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Analyses

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Bulgaria and the Global Crisis

Economic, Social and Political Implications

- Bulgaria with its high economic dynamism and financial stability is in a good position to counter the global crisis. Over the past seven years it succeeded in registering high growth rates, in attracting foreign investors and capital and in bringing down unemployment. Thanks to a prudent fiscal policy, it managed to build solid reserves and even to generate budget surpluses in recent years. The Currency Board has been and will remain the guarantor of stability.

- In the last quarter of 2008, though, the repercussions of the global financial and economic crisis could clearly be felt in Bulgaria too. It is to be expected that under its impact Bulgaria's economic growth will slow down considerably.

- Bulgaria does not face the risk of a collapse in its banking sector and tremors in the national economy can be cushioned with additional economic programmes, while social disruptions can be minimized through adequate labour market policies. The crisis will lead to an overdue cleansing and market consolidation, especially in the real estate sector.

- The global crisis may lead to a new boom in Bulgaria's "corruption economy". With investments going down and the money flow from abroad depleting, public expenditure and public tenders will grow as a counter-measure, thus increasing the "corruption pressure" in the institutions involved.

- The extent to which the global financial and economic crisis will impact in Bulgaria will also determine how substantially this might affect social and political parameters.

March 2009

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1. The Pre-Crisis Situation: Stable Macro-Economy and Dynamic Development

After the last economic crisis of 1996-97 in Bulgaria when hyperinflation topped 1000%, the successive Bulgarian governments managed to stabilize the macroeconomic framework. The Currency Board, which was introduced in 1997, pegged the New Bulgarian BGN (BGN) to the German Mark (DM) in a 1:1 ratio and thus secured the monetary stability of the country. The obligation to spend only what had been generated before stimulated a prudent and restrictive fiscal policy which gradually managed to achieve a balanced budget, to bring down external foreign debt, to build solid foreign-currency reserves and even accumulate budget surpluses in recent years. The currency board still remains the guarantor of stability and the BGN is now pegged to the Euro, with 1 Euro at 1.95583 BGN.

Bulgaria with its high economic dynamism and financial stability is in a good position to counter the global crisis. In September 2008 the budget surplus amounted to 5 billion BGN or 7.5% of estimated GDP. By the end of the year fiscal reserves were 13 billion BGN or 20% of GDP, domestic currency reserves – almost 30 billion BGN or 45% of estimated GDP, sovereign debt – 10, 5 billion BGN or 15% of GDP. In December 2008 the foreign direct investments (FDI) amounted to 3.7 billion Euro or 11% of GDP and were already less than the 4.7 billion Euro (16.3%) of the preceding year. There has been a positive development in the manufacturing industry where FDI marked a five-fold increase from 3.4% to 16.3% of the overall amount.

Bulgaria consistently maintained high growth rates in the past seven years. In the first half of 2008 growth was still at 7.1%, stimulated among other factors by the 10% "flat" tax on corporate and personal incomes. The high growth of recent years was also due to the flexible, almost generous credit policy of the banks.

In the last quarter of 2008, though, the effects of the global financial and economic crisis could already be felt in Bulgaria as well. Growth went down to 6.8% in the third quarter, only to drop sharply to a modest 3.6% in the last quarter of the year. As a result, the average annual growth did not exceed a mere 6%, staying below the officially planned 6.4% (already downsized by the Government from previous 6.7%). More than half (55%) of the growth is generated by three sectors – real estate, construction and financial services.

It is to be expected that Bulgaria's economic growth will slow down significantly under the impact of the global financial and economic crisis. This is an imported effect of the recession in Bulgaria's major trade and investment partners. The initial forecast of the Bulgarian National Bank of late 2008 was for 4.4% growth, the national budget adopted in December 2008 was based on 4.7%, while now the grimmest scenarios of the National Bank are between 1.2% and 1.5%. The Finance Ministry's forecast in December was 2.1%. The latest IMF estimates for 2009 indicate that growth will go down to 2% and inflation will be around 4.5%[1]. In late January, the European Bank for Reconstruction and Development (EBRD) lowered its estimates about growth in the Balkan countries. Southeast Europe is expected to grow at 1.9%, 1.5% less than predicted last November. The EBRD, likewise, estimates Bulgaria's growth at 2%.

