Transition in Bulgaria
Paradigm, Outcomes and Lessons for the Late Starters

ATANAS GOTCHEV

Five years have passed since the beginning of political and economic reform in Bulgaria. Analysts and observers of this process sometimes wonder how to assess the transformation. On the one hand, one can see visible changes: domestic prices, foreign trade, and foreign exchange were liberalized; restructuring of state-owned enterprises and restitution of agricultural land and real estate took place; a private sector emerged; and a two-tier banking system was established. On the other hand, in some areas change is vague and not readily visible. Is the Bulgarian experience relevant and useful for other countries—late starters that are lagging behind Bulgaria in their post-Communist transition? Though these countries differ widely and their transition is unique in each case, the analysis of the reform policies could provide useful information and background for policymaking.

The term "political and economic transformation of post-Communist societies" cannot be clearly defined. It does not have a previous analogue and the developments are recent, which limits the application of a standard empirical approach. History can offer very little in terms of deriving useful information to construct new theory and make sound predictions. In spite of the methodological difficulties, noted by others, one can make certain observations and typologies based on the existing data.[1]

From this point of view, research and analysis of different aspects of political and economic reform in east and central European (ECE) countries provide invaluable observations and expertise for social sciences. The experience of the countries that are ahead in their reform efforts could also be useful for latecomers. However, different post-Communist countries operate under widely diverging conditions, and their accumulated experience should be assessed very carefully, particularly when used to design and implement reform policies.

> ***"The transition does not create special social and economic laws."***

The transition does not create special social and economic laws. The emerging outcomes of the function of rules and the operation of institutions could be regarded as new and specific and they approximate democracy and market structures to varying degrees. Some of these rules, institutions, structures, and subsequent behavioral patterns could be considered to be deformed images of market economy and democracy, or as an imaginary virtual reality which reflects certain aspects of market economy and democracy.

In the initial stages of the reform in the ECE countries, their approaches to the transformation process were more similar. As the reform process developed further, the

---

Atanas Gotchev is a visiting scholar at the School of International Service, The American University, Washington, D.C.

differences became greater and more substantial. This is mainly due to the different starting positions, the different models, the intensity, determination, and cohesiveness of their implementation. The specificities of the approaches of the international financial institutions, the differing perceptions of the individual countries in the Western world, and the presence or absence of internal political stability also contributed to these differences. Thus, now we have a more diverse picture in ECE, compared to the one five years ago.

The paradigm of Bulgarian political and economic reform was formulated in late 1989 and early 1990, at the time when the Polish stabilization program had already been introduced. The main elements of the Polish program were adopted and implemented by the reformers in Bulgaria. Later, attempts were made to adopt privatization methods and techniques earlier applied in the Czech Republic.

One basic assumption underlining the Bulgarian reform paradigm was the initial emphasis on monetary reform and institutional changes. The reasoning was that financial stabilization could be achieved very quickly by eliminating the existing imbalances. It was also believed that this would require shrinking of consumption, which was assumed to be socially acceptable. The second part, institutional change, was considered to be a slower process, requiring time as it involved a much broader social and political change. As elsewhere, this provoked a discussion about the sequencing of the reform measures and initiatives. The issue of sequencing is not new as it has been widely discussed in the International Monetary Fund (IMF) stabilization programs for the Third World. However, the scale of this issue in the context of Eastern Europe was enormous as nearly every problem had to be resolved immediately. After the initial shock, it became obvious that the sequence of reform should emphasize institutional reform and then stabilization.

However, the Bulgarian reform began with strong emphasis on macroeconomic stabilization with particular emphasis on the monetary sector. The priority of stabilization was based on several assumptions. It was believed that market relations could be established on the basis of the predominance of state property. Liberalized prices and interest rates, as well as other market mechanisms, were presumed to be a sufficient condition for the development of a quasi market where the main actors would be the state enterprises. Then, because of the pressure of monetary and financial restrictions, the actors would automatically begin to behave as true market actors. This model also assumed sufficient elasticity of supply that could provide adequate reaction to the change in price levels. It was also believed that households, and private sector and state enterprises (after a certain time lag) when subjected to financial constraints would behave rationally and would become efficient utilizers of resources trying to maximize their income. The international financial institutions were supposed to bridge the existing initial financial gap, and in a few years the country could finance itself largely by attracting foreign direct investment. In other words, overall economic liberalization (without differentiating the stages and spheres of liberalization) was the main motto of the Bulgarian reform.

