



Faculty of Economics, University of Niš, 16 October 2015

International Scientific Conference

**CHALLENGES IN BUSINESS AND ECONOMICS:
GROWTH, COMPETITIVENESS AND INNOVATIONS**

**ECONOMIC DEVELOPMENT
AFTER THE CHANGES IN BULGARIA**

Elka Tsoneva *

***Abstract:** After 1989 Bulgaria takes a new way of economic development. Structural reform in Bulgaria is going much more slowly than in other countries that have taken a course towards the transformation of their economic systems. Economic changes lead to both positive changes and to many negative phenomena such as high inflation, high unemployment, low incomes, insecurity, etc. The new problems had not been present before for many years and caused serious conflicts in society. The process of separating the society into classes was speeding up.*

***Key words:** market economy changes, restitution, privatization, inflation, unemployment.*

I

There were significant changes in Bulgaria in the last decade of the last century, which caused serious upheavals in its economic and political development.

At the end of the 1980s the country's economy was stagnating, the internal debt was increasing, and the negative views towards the centrally planned economy. The lack of market mechanisms led to lack of interest among the producers, while the lack of initiative led to apathy and waste of money and resources. The state companies' monopoly deprived the economy of the stimulating effect of competition and held back innovations. At the same time the Western European states and the USA were experiencing significant growth in the area of information and communication technologies. It became clear that our economy needed significant reforms. This led to the logical conclusion of an era which lacked the potential for dynamic development. The economic progress made during the 20th century confirms that the market economy is best in terms of the ability to ensure high economic efficiency. The transition of Bulgaria from a centrally planned economy towards a market economy become inevitable. The state regulated economy was gradually replaced by the free market economy and the situation changed significantly.

* D. A. Tsenov Academy of Economics, Svishtov, Bulgaria; ✉ elka_tsoneva@abv.bg
UDC 338.242.2(497.2)

II

After 1989 Bulgaria embarked on a new road of economic development. The implementation of market mechanisms provided the necessary conditions for more effective use of the factors of production. The demonopolization and the market competition created conditions for producing more and better goods with the available resources. The liberalization of the market stimulated the economic activity of many people. The privatization and the restitution of property increased the level of motivation and interest of people. The restitution of property provided unexpected income for part of the population. Lifting the border restrictions allowed those who were willing to travel, study and work abroad. The freedom of each individual presented people with more choices and with opportunities for personal and professional development.

Alongside these positive developments, our country experienced a number of negative ones which led to serious upheavals - high inflation, high unemployment, low salaries, uncertainty, etc... "The restructuring of the economy did not happen the way the experts had predicted it and the reform faced different types of problems, which led to this process taking much more time than expected. Very rarely the chasm between expectations and reality has been any larger than in the case of the transition from communism to market economy."

The specific manifestations of these dissonances, as well as their mostly negative influence on the economy and the population, are mostly seen in several areas: changing the property owners through privatization and restitution; changes in foreign and domestic policy; liberalization of prices and foreign trade; implementing the currency board system, etc. All of them have influenced the processes taking place in the Bulgarian economy, including the labour market.

The structural reform in Bulgaria was much slower than in the other countries which had started to transform their economic systems. There were much more significant difficulties in transforming the state owned properties into private ones than in other former socialist states like Hungary, the Czech Republic and Poland. The main reason for that was that during the totalitarian period all property in Bulgaria was state owned and there was no entrepreneurial activity to speak of, while for example in Poland and Hungary the agriculture, some service industries and the retail trade were privately owned.

The difficulties were caused not just by the processes going on in Bulgaria at the time, but also by the state of affairs abroad during that period. The wars in former Yugoslavia, as well as the embargo imposed on Iraq in the early 1990s, led to the closing of the main transport corridors towards Europe and the Arab states in the Middle East. The lost markets of traditional Bulgarian goods, mostly in the states which had been members of the Comecon, made it necessary to close many production facilities, which led to a decrease in the GDP and increase in unemployment.

