of its bulletin *Economic Policy Review* (EPR), which was launched in the beginning of December 2000 as weekly issue in Bulgarian and monthly-in English. It contains reviews on pending legislation, compliance with just passed and existing regulations, cost-benefit analysis of adopted regulations and draft-regulations, reviews on transparency, lobbying and regulatory impact assessment efforts, Bulgarian and foreign, comments on the business attitudes towards public governance, presentations of different web-sites and papers. So far EPR is the only regular publication in Bulgaria, which promotes such assessments.

We are proud to think that the bulletin is a huge success. The distribution list comprises more than 900 readers, among them business associations, government institutions, companies, financial institutions, international organizations, NGOs, media, embassies, members of parliaments, independent experts, etc. Since 2000, there are no registered drop-outs from the distribution list. Among our readers are experts from IMF, European Commission, USAID, EBRD, investment banks, etc. Their analysis and position papers proved that our comments not only became important factor shaping the public opinion but also were used as basis in the experts' position on the country's economic policy. Local chambers of commerce and business associations distribute, resend, print and/or reprint the publication further to members. EPR is published on our website (<http://www.ime-bg.org>) as well and has about 300 visits daily. In the case of important policy events we have registered more than 650 daily visits.

EPR became an important source of independent analysis and comments in the press and contributes to deeper understanding of the tendencies in the economic policy.

2. In 2002 IME continued to monitor debates at the Economic Policy Committee and Budget and Finance Committee of the Parliament. IME is still the only non-government organization regularly presented on these

committees' hearings. The objective of our work is to provide services to the economic and budget and finance committees, which improve the content of the bills in pipeline and enhance dialogue between the committee, businesses and expert community. In this respect IME activities are oriented towards analysis of the bills in pipeline and their effects on business and citizenship, submission of position papers on pending hearing draft bills to the committee, dissemination of information on the debates.

SPV Regulations

An IME project in 2002 aimed at the successful introduction of a legal framework of Special Purpose Investment Vehicles in Bulgaria, i.e. that would allow for the tax transparent securitization of assets.

The IME effort, managed by Krassen Stanchev, began in mid-2002 when a first draft of the Special Purpose Investment Companies Act was already in place.

Thereafter the IME team (mainly Latchzar Bogdanov and George Stoev) elaborated a number of alternative tax treatment regimes of the special purpose investment companies, that is draft of regulations that set rules how to treat ownership of tradable instruments as compared to direct ownership of assets. Meanwhile the work on the regulation included comparison of Bulgarian, EU and other legal frameworks. IME Research Director, Assenka Yonkova, coordinated this work. In addition there was a parallel promotion and public awareness campaign to avoid political misunderstanding and prejudice.

Credit Information Bureau

In 2002, IME in collaboration with the Bulgarian-American Enterprise Fund initiated and successfully accomplished Due Diligence for Establishment of a Private Credit Bureau in Bulgaria. The due diligence was completed in the beginning of November 2002. The activities were concentrated on 3 main areas: evaluation of the legal framework in the country, comprehensive survey of perception of potential stakeholders and comparative analysis with the best practices of the credit reporting system in countries with similar economic conditions.

Our team performed discussions with the top largest banks in Bulgaria as well as banks, which operations are focused on retail lending or play a significant role in the banking society. It also had interviews with key non-financial private entities, credit card issuers, leasing companies and utility companies. All meetings were intended to investigate attitudes of the potential stakeholders to the concept of the private credit bureau and to investigate their needs for certain credit data items through fulfillment of detailed questionnaires. Additionally, in cooperation with legal experts we conducted analysis of the current and pending legislative framework in

Bulgaria, which is related to the collection and distribution of credit and personal data. The team also surveyed the perception of the key banking regulatory institutions and some government bodies as well as investigated operations of other companies offering credit-reporting services in the country. Research of the credit reporting practices and operations of the private credit bureaus in Turkey, Poland, Czech Republic, Croatia and Germany has been performed, in the case of Poland and Turkey – on the field research basis.