"The model of transition failed to reflect . . . the existing specific social and institutional environment . . ."

The architects of the model were also assuming that liberalization would lead to rapid economic recovery, quick privatization, visible improvement of living standards (after the initial shock), and painless integration in European and world economic structures.

But soon the negative effects of this paradigm became obvious. The model of transition failed to reflect adequately the existing specific social and institutional environment in the country. It also did not take into account the possibility of unfavorable developments in the regional and global political and economic environment.

The Economic Performance of Bulgaria During the Transition Compared to Other ECE Countries Undergoing The Same Process

The outcomes of the economic reform in Bulgaria are more negative, compared to those of other ECE countries. The failure of this paradigm can be measured by GDP decrease, high inflation rates, rise in unemployment, drop in real incomes, failure of the state to collect taxes and other budget revenues, low level of foreign investment, limited scope of privatization, balance of payments deficit, and outstanding foreign debt. Using these indicators for comparison, usually Bulgaria is in last place, or the last but one, among the ECE countries.

Economic Growth

Bulgaria's recession is one of the deepest among the ECE countries. The drop in GDP growth is measured with two digit numbers in 1991-1992 (-16.7 percent and -12.4 percent). In 1994, however, there are signs that this trend is reversing and the GDP drop will be -2 percent. Industrial output in Bulgaria showed some improvement in late 1993 and early 1994. The main reason for the decline is that reforms continuously weakened uncompetitive industries. This is complemented by poor weather conditions, slow demand in key markets, and unfavorable external political environment due to the war in the former Yugoslavia.

Another reason for the recession is the slow growth of the private sector. In 1994 the share of the private sector in the Bulgarian GDP was 40 percent, compared to 65 percent in the Czech Republic, 55 percent in Poland, Hungary, and Slovakia, and 35 percent in Romania and Macedonia. In 1994, however, the private sector was the dominant player in Bulgarian retail trade and services.

Inflation

Inflation measured by the consumer price index in 1991-1993 can be expressed in three-digit numbers. The highest inflation rate is found in Romania, Bulgaria follows, and the lowest is in the Czech Republic. In 1994 the Bulgarian inflation rate amounted to 121 percent. The high inflation rates can be attributed to the price reforms, partucularly the freeing of prices and the budget deficits. The introduction of the value-added tax in April 1994 also contributed to the high inflation in Bulgaria. The other major factor was the devaluation of the Bulgarian currency by nearly 100 percent in 1994.

Unemployment

Unemployment has reached disturbingly high levels. In 1994 the average rate in East Central Europe was 13.5 percent, the highest was in Bulgaria, around 18 percent, Poland had a rate of 16 percent, and the lowest rate was in the Czech Republic, in the range of 4 percent. Rural areas and small towns which are dependent on single companies or businesses that close down are particulary problematic.

This trend will continue for another two to three years after the beginning of the economic recovery. In 1992 Bulgaria had the highest rate of long-term unemployment (over one year), amounting to 6.1 percent of the labor force, followed by Poland with 4.8 percent, Slovakia with 4.1 percent, Hungary with 1.3 percent and the Czech Republic, with 0.4 percent. Bulgaria is also lagging behind other Central and East European countries in terms of private-sector employment.

Budget Deficits

The budget deficits of ECE countries are dangerously high. There is a constant struggle between proponents of IMF austerity requirements and political forces, arguing for support of state enterprises and for provision of a social safety net. The major reasons for the high deficits are that expenditures were swollen by unemployment and retirement benefits. On the other hand, taxes do not yield enough revenue because of the poor economic performance and the inefficient internal tax revenue service. Efficiency figures are negative in Bulgaria, -11.2 percent in 1993 (measured as gross profits divided by sales cash flows), and very low but positive in the other countries. In 1993 the budget deficit, measured as a percent of GDP, was highest in Bulgaria at 11.4 percent, and lowest in Romania at +0.5 percent. Poland had a deficit of 2.4 percent, Slovakia had a deficit of 10 percent, and Hungary had a deficit of 7 percent.