Before the changes most of the Bulgarian economy had been developing mostly by relying on imported raw materials, while the finished goods were intended to be sold predominantly abroad. In the new conditions the removal of the central planning and coordination had a negative effect on the system which provided resources (imported raw materials, fuels, nodes and parts) for the industrial production, and on our foreign markets. This forced many of the production companies to scale down their business and to lay off

Economic Development After the Changes in Bulgaria

many of their employees. The lost foreign markets also caused a decrease in investments and in the gross domestic product (for 1991 the decrease was 31% compared to 1989).

During the years of planned economy the import of raw materials for the Bulgarian producers within Comecon had been at artificially lowered prices¹. This had led to the formation of an inadequate structure of the national economy in terms of the connection between resources, production and competitiveness. After the breakdown of the socialist system the prices of most resources began to be formed using market principles. As a result of this, the high usage of materials in production and its typically low efficiency made it unable to compete against the imports from other countries. This also led to a decrease in the production volume, which resulted in the laying off of many employees.

Many inefficient production companies, who had been created in order to maintain a low unemployment level and had been subsidised by the state budget, were closed. The massive cuts in budget spending in order to decrease the budget deficit led to the contracting or closing of many organizations which had been financed by the state budget until then. The closure of many managerial structures caused the lay off of many people who were highly educated and well trained in the areas of management, economy and technology.

The democratic model of government set the foundations for new relations in society and the creation of a civil society. This in turn was the reason for the closing of many production facilities, because they had been polluting the environment. It also caused significantly decrease in the number of people employed in the defence industry and the so-called special productions.

The implementation of market mechanisms was done without any deliberate and well thought out government programs. This led to negative consequences in regards to the standard of living and the way of life of the population. The society and the individual person turned out to be completely unprepared to deal with such a situation.

The transformation of the state properties into private ones, the delayed structural reform, the privatization, the reforms in the agricultural sector, etc - all of this caused a rapid decrease in the industrial production of the country, which in turn caused a major increase in unemployment and a massive decrease in the incomes of the population. The decreased incomes of the population caused a contraction of the internal market and sharp decreases in consumption. The chaotic and inadequate liberalisation of trade and prices didn't lead to an increase in incomes. According to Joseph Stiglitz "The first mistakes were made at the very start of the transition. Due to the enthusiastic urge to transform the economy into a market one, most prices were freed too quickly in 1992, which caused hyperinflation, which massively depreciated the savings of the people, and that made the macroeconomic stability the most important item on the agenda. Everyone recognised that it is hard to conduct a successful transition to market economy when there is hyperinflation". In 1996 goods became over 3 times more expensive, in other words the annual inflation was 310.8% compared to the previous year. The biggest increase in the monthly consumer price index was in December 1996, when the inflation was 26.9%. This

¹ The data about the foreign trade between Bulgaria and the Comecon members for the period 1970 – 1989 shows that it was between 76.2 and 79.0% of the total foreign trade volume of Bulgaria and this reveals that Bulgaria was more reliant on Comecon and more strongly connected to it than the other Central and Eastern European socialist countries.

was the highest monthly inflation since February - March of 1991. The US dollar became almost 7 times more expensive. This was automatically reflected in the prices of the imported goods, which in December of 1996 were 5.5 times higher than the year before. The inflation was combined with a decrease in production. There was stagflation. According to the data of the National Statistical Institute (NSI), the GDP decreased by 5-7% in a year. These processes were caused and stimulated by disturbances of the market equilibrium, which is fundamental for the efficient functioning of the economic system. From the beginning of January 1997 until the beginning of February 1997 Bulgaria was in a deep political and financial crisis.

The new problems had not been present before for many years and caused serious conflicts in society. The process of separating the society into classes was speeding up. The incomes of a large part of the people were decreasing, which led to them getting progressively poorer. The income inequality gradually became more pronounced. "Bulgaria went through large scale transformative processes, which resulted in a huge social price, which was paid and continues to be paid by the unemployed, the employed, the pensioners, the poor and the young people." The question of the balance between market efficiency and social justice was put on the agenda.

The implementation of quick measures for stabilising the macroeconomic situation in the country began early on in 1997.

