BUSINESS SURVEY SERIES

THE BULGARIAN ECONOMY IN 2000
(annual survey)

AGENCY FOR ECONOMIC ANALYSIS & FORECASTING
31 Aksakov St., 1000 Sofia, Bulgaria

31 Aksakov St., 1000 Sofia, Bulgaria
Tel. (+359 2) 980 04 84, 980 24 74
Fax (+359 2) 981 33 58, 980 93 22
e-mail: aeaf@minfin.government.bg

Translated by Albena Toneva and Ventsislav Voikov.

ISSN 1310-327X

In 2000 the Bulgarian economy registered the highest growth rate of 5% since 1990. Two major factors contributed to growth – the improving external environment and the process of intensive restructuring of the economy after privatisation. The economic policy included the following basic parameters:

- The smooth operation of the currency board arrangement and an increase in foreign reserves as of end-2000;
- The restrictive fiscal policy and achieving 1% cash deficit of the general government; reduction in the debt/GDP ratio;
- The amendments in the legislation providing for improvement in the business climate, in particular by streamlining procedures related to bankruptcy, privatisation, tax payments, issue of permissions and licenses; reducing certain tax rates and abolition of a number of permission and licensing regimes; liberalisation of capital movements according to the Exchange rate Law, enforced as of January 2000;
- The further progressing in the pension and health-care reform;
- The designing of strategies for deregulation and restructuring/privatisation of natural monopolies.

The report presents a brief overview of the international environment in 2000 and its favourable impact on the Bulgarian Economy. It elaborates the factors for growth related to the demand and the supply side. The next two sections represent the analysis of the sources of macroeconomic stability – the prudential management of public finances and the process of deepening of financial intermediation. Inflation has gone up in 2000 mainly due to external factors – oil price rise and EUR depreciation.

Structural reform analysis covers restructuring in industry, in the social sphere and the banking sector. Rising unemployment rate in the first half of 2000 and its stabilisation at the end of the year dominated the developments in the labour market. Rising unemployment coincides with high productivity growth rate.

Finally, the conclusions summarise expectations for 2001. ❑

INTERNATIONAL BUSINESS SITUATION IN 2000

In 2000 global growth gained higher momentum and economic recovery spread over all regions. The expansion of the developed industrial countries put a spoke in the wheel of the 1998 and 1999 recession trends. The US economy in the same years reported a GDP growth of over 4%, further speeding up to 5% in 2000

The business situation in the EU, Bulgaria's largest trading partner, improved significantly. GDP in the Euro area was estimated at 3.3% – 3.4% in 2000 registering an increase of more than a percentage point on a year earlier. The expansion of EU exports favoured by the Euro depreciation and increased internal demand were the factors contributing to EU's growth. In the first three quarters of 2000, household consumption was steadily rebounding at a rate of 2.5% and 3.2% on an annual basis while fixed capital formation reported a growth rate of 4.1% and 5.4%.[1]

Business activity in Central and Eastern Europe improved and in most cases it was exports to the EU that were the engine of growth. The highest growth rate was reported by Estonia (over 5%) and Hungary (over 5%) followed by Slovenia (over 4%) and Poland (4%). The remaining countries in the region reported a rate of 2% to 4%[2]. After three years of continuous GDP decline the Czech Republic registered a positive growth rate, although according to IMF estimates the sluggish restructuring of the country's banking and real sectors appeared to be a barrier to rapid economic recovery.

---

[1] *European Central Bank Monthly Bulletin, March 2001*
[2] *Business Central Europe, March 2001.*

The business situation in Romania remained largely unpredictable but the stabilisation effort seemed to have produced the desired effect. The tightening of fiscal discipline and depreciation of the Romanian currency led to some improvement in the balance of payments. The country, however, failed to make any significant progress in structural reforms.

Despite the remarkable increase in exports, the CEECs were continuously reporting current accounts deficits. Thus, for instance, the current account deficit in Poland was estimated at 7.4% of GDP, and projections for the other CEECs pointed as follows: Latvia (8.6%), Estonia (5.9%), Lithuania (7.4%) and Hungary (4.5%).[3]

The Russian economy rebounded from the severe financial crisis in 1998. Following the 3.2% growth rate in 1999, 2000 growth was estimated at 7%, as brought about by the healthy effect of the improved terms of trade. The international prices of fuels appeared to be the most favourable factor promoting exports. The 1999 current account surplus in Russia amounted to 11% of GDP further rising in 2000 as the value of Russian exports over the January-November period alone stepped up by 44% against an increase in the value of imports of 11% only. The trade balance surplus is expected to hit USD 50 billion. The higher export prices and economic recovery led to an improvement in the implementation of the budget, raising revenues and stabilising the fiscal stance.Turkey is an important trading partner of Bulgaria. Industrial output in 2000 rose by 5.4% and despite the end-2000 decline due to the financial crisis the expectations were for a 5.9% GDP growth.

[3] *IMF World Economic Outlook, September 2000*

The high growth rate reported by the Yugoslav economy (about 10%) was mainly due to the low 1999 level of comparison when the country's GDP declined by 20% as a result of the Kossovo crisis and economic embargo.

According to preliminary estimates, GDP growth in Asia (Japan excluded) was expected to amount to 7.5%. The remarkably high region's growth was triggered by the stabilisation programme and adequate fiscal and monetary policies duly implemented. Furthermore, growing demand and rising prices of electronic devices and components had a major contribution to the recovery of the Asian economies. Following the depreciation wave that affected all national currencies in the region during the 1997/98 financial market collapse, almost all Asian economies reported significant current account surpluses.

It was as early as the beginning of 2000 that the developed market economies showed signs of fears of overheating and rising inflationary pressures. It was for these same reasons that the Federal Reserve and the European Central Bank opted for a series of increases in the benchmark interest rates. Notwithstanding the strong performance of the EU economy in 2000, the Euro/US dollar exchange rate remained undervalued throughout most of the period surveyed. The US economy reported a robust growth rate, the interest rate differential between financial instruments denominated in EUR and USD remained high. The European Central Bank carried out a series of interest rate adjustments in an attempt to counteract to the inflationary pressure and curb the depreciation of the single European currency.

The measures undertaken by the Federal Reserve to cool down the US economy began to bear fruit in late 2000 and early 2001. As a result, growth has slowed down expected to further step down to 1.1% in 2001 against 5% on a year earlier. The expectations for the EU are comparatively more favourable where the growth rate declined by about one percentage point down to 2.2%. 2001 forecasts point to a decrease of about two percentage points in the growth rate of the world economy to 2.9%. ❑

Real Growth in 2000

The favourable external environment and significant progress in the restructuring of the Bulgarian economy led to the acceleration of its growth in 2000. In the first nine months of 2000, the real-term GDP growth amounted to 5.3% – the highest rate ever reported since 1990. The rates of change in the components of GDP final expenditures over the nine-month period reflected the prevailing importance of external demand that boosted GDP growth. Exports increased at a two-digit rate in real terms.

Table 1. Growth Rate of GDP Final Expenditures on an Annual Basis

(on a year earlier, %)

	1998	1999	Jan – Sep 2000
Final Consumption	7.5	4.7	3.7
Gross Capital Formation	16.3	25.3	9.8
Exports (goods and services)	-15.6	-5.2	23.4
Imports (goods and services)	-2.8	5.1	12.9
GDP	3.5	2.4	5.3

Source: NSI

In 2000 the engine of growth was net exports of goods and services, followed by final consumption and fixed capital formation.[4]

Table 2. Breakdown of GDP by Contribution of Final Expenditures

(on a year earlier, %)

	1998	1999	Jan – Sep 2000
Final Consumption	6.2	4.1	3.4
Final Household Consumption	5.7	3.8	1.5
Fixed Capital Formation	1.8	3.3	1.4
Change in Inventories	3.3	-0.2	-3.4
Net Exports (goods and services)	-8.0	-5.1	3.8
Exports (goods and services)	-9.6	-2.5	10.7
Imports (goods and services)	1.6	-2.6	-6.9
GDP	3.5	2.4	5.3

[4] *The following two sections dwell on domestic demand and its analysis – household consumption and investment. The impact of external demand on the economy is tackled in Section Foreign Trade in 2000.*

DOMESTIC DEMAND

Household Consumption

Household consumption continued to report a significant contribution to the real-term growth of GDP though its real growth rate had subsided. In the nine months of 2000, household consumption increased by 2.7% in real terms.

Data on the national accounts in the nine months to October 2000 pointed to an increase as follows: food consumption (by 3.6%); non-food consumption (by 5%) and public catering (by 20.5%). Heating consumption reported a real-term decline while energy consumption remained unchanged at its 1999 level. Water consumption, on the other hand, stepped up by 25%. On a year earlier, the consumption of transport and communication services registered a notable increase of 28.2% and 53% respectively. The consumption of products of self-sufficiency decreased by 12.7%. The decline in self-sufficiency, i.e. of non-marketable goods and services produced for household use, and the growing share of public catering were a clear indication of the broadening scope of market relationships in the Bulgarian economy.

According to the household consumption data under the national accounts, food and beverages consumption amounted to 33.4% in total household consumption (imputed rent and in kind consumption excluded), non-food consumption amounting to 29.1%, household expenditures on transport and communication services raised to 11.0% and 6.0%.

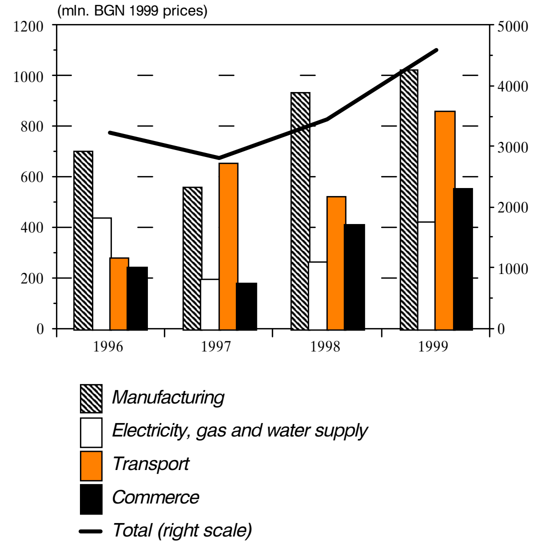
In the third quarter of 2000 consumption real growth rate was substantially influenced by the inflow of tourists from abroad. National household consumption (net exports of tourist services excluded) rose by 2.9% while domestic household consumption (net exports of tourist services included) stepped up by 5.1%. Hence the two breakdowns of household consumption retained the difference in their growth rates for the 9-month period, of 2.7% and 4.0% respectively. Drawing upon the above data, it can be concluded that tourism had a growing importance for the Bulgarian economy and was a major contributing factor for the increase in domestic demand.

Investment Demand

The contribution of investment demand (fixed capital) to GDP growth amounted to 1.4%, given a real-term growth of 9.8% in the nine months to October 2000. The increase in fixed capital formation over the last two years was due predominantly to the government economic policy that created and maintained successfully a favourable environment for the development of the economy. The real growth rate of gross fixed capital formation was 34.2% in the nine months of 2000 relative to 1996. According to balance of payments (BoP) data, imports of investment goods reported a rapid increase in USD terms over the last couple of years of 27.8% (1998), 39.8% (1999) and 6.3% (2000), which fully corresponded to the indexes under the national accounts.

This high investment growth rate was fully matched by the growing FDI inflows in 2000. Drawing upon data on expenditures on the acquisition of fixed assets in the private sector and BoP data on

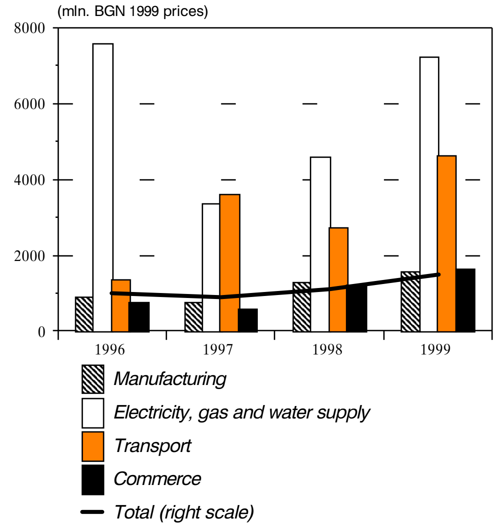
Expenditures on Acquisition of Fixed Assets



Note: Data deflated with the deflator of Gross fixed capital formatio

Source: NSI, AEAF

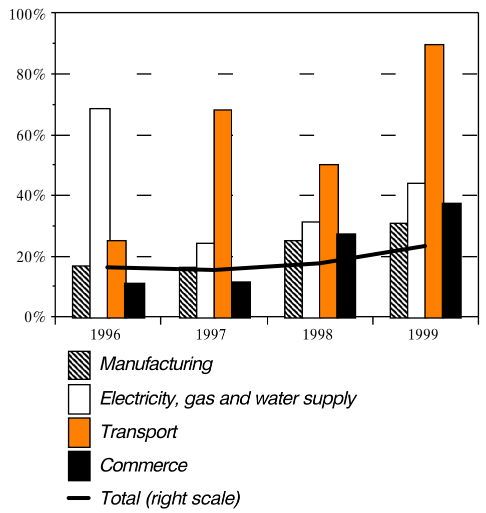
Expenditure on Acquisition of Fixed Assets per Employee



Note: Data deflated with the deflator of Gross fixed capital formatio

Source: NSI, AEAF

Expenditure on Acquisition of Fixed Assets, in Percent to Gross Value Added



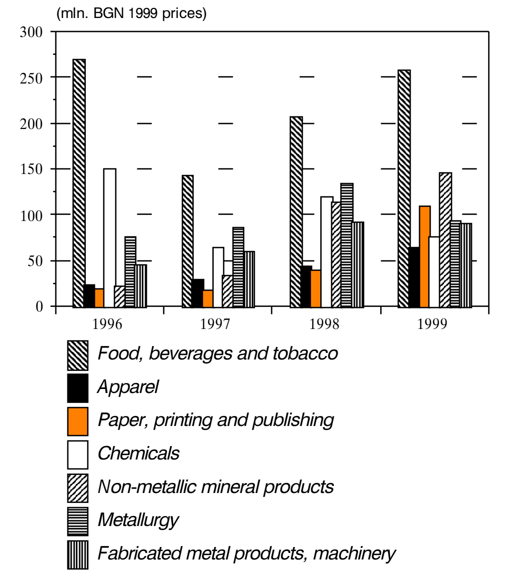
Source: NSI, AEAF

greenfield FDI, it may be assumed that half of the private sector investments were financed by FDI.

Expenditures on the acquisition of fixed assets have gone on the increase in the last couple of years, with the leading sectors being the processing industries, transport infrastructure, trade and production and supply of electricity, gas and water.

