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## **STRATEGIC ELEMENTS OF MACROECONOMIC POLICIES IN BULGARIA**

To formulate an overall vision of how to outline and work out adequate macroeconomic policies in perspective needs pinpointing the probable sources of economic tension as well as the respective areas of tension within the specific macroeconomic goals.<sup>1</sup> There has been made an attempt in this paper to find out the major types of potential strains in Bulgarian economy in the mid-term and set out some preferable options of macroeconomic policies. The analytic study is aimed at standing up for the strategic principles of conducting macroeconomic management rather than constructing tactical ways for attaining some given short-term objectives. The whole analysis and the recommendations made are in the light of the liberal economic teaching and led especially by the belief that the key levers of macroeconomic policies are (without any claims about their hierarchical ranking) in the field of budget and monetary policy measures and on the other hand, within the scope of building of a functioning institutional environment of good quality.

JEL: E61; E63

### **Exchange rate arrangement**

#### *Current stance*

Following a series of breakneck ups and downs during the first half of the 90s of the twentieth century the Bulgarian lev (BGN) has finally found a safe and solid anchor by being pegged to the DEM (respectively the EUR). This was not a trivial choice then but time has proved it right. The extreme depreciation of the local currency right before the introduction of the currency board arrangement (CBA)– by more than 20 times in only 18 months (January 1996 – June 1997) had eased the situation. This point of departure created a favourable domestic environment for a gradual and less painful adjustment of production structures to the new reality.

The CBA substantially reduces the transaction costs in any foreign trade and contributes to systematically clearing any “*windage*” in the production sector. So, the structural reforms carried out consistently and in line with the CBA have imposed a new style and a new attitude to the economy itself and economic relationships.

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<sup>1</sup> The major data base on the development of economic processes in Bulgaria can be found on the internet sites of the Bulgarian National Bank (BNB), the National Statistical Institute (NSI) and the Ministry of Finance (MF). To facilitate reading every time the information is based on these sites the sources are not mentioned. In every other case there is a detailed bibliographical reference.

The CBA has been constantly the subject of great professional interest in this country. From time to time there are calls for reassessing the exchange rate arrangement, for a change of the currently functioning CBA. Most often, these calls are based on the so called “*overvaluation*” of the BGN. However, defining the notion of “*overvaluation*” of the local currency is being ignored. Such a telling example is the demand, unsubstantiated professionally, for an immediate rejection and discontinuation of the CBA in Bulgaria right after the financial crisis in Argentina in the early 2002, when the alternative (keeping the functioning of the CBA) was connected with inevitable financial and economic cataclysms in the near future similar to the crisis in Argentine. Life has proved how wrong these forecasts were.

Figure 1

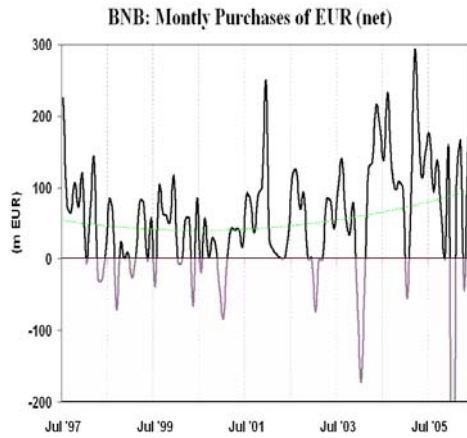


Figure 2

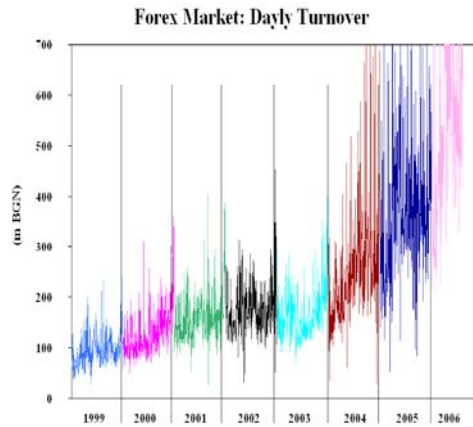
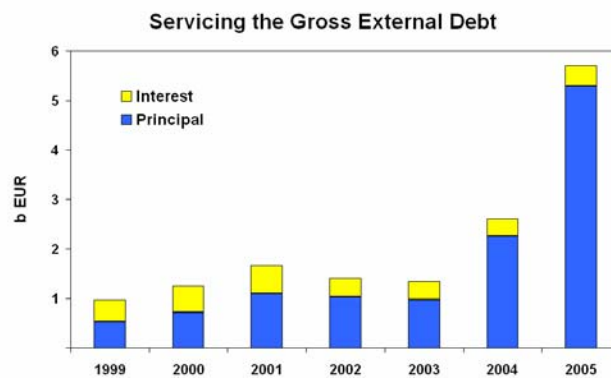


Figure 3



The adequate and committed understanding of economic realities in Bulgaria has led to another conclusion. The search for BGN on the domestic market has been steadily growing. Since the introduction of the CBA the BNB has been ever more and more a net buyer of reserve currency (Figure 1). In 1998-2000 the BNB's purchases at the domestic forex market were at a net average annual of about EUR 320 million, in the following three years (2001-2003) the same indicator grew to EUR 550 million, and in 2004-2005 – to EUR 1300 million. At the same time the daily turnover at the domestic forex market grew steadily (Figure 2). For 1999-2000 it was EUR 55 million, rose to EUR 85 million in 2001-2003 and to EUR 160 million in the following 2004-2005. Investors in the Bulgarian economy, economic agents and the people assessed positively the position of the local currency, looked for it and used it in their operations. Such a reality is not in conformity with the concept of “*overvaluation*” of the local currency, which would involve massive withdrawal from the Bulgarian currency and adopting forex positions.

The safety offered by the BGN allowed the BNB to increase its gross international reserve by almost five times after the adoption of the CBA – from a less than BGN three billion in the mid 1997 to BGN 14.4 billion at the end of 2005. Moreover, during all this time Bulgaria was paying off huge amounts of forex to service its gross external debt (GED, over EUR five billion in 2005 - Figure 3).

There has been a positive development in the currency composition of deposits too - both those of people and economic agents and more generally of the commercial banks' (CB) liabilities in Bulgaria. The deposits in BGN rose from 42% in 2001 to about 50% in 2006. There has been a more vigorous development in the currency composition of CB's liabilities in distinguishing between the EUR- and BGN-component, and the component in other forex, on the other hand. In 2003, the other foreign currencies (not-BGN and not-EUR) accounted for 22% of the liabilities of CB, whereas in the early 2006 this share fell to 13%. Such a development is quite remarkable for Bulgaria, where the USD was traditionally reputed as the dominant currency.

All this could not have happened without the healing effect of the CBA.

#### *Macroeconomic policy*

Macroeconomic policies in the mid-term should take into account the positive impact of the CBA, already undoubtedly established, and unflinchingly been adhered to. The more so in view of the final adoption of the EUR in the not very distant future as the only legal tender in the country. The BNB's strategy of 2004 explicitly stated their firm support of the CBA but the choice of this kind of exchange rate arrangement is finally up to the government and the National Assembly. Any hesitation of the macroeconomic elite in their firm decision to further maintain the CBA might shake the confidence in the stable

financial situation in the country and create unrealistic expectations and thus undermine the overall financial stability in Bulgaria which would lead to some negative consequences hard to predict.

### Budget performance

#### Current stance

The macroeconomic impact of fiscal policies become of greater importance under the CBA. Bulgaria has managed to keep remarkable budget discipline after the adoption of the CBA (Figure 4). It appears still more important on the background of economic situation in the EU (Figure 5). Tight budget discipline was necessary most of all to counter the expanding deficit on the current account of the balance of payments (BoP).

Figure 4

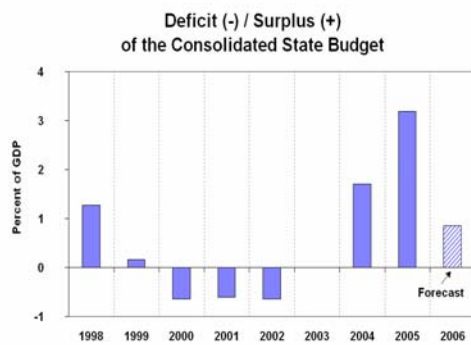
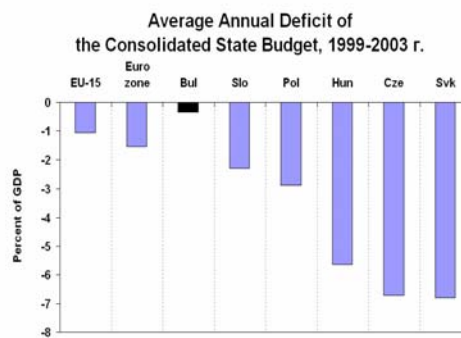


Figure 5



Source: World Economic and Social Survey 2004 (Trends and Policies in the World Economy). UN, DESA, N.Y., 95 p. and my own estimates.