A currency board was put in place, which contributed to the stabilisation of the economy and the gradual escape from the recession. Fiscal policy became more important for influencing the dynamic of the economic processes in the country. This was the time when the processes of restructuring the production industry really began in earnest. Many of the subsidies for the inefficient state owned companies were cut, which decreased the effects of wealth redistribution. Many of the actual prerequisites for the wide implementation of private initiative were set in place. The process of privatization in the real sector and the banking sector was accelerated. But this led to the creation of a new wave of unemployed people. The process of liberalisation of the pricing system was continued. The increased depth of the reforming process necessitated the removal of the price control over many of the goods in the consumer basket. According to some studies, about 50% of all prices were controlled as of 1997. Freeing the price setting processes could be classified as one of the most important conditions for reaching higher efficiency in redistributing the resources. A number of protective tariffs, especially on the import of agricultural products, were implemented at the same time as this process and the removal of the limitations on foreign trade. The tariffs contributed to the preservation of the production and jobs, which had been threatened by the increased competitive pressure of the imported goods.

A tax reform was also implemented. As a result of the fiscal policy undertaken by two successive governments, the maximum combined profit tax rate was decreased from 40.2% in 1997 to 23.5% in 2003, while the income tax rate was decreased from 22- 38% to 18 - 22%. In 2007 the corporate tax rate was decreased from 15% to 10%, which made Bulgaria one of the EU member states with lowest tax rates. A proportional tax regime for personal income was implemented in 2008. The tax rate was a flat 10, which increased the amount of disposable income left in the hands of the population. The consistent tax policy conducted by the government created a positive environment for investments in the economy. Its goal was to make things easier for the business community and to increase the

Economic Development After the Changes in Bulgaria

real incomes, which in turn would stimulate consumption and thus lead to an increase in production and employment.

Even though the state policy in this area wasn't without its flaws, it could be said that after 1997 there was a period of relative stabilization of the economy. This period lasted only ten years, because after 2008 the global financial economic crisis, which began back then, had a negative effect on our country. As a result of this the main macroeconomic indicators again got worse, even though they didn't reach the levels of the 1989 – 1996 period.

Between 1997 and 2007 the annual growth rate of the GDP of the Bulgarian economy was gradually increasing and started reaching positive values, which in 2000 and 2001 were among the highest among all countries undergoing economic transition - 5.4% and 4% respectively. This economic boom continued in the next several years.

In the period 2006 – 2008 Bulgarian economy's growth rate increased again and it was over 6% in each of these years. The main driving forces of this growth were the end consumption and the investments in fixed capital, which were supported by the significant increase in the lending activity of the commercial banks and the increase of the disposable incomes of households due to the increase of the average salary. Bulgaria joining the EU also had a positive effect, since that guaranteed a stable and predictable business environment.

But the growth of the real GDP slowed down in the fourth quarter of 2008. The expanding crisis contributed for the contraction in the foreign demand for the goods made by Bulgarian exporters and a decrease in the international prices of major export goods, as well as for the decrease in the lending activity of the banks and the sharp decrease in the foreign investments in our economy as a result of the increased risk for the investors. Actually in the beginning of 2009 Bulgarian economy registered its first negative growth in many years: -4.5% compared to the previous year, and for the whole of 2009 the negative growth was -5.5%. This tendency was apparent in all economic sectors, most strongly in the industry, which was the first one to be negatively affected by the crisis. In 2010 the Bulgarian economy showed some signs of recovery - in the second and third quarter of the year production gradually increased compared to the 2009 volumes. The economic growth was minimal, but it continued in the next few years - it rose from – 0.2% to 1.7% in 2010 and 2011 respectively, 0.8% in 2012 and 0.9% in 2013.

The growth of the economy affected the employment and unemployment levels – between 2005 and 2008 unemployment decreased from 10.1% to 5.6%, while the employment level increased from 55.8% to 64%. This made Bulgaria one of the EU member states with unemployment below the average EU level and with employment level near to the average EU level. But after that the global crisis caused a decrease in the revenue of the companies and they were forced to deal with the necessity of optimising their labour costs. Until the middle of 2009 entrepreneurs held off from laying off workers because they expected that the difficulties would be only in the short term, but gradually they started to lay off workers en masse, which led to the unemployment reaching 10.2% in 2010, same as in 2005. The negative tendency has continued up to now and the unemployment has increased from 11.2% in 2011 to 12.3% in 2012 and 13.0% in 2013.