In December 2008 industrial output still increased by 1.7% as compared to the previous month but it dropped significantly by 8.3% compared to the previous year, the average growth thus staying at 4% annually. The manufacturing industry shrunk by 10%, while mining was hit even worse with a 25% decrease and metal mining plunging deeply by minus 65%. The present

[1] Ref. http://www.euromonitor.com/The_global_financial_crisis_Eastern_Europe_and_CIS_hit_hard

motor of growth is agriculture, with an increase of 23% compared to 2007.

The weak spot in Bulgaria's economic indices is definitely the current account deficit which grew from 6.3 billion BGN in 2007 up to 8.3 billion BGN in 2008, representing 24.3% of GDP. Until now, the deficit was financed by money transfers of Bulgarians living abroad, FDI and credits. But the credit crisis will make its financing harder. In 2008 FDI dropped considerably and could cover only 68% of the current deficit (compared to as much as 129% back in 2007!).

Exports, which were still booming in the first nine months of 2008, fell by 6.8% in the last quarter and marked an annual increase of only 2.8%, while imports went up by 4.8%. With 65% of Bulgaria's exports destined for the EU, recession in European countries like Germany is bound to pervade Bulgaria as well. On the other hand, the falling prices of oil and food products also exert pressure on the economy. And if it were not for the "grey" sector of the economy which, according to experts, in good years added 2-3% on to the official growth rate, the economic collapse would have been even more dramatic.

2. No Crisis in the Financial Sector

The global financial crisis has no direct impact on the balance sheets of Bulgarian banks. Their crediting activity is mostly targeted to the Bulgarian economy and banks remained uninvolved in speculations with American financial instruments. Yet, there are reasons to be worried because over 90% of the Bulgarian banks are foreign-owned. The five major banks are the Italian UniCredit, the Austrian Raiffeisen Bank, DSK which has a Hungarian "mother", and UBB and Pireus Euro-Bank which are subsidiaries of Greek banks. If the "parent" banks are ailing, there is a risk for credits in Bulgaria to dry up.

West European banks in Bulgaria have credit claims of approximately 32 billion Euro (Italy has 6.4 billion Euro through UniCredit and Austria has 4.5 billion Euro through Raiffeisen). This amount, though, is a lot less than the 162 billion Euro in the Czech Republic, the 121 billion Euro in Hungary, the 227 billion Euro in Poland or even the 98 billion Euro in Romania. Even in an "ugly risk scenario", the banks do not expect losses exceeding 20%.

At the moment Bulgarians are not worried about their money and there are no lines of people in front of the banks. This may also be due to the fact that the government recently raised the level of state guarantee on deposits from 40.000 to 100.000 BGN.

The obligatory minimum reserve of bank deposits was reduced from 12% to 10%. At present the government is checking the option of an inter-bank deposit guarantee scheme which, if introduced, would give the banks additional security.

The Ministry of Finance will soon issue state obligations of 3, 5 and 10-years maturity with a total nominal value of 750 BGN, plus short-term bonds for a total of 50 million BGN. The goal is long-term stability of interest rates which is one of the Maastricht criteria for joining the Euro-zone.

Experts sustain that industrial and commercial banking may be declining but by no more than 5%. The leasing market will be the first to contract either because credits will be unavailable or because of growing interest rates. Credits will become more expensive and companies will find it harder to finance current spending, let alone investment. This shortage will also embrace the non-banking financial sector which slowed down by 5.6% in the third quarter of 2008. Insurance companies however, remain in a good position because all creditors in Bulgaria want to secure their credits. But they will be more prudent and will weigh their risks more cautiously.