Figure 6

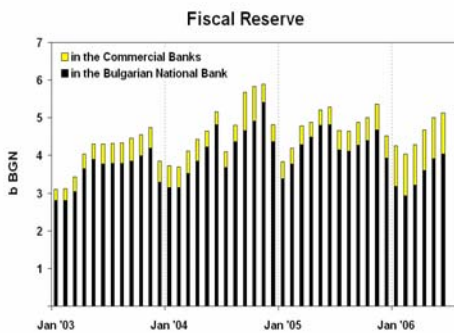


Figure 7

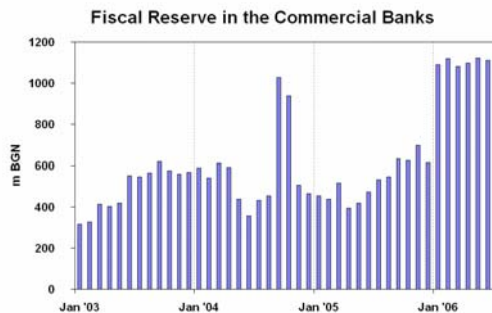


Figure 8

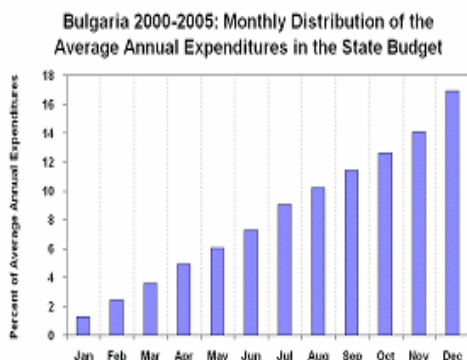
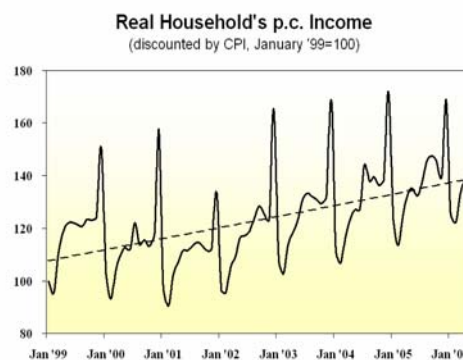


Figure 9



Source: NSI and own estimates.

The improved possibilities to finance the budget items have enabled a considerable growth in the financial resources available to the government and the so called *fiscal reserve*,<sup>2</sup> in particular (Figure 7). Its record high values at the end of 2004 whetted the appetite of politicians to defend the “national interests” by means of spending the money accumulated without paying enough attention to its functional composition and purpose. These desires have been cooled down (with the IMF assistance including) but there came up an alternative option. The MF decided to use a part of the *fiscal reserve* accumulated to provide additional budget revenue – by depositing it with the CBs. What was not taken into account, however, was that the MF pursued a kind of monetary policy without being sufficiently ready for it. This aberration was overcome but what remained was the possibility to still accidentally increase the financial resources of budget organisations held with the CBs (Figure 8), which might have a discretionary impact on the money supply.

The possibilities to realise a substantial budget surplus went along with the considerable surplus in the revenue side of the government budget. For 2003-2005 the revenues in the central government budgets were exceeded by 12% on an average annual! Along with the natural satisfaction with the higher revenues obtained (planned reserves!), anxiety about the undesired consequences gets higher. The already traditional model of monthly allocating expenditure from the budget follows a clearly terrace-like structure (Figure 8).<sup>3</sup> The cyclic recurrence

<sup>2</sup> The purpose and design of the *fiscal reserve* is to provide for sufficient financial resources for unimpeded servicing of the external debt. In the near future major debt principals are due for repayment (most of all connected with the issues of global bonds), whereas privatization has almost exhausted its potential. The assessment of the *fiscal reserve* should be made in perspective, not from the point of view of today's cravings.

<sup>3</sup> There are two models of budget performance and budget accounting discussed in professional readings – on a *cash basis* and *accrual basis*. What is being practiced in Bulgaria is cash

thus obtained reflects on the monthly growth of the *fiscal reserve* too. The year starts from low levels of budget financing which rechannels resources to the *fiscal reserve*. Gradually, in the course of the year the reallocation of financial resources increases to reach a record high in the last month. A similar monthly distribution of expenditure is very convenient for the MF people in charge of the budget but it is highly undesirable in the context of harmonious economic development. There is a striking resemblance to the cyclic monthly development of the real income of a household within the year (Figure 9) – in the beginning of the year it is typically marked by low real income which grows to reach a record high level at the end of the year.

There is a direct correlation between the monthly distribution of income observed, and the monthly development of inflation, on the other hand. A similar monthly cyclic recurrence describes the consumer price index too. Such sharp variations tend to create social tension and the specific time structure of income has a reflection on the irrational use of consumer resources available, i.e. they remain underused and ignored as structural elements to raise consumer satisfaction.

The quality and assessment of consumption is not lacking in variations in terms of income distribution over the year – at one and the same level of annual income its relatively more even monthly distribution increases consumer satisfaction, the feeling of social justice respectively. Improving the time structure of income received in the direction of balancing and smoothing the significant monthly variations raises their consumer value, i.e. represents an additional reserve to raise the positive social effect from the improved economic performance.

Although the possibilities of macroeconomic management of change in income are relatively limited (up to the impact on the income of employed in the public sector), the behavior of the government exerts an influence over the principles of management in the private sector. And what is more, it is a model to copy from the private sector. That's why the approach of the macroeconomic elite to planning the monthly structure of expenditure in the government budget, respectively the time structure of income within the year, is important for the overall process of income regulation.

Recently, in search of incentives for economic growth there were some experiments with various tax structures. The outcomes observed are not simple, as well as those observed from similar experiments in other countries. The idea to leave a greater part of income in the business in order to promote higher economic activities is so tempting that it rouses suspicion. What is evident on the surface is that there is a positive economic performance but also that social stratification and differentiation is intensified. So it is questionable to what extent the positive

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budgeting. The OECD countries are redirecting themselves to accrual budgeting, which is being recommended by budget analysts to the transition economies as well (*Diamond, J.* Budget System Reform in Emerging Economies. IMF Occasional Paper N 245, 2006, VI). The latter, however, requires purposeful technical and administrative training.

economic development witnessed is the outcome of the changed structure of taxation and to what extent it follows its logical positive development. A considerable part from the reduction in the tax burden is to the benefit of the more well-off and the latter pretend to prefer to increase their ostentatious consumption and invest in non-productive accumulation (spacious houses). Macroeconomic management has not made any attempt so far (neither shows that it perceives the problem) to restrict non-productive accumulation at the expense of the productive one. The wide-spread policies in the world in this respect are for instance to apply progressive taxation which makes it freezing financial resources in real estate for consumer purposes inefficient.

At the same time key activities connected with the normal performance of the state remain underfinanced. This is the case too with some long-term activities of the state to which it seems to have turned its back. Education and healthcare, that should firmly and constantly be in the focus of government attention, suffer from vague and diluted management decisions, all of them keeping up the marginal status of the employed in these sectors. The status quo thus established creates the prerequisites for the search of unregulated additional income and whenever this turns impossible – it leads to accumulating and mounting social tension.

#### *Budget policy*

The temptations to carry out active budget policies in the context of the overall macroeconomic policies are not a few, nor little. One shouldn't forget, however, the long-term perspective and the necessity for anticipated financing of crucial government functions, and by the way, the current outcomes of active budget policies carried out are not yet satisfactory enough. Management expectations are heightened while the reactions of investors remain restrained - in an attitude of wait-and-see. There are some grounds to believe that such activism brings in insecurity and hesitation in business circles rather than certainty. Rational expectations bring about openly or not a backward turn of the wheel in investment accounts, a return to the status quo which raises caution.

What the country needs above all, in the light of the pending accession to the family of the EU, is abiding by firm, steady and predictable rules of budget policies. Macroeconomic policies ought to avoid any quite often chaotic changes in legislation in search of the winning solution or just trying to demonstrate doing something. The too frequent amendments to the legislative principles (taxation rates, various tax concessions, regulations) arouse unjustified expectations in people and economic agents, and at the same time stimulate activities that try to break or go round the laws.<sup>4</sup> There is no quick and

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<sup>4</sup> It is worth looking at (although simply for information's sake) the development of corporate taxes. The average corporate tax in EU-15 was worked out at 34.4% in 1999 and it fell to 32.2% in 2004

easy way to solve the difficult economic problems. What is required is to staunchly and firmly stand for strict financial discipline and adherence to the laws and regulations. The artificially initiated management measures, looking for a way to demonstrate action, might bring to just the opposite outcomes eventually.

