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THE YEAR ORGANIZATIONAL CHALLENGES AND GROWING POPULARITY OF IME

2004 Annual Report

Organization Background

Two of the IME contracts had a delay in the payment schedules in 2003 and 2004. As a result the annual turnover for the reporting year has dropped from BGN 466,000 to 287,000 in 2004 (with some of the payments still pending at the time of this report).

This necessitated a significant downsizing of the staff and assets: one department of the Institute, the Innovation Training and Consulting Center (ITCC) was closed, one IME associate, Dr. Friedrich Bauersachs retired (and now serves IME as an advisor), and five of the oldest IME associates (Latchzar Bogdanov, Yordanka Gancheva, Pavlina Petrova, George Stoev and Assenka Yonkova-Hristova) have established their own corporations and now contribute to reforms on their own, in Bulgaria and Macedonia, and still cooperate with IME and participated in the key initiatives in 2004.

Latchzar Bogdanov, George Stoev and Assenka Yonkova-Hristova have set a industrial and macro-economic consultant company, Industry Watch, which in a period of six months has become a reputable and most quoted consultant company in the country.

Yordanka Gancheva and Pavlina Petrova have moved to Macedonia and currently are in a process of establishing a free-market, independent think tank in Skopje, the Economic Policy Research Institute.

In addition, four of the IME staff have become founders of Bulgarian Society for Individual Liberty and six of us initiated and become founding members of the Bulgarian Macroeconomic Association (BMA). IME senior economist, George Angelov is currently a BMA board member and IME covers the organizational costs of BMA. All IME staff economist actively participate in the activities of the Bulgarian Hayek Society.

IME and the Hayek Society supported the establishment and the organization of first annual meeting of the European Resource Bank – a network of free market thinkers and individual from all over Europe – which took place in Bulgaria in October 2004.

Amending IME mission Statement and Policy Priorities

In March 2004, IME has amended its mission.

Since January 1993 it has been to develop and advocate market approaches to challenges Bulgaria faces in the transition.

We believe that in 2004 the so-called transition is approaching its end and that in the face of the EU accession there is a need to pay greater attention to individual freedom and competition, not limiting them only to Bulgaria.

Bearing this in mind, all IME staff and Board Members agreed on the following formula:

IME mission is to develop and advocate market approaches to address challenges that citizens and business encounter in pursuing their initiative.

The new mission necessitated a new definition of 2004 priorities, they were the following:

- 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 to specific economic policy

During the year IME has paid a special attention to the following policy areas:

- European Union Accession and Integration: IME has become the only public institute in Bulgaria that monitored EU developments and the country accession to the Union. We have attempted our best to assess costs and benefits of accession and advocate market solutions to the challenges of the process.
- Military Reform: in 2004 IME worked with the Bulgaria's ministry of defense to outline macro-economic and provisional fiscal development for the period 2004-2015. The review was a key part of Bulgaria's accession to NATO and we are proud the IME managed to contribute to Bulgaria's membership. In the view of the expected developments, IME has become a key advocate of the reform to skip the compulsory military draft and set a professional army. We have supported the reform with a calculation of costs, benefits and fiscal projections. The has entered the political agenda and we expected the reform would actually happen in 2009, although we believe it is possible to launch it 2005 and enact it in 2006.
- Pension, Healthcare and Education Reform: IME staff economist have been playing a key role in all non-government initiatives to reform the welfare state in Bulgaria; we maintain a special sub-page on the IME Bulgarian website, advocating fully private pension system; we have outlined for Oxford Analytica Bulgaria's situation in regulation working hours (in the view of the applicability of the EU Work Time Directive) and IME has become a co-initiator of the Work First Europe Initiative.
- Fiscal Decentralization and Regional Development: this effort has been a by-product of IME leadership in the tax reduction debate. George Angelov continued to lead

IME effort to draft alternative state budget as a tool to promote reforms. This year 100 reputable Bulgaria economists and the two largest business associations, Bulgarian Chamber of Commerce and Industry and Bulgarian Industrial Association and a number of guilds supported the IME tax reform outline. As a result of IME initiatives the tax situation, effective as of January 2005 is the following:

2003	2004	2005
23.5%	19.5%	15%
15-29%	12-29%	10-24%
42.7%	42.7%	42.7%
20%	20%	20%

The campaign supported local governments to seek reforms also in terms of decentralization and pay attention to the efficiency to government allocations. IME staff economists and former associate have been members of all non-government working groups in the country dealing with these issues.