A more correct picture can be obtained if one compares budget revenues as a percentage of the GDP. Again, Bulgarian indicators (in 1992) are worst of all at 36.7 percent, followed by Romania, while the highest figures are those of the Czech Republic at 56.5 percent and Hungary at 54.6 percent.

Trade Balances

All ECE countries have unfavorable trade balances. It is difficult to make precise comparisons due to methodological difficulties. Nevertheless, Bulgaria has experienced the greatest drop in its foreign trade volume. In the period of 1989-1993 it was at 52.4 percent, followed by Romania at 32 percent. Bulgaria also has a smaller share of trade with Western countries at 41 percent of former levels, compared to Romania at 51 percent. The Czech Republic has 63.2 percent, Hungary has 68 percent, and Poland has 72 percent.

The main reasons for negative trade balances include the loss of traditional markets, the flood of imports, and the poor quality performance of Bulgarian goods traded abroad. Also, the recession of Western economies, the poor harvests and increased domestic demand, and the trade sanctions against Yugoslavia have also played a significant role in the deterioration of the Bulgarian trade balance. Poland and Hungary had deficits in the range of $2 billion, and Romanian and Bulgarian deficits reached up to $800 million and $700 million respectively.

Foreign Investment

Nearly 90 percent of the $13 billion invested in the ECE by foreigners has gone to Hungary, Poland and the Czech Republic. More than half of the region's foreign investment is in industry. Western investors are attracted mainly by low-cost labor. The European Union has provided 43 percent of investment in the ECE while 38 percent of investment in the region is provided by the United States. In contrast, the bulk of investment in Bulgaria comes from the Balkan countries and the Middle East. Bulgaria has the lowest figure for foreign investment and attracted roughly only 1 percent of the total Western investment in the region until 1994. The only countries in a worse position are the countries from the former Soviet Union, Yugoslavia, and Albania.

Main Reasons for the Slower Pace of the Bulgarian Reform: A Lesson of the Transition

The major reason for the slower pace of the Bulgarian economic reform can be attributed to the difference in the initial positions of Bulgaria and the other ECE countries. Reforms in central European countries started earlier. These countries had lower levels of internal and external debt and better trade ties with OECD countries. Moreover, east-central European countries were more adaptive to Western markets, and their products are more competitive. An important factor was that they were not affected by external shocks such as the Gulf War and the war in the former Yugoslavia. Also, the existence of ethnic lobbies in Western countries made a difference in terms of greater support of the West to their transition efforts.

The second reason for the slower speed of the reform in Bulgaria can be attributed to the choice and implementation of the transition policies. All ECE countries applied similar transition techniques. However, the degree of consistency and coordination in the application of these policies differs from country to country. From this point of view the Bulgarian experience might also be useful for other post-Communist countries.

Since 1990 the transition in Bulgaria has been managed by five different governments with diverging objectives. The result was a lack of clarity about the ultimate goal. It was not clear whether the reform aimed at creating a social and highly regulated economy or achieving a laissez faire type of economy. These different types of market economies require different approaches and technologies in the transition. When objectives are changed within short periods of time the result is a lack of consistent strategies and a lack of clear priorities.

Another consequence of the policy changes is insufficient coordination between monetary, fiscal, foreign, economic, and structural adjustment policies. The lack of synchronization between different policies leads to a chaotic model of transition. Economic and social chaos tremendously increases social costs of the transition and leads to an aversion to reform. Rising social costs are reflected in declining popular support of the reforms. It is not surprising that in 1994, opinion polls indicated that 70 percent of the Bulgarians claimed that their well-being had deteriorated since the end of communism, and only 20 percent thought that they lived better. Maybe one of the positive results of the 1995 elections in Bulgaria could be the presence of a government with enough parliamentary support to guarantee the implementation of consistent policies, regardless of being right or wrong. In this respect the Bulgarian transition clearly indicates that incurring unnecessary transition costs could slow down or possibly divert the direction of the reform.