The indicators obtained by normalising the expenditures on the acquisition of fixed assets by value added and the number of employed reported an overall increase and, particularly, an increase in the sectors registering the highest nominal value of investments. All this implies that the growth in fixed capital formation outstripped value added growth. Investment increments per employed reported a most remarkable rise by about 50% relative to 1997. The trends reported by the normalised indicators may also be seen as the accumulation of significant growth potential to be realised in the near future.

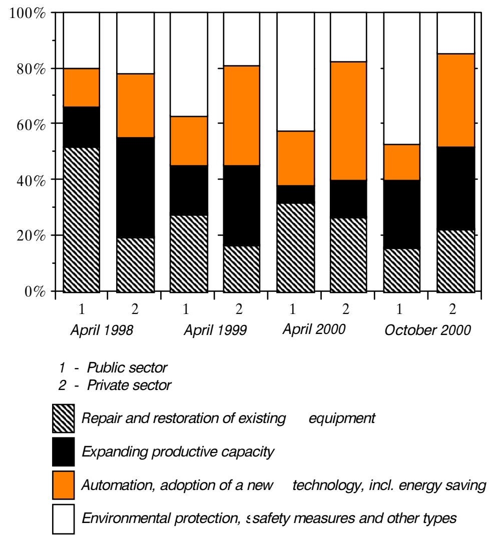
Expenditure on Acquisition of Fixed Assets in Manufacturing



Note: Data deflated with the deflator of Gross fixed capital formation

Source: NSI, AEAF

Structure of Planned Investment: Industrial Sector



Source: NSI, Investment survey

The allocation of investments in the manufacturing sector may be assessed on the basis of the distribution of expenditures on the acquisition of fixed assets by industry. Investments in the food industry, an important sector of the economy, went on the rise.

The investment activity surveys conducted by the NSI in the manufacturing sector twice a year provide valuable data on investment allocation patterns. Over two-third of the investments in state-owned enterprises were allocated for the purposes of renovating machinery and equipment, environmental protection and work safety that was in a direct relation to the branch structure of the enterprises on the sample – mainly in the sector of power generation. As for the private sector, about two-third of the investments there were aimed at the expansion of production, mechanisation and automatisation, introduction of new technologies, energy-saving technologies, i.e. at improving production technologies, product diversification and quality improvement – all of them being indispensable pre-conditions to the enhancement of on-firm competitiveness.

In the past few years the international business environment did not contribute to investor's interest in Bulgaria. In 1998 the turmoil in the international financial markets created a capital flight from the emerging markets. A regional factor repelling investors is the long lasting unrest in neighbouring Serbia, the Kossovo crises of the first half of 1999 being a climax. Despite the unfavourable environment, FDI inflows in Bulgaria have increased over the last three years as a result of the government policy credibility. The relatively low wages in Bulgaria created a number of advantages as regards profitability and under favourable external conditions foreign investors may make the best of those advantages.

Profitability (the ratio between the gross operating surplus and gross output in a sector) can be approximately estimated using data from the income statements (profit and loss accounts) of firms by sectors of the economy. The indicator reported the highest increase in the sector of communications (43%) and the financial sector (39%), remaining however lowest in the processing industries (8%). However, estimates of the profitability/FDI relation indicate that there was no such correlation over the 1997-2000 period. Major reason might be the inflow of FDI, induced by privatisation and not by profitability indicators. The financial sector reported the highest FDI share as brought about by the privatisation of banks followed by trade, repair of cars and household appliances (inflow of green field investment), the food industry (most probably due to the inflow of investments in the post-privatisation period).

Supply

The Bulgarian economy has all the capacity of a fast supply growth as brought about by the privatisation of state-owned enterprises and their structural adjustment.

In the nine months to October 2000, industry reported the fastest growth rate, with manufacturing registering a 12.8% real-term increase in value added followed by construction (7.1%). The production and supply of electricity, gas and water accounts for 20% of total value added in industry and reported a real growth rate of 14.6%.

The service sector registered the highest contribution to value added growth as follows: communications (41.2%) followed by trade (18.5%), finance, lending and insurance (16.8%) and transport (12.3%)[5].

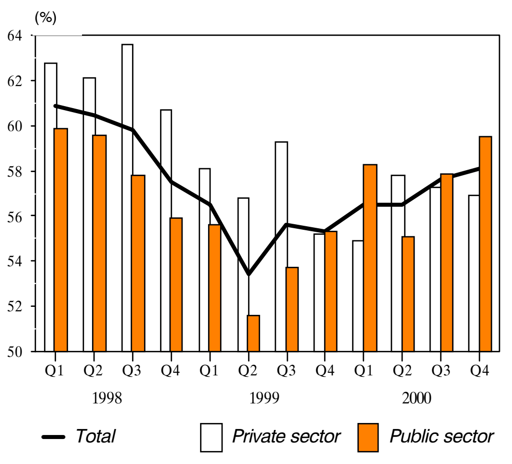
Agriculture was most severely hit by the unfavourable spring weather conditions and summer drought and fires.

Table 3. Growth Rate of Gross Value Added in Real Terms by Sectors

(on a year earlier)

	Growth rate (%)			Contribution to growth		
	1998	1999	2000 (nine-month period)	1998	1999	2000 (nine-month period)
Agriculture and forestry	1.4	0.6	-15.5	0.4	0.1	-2.8
Manufacturing sector	4.3	-4.4	12.0	1.2	-1.3	3.3
Services	0.5	5.8	10.3	0.2	2.9	5.5
Total	1.8	1.8	6.0	1.8	1.8	6.0

Capacity Utilization in Industry



Source: NSI

Manufacturing Sector

Business survey data in the manufacturing sector in the last quarter of 2000 pointed to an improved capacity utilisation of 58.1% on a country's average.

In 2000, industrial sales reported a 4.6% real-term increase on a year earlier, with export sales alone stepping up by 26.1% in real terms.

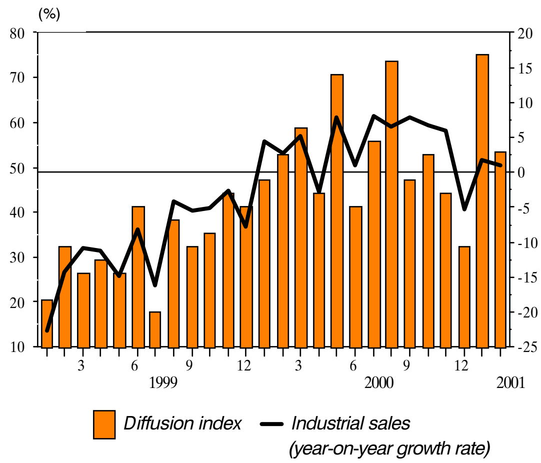
Table 4. Real-Term Change in Industrial Sales

(on a year earlier, %)

	1999	2000
Revenues from industrial sales	-10.5	4.6
O/w revenues from export sales	-13.3	26.1

[5] *In brackets – real value added growth rates for the nine months of 2000 compared to the same period of the previous year.*

Diffusion Index and Industrial Sales



Source: NSI

Two sectors, in particular, where the business environment improved tremendously last year reported a most notable growth rate: metallurgy (26%) and the manufacture of coke, refined oil products and nuclear fuel (20.2%)[6]. Their overall contribution to sales growth in the manufacturing sector amounted to 4.4%. The production and supply of electricity, gas and water sector registered a 0.7% contribution to sales growth. Although the 2000 growth in industrial sales was mainly due to the sales increase in three sectors only, the diffusion index, measuring the per cent of sectors reporting an increase within the total number of sectors, was steadily registering a twofold rise throughout 2000 on a year earlier, which was a clear-cut indication of the broadening growth basis of the Bulgarian economy.

Agriculture

As a result of the poor weather conditions in 2000, crop production remained rather low. In the nine months to October 2000, gross value added in agriculture reported a 15.5% decline brought about mainly by the 39.4% volume decrease in grain and fodder crop yields[7] . Besides the poor climatic conditions, there were other factors still affecting negatively Bulgarian agriculture such as: land ownership fragmentation, credit access difficulties, low investment activity in the sector and external demand contraction (in particular Russian demand for Bulgarian agricultural products).

Land ownership restitution was an important element of the structural reforms in the sector.

[6] *In brackets – real growth rates of sales for 2000 compared to 1999.*

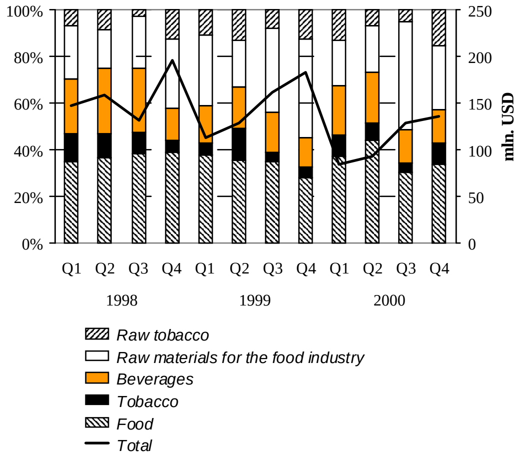
[7] *Preliminary data.*

End-2000 saw the restitution of ownership rights to 56 796 thous dka of land, accounting for 99.8%[8] of the land subject to restitution. Land restitution led to ownership fragmentation, which in turn produced an adverse effect on agriculture in the short run. The enormous number of landowners makes transaction costs for a consolidated land plot extremely expensive and triggers high land price volatility. According to a land market research conducted by SAPI ltd. in September 2000, the number of land deals stepped up on a year earlier but the size of arable land under the individual deals remained smaller. Most deals had to do with ownership transfers by inheritance or voluntary partitions, and 40% of the deals were on the purchase and sale of non-arable land. Despite the problems stemming from land ownership fragmentation, established land ownership is an important precondition for the development of an active land market and land consolidation.

The adoption of the Land Cadastre and Register Act in April 2000 was aimed at fostering the land market and facilitating real estate deals. The establishment of a land cadastre and register guarantees ownership rights to real estate and provides incentives for banks to extend mortgage loans, including land mortgages which until recently were the most acceptable form of bank loan security. The Land Consolidation Act still in the drafting is expected to resolve the ownership fragmentation problems currently faced by the Bulgarian agricultural sector and make arable land in the country attractive to foreign investors.

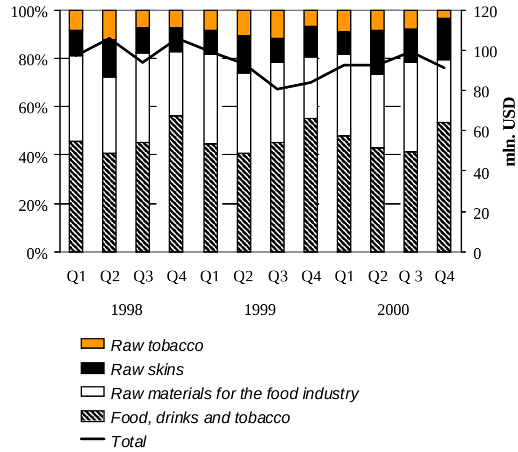
[8] *NSI data.*

Exports of Selected Agricultural Commodities



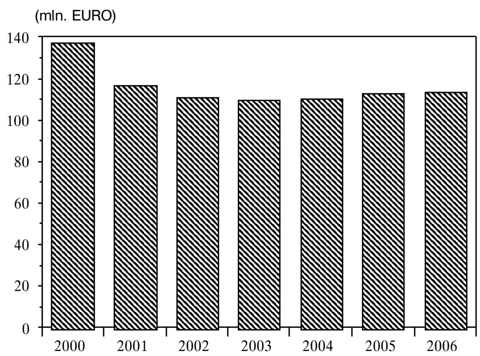
Source: BNB

Imports of Selected Agricultural Commodities



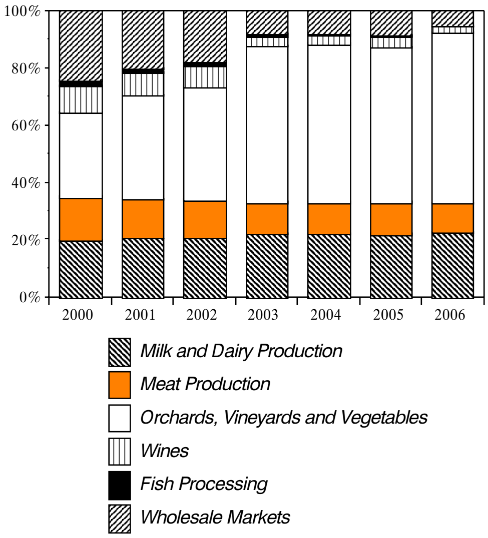
Source: BNB

SAPARD Investments



Source: MAF, National Agricultural and Rural Development Plan

SAPARD Investments by Sector (Measures 1.1* and 1.2**)



* - Investment in agricultural holdings
** - Processing and marketing of agricultural and fishery products

Source: MAF, National Agricultural and Rural Development

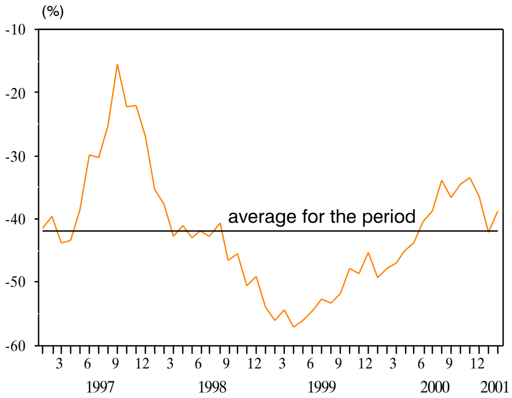
A system of public warehouse licensing was launched in 2000 to facilitate trade in agricultural goods and ease farmers' access to agricultural credit. Banks may accepts warehouse receipts as loan security. Futures contracts are traded in the Sofia Commodity Exchange funding farmers in advance.

Foreign demand for Bulgarian food products squeezes mainly because of a contraction in demand of Russia, producing an adverse effect on agricultural growth. Bulgaria managed to sustain its agricultural trade surplus in 2000 as well, though agricultural exports stepped down by 24% on a year earlier while imports reported a 5% rise.

Investments in agriculture in 2000 remained extremely low. Practically, there were no FDI in the sector. Total FDI in agriculture over the 1992-1999 period amounted to about USD 8.5 million, accounting for less than 1% of total FDI in the economy. The State Fund Agriculture extended investment loans amounting to Lv 13 million in 1997, Lv 23 million in 1998, Lv 31 million in 1999 and Lv 82 million in 2000[9]. EUR 53 million worth of allocations is expected on an annual basis under SAPARD.

[9] Data from State Fund Agriculture.