Many experts had feared that inflation would grow in Bulgaria but the opposite happened – the falling prices of raw materials brought down inflation to 10% as early as in 2008. Inflation will continue to decline but since there is no likelihood of salary cuts, Bulgaria does not seem to be in danger of deflation.

3. The Currency Board as a Factor of Stability

Will the Currency Board survive the crisis?[2] There is a universal argument that at time of crisis currencies should be devaluated in order to enhance the competitiveness of exports. Thus a number of East European countries lately devaluated their currencies: the Serb Dinar fell by 23%, the Turkish Lira by 27%, the Hungarian Forint by 31%, the Romanian Lea by 39%, the Polish Zloti by 44%, etc. With all neighbouring currencies falling like dominos, the logical question arises: for how much longer will the Bulgarian Lev remain as strong as a "lion" (= lev)? It should be noted that because of pegging the BGN to the Euro Bulgaria indeed loses some competitiveness in the race among the neighbours to attract foreign clients. At least theoretically speaking, but practically so far no visible benefit has been noticed in the neighbouring countries after they had devaluated their currencies. The collapse of external demand is so dramatic in some sectors that devaluation simply does not work. On the contrary, disbanding the Currency Board and subsequently devaluating the BGN would have an abrupt boomerang effect on the huge private debt which amounted to 88% of GDP in 2008, credits which are mostly denominated in Euro, but paid in BGN. The Bulgarian Industrial Association already warned that if the BGN is depreciated many companies will be unable to pay their debts because of the increased cost. At the moment company debts amount to 160 billion BGN and is likely to reach 200 billion BGN in 2009.

Over one-third of the Bulgarian households have taken up bigger or smaller credits for a flat, a car or commodities. And if they become unable to service their credits because of unemployment or lower income, income conditions will turn worse and fear will grow. Half of the households spend 25% of their income on servicing a loan and half of them struggle regularly or from time to time with the payments.

The population has high confidence in the Currency Board, memories of the hyperinflation of 1996/97 are still alive and there is still a lingering fear of falling into poverty and deprivation. Thus both political leaders and the Central Bank want to maintain the Currency Board and the fixed exchange rate. Also the IMF is in support of this because in troubled times it becomes all the more important to keep up the confidence in the currency regime and in the financial system. In other words, the Currency Board will stay. It is well structured and stable enough to survive rough blows.

The alternative idea to introduce the euro earlier than originally planned for in 2012 is off the table following the EU summit on the crisis held on March 1 in Prague. The "old" member states do not want to hear about it. An early entry into the Euro zone looks much less likely now than it did before the crisis.

4. A Weakening Real Economy

The alarm bells of crisis are heard not so much in the Bulgarian financial sector itself, with regards to banking or the currency. It is rather the "real" sector of the economy that feels the contraction of financial flows most acutely and has been sending out bad news lately.

Beginning in October 2008, the business climate index has been deteriorating by the month having already gone down below its 10-year average. The indices of construction, industry, retail and services have worsened the most.

Surveys in February 2009 indicate that companies which believe to be facing hardship are three times more than those that

[2] Ref. http://crisistalk.worldbank.org/2009/02/will-the-currency-board-survive-in-bulgaria.html

are not in difficulty; 31% of the companies believe to have been affected by the crisis; 20% report reduced sales; 19% report a reduced number of clients. A survey among the members of the German-Bulgarian Industrial Chamber shows that almost all consider themselves affected by the crisis, especially with regard to sales. While turnover did not suffer adverse effects in 2008, the estimate for 2009 is a 40% drop in sales. The complaints are mostly related to the deterioration of financial conditions, which prompt companies to cut or cancel expenditures. Yet, only a small number consider laying off personnel! Investment plans are either reduced or completely abandoned. No company pledges an increase in investment and only 30% hope to deliver as planned.

