

Institute for Market Economics

LEGAL AND REGULATORY REFORM

IMPACTS ON PRIVATE SECTOR GROWTH

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Contents

I. Introduction

Task and scope of work

Structure of report

II. Sources and methodology

III. Pre-1998 peculiarities of legal and regulatory reforms

Banks and creditor rights: key institutional developments before 1997

Contract “enforcement”

Emerging private sector

Fiscal environment before 1998

State owned enterprises and the administration

IV. Analysis of 1998-1999 legal and regulatory reform

Attitudes and general test cases

Original public attitudes

Test cases: public procurement, concessions, privatization

Financial stability

The Currency Law

The Bank Deposit Guarantee Law

The Law on the Redenomination of the Bulgarian Lev

The Law on the Public Offering of Securities

Microenvironment for companies’ operations

1. General

The Law on Measures Against Money Laundering

The Customs Law

The Value Added Tax Law

The Health Insurance Law

The Mandatory Social Security Code

Advocacy and Social Welfare Reform

The Laws on Amending and Supplementing the Personal Income Tax Law

The Law on Amending the Corporate Profit Tax Law

The Tax Procedure Code

The Law on Amending and Supplementing the Excise Law

The Law on Consumer Protection and Rules of Trade

The Law on Protection of Competition

The Law on Foreigners in Bulgaria

2. Sectors

The Law on Tourism

The Law on Road Freight Transportation

The Laws on Amending and Supplementing the Insurance Law

The Law on Gambling

The Law for Wine and Alcoholic Beverages

The Law on Veterinary and Medical Activity

Enforcing private property and creditors rights,

General Remarks

The Cooperatives Law

The Law on Amending and Supplementing the Land Leasing Law

The Laws on Amending and Supplementing the Law on Compensation of Owners of Nationalized Property

Public governance

The SME Law

The Administration Law and Public Servants Law

The Law on Regional Development

The Public Procurement Law

The Political Establishment and Access to Parliamentary Debate

Requirements of international agreements

Tariffs and advocacy

V. Private sector advocacy

VI. Conclusions

VII. Methods for monitoring and evaluating

Goals and Purpose

Specific Activities

Relevance

I. Introduction

Task and scope of work

This report summarizes results from USAID-funded research on *Legal and Regulatory Reform in Bulgaria That Affects Private Sector Growth*. It deals mostly with laws endorsed by the Parliament” in 1998-1999. The general objective was to assess the level of regulatory reforms in the country that affect the private sector’s performance.

Structure of the report

The report begins with the description of the sources and the methodology. Then it gives a brief summary of the peculiarities of legal and regulatory reforms in the years preceding the 1998-1999 research period. The idea of this part of the report is to give an insight into the legacies of previous reform attempts. The actual analytical part is divided into six sections:

- 1) impacts through general financial stability;
- 2) immediate impact on microenvironment of companies’ day-to-day and year-after-year operations;
- 3) the provisional effects of regulations enforcing private property and creditors’ rights;
- 4) provisional impacts of regulations related to public governance (e.g., the SME Law, the laws on administration and public service);
- 5) the regulatory requirements stemming from international agreements expected to have an impact on private sector performance;
- 6) a review of the customs tariffs and private sector advocacy efforts to influence policies in this field.

These sections contain brief summaries of advocacy effort where relevant. However, the next major part provides an overview of the private and non-governmental sector activities that aimed at influencing the regulatory reform. It also contains a table of foreign and domestic foundations, which sponsored seminars on different reform segments. Conclusions of the analytical part are presented in a separate paragraph and another section deals in particular with different methods of continuous monitoring and efficient evaluation of the legislative reform. The final part of the report explains the structure of the attachments and gives tips on how to use them.

II. Sources and methodology

1. The content of the report reflects the following sources: Naturally, it deals first of all with laws and regulations as they were published in the State Gazette. However, there are a few international and bilateral agreements, which have not been published but have been of major importance for the regulatory reform. For instance, there are the WTO-Bulgaria Protocol, agreements between the government of Bulgaria (GOB) and the IMF and the World Bank, and bilateral free trade agreements. They are taken into account as well when directly affecting specific laws and regulations or indirectly when necessitating a certain policy approach. This is the second source of the report, although it is not commented on separately. The third source is the information, position papers, letters sent to parliamentary committees, etc., submitted to IME by the following major advocacy centers: Bulgarian Chamber of Commerce and Industry (BCCI), Bulgarian Industrial Association (BIA), and Center for Economic Development (CED).¹ Along with these, IME summarizes its own experience in advocating “pro” private sector growth policies and regulations. The fourth source of information is the IME own monitoring of the regulations and the respective public debate in the 1997-2000 period.²

¹ Some organizations failed to submit the information IME requested due to the short notice.

² It includes: IME assistance to the Bulgarian Association for Partnership (BAP) to draft the advocacy agenda for the private sector and SME development (September 1997); IME participation in the SME Development Strategy (December 1997-May 1998); its advocacy to amend VAT regulation in order to include bread and milk products (June-September 1998); IME participation in all four (1998-1999) Borovetz Meetings of GOB and the majority faction in the Parliament with free-standing public policy institutes and experts; IME-team weekly visits to (and direct participation in) the hearings of the Economic Policy Committee sessions (since March 1999); bi-monthly report on the impact of the regulatory reforms on competition and private sector (since April 1999); weekly reviews of the press comments on regulatory changes (since April 1999) and IME’s own comments on major weekly events (since January 2000), IME representatives’ work on the FIAS report on Administrative Barriers to Business in Bulgaria (November 1999) and its own report on Licensing and Permit Requirements (January 2000). Comments and policy papers related to this experience are not included in this report in any direct form. Besides the FIAS report, all the IME comments have been

2. The methodology of compiling this report is the following: IME reviewed the content of all 314 acts adopted by the Parliament in 1998-1999. Of them, 149 acts were adopted in 1998, and 165 acts were adopted in 1999. Of the 314 acts, we selected 107 new laws and amendments to previously adopted acts which presumably could have a direct or indirect impact on private sector growth. 51 of the selected acts were adopted in 1998, and 56 in 1999. It is possible to distinguish two major categories of regulations: those with immediate and those with remote impacts. Although there is no absolutely strict dividing line, within this distinction we looked for factors like:

- Impacts mediated by financial (i.e. monetary plus fiscal) policies;
- Impacts stemming from microeconomic rules of the game (taxes, compulsory payments to the budget or centralized semi-government bodies such as pension or health insurance, and provisional quasi-taxes such as licensing requirements; costs of operation, such as reporting requirements, costs of contract enforcement);
- Immediate but dispersed over time effects regarding enforcement of private property rights (price controls, restrictions on free contracting, transferability of property, protection of creditors' rights, etc.),
- Remote or direct impacts of administrative regulations affecting the costs of dealing with the government, or the impacts of international agreements.

For the latter group we devote special analytical paragraphs. For each of the former three groups of laws and amendments we tried to evaluate the overall impact on private sector development. All the individual texts under review were put in an "evaluation form", with boxes for "yes" or "no" listed next to each factor. In addition, the form contained a slot for specific comments and for presentation of the content and detailed comments. For most of the regulations even rough quantitative measurement of the impact was not possible. But it was possible to have highly probable assumptions on the expected influence. For easy comparison and future update and use, IME prepared a database of regulations adopted by the Parliament and reviewed in this report. Based on the information received, we reflected upon the major attempts of private organizations to draft regulatory changes.

III. Pre-1998 peculiarities of legal and regulatory reforms

It seems as if in the beginning of the 1990's the key principle of institutional reforms was: no regulation when using other people's and tax-payers' money, but over-regulation when people use their own properties and savings. The actual implementation of this is visible in the rules for the banking sector and in the manner of operation of state-owned enterprises on one hand, and on the other in entry barriers (licensing, permit procedures and other requirements) for the private sector. The regulatory reform of 1998-1999 had an immediate task -- to clean up these legacies of the past.

Banks and creditor rights: key institutional developments before 1997

Capitalization of the private sector was easy in the area of financial and banking services and hampered by administrative barriers in the non-financial sector. Establishment of private banks began in 1990, and was active until 1993; banks emerged in an environment of low capital requirements with almost no barriers to entry.³ Bankruptcy regulations were adopted only in 1994 but essentially were not applied to loss-making SOE's until late 1998. Creditor rights have been protected on paper but difficult to enforce for political and institutional reasons. In 1995, the ministry of industry, being a principal of the then still state-owned "sacred cows" of Bulgarian industry, forbade its enterprises from paying debts to the banking sector. Foreclosure procedure by law may take 19 months, a term, which in a high inflationary environment made little sense. Banks "decided" to distribute credits to inner circles that brought them under informal control. They also tried to establish contract enforcement body or used informal "contract fixers". Delayed privatization and restructuring of the real sector, lack of financial discipline and widespread possibilities for SOE's to use soft

disseminated electronically by MSI, published in the central and local press and are available on IME website (<http://www.ime-bg.org>)

³ There was no requirement to justify the origins of founding capital; most private banks started with borrowed funds. The number of private banks increased significantly (from 2 in 1990³ to 70 in 1993, consolidated to 26 in 1995); their share of total bank assets was 3.1% in 1992, 22.4% in 1995, and 19% in 1999, mostly due to newly privatized banks, following the closure of 18 banks in 1996-1997.

credits and thus to transfer their losses to the banking system, combined with poor lending practices and attempts by the BNB to “cure” the situation with “measured” issues of notes, gradually led to the decapitalization of banks and transfer of the costs to the general public.⁴ The net losses of the banking sector in 1993 amounted to BGL 5 billion, while in 1994 they hit nearly BGL 7 billion; the problems were aggravated in 1995, when the net loss increased to BGL 30 billion by mid-year and about BGL 100 billion by the year’s end. In 1996, nine of the ten state-owned banks, which held 80% of banking sector assets, reported negative capital. Direct fiscal transfer costs for resolving the banking crisis of 1996-1997 amounted to 14% of GDP.⁵

The 1997 and 1999 OECD Economic Surveys of Bulgaria identified two major functions of the above-described institutional design of the banking system, both conducive to corruption. It has been found that first, “The Bulgarian government used commercial banks for the administration of implicit subsidies as soft credits to loss-making state-owned enterprises.” On the other hand, “with access to soft financing, the managers of (undercapitalized) commercial banks themselves actively expanded credit, primarily to the new private sector and often in the context of corruption”.⁶ Thus, corruption has been recognized by the OECD as one of the key reasons for this situation but it also found that a very large share of bad credits was concentrated in a small number of large loans (each over USD 1.4 million) to private firms whose total volume was around 10% of GDP. The OECD found also that “Bulgaria was unique in maintaining a relatively high ratio of credit to the non-financial sector in GDP that was comprised of new (post-transition) loans”.⁷

Presumably, there was no problem in identifying beneficiaries of this peculiar system. Bulgarians have a common name for these people: “credit millionaires”. At the same time, it is obvious that there was a tacit consensus to bankrupt banks, not the debtors or the loss-making enterprises. The government was satisfied by the fact it could delay liquidation of “socially sensitive” enterprise, still appointing political friends and senior public servants to manage them. Workers did not object to keeping their jobs. Private bank managers and shareholders were happy to receive access to wealth and influence: companies close to this circle, serving as suppliers and marketers to the public sector enterprises, privatized the profits while the debts were assumed as public (and were devalued via high inflation in 1994, and especially 1996 and 1997).

Contract “enforcement”

The weak government role in securing property and creditors’ rights, its resignation from the monopoly on coercion in this field, has opened a gap in the public order which was filled by private organizations. Bulgarians call them “wrestlers”, a general name for racketeers and protection sellers. The industry originated in Bulgaria’s success in sports like wrestling and weightlifting in the 1970’s and 1980’s. The communist-era ministries of interior and defense managed the best clubs. Sportsmen had army and police ranks and often constituted a pool of future employees of these ministries. When government sport subsidies disappeared in 1990, there was a vast supply of underemployed athletes. They were prompt in creating (or renewing) friendships with other servicemen and in filling the niches in contract enforcement left by the withdrawal of government agencies. They established companies whose original area of activity was protection of property and personal security. Sooner rather than later, they arrived at a broad interpretation of the term “personal and property security”. Besides guarding offices, warehouses and persons, their major services (though not explained in these terms) also included: “motivating” parties to accept contractual terms imposed by an initiating party, “monitoring” the loyalty of fellow-circles, “convincing” people to meet the terms of a contract. In order to increase demand for their services, they had to induce violence in the society, create a supportive subculture, and “invent” relevant industries like gambling, prostitution, etc. The security services remained unregulated until April 1994 when the first ordinance (Ordinance 14 of March 25, 1994) of the minister of interior was issued to introduce some rules in this field. In response to the regulation most of the protection field reregistered as insurance companies or advertised themselves as investment companies.⁸ An IME 1996 survey on private sector transaction costs found that 35% of private firms in big

⁴ A detailed description of the money transfer mechanism may be found in: *Roumen Avramov, Kamen Guenov, Rebirth of Capitalism in Bulgaria*, Sofia, AECD, 1995.

⁵ See: *Caprio, Gerard, and Daniela Klingebiel*, “Bank Insolvencies: Cross-Country Experience,” The World Bank (unpublished), Washington, 1996.

⁶ 1999 OECD Economic Surveys: Bulgaria, p. 59.

⁷ *Ibid.*, p. 102, 103.

⁸ As was the case with banking, the insurance industry enjoyed a long period of free entry; it remained without any specific regulation until April 1998, when the 1997 Insurance Act was implemented. Meanwhile, strong-arm insurance companies were combining car insurance with car theft, house insurance with burglary, etc. In March 1999, the Ordinance 14 of 1994 was replaced by a new regulation, Ordinance I-39 of the minister of interior, which provided a more detailed list of licensing requirements, the key innovation being a cross-checking with tax authorities of the fiscal transparency of the license-seeking company and its managers.

cities in the country had an informal protection contract.⁹ There was hardly any small private bank without a board member with an athletic background, and there were few banks that did not resort to using the services of such companies. Implementation of the 1997 Insurance Law permit requirement (in 1998 and 1999) allowed the Insurance Supervision Directorate to refuse to license most such companies.

Emerging private sector

In a contrast to this lack of (or delayed) regulations on public procurement, state enterprise management, concessions, banking, creditors' rights, and insurance, the emerging private sector was subject to numerous entry barriers. There is strong evidence that fixed capital of small private firms is mainly financed by personal and family sources. Meanwhile, the process of obtaining a government "license" and "permit" or other document in order to start and operate a business in the non-financial sector was difficult originally because of old communist-era regulations and attitudes, and then it became increasingly difficult due to new regulations. The table below shows the increase of the number of permits in the transition years.

Government permits to operate a business (as explicitly outlined by laws)

| Year | Newly enforced permits | Number of permits in place |
|-------------|------------------------|----------------------------|
| 1989 | 2 | 2 |
| 1990 | 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: IME¹⁰

The two most significant increases in the number of permits (in 1995 and 1997-1998) coincide with both radical changes in the government: from centrist technocrats to socialist in 1994, and from socialist to democrats in 1997.

Since 1997, the government has abandoned discretionary policies that affect the macroeconomic environment. However, it expanded its role in direct regulation of business activities through the increased scope of licensing or at least registration requirements. The table does not count regulations dealing with direct government interference in economic affairs, e.g. the Price Act of September 1995, or Decree 269 of 1997 On the Methods to Contract Prices on Key Consumer Products¹¹ -- both regulations were discontinued in 1998. Oftentimes, the need for more regulations and permits is explained by EU accession, but the more precise motivation behind this explanation is the desire to have an official government presence in-between transactions. Such motivation was obvious in the Price Act and Decree 269; it is present in some recently adopted acts (e.g. the International Road Transport Act, in force as of January 1, 2000, provides for the ministry of transport to regulate tariffs and the number of carriers "in times of crisis"). There is little research as to what extent harmonization of the laws with the EU would create more sources of corruption. However, given the level of administrative competence and the lack of tradition in Weberian bureaucracy it is likely that the new regulations will be adopted with the highest possible costs for businesses to comply and with the least transparent procedures.

⁹ Barriers to Free Enterprise, *IME Newsletter*, vol. 3, No 7-8, 1996.

¹⁰ *In Search of Growth: Policies and Lessons From Bulgarian Economic Reforms*, *IME Newsletter*, vol. 5, No 11-12. A more detailed picture can be found in: *Administrative Barriers to Investment in Bulgaria*, FIAS, February 2000; see also: *Licensing Requirements in Retail and Wholesale Trade and Commercial Road Transport Companies*, *IME Newsletter*, vol. 7, No 1-2, p. 2-11.

¹¹ 1995 Price Act legalized the trend of increasing price controls. Its adoption was excused by the need for "consumer protection" and government intervention "in times of shortages". Its impact was that in 1995 the level of controlled prices jumped two and a half times (See Attachment 2 for details). The intention of Council of Ministers Decree of 269 (of July 1997) was to eliminate wholesale and regulated prices of basic consumer commodities -- bread, meal, cheese, milk, meat, sugar, eggs, vegetables oil, etc., requiring that all contracts with these goods envisage the so-called "final" (or retail) price at which they are acquired by the consumer. The share of commodities whose prices are regulated by this act was 2,78% of GDP in 1998. The Decree was implemented with considerable political noise. It included: widely used rhetoric against wholesalers, presidential visits to open air markets, similar but more frequent visits of the ministers of trade and interior, street police, local government, and involvement of members of the Price Commission (a body established by the Price Act) in price checking, etc.

Fiscal environment before 1998

There is evidence that fiscal rules have been working against transparent and formal development of the private sector. Predictability of the regulations used to be one of the key problems. The major tax laws were changed 66 times during the period 1991-1998, and the respective “implementation rules,” 43 times. That is equivalent to an annual average of 8.25 and 5.38 times, respectively. Altogether, amendments (or adoption of new regulations) to tax regulations occurred 16.13 times per year. That makes 1.34 times a month. Since the beginning of the reform, the CM has issued 49 ordinances and instructions to complement tax legislation. Over the period 1996-1998 alone, the General Tax Directorate (GTD) with the Ministry of Finance issued 71 interpretation letters. Even after the Parliament announced at the end of 1997 that the new tax laws would be clear and would need no further interpretation, the GTD has issued 14 letters in 1998, and 12 in 1999. This makes long-term decisions impossible, or at least costly. Corporate taxation has been regulated by three different laws. The eventual impact of these policies is that the cost of compliance with tax legislation is several times higher than the cost of non-compliance.¹²

Taxation of labor is a separate case. Impediments to formal development of the private sector combined with delayed reforms in pensions and healthcare have maintained the high cost of formal employment.

Cost of formal employment

| | Average wage in public sector (in BGL ¹³) | Personal income tax due (in BGL) | As pct of average gross wage | Obligatory social welfare contributions paid by the employee (in BGL) | As pct of average gross wage | Obligatory social welfare contributions paid by the employer (in BGL) | As pct of average gross wage | Cost for the employer of 100 BGL net income received by the worker |
|------|---|----------------------------------|------------------------------|---|------------------------------|---|------------------------------|--|
| 1991 | 959 | 116 | 12.1% | | | 354.83 | 37% | 155.85 |
| 1992 | 2,047 | 301 | 14.7% | | | 757.39 | 37% | 160.62 |
| 1993 | 3,231 | 445 | 13.8% | | | 1,195.47 | 37% | 158.88 |
| 1994 | 4,960 | 700 | 14.1% | | | 2,083.20 | 42% | 165.33 |
| 1995 | 7,597 | 969 | 12.8% | | | 3,190.74 | 42% | 162.76 |
| 1996 | 14,392 | 2,639 | 18.3% | 288 | 2% | 6,044.64 | 42% | 178,25 |
| 1997 | 141,640 | 20,208 | 14.3% | 4,108 | 2.9% | 59,488.91 | 42% | 171.43 |
| 1998 | 208,135 | 35,746 | 17.2% | 6,036 | 2.9% | 84,502.81 | 40.6% | 175.91 |
| 1999 | 210,000 | 31,143 | 14.8% | 9,450 | 4.5% | 86,520.00 | 41.2% | 175.03 |

Source:IME

The table illustrates the dynamics of total labor costs imposed by the government through the tax and social welfare system. The last column shows the total cost paid by the employer to put BGL 100 in the pocket of the worker. With few exceptions, the cost has been constantly rising during the last 9 years. The effective personal income tax burden (on the average wage) being relatively stable, the overall increase of labor costs imposed by the government is mainly due to the social welfare system. The policy has been of increasing revenues through increasing tax (contribution) rates. The outcome is a vicious circle of fewer and fewer legally employed workers, and higher and higher rates over the years. Naturally, in order to maintain informal employment, businesses should also collect informal revenues, and thus activities move into the shadows. Employers and employees often come to an agreement to jointly seek tax-evasion schemes. This constellation of interests supports anti-rule-of-law corporate and employee behavior, erodes public discontent against corruption and stimulates a counter-reaction on behalf of the government to intervene on the verge of violating private property and privacy rights in order force businesses into legality.