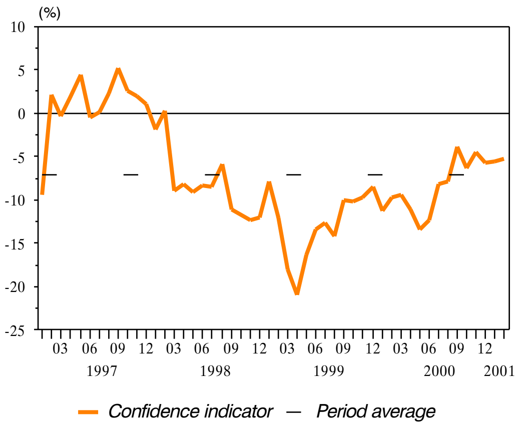
Level of Orders - Net Opinion*



* % of firms with positive opinion (expectations) - % of firms with negative opinion (expectations)

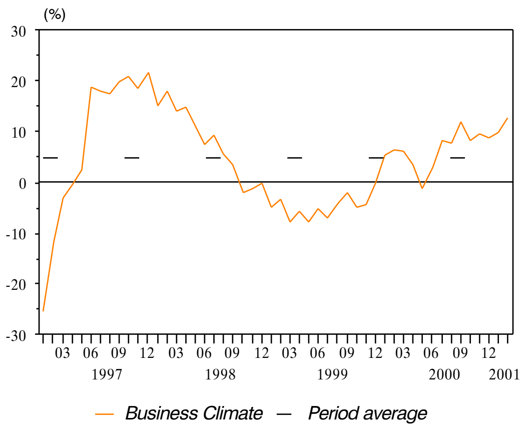
Source: NSI

Confidence Indicator in Industry



Source: NSI

Business Climate in Industry



Source: NSI

2001 Growth Forecasts

The data gathered from the monthly entrepreneurial surveys conducted by the NSI indicate that the business environment assessments of managers have remained positive. The broadening growth basis in the manufacturing sector as measured by the diffusion index is evidenced by order portfolio assessments that have sustained an upward trend since 2000. The confidence indicator[10] has too gone on the increase stepping up well above the period's average throughout 1997 to February 2001 in the last five months. The performance of the business climate indicator in the manufacturing sector supports the optimistic expectations of managers as to 2001 business activity.

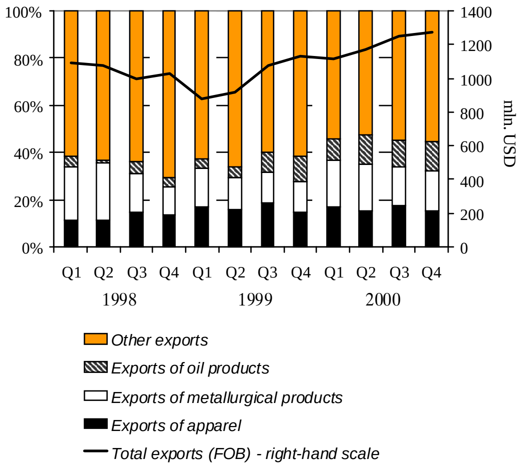
According to AEAF estimates, GDP growth in 2001 is expected to remain high at 5%, with the major contributors to 2001 growth being again the three main elements of GDP expenditures – consumption, investments and net exports. ❑

---

[10] *An arithmetic mean of the balances of the* order portfolio *indicator, the* production expectations *indicator and the* level of inventories *indicator (taken as a negative sign).*

Foreign Trade in 2000[11]

Exports of Selected Commodities



Source: BNB

Exports

The favourable external business environment and increased external demand on the part of Bulgaria's major trading partners contributed to the 20% increase in exports in USD terms in 2000. The value of exports was further influenced by the higher international prices of ferrous and non-ferrous metals and fertilisers that traditionally accounted for the bulk of Bulgarian exports. The majority of commodity groups reported an increase in exports, with some of them being dominated over by the price effect while others were prevailed by the effect of quantity. The sectors dominated by the price effect were as follows: metallurgy, the oil processing and chemical industries. Thus, for instance, the export of cast iron, iron and products thereof stepped up by 46% while copper and copper product exports rose by 103%. Fuel exports reported a 98% increase whereas organic chemical and fertiliser exports went up by 60% and 154% respectively. The robust export value growth in 2000 was mainly due to the low level of comparison in the preceding years when the business situation deteriorated and many of the sectors bottomed out. Estimates indicate that ferrous and chemical exports were strongly affected by international price volatility. On the other hand, the share of these aggregated commodity groups within total exports amounted to 18% (ferrous products) and 9% (chemicals) respectively.

---

[11] *Preliminary data. Source: Bulgaria's Balance of Payments over the Jan-Dec. period, Banking Dept. Statistical Directorate, February 23, 2001.*

The second group, i.e. the group of industries prevailed over by the effect of quantity, encompassed sectors steadily reporting a sustainable growth rate over the last few years that were not susceptible to drastic changes in the international business environment. These were the tailoring and footwear industries and furniture. In 2000, knitwear exports stepped up by 32% while footwear and furniture exports reported an increase of 6% and 13% respectively. The strong performance of the light industries had to do with Bulgaria's comparative advantages in relatively labour-intensive sectors of the economy, as brought about by the lower level of wages compared to labour productivity. Also foreign investors (mostly Greek and Turkish) providing machinery, equipment and market outlets played an important role in the sustainable export growth in these three commodity groups.

2000 witnessed a significant export increase in electric machinery and apparatuses of 24%. The expectations are that this upward trend will be steadily sustained, producing a strong favourable effect on the economy. The group includes high-tech industries such as the manufacture of computing machines and radio, TV and telecommunication equipment. The development of the above industries will further diversify Bulgaria's export basket and reduce the risk of drastic export volatility, as the demand for products of higher value added is more stable. Also, they are not so vulnerable to sharp price fluctuations characteristic of the raw material markets.

Agricultural and food products as well as tobacco and tobacco products reported a 24% decline in exports, as brought about by the geographic profile of the food industry exports to the markets of the former Soviet Union. Following the financial crisis, Russian imports have been steadily decreasing producing an adverse impact on Bulgarian food producers. Despite the rouble's stabilisation and positive growth rate of the Russian economy, Bulgarian exports to the Russian markets carried on contracting, reporting a 37% shrinkage in 2000.

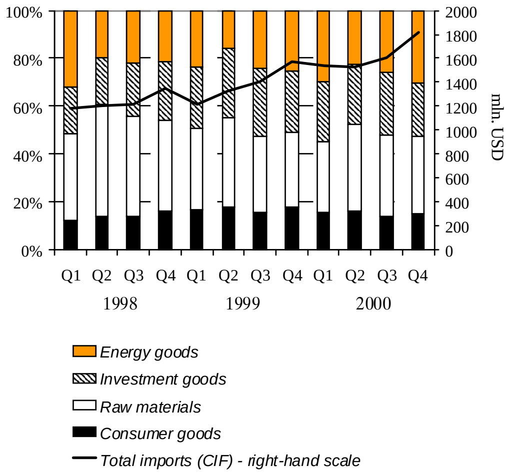
2000 did not see any important changes in the geographic structure of Bulgarian exports. The EU continued to be Bulgaria's biggest trading partner accounting for 51% of total exports. The sectors reporting the highest export growth rate were export oriented primarily to the EU markets.

The share of the Balkan countries registered a significant rise in Bulgarian exports from 7.9% in 1999 to 10.9% in 2000 due mainly to the 128% export increase to Yugoslavia following the lifting of the embargo.

Bulgaria's trade with the Balkan countries accounted for about 15% of the country's turnover. Greece, which is an EU MS excluded, other important trading partners of Bulgaria in 2000 were Turkey, FYROM and Yugoslavia.

Judging by the structure of the trade flows between Bulgaria and Turkey, it can be assumed that there was a comparatively distinct specialisation pattern. Over the 1993-2000 period, Bulgarian exports to Turkey were clearly dominated over by minerals, chemicals and products of metallurgy. As for the group of mineral products, energy exports accounted for about two-third of the group's exports.

Import Structure and Dynamics in 1998-2000



Source: BNB

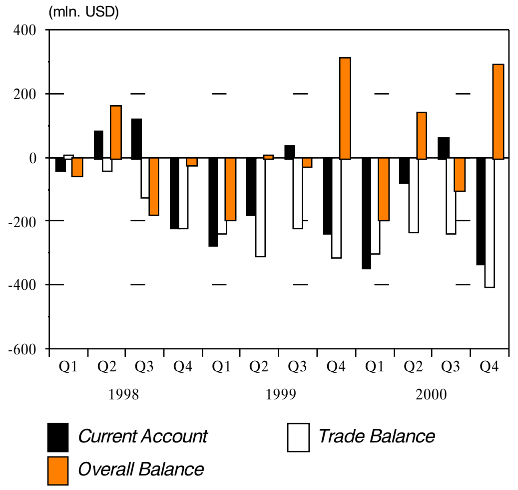
Imports

Import dynamics in 2000 was determined by the oil price index in the international markets. According to World Bank data, the average annual Brent crude oil prices stepped up by 58.7% inside 2000. Over the same period, mineral fuel and lubricant imports in Bulgaria reported a nominal-term increase of 46%. According to BNB estimates, imports rose by USD 453 million in nominal terms due to the higher oil and natural gas prices. The increase was partially offset by the higher revenues from oil product exports but the net effect on the country's trade balance remained negative. The deterioration of the trade balance as a result of the impact of energy prices was estimated at USD 275.5 million. The higher oil prices affected import volumes in 2000, with the imported amounts of crude oil stepping down by 525 000 tons (9%). On the contrary, on the volume side, natural gas imports registered an increase of 32.9 million m^3 (1.2%) as most probably due to the recovery of the chemical industry and rebounding production of fertilisers.

As for the non-energy commodity group, ferrous metals, products thereof and textiles reported a most significant increase in imports. These commodity groups provide raw materials (scrap and fabrics) for strongly export-oriented sectors such as metallurgy and the tailoring industry. Unlike the preceding years when the import of consumer goods registered a two-digit growth rate, it now went up by 5% only. The slower import growth in 2000 was probably due to the post-crisis stabilisation of household income and consumption and the depreciation of the Bulgarian currency. The import of investment goods registered an enormous decrease reporting an increase of 6.3% alone in 2000 against 40% on a year earlier.

Balance of Payments

Selected BOP Components



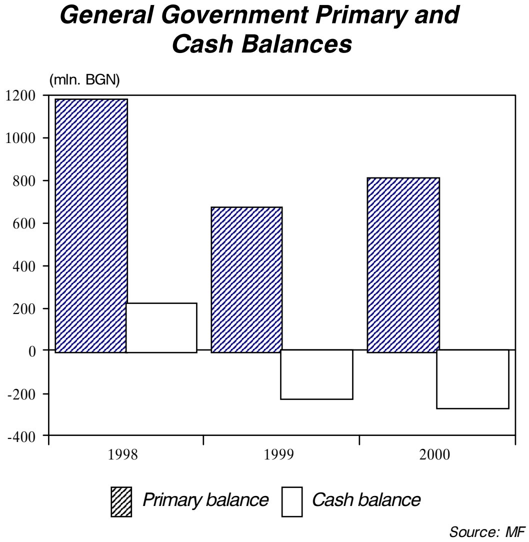
Source: BNB

According to preliminary BoP data, the 2000 trade deficit amounted to USD 1 173.1 million (against USD 1 081 million in 1999) and the current account deficit was estimated at USD 696.2 million (against USD 651.7 million in 1999). In 2000, a major item reporting a positive contribution to the current account was the balance on services. It amounted to USD 505.8 million against USD 314.3 million in 1999, with the increase in the indicator's value being due to the high tourist season in 2000: revenues from tourism amounted to USD 1 074.2 million, stepping up by 15.2% on a year earlier. At the same time, the travel debit item reported an insignificant increase of 2.2%, reaching a value of USD 538 million. Revenues from transport services stepped up by 20.9% as a result of the higher trade intensity against 1999 when the Kossovo crisis was the main barrier to trade. The import of transport services rose by 12.8%.

The current account deficit was financed by way of USD 974.6 mln worth of FDI (USD 818.8 million in 1999) and official loans amounting to USD 271.9 million (against USD 431.6 million in 1999). The 2000 growth in BNB FX reserves amounted to USD 409.2 million, exchange rate volatility excluded (USD 527.2 million in 1999).

In 2001 the ratio of the current account deficit to GDP is expected to improve by 0.5% on a year earlier due to the continuous export growth and lower imports.

Public Finance



The 2000 fiscal policy stance was more restrictive compared to 1999. This assessment draws upon the primary surplus/GDP ratio, which rose from 3.0% in 1999 to 3.2% in 2000. The tendency towards restricted budget expenditures of the first half-year period of 2000 was sustained in the second half as well, with the budget running a deficit as late as December. The restrictive fiscal policy stance had to be retained by end-2000 to avoid any risk of letting the current account deficit loose out of control under the impact of the growing fuel prices and foreign interest payments. The 2000 cash deficit of the consolidated government budget amounted to BGN 269.2 million, accounting for 1.05% of the GDP forecasts against deficit projections of 1.5%.

Table 5. The Consolidated Government Budget

(in mln. of BGN)

	1999	2000
Revenues and grants	9 678.6	11 065.1
(as % of GDP)	*42.5*	*43.2*
Tax revenues	7 480.5	8 707.2
(as % of GDP)	*32.8*	*34.0*
Non-tax revenues	1 995.2	2 154.2
(as % of GDP)	*8.8*	*8.4*
Expenditures and transfers	9 901.3	11 334.3
(as % of GDP)	*43.5*	*44.3*
Capital expenditures	1 076.6	1 036.5
(as % of GDP)	*4.7*	*4.1*
Interest expenditures	898.1	1 083.3
(as % of GDP)	*3.9*	*4.2*
Primary balance	675.4	814.1
(as % of GDP)	*3.0*	*3.2*
Cash balance	-222.7	-269.2
(as % of GDP)	*-1.0*	*-1.1*

**GDP=BGN 25 586.5 million (AEAF forecasts).*

Source: Ministry of Finance.

In 2000, consolidated government budget revenues reported a 14.3% nominal-term increase on a year earlier, with VAT and excise receipts making the highest contribution to the above increase.