The implementation of currency board in Bulgaria turned out to be an adequate solution for reducing the inflation and forcing the government to maintain a balanced budget policy. The average inflation before the implementation of the currency board was

over 210% on an annual base, while it has been less than 6%, after that - in other words, it was reduced 35 times. The low and more easy to predict inflation made longer term planning by companies and individual possible, which has been positive for the economy.

The increased amount of direct foreign investments (DFI) in Bulgaria contributed to the positive changes which happened immediately after 1997. Between 1998 and 2005 there was a comparatively large amount of direct foreign investments in Bulgaria - at the end of the period they reached a level of 34– 35 % of the GDP. DFI were very important as a source of capital and of income growth for the development of the Bulgarian economy. The companies and production facilities, which were created by using these investments, not only increased the production of goods, but they also led to new jobs and contributed to the decrease in unemployment. Data shows that about 22% of the DFI, which the country attracted between 1998 and 2005, were in the industry, about 9% – in the production of electricity, gas and water, and 3% – in the construction industry. Between 1998 and 2005 the largest portion of DFI (20.5%) were concentrated in the manufacturing industry (mainly through privatization) because of the relatively low salaries in it and the good ratio between the price of labour and the qualification of the work force. Foreign investments in the manufacturing industry were almost 10% of the GDP in 2003 – 2005. This is a higher percentage than the respective ones in the other countries of Central and Eastern Europe (9% in the Czech Republic, 8.2% in Romania, 6.1% in Hungary, etc.).

The period between 2006 and 2008 is notable for the continuous increase of the direct foreign investments (DFI) in Bulgaria - they reached a record level of 17.7 billion leva in 2007, almost 30% of the GDP. In 2008, again due to the global financial crisis, the investments decreased to 13 billion leva, even though according to a report by the United Nations Conference on Trade and Development (UNCTAD) Bulgaria was second in the world in terms of the amount of investments attracted, and it was in 12th place in the 2005 version of this report. In 2009 – 2012 the increased investment risk caused a sharp decrease in the volume of such investments in Bulgaria. In 2009 they were only 9.4% of GDP, 4.5% in 2010 and 2011, 3.7% in 2012 and 3% in 2013. The industry sectors which were most affected were "Real Estate Deals", "Business Services" and "Commerce".

The efforts for improving the fiscal sphere made the effective management of the government debt a priority. This led to its continuous decrease over the years - from 168% of GDP for the period between 1990 and 1998 it was cut down to 21% of GDP between 2006 and 2012. The positive development of the major macroeconomic indicators and the sensible fiscal policy of the government, on one hand, and the outlined long-term goals in the economic sphere, related to Bulgaria joining the European Union, on the other hand, were the factors, which contributed the most to the confirmation of the main directives and priorities of the policy, conducted by the Ministry of Finance in regards to the management of the government debt.

III

The outlined aspects of the economic development of our country after the transition from a centrally planned to market economy allow us to make the following **summaries and conclusions**:

The analysis separates the transition into three stages: *The first stage* encompasses the period from the start of the reform till 1996. *The second stage*, which stands out as the

Economic Development After the Changes in Bulgaria

period of stabilization, is from 1997 till 2007. The formation of *the third period* (from 2008 till 2013) is a result of two important economic events – Bulgaria joining the EU and the global financial and economic crisis.

The problems inherited from the period before 1989 made the structural crisis in Bulgaria hard to overcome. **The period between 1989 and 1996** was characterised by inconsistent reforms and almost continuous decrease of the real incomes, increasing unemployment level and relatively high inflation. The political changes in the country during that period did not allow the implementation of effective measures for the adequate transition of the economy towards market principles. The way the reform was conducted in the beginning of the transition made the crisis more severe and in the end of 1996 there was a total collapse of the economic system. Bulgaria entered into a severe financial and economic crisis, which necessitated the immediate acceleration of the reforms.