State owned enterprises and the administration

Since 1995 state owned enterprises (SOE) have had a secondary role in GDP, and during all transition years the private sector was compensating for the decline of the government industries¹⁴. But it is obvious that policies towards government enterprises have been the key factor in institutional reforms. They still retain over 45% of the assets in the Bulgarian economy. The major tool for “manual” (through direct involvement of the

¹² See for a detailed discussion: *Latchezar Bogdanov*, Transparency of tax regulations and costs of compliance, *Finansijska Praksa*, Zagreb, 1999, No 4-5, p. 497-509 (in Croatian).

¹³ In old Bulgarian leva

¹⁴ See: *In Search for Growth*.

central government officials and/or appointees) control in the real economy is the procurement of “state property rights”. Rules here were established as late as in 1994, by the Council of Ministers’ Decree N7. Since enacted it has been amended 17 times, mostly in sections dealing with the remuneration of managers and board members. Articles 10 and 11 stipulate that in the SOE’s, sole proprietor’s rights are exercised by the line ministries (those of industry, trade and tourism, agriculture, energy, posts and telecommunications etc.), and by the Council of Ministers (in the case of military industries). In fact, the prime minister and the cabinet are established as sole proprietors of last resort due their control functions over the acts of the line ministers. Line ministers appoint SOE managers and board members at their discretion. Members of the central administration are not allowed to sit on the boards of more than two enterprise, although there is no limit for members of parliament. There is no competition requirement or any provision to contract out managerial teams or use venture capital schemes. There is no prohibition to doing so but in reality it has never happened. Required to exercise public interest in SOE’s, line ministers are afraid of being accused of not fulfilling this requirement. All the governments that have taken power during transition have preferred to bring fellow-partisans into the system, thus paying them back for political services and loyalty. Decree N7 also requires managers and ministers to close down enterprises when liabilities exceed 50 per cent of the assets. This provision was never implemented by the administration before 1998. No measures to improve SOE performance through remuneration of managers and/or board members have been workable. There were efforts on restructuring SOE operation under the general provisions of the Commercial Code. None of the amendments succeeded in solving the major problem: the appointing of executive management with at least an element of competition or venture capitalism, for a designated period of three years. Managers protect their seats in the administration of the respective line-ministry, or on its “list” of people entitled to certain positions. These incentives, however, coincide neither with increased profit nor with the acquisition of managerial knowledge under market conditions. It used to form a constellation of interests which multiplies the detrimental effects on the economy in general. As a result, loss-making enterprises were not closed. It also led to political pressure for soft bank loans. It blocked privatization. It drained commercial banks. Nevertheless, five governments (two of them interim ones) maintained the same system. Currently it is being destroyed by privatization but supplemented via asset distribution to insiders. But even after privatization the government retains between 10% and 33% minority stakes in virtually every privatized entity. In other words, about 2000 government appointees still sit on enterprise boards. This fact supports the presumption that the administration could seek other opportunities to retain its involvement in the real economy.

IV. Analysis of 1998-1999 legal and regulatory reform

Attitudes and general test cases

Original public attitudes

The legacies and constellations of the first transition years have established a pro-corruption political and institutional environment. Though to some extent natural, the inherited sources of trust remained dominant over the new business networks and prevented emergence of formal (institutionalized) sources of trust that could benefit more agents in their pursuit of new economic opportunities. In fact, in Bulgaria, extended and formal trust is constantly losing out. This is reflected in delayed institutional reforms, in the non-transparent ways of privatization described above, and in the low volume of foreign investment. However, political consequences are equally important. There is a general feeling that reforms have been unfair, designed to benefit semi-formal interest groups. The majority of those who found that they are unjustly losing out due to reforms during most transition years expect a central government subsidy as compensation, or simply move into the informal sector. Fledgling political parties find few options but to seek their own clientele or recourse, again involving politically dependent state owned enterprises. The clientelistic behavior of incumbent governments was somehow excusable for the voters, given there was understanding that the “newcomers” should purge “old crooks” who had already looted the people. Voters, especially supporters of the “newcomers” or at least those disappointed by the “old-timers”, were most of the time even ready to tolerate some lack of transparency.

Test cases: public procurement, concessions, privatization

This necessitated an approach to regulatory reform which, with the idea of retaining central government control over the economy, was either delaying implementation of certain norms of transparency, or was sustaining (and in some sectors even increasing) a high degree of government discretion. The legal framework remained intentionally unclear, thus giving a chance for lesser accountability.

There were no general rules for government procurement of offers and services for most of the transition years. The first Bulgarian law on public procurement was adopted in January 1997, seven years after the beginning of transition. It remained without implementation until June 1999 when the second public procurement act was passed. The new act provided stricter procedures and much clearer division of duties of state bodies. But it lacks a definition of “public procurement”, and in fact excludes subsidiaries and NGO’s from being a subject of regulation when providing services to the government. The act also requires post-auction confidentiality of the offers, and restricts access to the files of the control bodies.

Also, for a long time there was no general procedure on granting concessions on exploration for and use of natural resources, building and maintaining infrastructure, etc. The first concession law, requiring unified auction procedures for all concession-granting cases, was adopted in November 1996, by the then Socialist dominated legislature. But it remained without implementation until the adoption of a second act (originally adopted in September 1997), its amendments (in early 1998) and its implementation rules¹⁵ in mid-1998. The new act, however, limits requirements for auctions and other transparent procedures.

Some sectors used to have procurement rules issued by acts of the cabinet. There has been a privatization auction ordinance in place since mid-1992¹⁶. At the same time a key feature of the privatization law (adopted in April 1992) is that it allowed for a wide degree of discretion in the selection of potential buyers. Cash privatization, in particular, could and can be carried out according to different procedures: tenders, direct negotiations, public offerings of shares, and auctions. Institutions in charge of individual privatization deals decide on a case-by-case basis which sale procedure to apply. Direct negotiation is the least regulated method but yet it is the most frequently used procedure to sell government assets, at least in the period before 2000¹⁷. The privatization law introduced a special regime for management-employee buy-outs (MEBO’s). In particular, a preferential payment system allows management-employee companies to provide a down payment amounting to 10% of the price offered, whilst scheduling the remaining 90% through installments over a period of ten years. Available estimates indicate that between 1993 and 1998, 44.3% of the total sales of whole companies went to management-employee buy-outs. (During privatization, insiders are already entitled to purchase 20% of the shares at preferential prices.) Looking only at 1998, a considerably higher percentage of 73.4% was found.¹⁸ In 1999, MEBO’s won one-third of all privatization deals. MEBOs are not a phenomenon typical of certain types of governments, say, socialist-led governments. Under the current cabinet, which is considered center-right and reform-minded, the recourse to this preferential system is predicated on the grounds of accelerating the divesting of state assets. In fact, at least in 1998, “privatization” to MEBO’s was an explicit attempt to redistribute the right to sell state-owned assets to managers appointed by the cabinet itself, allowing them in turn to re-sell the assets.

Financial stability

There are four important regulations adopted in 1998 and 1999 that are seen as affecting the macroeconomic environment. They influence private sector development and foreign investment through the general financial stability.

The Currency Law (State Gazette, No 83/1999)

In the last two years, there are relatively few acts with undoubtedly positive impact on private sector development. The best example in this sense is the Currency Law. Besides banks with full international licenses (i.e. the relatively big banks and branches of foreign banks, through the Association of Commercial Banks) and lawyers, there was no noticeable private sector involvement in the advocacy for this act. The reason is two-fold: the adoption of this act was scheduled under the 3-year Agreement between the GOB and IMF and the general public was paying little attention to the previous regime. But it was saluted by the private sector, regardless of the nature, size or sector of the company. The law completely legalized

¹⁵ Bulgarian legal tradition is based on issuance of such rules by the Council of Ministers.

¹⁶ Decree 105 of the Council of Ministers of June 15, 1992 (State Gazette, No 50 of June 19, 1992), amended five times since adoption.

¹⁷ According to available data, in fact, the percentage of auctions compared to the total number of deals contracted by both the Privatization Agency and line ministries in 1998 amounts to a mere 6%. It may be interesting to contrast this figure with those concerning the application of “open” privatization procedures in Hungary, where they account for nearly 70% of all the deals. See Maria Dezserine, *Accessibility and Transparency of the Public Procurement Process in Hungary, Albania and the Slovak Republic*, Budapest, FME, 1998. In Bulgaria, there is a pattern that for bigger enterprises, auctions are more frequently used in privatization procedures, but not for more than 20% of the sales through the Privatization Agency, while “selection of a strategic buyer” tends to prevail in smaller deals conducted by line-ministries and principals. For details, see: Luisa Perrotti, Krassen Stanchev, *The role of the core executive in the privatization process: Country Report on Bulgaria* (unpublished report for the OECD/SIGMA and the World Bank, March 1999).

¹⁸ Privatization Agency, *Privatization Strategy and Program*, no date (1999), p. 1.

denomination of contracts in foreign currency, which used to be a widespread practice to avoid currency risks. Even after the exchange rate was fixed and the Currency Board Arrangement (CBA) was introduced, some segments of the market remained mostly hard currency denominated. For instance, this is the case with the real estate market (excluding land), which works in USD as a reserve currency, and the DEM-denominated automobile market.

From a macroeconomic point of view, benefits for the economy are numerous. The law sets institutional incentives to improve the country's balance of payments via reducing the borrowing costs. It aims at increasing foreign investments via liberalization of international transfers. Capital account liberalization gives residents a greater choice when purchasing assets and services from abroad. The main characteristic of the law is liberalization of capital movements and the currency regime.

Currency activities have to be registered at the Ministry of Finance within 14 days. (There is a positive impact on private firms' transaction costs. In fact the procedure can not be more expensive than before the enforcement of the law; the previous permit regime was replaced by a registration requirement.) Capital transactions have to be registered with BNB. Transactions with precious metals are under registration as well. Bulgarian citizens have the right to open an account abroad. The law allows for local residents to borrow or place funds abroad, and for non-residents to have access to the Bulgarian capital market. Juridical persons have to report to BNB their debt to foreign residents. It leads to additional operational costs of the firms which did not comply with the previous permit regime.

The registration regime of capital transactions does not increase the operating costs of businesses due the fact that they discontinue more costly old regulations. The new regime is not an entirely efficient mechanism for facilitating and stimulating capital movements and could cause losses to businesses if the currency market grows. The obvious strategy of the drafters from BNB¹⁹ was to avoid any risk but not to put additional constraints on currency transactions. In other words, there is room for improvement.

Free of registration are bank transactions on payments of up to BGN 2,000, a rather small amount. Here also vast room remains for improvement in order to facilitate further international transactions.

Direct investments are also free of registration. It is a positive side of the law and, all things being equal, would have a favorable effect on the balance of payments towards improvement of the macroeconomic environment.

All rights of control and monitoring on the capital and currency transactions are concentrated in the Bulgarian National Bank.

The regulation for currency transfer is more liberal than the previous law.

According to the Currency Law, residents and non-residents have the right to export without limit up to BGN 20,000 (US \$10,000). Permission of BNB is still required for citizens and foreigners above this amount. Citizens can export above BGN 5,000, as long as they declare the sum with the customs. Foreigners can export currency above this limit without permission of the Ministry of Finance (as used to be the regulation before), after filling out custom declarations.

At first glance, the enforcement of the Currency Law creates an opportunity for increasing administrative staff and costs, because of the controlling and monitoring of international payments and currency transactions and collection of information by the Ministry of Finance and Bulgarian National Bank. (The Ministry of Finance sets up and maintains a register of direct foreign investments, a register of investment in real estate, and a register of domestic residents debts to foreign persons). But, in fact, the previous permit regime was cumbersome enough in administrative terms. So it is likely that implementation cost will remain unchanged.

It is even difficult to find anyone who is not benefiting from its adoption -- foreign investors, exporters, banks with mortgage loans, real estate brokers, car importers, and cross-border vendors are all helped out by it. The reason is rather obvious: it is an important step towards convertibility with all the expected impact. It would make difficult any further attempts to close the Bulgarian economy again. The previous permit regime was substituted by registration of the transfers; the registration itself seems to be rather a sort of notice. The implementation of the act does not require additional implementation costs for the enforcing agency (BNB) either. It is cheaper to comply with the requirements of this regime than with those of the previous. Most importantly -- it reduces the gray sector of the economy. And last but not least, it will impose a severe constraint on any confiscation-minded tax policy of any future government of Bulgaria: a higher tax burden may easily result in prompt capital flight. Any provisional government, which dares to plan tax increases,

¹⁹ The BNB is just the nominal drafter; representatives (experts and directors of the biggest banks) of the banking sector were insisting on more rapid liberalization; the conservative approach, an incremental change, was advocated by the IMF, actually by two Bulgarian experts, the representative of Bulgaria at the IMF, Nikolay Guergiev (currently deputy minister of finance), and by Luibomir Christov, Assistant Director at the World Bank.

must from now on take this probability into account. The policy choice is fairly obvious: to push taxes up, restricting the currency regime, or to maintain the currency status quo but to improve economic efficiency and the business environment in order to boost investment and prosperity. The law is in conformity with EU accession requirement for capital mobility.

The Bank Deposit Guarantee Law (State Gazette, No49/1998)

The drafting, professional public hearing and eventual adoption of this law was an interesting case of private advocacy for a regulation of general public and private sector benefit.

It was suggested and drafted by IME. It addresses a major issue of macroeconomic and especially banking sector stability. The idea was conceived during the outset of the banking crisis of 1996-1997. It was a reaction to the then adopted Law on Government Compensation of Deposits in Banks. It provided for 100% budget coverage of the BGL deposits of physical persons and virtually no guarantee for hard currency deposits of legal persons and corporations (envisaged was 50% compensation in four installments, one in six months). The 100% guarantee had no practical meaning in the near-hyperinflation environment of 1996-early 1997. The problem was in the moral hazard this law was inducing in the system. With the macroeconomic and monetary stabilization of 1997, this law could cause a serious fiscal imbalance in case of bank failure. Because of its poor institutional design, it could serve as a disincentive for companies to keep money in the bank. Another dimension of the issue was much narrower: since 1996 banks were contributing to a deposit compensation account with the central bank, but BNB did not have any transparent rules to manage those funds while commercial banks disagreed with the idea of capitalizing an unregulated fund.

In drafting the law, the team consisted of two central bank lawyers and two IME economists. The objective of the former was to fix the problem between BNB and the banks while that of the latter was to eliminate the moral hazard and prevent fiscal shocks, or at least to have a law, which is implementable under a CBA. The guiding belief of the economists was that having no regulations was perhaps the best option to induce competition among the banks, including schemes for deposit insurance.

The idea was similar to the experience of Estonia, which under a CBA did not introduce any regulation, thus actually forcing banks to disclose more information and depositors to look for better banks. (During the June 1997 debate on the draft bill with representatives of BNB, the ministry of finance and parliament this idea was defended by IME, Sir Alan Walter, an Advisory Board Member of IME²⁰, and Emil Harsev, former deputy governor of BNB.) Bank representatives were divided. Members of parliament (MP's) did not express any opinion but were present during the deliberations. Eventually, the BNB concept dominated, and the act reflected the compromise view of the prevailing opinion. With few exceptions, it was difficult for most to imagine a situation when government would not be involved in protecting depositors.

The Bank Deposit Guarantee Law (BDGL) replaced the Law on Government Compensation of Deposits in Banks and relieved the state budget of the obligations related to deposit protection. The scope of the law was extended to all the licensed Bulgarian banks and to foreign bank branches if they are not involved in a proper deposit guarantee scheme in their country of residence. At first glance, the deposit guarantee scheme is supposed to increase the confidence in the banking system and thus to enhance the financial stability in the country. However, it would achieve this objective only if BNB succeeds in imposing strict capital requirements for reduction of the risk in the banking system. Otherwise, the deposit scheme applied for all the banks would threaten the prudential behavior of the individual bank and the competitive environment in general. In a long-term, the negative effects of the scheme applicable for all banks is moral hazard and lack of incentives for exchange of information between banks concerning creditworthiness of their clients.

One of the main features of the BDGL is the fact that it partially overcame the unequal treatment of corporate and personal deposits imposed by previous regulation. As was mentioned above, prior to 1998 corporate deposits were excluded from the guarantee scheme and this furthered decapitalization of these deposits. According to the new law all deposits are guaranteed and the protection is 95% for all deposits of one client in one bank totaling up to BGN 2,000, while 80% of the amounts between BGN 2,000 and BGN 5,000 are covered. Deposits above BGN 5,000 are unprotected. This level of protection is low regarding corporate deposits but it is considered that corporate clients are able to make a better risk assessment. In fact, under such a scheme with a low level of protection, the depositors share the risk of their banks.

Every bank has to pay an affiliation fee and an annual fee. The amount of the fees is not differentiated according to the risk of the bank. The affiliation fee is 1% of the bank's registered capital, or 1% of the minimum required capital for foreign bank branches. The annual fee is 0.5% of the total deposit base as of 31 December the previous year. This method for determining the annual fees according to the bank's deposit base on a definite date (31 December) brings

²⁰ Sir Alan Walters contributed his time by writing a special letter on the costs and benefits of having or not having such regulation; his letter was a key part of the professional deliberations.

an element of fortuity. One of the main features of the scheme is the fact that commercial banks capitalize the fund but do not participate in its management, which presumably may lead to problems.

Further to the law on bank deposit guarantees, a deposit guarantee fund was established in January 1999 to administer the guarantee provisions under the law.

The Law on the Redenomination of the Bulgarian Lev (State Gazette, No20/1999)

The law was perceived (and conceived) as a symbolic act of stability. What it did was erase three zeros from the national currency. Its macroeconomic impacts were limited and of the following nature: there was a limited impact on inflation, through “rounding-up” of prices and the psychological impact of the smaller bills. The implementation costs were overestimated, at 12 billion old Leva. The actual printing costs for the new notes, as reported by the Emission Department, were 55% of this sum. (It seems that the reduction came from the fact that BNB managed to buy cheaper inputs for the operation.) The costs could be negligible if there were no costs imposed on the private sector for the adjustment to this entirely formal operation.

No private institution lobbied for the adoption of the law. It was drafted by BNB and designed by an inter-agency body, the Currency Commission of the Council of Ministers. (The mission of this body is to plan monetary policies, decide foreign debt issues, and coordinate and consult with the cabinet, BNB, and the ministry of finance on government debt related matters.) Members of the commission asked by IME said it was the prime minister who had insisted on passing this act. BNB and IMF did not find it particularly useful and considered it a technical operation (this opinion was reported by the press). Many private agencies, however, attempted to improve the content of the law after adoption. Among them was IME, which sent letters to individual MP’s and to the chairman of the Parliament, the contents of which are reproduced in the comments below. We also drafted different formulae to amend the act in the period before companies would incur expenses for complying with it and sent them with the letters. Unfortunately, without any success.

According to the Law the Bulgarian Lev was redenominated July 5, 1999. BGL 1,000 then became BGN 1. As expected, the redenomination did not have an impact on the macroeconomic environment. However, companies’ costs related to the “abolishment of the zeros” is a clear example of needless compliance costs. The immediate effect was on accountants, who had to recalculate information in new Leva. There was also a need for software adaptation. The shopkeepers had to adapt their fiscal memory cash registers, and the costs for such adaptation were estimated to be at least BGN 2 million.

According to the Redenomination Law (transitional provision, art. 5, par.1) “existing commercial entities are obliged to apply for new entry in the commercial registry of the court of the changes in the equity capital caused by the enforcement of this law, in the 1 year period after the law is enforced”; “No court or publication fees are collected... for the new entries and the publications in State Gazette”. Court and publication fees are however only a part of the expenses incurred in re-registration of commercial entities.