Currently, the project is in the stage of negotiations with interested provisional shareholders (banks) and partners (IFC, Experian, CRIF/TransUnion). We are expecting the registration of the company and initiation of a comprehensive feasibility study. The core team of the research consisted of: Krassen Stanchev, Assenka Yonkova, Latchezar Bogdanov, Elena Marinova, Petya Mandova-Platikanova and Alexander Kashamov of AIP.

Reform on Administrative Barriers to SME Development in Bulgaria

It was a DFID project implemented by Bannock Consulting Ltd. in cooperation with the Agency for Small and Medium Enterprises. In the framework of that project in year 2000 IME was subcontracted by Bannock Consulting to conduct a survey on costs of dealing with the government in Bulgaria.

The data from that survey confirmed our previous observations that the licensing and permission regimes represent one of the major obstacles to small and medium businesses and are a source of high costs of dealing with the government and corruption among the administration.

Taking into account the conclusions and recommendations from that survey in year 2001 Bannock consulting subcontracted IME to design and to promote principles for a new law on licensing. In year 2002 those principles were incorporated in the first draft of the Law on Reducing Administrative Regulation and Administrative Control over Economy. IME (i.e. Krassen Stanchev, Yordanka Gancheva and Latchezar Bogdanov) was the team leader and the coordinator of the drafting team, which included experts from IME, Bulgarian Chamber of Commerce and Industry, Bulgarian Industrial Chamber, Agency for Small and Medium Enterprises, Competition Protection Commission, administrative judges, etc.

As it was expected the draft faced a very strong bureaucratic resistance. One of the key concepts like “silent consent”, preliminary impact assessment and preliminary affected parties notification were excluded from the draft during the Council of Ministers work on it.

Following the general principals of the good regulatory practices IME made the draft available for the public. It was pasted on the IME website and was open for debate and suggestions. The team organized also several discussions with representatives of the business, the administration and members of the parliament. As a result of those discussions the final version of the law was improved between first and second hearings in the parliament. The articles rejected from CM were submitted again by members of the parliament and were finally adopted.

By mid-2003 Bulgarian Parliament passed the Law on Reducing Administrative Regulation and Administrative Control over Economy. Its general idea is to introduce clear terms and competence for the administration and clear rules of the game for all market players.

General Economic Knowledge

Economics on Internet

In 2002, IME continued to expand its educational activities. The Economics Access Station on Internet (EASI, www.easibulgaria.org) website attracted new visitors and grew in popularity. The new products that we provided in 2002 include:

- A brief glossary of economic notions;
- A concise guide to entrepreneurship and competition;
- A survey of economic freedom in Bulgaria;
- Two lecture course on market process and property rights by distinguished professors;

The audience includes broad range of users, starting from university students and ending up with journalists and politicians

Economic Freedom Index

In 2002 the Institute for Market Economics published the study "*Economic Freedom in Bulgaria*". It follows the "*Economic Freedom of the World*" report, published annually by the Fraser institute and examines the obstacles before the economic freedom. The key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and protection of person and property.

The study is divided into five areas:

1. Size of Government: Expenditures, Taxes, and Enterprises
2. Legal Structure and Security of Property Rights
3. Access to Sound Money
4. Freedom to Exchange with Foreigners
5. Regulation of Credit, Labor, and Business

Counting the various sub-areas, the "*Economic Freedom of the World*" index consist of 38 distinct sub-components. Each component and sub-component is placed on a scale from 0 to 10.

The study shows the place and rate of Bulgaria in the "*Economic Freedom of the World*" report and the correlation between the economic freedom and the economic and social development.

The paper "*Economic Freedom in Bulgaria*" was placed on the special educational website of the Institute (www.easibulgaria.org) and presented in its bulletin "*Economic Policy Review*". Hard copies of the paper were disseminated among members of the Parliament, ministers, economists, universities, and think-thanks in Bulgaria. The weekly newspaper "*Capital*" and the business daily newspaper "*Dnevnik*" published extensive summaries from the paper and one of the authors appeared at the economic program of radio "*NET*". A short version of the "*Economic Freedom in Bulgaria*" was published in "*Economic Thought*", the academic journal of the Economic Institute of the Bulgarian Academy of Sciences.