The second period, which began at the end of 1996 and the beginning of 1997, could be defined as the turning point for the development of the Bulgarian economy and the start of the actual reform. Implementation of quick measures for stabilising the macroeconomic situation in the country began in 1997. Fiscal policy became more important for influencing the dynamic of the economic processes. The process of liberalisation of the pricing system was continued. The process of privatization in the real sector and the banking sector was accelerated. The implementation of a currency board created the conditions for achieving economic growth, rise of the real incomes and predictable business environment. The annual growth rate of the GDP of the Bulgarian economy started to increase gradually and reached one of the highest levels in all the countries going through an economic transition.

The third period is characterised by two main events, which has strongly influenced the economic development of our country - the joining of the EU in 2007 and the preparation for it, as well as the financial and economic crisis, the first signs of which began to appear in Bulgaria in 2008. Bulgaria's membership in the EU guarantees a stable and predictable business environment. The currency board provides stability until Bulgaria is accepted into the Eurozone, guarantees that the current exchange rate will be kept and contributes to the consistency and predictability of the monetary policy. Maintaining macroeconomic and fiscal stability has lead to accelerating the economic growth rate and a gradual convergence with the other EU member states in regards to a number of important economic indicators. The effect of the global financial and economic crisis stopped the positive trend of economic development which had formed in the previous years. That effect started to be felt in the end of 2009, when the growth of the real GDP slowed down. A weak recovery of the Bulgarian economy started to become noticeable in 2010 and has continued to the current day, but the positive trends have been weak and have not been felt by the population.

We can make the following **conclusion** on the basis of the analysis done so far: The transition towards a liberal market economy in Bulgaria is unique in terms of the direction of the implemented transformative decisions. The experience from the past years shows that in a large portion of the cases the goal was to try to remove the consequences of the negative processes and events, which were part of the transition, instead of attempting to remove the actual reasons for them. This significantly deformed the market environment and limited the opportunities for developing the production and for job creation.

Literature

1. Angelov, I. (2001) The Economy of Bulgaria and the European Union. Pre-joining period. Sofia, p. 135.
2. Grigorova, V. (2003) Structural Changes during the Period of Transition to Market Economy. Sofia, p. 13.
3. Stiglitz, (2003) J. Globalization and Its Discontents. Sofia, ,p. 171.
4. Statistical Yearbook of the People's Republic of Bulgaria for 1990. National Statistical Institute, Sofia, p. 113.
5. Stiglitz, J. (2003) Quoted Works, Sofia, p. 160
6. According to NSI data (<http://www.nsi.bg>) Accessed 17 March 2015.
7. Hristova, A, and collective. (2004) Anatomy of the Transition. Bulgarian Economic Policy between 1989 and 2004. Sofia, p. 141.
8. NSI (<http://www.nsi.bg>) Accessed 10 March 2015.
9. NSI (<http://www.nsi.bg>) Accessed 15 March 2015.
10. Personal Income Tax Act, Corporate Income Tax Act. // State Gazette, 1997 – 2012.
11. Statistical Yearbook NSI, Sofia (1997): p. 109.
12. Statistical Yearbook. NSI, Sofia. 2010, p. 120.
13. Source: Eurostat Accessed 15 March 2015.
14. http://unctad.org/en/Docs/wir2008_en.pdf. Accessed 15 March 2015.

EKONOMSKI RAZVOJ NAKON PROMENA U BUGARSKOJ

Rezime: Nakon 1989. godine, Bugarska primenjuje novi način ekonomskog razvoja. Strukturne reforme u Bugarskoj idu mnogo sporije nego u drugim zemljama koje su preduzele mere transformacije njihovih ekonomskih sistema. Ekonomske promene dovode do pozitivnih promena, ali i do brojnih negativnih pojava kao što su visoka inflacija, visoka stopa nezaposlenosti, niske plate, nesigurnost, itd. Novi problemi nisu bili prisutni ranijih godina, i doprineli su ozbiljnim problemima u društvu. Proces raslojavanja društva na klase se ubrzao.

Ključne reči: promene tržišne ekonomije, restitucija, privatizacija, inflacija, nezaposlenost.