Another lesson from the Bulgarian transition policies is related to the speed and scope of liberalization. It was relatively simple to deregulate the economy to an extent that, in terms of price liberalization, currency regulations, and foreign trade regime, Bulgaria can be considered one of the most liberal post-Communist economies. However, macroeconomic stabilization through restrictive economic policies can be effective only if there are policies to revive the economy and there is an ability to access foreign markets. Otherwise, anti-inflationary policies could easily become pro-inflationary. Recent Bulgarian experience shows that after the relatively successful control of demand-driven inflation in 1992-1993, supply -driven inflation rose despite monetary restrictions, reaching the level of 121 percent in 1994.

The experience of five years of transition suggests that the success of reform depends on the appropriate mix of regulation and deregulation of the economy. An economy without all market institutions in place and with 90 percent state-owned industry cannot rely entirely on the power of the invisible hand. It is also unrealistic to assume that once political change and economic reform has been initiated there will be an automatic access to Western markets.

Some analysts also believe that in Bulgaria there were more destructive and ill-designed policies and actions than in other ECE countries. Among these are land restitution in real borders, liquidation of former state cooperatives, and natural and asymmetrical restitution, prior to creating appropriate legal and administrative prerequisites.

The early introduction of liberal legislation (the Trade Act of 1991) coupled with the dominance of state property, led to various kinds of wild privatizations of state assets and their value rose. This had many negative consequences, but the most adverse one was the process of decapitalization of state and municipal property. The main priority of state enterprises is survival but their assets are rapidly depreciated while profits are privatized. Technological innovation has stopped and equipment replacement schedules cannot be sustained. In other words, investment activity has stagnated and the horizon of business thinking is limited to the next day.

Economies in transition cannot entirely eliminate the redistribution of wealth, which is inevitable and will occur regardless of the particular macroeconomic policy being pursued. However, redistribution of wealth has obvious ethic, moral, and political aspects. The concentration of public attention on these issues leads to political polarization and is a reason for delayed legitimacy of the private sector.

"An economy without all market institutions in place and with 90 percent state-owned industry cannot rely entirely on the power of the invisible hand."

Intense political polarization of the country has slowed legal and institutional reform and blocked privatization. The need for transition is no longer questioned. The main issue is who is the legitimate actor to proceed with the reforms. It seems to be more important to differentiate between "good" and "bad" capitalists rather than concentrate on issues related to the development of the private sector. The real problem is, however, whether the economic agents behave as authentic market actors.

The post-Communist economic and political realities pose questions about the relationship between economic and political power. Relative economic advantages are acquired by those close to former and current centers of power. These advantages stem from the collapse of statehood and the inability of state institutions to curb tax evasion or to control movements of goods, capital, and other assets.

Under the circumstances, there are many different social groups with vested interests that hope to preserve the status quo of the initial stage of the transition. For instance, privatization is delayed because for everyone—managers, labor, unions, new and old political elites—it is more convenient to exercise private management of state assets in the absence of a real owner. Managers privatize profits, unions and the political elite receive a slice of this cake, and labor keeps its jobs. This is a strong coalition that opposes real changes in property relationships.

Otherwise there is a vivid discussion about the best schemes of privatization. Should it be market-based or should it be a more socially acceptable mass privatization? Is restitution a substitute or supplement of privatization? Should the new cooperatives be based only on property in real boundaries?

All of these questions may have important theoretical, practical, moral, and ethical dimensions. However, these questions do not resolve the real problem of the legitimacy of the economic actors. The economy can function only through existing and legitimate actors. From this point of view the just and ethical redistribution of national wealth is not a central issue. Thus one of the main lessons to be learned by the political economy of the Bulgarian transition is the need to legitimize as quickly as possible all kinds of economic actors and to create the relevant rules and conditions for their legal operation. The political change in Bulgaria was inadequate for the main need of the economy, which was the redistribution of national wealth. This explains the slow pace of the reform, an experience that can be avoided by others.

Note

1. See for instance Mary E. McIntosh, et al, "Market Democracy in Central and East Europe 1991 - 1993," *Slavic Review* 53 (Summer 1994): 483.