Budget policies are supposed to take responsibility for building the long-term mainstays of social and economic development. Healthcare, education and science necessitate single-minded efforts over a great number of years (financial including) to enable them to give a reasonably good and long-term social return. Silently turning one's back to these activities can look good in the short-term but systematically avoiding responsibility for them can backfire and lead to the impossible settlement of their long-term problems. When the situation becomes unbearable, it will take many decades to restore their normal operation.

The management of the government budget should be aware of the too "safe" planning of the revenue side, the expenditure side as well. The comfort enjoyed by the people in charge of the budget will have a deterring effect on the smooth and harmonious development of economic processes.

It would be well-advised for taxation policies to try not to apply experimental regimes with dubious effects but strictly follow the well-established and proven principles of modern taxation. It cannot be acceptable while looking for some magic taxation schemes to further intensify income differentiation in society. This matter has a bearing on promoting productive accumulation too. Creating fiscal difficulties for the highly expanding and out-of-place growth of nonproductive accumulation has proved its efficiency and expedience all over the world. People and economic agents alike should feel that the traditional ideas about "safe" investment in real estate, freeze of financial resources respectively, is not welcome and unacceptable from the social point of view and will be adequately punished. Redirecting investment interest, however, ought to be well-grounded most of all by creating possibilities for alternative investment – above all providing for the effective operation of financial and capital markets.

The experience of the newly accessed countries to the EU (since 2004) has shown that budget policies in Bulgaria will have to face a new challenge after our own accession to the EU (in 2007). Bulgaria will join the domestic market of the EU and tracing deals with registered people will become much more difficult. So will the process of VAT collection since the currently traditional scheme for VAT calculation will stop functioning under the conditions of a transnational movement of goods. In addition, in many EU-member

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(Poirson, H. The Tax System in India: Could Reform Spur Growth? IMF Working Paper WP/06/93, April 2006, p. 14). Simultaneously, corporate tax in Bulgaria fell from 34% to 18%! We will certainly witness the reverse development (of the corporate tax in Bulgaria), the question is only - when? The business can feel such a necessity and starts subordinating its activities to its own rational expectations.



countries there is the principle of voluntary VAT registration without any obligatory threshold.

Macroeconomic management is supposed to timely get ready for the significant change in the institutional environment too. All attempts at registering and transferring registration of companies to fictitious or non-existent people should be stopped right away and the controls on all schemes meant to realize fictitious export tightened on time. The tax administration is supposed to know in detail all legislative particularities of deals made in the EU as well as the operation of special VAT regimes. Last but not least tax legislation should be made the same, especially to avoid and punish all VAT fraud. Otherwise, Bulgaria will be faced with a situation where VAT collection will be reduced substantially and budget procedures disorganized with all the unfavorable both economic and social consequences resulting from it.

Another issue to reconsider is the methodology applied to GDP assessment. The economic and social developments in the country are undergoing intense changes and statistical methodology should not lag behind them. The problems in the official statistics will reflect on the working out of macroeconomic policies in the end and this highly raises the issue's importance.

## **Prices**

### *Current stance*

Following the relative stagnation and decline in economic development in the first half of the 90s of the twentieth century, Bulgaria has made a remarkable progress over the last 7-8 years. The stabilized financial structures have had a visible positive impact on economic development. Economic progress has manifested itself in two major terms – nominal and parity ones. In 1998 the purchasing power parity (PPP) assessment of GDP per capita accounted for less than a quarter of the EU's, whereas seven years later it reached a third (Figure 10)! PPP measure for this period in Bulgaria grew by over 80% and this growth is one of the highest for the countries of Central and Eastern Europe (CEE).

There is still, however, a serious discrepancy between nominal and parity values. This can be attributed to the relatively low price level compared to that of the developed countries. By 2005 the general price level in Bulgaria reached about 40% of the developed countries' one (the USA, EU) and tends to a gradual convergence. The experience of CEE has shown that narrowing the gap in the GDP levels will certainly lead to narrowing the gap in the general price level (Figure 11).<sup>5</sup> Under a fixed exchange rate the latter is only possible given that inflation rates overtake those of the developed countries.

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<sup>5</sup>The positive correlation between the relative income level and the price level is considered studied quite extensively in professional readings. One has to mention that D. Ricardo used to say in his day that the price level of countries of a lower degree of economic development tended to lag behind.

Figure 10

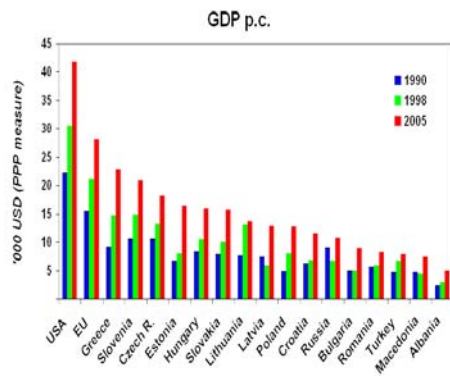
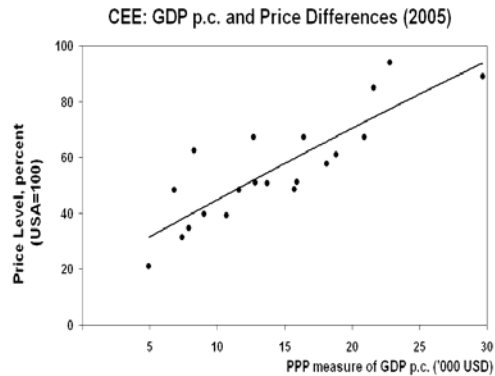


Figure 11



Source: The World Factbook 2005. CIA, Internet; NSI.

Economic rationale justified the faster price growth in Bulgaria and it should not be worrying from the economic point of view taking into account the values of the other macroeconomic indicators. Such a development is to be expected and is a normal. Incremental inflation growth has the same impact at least on income increase too, so there is no anxiety about making real income growth shrink. There are worries, however, with tension arising in other fields.

Under the CBA overtaking inflationary developments lead to a rising real effective exchange rate. The economic implications are manifested in several ways:

- Exports begins to feel a growing pressure in terms of higher production costs;
- Imports become increasingly more accessible and domestic consumers redirect their consumption from home goods to imported ones;
- Foreign tourists start finding the country less attractive from the point of view of providing them with relatively cheap (of undermined prices) tourist and any other kinds of services;
- But: The international evaluation of labour in the country goes up – people's income grows faster in international terms (EUR, USD) than their real income.

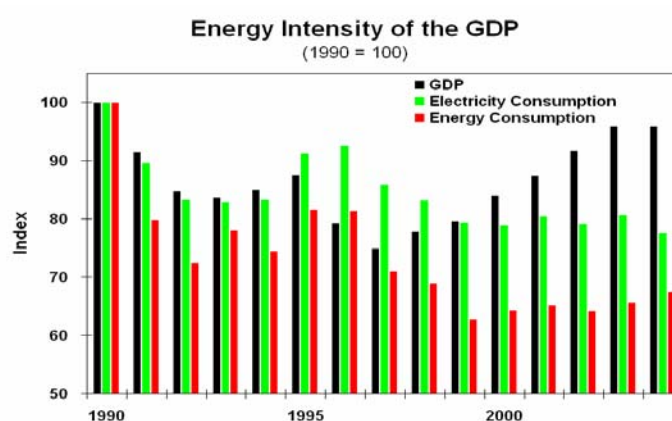
There arises an inflationary tension in production structures which is not fully reflected in consumer prices. Over the last three years (2003-2005) for instance, the average annual rate of producer price index (PPI) exceeded that of consumer price index (CPI) – 5.9% against 4.4%!

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(Ricardo, D. On the Principles of Political Economy and Taxation. London, 1817, chapter VII). There are examples of recent times as well. "... The higher is a country's relative income, the higher is its relative price level" (Dornbush, R. Exchange Rates and Inflation. The MIT Press, 1995, p. 281).

The only economic adjustment implies both production of goods and supply of services to look for ways to keep and increase their competitiveness mainly along the line of higher efficiency and better quality of the goods and services offered. This is the logic of economic prosperity – people might feel better well-off in comparison with other countries only when the economy is performing better (and more efficiently!).

Figure 12



The business has managed to meet the challenges of the steadily appreciating local currency in real terms and consumption reacted to the adjustments in relative prices too. A telling example is given on Figure 12 where one can trace the energy intensity of GDP. In the first half of the 90s the structural reforms went sluggishly and the change in energy intensity was rather imaginary. The situation has changed over the second half of the 90s and onwards. Administrative pressure on energy prices has gradually lessened and thus changed the attitude of economic agents and the people to energy resources. So the positive results have appeared quickly – GDP has recorded significant positive rates of growth at almost the same energy consumption. A certain amount of the overall reduction in energy intensity of GDP can be accounted for by the intrastructural production readjustment which can also be assessed positively as far as a progressive model of production activities is being imposed.