- **Administrative Reform and Public Service Efficiency:** by the end of 2004 it was already obvious that fiscal and quasi-fiscal burdens may jeopardize the country prosperity prospects. In order derive lessons from the years in transition we undertook an in-debt analysis of the economic reforms in the period between 1989 and 2004. This analysis has been published by CIELA Publishing House under the title *The Anatomy of Transition*.

Indicators (average)	1990-1997	1998-2004	2002-2004
Inflation (%)	210.1	7.5	4.8
Inflationary tax rate (%)	57.7	6.9	4.5
GDP growth (%)	- 4.7	4.4	5.0
GVA growth (%)	n.a.	4.0	4.9
Investment growth (%)	- 8.8	18.2	11.4
Budget deficit/surplus (% of GDP)	- 6.3	0.2	0.4
Government debt (% of GDP)	168	65.9	48.3
FDI (USD million, 1990-1996)	63.2	1,253.4	1,867.7
FDI (% of GDP)	0.8	7.4	9.1
Subsidies (% of GDP)	n.a.	2.1	2.5

In fact, there are two very different in terms of economy countries, one before and the other after 1997: one on the destruction, the other – of production. In 2004, Bulgaria have actually restored it levels of national income per capita of the late 1980's. The challenge now remains not in the restoration but in sustaining the incentives of individuals and companies to profit and prosper. The finding of the book has been holy or partially published in the press and often quoted in the political and parliamentary debates.

- **Regulatory Reforms:** in this area IME continued its work on the reduction of licensing and permit regimes, volunteered to comment on different drafts of the strategy to reform Bulgaria's administration and the strategy for the development of the different sectors of the government; it has stepped up its cooperation with the Institute for Public Administration and European Integration and the American University in Bulgaria in terms of providing knowledge on cost benefit analysis of regulations. By the end of the year IME finished its work on RIA and cost benefit chapters of the draft law on normative acts. We are confident that if not in 2006, in 2006 the draft will be submitted to the legislature.
- **Reforms in the Balkans, EU and Beyond:** in cooperation with the Greek foundation ELIAMEP, Wiener Institut fuer Internationale Wirtschaftvergleiche and the London School of Economics we research and provided policy recommendations to EU institutions on integrating Balkans in the EU.
- **Competitiveness:** in this area IME focused on three areas – the real estate market potential of Bulgaria, monitoring the financial system and advocating the functioning of the credit information exchange and the work force competitiveness. We surveyed and made recommendations on administrative barriers to real estate and land markets. Particularly important, we believe, were our efforts to advocate liberalization of land-ownership, unfortunately we cannot claim the campaign was as successful as we expected. Special purpose investment vehicles, a reform that in 2003 has been implemented with the help of IME, have become a key player in Bulgaria's economic performance.
- **Improving Environmental Quality Through Markets:** in this area we mostly published different material on the EASI website and monitored the development in the government effort to build a second nuclear power station in Belene in a situation of partial restructuring, limited liberalization of the energy markets and total dependence on Russia supply of energy resources.

Publicity and Other Achievement

The IME leadership in the flat tax debate has improved the public standing of the Institute. In 2004, almost 80% of the *Economic Policy Review* was weekly reprinted in other newspapers and electronic media.

With the support and following the idea of George Vassilev, a Bulgarian banker living in Switzerland we started publishing a special monthly, a *Flat Tax: Bulletin on Low Taxes*, which is reprinted 100%.

IME staff economists have been consulted by all major political parties on fiscal and tax issues. As recognition of the IME role in improving business environment Krassen Stanchev was nominated Mr. Ekonomika 2004.

February 2005,

Sofia