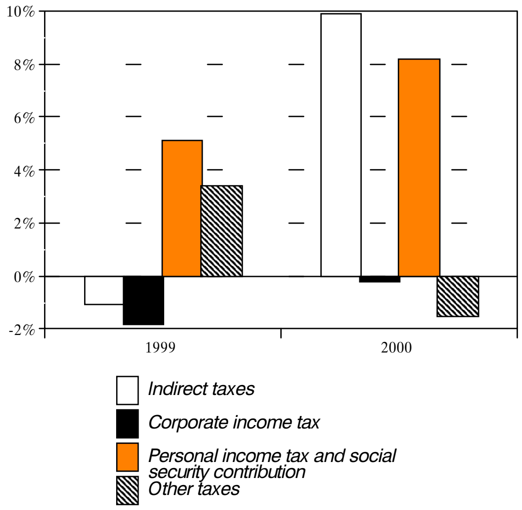
Table 6. Structure of Tax Revenues

(%)

	1997	1998	1999	2000
Tax receipts	100	100	100	100
Profit tax	21.73	12.11	9.78	8.22
Individual income tax	13.50	14.46	14.11	12.61
VAT	20.82	25.90	25.76	27.09
Excise	7.19	9.53	9.24	11.92
Customs duties and fees	7.22	6.26	3.46	2.53

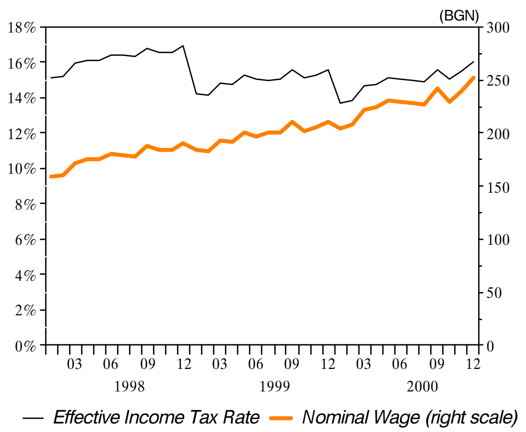
Source: Ministry of Finance.

Contribution to Total Revenues (General Government Budget)



Source: MF, AEAF

Effective Income Tax Rate to Average Wage after Payment of Social Security

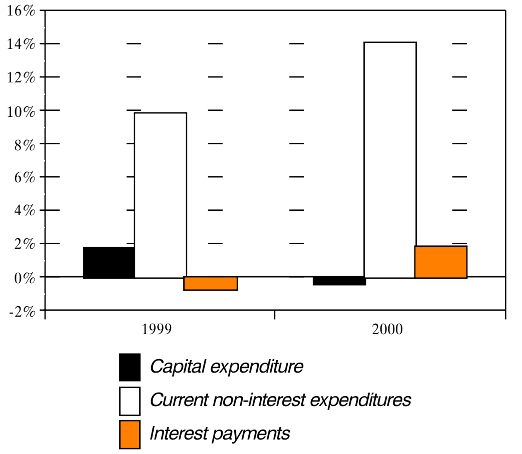


Source: MF, AEAF

In 2000, revenues from individual income tax registered a 4% nominal-term increase on a year earlier while stepping down in real terms. The country's average wages rose by 7.5% in real terms. In nominal terms, the wage bill, however, remained almost unchanged at its 1999 level due to the higher unemployment rate in 2000. The country's non-taxable income was increased from BGN 900 to BGN 960, allowing the average individual income tax rate to step down in early 2000. As a result of the wage updates in 2000, the income tax/wages ratio remained unchanged at its 1999 level of about 15%.

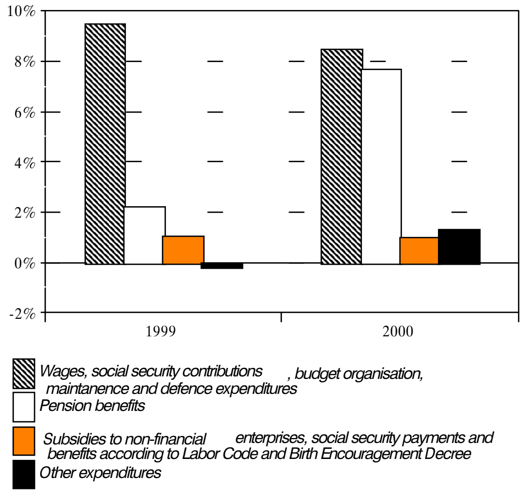
Relative to 2000, corporate income tax revenues declined by 2.1% in nominal terms in 2000. The corporate tax rate for firms falling within the profit tax bracket of over BGN 50 000 was reduced from 27% to 25% while the tax rate for other corporate tax payers, banks and other financial institutions excluded, amounted to 20%, i.e. there was no tax rate reduction on a year earlier. The corporate tax rate has been gradually reduced

Contribution to Total Expenditures (General Government Budget)



Source: MF, AEAF

Contribution to Current Non-interest Expenditures (General Government Budget)



Source: MF, AEAF

since 1998, with new reductions to be effected in 2001[12] and 2002.

Revenues from customs duties shrank by 14.6% in nominal terms – a trend sustained over the last three years and related to the country's foreign trade liberalisation in compliance with Bulgaria's commitments under the Europe Agreement, WTO arrangements and bilateral Free Trade Agreements (FTAs). The FTAs cover over 60% of Bulgaria's total trade.

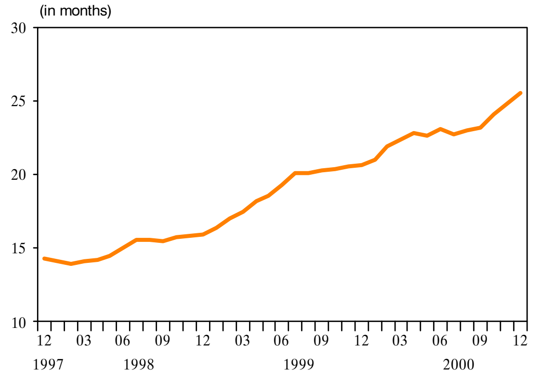
In 2000, non-tax revenues reported an 8% nominal-term rise, including BGN 136.7 worth of BNB remittances, which stepped up by 38.4% on a year earlier. The growing receipts under this revenue item (seiniorage) had to do with the increase in BNB's FX reserves and higher international interest rates.

Stepping up on year earlier, consolidated government budget expenditures reached 44.3% of GDP in 2000. Current non-interest expenditures (budget sector wages, pension payments and other social assistance payments – unemployment benefits) reported the largest contribution to the above growth.

2000 saw certain changes in the structure of interest expenditures, with the share of domestic debt interest payments reporting a decrease. The domestic debt stepped down from BGN 2 963.3 billion in end-1999 to BGN 1 767.2 billion in end-2000 in nominal terms. The low cash deficit under the consolidated fiscal programme made it

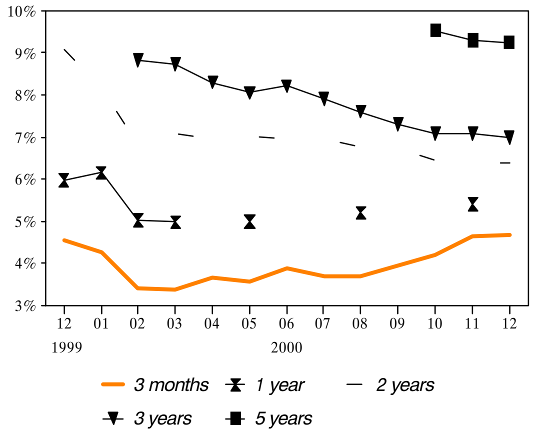
[12] In 2001 the corporate income tax rate for firms falling within the profit tax bracket of profit over BGN 50000 was reduced from 25 to 20%, and for firms with profits less than BGN 50000 the tax rate was reduced from 20 to 15%. In 2002 the corporate income tax rate will be 15% irrespective of the amount of profits.

Average Maturity of Outstanding Government Securities Issued for Budget Deficit Financing



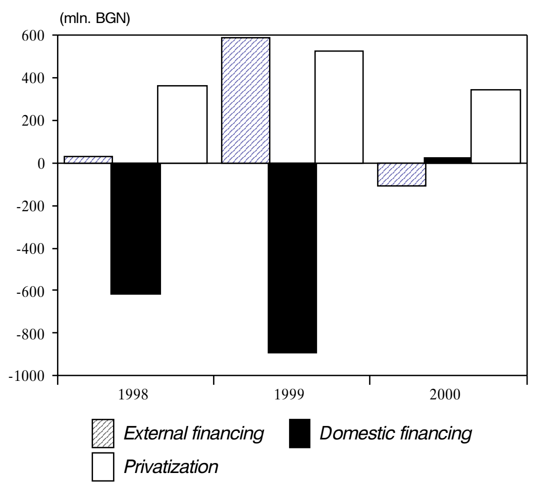
Source: MF

Yields on Government Securities (Issued for Budget Deficit Financing at the Primary Market)



Source: MF

General Government Overall Balance Financing



Note: IMF's debt changes are represented as external financing.

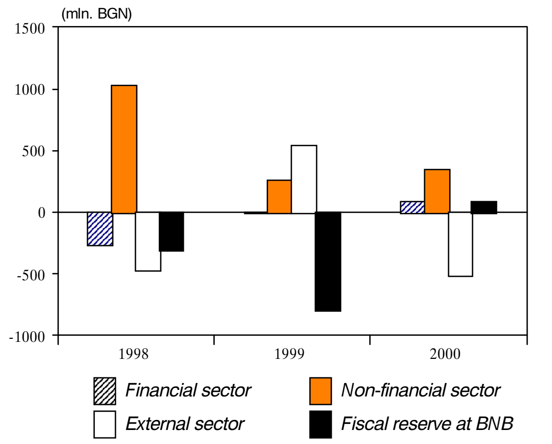
Source: MF, AEAF

possible for the Finance Ministry to sustain its policy of negative net issues of government securities. The average maturity (in months) of new issues of government securities and government securities in circulation was steadily rising throughout 2000 to surpass 2 years in end-2000. The increased maturity of the issues offered was coupled with a narrowing of the yield gap between government securities of different maturity.

In 2000, the sources of cash deficit financing underwent some changes, with domestic financing turning positive for the first time in the last three years. This was due to the net decrease in deposits and funds on accounts (BGN 270 million) which largely offset the negative issues of government securities (BGN 286 million) but also brought about a decline in the government deposit with the Issuing Department of BNB from BGN 2.7 billion in end-1999 to BGN 2.6 billion in end-2000. Unlike in 1999 when it had amounted to BGN 560 million, external financing in 2000 ran negative (BGN 98 million). Revenues from privatisation (BGN 345 million) were now a major source of financing the consolidated budget cash deficit.

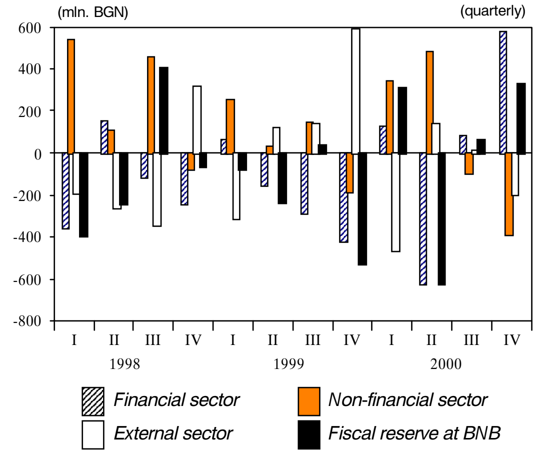
The fiscal stance influences liquidity across institutional sectors. Over the last three years it was through the consolidated government budget that funds from the non-financial sector were reallocated to the external and/or the domestic financial sector which had to do with government debt servicing. Thus the domestic debt/GDP ratio reached 80.6% in 2000, going down by about 10 percentage points on a year earlier. The decrease was brought about by the nominal-term GDP growth and reductions in liabilities as well. The

General Government Budget Cash Flows



Source: MF, BNB, AEAF

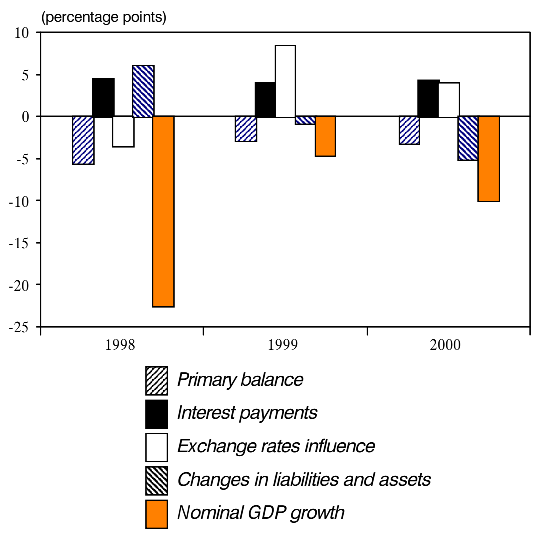
General Government Budget Cash Flows



Source: MF,BNB, AEAF

Note: Cash flows dynamics represents the redistribution between afore-mentioned sectors due to government interventions. Sign (+) denotes cash outflows from the corresponding sector. Financial sector comprises banks and other financial institutions (for 1999 the indicator is close to zero). Non-financial sector comprises firms and citizens. External sector comprises all foreign debt payments, new foreign credits and privatization receipts.

Factors Influencing Debt to GDP Ratio



Note: Exchange rates influence for 1998 and 1999 is based on AEAF estimates.

Source: MF, AEAF

removal of deposit insurance of deposits and accounts with the State Savings Bank and the primary budget surplus did enough to neutralise the effect of the higher interest payments and the depreciation of the single European currency against the US dollar.

In 2000, the Bulgarian government approved a draft Government Debt Management Act introducing clear rules of debt management and laying down certain growth limits. This was an important step towards improving the fiscal policy credibility of the government, for the debt/GDP ratio is a key indicator of fiscal sustainability monitored by foreign investors. Any fluctuations in the ratio are indicative of the degree of fiscal sustainability.

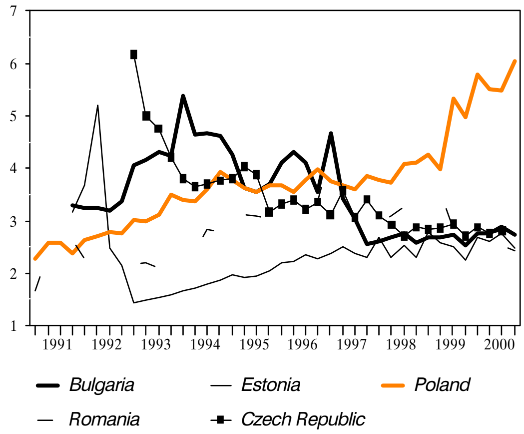
In 2001, government fiscal policy will continue to maintain its restrictive stance, with the consolidated government budget deficit expected not to exceed 1.5% of GDP. The primary surplus is expected to slightly rise to 3.3% of GDP, thus compensating partially the higher foreign interest payments.

Given the expectations of a nominal-term GDP growth and prudent fiscal policy, the debt/GDP ratio is expected to decline by another eight percentage points by end-2001. ❑

Financial Intermediation

In 2000, money supply measured by monetary aggregate M3 (broad money) increased nominally by 17.2% (BGN 1 264.8 million)[13]. Broad money's real-term growth amounted to 5.2%, a figure close to the expected real GDP growth rate of 5%. The ratio GDP/broad money, i.e. the velocity of money circulation, sustained its downward trend in 2000 and approximated values typical for economies with moderate inflation, economic growth and overall financial stability.