According to the type of incorporation, additional expenditures for such a re-registration vary as follows:

1. In the case of Limited Liability Companies the decision for change in the equity capital should be taken by the general meeting of the partners, which is solicited through written invitation sent at least 7 days in advance. The costs in terms of working time of the company itself or its partners are estimated to be approximately 2 working days. After that, additional expenses for lawyers are incurred (for preparation of the application to the court; presentation of the application before the court, regular checking to see if a court decision has been issued, and receipt of the court decision).

The preparation of the application takes not more than 2 hours. Taking into account the expected excessive overload of the courts with re-registration, and the fact that the submission of applications, checks on the current status of the case in court, and receipt of the court decision happen at one and the same place -- the court secretariat, which works only 4 and a half hours a day (9-12 a.m. and 1:30-3 p.m.), the re-registration process will use up at least 20 hours of a lawyer’s time. We can calculate the costs to comply with the law. We know the average wage for 1998, which according to the National Statistical Institute is BGN 187.44. We know company time spent on re-registration (assumed at the very minimum). And we know the minimum lawyers’ fees (they are fixed). Then, we multiply these estimated costs by the number of the registered partnerships, joint stock companies and limited liability companies (according to latest data from 1997). The results are as follows:

- ◇ Costs of soliciting the general meeting of the partners and preparing decisions: 2 working days multiplied by BGN 8.93 (or more precisely, BGL 8,925 at the time of calculation) multiplied by 75 544 partnerships = BGN 1,348,460;
- ◇ Lawyers’ fees: 75 544 partnerships multiplied by BGN 50 (minimum lawyer fee for court registration set by the Ordinance 1 of the Bar Association on the Lawyer Fees Rates) = BGN 3,777, 200.

2. In the case of Joint Stock Companies (JSCo) and Limited Joint Stock Companies (LJSCo):

The decision for change in equity capital is taken by the general shareholders' meeting. The latter is solicited by invitation that should be published in the unofficial part of the State Gazette. The publishing fee is BGN 22.50. Therefore the costs of soliciting the meeting would be 5,014 registered JSCo's and Ltd's, multiplied by BGN 22.50 equals BGN 112,815.

Shareholders will hardly need to review written documents (for re-registration of the zero's). However, shareholders that do not reside at the place of the meeting would incur travel expenses. Unfortunately these costs are difficult to measure; we suppose that they will probably range between 20% and 50% of the above-mentioned amount.

The general shareholders meeting in its turn would bring about rent expenses, as well as protocol and supervision expenses. The daily hall rent ranges between BGN 36 and BGN 360, depending on the size and location of the facility, which multiplied by 5,014 companies results in a cost range of BGN 180,504 to 1,805,040 (when calculating the total costs we will take into account the minimum).

The procedures for preparing of an application, its submission, and for regular checks and for receiving the court decision are the same as for partnerships. The minimum lawyer fee for registration of JSCo or LJSCo, as set by Ordinance 1 of the Bulgarian Lawyers Association on the Lawyer Fees Rates is BGN 100. The total cost is 5,014 companies multiplied by BGN 100 = BGN 501,400.

Additionally, we should take into account the costs of the corporate administration for preparation of the meeting, which are approximately 2 days multiplied by BGN 8.93 (or more precisely, BGL 8,925) multiplied by 5,014 companies = BGN 89,500.

Total costs for companies are BGN 5,829,375 (1,348,460 + 3,777,200 + 112,815 + 501,400 + 89,500). Their size is approximately 0.03% of GDP. Roughly the same was the cost of BNB to finance the redenomination. So, the combined effect of the law, as estimated using very minimal assumptions of the costs of implementation and compliance, is at the level of 0.06% of the then projected GDP for 1999.

It is interesting that the law was adopted during the Kosovo crisis when most of the expectations were that the economy could suffer losses. Also, after June it was already clear that in the first quarter of 1999, the GDP went down by 0.6-0.7% and many economists were skeptical about the ability of the economy to catch up. IME was one of the very few institutions to forecast growth. With the same opinion was the government economic think tank, the Agency for Economic Analysis and Forecast. But we believed it was absolutely pointless to spend an amount equal to 10% of the already registered decline on courts and lawyers' fees for a formal operation. When IME talked to individual MP's on the matter, the typical answer was: mistakes happen. The chairman of the parliament never answered the letters that were sent.

The Law on the Public Offering of Securities (State Gazette, No114/1999)

Bulgaria is one of many examples of successful macroeconomic stabilization and a still-weak capital market which does not play a significant role in the allocation of free capital. The gaps and frequent "adjusting" amendments in the Law on Securities, Stock Exchanges and Investment Companies (in force since 1995, amended 8 times afterward) and delays in adoption of the Law on Public Offering of Securities (which was passed after 542 days by the Committee for Economic Policy) might be pointed out as key reasons for unfavorable capital market development. Market participants considered this long-lasting unclear situation as a signal that capital market regulations had no legislative priority.

The Law on Public Offering of Securities (LPOS) was finally adopted on December 15, 1999, and came in force a month later, on January 31, 2000.

Given the vast interests affected by the law, it might be expected that the private sector would be actively involved in its advocacy. However, there were no signs of a catch-all advocacy campaign. Active participation in the debate that went along with the process of adoption of the law was important for only business associations: the Bulgarian Association of Licensed Investment Intermediaries and Association of Commercial Banks.

Although with some weak points, the Law on Public Offering of Securities makes progress in solving the problems related to effective functioning of the capital market, as well as regulation and supervision of the main participants in the market.

The main characteristics of the LPOS are:

- Adoption of new regulations on the securities market;
- Strengthening of regulatory and supervisory functions of the State Commission on Securities;
- Regulation of primary and secondary trading in securities, on regulated official and unofficial securities markets;
- Regulation of public companies and their transformation;
- Regulation of sanctions for manipulation of the market;
- Regulation of regulations strengthening minority shareholders' interests and their protection.

The law regulates two main types of securities markets -- a stock exchange and an unofficial market. Companies may be traded on the stock exchange only after acquiring a license from the Securities Commission. Unofficial markets are also subject to licensing by the commission. The commission may refuse a license if a market fails to observe basic requirements or cannot guarantee investor interest or the security of the market.

Minority shareholders obtain more options for defending their interests: shareholders possessing over 5 percent of the company's capital may turn to court in case of wrongful actions or deliberate inaction on the part of the managing body of the public company.

However, the new law does not solve completely the problem of increase of capital of public companies under condition and therefore does not wholly protect portfolio investors in the Bulgarian stock market. According to the law, such an increase is not envisioned, but at the same time it is a possibility with financial institutions (banks and insurance companies). Since financial institutions are expected to be the backbone of the capital market, such exceptions make them unattractive for serious portfolio investors.

LPOS defines an altogether new subject on the capital market -- the managing companies. The main line of action of these companies is the management of portfolios of securities, as well as the funds of institutional investors -- investment companies, pension funds, and others. The new regulation is expected to improve the quality of management and to promote the development of a securities market through improving the management of the assets of the institutional investors. The Securities Commission licenses and regulates both the managing companies and the natural persons working for them. The minimum required capital for obtaining a license is BGN 100,000. The only line of business of these companies is management of portfolios of money and securities (financial assets) through taking investment decisions. Every investment company is obliged to sign a contract with a managing company. On the basis of this contract the managing company will make concrete investment decisions which will be carried out by an investment intermediary. Such an introduction of a new market participant is seen to have an impact in several directions:

1. Expected improvement of the quality of investment portfolio management by developing a clear and regulated market;
2. Expected gradual reduction of the costs of investment management.

The law allows a managing company to take over the portfolios of several investors. Theoretically, this should improve competitiveness, the quality of the services and hence, would contribute to achievement of higher yields for investors.

A problem for the market participants may arise from interpretation of "systemic violation", which means "three or more administrative violations of the law in a period of one year". In such cases the law provides for revoking the license. If this provision is going to be strictly enforced, the result would be a considerable reduction of the number of intermediaries.

Trading on the official market of the licensed stock exchanges is allowed only after approval of the prospectus for public offering. These prospectuses are important, since they provide shareholders and investors with a comprehensive information on a company's legal, financial, and other conditions. Without such prospectuses as a source of information for a wide group of potential (non-professional) investors, the trade in shares is non-transparent and is a prerogative of a selected number market participants, which may lead to deformation of the market.

There is a possibility that the public offering of securities will become one of the most strictly regulated economic activities in Bulgaria, since the law stipulates some 20 ordinances are to be issued.

Microenvironment for companies' operations

1. General

The Law on Measures Against Money Laundering (State Gazette, No85/1998)

The Law on Measures Against Money Laundering is largely in line with international standards. The impact and effectiveness of the law cannot yet be effectively assessed.

Theoretically, it is recognized that a considerable part of the money supply results from money laundering and illegal redistribution of assets and property. This money is very liquid and pro-inflationary. Usually, it is spent very quickly and on luxury goods. Its velocity of turnover is much higher than that of the money supply as a whole. The higher turnover velocity generates inflation, which is beyond the control of the monetary authorities. Since the overall velocity of money turnover depends on the ratio of legal to illegal

money, the stricter control and measures against money laundering mean stricter control on the velocity of the turnover of the money supply, and thus on inflation.

According to the law, the measures against money laundering consist of “identification of persons, and collection, storage and disclosure of information concerning operations and deals”. These measures are obligatory for a certain group of economic agents (and their branches registered abroad). Among them are: banks and non-bank financial institutions, insurance companies, investment companies and investment intermediaries, privatization funds, stock exchanges or brokers, notaries, auditors, organizers of games of chance, pawnbrokers, professional unions, etc. The obligation to take certain measures against money laundering in cases of transactions or deals worth over BGN 30,000 (a level which is extremely low), is connected with additional expenses for this group of private companies such as:

- for creation and maintenance of specialized services (bureaus) for identification of clients (the law stipulates such requirement for banks and non-bank financial institutions, insurance and investment companies, investment intermediaries, privatization funds);
- for collection, processing, storage and disclosure of information for particular operations and deals, as well as “evidence regarding the ownership of the property subject to transfer” (!), collection of information about clients and maintenance of accurate and detailed information for their operations with money and valuables. Especially for banks and investment intermediaries implementation of such requirement concerning all deals above BGN 30,000 means considerable additional expenditures.
- for reporting the collected information about suspicious deals to the Bureau of Financial Intelligence (BFI). The Bureau of Financial Intelligence was established in November 1998 as a specialized body within the Ministry of Finance. If some financial operation or deal raises suspicions of possible money laundering, the case goes to the BFI.

For their clients, individuals and companies, the implementation of the requirements of the law means additional costs for submitting all required documents for identification -- excerpts of registers, certified copies of statutory statements, official identity documents, etc.

There is, in fact, nothing wrong with tracking capital flows in order to detect and prevent money laundering. For that purpose, it is normal to establish reporting requirements of financial intermediaries. What is peculiar in the Bulgarian case is that the reporting requirement does not rest with financial institutions, but rather with the individuals and companies themselves. Furthermore, financial institutions have to report any transactions over BGN 30,000 with information that allows the Bureau of Financial Intelligence at the Ministry of Finance to track and pursue illegal capital transfers (art. 4, par. 2 of the law). This certainly adds to the already significant reporting burden on individuals and companies in Bulgaria.

The Customs Law (State Gazette, No15/1998)

The Customs Law is an example of a regulation whose implementation was postponed for almost a year for objective reasons. It introduces a heavy regulating structure -- a centralized system of 4 levels governed by the ministry of finance, including a General Customs Directorate directly responsible for all policy and implementation decisions related to these activities. The Law regulates the tariff classification and mostly customs regimes. This Law's Implementation Rules (promulgated on 10 December 1998) present an additional burden on this sector's operation. The volume of the Rules is normally bigger than the Law itself. They were prepared more than a half year later, and regulate representation, origin of goods, preferential duties, etc.

The Law applies a strict registration regime -- the Customs Tariff (from January 1998) -- a table of duties for all goods presented to customs authorities after submitting declarations. The Customs Tariff is based on the International Harmonized Commodity Description and Coding System, and corresponds to the EU Combined Nomenclature. Thanks to this fact the Law and the Tariff mark a considerable improvement of the business climate for those who compete internationally. Practical procedures introduced by the Rule were a special issue of concern of the February 2000 FIAS Report on Administrative Barriers to Investment in Bulgaria. The Report reflected the concerns of private companies as they existed in the second half of 1999.²¹

All documents are submitted to the Tariff Policy and Customs Value Departments. Some guidelines and instructions have already been published such as Ordinance 11 on the Movement of Goods under a Single Administrative Document. (For instance, customs duties payment up to BGN 5,000 (\$3,000) may be made in cash or bank transfer, but above this amount only by transfer. Once proof of payment for customs duties, excise and VAT is confirmed, the goods are released.)

²¹ See for details the electronic version of the FIAS Report at: www.bfia.org.

The Customs Law has two major impacts on the business environment -- one is fiscal (since all payments collected by the General Customs Directorate enter the State Budget), and the introduced registration and fees regime directly influence the import and export activity of companies.

Problems appear, for example, with the inconsistency in border post procedures that must be addressed immediately because it can lead to delays in shipping, and create opportunities for corruption. The GOB has already been quite successful in approximating its customs regulations to the European Customs Union as set out in Article 94 of the Europe Agreement. Bulgaria is in full compliance with the requirements stipulated in the Agreement, and has with few exceptions harmonized its legislation with the *acquis communautaire*. But while the changes in the legal and the procedural framework have been achieved, Bulgaria still has difficulties in effectively implementing these reforms in day-to-day operations. Since January 1, 1999, the BULSTAT number had served as the customs number, and separate registration with the customs administration is no longer required. Customs compiles information in its database from other registration databases (i.e., BULSTAT) and other public databases. The BULSTAT number is placed on the customs declarations. The customs officer may require the importer or exporter's BULSTAT card or can perform a crosscheck through the database. The customs authority in Sofia is already electronically linked to other ministries and the statistical office. Regional offices are in the process of being linked. One of the major findings of the FIAS Report (paragraphs 60-61 of the Report) is the following: "Investors cited institutional capacity as one of the most critical problems facing the customs administration. It was routinely stated that clearance procedures for importing and exporting goods through the ports and airports function efficiently. However, when it came to clearance procedures at the border crossings or the inland customs houses, problems seemed to arise quite frequently. Investors also found that procedures vary from one customs region to the other, with investors depending on independent interpretations by individual customs officers. This lack of coordination partially results from the fact that the various customs regions and customs houses are not yet electronically linked to each other while a full set of implementation guidelines has not yet been issued." The government has already recognized the problems associated with implementation of the new legislation and regulations, and is moving to address them. Specifically, the government recognized the lack of knowledge of the new customs rules and techniques as a problem for the customs authorities. Consequently, the General Directorate is in the process of preparing internal and external implementation guides. These initiatives were implemented in the fall of 1999. Although the cohesion and coordination within the Customs Administration leave something to be desired, the change is in the right direction. In early 2000, the integrity rules of the customs have been strengthened: they include stricter division of responsibility and clearer reporting requirements to prevent corruption. It is too early to assess these changes. It is obvious, however, that changes came after sustained criticism of the customs procedures and allegations of corruption from the private sector, media and NGO's.

The Value Added Tax Law (State Gazette, No153/1998)

In 1996, the VAT was increased from 18 to 22% to raise more revenue. The 1996-1997 macroeconomic problems have been solved to a large extent, and in 1998 the VAT rate was decreased from 22% to 20% . Entrepreneurs point to an optimum VAT rate of 15.5%, but an adjustment due to competitiveness under the currency board system would require further reduction in the near future.

The main positive effects on the business environment were that:

- The decrease of the tax percentage means that a smaller part of the product's value goes to the budget, therefore a bigger part remains in the hands of consumers and producers.
- Some ambiguities in the previous law related to the definition of the business export transactions and the tax-free transactions were cleared.
- The elimination of the preferences for the so-called "first-need" or "survival" goods contributed to a more competitive environment. This was proved by the almost unchanged prices of those goods and services.

Although reduced by 2 percentage points, the VAT revenues in the state budget registered a slight increase, as did the total tax revenues. This indicates that the lower tax rates stimulated some of the firms in the "shadows" to legalize their businesses.

A problem for investors arises from the waiting period of approximately 7.5 months for reimbursement of VAT. Especially for new investments, where companies have not yet started exporting or where the business is primarily geared towards the domestic market, this waiting period can present a substantial cost factor. As the outstanding reimbursement amounts do not accumulate interest during this time, investors feel that they are simply providing interest-free loans in support of the budget.

The VAT Law was one of the examples of active private sector advocacy -- all private organizations included in the IME survey (BCCI, BIA, BIBA, Association of Commercial Banks) submitted to the

Parliament position papers and proposals regarding the draft law. The proposals were related mainly to reduction of VAT rates and the VAT refunding period.

The VAT amendments of 1998 (in force since January 1, 1999) presented one of the most interesting advocacy cases. The activity was conducted by IME. The objective was to include bread and milk products in the VAT regulation. The problem was that the inputs were taxable under VAT while the product was exempted. That is to say, producers, especially the larger ones, operating in the light sector of the economy, could not receive refunds and their relative competitive position vis-à-vis the producers operating in the shadow sector of the economy was hampered. IME's tasks were to:

- Survey the impact of this regulatory framework,
- Evaluate the impact of the provisional change on the prices, by developing scenarios of expected price increases in the aftermath of the provisional amendment and the expected time-frame of the price-decrease in the future,
- Identify public benefits of the amended regulation,
- Communicate all the above findings to members of parliament, the ministry of finance and the IMF resident mission,
- Communicate the same result to the public.

The research costs (USD 1,000) were covered by one of the leading companies in the sector, and the same amount was negotiated as a success fee. The regulation was passed in the form IME suggested. The IMF included the amendment in the 3-Year program and quoted the research in negotiations with GOB.

The Health Insurance Law (State Gazette, No70/1998)

According to the law mandatory installments should be paid by: employers, employees, sole proprietors, and freelancers. The installment rate was fixed at 6% and it can be changed every year. The central and the municipal budgets cover the installments of the unemployed, pensioners, military, etc. The effects of the new mandatory insurance on the business environment are the following:

- The overall insurance burden on wages increases, as only 3.7 percentage points reduced the social security installment rate; employers are required to pay 6% on the basis of the compensation for temporary disability, pregnancy or motherhood.
- The tax-insurance burden on the sole proprietors' income increases, as they virtually pay an additional 6% (and if they have to insure a member of their family, the percentage increases).
- The possibility of changing the installment rate contributes to the overall instability of the environment.

The law induced the following additional costs for employers and self-insured persons:

- Submission of declarations for every insured person every month,
- Payment of installments every month.

In this way the time spent for compliance with the law can reach one working day per month. The law is probably stimulating officially registered unemployment, as the registered jobless are insured by the state budget. However, a several-month awareness lag should be considered when inferring such a correlation.

The increased labor costs resulting from the new mandatory insurance is touching the supply side of the labor market, which may result in the following:

- Some of the workers receiving the minimum wage (or slightly above) will lose their jobs;
- Some of the small companies will move part of their activity into the shadows (as their workers will receive the wages "in envelopes").

The law sets the basis of doctors' fees regulation, namely the National Framework Contract. The competition between different providers will be somewhat hampered because of the fixed fees, which is the current system of incentives. Of course, market selection will probably come from fewer patients signing up with doctors that offer a lower quality of service. This will not come about immediately, but at a later date, doctors with better skills will presumably be in high demand. They will not be allowed to charge higher fees for their services. What is worse, "bad" doctors will gain some of the income that otherwise would have gone to "good" doctors, which is a form of indirect redistribution of income which may lead to an adverse selection. It is not yet clear how provisional intermediary organizations, i.e. those between the patient and the doctors (hospitals, volunteer health insurance funds, etc.) would fit into the system of fixed prices and centralized control. Eventually, there might be no incentives for some doctors to improve the quality or efficiency of their services. Also, the system of fixed prices creates a risk of misallocation of resources.

The Law introduces a licensing regime for private funds that offer voluntary health insurance. The licensing authority is the National Voluntary Health Insurance Committee. The law outlines 11 documents to be submitted when applying for such a license.

The preliminary vision of the reform and the content of the Law were not debated with the public, the provisional customers. The professional union of medical doctors was converted into a representative guild, becoming a part of the public law. The Doctors' Union was the only non-government organization to be officially involved in preliminary deliberations. The IME has rather vague information that the private Healthcare Fund Zdrave made some comments to the drafting committee, but we do not have details on proposed suggestions. Due some peculiarities of the advocacy process, private sector efforts are reflected in a separate section after the comments on social security regulations.