The changed attitude to energy resources made realizing a significant volume of electricity exports possible without an increase in energy generation.

A vivid example of the potential of the real sector to overcome difficulties caused by the appreciating local currency is the intensive development of exports of goods and services. In 1999 exports of goods amounted to USD 4 billion, whereas in 2005 the latter were three times higher (an average annual rate of growth for the six-year period in current USD of 20%!). There was a similar situation with receipts from tourism (a growth of 2.6 times in nominal USD terms for

the last six years!). Such a development would have been illusionary in the recent past. The altered conditions have enabled Bulgarian economy to find ways for a significant increase in the exports of goods and services despite the suppressing impact of the more expensive local currency.

The consumer has felt the positive economic development in terms of his growing real income (Figure 9), and the favorable influence of the appreciating national currency – in terms of the growing international evaluation of domestic labor. Imported goods and services are getting more accessible for the Bulgarian citizens mainly due to the overtaking growth of domestic revenues in international currency (EUR). The latter has contributed to integrating the country into the European and global structures too.

The findings (in a negative context) about the (relatively) high inflation rates in Bulgaria should be discussed constructively. By means of its higher inflation rates Bulgaria is preparing for its membership in the euro-area. The general price level is rising and the system of relative prices is changing. All this is taking place in adjusting to European economic stance. Overtaking inflation rates will continue until the country gets completely ready to join the euro-area. The good coach will only let the amateur boxer on the professional ring when he has already amassed the muscle and stamina required.

#### *Macroeconomic policy*

With the CBA in operation macroeconomic management enjoys restricted means and mechanisms for controlling and curbing inflationary processes. In addition - the striving for artificially (administratively) suppressing the natural price increase might eventually bring to undesirable consequences. The ultimate and irreversible successful integration into the European and global economic and financial structures would not be possible under a domestic price level, significantly lagging behind. Administrative intervention in market developments might temporarily suppress the price growth but that will be at the expense of distorting home economic and financial structures (as the negative experience of the mid-90s in Bulgaria has clearly demonstrated).

Macroeconomic policies ought to be fully transparent and predictable, without any unnecessary and harmful managerial initiatives with unclear implications.

There are mainly two macroeconomic management possibilities to deter the accelerating price increase under the CBA and dominant market relationships:

*First*, controlling lending activities of CB, which sets some requirements and imperatives to the BNB's regulations. Along with the BNB, the CB are in a condition to create money and influence the money supply. The BNB, in its capacity as defender of public interest, is called upon to monitor, control and regulate this process.

On Figure 13 lending operations of the CB can be traced. They reveal a noticeable trend towards shrinking at the end of the period as a result of the

restrictive measures taken by the BNB. The highly increased lending of CB has influenced the money supply (Figure 14), which is a prerequisite for promoting inflationary developments. The fast growth of money in circulation tended to slow down at the end of the period as a result of the restrictive BNB measures and helped reduce inflationary developments. No doubt, further BNB regulation on monitoring lending by the CB should go on in the future.

Figure 13

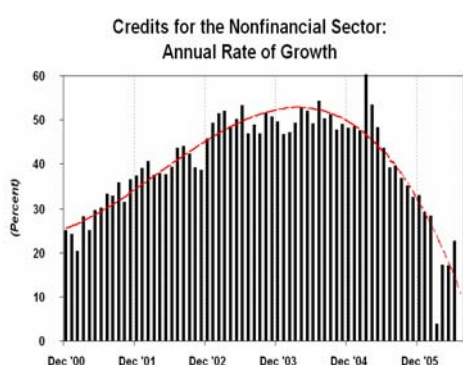
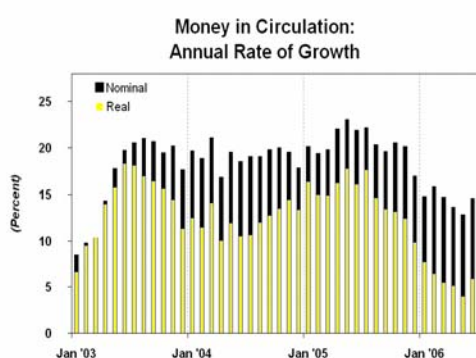


Figure 14



*Second*, a possible (positive) solution as an element of macroeconomic policy is to create and maintain solid institutional foundations which will enable the economy to adjust to the evolving situation and absorb managerial and technological innovations striving for irrevocable production aggression. One of the few efficient and highly needed principles of macroeconomic management aimed at acceptable price change is to promote and maintain the most well-meaning and propitious production environment, which is to remove all obstacles to the problem-free operation of competition. Besides restricting the unjustified price hike in a powerful way, competition is an indispensable and perfect teacher of production management to make it find its way to the consumer.<sup>6</sup> The need to constantly and flatly state a political will for administrative non-intervention in market imperatives, connected with a change in relative and absolute prices should explicitly be emphasized too. From the point of view of the special genotype features of the Bulgarian society it is definitely harmful and dangerous to nurture whatever expectations with our people for active administrative activities and measures in the way of deterring inflationary developments.

The issue with inflation and keeping to adequate macroeconomic policies acquires some new dimensions with a view to Bulgaria's accession to the EU. The

<sup>6</sup> F. Hayek noted that "competition is a procedure for finding out new things, procedure ... making people unconsciously enter new circumstances" (Хайек, Ф. Фаталната самонадеяност. "Отворено общество", Sofia, 1997, p. 30). The conscious or unconscious restriction of competition reduces the educational culture of producers.

financial framework for 2007-2013 envisages that Bulgaria will obtain from the EU funds EUR 6 billion for regional policies, EUR 5 billion for the agrarian areas and agriculture and EUR 500 billion for other policies.<sup>7</sup> The total inflow of financial resources along the lines of cooperation with the EU for this period is estimated at EUR 11.5 billion. This money supply accounts for about 6-7% of GDP, or 15-16% of revenues in the government budget and a fifth to a quarter of the money in circulation<sup>8</sup>. Macroeconomic management will be faced with a serious challenge, linked with the rational management of a substantially increasing money supply. Anyway there will be a tangible pressure on the price level which should be alleviated and neutralized in a suitable way. It has to do with both the BNB policies and the fiscal ones. Most likely, however, the administration will not be able to absorb the resources provided to a degree high enough, which, everything being equal, will mean again a delay in the process of integration into the European structures.

## **External debt**

### *Current stance*

Bulgaria began the early 90s of the twentieth century in an extremely difficult, almost hopeless state of the gross external debt burden (GED). Then the GED exceeded GDP by 60%. Even after signing the agreement with the London Club of bankers in 1994 the GED burden still used to be rather high – around 120% of GDP. Following the introduction of the CBA in 1997 there began a steady process of progressive improvement of the GED indicators. By the end of 2005 the GED was estimated at about 67.6% of GDP, and the public and publicly guaranteed external debt stood at 24.3% of GDP.

The remarkable progress in reducing the GED burden has not been due to the reduction in the absolute value of the GED, nor to the sharp growth in GDP. For 1999-2005 for example, both the GED in absolute terms (in EUR) and the GDP in real terms grew by about a third.

The improvement of the GED indicators has been due to the real appreciation of the BGN, i.e. to the improved positions of the national currency as a result of the successful CBA operation. Having in mind all the complexity of the situation, the issue is how to assess the GED burden in the future from the positions of today?

The GED interactions are directly linked to the nature and the way domestic economic processes take place. The external financial obligations issued promote the intensification of domestic economic activities, but they could become a heavy burden and difficult hurdle in front of economic growth. The key to success (as

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<sup>7</sup> As the Minister of Finance Pl. Oresharski pointed out (The Standard newspaper, 11.05.2006, p. 11).

<sup>8</sup> GDP for 2005 was BGN 42 billion, while the figure quoted corresponds to an average annual rate of growth of about 5 percent. Money in circulation at the end of 2005 in Bulgaria was estimated at about BGN 6 billion, with a growth of about a fifth an average annual for 2001-2005. In the next decade this rate of growth will most likely fall to about 15%, so that the net planned inflow of financial resources from the EU funds for 2007-2013 will account for nearly a fifth to a quarter of the money in circulation.

almost always) lies in the rational use of the resources available, having a clearer vision of future developments and adequately assessing the implications of one or another management policy.

The natural reaction to the deterring power of the GED burden thus experienced is to try to consistently decrease it, very often at all costs. At the same time the ultimate goal of macroeconomic management is achieving lasting economic prosperity, not paying off all GED. Moreover, any hurried imposition of interim accompanying goals (for instance overtaking and firm reduction in any external indebtedness) as major ones might lead to withdrawal and delay in the key development goals we are looking for, which are finally a guarantee for the settlement of key economic problems.