Money Multiplier (M2/Reserve Money)



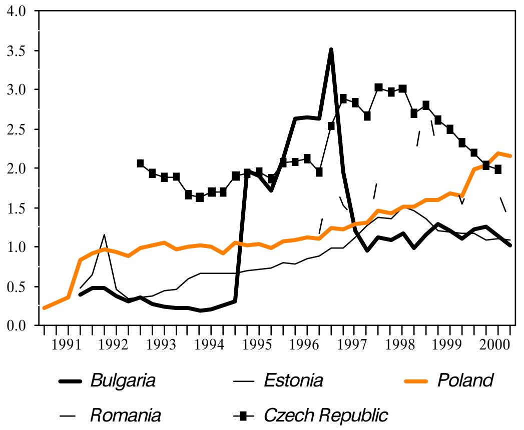
Source: IMF "International Financial Statistics", AEAF

Money outside banks was the most dynamic component of broad money, registering a 21% (BGN 411 million) increase in 2000. Quasi-money stepped up by 17.5% (BGN 687.3 million). The adjustment of the reserve requirements from 11% to 8% in mid-2000 contributed to the dynamics of these processes. As a result, money multiplier (M3/reserve money) increased from 2.7 in end-1999 to 2.86 in end-2000 (proceeds from the sale of *Bulbank* are not taken into account). Such values of the multiplier, however, signify that bank intermediation remained at a low level.

If money multiplier were to be used as an indicator of financial intermediation, then Bulgaria would not rank last in comparison to other EU candidate countries. In end-2000, money multiplier in Bulgaria (M2/reserve money) ran at 2.9 (or 2.7 if the proceeds from the sale of *Bulbank* were not taken into account) while its value in Poland amounted

[13] *The financial receipts from the sale of* Bulbank *amounting to EUR 345 million (BGN 675 million) are deducted from monetary aggregate M3. The sum was deposited in the central bank's Issuing Department and reported in its liability side. Thus, without taking into account the effect of these financial proceeds, in 2000 money supply measured by monetary aggregate M3 (broad money) increased nominally by 26.4% (BGN 1 939.6 million).*

Claims on Private Sector to Reserve Money



Source: IMF "International Financial Statistics", AEAF

to 6.03 in end-2000. The values of money multipliers in the Czech Republic and Estonia were a little bit lower than in Bulgaria, running at 2.8 in the Czech Republic as of September 2000 and 2.47 in Estonia as of end-2000.

The ratio between credit to the private sector and reserve money is another indicator of financial intermediation depth. In end-2000, the value of the ratio in the Bulgarian banking system was considerably lower as compared to the other EU accession countries. In most Central European countries commercial banks (probably foreign banks) use external credit lines and the money received are subsequently reallocated to domestic credits. Part of the long-term credits to private businesses in Bulgaria is also extended based on credit lines from foreign banks. The use of such an instrument for the fostering of financial intermediation while the volume of financial resources invested outside the country remains substantial means that the Bulgarian banks find it hard to transform the attracted short-term deposits into long-term credits to the real sector.

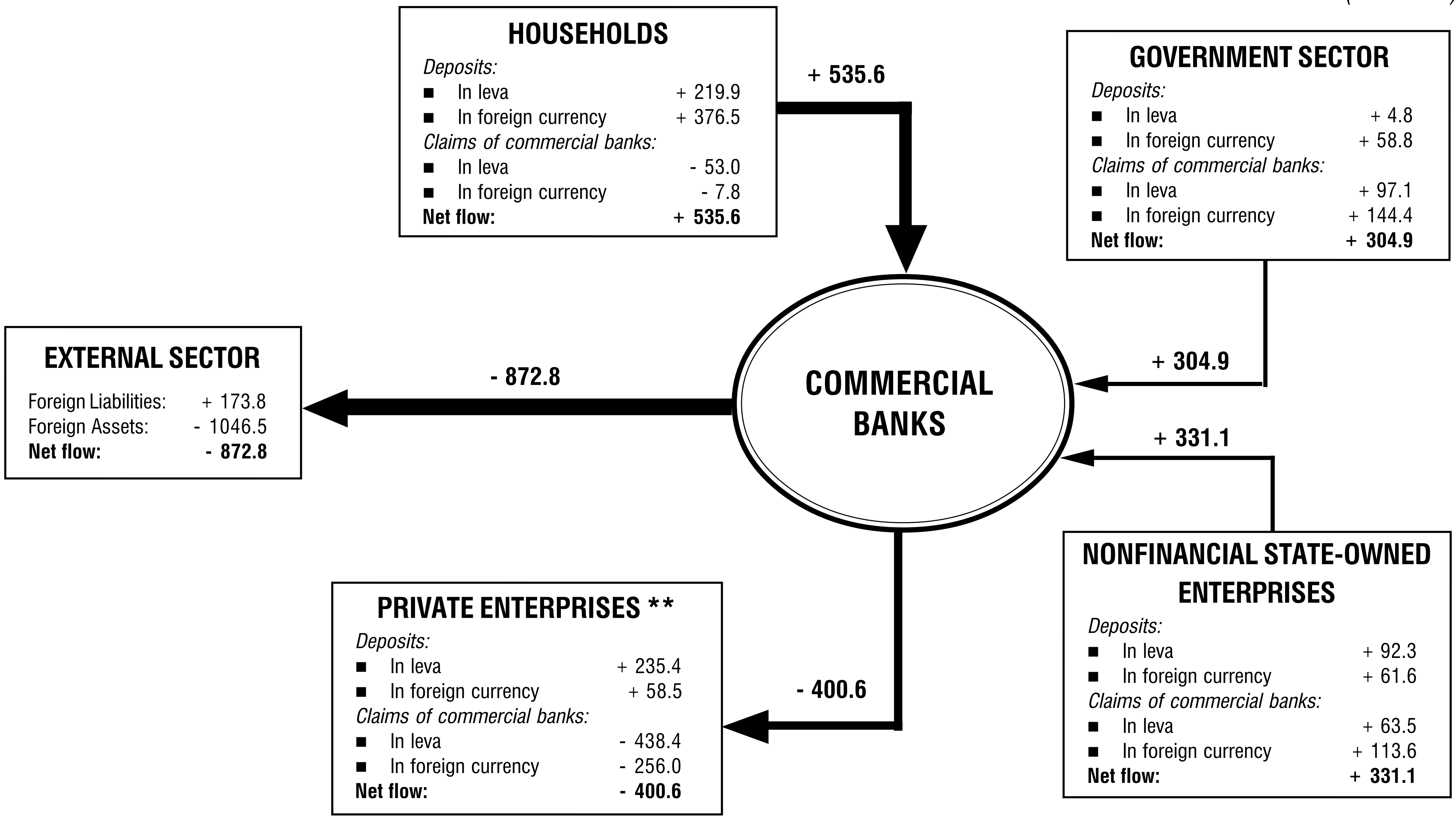
The diagram of net credit and deposit flows between commercial banks and the institutional sectors illustrates the activity of commercial banks as financial intermediaries. The deepening of financial intermediation would improve the efficient distribution of resources in the economy and would ultimately influence positively economic growth. Four years after the 1996 crisis in the banking system the level of financial intermediation remains low and commercial banks' credit policy continues to be extremely cautious.

The scheme's net inflows (money resources from the institutional sectors to the banks) are from

*NET CREDIT AND DEPOSIT FLOWS BETWEEN COMMERCIAL BANKS AND INSTITUTIONAL SECTORS FROM 31.12.1999 TO 31.12.2000 **

(BANKS IN LIQUIDATION PROCEDURE EXCLUDED)

(million BGN)



* Data from the Monetary Survey of BNB. The diagram describes credit flows only. The remaining money liabilities and receivables of institutional sectors (taxes, subsidies, wages) are not included. The plus sign (+) denotes flow from institutional sectors to commercial banks. The minus sign (-) denotes opposite flow.

** Nonbank financial institutions included.

households, the government sector and the non-financial state-owned enterprises. In 2000, for a second year in a row, households were the main source of credit resources to the banks.

Net outflows (money resources from the banks to the institutional sectors) were directed to the external sector and private enterprises. Unlike in 1999, the banking system's credit resources in 2000 were predominantly directed to the external sector in the form of deposits in foreign banks. The net flow to private enterprises was about two times smaller than that to the external sector. Obviously, the Bulgarian banks prefer to invest in low risk exposure assets and to re-channel abroad the resources attracted at home rather than to extend credits to the real economy.

The comparison of the same financial intermediation indicators across countries would provide a simple and definitive answer only if these indicators were fully comparable. In practice, however, a number of factors affect the indicators' dynamics in the various countries and distort the assessment. Therefore, it is difficult to give an ultimate evaluation of whether Bulgaria is characterised by a low level of financial intermediation when compared to other countries in the region or not.

The process of financial intermediation is highly susceptible to the influence of a number of factors of institutional and economic nature. In most cases, the impact of a single factor can be highly contradictory.

The level of the reserve requirements and the methodology for its determination is an important institutional factor governing the rate of financial intermediation. It sets the upper limit of the share of all attracted resources which commercial banks can use for the extension of credits. The higher the level of reserve requirements is, the lower the available resources for crediting become and the smaller the profit of the bank. Reserve requirements were lowered from 11% to 8% in July 2000, which, *ceteris paribus*, is a prerequisite for the improvement of financial intermediation.

The legislative and regulatory framework in Bulgaria particularly in view of the existing asymmetry in rights and responsibilities of debtors and creditors in favour of debtors impedes the expansion of commercial banks' credit activity. The lack of a simplified and rapid procedure for the seizure of collateral as well as the existence of a legal provision that criminalises the extension of loans without „proper security" contribute to the shifting of responsibilities almost entirely to the creditor. The recent amendments to the Commercial Code and the Law on Banks aimed at the elimination of these legal imperfections. Regardless, under a currency board arrangement that provides only a limited lender of last resort facility, commercial banks will continue to follow a cautious credit policy.

Commercial banks' credit policy brought about a sustainable interest difference that can be considered high. In 2000, interest rates on credits slightly increased relative to the end of 1999. The only exception were interest rates on long-term credits in US dollars which registered a fall of over 2 percentage points. Simultaneously, interest on households' demand deposits and on time (one-month) deposits of enterprises stepped up. Consequently, the difference between interest on short-term credits and time deposits shrank from

9.16 in end-1999 to 8.88 in December 2000. At the same time, however, the share of net interest income in commercial banks' operating profit decreased thereby indicating that banks did not earn from credit activity but rather from other operations.

The share of credits classified as a loss in the banks' credit portfolio affects financial intermediation in two ways. The lower the share of substandard credits, doubtful exposures and credits classified as a loss is, the higher the supply of credits should be owing to the availability of lending resources in banks and the existence of solvent customers. The share of standard exposures in the credit portfolio of the whole banking system increased from 88.3% in end-1999 to 91.8% in 2000. The share of credits classified as a loss registered the largest decline, shrinking from 5.53% in December 1999 to 3.4% in end-2000. Only the share of credits classified as substandard reported a slight increase on a year earlier, stepping up from 1.14% to 1.2%.

Capital adequacy as an indicator of commercial banks' financial stability may also be interpreted as an indicator of the potential for credit lending. Overall capital adequacy in the Bulgarian banking system considerably exceeded the minimum level of 12% required by BNB's Ordinance No8, reaching some 35.64% in end-2000. Thus, the Ordinance's requirements apparently do not impede intermediation as banks have a potential to expand lending yet remain much too cautious.

An analysis of the factors influencing financial intermediation reveals that a very small part of the change of money multiplier (taken as an indicator of the level of financial intermediation) can be explained by economic activity (presented by the industrial sales index), expected inflation (3-month moving average of monthly inflation), real interest on credits, the spread between time deposits and short-term credits, and a dummy reporting the lowering of reserve requirements in July 2000. Against this background, the importance of the other factors influencing financial intermediation, and namely the legal environment, is clearly visible.

❑

Inflation

In 2000, inflation in Bulgaria was highly influenced by several factors, namely the increase of the international prices of crude oil, the depreciation of the EUR against the US dollar and the recovery of international demand that triggered a considerable growth of world trade volumes. The international prices of crude oil stepped up by over 56% in USD terms while the depreciation of the EUR in 2000 amounted to 15.6% relative to 1999. End of year inflation in Bulgaria amounted to 11.4% whereas the average annual inflation in 2000 ran at 10.1%.

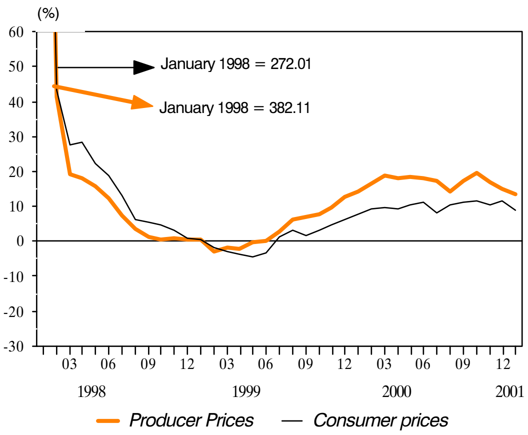
Table 7. Inflation

(December 2000 against December 1999)

	Price change (%)	Contribution (in % points)
TOTAL	**11.4**	**11.4**
Foodstuffs	12.8	5.5
Non-food items	7.0	2.1
Public catering	14.1	0.5
Services	14.3	3.3

Source: NSI

12-Month Rate of Change of Producer and Consumer Prices

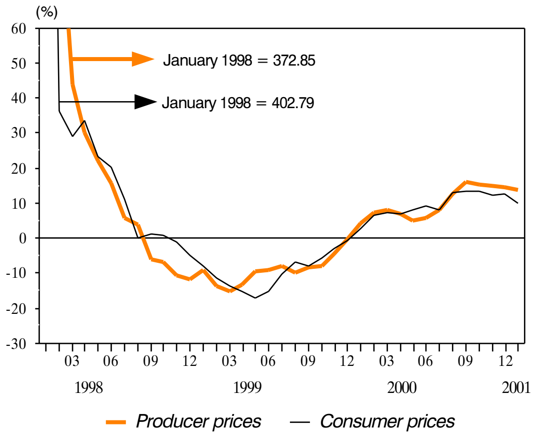


Source: NSI

Consumer prices are influenced by external factors through the impact of the latter on producer prices. Over 70% of prices in industry are under the influence of the international prices of fuels and non-energy goods, the exchange rate of the USD against the BGN and external demand.