The Mandatory Social Security Code (State Gazette, No110/1999)

The code, along with the Supplementary Voluntary Pension Insurance Law, was a classical case of involvement of private organizations in the process of drafting regulations. The working group, which developed both drafts, included NGO representatives from the Center for Economic Development. The working group also included representatives of the Bulgarian Industrial Association.

The code introduced an entirely new social security system where mandatory contributions are made to three funds: the Pension Fund, the Labor Accident and Professional Illness Fund, and the General Illness and Maternity Fund. The code widened the income basis on which contributions are due. Regarding the labor contract the employer is obliged to contribute 80% of the installments due, while the employee pays 20%. This ratio will be adjusted over the next 7 years and by 2007 it will be 50:50.

The immediate effects on the micro-level are:

- the overall tax-insurance burden is increased; (see table below)
- the labor costs are increased.

The reaction of the private businesses will probably be a combination of the following:

- part of their activity will go into the gray area;
- the effective remuneration of their employees will decline;
- workers whose pay is on the margin of the minimum wage will lose their jobs.

The effects on macro-level will follow from this reaction:

- increased share of the informal sector;
- increased unemployment;
- decline in the officially registered wages;
- no significant change on the revenue-side of the social funds' budgets.

The table below presents a comparison of the tax-insurance burden in 1999 and 2000 for the sole proprietors (the most numerous form of entrepreneurship in Bulgaria). The change in the income basis on which the contributions are estimated significantly increases the total costs of the businesses.

| Monthly income (BGN) | Health insurance 6% | Pension insurance 32% | Income after paid insurance | Personal income tax | Net income | Total tax-insurance burden |
|--------------------------------|------------------------|--------------------------|-----------------------------|---------------------|------------|----------------------------|
| Second half of 1999: | | | | | | |
| 250 | 15 | 21.44 | 213.56 | 34.53 | 179.03 | 28.39% |
| 500 | 30 | 21.44 | 448.56 | 95.63 | 352.93 | 29.41% |
| 750 | 45 | 21.44 | 683.56 | 152.83 | 530.73 | 29.24% |
| Since the beginning of 2000 ã. | | | | | | |
| 250 | 15 | 80 | 155 | 15.40 | 139.60 | 44.16% |
| 500 | 30 | 160 | 310 | 55.70 | 254.30 | 49.14% |
| 750 | 45 | 240 | 465 | 101.10 | 363.90 | 51.48% |

Source: IME calculations.

Advocacy campaign and social welfare reform

Regardless of the obvious broad impact on economic behavior (of both companies and individuals), the efforts of the private sector to influence the decision-making and the eventual shape of the regulations could hardly make a difference. The major problem comes from the government's manner of designing reforms (and the campaign) in the area of pensions and health care. First of all, the reform started without any consultation and preliminary debate with the public at large and private sector players. On the other hand, the logic of the regulatory work was, by and large, mistaken. It started with the voluntary pension funds while the mandatory segments of the system were delayed, even in terms of preliminary drafts; what was in the government pipeline was not available even for the interested public (private pension funds and economic

think tanks). After the first public discussion at the Social Welfare Commission of Parliament (July 1998), and the first public criticism of the concept in the specialized and general press, the government remained silent for nearly six months. The private sector (individual private pension funds and their associations) was dragged into a discussion over the three-pillar system, two of whose segments were generally unknown. Pension funds could hardly plan their activities and employ any rational business strategy. Their advocacy efforts had two contradictory objectives: to insure no restriction regime in capitalizing funds and investing their assets, and to advocate the highest possible protection of investments on the part of the government. Even in those circumstances, it was possible, under the government's leadership, to initiate the negotiation of the interests of all interested parties. (Such a provisional negotiation could agree upon the following: provisional starting day of the reform, provisional sizes of the mandatory components, provisional communication about the system to the general public, original investment opportunities and restrictions, and the possibilities for upgrading the system when circumstances provide for development.)

International technical assistance including high caliber expertise from the World Bank and USAID had its own limitations. These institutions were not in a position to directly advocate one design or another. They had to work through a Bulgarian organization, thus being dependent on the deficiencies of the local partner. The local partner, for its part, had no choice but follow the preliminary design as drafted by the government in rather abstract terms and invest in advertising a system which was difficult to improve.

In addition to all this, the environment for institutional investment remained poor. The money in the Bulgarian economy is short-term and expensive. The longest available instrument is the government T-bill, with a growing but still limited maturity of 23 months. The monetary environment lacks products with maturity comparable to the liabilities of pensions and health care funds.

Private sector advocacy could hardly compensate for this and, being limited to the promotion of the pension funds' vision, failed to ensure a systemic approach to the reforms.

The Laws on amending and supplementing the Personal Income Tax Law (State Gazette, No71/1998, No 104/1999)

The most significant changes in the law in 1998 refer to the *patent* tax:

- The figures were differentiated according to the place (region and zone) of activity;
- Regarding the transportation services, including taxis, the taxes due per vehicle fell between 36 and 50% depending on type of the service and category of the vehicle;
- Taxes due for virtually all of the businesses, except the hotels and restaurants, were changed.

The following list gives the change in the tax due for some of the activities:

Retail trade – the highest tax fell by 4%;

Parking services – the highest tax fell by 10%;

Food production – the lowest tax fell by 67%;

Carpentry services – the lowest tax fell by 38%;

Tailors' services -- the highest tax fell by 25% and the lowest by 20%;

Positive effects on the business environment were the following:

- Tax burden for most of the businesses paying patent tax decreased;
- Fixed differentiation of the figures replaced the intervals formulated "from X amount to Y amount..." which previously allowed for discretionary setting of the tax due.

With the amendment the government invited a significant share of the small businesses to go out of the shadows. Probably on a macro-level this had a slight impact on:

- The rise of officially registered unemployment, due to the fact that patent-tax payers have no incentives to declare their costs of employment, but do have incentives to avoid social welfare contributions, and their employees have to be registered for healthcare insurance;
- The officially registered aggregate output, due to mis-reporting in order to remain eligible for patent tax.

With the amendment promulgated on 21 December 1999, the government invited the shadow sector in several branches to go into the light. The following concrete changes were made:

- The circle of activities for which a patent tax is due was widened.
- For the different categories of catering and entertainment services a different tax is due; we consider this fair, thus improving the environment;
- The tax due from pawnbrokers was raised from 3,000 to 20,000 BGL, which will force some of them to report their revenues above 75,000 BGL. (We presume that most of them will prefer paying 32.5% of the profit rather than 26.7 of the total revenue); the smaller houses will merge or go bankrupt;
- The profit tax rate for companies with profits above 50,000 BGL was cut by 2 percentage points; this will stimulate investments and the growth of the small companies;

- With the changes in the tax table (the non-taxable income was raised by 6.7%) the tax burden was slightly reduced;

The voluntary pension installments will be tax-exempt up to BGN 30 per man-month; this discriminates against the private pension funds, and reduces the freedom of personal income disposal.

The Law on Amending the Corporate Profit Tax Law (State Gazette, No153/1998)

There are two important changes, which the amendment makes in the Personal Income Tax Act and the Foreign Investment Law:

1. Amendments to the first of these laws increase the lowest threshold for tax duties by 25% while the highest by only 1.6%. This practically means a decrease of the tax burden *ceteris paribus*, i.e. if the income is held unchanged. The biggest decrease of the tax burden was for those who received income between BGN 60 and 80 per month. Thus, although the change probably had a positive impact on the business environment, this affected only the labor costs in businesses where the wages are about the minimum. This provision reveals legislators' concept of justice and fairness. Obviously the assumption is that it is more just and fair that low-income persons pay lower taxes, while those with higher income pay disproportionately more. A radical change would rather mean that different levels of income are taxed equally. The current law put higher income in a disadvantageous position.

2. In the Foreign Investment Law articles were abrogated which allowed for:

- Free import of investment goods above USD 100,000 which are to be incorporated into the capital of a company as an *aport* installment by a foreign partner or shareholder.
- A temporary import regime (which means free of customs duties for a given period) for investment goods which are subject to financial leasing, i.e. they are not property of the foreign investor for the whole leasing period.

The immediate effect of the change was an increased cost for fixed capital, thus decreasing the incentives for foreign direct investment (both for the "green-field" investors and those who entered Bulgaria through privatization). These amendments were resisted by BIBA, but without success.

The Tax Procedure Code (State Gazette, No103/1999)

The code regulates registration of the tax liable persons, tax and state receivable collecting and tax administration. Positive impact on the microeconomic environment comes from the outlining of the clear tax procedure, which was regulated before by different decrees.

According to the Tax Procedure Code tax liable persons are:

- Bulgarian natural and legal persons;
- Foreign natural and legal persons;
- Non-incorporated partnerships, branches and representative offices of foreign persons which have permanent establishments in Bulgaria or have income from Bulgarian sources.

A new concrete regulation in the TPC is the accepted notion of a branch of a foreign legal entity as a separate tax liable person. This means that currently trade representative offices are identified as separate tax-liable entities, although under the Foreign Investment Law they are not allowed to perform business activity in Bulgaria. This inconsistency can lead to impediments for foreign investment in the country. But this provisional impact depends on the underlying reason to register a given business branch. The new regulation will most likely discourage branches which are in Bulgaria to tackle administrative barriers to trade. Those who are here for longer-term investment will not suffer. It seems that the new regulation will have a negative impact on registered companies from neighboring countries: currently their number is equal to that of EU companies while their investment is five times less than that of European companies.

Tax authorities are required to keep a tax register of all taxpayers and foreign entities are obliged to have a general tax registration if their effective management is in Bulgaria. This notion is new for Bulgarian tax legislation and its implementation is still unclear.

Tax procedures are described in detail and new provisions allow the filing of tax returns through banks approved by the Ministry of Finance and by electronic mail. This will make the procedure easier and will cut down on the administrative and transaction costs.

According to the Tax Procedure Code regulation the State has the right to collect its revenues "first", before other creditors, and this negatively influences the microeconomic environment.

The State Revenue Agency is a new institution, which is established by the amendment to the Law on Collection of State Revenues. The Ministry of Finance supervises it and its main tasks are the organization and supervision of forcible collection of state liabilities and representing the state in insolvency procedures. The establishment of the Agency has a positive impact on the microenvironment due to better control,

especially on state enterprises, which are the main debtors. It also will increase the transparency in granting subsidies, in one form or another, including subsidies to the private sector. (It already happened in late March 2000, in the context of the parliamentary hearings on the State Railways Law). On the other hand it will increase the volume of collected liabilities. A non-government organization, which was involved in advocacy on this and other tax bills, was the Union of Bulgarian Taxpayers (UBT). For the time being, however, UBT is rather a promoter of the government regulations than a partner in improving them.

The Law on Amending and Supplementing the Excise Law (State Gazette, No153/1998)

This amendment affects the macroeconomic environment as the excises constitute a big part of the state budget revenues and every change in the excise legislation affects the state budget. In this case the amendment affects the excise revenues positively because it abolishes some possibilities to avoid the Law:

- The excise is defined as an absolute amount paid for each liter/percent of alcohol which should discourage producers/importers from declaring lower prices in order to pay lower excises;
- Trade in draft spirits (wine and beer not included) is forbidden according to the amendment. Prior to the enforcement of this rule, the shopkeepers avoided paying excise in this way.

The impact on the microeconomic environment is both positive and negative. On the positive side we have the following: domestic and imported spirits are treated equally, the unused excise stickers are treated as expenditures for accounting purposes, some goods were taken off of the excise-list, etc. On the negative side we have some odd regulatory harassment like the obligation of wine and spirit producers to buy measurement appliances, to conduct and pay for different additional analyses upon request from the tax authorities, etc. These provisions are merely transferring costs from the government control bodies to the private sector. The excises for the cigarettes were defined according to the so called "mixed tax system" -- as an absolute amount per number of cigarettes and as a percent of the selling price. This lowered the excises of the imported cigarettes and increased the excises of the domestic ones but this did not have a greater impact on their competitiveness and prices. There is no data on private sector advocacy on this bill.

The Law on Consumer Protection and Rules of Trade (State Gazette, No30/1999)

The private sector involvement in advocacy for this law was substantial. The law has been widely discussed and criticized before and after its adoption. On the one hand, it regulates the consumer protection, the rules of trade, and the relationships between government institutions, consumers' alliances and professional organizations of tradesmen. It also sets the rules for labeling of goods, producers' responsibility for guarantees, etc.

On the other hand, it increases significantly the trade firms' costs. Also, it takes no account of the costs of protecting consumers' rights. Consumer protection is perceived, for some reason, as a duty of government institutions. If a municipal or state authority suspects a harmful impact from a specific good, the law allows them to stop its trading and start an investigation. (Such a procedure is not constituted under the Civil Procedure Code.) If the good proves to be harmful, the merchant must bear all the charges for the investigation procedure. If the good proves to be harmless for provisional consumers the charges are borne by the authority which initiated the procedure. It is not clear who will compensate the business for the lost profit.

The Law also gives inconsistent definitions of unfair and misleading advertising. Moreover, the people who use such advertising can be sued. During the trial the court may require proof of the correctness of the statements in the advertisement (such as the bigger bubbles that occur when chewing a certain gum). Additionally, the producer is responsible for property damages that incur as a result of the use of a good he manufactured even if he is not guilty for the defect.

The Law also imposes more obligations for the institutions themselves. The municipal authorities are obliged to create special departments on consumer protection, which duplicate the responsibilities of civic consumer alliances. The National Information Register of Tradesmen in Bulgaria, within the Ministry of Economy (previously, the Ministry of Trade and Tourism) is created under this law. It is duplicating to some extent other registries such as BULSTAT. The Law also requires documents issued by different ministries and also requires eight additional regulations from the Council of Ministers to license trading in specific goods.

The overall impact of the law is negative. The civic organization that advocated the adoption of this law was the Bulgarian Federation to Protect Consumers. The content of the law is one evidence that advocacy for private sector development is still weak and inefficient. An interesting dimension of the rhetoric to defend the content of this bill is that the argument of EU accession was used, pretending that "this is how EU-members protect their consumers". The adoption of this act (in this form) is, in fact, a pervasive result of the poor product liability regulation in the Bulgarian legal system. Another factor in the adoption of this law was the strong backing it received from the then minister of trade and tourism who insisted on having the ministry protect the consumer.

The Law on Protection of Competition (State Gazette, No52/1998)

The private sector involvement in advocacy for this law was modest. There are two known efforts to influence the content of the law, which were only partly successful.

IME contributed successfully to the adoption of three provisions ensuring better implementation. IME's contribution was related to applicability of the law to all persons and institutions. The original version of the draft excluded natural persons (i.e. sole proprietorships) and government institutions, which presumably could support pro-cartel practices. IME failed, however, to defend its vision on how to regulate government monopolies. The original draft required that "respective government agencies" control government monopolies, whereas we insisted on independent controllers. Eventually, the Parliament decided that these monopolies would be regulated by special acts, (e.g. communications, power sector, railways, gas-supply laws, etc.) Telecommunications and Energy Sector laws have already established respective regulatory bodies as agencies of the central government (i.e. not involving any customer control). An exemption of this tradition is the Water Law, which provides for the establishment of four locally based Water Councils, following the French-Dutch regulatory model.²² (This part of the water act is not implemented yet.)

Private sector companies, Danone and McDonald's in particular, poorly represented in the draft, led the second attempt. They advocated a better definition of product promotion activities but failed completely.

The law sets regulations to limit the possible monopoly position of the companies on the domestic market. The definition is that an enterprise is considered to have a monopoly position if it holds more than 35% of the relevant market. A positive achievement is the definition of monopolistic practices. This allows for the efficient activities of the Competition Defense Commission (CDC).

Under art.11 (1) the enterprises have to inform CDC about agreements with other enterprises concerning joint market activities or acquisitions. The procedure of informing the Commission, preparation of all documents and getting approval by the Commission is a long administrative process that imposes time costs for the managers and for the administrative staff. The requirements for verifying the compliance with the law's rules are related to examination of huge volumes of information and documentation.

The law restricts government interventions in support of enterprises. In principle such restrictions would have a positive impact on development of competition among the companies but for the period before mid-1999 it has been applied only to private companies. But whether it is actually happening is matter for a special survey.

The anti-trust regulations strengthen control and aim at promoting fair competition on the national market. The CDC has all the rights to observe and control the joint activities of enterprises and to estimate the level of concentration of the enterprise's activities on the market.

The Law on Foreigners in Bulgaria (State Gazette, No153/1998)

This law has direct impact on the microeconomic environment as it defines the entrance, residence and exit of foreigners in Bulgaria.

Regarding initial entry of foreign persons, the law does not seem to create difficulties or to impose additional burden on foreign investment.

Obstacles can appear when investors from visa-free countries enter Bulgaria only on this ground and according to the regulation they can stay in the country only for 30 days. If they want to stay longer they should either find another reason to reside or spend more time or to exit the country and to enter again. For those who need visas, they are typically issued in one week or less. In addition, the documentation requirements for obtaining a visa are not particularly complex.

Regarding residence, the law reduces previous red tape. But the process might still be more cumbersome than expected. A permanent residence permit requires that the applicant:

- have a work permit,
- perform a commercial or other activity,
- be a manager of a representative office of a foreign commercial company registered with the Bulgarian Chamber of Commerce and Industry,
- perform activities according to the Law on Foreign Investment;
- perform activities at the request of a person who has invested in the country under the Law on Foreign Investment

Negative impact on the foreign investment may come from the limitation of long-term residence visas to one year. It leaves foreign persons in a continuous state of administrative uncertainty. Additionally, long-term

²² Drafting and hearing of the draft water bill was done with the support the Center for Social Practices with the technical assistance of the Dutch foundation NOVIB.

residence permits are renewable annually and for renewal the individual must submit the Court Registration certifying that the company is still in existence, as well as a certificate from the tax office stating that all tax obligations have been met. The fee for a long-term permit is DM 200 or DM 500 for residence periods of up to 6 months and 1 year respectively.

Obtaining permanent residence is an incentive for the foreign investors to operate in the country as they will not spend time in solving administrative residence problems. Permanent residence can be obtained when:

- foreign individuals invest at least US\$250,000 in Bulgaria. A certificate is issued from the Bulgarian Foreign Investment Agency (BFIA) stating that the individual is a foreign investor and that he/she has met the required amount of investment. In addition, a certificate from the Central Bank is required;
- he/she has legally resided in Bulgaria for at least 5 years.

The fee for a permanent residence permit is 1,000 DM. Issuance of permanent residence permits is reasonably straightforward.

Foreigners who have a visa or a long-term residence permit also need a work permit in order to be legally employed in Bulgaria. A work permit allows a foreigner to work only under a specific contract for a specific company for the period indicated in the permit. Foreigners who have a permanent residence permit do not require a work permit. Issuing a work permit is rather time-consuming procedure -- 10 documents are needed and there are five strict conditions to satisfy.

Under the authority of the Ministry of Labor and Social Policy, the National Employment Agency (NEA) is charged with issuing work permits. Only the employer can apply for a work permit issued to one of his or her future employees. Prior to the application, a written labor contract needs to exist, while the foreign worker is formally not allowed to reside in the country. Bulgaria's work permit policy is motivated by the desire to maximize local labor participation in foreign investment projects. However, the effectiveness of the system currently in place is questionable. Investors almost consistently reacted negatively to the process as the educational background of the applicants can be questioned or not accepted by the NEA. Determination of job qualifications will always be subject to judgment rather than objectively measurable criteria. Investors are the only ones that can determine whether a particular individual is qualified for a specific job. No government entity, no matter how specialized, will ever be able to make these decisions on behalf of investors. Should the NEA refuse a work permit, it is not very likely that this will result in the employer turning to a Bulgarian national for this job instead. More likely, the employer will try to find other means to avail himself of the services of this expatriate. Hence, it is fair to assume that the existing system does not contribute to a significant increase in local employment; instead investors rather try to avoid the mechanism as a whole.

The limitation of the length of work permits to one-year periods creates difficulties for investors and the administration alike. Employment contracts are typically for several years, forcing the employer and the expatriate to re-apply every year. This adds to the paperwork burden for the government as well as the companies, while expatriates cannot be offered a minimum degree of certainty regarding their employment arrangement.

Hiring more than ten workers with a work permit requires the consent of the Ministry of Labor and Social Policy.