Analytic assessments show that in the current economic situation in Bulgaria by the beginning of the twenty first century any reduction in the relative external indebtedness as an end in itself is far from the best macroeconomic decisions to be taken. Pursuing such a policy can hold back economic growth, which in turn will have a negative impact on improving the country's international financial position. What comes to the fore are requirements connected with the overall movement of the economy towards higher efficiency and integrity and this movement is the prerequisite for the reduction in the relative GED burden as well.

Figure 15

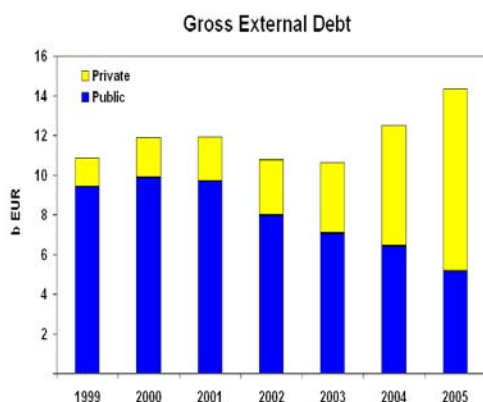
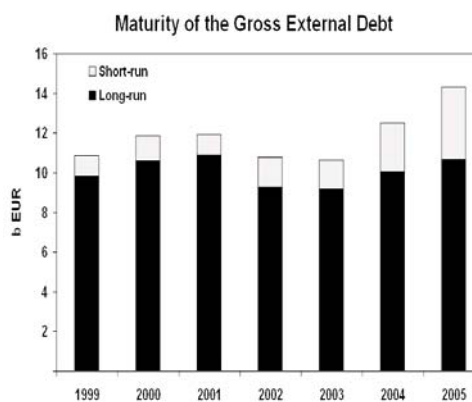


Figure 16



As time goes the issue of external indebtedness has changed address too. In the first half of the 90s of the twentieth century all the GED was weighing on and carried by the government. After the introduction of the CBA and most of all in the beginning of the twenty first century the situation changed markedly. The state started consistently shrinking its external indebtedness at the expense of the private sector (Figure 15). There was in parallel a clear trend towards change in the maturity structure of the GED (Figure 16) – in the direction of growing short-term indebtedness, which is the riskiest element of the GED.

Table 1

## Bulgaria 2000-2005: Balance of Payment (m EUR)

	2000	2001	2002	2003 r.	2004	2005
Current Account	-761	-855	-403	-972	-1131	-2531
Direct Investment (net)	1100	893	951	1827	2244	1856
Growth of the GED	1036	52	-1166	-128	1882	1803
Public External Debt	481	-178	-1738	-913	-619	-1290
Private External Debt	556	231	572	784	2500	3093
Others (net)	-1186	333	1335	-97	-1594	-559
Reserves and Related Items	-188	-425	-717	-630	-1400	-569

These changes became possible due to the propitious environment created for advance of the private business. Growing FDI in Bulgaria threw financial bridges to the global capital markets. The business began assessing the risks of expanding its indebtedness on their own and to take such risks too.

The aggregate structure of the BoP can be traced on Table . The current account was worsening all the time but it was being financed by the inflow of forex through the financial account. Over the last two years the new issues of external debt of the private sector have had a decisive contribution to the overall positive balance. In 2005 the net receipts of FDI were not able to cover the deficit on the current account and there was a significant leakage of forex resources linked with the reduction in the external debt of the public sector. The shortage of forex resources, for replenishing the international forex reserves of the country including, was covered by the attracted foreign financial resources of the private sector. The point is whether such a situation might induce tension and risks on the macroeconomic level and how much or many these will be.

Under the CBA and the current exceptionally liberal Currency Law in force macroeconomic management does not enjoy instruments to regulate and monitor the external debt issues of the private sector. The free transnational flow of capital (liberalization of the BoP), guaranteed by the Law does not let administrative intervention to influence capital flows.

Under some circumstances the changed flows of Figure 15, Figure 16, and Table might cause macroeconomic tension. The new issues of private external debt should improve the business opportunities to generate forex receipts. If this does not happen at the time and the amounts needed, however, then the future settlement of the external debts of the private sector might take place at the expense of the international reserves of the country. The government might be faced with a situation requiring the issue of a new public external debt to replenish its international reserves. And such a development is highly unwelcome.

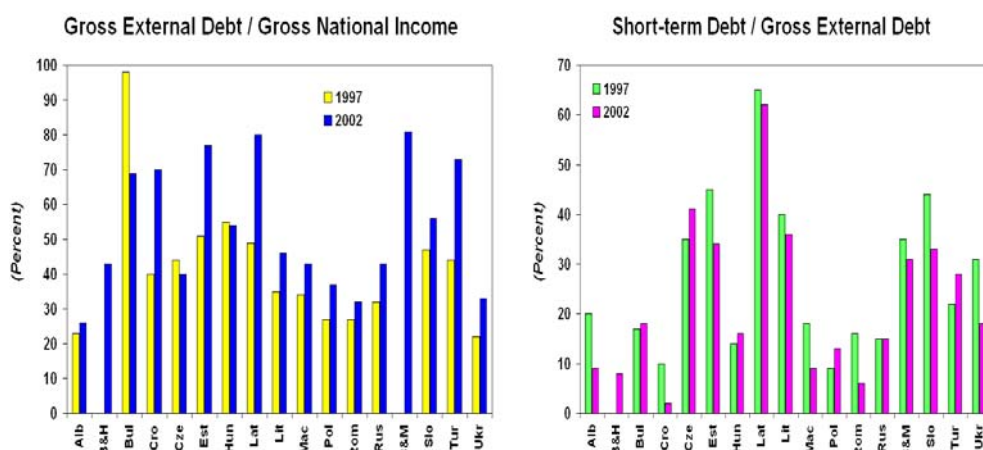


*Macroeconomic policy*

Analytical assessments show that a further purposeful (forceful) reduction in the external indebtedness might have a negative impact on the possibilities for economic growth. The improved GED indicators in the future should not be achieved at the expense of the absolute reduction in the GED but at the expense of progressive home economic development and most of all – at the expense of the growing international positions of the national currency. The more so, experience teaches that moderate external indebtedness, especially if it develops in the context of our European integration, is perceived positively (Figure 17 and 18).

Figure 17

Figure 18



Source: Global Development Finance 2004. Volume II: Country Tables, Table 3, WB.

Using the accumulated *fiscal reserve* for repayment of part of the public external debt ahead of schedule at the end of 2005 and the beginning of 2006 might be viewed positively both in economic and political terms. It is no doubt recommended to use the existing possibilities (well-weighed of course) to take economic advantage through the buyback of external indebtedness. In this specific case the act had also somewhat political dimensions as far as it was meant to show that the purpose of the *fiscal reserve* is first of all to make sure there existed a stable environment for regularly servicing the public external debt. A further development of forced events in this field in the future, however, would be considered inexpedient. The more so that, for instance a fifth of the *fiscal reserve* came from the social security funds (2005), which the government should not resort to and make use of.

There is no need at this stage of specific activities aimed at restricting the external debt operations of the private sector. Macroeconomic management ought

to carefully monitor developments and the potential of the private sector to regularly service its external debts. Any difficulties in this field, which will certainly reflect on the growth of the international reserves, should be removed on time, mainly through promoting the country's exports.

## **Current account**

### *Current stance*

Keeping a deficit on the current account of the BoP is a typical feature for the transition countries. Of all of them Russia only firmly recorded positive values on its current account thanks to its exceptional wealth and intensive exports of mineral resources (above all oils).

Bulgaria's current account has been negative for almost all the period since 1990. The only exception with a positive current account was in 1996-1997 due to the observed dramatic depreciation of the national currency<sup>9</sup>. However, statistics revealed a systematically increasing gap in the trade balance followed by an intensifying negative impact on the current account, which has increasingly been attracting the analysts' attention.

The causes for the deficit of the current account are comprehensible but still worrying. The accelerated integration of the country into the European financial and economic structures demands and implies interweaving of financial and economic interactions, and the initial effect is always negative on the current account.

One can see the structure of the BoP of Bulgaria in the beginning of the twenty first century on Table 2. Traditionally, the BoP is a negative value, which is offset (partly) by the other aggregate elements of the current account. Services (with tourism as the main positive component) help alleviate the trade deficit. Another positive influence comes from the net current transfers, whose main component are the private current transfers. The latter are formed predominantly from remittances. Lately (in 2006), the share of the income (compensation of the employed) in working out the current account has been reevaluated (statistically). Using an updated methodology, the income in forex of Bulgarian citizens working temporarily abroad – mostly within the three months allowed in the EU countries, was reevaluated for 2004-2005 especially, (to start with). The difference proved to be significant – while the old methodology was evaluating the earned income at about EUR 50-60 million annually, the stricter recording of reality raised this income to over a billion EUR!<sup>10</sup>

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<sup>9</sup> Actually, the situation with the current account in 1996-1997 could be quoted as a case example (though to a certain degree in grotesque forms) of the healing effect of currency depreciation under a deep financial crisis.