The state is expected to extend guarantees to the banks, to support entire branches, to increase public spending and especially to lower taxes. A clear majority expects lower exports from Bulgaria to Germany and a lower level of German investments in Bulgaria.

Bozhidar Danev, Chairman of the Bulgarian Industrial Association, predicts an impending severe economic crisis in Bulgaria, especially with regard to the companies' credit obligations which will not be paid off because of the limitations in the availability of new credits. In his view, inter-company and inter-bank indebtedness in the private sector is a very serious issue. In the absence of liquidity, the companies have no resources to pay their mutual obligations and this will affect their productivity. He expects bankruptcies especially among small and medium enterprises (SME) soon.

The companies with the highest debts are those in the sectors real estate, construction and trade. The situation of companies which are listed on the stock exchange is also very serious because they incur additional losses due to the falling prices of their stocks. Also in Bulgaria the stock exchange has collapsed. From October 2007 through October 2008 the index of the Sofia Stock Exchange SOFIX went down by 70%.

In this way the financial crisis hit the new oligarchs as well, the super rich Bulgarians, the shady winners of transition. Vassil Bozhkov, the richest Bulgarian and tycoon of gambling and construction, is estimated to have lost 60% of his wealth which is now estimated to "merely" around half a billion BGN. He is slightly ahead of Mitko Sabev who suffered a 20% loss in his oil business. The third one to follow is energy tycoon Hristo Kovachki who lost almost half of his wealth, now amounting to less than half a billion BGN.

The structure of FDI for 2008 shows that almost half of it, i. e. about 2.4 billion euro, went to real estate. In the last few months this sector suffered a dramatic collapse, the prices of homes in Sofia went down almost by half, while the drop in the prices of office space is slightly less. It could be, though, that the crisis in this sector is only speeding up a process which was bound to happen anyway. The real estate bubble in Bulgaria was reaching its maximum and a consolidation was long overdue. The crisis will let off some air from the bubble before it is blown out of proportion and explodes with a much bigger bang.

The trade sector as well is feeling the liquidity shortage, car sales went down by 70%, many car dealers risk insolvency in the coming months. The prices of Mercedes are down by 20-30%, while used cars sell for less than half their price. The trend in Bulgaria is changing towards smaller cars too.

Additionally, the gas crisis of last January caused by the Russian-Ukrainian dispute cost local enterprises around 150 billion Euro.

The economic crisis heavily affected Bulgaria's exports. According to data of the National Institute of Statistics, foreign orders for exports were down by 4.7% in January and production fell by 11%.

5. Slight Fluctuations on the Labour Market

As a result of the economic boom of the last years and the massive labour migration to the EU, the US, Canada, South Africa and other countries, Bulgaria maintained a relatively low level of unemployment of 6.3%. Sometimes even acute shortages, particularly of qualified labour, could be felt mainly in Sofia and the bigger cities.

The above mentioned surveys of early 2009 indicate that 72% of employers do not expect major lay offs as a consequence of the economic crisis. With respect to their own company, a total of 55% of respondents do not expect discharge of workers and employees. It is surprising that in spite of the crisis many employers (40%) are even planning new recruitments. They are happy to find a better choice on the job market, which used to be rather depleted until recently. In view of the crisis, however, most firms will hire only on a provisional basis and for a specific project. This corresponds with 68% of those looking for jobs at the moment. Both employers and employees expect wages to grow or stay the same, but not to go down.

But yes, there are dismissals and unemployment is growing. The government estimates that unemployment will grow from 6.3% at the end of 2008 to 7.4% during the year. Others estimate 10% to be a more realistic figure. In February it already stood at 6.7%. According to surveys, the first 12.000 jobs were lost as a result of the crisis as early as in the last four months of 2008, mostly affecting the manufacturing industry. The trade-unions foresee more waves of dismissals in mining, chemical industry, machine-building, and especially in the textile industry. Tourism will most likely be hit hard as well and large-scale losses of seasonal jobs are expected. Even banks are discharging staff and 1.000-1.500 out of a total of 25.000 employees have already been laid off.