The current policy on work permits does not reflect the market realities that local labor is considerably less expensive than equivalent foreign labor from the home countries of the most important investors. Hence, there is a strong incentive for investors to hire local skills whenever possible. However, in a small economy such as Bulgaria, it is often impossible for a firm to find individuals with the necessary training, experience, or qualifications, especially in fields such as management and marketing. Foreign firms typically bring in expatriate personnel for these positions initially, train domestic personnel, and replace the expatriates as soon as possible.

2. Sectors

The Law on Tourism (State Gazette, No71/1998)

The law stipulates that hotel and restaurant business, tour-operators and tourist agencies are all subject to licensing by the Minister of Trade and Tourism. The law postulates that licenses are issued for an unlimited period of time and the conditions for issuing licenses are defined in the Ordinance on Tourist Activities' Licensing. (State Gazette 99, 25 August 1998). These conditions include submitting a certain number of documents (up to 11), having an educational degree, and paying a license fee. Licensing fees for tour-operator and tourist agencies are BGL 5,000 and BGL 2,500 respectively, and they do not depend on the scale and scope of firms' activity. Obviously the aim of the license fee was on one hand fiscal, and on the other hand, regulative (only firms which meet the stipulated conditions and choose to confess part of their firm secrets for the purposes of registration are allowed to perform tourism activities). The law also envisages that "the state supports tourism development through providing sources for national and regional tourist advertisement, market surveys" and so on. Necessary funds for covering these costs should be

collected from license and categorizing fees. It is proper to analyze the effects of these regulations in three aspects:

- net fiscal effect, i.e. incomes and costs (including unrealized incomes due to these regulations) in the state budget in the short-term and long-term periods;
- net effect on the tourism industry (in terms of benefits and direct and opportunity costs);
- effects on the overall business environment (general and concrete for tourism).

If we assume that the Ministry of Trade and Tourism's administration keeps unchanged, the net fiscal effect in a short-term period will be positive (at least not negative), as the single collected fees from tourist firms will increase state budget revenues at once. But in the long run we must mention the missed tax income from firms which stopped operation because of the new licenses. Moreover, tourism is a branch around which many supporting and connecting industries could be developed and it could turn into a relatively strong cluster. Slowing down this development will have an indirect negative effect, although hard to estimate, on the state budget revenues.

Travel and tourism firms benefit from some state activities, such as national advertisements, surveys and providing of information. However these benefits are almost impossible to measure, and so are the costs deriving from them. In addition, the opportunity cost of these benefits, i.e. if these activities were privately financed, probably would be very high. Therefore, the net effect on tourism business will be negative as a whole. Hypothetically, big companies should be favored as the costs will not be reciprocal to the benefits; however this holds only if they do not spend their own resources for advertisement (national and regional).

Conditions in the tourism business environment have been deteriorating since the law was enforced for at least two reasons:

- 1) There are new administrative barriers to small firms entering the tourism market;
- 2) The costs of active tourism firms have increased because of the license fees

These additional costs should be added to the price of the service or absorbed at the expense of decreasing profit in the short-term period, because firms are not sure that the "life-long" licenses will be valid for more than a few years (because of the unstable normative and administrative framework for business regulation).

The law has a negative effect upon the overall business environment. The latter has deteriorated due to the preservation of a tax policy which is not based on a reciprocal principle between income and tax. Every deviation from that principle is accepted as unjust because, naturally, big firms are more favored by state services. Therefore such regulations influence negatively entrepreneurship which flourishes in a legislative framework that is first, stable and secondly, in compliance with the generally accepted criteria for justice.

The Law on Road Freight Transportation (State Gazette, No 82/1999)

The Law on Road Freight Transportation is another good example of the imposition of regulation of sector activity by central institutions (the Ministry of Transport and the Autotransport Administration Chief Department). It is a perfect example of the suspicious attitude of the government towards the private sector. The requirements that all private transport companies (domestic and international) should meet reflect a "government-knows-best" understanding of how the economy functions.

Freight Road Transport must be treated as an institutional issue as well an issue which is an important factor for transaction costs in domestic and international exchange. The Law establishes that the Minister of Transport must license all carriers (domestic and international). The license issued by the Minister of Transport is valid for two or five years according to the type of transport. The requirements set in the Law are "reliability, professional competence, financial stability, and road-worthiness of the vehicles". The law 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. The term "crisis" (one of the most difficult terms in the theory of economics) is defined in the Law as: "*existence of substantial and probably long-lasting surplus in the supply of transport services compared to consumer demand, which presents a serious threat to the financial standing and survival of a substantial number of carriers*".

Adoption of such a provision presupposes an intervention on behalf of the Minister. It is directed towards the protection of the interests of the group of already licensed carriers. And it harms the interest of the carriers who would like to enter the market and those of the relatively huge group of consumers of transport services and consumers of goods and services whose prices include transport expenditures. The grounds for such an intervention of the Minister of Transport were not defined. There is a possibility for pressure on the Ministry of Transport's administration on the part of the carriers that are already licensed, and respectively possibilities for corruption. Having in mind the increased transport expenditures for Bulgarian exports due to the damage to Yugoslavian infrastructure and expensive procedures regarding cross-border transportation through Romania, introduction of the legal opportunity for maintaining the prices in transportation is more than inadequate.

The law requires that the Ministry of Transport issue ordinances to establish the necessary documents and procedures for licensing. As of the end of 1999, no such ordinance existed. According to the Law there are 11 cases in which the Minister of the Transport should issue ordinances in order to establish procedures and/or necessary documents. In addition to the requirements for licensing, there are requirements for obtaining permits for international freight and passenger transportation. Such permits have to be obtained by domestic carriers for transportation of freight and passengers abroad, as well as for foreign carriers for transportation to or transit through Bulgaria. The law also imposes reporting requirements. The carriers are obliged to submit statistical information on their activity.

The Laws on Amending and Supplementing the Insurance Law (State Gazette, No 93/1998, No 88/1999)

Insurance was among the sectors that went through the most serious changes in 1998 and 1999. The amendments of the Insurance Law are important since they resulted in re-distribution of the insurance market. In 1998, all insurance companies went through obligatory re-registration. The idea of such licensing was to eliminate from the market the criminal insurers (most of them moved over from the security business) and to develop the insurance market with participants that comply with the rules. The amendments are aimed at excluding from the insurance market companies that have been transformed from previously existing insurance companies who did not manage to obtain a license, through renaming, merger or restructuring. The changes stipulate that a license will not be issued if the insurance companies have provided security services after 22 July 1997 or if their capital is partially or fully paid by persons involved in the security business. The same are the terms for revoking licenses. Insurance companies which were refused a license cannot appeal the decision. According to the new requirements imposed by the law, in case a license is refused, the company should transfer its insurance portfolio to insurance companies who have obtained a license. In practice, this means transfer not only of insurance contracts, but also of insurance risk. In reality, the tacit objective of the law was to put some order in contract enforcement, prohibiting racketeer-companies registering under the name of insurance companies (see the paragraph on regulatory reform legacies). Without a doubt, it was and still is a popular regulation. But in fact it was saving the costs of the regulatory agency in collecting evidence in order to refuse a license. There is no guarantee that this provision will not be misused in the future.

In the end, of the 112 insurance companies operating on the market at the beginning of 1998, 27 insurers were registered at the beginning of 1999, including 17 general insurers and 6 life insurance companies. At the beginning of 1999, 82 liquidation and insolvency procedures against insurance companies, which were operating but did not receive licenses, were taking place.

The significance of this process of licensing and the following re-distribution of the insurance market obviously imposed the necessity of strengthening the supervisory functions of the Insurance Supervision Directorate. According to the amendments, the Directorate is responsible for:

- Granting permission to companies to acquire more than 5% of the capital of an insurance company. Before the change in the law, such permission was given by the National Insurance Council. The argument for the change is that in this way it will be easier to control the origin of funds in the insurance business;
- Approving insurance companies' mergers;
- Licensing brokers and respectively revoking licenses;
- Permitting entrance of new companies into the market;
- Allowing transfer of portfolios from one insurer to another;
- Opening liquidation procedures;
- Allowing sales of insurance companies in the process of liquidation;
- Approving the annual re-insurance programs of the insurers, controlling their re-insurance contracts and enforcement of these contracts. The aim of the introduction of such control is to prevent some companies from turning into mediators for unlicensed foreign insurers;
- Auditing funds and other financial matters.

The institution responsible for the licensing of the insurance companies is the National Insurance Council. Amendments in the law also impose more comprehensive regulation of the statute of the insurance broker and the insurance agent. The strengthening of requirements could be explained by the expectations that most unlicensed companies would become brokers of the licensed insurers. Therefore, brokers should be licensed by the Directorate and should be entered into a special register kept by the Directorate. The brokers' transaction costs are affected by the requirement for brokers to be insured against damages due to negligence for the duration of their activities. New restrictions concerning the insurance agents were imposed. An insurance agent cannot enter into a labor agreement with an insurance company. It can work with more than

one company but must choose whether to work in general insurance or life insurance. The agent cannot work with an insurance broker and cannot be involved in security services.

An important change, which has an impact on the microeconomic environment in the insurance business, is the requirement that the minimum required capital be collected only in cash. Prior to amendment, it was possible for half of the capital to be subscribed through in-kind contribution. There was a practice among insurance companies to fulfill the capital requirements by using in-kind contributions whose value was overestimated.

The costs of operating of the insurance companies are affected as a result of the requirement for these companies to maintain something similar to the banks' minimum required reserves. Insurance companies are obliged to maintain an account at a commercial bank which represents at least half of the minimum guaranteed capital for the respective kind of insurance policy. The purpose of this requirement is to guarantee that the companies permanently will have enough liquid money to pay for damages.

The above mentioned requirement, together with the requirement for giving information to the control body, additionally raises the price of insurance.

The Insurers Association advocated the original (1997) insurance law. The amendment was almost entirely supported by the regulatory body itself.

The Law on Gambling (State Gazette, No 51/1999)

The Law on Gambling has been welcomed by all interested parties involved in the gambling business (firms, supervisory authorities, etc.). The leading commission in the Parliament was the Budget and Finance Committee. The chairman of the committee, Mr. Yordan Tzonev, himself took part in the drafting. It introduced a new and complete regulation of the "rules of the game". The law provided for re-licensing of the existing firms in accordance with the new requirements which imposed some costs for them. The tacit aim of the draft was to put alleged criminal structures out of business. It is not yet clear whether the objective was achieved. For the time being it is obvious that the entry barrier (in a form of a tax per gambling machine) forced many small vendors to close their operations.

The law created the Government Commission on Gambling and the General Directorate for Control on Gambling Activities and specifies their rights and obligations. It also defines the different types of games which are included in the Law's scope. The general impression of the Law is that it introduces a complicated set of permissions, licenses and prohibitions. But we should bear in mind that it is a normal practice in most of the countries to maintain rigid control on gambling. Also, the Law sets clear deadlines within which the General Directorate should close all investigations of the requests for permission, which is a very positive regulation. As the Law sets clear rules for conducting gambling activities we think that it has a rather positive impact on the microeconomic environment. However, it introduces higher requirements for foreign persons who would like to get involved in the gambling business in Bulgaria and sets respectively higher sanctions. In fact there is a double pricing (upon entry) for domestic and foreign entrepreneurs. In general the law protects the interests of bigger domestic players versus small and foreign entrants. We believe there was a tacit influence of these players on the content of the law.

The Law for Wine and Alcoholic Beverages (State Gazette, No 86/1999)

The law is an example of restrictions imposed on private initiative on a sector basis.

This stems from the following factors:

- The requirement that all producers of grapes and grape products must submit declarations about the yield;
- Wine and grape producers and traders must declare the stock.

These two requirements violate the commercial confidentiality of producers and traders and can create incentives to present incorrect information.

The law requires establishment of a large number of normative orders – more than 10 regulations and instructions, which burden the law's implementation, and increase bureaucracy and possibilities for corruption.

Implementation of the law may increase transaction costs. Wine producers have to be registered and alcoholic producers have to have licenses. A registration regime has been introduced. Storing and wholesale trading of grapes and grape products can be possible only after receiving a license from the mayor of the municipality. There are introduced registration regimes (3 types), licensing regimes (2 types), and a host of required documents and certificates. All these requirement increased transaction costs.

The law does not create favorable conditions for foreign investments in the sub-sector, mainly because of the prolonged and complicated regulative measures and existing bureaucratic system.

The Association of Wine and Alcoholic Beverages Producers advocated the law.

The Law on Veterinary and Medical Activity (State Gazette, No 86/1999)

The law imposes unfavorable conditions for importers and exporters of animal and vegetable products. The National Veterinary and Medical Service is not responsible for damages and losses stemming from “necessary” shipment detainment at the border veterinary control services. There are no stipulated terms for processing the goods at the veterinary control services. Owners of goods can be compensated only in case of forced slaughtering of animals. All private entrepreneurs’ losses – damages due to improper storage (of animal and vegetable products, not durable goods), default due to unobserved contract deadlines, missed profits – are not covered by the state.

The National Veterinary and Medical Service creates a Government Prophylactic Program annually and compiles a list of contagious and parasitic diseases, which should be controlled. The Minister of Agriculture and Forestry defines the implementation of prophylactic measures and terms. All these measures are financed by the state budget. The animal and vegetable product owner covers all other preventative measures not included on the list.

According to the obligatory government prophylactic program, the state agency can indirectly finance:

- Certain production of animal and vegetable raw materials in different regions as the diseases are specific for animals and geographic regions;
- Firms producing veterinary patent medicines preventing diseases because, first, medicines licensed only by National Veterinary and Medical Service can be used; second, specific preventative measures are defined by ordinance and not by the law itself.

The law prohibits selling foodstuffs of animal origin without passing veterinary and sanitary control. But the law does not envisage a special seal of approval for the checked products. Thus private firms are deprived of veterinary control benefits which are connected with costs but do not yield anything in return.

The Law on Veterinary and Medical Activity imposes government institution monopoly on export of products of animal and vegetable origin. The National Veterinary and Medical Service not only certifies export firms but the places where animal and vegetable products are produced and processed.

Enforcing private property and creditors’ rights

A general remark

In the period under review there was limited progress in enforcing creditors’ rights. Registries of public property do not function properly, and remained structured along ownership, not by location of land and real estate. This hampers the general access to information on property transfers. These problems are fairly visible in the area of restitution (see the remarks on the Compensation Law below and footnote 23). It seems meanwhile that private parties in property transfers are obliged to register changes in ownership with the notaries but government institutions are not (e.g. when privatizing), or attempt to transfer the cost to private parties. The present legislation in Bulgaria provides for opportunities of owners and companies’ creditors to initiate liquidation and insolvency procedures. These procedures are borrowed from the EU legislation. Implementation is comparatively patchy – the average insolvency procedure duration exceeds two years, whereas liquidation procedure takes one year. The main reason for this delay is the lack of practice and low level of interaction between institutions. Another weakness is the fact that the government prevails as initiator of insolvency procedures for other subjects. All the above actually means that the involuntary exit from business of non-effective economic agents is still dependent on the State, while private subjects are not active yet.

In this respect, there has been some improvement since 1999 in procedure implementation, which brought an increase in their number. For the first half of this year, 100 insolvency procedures and about 1,600 liquidation procedures were started. In both categories, an acceleration in procedure realization has been noted compared to previous periods. This development is due to amendments in the procedure, as well as accumulation of experience, as some insolvency procedures were commenced in almost all regional courts. Considerable progress became evident during the second quarter of 1999 through the initiation of insolvency and liquidation procedures of non-performing state-owned enterprises. According to the IMF Agreement, insolvency procedures were to be started for not yet privatized SOEs on the so called “second list”. (There are some economic activities protected by the Constitution and/or special laws which are excluded from insolvency procedures. This “protection” is compensated so far by stricter financial control and monitoring. In order to introduce hard budget constraints in SOE’s, they were aggregated on a special list for financial recovery and intense control).

Generally, introduction of insolvency procedures in the country during the last few years has revealed both disadvantages and advantages in terms of regulating “the rules of the game”, hence promoting economic development. The positive development is the fact that many insolvency procedures have been initiated;

some are still in the process and some have been concluded. This will enforce discipline in the market. However, one big negative is still the situation of insufficient experience and inept implementation. In September 1999, the cabinet adopted a draft bill to amend bankruptcy provisions of the Commercial Code. The idea is that Sofia City Court would assume all insolvency procedures in Bulgaria (thus compensating for the lack of expertise in other regional courts and saving time and costs by speeding up the procedure). The suggested amendments anticipate simplification and acceleration of procedures. This should be reached through decreased protection of both creditors and debtors, i.e. they would have to strictly follow regulations, observe deadlines, etc. The bill is still pending in Parliament. Similar was the fate of the advocacy activities of the Association of Commercial Banks and some private think tanks to amend the Civil Procedure Code foreclosure provisions.

The Cooperatives Law (State Gazette, No 113/1999)

This act revoked the Cooperatives Law of 1991 (amended seven times since 1991) and the Facilitating Merging of Cooperative Associations Law of 1947 (amended twice in 1948). The Law has a deep impact on a micro level, especially on transaction costs, and property and user rights involving land. The main points in the Law are that:

- Only physical persons can become cooperative members. The Law does not create favorable environment for entities to become cooperative members. Thus, the main goal pursued by the Law is the so called “social role/function” of the cooperatives.
- In contrast to the previous law, this one explicitly prohibits agricultural land to be transferred to a cooperative as an asset installment. A cooperative can have only use rights over land. There is a requirement for a cooperative to sign contracts with all landowners, which has a dual effect on the cooperative and on landowners.
- A written form of contract supposes personal agreement with all real (current) landowners. This indirectly refers to the Land Leasing Law which insists on registering of all lease contracts in the MLCs and court. Average payment for documents for one parcel equals BGN 20. Usually land is located in two or three parts of the territory belonging to the settlement (TBS). Thus, the average documentation costs per landowner increased to BGN 40-60 (average BGN 50). The prevailing part of land owners are “absentee landowners”, and their costs increased with another BGN 40 for accommodation and travel. Let’s assume that a cooperative has to rent land from 100 owners – thirty living there (transaction costs [TC] = BGN 50) and the other seventy living far from the property (TC=90 BGL). Consequently the total TC should be 7800 BGL. Taking into account that the average number of cooperative members varies from 250 to 300, transaction costs per cooperative have increased tremendously.

In general, the act provides for clearer landownership rights. The limitation of cooperatives in dealing with land (on behalf of the owners, as used to be the practice), in fact, has opened up the prospects for the land market and consolidation. The adoption of the Law coincided with the already visible impacts of macroeconomic stabilization and the fixing of some agriculture finance instruments, especially the pioneering work on warehouse receipts²³. (They were regulated by the Law on Storage and Trade with Grain - State Gazette, No 93/1998). Especially in grain-growing regions of the country (North East Bulgaria) the process has already taken off. It passes as a rule through four stages: investment in machinery and limited lease, securing of warehouses, leasing of scale and purchasing land.

In another part of the law, however, legal scrutiny may find that this law violated in a very specific sense the freedom of association. Private persons may establish cooperatives but they are to be controlled by a government body, State Financial Control. The Central Cooperative Union and the Union of Credit and Savings Cooperatives failed to oppose this provision. The latter union also failed to promote the idea of permitting cooperatives to engage in credit activities.

The Law on Amending and Supplementing the Land Leasing Law (State Gazette, No 82/1996, No 35 and 113/1999)

The Land Leasing Law regulates leasing relations in agriculture. The law’s impact is dual. On one hand, transfer of land/farm usage rights creates opportunities for private initiative in agriculture to be stimulated by the determining of the minimum duration of the contract (4 years), and the necessity of having a written form of the contract.

Besides this, amendments of 1999 impose a registration regime for land leasing contracts in Municipality Land Commissions (MLC’s). The result is increased transaction costs for the lessee in terms of issuing the notarized sketch for the parcel from the MLC, and filing the contract with the notary entry book and in the

²³ The draft provisions on warehouse receipts have been substantially assisted by ACIDI/VOCA. We think it is one of the best advocacy examples in the reviewed period.

MLC. Contract registration in the notary office is a more than sufficient condition for a security guarantee. The rest of the registration procedures increase bureaucracy. Its purpose is to have a file on tenants for tax-collection purposes. The conditions and order of registration procedure in MLC's are under the regulation of a special Decree of the Ministry of Agriculture and Forests (MAF).