<sup>10</sup> The analytical estimates stated the actual remittances through this channel as twice more (Ratha, D. Remittances: A Lifetime for Development. - Finance and Development, IMF, December 2005, p. 42).

Table 2

## Bulgaria 2000-2005: Current Account (m EUR)

	2000	2001	2002	2003	2004	2005
Current Account	-761	-855	-403	-972	-1131	-2531
Trade Balance (goods)	-1280	-1778	-1878	-2426	-2954	-4369
Services	548	331	505	553	693	667
Income	-345	30	404	288	238	247
Current Transfers	316	562	566	613	891	925

The sources for the higher deficit in the trade balance lay both in the current account and the financial account. For 2004-2005 for instance, it was calculated that there came about two billion EUR on an average annual each year (nearly a tenth of GDP!), earned by the Bulgarian citizens abroad (official emigrants and visiting workers) – half of the remittances on the one hand and visiting workers on the other. This money contributed to a great degree to forming the trade deficit of three to four billion EUR. The flow of forex through the Bulgarians working abroad (the EU), and the remittances might be assessed as an indirect material support most of all by the EU.

The transnational movement of capital flows is reflected in the financial account of the BoP. In 2004-2005 for example, the average annual net inflow of forex was about three billion EUR. The main part of this amount came as foreign investments or as issued external debt of the private sector. The last indicator describes mainly the financial relationships between the local enterprises along the line of FDI, and the respective organizations abroad, on the other hand. In both cases the inflow of capital in the country was meant to develop the production sector, i.e. it involved imports of machines and equipment. The detailed calculations revealed that the predominant part of this in-coming capital left back the country to pay for imported raw materials, machines and equipment within the same current year, i.e. they did not remain in Bulgaria. The BoP registered an almost constant turnover of forex through foreign investments and issued GED. Only a small part of these financial resources stayed in the country in the way of domestic expenditures.

There is one more component of the BoP which brings confusion in assessing the deficit on the current account. It is a question of the item “*Errors and omissions*”. It reflects undistributed transnational forex (net) flows. In 2006 the BNB undertook some consistent measures to redistribute this position by which key financial indicators were altered. There are grounds to believe that a substantial part of these “*Errors and omissions*” are connected with the current account.

#### *Macroeconomic policy*

Macroeconomic policies, aimed at reducing tension in the BoP, induced by the deficit in the current account, should be directed at the sources of origin

causing this deficit. The possibilities to restrict people's income with a view to restricting demand for imported goods and services should not be neglected nor overestimated either.

One should explicitly say that Bulgarian economy has recorded positive impulses from Bulgarian emigration (both permanent and temporary) abroad in the way of repatriated financial resources of significant amounts (up to a tenth of GDP!).<sup>11</sup> Macroeconomic management is supposed to find a way to maintain and intensify this development. Establishing long-lasting and efficient contacts with the Bulgarian citizens living abroad (permanently or temporarily) and promoting their natural relationships with the home country are activities of nothing less than economic implications of mutual interest. No contacts should be underestimated, culture, sports, tourist etc. including. It does not do to let Bulgarian citizens abroad feel isolated from their mother country. Bulgaria is to work out a new active policy towards the Bulgarian Diaspora - in the way of maintaining Bulgarian spirit and self-awareness, preventing their isolation from the home environment, providing complete information about the changes and prospects of the country without hiding whatever truth, disclosing business opportunities. Part of (perhaps not a small one) Bulgarian emigration will be assimilated into their new home country, but another one (a significant one maybe) will remain attached to Bulgaria. Experience teaches that not a few emigrants (and their descendants too) continue to be interested in keeping economic contacts with their first mother country, and this should not be forgotten at all.

Trade deficit in the near future will most likely go on keeping its significant negative values. It is unrealistic to foresee possibilities of shrinking of imports directly. However, the negative trade deficit could be offset by other activities – for instance tourism. The latter as a source of national wealth has not been depleted at all. It could double, even triple the forex receipts in the near future. Such a development however, involves single-minded and systematic policies for improving the quality of tourist services (infrastructure including) and appropriate advertising. In this respect macroeconomic management still owes a lot to society.

Last but not least there have to be created and nurtured conditions for promoting competition at home, attracting global, well-known producers to Bulgaria with a view to developing anti-import production. The long-term and strategic investors are interested mainly in political stability, long-term currency convertibility, safe repatriation of revenues. The particularities of the taxation system, the fair attitude to all investors, the guarantees against tax malpractice by the local competent authorities are considered much more important than various tax concessions given. The latter cannot make amends for the lack of security, which the system as a whole is (or is not) able to provide and answer for.

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<sup>11</sup> There are large-scale studies in professional readings which prove the substantial contribution of the financial resources inflow through these channels on home economic development in practice (*Giuliano, P., M. Ruiz-Arranz* Remittances, Financial Development and Growth. IMF Working Paper WP/05/234, December 2005).

Any wavering and compliance with the insistence of local production associations on the so called “*protection of national producers*” through the introduction of anti-import umbrellas is harmful and without future (although politically very luring). The local producer has to be fully aware that the only possibility for prosperity available is to raise efficiency and competitiveness and that they should themselves work and carry out the necessary production and management policies to win the consumer over.<sup>12</sup> If there is even a hint of some signals of hesitation towards carrying out some forms of protectionist policies, this will put in motion the *moral hazard* syndrome, well-known both in practice and theory – if a possibility is imagined, it will be used. The consequences will no doubt lead to delayed social and economic prosperity.

### **Institutional set-up**

#### *Current stance*

In the conditions of Bulgarian economy on the threshold of Bulgaria’s accession to the EU the importance of the institutional factors of social and economic progress outweigh the others. In fact all EU criticism to Bulgaria at the moment is addressed at the unsatisfactory performance of national institutions. Corruption, crime, the quality of the legal system and many other pending problems (economic by nature – in the end) are the result of the poor performance of institutions.

Building working market institutions is a process requiring consistent and purposeful efforts of long standing. Price liberalization, interests and exchange rate arrangement might be altered literally overnight, large-scale privatisation requires a much longer period and preparation, whereas institutional building implies and involves a change in the dominant way of thinking. When building the necessary institutional environment personal, group and party interests come in collision, and this delays and postpones economic progress. Institutional change affects most intimately and in the long-term both personal and group positions, due to which its realization is a painful and difficult process. It is a question how to think those mechanisms which would provide a long-term economic and social prosperity and attack the reasons for the poor performance of the economy (not the consequences) on this basis.

It is hard to evaluate the quality of institutions in quantity terms. However, there might be individual indirect macroeconomic indicators which provide information about the way economic players and the people assess the complex overall institutional structure and its impact on the behavior of economic players and the people on the other hand.

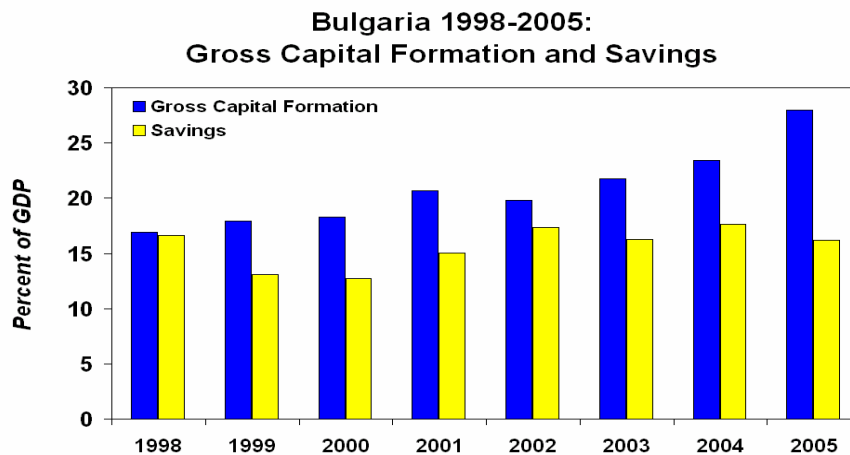
The growth of gross capital formation ratio and savings in Bulgaria after 1998 is shown on Figure 19. Economic theory and experience reveal that the levels

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<sup>12</sup> For J. Schumpeter “the point of departure” of the analysis of economic dynamics is that “...every producer always acts on the basis of some given, habitual situation of things for him and adjusts his behavior only as much as circumstances will make him to” (*Шумпетер, Й. Теория экономического развития*. “Прогресс”, Moscow, 1982, p. 109).

of these indicators of the order of 15% and less than that are not sufficient for providing a modern technological renovation and acceptable rates of economic growth. This is exactly the level of savings in our country. No doubt, purely psychological motives are not be ignored here. The readiness of people and economic agents to save is a kind of measure of the confidence in official institutions. If the future seems predictable and institutional behavior of the macroeconomic elite instills confidence, then people will tend to increase and invest their savings. On the contrary, if the institutional set-up of the society does not inspire safety and confidence, then they would rather use whatever has been earned to the full today.<sup>13</sup>

Figure 19



The ratio of gross capital formation recorded a clear trend towards growth till about 25% at the end of the period, which should not be overestimated though. During this period there were finalised privatisation deals of large state-owned companies and they had attracted a lot of foreign investments. Over the last five or six years FDI in Bulgaria accounted for about half of the gross capital formation, i.e. the domestic sources of gross capital formation were at a lower level than the one shown on Figure 19. In the near future, however, we have to only rely on the attractiveness of the economy and the improved institutional environment in order to draw investment.