Nevertheless, even in the trade-unions' view this will not lead to a dramatic growth in unemployment because the initial acute shortage of qualified personnel makes it easier for the newly discharged ones to find a new job right away. The more visible fluctuations on the job market are mainly the result of regional factors. In the cities of Varna and Burgas unemployment is rising, while in Sofia nothing has changed so far. Unemployment in the capital stays at 4% and is thus still in the "full employment" range.

Another factor could be the "returnees", Bulgarians labour migrants, affected by the crisis in the EU, the US and other countries that now have to consider coming back to Bulgaria to earn their living here. This is an opportunity for the national job market because many of the returning Bulgarians are expected to be highly qualified and will provide expertise that has been unavailable so far.

Many enterprises will look at redundancy only as a last resort because they want to keep their qualified staff. Many of them may just send their workers on unpaid leave and survive the crisis in a "week in, week out" rhythm, without discharging workers. This is the "grey" option of part-time work.

6. Bulgaria in International Comparison

Bulgaria has been repeatedly compared to other countries and their problems in the crisis but it does not fall into any cliché. Why is Bulgaria not Iceland? Because its banking sector is small and of high quality, its volume almost equals the country's GDP and is not ten-fold bigger, as is the case in Iceland. Bulgarian banks are well capitalized and not heavily leveraged; they do not suffer losses from American sub-prime loans. In addition, it is highly unlikely for the Bulgarian state to intervene in the banking sector since most of the banks are subsidiaries of foreign banks. The currency risk is reduced by the Currency Board which has been in place for 11 years now. Iceland is just considering introducing one! Why can Bulgaria not be compared to Hungary, Argentine or Romania either? Unlike these countries, Bulgaria is not burdened by overwhelming public debts, nor threatened by a weak currency. In August the budget surplus was 7.5% of estimated GDP, which made Bulgaria unique in the entire European Union!

Romania has never had surpluses, on the contrary – it has almost reached a 7% deficit. The nominal debt is just 15% of GDP, and the net one is almost zero.

Various scenarios are circulating regarding possible implications of the crisis, its duration, how strongly it may affect Bulgaria and what consequences this might have for the country's future development be. If the crisis is over by the third quarter of 2009, the situation in Bulgaria would not be too bad. If, however, it is to last longer and make its way into 2010, the situation will be more difficult. The effect of the crisis is likely to reach Bulgaria with a delay of 3 to 6 months.

On 27 February Standard & Poors downgraded Bulgaria from level 7 to level 6, to a country of "increased economic risk", bringing it thus to the level of Romania. Standard & Poors also expect that the financial profiles of Bulgarian banks will suffer growing pressure. On October 30 they had already lowered Bulgaria's rating from "bbb/a3" to "bbb-plus/a2". Its long-term debt ratings are now the same as those of Croatia and Latvia.

In spite of all pessimistic forecasts, though, the situation now is not as dire as suggested. The peak of the crisis is expected in May-June and only then one may predict any future developments.

7. The Economic Programme of Government

In December, Finance Minister Plamen Oresharski submitted to parliament the objectives of the 2009 budget.[3] The government will ensure a favourable economic environment but will not intervene directly in the real sector. The budget provides for measures to stimulate the economy and step up investment activities, as well as for "cushions" to ease the possible effect of the financial and economic crisis in the real sector. The budget pursues an anti-cyclic fiscal policy, which is in compliance with the recommendations of the European Commission and the IMF. The objective is to keep spending (except for EU contributions) under 40% of GDP and generate a surplus of 3%. The mid-term targets as defined in the 2007-2010 Convergence Programme shall be observed. The adopted budget for 2009 is based on the assumptions of 4.7% growth, 5.3 billion FDI and 5.4% inflation[4].