It is a typical case of combined negative impact of different laws, regulations and inefficient administration. In principle, the rental of land for use is tax deductible. It is expected that land-users would report their rent expenses. Tax officials can easily track the tax situation of landowners. Notary registry and deeds presumably function through the free choice of contracting parties (protected by the Contracts and Obligations Law) who voluntarily cover these security costs of their transaction. Article 3 of the Law requires compulsory registration of the contract with the notary and with MLC's. MLC's meanwhile are being transformed into local government branches. In fact, by mid-2000 two departments (land reform plus taxation) of one and the same government agency will keep the same information. It is not clear what is the rationale behind this paperwork. Perhaps the reason is lack of horizontal coordination within the administration. Since 1992, MLC's have been fully computerized with the support of the EU PHARE Programme. And parcel related information is easy to find. Many tax departments are computerized as well. Double registering may save administrative officials' time but at the expense of the contracting parties. The estimated direct costs of registration (issuing of necessary documents, sketches, and registration in entry book, different fees) equals BGL 30 per parcel. In addition there is in-kind cost (the time to visit offices in order to comply with the law). Altogether, the costs are BGL 40, if the respective departments work properly. It is three times the average rent per decare.

The Laws on Amending and Supplementing the Law on Compensation of Owners of Nationalized Property (State Gazette, No 45/1998, No 135/1998, No 12/1999)

The original (State Gazette, No 45/1998) had the objective of enlarging the scope of restitution of formerly confiscated urban and transformed real estate and assets. Previous restitution laws (eight laws adopted in 1991-1992) dealt with restitution of parcels of arable land as (and if) they existed in their physical boundaries. This law is one of the unique cases of a draft submitted by an individual member of the Parliament, Mr. Svetoslav Louchnikov, chairman of the Legal Issues and Anti-corruption Legislation Committee. The law has and will inevitably have a long-lasting impact on private sector development and public governance. A business association, namely, the Union for Bulgarian Industries (UBI), suggested the idea for the law. UBI is an organization which used to be a major private sector advocacy group before 1947. It was restored in 1990, and currently represents those ex-owners of factories and estates who now have the right to get ownership back over not just houses and flats but also production facilities.

But there was no particular advocacy for the adoption of the Law. Such regulation was part of the pre-election campaign of the ruling party. UBI had members within the UDF factions in previous Parliaments, but they lacked the needed majority to pass their agenda.

The idea was simple – to create a means of payment which the government would grant to those eligible for restitution of their former properties, and allowing those means for use in the privatization deals, e.g. to be converted into shares. The Law also declared these means tradable. The Law on Restructuring and Privatization of State and Municipality Owned Enterprises, or in short, the Privatization Law, had already reserved 10% of the shares of privatized enterprises for restitution claims (in addition to those 20% reserved for insiders). Any government share over 10% in a government owned entity was subject to restitution and compensation. This situation motivated the amendments to the Law. They had to solve two problems: a) to enlarge the implementation scope, including voucher privatization (regulated differently in comparison with conventional privatization deals), b) to attempt to overcome delays of privatization *per se*.

It is difficult to estimate the exact amount of properties and owners to be involved in the process: properties were transformed or vanished as physical assets, and the heirs of former owners have dispersed.

The process of the compensation is equal to the possible use in privatization of the so-called compensatory notes. The latter is a generic term for all three compensation means, i.e. notes as such, temporary notices (which notify possession of formerly nationalized properties), compensatory notes for nationalized living areas (houses, flats, etc.), i.e. "housing compensatory notes".

The implementation of the law was entrusted to district governors (who were to register claims and claimants) and privatizing bodies (the Privatization Agency and line ministries). Line ministers remain the principals of enterprises in privatization. They own the remaining government share after privatization. But they had to appraise the assets subject to compensation.

The Law represents a typical case of miscalculated impacts on the broader business environment, especially a miscalculation of the ability of the administration to cope with the requirements of the law itself. In brief, the problem is the following. Eligible former owners rushed in to file claims with government bodies.

Consultant companies, associations of compensatory-note holders, and other NGO's came in between to facilitate the process for the benefit of different players. Newly established district (or "*oblast*") bodies failed to register all claimants and to coordinate matters with privatizing agents (and principals). Line ministries, though not explicitly required by the Law, had to open their own registries of provisional claimants. The 10% stake merely reserved for restitution happened to be very different from managing these 10% as assets of a privatized enterprise. Former owners were interested in having the highest possible price, a provisional buyer wanted the lowest possible price. In addition, compensatory notes are tradable. People who own them want them for swapping into equity at the highest possible nominal value.

The implementation encountered a number of challenges. *Oblasts* did not have sufficient trained staff to perform their duties. Line ministries had additional work, which contradicted their duties related to the need to swiftly privatize. The emergence of a cheaper legal tender to be used in privatization tenders set an incentive for third parties to exercise influence, impede trading of the instruments, and thus decrease their purchasing value. Privatizing bodies had to deal with three sets of prices (for restitution claims, for insiders, and for outside buyers). The first result was delayed application of the law. UBI and its chairman, Mr. Ruslan Chilov, were the first to complain. He publicly alleged that *oblasts* and privatizing bodies were involved in corruption, provided faster service for political cronies, and created delays for the majority of the eligible ex-owners.

The amendments specify eligible persons' right to compensation. Compensatory notes issued under the Law have become legal tender (called an investment voucher) in privatization procedures regulated by Articles 43-52 of the Privatization Law (known as mass privatization).

- Compensatory notes, temporary notices, and the "housing compensatory notes" may be used as means of payment not only in privatization deals but also in some other deals prescribed by the Law like transfers of state property including land or the right to build on it etc. (Article 8.1). Actually, this provision recognizes (and legalizes) the fact that after the adoption of the law the privatizing bodies, in order to keep up with the pace of sales, have been selling detached units of which old owners did not know anything about. Presumably, in the eyes of the former owners such deals either decreased the value of the assets or dispersed the ownership right to parties they do not have any knowledge of. They were the first to complain, and Mr. Louchnikov expressed his disagreement with the amendments.²⁴
- The terms in which people are entitled to claim compensation from the relevant central or local government authorities was extended to one year (that is to say until 25/4/1999) (Article 6.1)
- The competence of the courts to review the government authorities' decisions and their so called "silent denials" was clarified and harmonized with the Law for the Supreme Court of Administration (Article 6.6)
- Registers were created of the compensatory notes given to the people whose claims were recognized. Actually people are given not orders but so-called temporary notes containing the information concerning the respective compensation notes. The registers are kept with the authorities obliged to deal with the claims under the Law (Article 6.9).
- The compensation given are not considered income in the meaning of the laws of taxation and therefore a tax preference appears in connection with them (Article 6.11)

The Compensation Law is a case in which a regulation intends to solve a detail in a counterproductive institutional environment. The majority faction in the Parliament gave the draft(s) top priority. It has even entered the field of taxation, regardless of the tradition of the last three years not to touch tax regulations via a specific act of the Parliament, which is not included in the agreed fiscal framework of the next year. But the Law created more conflicts than it solved problems. The reason is that it attempted to regulate a segment of property rights without parallel improvement of the general rules of the game in this area.

²⁴ The original law failed to diversify investment opportunities for eligible claimants because they did not manage to track the information on privatized assets. They even have problems proving their eligibility ("*oblasts*" - i.e. holders of registries have poor information on enterprise situation and legal status, privatizing bodies do not disclose the information they have) due to administrative mis-coordination. An alternative solution – identification of deals with detached units through property registries – seems close to impossible: registry is after the name of the owner and privatizers do not disclose the lists of completed deals with the names of the buyers of minority shares (at least not before the reporting period). Mr. Louchnikov opposed the permission privatizing bodies (i.e. line ministries) to sign deals with detached units as a violation of old/future rights of previous owners. His opinion, however was not sufficient to restrict the rights of current owners (line ministries). The amendments were looking for a compromise. But it looks virtually impossible not simply because of the content of the Law but rather due to asymmetric and expensive information (on privatized enterprises).

Public governance

The Law on Small and Medium-Sized Enterprises (State Gazette, No 84/1999)

The Small and Medium-Sized Enterprises Law (SMEL) is a concrete attempt to support small business. Besides the draft submitted by the government, different parliamentary groups submitted seven more drafts (prepared as follow up versions on draft bills discussed in previous years). The bill submitted by the Council of Ministers was based on the 1998 SME Strategy and accepted as a working draft. All other drafts, according to the decision from the first plenary hearings, were to be taken into account as well. In fact, all Parliament factions considered such a law as a priority. Hearings at the Economic Policy Committee were intense and well attended.

The difference between the drafts was that the cabinet bill was the latest and required no direct subsidy from the central budget (leaving most of the initiative to the local governments) while others would require a substantial central government financing. All the bills aimed at establishing a government Small and Medium-size Enterprises Agency (SMEA), as a body of the Council of Ministers. The law is the brightest example of the mass advocacy of business associations.

The assessment of its possible impact and level of enforcement might be done after comparison of the expected positive effects of its application and costs for achievement of these effects. For the time being, it is impossible to assess benefits envisaged by SMEL. They include advantages in privatization procedure equal to those for management-employee-buy-out companies, preferential rents, etc. The Law says most of these should and *might* be provided by local governments. Drafters of year 2000 municipal budgets have not exactly been rushing to create SME preferences. Any local quasi-fiscal subsidy would diminish the future bargaining position of mayors vis-à-vis the central government. For this reason local government would prefer to wait for a central solution. Elaboration of central programs to stimulate SME development is still forthcoming. The preferential regime for SME was not completed until early April 2000. Most SMEL chapters promulgating some sort subsidized preference for SME's have not yet been implemented. The exception is that the Promotional Bank has already opened its doors and accepted its first clients. Also, there was a spin-off impact of the SMEL hearing into the area of public procurement. The Economic Policy Committee put a special requirement in the public procurement law that the Council of Ministers should adopt a regulation on advantages for SME's when government bodies purchase goods and services.²⁵ Therefore, we concentrate our attention on *provisional implementation* costs and the *institutional impacts* of the Law.

- Article 5 creates a SME registry. In practice it will duplicate and enlarge the data in the BULSTAT registry, but the entrance will be voluntary. One should keep in mind that when measured by the number of employees, 98% of the active firms in Bulgaria are “small and medium-size”. We can expect that the administrative costs of the registry will be close to those of the BULSTAT registry.
- Another problem is fraud and embezzlement prevention, i.e. ensuring that the preferences are being used only by the eligible companies. It would require reliable registration and checking of the information submitted by companies which apply for preferential treatment. In case that the individual data continue to be treated as confidential, the transfer of such data between statistical bodies would be in written and confidential form. Thus additional time and direct costs for the agency and the other bodies, including courts, will be imposed. IME's calculation of administrative costs of registering enterprises with SMEA, with all the needed checks and balances, puts these costs as high as BGN 400,000. This is the one-time cost to put the registry in motion. Judging from what is published in the consolidated budget for 2000, the Agency is not envisaging full-speed operation this year. So far, it is difficult to estimate annual maintenance costs of the registry as well, as there is no information on additional costs imposed on the state budget.
- It is likely that SMEL has already created additional bureaucracy with unclear prospects for effective and transparent services to SME's. For this reason, it was important to include in the draft and to advocate adoption of a mechanism, which would allow for an improvement of the system in the future. Such a mechanism was found in the Annual SME Report. According to SMEL, it should be drafted by the Agency, submitted to the Council of Ministers, and disseminated for general discussion.

In September 1997, BAP (with the assistance of the Center for Liberal Strategies and IME) drafted and presented to the prime minister its 10-point agenda for SME development. The first of these points was that SME's must be given priority. The idea was picked up by the chairman of the Economic Policy Committee,

²⁵ The respective regulation was adopted in early April 2000 but is not yet published and implemented.

Mr. Nikola Nikolov. He hosted a group of independent experts who eventually, with the technical assistance of MSI, drafted the National SME Strategy.²⁶ The SME Strategy itself spurred a unique coordinated effort of different groups to influence the lawmaking. It was sustained over a long period of time (from late 1997 until mid-1999 when the SME Law was adopted) and was extended to influence other draft laws (e.g. the bill on public procurement). It has an institutional impact: the SME Agency was converted from a branch of the ministry of industry into a body of the Council of Ministers. We are convinced that SME advocacy constituted a case for broad political education of both business associations and politicians. It helped to outline different approaches to private sector development. Before this debate, business associations were rather focused on lobbying for privileged treatment of their members by the government. Amidst SMEL committee hearings, different political factions in the Parliament had their own internal deliberations on matters related to the law, e.g. the Conrad Adenauer and Hans Seidl Foundations organized discussions of the draft with the majority faction. As a result, the majority decided to accept the proposal for the Annual SME Report. The proposal was originally moved by think tanks and business associations but was left for a long time without consideration.

It is likely that the advocacy effort will be sustained over time because the SME Law promulgates a procedure for a public dialogue, namely the Annual SME Report, which gives an opportunity for a repeated reflection on the business environment and regular public consultations on policies to improve it.

The Administration Law and Public Servants Law (State Gazette, No 130/1998)

Frequent changes in the government, and especially of the core executives, in the 1990-1998 period took place without a framework for hiring and firing procedures. In 1992, the government of the Union of Democratic Forces, challenged in the courts for its efforts to restructure the administration and replace Communist-era civil servants, adopted an amendment to the then already completely outdated Labor Code (Article 358). It allowed for a relatively easy administrative reshuffle but induced insecurity among public servants. Eventually, this article was discontinued in 1995. But again there emerged a difficulty in adjusting the government institutions to economic and political reform requirements (understood differently by different incumbent political parties). The only remaining legal possibility to bring new public servants in office was to “liquidate” an administrative structure in order to create another one. Both political will and pressure to use administrative posts for the benefits of the party in charge, that is, its members and supporters, have remained. Often the rhetoric of reform has been used to further administrative restructuring which was brought in new bodies as a solution to different personal (possibly even intra-party) power games while only afterwards the new institution had to search for and identify its mission and duties.²⁷

Since 1995 parliamentary hearings on the Labor Code amendments, there has been a declared agreement among leading political parties to launch a comprehensive administrative reform. The rhetoric is that this should put an end to administrative uncertainty, incompetence, and frustration, as well as to bureaucratic resistance to change, and that there should exist a modern, cohesive, professional civil service. However, the different political parties have been constantly failing even to launch a debate on what this service should look like and how the desired condition could be achieved.

Eventually, the current government admitted it had a responsibility to proceed with the reform of the government institutions. It enjoyed an absolute and united majority of the seats in the parliament. It used to have unprecedented high approval rates for most of the time since it entered office. It had secured three-year IMF support for its programs. The World Bank has been assisting the cabinet in its effort to meet the challenges of the EU accession, and was planning to make available a Government Administration Modernization Loan in late 1999.

²⁶ The strategy was publicly presented in April 1998. It did not manage to become neither an unifying policy document of the business community (BIA issued a parallel strategy at the eve of the April presentation, focusing more on subsidies and preferential treatment of SME's) nor it proposed some sort of consistent policy. It, actually, has two parts: one dealing with mechanisms to improve business environment, the other pleading for a government support to SME's. But the Strategy was a real compromise between different views. Such a duality of the approach is not at all peculiar for Bulgaria.

²⁷ The most notorious case was the creation of the “super” (as Bulgarian used to call it) Ministry of Economic Development (MED). It started as an ambition of new economic visioning as well as a restructuring of a respected government think tank (Agency for Economic Coordination and Development, AECD). It ended in controlling privatization, prices, bank reforms and privatization (being a principle of government banks), negotiations with international financial institutions, OECD and EU. Later, with the new cabinet MED was closed. But the effort to preserve AECD as a research arm of the government (with people capable of doing research) had passed through AECD liquidation and the creation of a new institution, the Agency for Economic Analysis and Forecast (AEAF), a branch of the ministry of finance.

It is still at the level of legislative efforts. The necessary laws are adopted and implementation is either pending or is already taking place. The general feature of the preparation period of these laws is that, in fact, nobody was consulted with and there was no public debate. Citizenry and the private sector, as the major consumers of the government services, were never asked to express their vision. No private public-policy institute was involved in the drafting. Even the incumbent public servants were not asked what administrative model was acceptable. Trade unions did not pay attention as well.

The key act in initiating the reform was the Administration Law (AL, adopted in October, promulgated in November 1998 - State Gazette, No 130, 1998). It distinguishes between specialized (or the core civil service), general (support services) administration and political appointees (the PM, ministers and their deputies). Servants of the general administration have labor contracts according to the Labor Code, while others have special contracts regulated by a special act, the Public Servants Law (PSL, adopted and promulgated in July 1999 - State Gazette, No 67, 1999). The AL also introduces ministerial administrative secretaries (who run support services) and stipulates that the PM, his deputies and ministers establish their “political cabinets” (Article 27). Formally, political cabinets have a separate item in the ministry’s budget with “advisory, info-analytical” and “PR” functions to implement “the links between a given executive body and the public”; they also “assist in the elaboration of concrete policy solutions” as well as “the presentation of the policy before the public” (Article 28,1). Members of the PM’s and his deputies’ political cabinets are their respective chefs d’cabinet, parliamentary secretaries, and PR officers; the political cabinet of the line ministers includes their deputies as well. The PSL establishes hiring and firing procedures, unifies career ranks for specialized public servants, and secures pension contributions and healthcare insurance from the state budget. The Law requires the establishment of a Unified Classifier of Administrative Ranks (seven junior and five senior ranks) listing all positions, and the creation of a State Administration Commission²⁸ to control the PSL’s implementation, and its fairness.

The devil, however, is in the details. The AL and PSL leave a number of important details to minor government acts and implementation rules. The Unified Classifier is not yet published and its content is yet unknown. The PSL (Article 74.1) stipulates that promotion from one rank to a higher administrative position requires “no less than 3 years and not more than 5 years of service”; qualification and all other requirements are left to the internal rules of procedure of line ministries.

The Law on Regional Development (State Gazette, No 26/1999)

The law required district governors, in cooperation with the broader public, to draft regional development plans.

The main characteristic of the law is the creation of conditions for sustainable and balanced regional development and decreasing the income disparity of the regions. The law outlines a new approach to planning and management involving districts and local authorities. The favorable effect on macroeconomic environment could be expected in the long run, after improvement of the allocation of resources and investments on the basis of the priorities and advantages of the regions.

The Council of Ministers takes decisions on investment policy and identifies needs for financing the priorities of the regions. The centralized regional planning and development is a form of inefficient management and creates preconditions for the state to influence development of the private sector on a regional level.

The enforcement of the law will increase the administrative costs because of the necessity of creating administrative staff serving regional planning and its adoption at central and regional levels.

The National Development Plan is a major tool for improvement of investment policy on national and regional levels. One of the EU criteria for efficient structural policy is the introduction of general rules for preparation of regional plans and the national development plan.

The partnership between central and regional administrations, community authorities, non-governmental institutions and private sector is not clearly recorded in the law. Under the law the district governor and district councils have obligations and responsibilities on regional plan development and administration of the process of region planning. The district councils are the consultants and main actors for preparation of the regional plan and for identification of the business priorities on regional and local levels.

An administrative approach to business and private sector development on the ground of centralized criteria is not an efficient way for promoting the private sector and entrepreneurship. The main issue of the law is that representatives of the private sector are not involved in regional planning and district administrations and bureaucracy defends their interest.

²⁸ This Commission was established by a State Council’s (a body parallel to the Council of Ministers under the constitution of 1971) Decree 2472 of 1985; it is currently a part of the Council of Ministers, but exists only on paper.

Private sector development in the regions depends on priorities stated in the regional plan approved by the government, more specifically, by the Ministry of Regional Development.

In terms of the law, civil servants (the Council of Ministers and Ministry of Regional Development, district councils) play the crucial role in specifying the criteria for determination of priorities and investment needs and this leads to implementation of an irrational policy for promoting business and improving private sector development. Establishment of development agencies aimed at supporting the use of regional resources and opportunities and enforcing self-government on the local level. To a great extent regional development planning resembled central planning, but the law served as a laboratory for public/private partnerships.

No private sector company is thought to have had an influence during the preparatory stage of the law. But the private sector was actively involved in elaborating regional development plans in all districts of the country. Particularly extended was the debate on the Sofia District Development Plan (which involved BIA and BCCI). Some other districts initiated a broad public debate as well. In Razgrad, seven USAID sponsored organizations and IME (led by MSI) have been involved in the first and the later stages of the public debate. The Foundation for Local Government Reform was involved in the debate from the very beginning.