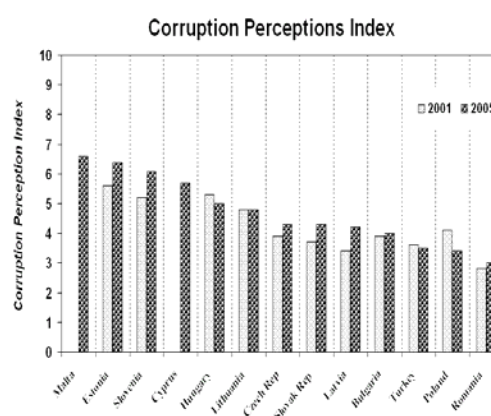
<sup>13</sup> There is a wide-spread simplified belief that the low level of savings is determined by the low level of income. This might be considered a delusion and an example of unadvised superficial conclusion. *First*, the notion of "low income" is hard to define in absolute terms, and *second*, there are savings, no matter what the size of income is. In addition, even J. S. Mill proved that "savings do not reduce consumption" (Шумпетер, Й. История на икономическия анализ. Vol. II - от 1790 до 1870 година. "Прозорец", Sofia, 2000, p. 381).

One cannot ignore the massive investment of people in nonproductive capacities and activities (luxurious houses, ostentatious consumption etc.). The flight from and reluctance for productive investment might be evaluated as a form of distrust in official state institutions too and as a result of the poor performance of government authorities. Production capacities are much more prone to various ways of actual expropriation than real estate of non-production purposes. Another thing not to be forgotten is the influence of inefficient capital and financial markets.

Figure 20



Figure 21



Source: Transparency International (Internet).

Corruption is a problem which has attracted analysts' attention all the time. The unsatisfactory functioning of the institutions gives birth to and nurtures conditions for corruption, which undermines the possibilities for steady economic growth. Figure 20 illustrates the insignificant progress of Bulgaria made in the way of fighting corruption.<sup>14</sup> It should be noted that this progress was made until 2001 and after that it actually kept that level of corruption with even a certain worsening in 2005. Figure 21 ranks the CEE countries by levels of corruption and the picture is hardly positive. There cannot be a positive attitude of people and economic agents to macroeconomic institutions in such an environment of "steady" corruption. If the latter does not improve significantly, economic outlook cannot be brighter.

*Macroeconomic policy*

Bulgaria's transition to market economy began in the early 90s of the twentieth century and will most likely finish with the building of institutional set-up of

<sup>14</sup> According to the international non-governmental organization *Transparency International* the highest mark is 10 and it corresponds to non-corrupted administration while the lowest one 0 means fully corrupted administration.

good quality. There, in the institutions (in the most general meaning) all dominant group and personal interests get interwoven. These cannot be changed by a magic wand in a few days (years!?). They demand persevering and consistent efforts aimed at achieving given principles.

As a rule the managerial elite does not realize the scale of negative outcomes and implications of the poorly performing institutions.<sup>15</sup> Consciously (because of vested interests) or unconsciously (because of ignorance) some unfinished laws, as well as lenient (or unscrupulous) abidance of legal requirements shape an environment of distrust and insecurity, which eventually erodes the principles and pillars of economy and society. The imperatives of today become predominant naturally and the painful adjustment is put off for better times. However, as experience has shown consistently times and times again, the more this is put off, the stronger the foundations even of short-term goals are undermined.

The most efficient way to leave lasting positive traces in national history is dealing with the painful problems of society. Bulgaria cannot continue to successfully go forward without well performing institutions. The macroeconomic elite (and the political one too) ought to find the strength and the means to build the necessary modern institutional environment. All other "successes" will be illusionary and transient.

Modern institutional set-up implies a change in the way of thinking of both the managerial elite and the people. Finally, the accession to the European structures means above all enjoying similar lifestyles, environment assessment, attitude to given elements of social and economic life. What is needed here is to carry out education policies leaving out all kinds of populist elements, targeting these policies at both the people as a whole and the party structures.

## **Social and economic stratification**

### *Current stance*

Bulgarian society is permanently sick of a very serious problem of the structure of population, a problem whose solution has been much delayed and negative consequences subdued for long. It is a question of this part of the population, which always stays at the lowest floors in terms of human capital quality and is reproduced all the time in the same way, remaining in one and the same unattractive marginal category, the so called "rome" (gypsy) population. Such a sustainable and steadily reproduced category in the structure of the population is

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<sup>15</sup> Looking after its personal and group interests the managerial elite tends to go lobbying in drawing out the laws and not to think much about the likely (purely economic!) unfavorable consequences for society. This problem is studied in detail in specialist reading. See especially R.Coase who states that "... the legal system will have a profound effect on the working of the economic system and may in certain respects be said to control it" (Coase, R. Essays on Economics and Economists. The University of Chicago Press, 1994, p. 11).



both a social and purely economic problem. This is a population of high birth rates, it does not get involved in the education system (most of them remain illiterate), is unable to do any skilled production work. It is a constant net user of social welfare assistance and aid programs, i.e. it is doomed to permanently “weigh” on the government budget.

#### *Macroeconomic policy*

Bulgaria and its society should face this problem in an increasingly committed way. It lies within the competence of Bulgarian society only and obviously will not be solved by itself. One should look for and apply working mechanisms to change the status quo. As global experience shows the solution to the problem (probably) lies in taking charge of and educating first and most of all the youngest generation. Strong managerial will and substantial financial resources will be required for a prolonged period of time. Further ignoring this problem will conceal real risks of social destabilisation. And this is both a social and economic problem as well.

A possible alternative to solving the problem is involving, educating and integrating the coming generation under the custody of official government institutions when the parents are unable (or unwilling) to take care of their children. Such an experience has given good results in the developed countries (the USA above all). Proceeding from the principle that social environment shapes the conscious attitude to the world, one might expect that the coming generations of such an origin will become aware of the winning option for their own existence and make conscientiously the expected good choice.

### **Macroeconomic statistics**

The official economic statistics has gone through a dramatic period of its development over the last 10-15 years in Bulgaria. Starting from an exceptionally dubious quality of statistical macroeconomic data in the early 90s of the twentieth century, in time positive statistical practices have gradually been adopted. Despite that, however, there are a number of indications (both purely methodological and indirect ones - as outcome) that not everything is of the best quality. This issue is important not only and not so much from the point of view of having statistically clean indicators but also to form a realistic idea about the changes in the social and economic life and be able to adequately assess the consequences from the macroeconomic policies.

#### *Methodological imperfection*

The composition of *household budgets* is the basis of assessing the consequences from specific macroeconomic impacts – influence of economic policies over the standard of living (most generally), and the evaluation of inflation (through the system of weights used). At the same time there are grounds to doubt how accurate this indicator is.

Table 3

## Monitored Households for Estimation of the Household Budget (number)

	1984 – 1993	1994.	1995 – 1997	1998 - 1999	2000 – 2001	February 2002	July 2002
Households	2508	6108	6000	3000	6000	4200	3000
Clusters	418		1000				

Source: Statistical Yearbook 2004. NSI, p. 103.