Producer prices have a considerable impact on inflation calculated through the consumer price index. For the present analysis, we have calculated the producer price index of those commodities that can be classified as goods for personal consumption. In end-2000, the value of the index amounted to 15.8%. In the whole period after the

12-Month Rate of Change of Producer and Consumer Food Prices



Source: NSI, AEAF

introduction of the currency board, an increase of 1% of the overall producer price level has brought about 0.24 percentage points of overall inflation.

In December 2000, producer prices stepped up by 14.8% on a year earlier whereas their average annual increase ran at 17%. Refined petroleum products reported the highest producer price growth in industry. Their year-on-year price rise amounted to 41.1% in end-2000, contributing 5.2 percentage points to the overall producer price increase. Across industrial sectors, chemicals (16.1%), non-ferrous metals (22.7%), machines and equipment (18.7%), electric machines (16%), and foodstuffs (14.4%) reported more substantial annual producer price rises.

The increase of consumer prices of food items was strongly influenced by their producer price dynamics since there is a strong correlation between both price indexes of food items.

In 2000, the purchase prices of agricultural production also stepped up considerably, especially in the third quarter of the year when both producers and traders expected higher prices following the poorer crop. The average annual purchase price growth in crop production and livestock production amounted to 9.4% and 18.7% respectively. The fall in agricultural output is another factor behind the higher producer and consumer prices of foodstuffs. The high tourist season was yet another factor which affected the dynamics of foodstuffs prices in the third quarter of the year. In nominal terms, the effect of net tourism on individual consumption was estimated at a 5% increase of consumption particularly during the third quarter of 2000.

The adjustments of administered prices represented an internal factor pushing up the overall price level. Since the introduction of the currency board, the number of commodities and services having fixed and government-controlled prices had been greatly reduced to encompass only several of them. Since mid-1997, the adjustment of these prices with the objective to phase out subsidies and financially rehabilitate companies in the energy sector has had an adverse impact on overall inflation but without a spill over effect on other prices of goods and services. As a result of these price rises, household expenditures for the purchase of commodities and services with administered prices stepped up and their relative weight increased from 14.4% in 1997 to close to 20% in 2000.

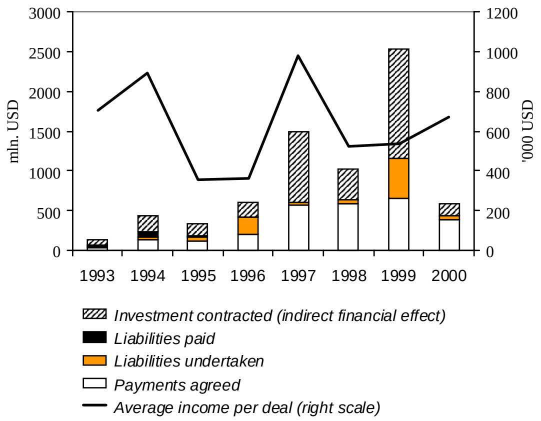
The government can exercise some sort of control over inflation through the adjustment of administered and controlled prices. The price of electricity was increased twice in 2000 (in January and in August), price of district heating was frozen. In 2000, the overall administered price growth amounted to 13.8% in end-year and contributed some 2.8 percentage points to the overall CPI increase. An increase of 1% of the general level of administered prices results in inflation growth of 0.31 percentage points.

The rise in the general level of prices in mid-2000 was accompanied by an increase in money supply as a result of the inflow of foreign currency. The growth of money stock had to do with the inflow of tourists. In the nine months of 2000, the flow of foreign tourists stepped up by 18.2% while the annual balance on tourism improved by 32.3% relative to 1999. The impact of money stock on the rate of inflation is seen with about one month's lag in time and the regressive correlation with monetary aggregate M3 points out that its increase by 1% results in 0.14 percentage points growth of the inflation rate.

In 2001, the rate of inflation will decline and the forecast end-of-year inflation is 4.5%. The estimate is based on forecasts for the stabilisation of the international prices (particularly those of crude oil) and the expected steady exchange rate of the EUR to the USD. ❑

Privatisation

Financial Results of Privatization and Average Income per Deal



Source: PA

As of end-2000, a total of 51.4% of assets of all state-owned enterprises in Bulgaria had been privatised, accounting for some 78% of total assets slated for sale. In 2000, some 473 deals were concluded (representing about one-third of the number of deals closed in 1999), out of which 160 deals for the sale of detached parts of enterprises. The Privatisation Agency reported to have finalised 92 dales. The overall financial effect from privatisation amounted to USD 584 million in 2000, while the average yield per deal reached USD 671 000.

As a whole, the main objective in privatisation has been achieved. Until end-2001, the remaining state-owned minority packages of shares in already privatised firms will be sold. Work on the finalisation of procedures for the sale of infrastructure companies will continue. Some substantial amendments to the Transformation and Privatisation of State-Owned and Municipal-Owned Enterprises Act (Privatisation Act) were passed so as to increase transparency in the privatisation process in view of the remaining few but large-scale and important enterprises slated for sale. The changes had as a goal to increase public awareness of the privatisation process, to enhance the responsibility and statutory authority of the Supervisory Board of the Privatisation Agency, to introduce more severe sanctions against managers of the enterprises due for privatisation for withholding or misrepresenting of the required information.

The decisions for the privatisation of certain enterprises included in a separate list in the annual privatisation program are to be adopted by the

Council of Ministers after the consent of the National Assembly. The Council of Ministers submits to the National Assembly an annual report on the implementation of the privatisation program and the privatisation of the above-mentioned enterprises. The Council of Ministers drafts the strategies for the privatisation of enterprises with a monopoly or dominant position at the market in public utilities as well as for the national and infrastructure network companies. The National Assembly should approve these strategies.

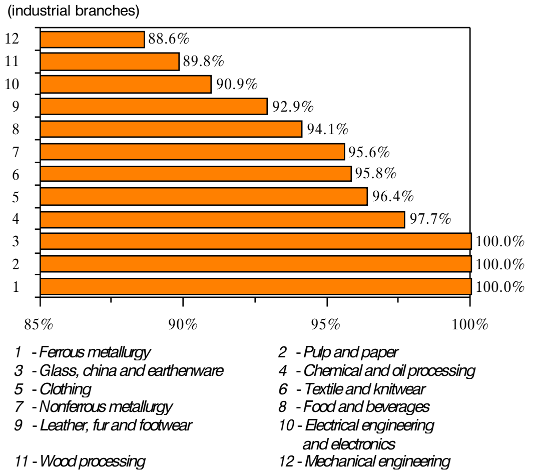
The amendments to the Privatisation Act extended the list of privatisation instruments by including the possibility to float packages of shares at the stock exchange in conformity with the provisions of the Public Offering of Securities Act. The terms and conditions of management and employee buy-outs (MEBOs) underwent the following changes pursuant to the amendments of the Privatisation Act: the down payment was increased from 10% to 25% of the purchase price while the 10-year (deferred) repayment period was reduced to 5 years; in case of a delinquency (no more than 1 year) the unpaid amount accumulates at the base interest rate in the period of arrears; the bids are now discounted by 25% to account for deferred payments following a methodology determined by the Privatisation Agency.

Restructuring in Industry[14]

In 2000, the privatisation of small and medium sized industrial enterprises was practically accomplished. As of end-February 2001, some

[14] Source of information: the speech of Mr. Ivan Mihailov (Ministry of the Economy) at the seminar on Industrial Policy jointly organised by the Ministry of Economy and the EU (15-16 March 2001).

Privatized Assets by Industrial Branches



Source: ME

89.5%[15] of state-owned assets in industry had been transferred in private hands. No state-owned firms remained in the following branches: ferrous metallurgy, pulp and paper industry and glass and china industry.

As of end-February 2001, some 86 firms in liquidation had been deleted from the Commercial register. Presently, other 129 industrial enterprises are in liquidation and their assets are being sold. Other 72 industrial enterprises are in bankruptcy proceedings. Financial rehabilitation plans are being devised for 45 of them whereas the assets of the remaining 27 companies are slated for sale. The bankruptcy proceedings for another 69 firms had been ended, out of which 36 enterprises had resumed economic activity and 18 firms had been deleted from the Commercial register.

The analysis of the situation of privatised industrial firms shows that successful technological, product and market restructuring is monitored in enterprises with a distinct majority owner. A number of enterprises also attained growth by employing professional managers with market-type thinking and behaviour.

At the same time, a great part of the new owners (MEBOs, voucher privatisation holdings and other firms lacking sufficient financial resources) find it hard to cope with the challenges of restructuring and the market reorientation of the acquired enterprise. In such cases, the successful outcome (already being applied) is the secondary privatisation of the already private companies.

The last years saw another positive trend, i.e. the establishment of a new generation of small firms

[15] *As per the World Bank criteria.*

and research organisations created by leading experts who had left the big research institutes and designer's bureaux. Notwithstanding their initial stage of development, these firms are characterised by flexible management, innovative thinking, and entrepreneurial spirit.

In *ore mining*, restructuring of production whereby inefficient mines and pits with depleted stocks are closed was carried out simultaneously with privatisation (three foreign investors from Ireland, the United Kingdom and Germany). Environment in the regions affected by ore mining and dressing is being restored.

The procedure for the establishment of a concession for the utilisation of ore-fields, barren mineral deposits and stone and lining deposits in exploitation was streamlined.

New programs for technological and product restructuring have been devised and implemented in the privatised *steelworks* in order to enhance their competitiveness in a market environment and to achieve the European standards for economic viability.

There are a number of examples of successful overall restructuring in *non-ferrous metallurgy* (capacities for the production of copper, lead, and zinc). *Junior Meniere Pirdop Copper* AD in Pirdop and *KCM* AD in Plovdiv are among them. Their production is ISO certified, recognised and traded at the London Metal Exchange and at the other international markets. Projects are currently underway to clean up past pollution and improve environmental conditions in the areas close to the metallurgical works.

Restructuring in *chemical industry* is well advanced. Only the fertiliser industry experienced difficulties caused by the lack of choice of natural gas supplier as well as by the unfavourable situation at the international markets in the last two years.

The number of enterprises in *machine industry* that had achieved market-oriented restructuring is still small. Certain products in the enterprises producing hydraulic and pneumatic machinery and equipment, electric hoists, machine tools and woodworking machines are made under license of leading firms, hence the swift re-orientation to new markets monitored lately. It is also noteworthy that this branch recorded an increase in the relative share of exports simultaneously with the registered growth of production.

The real restructuring *in electrical and electronic industry* is still at an early stage. The management of most of the enterprises has not yet elaborated purposeful strategies and lacks a comprehensive vision for the future development of the newly privatised companies.

According to data from the Ministry of economy, as of end-2000 there were some 1300 enterprises in the *food industry*, out of which about 1000 new small and medium firms. Wine and canning industries are export-oriented whereas the other food sub-sectors satisfy predominantly domestic demand.

Over 3100 enterprises are registered to operate in *textile, knitting and clothing industry* with more than 160 000 employees. The share of exports in the total volume of output follows a steady upward trend. Most of these enterprises had finished their product and market restructuring based on long-term orders.

The privatisation and deregulation of state-owned monopolies in infrastructure are on the agenda and the first steps in this direction have already been made.[16]

In conclusion, it is now indisputable that the private sector holds a dominant position in the Bulgarian economy and contributes to the attainment of high and sustainable growth rates.

Reforms in the Social Systems

Two of the most important social systems, viz. the social and health insurance systems underwent profound changes in 2000.

January 2000 saw the start of the reform in the social insurance system. Three insurance funds were established, namely the Pension Fund, the Work Injury and Occupational Sickness Fund and the General Sickness and Maternity Fund. The contributions for the coverage of each of the risks were determined. The objective was to avoid the mixture of short-term and long-term type of insurance by establishing separate funds and to determine annual contributions commensurate with expenditures.

Early-2000 saw also the start of the pension reform which aims to restore the long term financial viability of the traditional Pay As You Go (PAYG) scheme and complete it with a fully funded compulsory alternative. Retirement age for men and women were raised with the requirement to accumulate a minimum number of points to be eligible for retirement. Other changes included:

---

[16] A detailed analysis of the principles on the basis of which the procees of deregulation of monopolies in infrastructure will be implemented is presented in AEAF's publication „The Bulgarian Economy in 2000. Semi-annual Survey".

the introduction of a new pension benefits formula; the increase of the allowable upper limit of the pension benefit; and changes to the occupational categorisation of employees resulting in changes in the level of their social security contributions.

Greater retirement eligibility requirements did not influence the number of pensioners as their number decreased by 0.13% in 2000 on a year earlier. However, the balance of the Pension Fund deteriorated as a result of the other changes and particularly due both to the new formula of pension determination and the diversion of contributions of employees in labour categories I and II to occupational pension funds. In 2000, the National Social Security Institute (NSSI) reported a deficit of BGN 117.3 million, or 0.4% of GDP.

The start of operation of the occupational funds was delayed till November 2000 since the State Agency for Insurance Supervision (SAIS) had to licence pension companies and funds. In practice, in 2000 the NSSI collected the social security contributions to the occupational funds and deposited them in the BNB. As of 31 December 2000, the NSSI account in the central bank had accumulated BGN 27 million. In 2001, after the insured persons have chosen a pension fund[17], the NSSI will transfer their accumulated contributions to the respective pension funds.

In 2000, nine companies received licenses to manage pension funds. Each one of them has the right to manage an occupational, a universal and a voluntary pension fund. All of them had registered voluntary and occupational pension

[17] The NSSI will assign ex officio a pension fund to the insured persons who had not availed of their right to choose one. They will not have the right to switch to another fund during one year.

funds while seven of them had also registered universal pension funds[18].

According to data from the State Agency for Insurance Supervision, as of 30 June 2000 the voluntary pension funds had accumulated BGN 65.4 million, some 80% of which had been concentrated in two pension insurance companies, viz. 53% in „Allianz Bulgaria“ AD and 25% in „Doverie“ AD. The insured persons are distributed in a similar way: 55% of them are in „Allianz Bulgaria“ AD and 25% – in „Doverie“ AD. Such an oligopoly structure may find its explanation in the relatively small market and the necessity to attract a wide range of insured persons to maintain a fund’s profitability.

As of 30 June 2000, the number of people insured in voluntary pension funds amounted to 377 457, however, we must differentiate between regular contributor and person who had made a lump-sum contribution payment. Again as of end-June, some 7 513 people had acquired the right to receive additional pension benefits from voluntary pension insurance: one-third of them receive monthly payments while the others had received a lump-sum pension benefit. The reasons for such a pension structure can be found in the short period of accumulation of contributions sufficient to permit a monthly pension (e.g. the oldest pension company was established in 1994) and the existence of certain tax breaks allowing people approximating the retirement age either to defer tax payments or to substantially reduce them.