The Public Procurement Law (State Gazette, No 56/1999)²⁹

There were no general rules for the government to procure exclusive rights, offers and services for most of the transition years. The first Bulgarian law on public procurement was adopted in January 1997, seven years after the beginning of transition. It remained without implementation until June 1999 when the second public procurement act was passed. The new act provided stricter procedures and much clearer division of duties of state bodies. But it lacks a definition of "public procurement", and excludes, in fact, subsidiaries and NGO's from being subject to regulation when providing services to the government, requires after-auction confidentiality of the offers, and restricts access to the files of the control bodies.

The Law on Public Procurement is to a great extent harmonized with the EU legislation. Besides the better establishment of duties and responsibilities, there are three key positive achievements of the Law:

- 1 Its scope includes the so called "natural monopolists", i.e. the suppliers of public services such as Bulgargas, NEC, Water Supply and Sewage, etc., and thus it attempts to provide higher transparency in their expenses.³⁰
- 2 Upon the advice of outside experts (from think tanks and business associations) the government draft was changed -- the possibility for avoiding the Law through creation of joint companies between contracting entities and bidders was removed.
- 3 The creation of a public procurement register will guarantee preconditions for the transparency of the procedures, if and only if minor regulations ensure access to the registry.

The impediments to the Law's effective application are as follows:

- The thresholds under which the competitive procedure applies are too high for Bulgaria (BGN 600,000 for construction services³¹, BGN 50,000 for goods and BGN 30,000 for services purchased by the government) which means that a big part of the government expenses will not be subject to public procurement rules (keep in mind that the government expenses constitute 38% of GDP); interestingly enough, during committee hearings members of Parliament advocated higher thresholds while representatives of the Council of Ministers insisted on the original version, while business associations and think tanks proposed 50% lower rates;
- The Council of Ministers should issue an Ordinance covering procurement in amounts under the Law's thresholds that provides for "encouraging of small and medium-sized enterprises", but the impediments to these firms are the high thresholds and the guarantee requirements;
- Probably due to considerations regarding lower implementation costs, the Minister of State Administration has been given additional functions under this Law (after the government changes at the end of 1999 the Prime Minister took over the functions of the Minister of State Administration, which was seen by some experts as concentration of power);
- The Law imposes obligations on other institutions which are governed by separate laws (i.e. the Chamber of Accounts and State Financial Control); these institutions are relatively independent of the Council of

²⁹ See also, the above paragraph on Attitudes and general test cases.

³⁰ Some solution of the Law remain disputable; e.g. big infrastructure companies usually out-source some services (management, supply, etc.) to daughter companies, such outsourcing is, in fact, banned by the Law, i.e. such companies should auction out their demands.

³¹ At current prices, it is equal to 2-store house built in downtown Sofia.

Ministers when carrying out the activities under this Law but the required coordination of the activities could put them in a subordinate position in the field of public procurement;

- The Law prohibits use of e-mail or even fax to submit bidding documentation, a provision which increases paperwork;
- The EU Directives allow bidders to submit more than one offer, a practice which is prohibited by this Law. This is rather strange having in mind that in some cases (for example the architectural services) such multiple choices are even encouraged;
- The term "commercial reputation" as defined under this Law is unclear and could be used to eliminate unwelcome bidders;
- The provision on subcontractors' participation contains preferences based on nationality;
- The bidding guarantees set a minimum but not a maximum guarantee amount which might hamper SME's in continuing their participation in the bid;
- Even if the winning party is refused a contract due to some reluctance on the part of the contracting entity (in connection with, say, "commercial reputation") or an unexpected development, the winner loses its deposit for the bidding;
- Contracting entities do not pay interest on the deposits for bidding; as criticized by DG XV/B this virtually means that the participants "finance the state at zero cost";

There is no doubt that this Law provides for improvement of the macroeconomic environment but it can be easily violated on the levels of firms and implementing agencies. As previously mentioned, there are two major omissions: a) there is no definition of "public procurement", which makes possible attempts to avoid requirements of the Law; and b) there are limited disclosure procedures, which impedes opportunities for public control and will prevent the work of civic watchdogs. Cabinet changes in December 1999 have concentrated the administration of public procurement in the hands of the Prime Minister. Such a development may create technical difficulties and leave the system with less "buffers", checks and balances. Besides IME, there was no other non-government organization present at the committee hearings in the Parliament.³² However, outside the Parliament, the legal departments of BIA and BCCI organized their own expert surveys on the draft and sent letters with comments to members of Parliament. They were dealing with the technicalities of auction procedures, and, in general, were not taken into account. Similar was the fortune of the comments of the European Union. A positive side of the advocacy effort on this Law was that ABA CEELI organized a high caliber 2-day course for members of Parliament on issues related to the content of the law. As far as we can judge, the course helped legislators improve their understanding of procurement matters.

Political Establishment and Access to Parliamentary Debate

It is obvious that the impact of regulations on private sector development depend to a considerable extent on the political system of the country. Private professional and business organizations are in fact adjusting themselves to these establishments and conditions.

The election system was amended in 1991 from 50% one-man-one-vote to a total party-list system (with 4-percent threshold). Also, as mentioned above, there has been a tradition since 1991 that the prime minister is also the winning political party's chairperson. In principle, as a party chairperson, he/she controls the apparatus, the pre-selection of candidates and eventual compilation of the party lists for the next elections. At the end of the day it turns out that although elected by the majority in the legislature the prime minister is in a position to significantly limit the legislature's control over the executive branch. This mix of election rules and tradition plus regulations on the "government ownership rights in SOE's" creates preconditions for gravitation towards centralization and central government involvement in day-to-day management of the economy and institutions. An underlying factor here is the inadequate financing of political parties and election campaigns. Lack of transparency on this front creates noise in any concerted attempt to influence the economic policy agenda.

The rules of the game, including tradition and habits, in this field are the following:

³² Heated debates at Economic Policy Committee gave an excuse for committee members to change the tradition of the Committee to give the floor to independent experts. Referring to Article 69 of the Rules and Procedures of the Parliament deputies decides not to allow such experts to take part in future hearings, except at the beginnings of respective sessions.

The Law on Political Parties (LPP), agreed upon in the Round Table Talks (January-March 1990) between incumbent ex-communists and upcoming democrats, has not been significantly amended since it was drafted and adopted in April 1990. At that time, it was one of the laws that allowed for the organization of the first post-communist free elections of June 1990. The LPP does not limit the sources of party financing, and lists four of them: membership fees, donations and wills, for-profit activities and government subsidies. Subsidies are provisional: “the government may subsidize political parties’ participation in elections, as well as their activities, taking into account their respective seats in the parliament and the framework of the earmarked budget resources”. “Aid, donations and wills to Bulgarian political parties from foreign governments and organizations as well as from anonymous sources are not allowed”.³³ Enterprises, institutions and organizations are prohibited from sponsoring political parties.³⁴ Financial “activities” of the political parties are said to be public, annual financial statements must be published before March every year in the State Gazette or two weeks before elections, and the rules are subject to a control by “a standing parliamentary-and-civic body of the National Assembly”.³⁵

The above provisions have not been implemented in the last eleven years. No political party financial statement has been ever published. Foreign organizations have been actively financing political party activities. Election campaigns are not financed directly, however, and often it is not the parties themselves but their think tanks and foundations that receive the money. The standing parliamentary committee was established after the first elections and functioned during the constitutional assembly of 1990-1991, and within the mandate of the 36th National Assembly (1991-1994). It was named the Political Parties’ Finances and Real Estate Committee. In its five years of existence the committee met irregularly; members of parliament (there were no independent committee members) who were sitting on the committee did not agree on procedures so they could implement the LPP. In 1990-1991, parties reported on how they spent their election subsidies (but not other sources of income). In 1992-1993, there were disclosures on how a few parties’ leaders spent funds provided by the government for their election campaigns. The committee drafted a law on Nationalization of the Real Estate of the Totalitarian Organization in 1992. But it failed to control political party financing whatsoever and although its existence is required by the PPL, since 1994 there has been no such committee.

The parliament votes its own budget and determines the remuneration for individual deputies when it votes its own Rules of Procedure and Operation (RPO). Since 1990 there is a tradition that the size of the individual MP salary is three times the average salary (currently 3 x USD 120 = USD 360). It is subject to quarterly adjustments (on the basis of figures from the last month of the previous quarter). After being elected MP’s have to declare their family property and income with the Budget and Finance Committee, and then submit such declarations annually. In addition, a sum amounting to two-thirds of this figure is granted as a “representative expense” to cover the costs of individual MP’s for technical assistants, advisors, etc. In 1990-1991 (the constitutional assembly) “representative” funds were given to the individual MP’s; later the tradition became that these funds are transferred to parliamentary factions, which decide how to distribute them.³⁶

These are the legitimate sources of political party and individual MP financing. The only legally required control body has not existed since 1994, and was malfunctioning in the years before 1994. Its functions have not been transferred to any other body.

Election campaign experts estimate that the minimum sum to put 10 MP’s in the legislature is at least USD 2 million and this figure has not changed since 1994. The largest pre-election budget subsidy of (current) USD 4,500 was allocated to presidential candidates for the elections of 1996. One minute of prime time TV ads would cost USD 10,000 on the state channel (the only one with nation-wide coverage). Rules of financing parties and MP’s (both campaigns and parliamentary duties) are hardly sufficient and leave little freedom to undertake individual motions and to develop opinions outside those of the party or faction. It is one of the reasons why individual initiatives to propose legislation are so limited and basically doomed to fail.

The period between April 1990 (the adoption of the LPP) and 2000 was a period of no reform in the rudimentary and poorly observed formal rules of political financing. It is possible to distinguish three

³³ See PPL, State Gazette No 29, 1990, Article 17.1 and 17.2. Donations from “foreign citizens or group of persons” at the respective limits of USD 500 and 2000 per annum.

³⁴ *Ibid.*, Article 18 (at the time PPL was adopted all enterprises were state owned).

³⁵ *Ibid.*, Article 21.

³⁶ See RPO, The Budget of the National Assembly, Articles 3, 4 and 10; RPO, Article 100.3 and 100.4, State Gazette, No 44/1997; MP’s have also other privileges: free ride on the public transport, rent coverage, life insurance, free motor-way passage (though there are yet no tolls for highways in the country), up to 40 airline ticket annually, etc.; MP’s are not allowed to take monthly gifts of an estimated value higher than 20% their salary; see *ibid.*: Articles 8 and 9.

(overlapping) stages of informal but widespread party and electoral finance as a factor in pro-corrupt political behavior:

- The initial stage of 1990-1991. The new political establishment and interest groups were still taking shape. But there was a sentiment to prevent misuse of public and societal positions for a given party gain, and to attempt fair competition for public office. At this stage the incumbent ruling (socialist/ex-communist) party was using cash and in-kind support from the government agencies to benefit offspring firms established by fellow party-members as well as candidates for seats in the parliament. They were entitled also to a government subsidy. Rival parties of newcomers (democrats, non-communists) were running their campaigns on government subsidies and through donations (often foreign) to fellow civic groups³⁷ (not registered under the LPP). The ex-communist victory in the 1990 elections set a wrong pattern to follow; the coalition cabinet of 1991 allowed democrats to have access to privileged transactions with the then emerging private sector and SOE's, thus building up their election financing for the fall of 1991.
- The second stage is 1992-1997. Financing of election campaigns and political parties (of both incumbent and rival parties, left or right of center) was secured through the already set tradition of privileged contracts with the government. It was mediated by circles which controlled private banks and private contract enforcement agencies (the so called wrestlers). In this period, the legislative agenda was managed by ad-hoc majorities in the Parliament and of individual MP's sitting on the payrolls of given companies.
- The third stage is the period from April 1997 until the present day. The incumbent party (democratic reformers) enjoyed support from government and private monopolies, yesterday's SOE managers and today's enterprise MEBO-owners. Rival parties (socialist and allies) seek support from their ex-clientele of 1991-1997. Unfortunately, privileged contracts with the government remain the major source of party financing.

Against this background it is possible to outline the steps and chances of reform in financing Bulgaria's political establishment in order to eliminate one of the key underpinnings of (political) corruption. Such an effort should level the playing field for private sector advocacy activities. Of course, there is no 100-percent clear-cut solution. A successful strategy to induce integrity in the political process via party and election campaign financing could include the following measures:

- Reduce sources of funding to membership fees, donations and budget electoral campaign support, eliminating (or limiting) for-profit activities of the political parties;
- Introduce a requirement for publicizing donor lists, for individual campaigns as well, explicitly prohibiting government monopolies in financing political campaigns, parties and individual members of parliament;
- Implement a set of sanctions for not complying with the law;
- Introduce a majority element in the election system, e.g. a return to the election law of 1990 (50/50 majority/party list system).

The above steps could make a difference if there is a set of policies undertaken and maintained in other related areas: "sunshine" regulations, transparent public procurement procedures, enforcement of anti-trust laws, easy access to company and other registries, and separation of political party functions from the administration and to the greatest possible extent from the core executive office.

Future attempts to influence the legislative agenda in the interest of private sector development will become more successful with an improvement of the general advocacy environment. The progress of the administrative reforms is half way there (see below). As already stated, the recently adopted (1998 and 1999) anti-trust and public procurement regulations remain unclear. The progress in adoption of access to public information rules and in amending and/or implementing the LPP is either counter-productive or minimal.³⁸ There are seven draft bills to change the PPL submitted by different factions and MP's; they have been pending in the parliament since 1998. There is an agreement to combine these bills into one. It seems that there is a consensus on two points: to not allow political parties to maintain for-profit activities and to maintain the current practice of limited or no public availability of files related to party and campaign financing. The key weakness of all drafts is the limited public access. As to the sources of funding there are two contradictory approaches (full funding from the budget, a system close to the German model, and/or only private individual donations). Drafts allowing for private donations differ between schemes that allow for both individual and corporate contribution and one which bans corporate donors entirely (an approach similar to the French model of 1992).

³⁷ Decree 133/1991 of the coalition cabinet tax exempted foundations, associations, student cooperatives, etc.

³⁸ E.g. end of 1999-2000 committee hearings the draft bill on access to public information have been focused on inducing more secrecy and the RPO requirement to declare MP income situation has replaced by dimmer regulation in February 2000.

The understanding of the broader context of the issue is there, but there is yet no idea of fixing the holes in the public procurement and anti-trust acts. The public mood for a majority vote based election system is rising but it is unlikely to lead to a major change of the party list system.

Requirements of international agreements

The open type of the Bulgarian economy defines the foreign economic relations as a key factor in the economic development.

In recent years, Bulgaria has been catching up with the other Central and East Europe countries in adoption of the international legal framework of world and European integration. Unfortunately, the major part of them is not yet accessible – they are not properly promulgated or else the business community has limited access to them due to the limited circulation of only outdated versions. There is no national export promotion strategy (for products and markets). Bulgaria is late in establishing an EU-compatible national system of standardization, certification and accreditation. There are signs of continuing red-tape practices. Non-governmental trade related structures do not have sufficient capacity to formulate and protect private sector interests in a competitive environment.

International acts that influence private sector development

| No | Basic Acts | Promulgated, amended, supplemented | Notes |
|----|--|---|---|
| 1 | <ul style="list-style-type: none"> World Trade Organization -Marrakech Agreements from establishment of WTO -Bulgarian Membership Protocol - Multilateral Trade Agreements | <ul style="list-style-type: none"> Decree #380 ratification, without the full; State Gazette (SG) #93/1.11.1996 - Council of Ministers Ordinance #307/27.12.1996 for coordination and execution of obligations (SG #1/3.1.1997) | In force since 1.12.1996; full text of 700 pages is not published and is inaccessible to business community; part of partners' obligations are reflected in Tariffs, Quotas and other Council of Ministers ordinances |
| 2 | <ul style="list-style-type: none"> European Association Agreement (EAA) - Protocol # 4 for determination of goods' origin | <ul style="list-style-type: none"> Supplement of State Gazette from 1997, issued in 1,000 copies - Prom. in State Gazette #100/1998, amended SG #3/1999, SG#113/1999, SG #3/2000 | In force since 1.2.1995; the section establishing the free trade zone has been in place since 31.12.1993 |
| 3 | <ul style="list-style-type: none"> CEFTA Membership Agreement | <ul style="list-style-type: none"> Ratification, without full text - SG #108/15.9.1998; CEFTA arrangements, without the Agreement full text - SG #17/25.2.1999 | In force since 1.1.1999 |
| 4 | <ul style="list-style-type: none"> Council of Ministers Ordinance #205/1999 - a list of arms, goods and technologies with potential dual use | <ul style="list-style-type: none"> Supplement of State Gazette #108/15.9.1998 | In force since 18.9.1998; subordinated to EAA |
| 5 | <ul style="list-style-type: none"> Customs Law - Implementation Rules - Customs Tariff, 1999 | <ul style="list-style-type: none"> Prom. SG #15/1998, amen. #89/1998, amended #153/1998, #30/1999 - Prom. SG #149 and 150/1998, amended SG. #6 and 7/1999, #23/1999, #34/1999 | In force since 18.9.1998; in conformity with EAA |
| 6 | <ul style="list-style-type: none"> Ordinance # 11/23.12.98 for written declaration of goods to customs offices; etc.; | <ul style="list-style-type: none"> Prom. SG #2/1999, amended SG # 23/1999 | n.a. |

Source: State Gazette, IME

Tariffs and advocacy

The above table lists international agreements and gives short comments on their availability. It is obvious that most of them have been made available with considerable delay but still not in their entirety. Even this factor may hamper the search for trade and investment opportunities by the private sector. Many advocacy efforts in the last two years aimed at protectionism policies. In 1998, meat producers and vegetable growers lobbied for tariff protection against competition from Turkey and Macedonia; on some items (such as radishes, tomatoes and cucumbers) it was successful. A number of policy stances of BIA and BCCI in 1999 advocated protection against imports as a principal policy. Such advocacy, in fact, already contradicted some of the international agreements and tariff practicalities.

Custom tariffs constitute a sensitive issue both for the government and private sector. Future advocacy efforts must take into account realities in this area. Here is the general picture:

Tariffs in foreign trade are measured via average weighted duties. We use two methods. According to the first one, data for real import of agricultural (from 1 to 24 Customs Tariff Chapters), industrial (from 25 to 97 chapters) and total goods is multiplied by the active tariffs and the result is divided into total imports. Thus we find weighted average rates or the protection rate of Bulgarian production.

According to the second method, state budget revenues are divided into the total volume of imports during the year and the result is the weighted average total import tariff. Budget revenue statistics do allow measurement of agricultural and industrial goods separately. The results can be seen in the following table:

Tariffs and budget revenues

| Weighted average tariff | 1998 | | 1999 | |
|-------------------------|--------------------|-------------------------------------|--------------------|-------------------------------------|
| | Foreign trade data | Foreign trade data and state budget | Foreign trade data | Foreign trade data and state budget |
| Agricultural goods | 24.17% | n.a. | 23.66% | n.a. |
| Industrial goods | 10.82% | n.a. | 10.58% | n.a. |
| Total | 11.89% | 5.03% | 11.44% | 4.91% |

Source: NSI, Ministry of Finance, IME calculations.

The table allows for some important conclusions. 1) Bulgarian goods are well protected in the European and regional context where tariffs are at the same level or below it. 2) Trade statistics reports twice as much trade than actual revenues to the state budget. The latter issue needs additional research to reveal the reasons for such a discrepancy. However, what is important in terms of advocacy is the following: Any attempt to promote protection may result in fact decreasing protection due to inequality vis-a-vis international agreements. Also, a general advocacy of protective tariffs may have a non-transparent fiscal effect and in fact support less integrity of the rules of the game.

In addition there is no clear picture of the impact of non-tariff barriers. Such measures are related to different permission regimes, quality requirements stipulated in standards, etc. They should be compared with the volume of collected fees and the rationality of the registration costs under different regimes. We do not know what is the impact of such regulations but it is very likely that they impose additional costs on doing business in Bulgaria.

In 1999, the government established the Bulgarian Accreditation Service (BAS). There are signs that BAS is controlled and managed by the government, which is in contradiction with the EU practice.

According to official registry, there are now more than 65 non-government organizations which deal with foreign trade issues. They include BCCI, BIA and their regional branches, BIBA and some other branch guilds. None of them has pursued a comprehensive approach to the conditions for international trade and competitiveness. For the time being, the only exception is the annual White Book of BIBA.