Over the last two decades the NSI has changed greatly the number of households surveyed to assess their household budgets (Table 3). No official information about the reasons leading to this change has been given. And the alteration is quite significant at that. There are cases too when the number of households surveyed was changed in the course of the year (for instance 1997 and 2002). The criteria for choosing the number of households remain vague. Moreover, the doubts how representative the samples are, are significant. The choice of households, included in the Clusters survey, is made at random but there are important conditions. Thus for instance, “...each randomly chosen household, which does not want or is unable to cooperate with the research is replaced by another one from the same cluster and the same number of members in the household”. As the NSI admits “... some of the households, especially those of higher income, do not want to reveal their true income ...”, and “... the share of the households that did not answer the questions represents about a third and it is the highest in the highest income group”.<sup>16</sup> In this case it remains dubious how authentic these estimates are as well as their comparison, the more so when they are used as input data to calculate other indicators (such as inflation, the growth of the real income, etc.). A very important circumstance is that the household surveys are used as a source for the GDP estimate by elements of final consumption expenditure.<sup>17</sup>

The *CPI* is a key macroeconomic indicator which is used both as an output (from a specific macroeconomic policy carried out) and an input (for instance compensation payments, evaluation of real growth, etc.). A number of reasons give grounds for doubting the accuracy of its assessment:

1. The index calculation is based mainly on the composition of household expenditure and the considerations for its conditionality were already mentioned above.

2. Regional special features are ignored which should bring about distorted final estimates. This consideration is ever more important in view of

<sup>16</sup> Методика и организация на изследването на бюджетите на домакинствата. NSI (Internet), 2006, p. 5; Национални сметки за България (източници, методи и оценки). Sofia, NSI, 1996, p. 63-64.

<sup>17</sup> Национални сметки за България..., p. 63.

the significant disparity in the life style in the developed centres on the one hand and in the peripheral areas on the other hand. The index evaluation is only worked out at a national level by smoothing out the models of expenditures and disparities.<sup>18</sup>

3. Monitoring prices by Bulgarian statistics covers “*supermarkets, department stores, specialist shops etc.*” (for example co-operative markets).<sup>19</sup> There is a basic difference compared to Portugal for example - the absence of recording prices in *discounting shops*, i.e. such as the widely spreading lately shops of European and global chains for mass consumption at discounted prices in Bulgaria. This type of shopping centres tend to cover greater and greater part of commerce by offering discounted prices.

4. The problems arising from taking into consideration the changed quality of goods remains unsettled.<sup>20</sup>

5. Using additional information sources to adjust and amend data collected in a problematic way is still unsatisfactory.

#### Disparities

If your speedometer shows that you are driving 100 klm/hour and still it takes you three hours to go from Sofia to Plovdiv (150 klm), then there is something wrong in your measuring instruments. No assurances that such speedometers are being used by the Apollo spacecraft will not sound reassuring. This is the way to assess the quality of statistics too, through the final output.

Table 4

Main Indicators of the Fiscal Policy, 1997 (percent)

	VAT (standard rate)	Personal Income Tax Rates	Corporate Tax Rates	Budget Revenues Share in the GDP
Germany	16.0	27-53	30-45	37.5
United Kingdom	17.5	20-40	33	35.3
Spain	16.0	28-56	35	35.3
Ireland	21.0	27-48	30	34.8
Portugal	17.0	14-40	36	34.5

Source: *Tanzi, V.* Globalization, Tax Competition and the Future of Tax Systems. IMF WP/96/141, Dec 1996, p. 14, 17; *Shome, P.* Taxation in Latin America: Structural Trends and Impact of Administration. IMF, WP/99/19, Feb 1999, p. 5; Financial Times, Oct 28, 1998, p. III.

<sup>18</sup> This particularity was pointed out in a joint Bulgarian-Portuguese study *Dancheva, A., R. Evangelista.* A Comparison of the Portuguese and Bulgarian Consumer Price Indices. NSI (Internet), 2004, p. 6.

<sup>19</sup> Методика за статистическо изследване на потребителските цени. NSI, Sofia, 1997, p. 12; *Dancheva, A., R. Evangelista.* Op. cit., p. 8.

<sup>20</sup> This is being underlined in the Bulgarian-Portuguese study quoted above.

An indirect indicator for problems with assessing the GDP is the change of the relative share of total tax payments (net tax on products, duties on imports and VAT) in GDP. In 1998 total tax payments accounted for 12% of GDP and this share grew steadily to 17.4% in 2005 notwithstanding that there was a clear trend for reduction in all tax rates during all these years. The logical explanation of this statistical phenomenon is connected with the incomplete GDP assessment as far as tax receipts are an undoubted and established fact.

Increased attention is needed in analyzing the relative values of the items of the government budget (above all revenue and expenditure) compared to the aggregate macroeconomic indicators (GDP) in the context of the current tax rates. To illustrate the problem key indicators of fiscal policy in selected EU countries in the second half of the 90s of the twentieth century are shown on Table . The major tax rates in the countries in question exceed substantially the respective rates in Bulgaria and still the relative receipts in the Government budget in these countries are below the respective indicator in Bulgaria (where they stand at about 40% of GDP for example) The conclusion cannot be ambiguous – the officially recorded GDP value is much below than the really produced GDP in the country. The reasons for that should be looked for most of all in the quality of official statistics. In any case the disparities observed are not to be underestimated as far as they are connected with an adequately projected fiscal policy.

Improving official statistical records implies expanding the basis for possible additional composition estimates. Thus for instance, GDP is still assessed only in terms of the production approach and the final consumption expenditure approach.<sup>21</sup> The NSI forms the GDP components by means of the incomes approach as an additional outcome activity (although parallel) and thus neglects using additional criteria to specify the statistical estimate of GDP.

## Conclusion

Economic theory does not provide fixed and safe recipes for economic growth.<sup>22</sup> There co-exist various economic policies in the world, which sometimes lead to too different and even divergent outcomes. Not a single specific macroeconomic policy can by itself make sure you will get the positive results so much wished for. This is why very likely macroeconomic

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<sup>21</sup> Основни макроикономически показатели 2003. Sofia, NSI, p. 12.

<sup>22</sup> In recent times a thorough review of the various theoretical ideas about attaining economic growth, as well as the practical applications in the field of the searched economic expansion might be found in the special issue of Finance and Development (Understanding Growth). IMF, March 2006 ([www.imf.org/fandd](http://www.imf.org/fandd)).

management is described as a combination of science and art<sup>23</sup>. Economic intuition and the ability to correctly find your bearings in the exceptional diversity of many-sided and versatile conditions and factors play a great role.

When working out your macroeconomic policies one should take into account all the combination of genotype characteristics. The future depends on the present, but for good or for bad – from the past too. Ignoring any traditionally established special features, although led by the sincere striving for a faster and more efficient movement to a desired end and standard is prone to distorting the expected outcomes. The more so if these expectations are based on unrealistic and overexposed hypotheses.

The pursuit of promoting economic growth should be appropriate. Under the conditions of Bulgaria of the early twenty first century the most important thing when prioritizing is building up an overall logically connected system of working market institutions. These would predetermine the quality of business environment which eventually will define the attitude of investors towards a specific economic expansion. Going round institutional imperatives by pursuing some seemingly active macroeconomic policies would be equal to trying to treat the consequences, and not the reasons. Such an approach cannot give a positive outcome.

It is particularly important to make sure all possible social and economic freedoms are made available to the population, which will definitely support the constructive performance of market interactions and unfold creative private initiative. The availability of one of the types of freedom only (for instance the political one) might have a propaganda effect for the managerial elite, but will not trigger the market engine of economic growth. Establishing and asserting firmly all kinds of human freedom is closely connected with social justice which is the active prerequisite for the exercise of individual initiative.

Managerial teams should forget the illusion that there are easy and magic solutions to difficult economic problems. In Bulgaria, this understanding is in the heart of some macroeconomic experiments with discretionary management. In line with a well-known cybernetic principle difficult problems require difficult solutions. Things go awry when people tend to believe in suggestions, logically followed by disappointment.

Economic theory is not unanimous in its opinions about the advantages and disadvantages of discretionary macroeconomic policy. However, there have been made recently some clear signals for looking for better weighed, more restrained and limited policies on macroeconomic level. This is especially

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<sup>23</sup> Many well-known economists emphasize on the connection between science, art and intuition in making economic analyses. As J. Schumpeter said for instance "the intuitive feeling for the inner logic of things goes beyond current evidence" (*Шумпетер, Й. История на икономическия анализ*. Vol. II..., p. 319).

true about the small (even the mid-size economies, as far as the globalising world presumes a priori movement within some limits.

It is worth noting how fast and definitely the CBA has established itself and has been accepted by the people and economic players. Confidence in money aggregates returned to acceptable level. As a whole the people and economic agents did justice to imposing strict rules in carrying out monetary policy. Transaction costs fell sharply, investment planning was facilitated (especially the long-term one), predictability of monetary processes rose. All this led to an improved business environment.

The good strategy is to keep to strict, clear and steady rules in carrying out macroeconomic policies of high predictability. These rules should no doubt include respect for the market principles of management along all the line of economic interactions, consistently cultivating the readiness to take responsibility by both the people and economic agents alike in their economic performance and accountability for any possible consequences. The state should stop acting as a social guarantor for all possible economic failure in the country. It ought to act in accordance with clearly defined, set out and publicly made well-known functions, well enough described in the theory of market economy.

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