According to data from the Bulgarian Association of Additional Pension Insurance Companies, the

[18] *Seven of the licensed companies had previously had voluntary pension funds as per legislation before 2000.*

total amount of assets accumulated by the voluntary pension funds since their establishment till September 2000 ran at BGN 74.18 million[19]. In end-September 2000, the Council of Ministers adopted an Ordinance on the way and order of evaluation of assets of pension funds and pension insurance companies.[20] The Ordinance ensures that the same approach is applied in the evaluation of all pension funds' assets.

The structure of invested pension assets of the voluntary pension funds complies with the requirements of Chapter IV of the Additional Voluntary Pension Insurance Law, i.e. that at least 50% of assets should be in government securities or deposits. As of 30 June 2000, the structure had an extremely conservative profile, as 91% of assets were in government securities and deposits, viz. 74% in government securities and 17% in deposits.[21]

Two new investment instruments were created in 2000, namely mortgage bonds and Bulgarian deposit receipts, both of them available to the voluntary pension funds.[22] To date, there has not been any issue of mortgage bonds while the fees related to the purchase of Bulgarian deposit receipts together with the small volume of such securities sold and their low liquidity at the secondary market deter pension funds from investing in them.

A new market player was expected to enter the capital market and push stock trading forward, as

---

[19] Bulletin 8/9 of the Bulgarian Association of Additional Pension Insurance Companies, 2000;

[20] Decree 202/29.09.2000 of the Council of Ministers;

[21] SAIS Bulletin 1, 2001;

[22] The Bulgarian deposit receipts are certificates of ownership of foreign financial assets. They are traded in BGN at the Sofia Stock Exchange.

occupational pension funds started operating in 2000. However, for reasons above mentioned, the funds accumulated throughout the year could only serve this purpose in 2001 after having been allocated by the National Insurance Institute to the pension funds. On the other hand, they are not be expected to revive the capital market, as these funds are rather small in volume due to the relatively small number of contributors to the occupational pension funds. The pension funds are likely to opt for investing in low-risk bank deposits.

The Social Code provides for the State Agency for Insurance Supervision to set out a minimum rate of return on investment for pension funds of the Pillar II type (additional compulsory pension insurance)[23]. In practice, however, such an approach usually leads to the investment portfolio standardisation of pension funds in an attempt to avoid any drastic deviation off the average rate of return in the industry.[24] Thus in addition to investment restrictions[25], there comes to fore another factor standardising the investment structure of pension funds while making the contributor's choices harder.

Pension funds raise funds from pension contributions and return on investment. Their expenditures, on the other hand, cover investment management and administrative costs, annuity payments under all the risks provided for by law (disability, retirement, death or in case the contributor has subscribed to a new pension fund). With pension funds of the capitalised type, pension

[23] Article 193, para 1.

[24] Toward Better Regulation of Private Pension Funds, Hemant Shah (June 1997), World Bank

[25] *Under art. 172 – 180 of the Social Code.*

benefits are usually not paid out in the initial years of operation due to the short period of accumulation of funds. When pension benefit payments are initiated, the contributor shall contract with the pension insurance fund the terms and conditions of receiving pension benefits on a regular basis for life or a limited term against his/her account accruals (depending on his/her choices and legal options). Therefore, it is important that the necessary legal requirements to pension funds' reserves are adopted and strictly implemented by the State Agency for Insurance Supervision in 2001. Pension insurance companies shall be required to set aside reserves to meet future liabilities.

The reforms in public health care and its financing were launched in July 1999 with the introduction of health insurance requirement and the establishment of the National Health Insurance Fund (NHIF). A year later NHIF took over primary care financing. Hospital care funding will be gradually transferred within the competence of the Fund but in 2000 health care expenditures were still jointly covered by the NHIF (BGN 97 million), local governments (BGN 414 million) and the central government budget (BGN 372 million).

According to NHIF data[26] the number of health insured amounted to 7 390 876, or 90% of the population whereas 88% of it made their choice of a GP.

In 2000, NHIF spent a total of BGN 126 million (13% of total health care expenditures) as follows: BGN 97.2 million – health insurance payments (65.7% – primary care and 34.3% – medications);

---

[26] *Data from the draft NHIF 2000 Annual Report.*

BGN 13.3 million – operating costs and BGN 15.0 million – capital expenditures. The Fund ran a surplus of BGN 423 million. NHIF will carry on accumulating funds and set aside reserves to meet hospital care financing from mid-2001 onwards.

The social reforms in Bulgaria started successfully in 1999 and 2000. Further reform efforts will be aimed at ensuring the normal operation of the restructured systems and improving the mechanisms of functioning.

The Banking System

In 2000, the financial situation of the banking system remained stable. Out of 35 operating banks, only four (mainly local branches of foreign banks) recorded losses in 2000.[27] The reason for these losses had to do mostly with the discrepancy between the Bulgarian bank accounting standards and the foreign banks own internal accounting rules. The rate of return of the banking sector assets improved, amounting to 3.1% in 2000 as compared to 2.4% reported in 1999.

In 2000, the balance-sheet value of the banking system increased by BGN 1 550 million (18.8%), reaching BGN 9 773.5 million. In absolute terms, the value of the indicator exceeded almost two-fold the increase reported in 1999 (BGN 797 million). Against end-1999, commercial banks' BGN assets stepped up by 11.2%, or BGN 403.1 million, while their foreign currency assets grew by 24.7% (BGN 1 147 million). Over the same period, the USD equivalent of bank foreign currency denominated assets registered a lower growth rate (15.5%) due to the BGN depreciation against the

---

[27] *In end-1999, six out of all 34 operating banks recorded losses.*

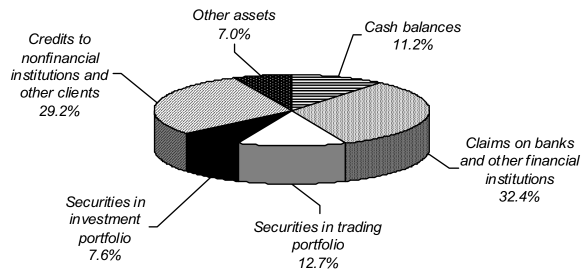
USD. As of end-2000, the three largest banks (Bulbank, United Bulgarian Bank and DSK Bank) held 49.9% of total banking sector assets (as compared to 51.7% in end-1999).

On a 12-month basis, the 7.4 percentage points increase of the share of claims on banks and other financial institutions up to 39.3% represented the most substantial change in banking sector assets structure. The increased rate of return on USD and EUR deposits held in foreign banks is most probably the reason behind this change. The relative weight of credit lending to non-financial institutions and other clients also stepped up (by 1.7 percentage points) to reach 30.9%. The contraction of the share of money cash in hand and resources in the banks' settlement accounts in the BNB by 3.6 percentage points down to 7.5% had to do with the lowering of the reserve requirements from 11% to 8% in July 2000. The fall of the relative weight of securities in bank total assets was probably due to the negative net issue of government securities by the Bulgarian government as well as to the year-on-year decrease in the rate of return on these government securities. The changes in the assets structure demonstrate that banks still prefer investments in relatively low-risk, low-return foreign securities.

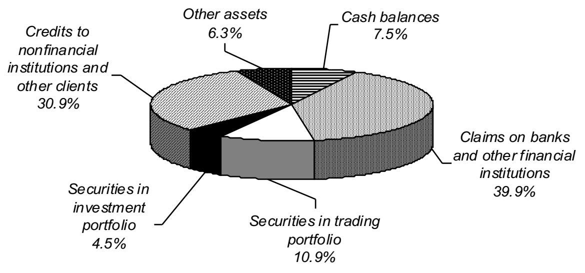
The liability side structure did not undergo any substantial changes relative to end-1999. Out of all liability components, deposits of non-financial institutions and other clients registered the highest absolute increase, stepping up by BGN 919.7 million. On a 12-month basis (against end-1999), banking sector capital and reserves grew by 17.3% (BGN 221.4 million) while capital and reserves of the three largest banks alone increased by BGN 87.8 million.

Assets Structure

31.12.1999



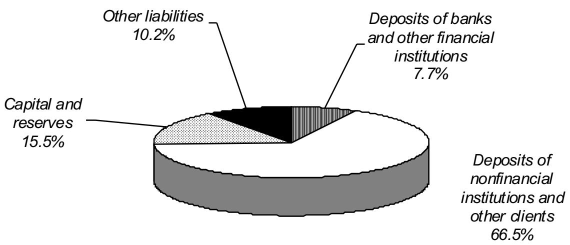
31.12.2000



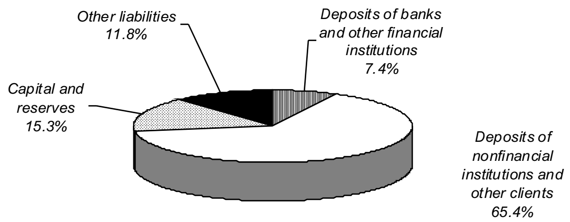
Source: BNB

Liabilities Structure

31.12.1999



31.12.2000



Source: BNB

Commercial banks post-tax profit amounted to BGN 282.7 million, exceeding by 45.3% the profit recorded in 1999 (BGN 194.6 million). The three largest banks, namely Bulbank, United Bulgarian Bank and DSK Bank, generated the bulk (some 84%) of the banking sector annual positive financial result. Inasmuch as that concentration had augmented on a year earlier when the three banks' share ran at about 66%, we may conclude that the smaller commercial banks remained relatively less profitable than the big ones. Relative to end-1999, the increase in net income from trade and revaluation at the expense of the lower relative weight of net interest income and net income from commissions and fees represented the main changes in the structure of bank operating profit. The change is mostly associated with the sale by Bulbank of its shares in other financial institutions (United Bulgarian Bank and Corporate Commercial Bank). The net interest income to operating expenses ratio in end-2000 amounted to 88.4%, some 10 percentage points higher than the value of the indicator reported in end-June 1999. This is indicative of the growing capacity of the banking sector to cover its operating expenses with its operating profit. The higher growth rate of bank operating expenses in 2000 as compared to 1999 was probably due to the introduction of new bank products requiring considerable initial investment.

Commercial banks' capital adequacy indicators sustained significantly higher values than those fixed by BNB's Ordinance No8. In end-December 2000, the banking sector overall capital adequacy reached 35.64%, stepping down by 5.7 percentage points against the indicator's value in end-1999. Over the period 31 December 1999 to 31 December 2000, the total risk component of the sector assets had risen by 34.4% (BGN 989.7 million) while the capital base had increased by 16%, or BGN 189.8 million. The contraction of the banking system capital adequacy indicators is a sign that commercial banks had started to extend, although quite tentatively, more credits to the real sector of the economy.

Commercial banks credit portfolio had improved relative to end-1999. Thus, in December 2000, some 91.8% of bank risk exposures were classified as standard against 88.2 % in December 1999. In end-2000, some 3.4% of credit exposures were classified as a loss as compared to 5.5% in end-December 1999.

Table 8. Commercial Banks' Credit Portfolio

(%)

Credits	Dec 1999	Dec 2000
Standard	88.28	91.8
Watch	3.83	2.8
Substandard	1.14	1.2
Doubtful	1.22	0.8
Loss	5.53	3.4

Source: BNB

Banks continued to maintain relatively high liquidity although its level in end-2000 stepped down on a year earlier. In December 2000, the banking sector primary liquidity indicator (foreign bank branches excluded) ran at 10.36% against 15% in December 1999. The value of secondary liquidity indicator amounted to 25.98% against 35.15% reported in December 1999.

Table 9. Liquidity Indicators of Commercial Banks

(%)

	December 1999	December 2000
Primary liquidity	15.00	10.36
Secondary liquidity	35.15	25.98

Source: BNB

In 2000, competition on the bank market continued to grow. The table presents two of the most commonly used indicators gauging competition within an industry, viz. Herfindahl Index and the concentration ratio. These indicators of concentration in the Bulgarian banking system are calculated for the period 1991 to 2000 with respect to three measures of bank size: total assets (balance-sheet value of a bank), claims on non-financial institutions, and deposits of non-financial institutions

Table 10. Measures of Concentration in the Banking Sector

	1991	1993	1995	1997	1999	2000
Bank assets						
Herfindahl Index	0.38	0.30	0.14	0.27	0.12	0.11
Concentration Coefficient (%)	80.9	73.4	60	72.3	57	55.2
Claims on Non-financial Institutions and Other Clients						
Herfindahl Index	0.18	0.24	0.14	0.14	0.08	0.07
Concentration Coefficient (%)	69.2	66.0	57.8	62.4	43.6	42
Deposits of Non-financial Institutions and Other Clients						
Herfindahl Index	0.15	0.15	0.13	0.15	0.13	0.13
Concentration Coefficient (%)	66.2	57.3	54.3	65.8	61.7	62.2

Source: J. Miller, S. Petranov – „Banking in the Bulgarian Economy“, BNB, 1996; BNB; AEAF

In 2000, the decline of Herfindahl Index with regard to bank assets relative to 1999 most probably had to do with the privatisation of some state-owned banks (Bulbank, Expressbank and Hebros Commercial Bank), the aggressive market strategy of some of the middle-sized banks (First Investment Bank and Economic and Investment Bank) and the entry of new foreign banks such as Citibank.

The changes of Herfindahl Index and the concentration coefficient with regard to the claims on non-financial institutions also point to intensified competition on the bank market. The rise of competition was to a certain extent due to the bank cautious approach to credit lending to the real economy. Characteristically, claims on non-financial institutions account for a relatively small share of the assets of some of the big banks such as Bulbank and the United Bulgarian Bank. At the same time, the relative share of credits to private and state-owned enterprises in the assets of some of the relatively small banks (most of the branches and subsidiaries of foreign banks) remains high.

Bank groups	Share of credits to non-financial institutions within the bank's assets	Number of banks	Share in total banking sector assets
I	Over 50%	10	11.4%
II	30% – 50%	13	35.9%
III	Under 30%	12	52.7%

Source:

Group I: *Bulgarian-American Credit Bank, International Commercial Bank, First East International Bank, Raiffeisenbank, ING Bank, Alfa Bank, National Bank of Greece, Xiosbank, Hypovereinsbank, Citibank*

Group II: *DSK Bank, Bulgarian Post Bank, Demirbank, Eurobank, Corporate Commercial Bank, International Bank for Trade and Development, First Investment Bank, S. G. Expressbank, Economic and Investment Bank, Hebros Commercial Bank, Central Cooperative Bank, Teximbank, Unionbank*

Group III: *Biochim, Dresdnerbank, Bulbank, Bulgaria-Invest, Promotional Bank, Neftinvestbank, United Bulgarian Bank, Municipal Bank, Roseximbank, Tokuda Credit Express Bank, TC Ziraat Bank, Societé Générale.*

The lowering of Herfindahl Index with regard to claims on non-financial institutions also suggests intensified competition among banks in the attraction of first-rate borrowers. Such customers, however, are few in number given the fact that the bulk of small and medium firms have short or absent credit history.