International Efforts and Projects

Ten Years of Conflicts and Reforms: Developing a Long term Strategy for Democratisation on the Balkans

This is the official title of a project, in which IME was a partner of the CLS with six other think tanks from Serbia, Montenegro, Macedonia and Kosovo. NED financed the activities.

The division of responsibilities was the following: CLS led the organization and compilation of country reports on political reforms and issued an overall report on democratic and political developments; IME (Martin Dimitrov, Petya Platikanova-Mandova and Krassen Stanchev) drafted an overview on political/economic changes (*Balkan Political Economy: Crisis, Policy and Business*) and on constitutional reforms (*Balkan Constitution Making: Is There a Peculiarity and What is to Be Expected?*). Prominent experts from across the region commented the latter paper.

The idea of IME contribution was to discuss what a pattern of functioning democracy and economy is likely to emerge from diverse Balkan political establishments. The constitutional overview is first of this kind. It is an intra- and extra- regional comparison of specific constitutional provisions, which could justify governments' protectionism and intervention, aim at protection of private property rights and freedom to engage in business, and regulate power transfers in case of a political crisis. The economic policy overview assesses the role and size of the Balkan governments and provides a summary of different company demographics of individual countries.

The report was presented at two (NED and CSIS) conferences in Washington in February 2002 and is available at IME, NED, CLS and the Balkan Network (www.balkannetwork.org) websites. All papers have been published in a book titled "The Inflexibility Trap: Frustrated Societies, Weak States and Democracy".

Institutional reforms: business entry costs and costs of contract enforcement in neighbouring countries (Bulgaria and Macedonia)

The project was financed by Freedom House. It started in March 2002 and will last till the end of December 2003.

The project content was measuring instances of government discretion and inefficiency, comparing two countries - Bulgaria and Macedonia - with a prospect to provide arguments for lesser government interference in business affairs.

The intention of the project was to transfer knowledge in transaction costs resulted of IME efforts to improve conditions for doing business in Bulgaria. It is not surprising that transition countries face similar problems in economic reforms.

However, it is still rather strange that many inefficient policy decisions are copied without learning lesson form other countries experience. On the other hand, there are also good governance practices, which may be multiplied in other transition countries.

The main project activities were to support policy changes with an advocacy campaign for institutional reforms. Although the transaction costs problems are relatively new for both countries and the decision-makers are not prepared to make assessments of their policy, the results of the project has been accepted more than well. Macedonian partner was the Forum Foundation.

However, the issues of business entry costs and costs of contract enforcement are not new for IME. During the last 10 years IME has accumulated a great expertise in dealing with these issues. Therefore one of the primary goals of the project was to transfer that knowledge from Bulgaria to Macedonia, thus raising the issue of transaction costs there.

Probably one of the most important project results for Macedonia is that during the project implementation we succeeded to initiate a public debate on economic policies and business environment.

In Bulgaria, the main project findings were used as an additional argument in the drafting process and the public advocacy campaign of the Law on Reducing Administrative Regulation and the Administrative Control over the Economy. Particularly valuable were finding on municipal level.

One should take into account that business registration costs in Bulgarian and Macedonia are relatively high: In Bulgaria they range from 6.5 to 14% of GDP per capita and from 1.3 to 2.7 of the average net wage, in Macedonia these indicators are respectively: 32% and 3.3%. This means that the problem deserves being tackled with high priority.

Priorities for 2003-2004

Internal Priorities

- Building Fundraising Capacity
- Stepping up Applied Economic Research
- Internet Provision of Economic Knowledge - EASI
- Interns
- Associate Membership

Policy Priorities

- Monitoring and Assessment of Economic Policies;
- Free Movement of Capital and People;
- Ten Percent Flat Taxes – 10% income tax, 10% corporate tax, 10% pension contribution to personal retirement account
- Shadow Economy Surveys and Policy Recommendations
- Market Reforms in the Financial Sector

Special Attention

- European Union Accession and Integration;
- Military Reform;
- Pension, Healthcare and Education Reform;
- Fiscal Decentralization and Regional Development;
- Administrative Reform and Public Service Efficiency;
- Regulatory Reform;
- Reforms in the Balkans and Beyond;
- Competitiveness;
- Improving Environmental Quality Through Markets.



Krassen Stanchev,
Executive Director
June, 2003