V. Private sector advocacy

The period of 1998-1999 has brought about a new character in the advocacy activities to improve the regulatory framework for private sector development and economic growth. The changes resulted from the major institutional changes of 1997 (especially the introduction of the currency board regime) and from the bitter experience of 1996-1997 economic mal-performance.

1. The first new feature is the coordinated and more focused nature of the pro-private sector and pro-growth advocacy. The advocacy was also more intense than in the previous periods of reforms. The test case for these changes was the process of drafting the SME Strategy and consulting the legislature during the hearings on the SME Law.

2. The private sector attempts to influence the legislation seem much more frequent than in previous years or compared to what one would expect from reading the press reports related to the issue. At the beginning of the period under review we find that the advocacy effort has already taken off. It was a reaction to economic decline in late 1996-early 1997. A number of organizations have tried to attract government attention to SME and private sector development.³⁹ In the aftermath of the elections of April 1997, those attempts evolved into a commitment to influence the reform agenda of the new government.

The chairmen of BCCI and BIA have become members of the (voluntary) President of Bulgaria's Council on Economic Policies. Both BCCI and BIA have reached an agreement with the cabinet to have regular consultations. Eventually, the consultation was channeled to the 3-party commission while the actual meetings with the cabinet remain sporadic. The important achievement was the very awareness of the need for regularity. In the second half of 1997 BCCI and BIA, facing competition from smaller organizations, have streamlined their reviews on current regulatory reforms and have revitalized their presence at committee hearings in the parliament. In September 1997, BAP (with the assistance of the Center for Liberal Strategies and IME) have drafted and presented to the prime minister its 10-point agenda for SME development. The first of these points was that SME's must be given priority. The idea was picked up by the chairman of the Economic Policy Committee, Mr. Nikola Nikolov. He hosted a group of independent experts who eventually, with the technical assistance of MSI, drafted the National SME Strategy.⁴⁰ The SME Strategy itself caused a unique coordinated effort by different groups to influence the law-making. It was sustained over a long period of time (from late 1997 until mid-1999 when the SME Law was adopted) and was extended to influence other draft laws (e.g. the bill on public procurement). It has an institutional impact: the SME Agency was converted from a branch of the ministry of industry into a body of the Council of Ministers. It is likely that the advocacy effort will be sustained over time because the SME Law promulgates a procedure of a public dialogue, namely, the Annual SME Report which gives an opportunity for a repeated reflection on the business environment and regular public consultations on policies to improve it.

3. Another new dimension of the advocacy practices is its greater focus on administrative barriers to private sector development and growth. This change stems from the financial and macroeconomic predictability which emerged thanks to the underlying economic policy reforms of 1997. This change of focus came entirely from the efforts of the private sector. And it coincided with the general tendency for a more transparent and flexible fiscal and quasi-fiscal regulatory framework required by the currency board regime.

4. At the same time, the advocacy become regular and obtained some "normality". Before 1998 only BIBA had some regularity in its meetings with government representatives and in publication of its annual White Books. The regularity is there also because of the changes towards the positive development in government regulatory behavior. Since 1997, there have been no delays in the work on drafts preparing for the next fiscal year. Taxation laws have been drafted, debated and amended according to the set course. (In 1999, for the first time in the transition years the government published the full version of the consolidated budget.) The general fiscal transparency has been significantly improved. These achievements in transparency of economic policy formation under the 3-Year IMF Program of 1998, and the fiscal and government debt information has been indicated by a special IMF report.⁴¹ In addition to this, since 1998 the cabinet has published its legislative program for the coming session of the legislature. It is being debated within the majority faction and then adopted by the Parliament. It may not be 100% fulfilled but the public is informed and representative organizations can plan their advocacy activities.

³⁹ E.g., such a reaction were Bulgarian Association for Partnerships (BAP) November 1996 Conference on Conditions to SME Development in Albena and December 1996 Center for the Study of Democracy (CSD) policy paper on SME Development.

⁴⁰ The strategy was publicly presented in April 1998. It did not manage to become neither a unifying a policy document of the business community (BIA issued a parallel strategy at the eve of the April presentation, focusing more on subsidies and preferential treatment of SME's) nor it proposed some sort of consistent policy (it actually has two parts: one dealing with mechanisms to improve business environment, the other pleading for a government support to SME.) But was the real compromise between different views. And such duality of the approach is not at all peculiar for Bulgaria.

⁴¹ See IMF Mission report on Transparency of Economic Practices in Bulgaria, published on the website of the government of Bulgaria (www.bulgaria.government.bg).

5. A special precedent in the advocacy climate was created by the use of the Internet by the government to consult interested groups. This came with the draft Access to Public Information Law, which was posted on the government website in late July 1999 for a public debate. No business association participated in the web-deliberations but the interest of the business community for greater transparency was advocated by the Access to Information Program (AIP), an NGO specializing in freedom of information issues. Starting in February 1999, MSI launched a regular Internet exchange on issues related to legislation in the pipeline and disseminates draft regulations as soon as they become available.

6. It seems that private sector or interest group efforts to influence the regulatory reform have been present in an indirect form in most of the important bills related to the economic reforms of 1998-1999. It is evident from reports in the press, from the lists of courses, meetings and workshops with legislators and members of the cabinet organized by different business associations, chambers, think tanks or other non-governmental organizations.

It is possible to distinguish two stages, a preparatory (including preparation of the public opinion and drafting regulations) and the stage of the submission, committee hearings and passing the draft through the parliamentary plenary vote.

At the stage of preparation and “education” of members of parliament on matters related to principal issues of a given draft or to a general field of law, in-between are international programs run by foreign foundations and organizations. Active organizations on this front were the American Bar Association CEELI (which has been around since the 1990-1991 debates on the constitution), EU accession departments from Brussels and German foundations dealing with political education (Zeidel, Friedrich Naumann, Konrad Adenauer).

At the stage of passing the law, it is specialized groups of independent experts and business associations which join the debate. Among the business associations the most active are BIA, BCCI, BIBA and BAP. On sector regulations, guilds have become active. Independent experts who have been most regularly taking part in parliamentary deliberations were affiliated most often with the following public policy institutes: Center for Economic Policy, Center for the Study of Democracy, Center for Liberal Strategies and the Institute for Market Economics.⁴² On some special occasions there were other NGO's (e.g. the above mentioned case with AIP, the Foundation for Local Government Reform on the hearings of municipal budgets and regional development bills, etc.).

7. Reviewing the advocacy experience of 1998-1999, it is evident that since 1998 a well featured, though yet sporadic, coalition between businesses and public policy institute has emerged.

VI. Conclusions

1. In 1998-1999 the Parliament adopted 314 acts. Of them, 149 acts were adopted in 1998, and 165 acts were adopted in 1999. The IME team selected 107 new laws and amendments to previously adopted acts which presumably could have a direct or indirect impact on private sector growth. 51 of the selected acts were adopted in 1998 and 56 in 1999.

2. The IME team has managed to find out how long it takes for new bills and amendments to be passed, if we take the time between registration with the Secretariat of the Parliament to the last hearings in the plenary.⁴³

In 1998, the average time needed to pass a law through the Parliament was 125.5 days, and for an amendment, 160 days. In 1999, laws were passed on average in 221 days while for an amendment the procedure lasted 180 days. For both 1998 and 1999 we have witnessed the following procedural “records”. The Law Amending the Law on Pensions (which is expected to influence the macroeconomic and also microeconomic environment) needed 759 days to be passed by the Parliament. It is difficult to speculate about the reasons. But among them was the difficult compromise between interests and the failure of the Labor and Social Policy Commission to reconcile those interests and convince the MP's of the necessity of the change. Unfortunately, the time was not used for broader public debate, and this omission seems to have created implementation and reform problems already in 2000 (not directly but through not entirely envisaged

⁴² The same group of think tanks have influenced the overall legislative agenda of the government; special fora to channel this influence were the so called Borovetz Meetings of the Cabinet and the Majority faction of the Parliament (four such meetings took place in 1997-1999).

⁴³ For 1998, we checked 18 new bills and 24 amendments, and for 1999 - 29 new bills and 16 amendments; we believe the sample allows lessons and have insight of the average legislative cycle.

fiscal effects). At the same time, the amendment to the Law on Securities, Stock Exchanges and Investment Companies (which supposedly has a broad impact as well) needed only two days in October 1998 (the leading commission in the National Assembly was the Economic Policy Commission). This amendment is a typical example of a last minute quick-fix: the deadline within which the shares acquired in mass privatization may be traded at the exchange without prospectus was prolonged by five months, or until March 31, 1999. There were two reasons for such an approach. The first was the idea that such trade would boost stock trading. The second was the original delays in enforcing the law; the initial grace period stipulated by the law expired on October 31, 1998. The deadline was extended on October 31, 1998. The adoption of new laws may differ to a great extent as well. The new VAT Law was passed in only 29 days through committee and plenary hearings (the leading commission in the National Assembly was the Budget and Financial Policy Commission), while the Economic Policy Commission adopted the Law on Public Offering of Securities in 542 days.

3. Besides all the differences there are also some regularities:

- Fiscal regulations and regulations envisaged in international agreements have, in general, shorter “waiting times”; this is especially the case with laws implementing the three-year IMF Extended Fund Facility (the so called IMF Program)⁴⁴;
- Regulations submitted to the legislature by individual members have as a rule long waiting times; opposition MP’s have been more often the submitters (and/or drafters) of entirely new draft bills which eventually passed as acts;
- The fastest track is reserved for bills fixing holes in existing rules of the game or in their implementation (such amendment bills are very often drafted and submitted by majority faction members, or heads of parliamentary commissions).

4. The number of entire laws in which through drafting and development the private sector had a leading role is rather limited. But many non-government actors generally influence the policies. At the same time business associations have been actively participating in most deliberations on tax regulations and sector rules of the game. The picture of the efforts related to different laws is as follows.

| Name of Organization⁴⁵ | Number of Position papers on Draft Laws |
|--|--|
| Bulgarian Industrial Association | 16 Draft Laws |
| Bulgarian Chamber of Commerce and Industry | 13 Draft Laws |
| Association of Commercial Banks | 9 Draft Laws |
| Institute for Market Economics | 8 Draft Laws |
| Center for Economic Development | 4 Draft Laws |

Position papers written before official proposal

| | |
|--|--|
| Bulgarian Industrial Association | Draft Law on Amending and Supplementing the Corporate Profit Tax Law |
| Bulgarian Chamber of Commerce and Industry | Value Added Tax Draft Law and Draft Law on Corporate Profit Tax |
| Bulgarian Chamber of Commerce and Industry | Draft Law on Consumer Protection and Rules of Trade |

4. The best examples of advocacy activity might be put in two categories: a long-term sustained effort from many organizations or focused activity related to the adoption of a specific regulation.

The best example of focused advocacy activities seems to be the IME regarding VAT amendments in 1998 (see the respective paragraph of the report above). The best-sustained long-term effort was the coordinated influence of the development of the SME Strategy (see the paragraph on private sector advocacy). In addition, however, there are interesting examples of advocacy related to technical assistance programs. Such efforts, for instance, had a limited impact on the eventual content of the Competition Defense Law and the Public Procurement Law. But draft provisions on warehouse receipts (in the framework of the Grain Storage

⁴⁴ A typical case is the Law on Transformation of the State Saving Bank, which restructuring was envisaged in the agreement with IMF.

⁴⁵ These and the next table represent just the information IME managed to collect.

and Trade Act) have been substantially assisted by ACDI/VOCA. We think it is one of the best advocacy examples in the period under review: the immediate beneficiaries of the new regulation were a relatively few number of companies and farmers but its positive impact on land and agriculture reforms goes far beyond this group.

5. These examples demonstrate the following steps of any successful strategy:

- Survey the impact of the framework in question, using the best available expertise;
- Foresee “who wins, who loses, and who pays the bill”, use cost-benefit analysis where applicable and possible;
- Identify public benefits of the amended or proposed regulation;
- Consider the needed policy mixes and changes;
- Communicate all the above findings to members of parliament, the ministry of finance and (if appropriate) resident missions of international institutions,
- Communicate the same result to the public;
- Build a coalition for change;
- Place the effort in the overall reform time framework.

6. There are also obvious failures in fairly simple cases. The best-documented example is IME’s lack of success in advocating an amendment to the Redenomination Act.⁴⁶ It was a case of relatively easy cost-benefit analysis. The unstated group favored by the reluctance of the parliamentarians was a small group of law firms which mediates the private sector’s dealing with the court registration and the court itself. The provisional impact on public good was entirely negative. The major reason for the advocacy failure was that we lobbied for an amendment of an act already adopted. We failed to prevent the very adoption of the act, and its harmful provision in particular.

7. A deeper look at the advocacy failure cases allows for number of conclusions on what the weak characteristics of the regulatory reform are, especially in terms of pre-conditions for advocacy. We can identify several major deficits:

- The level of extended trust, institutionalized integrity and cooperation within the business community is low; this situation reflects the lack of social capital on a more general level but the very awareness of the problem is also missing; it hampers the capacity for joint action with other societal players, including academia and public policy institutes; it prevents initiatives to defend and promote public good;
- There is no system to prevent draft bills that eventually hamper public good and private sector development; there is no habit of or mechanism for preliminary administrative and public screening of the regulations in the pipeline;
- There is no regular (as stipulated by laws and supported by procedures) access to regulations in the works; it allows for situations when public opinion and civic and business advocacy groups are taken by surprise, and by negative regulatory developments (in terms of the public good);
- The administration lacks a foundation for taking initiatives in the name of the public good and private sector development; it is not merit-based and customer-oriented, because it lacks clear career and promotion prospects and transparent hiring and firing procedures;
- The overall lack of transparency prevents negotiated regulations and increases both advocacy group and government inefficiency.

VII. Methods of monitoring and evaluating

Goals and Purpose

1. The key objective of monitoring and evaluation activities must be to streamline the private sector activities in commenting on and promoting democratic and market reforms in Bulgaria.

It is a "learning by doing" process of assessing the impacts of laws and regulations on democracy and economic freedom, including those in the pipeline of the legislature or the cabinet. It promotes rational argument in debating regulations.

The basic principle is that early analysis avoids problems later.

⁴⁶ We worked on this case with two other organization, Center for Liberal Strategies and Access to Information Program.

It makes sense in addition to the early (or preliminary) analysis to launch and/or support special business associations' and economic think tanks' projects under the working title "legislation correction studies" (LCS). LCS is the public dissemination of analyses that motivate the government to pay attention to regulatory impacts and to improve the quality of the regulations by providing a preliminary assessment on how they would affect the economy and the political institutions of the country.

LCS must be based on independent research into the provisional costs and benefits of the debated regulations or of those already enforced without forethought into its impact. In the LCS approach, the second step, taken in parallel, must be a broad public debate on the findings in the media to help affected parties form a non-partisan opinion on the identified impacts.

2. Such LCS and early analyses are known from the OECD terminology as Regulation Impact Analysis, or RIA. IME's experience and this report show that it is possible to amend RIA-methodology with the following two elements:

a) it should involve access to regulations in the pipeline by interested parties (and thus to the broader public), and

b) adherence to a set of democratic and economic freedom values.

For this reason it makes possible rather to speak of the impact assessment of regulations, not merely their analysis. Most of the IME projects to date have followed such an approach. We believe that its broader use by more organizations would motivate both the cabinet and the parliament to introduce regulation impact analysis on their own (e.g. through the new Law on Normative Acts).

But in 2000, it is possible to make a consistent effort to borrow such practices from OECD countries and further develop skills to conduct RIA and establish a long-term capacity for LCS not only in IME itself but in partner public policy institutes, business associations and media as well.

With the financial support of MSI, in February 1999 IME started such an activity with the Economic Policy Committee of the Bulgarian Parliament. The key focus of this RIA is to monitor the impact on private sector transaction costs. IME, in an attempt to broaden the activity involving the impact on democratic rules of the game, included in its efforts as partners the Center for Liberal Strategies and the Access to Information Program. The accumulated experience must be shared with a larger group of representative advocacy organizations.

Specific Activities

3. Any regulatory monitoring activity should promote a rational debate on immediate and long-term impacts of government regulations on democracy and economic freedom.

The goals of the program are as follows:

- to apply best available RIA practices in monitoring government policies;
- to provide measurable arguments for assessing and debating regulations;
- to advocate openness, accountability and public participation based on access to draft-regulations, required involvement of interested parties, and access to public information;
- to establish a capacity and a network for legislative correction studies;
- disseminate results of the applied RIA-approaches and material reflecting the RIA experience of other countries.

Relevance

4. RIA is a translation of requirements usually imposed on fiscal policies into an analysis of the government acts (either in the pipeline or already adopted). It is an attempt to determine "who wins and who pays and how much". The closest to RIA techniques are: the cost-benefit analysis in the area of economic evaluation, and the budgeting in the area of fiscal policies. The most similar public negotiation (debate) procedure is the environmental impact assessment (EIA). EIA is already a tradition in Bulgaria as it is required by the Environment Protection Act of 1991⁴⁷. RIA is not simply an impact analysis, something which, ideally, is done on behalf of the government. As in EIA, RIA combines access to information on what is in the pipeline, reflection, calculus and debate (dissemination of the findings) on "who wins and who loses", and "what might be done".

In the area of the assessment of the economic regulations it is possible to use the methodology of the Economic Freedom Network (EFN), a coalition of economic think tanks which co-publishes the Economic

⁴⁷ Environment Protection Act was drafted and submitted to then Constitutional Assembly of Bulgaria by Krassen Stanchev, then member of the Parliament and chairman of the Environment Committee.

Freedom Index (EFI).⁴⁸ IME is an EFN member. Thus, LCS and RIA seek a link to economic assessment and democracy.

We hope that eventually RIA results will initiate somehow legislative corrections, which would benefit a broad segment of the society, not just a particular segment, group or firm.

In the area of democratic institutions, we would like to introduce the same "who wins, who loses" component, along with a procedure of preliminary disclosure of what is in the pipeline of the government regulatory initiative.

4. The general rationale of the above-described methods to monitor and evaluate legal and regulatory reforms are the following: the constitutional foundations of CEE democracies involve general rules of lawmaking, part of which is allocation of the law-origimator's rights, duties and procedures of preliminary scrutiny, and adoption and implementation requirements. However, emerging into freedom, CEE societies are much more complex compared to those of the ancient regime, while the administrative capacity of the governments to handle this variety can hardly catch up with dynamism of the changes. Most CEE governments, in the process of EU accession and cooperation, need to digest as many as eight thousand acts in order to comply with the European law. Currently, international programs assist governments. An improved ability for independent RIA statements would be a significant contribution to the quality of the law-making and accountability of the government bodies.

The Bulgarian Administrative Procedures Law (1968) and Normative Acts (i.e. government regulations) Law (1969) establish two basic principles: that administrative bodies should answer inquiries from citizens and that draft regulation should be accompanied with a letter (called "Motivation") explaining the needs and the purposes of the act. The State Budget Compilation Law (1994) requires a scrutiny of the fiscal analysis and budgeting but it does not require an explicit assessment either of the cost of implementation or an answer to the "who wins, who loses" question. The costs of implementation are rarely taken into account in regulations drafted by government bodies other than the ministry of finance. A series of Government Decrees grant the coordination responsibility to the ministry of justice and legal Euro-integration which has a packed timetable. Staff turn-over in ministries, political pressure and legal demand for good and clear regulations contribute a variable quality to the regulations.

There is no tradition of cost-benefit analysis in most of the government bodies and political parties (although Parliamentary Rules of Order require such statements). The first attempts at public scrutiny came with the establishment of independent public policy institutes in the early 90's. The Administrative Procedures Law is a fairly modern act, unlikely to be amended. A new Normative Acts Law has been recently drafted, approved by the Council of Ministers, and submitted to the legislature, but in early 2000 was withdrawn for further improvement according to the EU practices.

This report is the first attempt to draw comprehensive overview of the legal and regulatory reform from the point of view of impacts on private sector development for a certain period. Previous attempts were in many respects deeper but focused on sector issues, depending on the interest and duties of the reviewing group. As such an attempt, it is far from perfect. A follow up reflection is needed to correct mistakes and fill in the gaps in information.

⁴⁸ See: Economic Freedom of the World: 1998/1999 Report, Vancouver, The Fraser Institute, 1998.