The increase of Herfindahl Index with respect to attracted resources from non-financial institutions relative to 1999 shows that large banks with an extensive branch system continued to attract the highest number of households' and companies' deposits. Therefore, these are the banks, namely Bulbank, DSK Bank, United Bulgarian Bank, Biochim and Bulgarian Post Bank, rigorously competing for the attraction of more depositors.

The banking system is stable and gradually becomes more active in fully assuming its function as financial intermediary. This activity will sustain its upward trend in view of the almost completed by end-2000 privatisation in the sector. Thus, as of December 2000, private banks held some 82.4% of total banking sector assets. Only three banks (incl. Promotional Bank) remain state ownership, one of them, however, should be privatised in the forthcoming months.

As of end-December 2000, foreign banks held 73% of total banking sector assets, 69% of attracted deposits and 62% of total loans extended. In 2000, measures were taken to remove the legislative obstacles to credit lending. The expected legislative amendments should accelerate the court procedures for the seizure and sale of collateral and facilitate procedures for the collection of claims. In 2000, the central bank amended its bank supervision ordinances in order not only to harmonise them with EU standards but also to create clear and invariable conditions for the banking activity and particularly for credit lending. In this respect, the changes in the bank-licensing regime, the reporting of their capital adequacy and the employment of consolidated supervision will exert a positive indirect effect on the banks' lending practices as well. ❑

LABOUR MARKET

Unemployment

Labour Force Surveys Data show that the number of employed in Bulgaria declined by 2.8% in 2000 due primarily to the deepening of structural transformation at the micro level following the privatisation of state-owned assets in the period 1997-2000. Apparently, the newly privatised state-owned enterprises had previously maintained a level of excess employment, which could not have been preserved under private ownership. Industry reported the highest pace of labour shedding in 2000 with employment contraction of 9.4% on a year earlier. Employment in the service sector shrank by about 2%. Yet, the number of employed in agriculture, forestry and fishery stepped up although the year 2000 was not favourable for the sector, registering a considerable fall of generated gross value added.

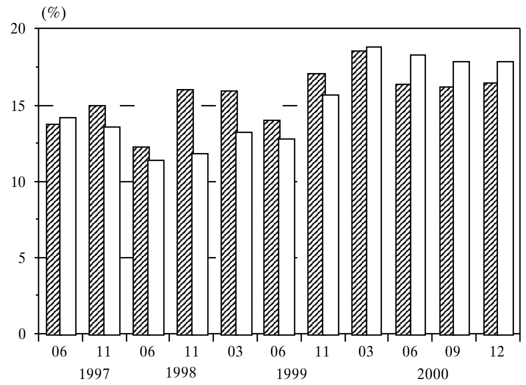
Table 10. Employed by Economic Sectors

	Mar'99	Jun'99	Nov'99	Mar'00	Jun'00	Sep'00	Dec'00
Total (thousands)	2844.2	2970.8	2811.0	2733.5	2872.4	2837.2	2735.5
Agriculture, forestry and fishing	248.2	323.4	252.8	250.6	377.0	336.0	226.3
Industry	1040.3	1023.1	961.4	933.0	938.1	932.1	943.3
Services	1551.0	1620.2	1594.2	1548.3	1549.0	1561.6	1555.1
Unknown	4.8	4.1	2.6	1.7	8.3	7.4	10.7
Structure (%)							
Agriculture, forestry and fishing	8.7	10.9	9.0	9.2	13.1	11.8	8.3
Industry	36.6	34.4	34.2	34.1	32.7	32.9	34.5
Services	54.5	54.5	56.7	56.6	53.9	55.0	56.8
Unknown	0.2	0.1	0.1	0.1	0.3	0.3	0.4

Source: Labour Force Survey

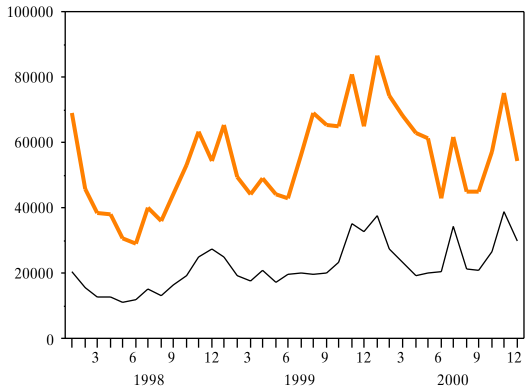
The increase of the unemployment rate is the mirror image of employment contraction. There are two sources of information about the unemployment rate: the number of registered unemployed at the

Unemployment Rate



Source:NSI, NES

Newly Registered Unemployed



Source:NES

job centres reported by the National Employment Service and the number of unemployed as per the Labour Force Surveys carried out by the NSI. Both sources registered an upward trend in the unemployment level in the period mid-1999 to early-2000 and its subsequent stabilisation in end-2000.

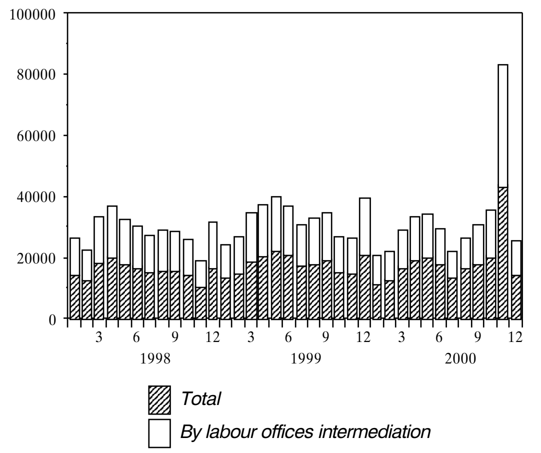
The intensity of the process of enterprise restructuring can be gauged by the dynamics of newly registered unemployed. In the second half of 1999, i.e. the beginning of the period of rapid growth of registered unemployment, the inflow of unemployed was by about one-third greater relative to its level in the whole 1998. In 2000, the level of the inflow of newly registered unemployed remained high.

The unempleoyment inflow is conventionally divided into two groups: (i) newly registered unemployed entitled to unemployment compensations and benefits and (ii) newly registered unemployed under general terms. Since early-1998, the first subgroup of newly registered unemployed has been composed almost entirely of people laid-off due to production declines or enterprise closedowns.

The structure of the number of newly registered unemployed entitled to unemployment compensations and benefits underwent some changes that already started reflecting the ownership structure. The number of labour shedding in the public sector followed a steady downward trend, stepping down from 81 400 in the first half of 1999 to 65 100 in the second half of 2000. At the same time, the number of newly registered unemployed entitled to unemployment compensations and benefits coming from the private sector constantly increased, from 25 500 in the first half of 1999 to 83 300 in the second half of 2000. Thus, within the span of two years, the number of lay-offs in the private sector had more than tripled, already exceeding the number of newly registered unemployed entitled to unemployment compensations and benefits coming from the public sector. This trend was largely due to the attempts of the new owners of privatised enterprises to improve the efficient utilisation of the factors of production, including labour, and to optimise the inherited employment level in those firms. The ongoing conflicts between the new owners of privatised firms and trade unions on the number of employed demonstrate that the above-mentioned process preserves its intensity and therefore, the process of labour shedding in the country will continue but with a slower pace.

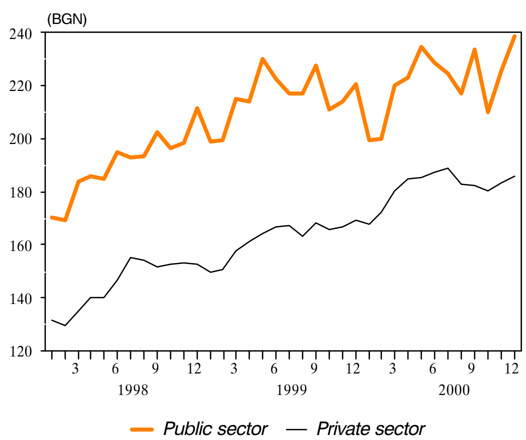
The Health Insurance Act adopted in 1999 and the Social Security Code voted in early-2000 affected the structure of newly registered unemployed as well mainly through the re-distribution of social security contributions between employers and insured persons. A part of the social security contributions (for both health and social insurance) are now directly deducted from the gross labour remuneration of the insured persons whereas before the adoption of the new legislation social security contributions were determined as a percentage of the gross labour income of people employed under a labour contract but were paid by employers. People employed under civil contracts had to pay themselves their contributions on the basis of a chosen sum of income, which was not to be lower than the minimum wage. Under the new social security payment scheme, however, it became more difficult to evade

Unemployed Who Had Found New Jobs



Source: NES

Real Average Wage



Source: NSI

payments due to the National Social Security Institute or the National Health Insurance Fund. Thus, if an employer continues to evade payment of some of the payroll taxes due, the new scheme of their distribution will bring about either a fall in disposable income of the insured persons (in case the employer does adjust their remuneration in order to compensate for the new payments made at the expense of the gross salary) or an increase of his labour costs (if he raises the gross wages of his employees and thereby reveals a part of the previously concealed social security payments). We can assume that in the second case employers will strive to preserve their labour costs by undertaking employment reduction measures in their firms.

In the second half of 2000, due to growing deamnd for labour and an increase in the number of registered unemployed who have found new jobs, the unemployment rate stabilised and even slightly fell down.

Wages and Labour Productivity

According to NSI preliminary data, in 2000 the average monthly salary in the country increased by 7.5% in real terms on a year earlier (deflated by the average annual CPI). The average private sector salary stepped up by 15.2% in real terms relative to 1999 whereas real public sector average wages increased by only 4.3%. The biggest differences between the dynamics of private and public sector wages were reported in industry and in some service branches like trade, business services, education and healthcare. Thus, all economic sectors witness a process of gradual approximation of the average wage in the private and in the public sector. At the same time, the average private sector salary in agriculture, mining industry and financial organisations already exceeded the respective public sector one. In 2000, the average real wage in state-owned enterprises in the processing industry fell by 8.8% on a year earlier whereas real private wages in the same industry increased by 13.5%.

The government can influence the average wage dynamics with the help of two instruments: first, through the control over wages in state-owned enterprises and the budget sphere, and second, through the level of the minimum wage. According to the existing legislative and regulatory framework, public profit-making enterprises form and increase their labour costs in compliance with their financial situation. This principle ought to be applied in private sector firms as well. The state can directly exercise control over wages in loss-making state-owned companies and SOEs with delinquencies.

In 2000, the following branches reported the highest year-on-year increase of real wages in the pubic sector: public administration (15.9%), education (11.5%), and healthcare (11.2%). It should be noted that most of the organisation in those branches, however, are budget-financed. Increased budget revenues in 2000 enabled the government to adjust upward wages in the budget sphere in order to reduce the gap between them and wages in the other sectors of the economy.

In 2000, the average minimum wage in Bulgaria was raised by 6.9% in real terms relative to 1999. Inasmuch as the minimum wage has a role to play on the functioning of the labour market as a whole, the government must cautiously increase it as the rise may result in labour market rigidity and stagnation given a relatively high level of unemployment. The way the minimum wage affects labour markets combines both the demand and supply of labour. Higher labour costs will bring about a decrease in demand for labour and the pace of new job creation will slow down. An increase of the minimum wage may well result in a contraction of supply of low-qualified labour due to the fact that some of the social assistance benefits are linked with the minimum wage. Unemployed without any profession or qualification or with a low level of qualification form the bulk of unemployment, and particularly of long-term unemployed.

The growth of the average wage was accompanied by increasing labour productivity. Thus, in the nine months of 2000, labour productivity grew by 8.8% relative to its level in the respective period in 1999 (at 1999 prices). Labour productivity in industry and the service sector followed a sharp upward trend, increasing by 23.7% and 26% respectively. The rapid growth of labour productivity in industry and services is a good prerequisite for a prospective wage rise in these sectors. It also pre-conditions the improvement of competitiveness in most of the enterprises operating in those sectors and the subsequent recovery and possible increase of employment.

The high unemployment rate and the low income level in the country represent a serious challenge to the government. Furthermore, emigration additionally aggravates the situation, by bringing about quick deterioration of the demographic structure. The positive resolution of these problems may only be accomplished under the conditions of high economic growth rates. The sustained growth rates of the Bulgarian economy in the last three year, and particularly in 2000, as well as the dynamics of employment and unemployment in the country in the second half of 2000 gives us every reason to believe that the absolute trough in employment contraction or the peak of unemployment growth had been probably reached in the last months of 2000. It is quite probable that in 2001 the emerging private sector will create enough new jobs that will offset labour shedding in the still reforming privatised former state-owned sector. It is expected that active labour market measures and the infrastructure projects envisaged for implementation in the forthcoming five years will also alleviate the unemployment burden both at national and regional levels. ❑

CONCLUSIONS

Based on economic development in 2000 and forecasts for the world economy and international prices in 2001 we estimate the main macroeconomic indicators of the Bulgarian economy in 2001 as follows:

- the GDP growth in 2001 is expected to remain high at 5%, with the major contributors to 2001 growth being again the three main elements of GDP expenditures – consumption, investments and net exports;
- the ratio of the current account deficit to GDP is expected to improve by 0.5% on a year earlier due to the continuous export growth and lower imports;
- the government fiscal policy will continue to maintain its restrictive stance, with the consolidated government budget deficit expected not to exceed 1.5% of GDP. The primary surplus is expected to slightly rise to 3.3% of GDP, thus compensating partially the higher foreign interest payments. Given the expectations of a nominal-term GDP growth and prudent fiscal policy, the debt/GDP ratio is expected to decline by another eight percentage points by end-2001;
- the rate of inflation will decline and the forecast end-of-year inflation is 4.5%. The estimate is based on forecasts for the stabilisation of the international prices (particularly those of crude oil) and the expected steady exchange rate of the EUR to the USD;
- the emerging private sector will create enough new jobs that will offset labour shedding in the still reforming privatised former state-owned sector. It is expected that active labour market measures and the infrastructure projects envisaged for implementation in the forthcoming five years will also alleviate the unemployment burden both at national and regional levels. ❑

CONTENTS

International Business Situation in 2000 .... **3**
Real Growth in 2000 .... **7**
Domestic Demand **8**
Household Consumption 8
Investment Demand 9
Supply 12
Manufacturing Sector 13
Agriculture 14
2001 Growth Forecasts 17
Foreign Trade in 2000 .... **18**
Exports 18
Imports 21
Balance of Payments 22
Public Finance **23**
Financial Intermediation **29**
Inflation **36**
Structural Reforms **40**
Privatisation 40
Restructuring in Industry 41
Reforms in the Social Systems 45
The Banking System 51
Labour Market **58**
Unemployment 58
Wages and Labour Productivity 61
Conclusions **65**