The Government will increase capital spending by 5.6 billion BGN destined to all sectors of the economy in reaction to contracting markets and the receding demand. Another 700 million BGN are earmarked as additional reserve. At a conference of the Friedrich Ebert Foundation in Sofia on the effect of the crisis in Bulgaria, Bulgarian Minister of Economy, Petar Dimitrov already hinted at the possibility of cutting the budget surplus, if necessary, down to 1%[5].

The budget 2009 includes 3 stimulus packages in support of the economy and investments. The guiding principle in determining the priorities of these investment programmes will be the support for local economic activities. The economic packages comprise of: a) economic activities, b) flexibility of the market and c) flexibility of the social network.

- The Bulgarian Development Bank shall set up a credit facility of 500 million BGN for small and medium enterprises, of which 100 million will be earmarked for farmers. Additional measures in support of the local economy include improving public services, simplifying regulations and reducing bureaucracy, as well as introducing shorter periods for VAT reimbursement and last but not least the construction of 20 industrial parks.
- The Ministry of Education will initiate an investment programme worth 100 million BGN for the renovation of students' hostels and of 150 to 200 schools, playing grounds, etc.
- The Ministry of Labour and Social Policies intends to create 58.000 new jobs for un-

[3] Ref. http://www.minfin.bg/en/news/3049

[4] Ref. http://www.econ.bg/content/Budget%202009.doc

[5] Ref.: http://www.fes.bg/?cid=52&NewsId=649

qualified labour and shall launch qualification programmes for 16.000 persons.

- The Ministry of Health plans to invest 3 billion BGN in the health sector, mainly in the renovation of regional and national health centres, and for medical equipment; 41 projects are being planned.
- The Ministry of Transport shall launch 33 projects for a total of 520 million BGN; 195 million BGN of which shall come from public funds and the remainder from EU and ISPA funds under the operative programme on transport; among other projects these shall include the modernization of the Plovdiv Airport, the refurbishing of trains and wagons, as well as the purchase of new ones, a modern inter-modal container terminal in Sofia, etc.
- The Ministry of the Environment has already approved 2 billion BGN for projects under the operative programme on the environment; priority is the construction of water infrastructure, the restoration of existing and the construction of new water-supply systems, as well as building installations for sewage and waste management.
- Workers in the industrial and service sectors who have been put on part-time due to the crisis shall be entitled to a monthly compensation of 120 BGN under a new programme for labour market flexibility. The national employment plan of action for 2009 set aside 6.75 million BGN for these compensations. Almost 19.000 workers will take advantage of this programme.

The government programme has received support from various institutions. The European Investment Bank has offered Bulgarian commercial banks 200 million Euro under the programme on competitiveness. Talks are under way with the European Commission for over 209 million Euro for energy efficiency programmes. The money will come from EBRD, under the International Kozlodui Fund. 45 million euro from the programme on competitiveness have been rescheduled from 2010 to 2009. The President of the European Commission Jose Manuel Barroso declared that Bulgaria will receive 528 million Euro in the form of advance payments from the cohesion funds; under a separate plan for urgent energy projects Bulgaria will receive 40 million Euro for a gas pipeline with Greece and 10 million Euro for linking up with the Romanian network. As of now, no new agreement with the IMF is considered.

8. The Neo-Liberal Mantra

There are experts like Georgi Angelov from the Open Society Institute (OSI) in Sofia who advise the government to further limit government spending because the global recession would have a negative impact on public revenue. Lachezar Bogdanov from Industry Watch recommends that government should downscale support for unprofitable state companies like the Bulgarian state railways, the postal service or the central-heating companies and cover eventual financial losses by selling public property or through further privatization measures. Georgi Danev from the Center for Liberal Strategies, who is very critical of the government's plan to increase spending, likewise sustains that from his point of view it would be better for the government to reduce its public investment.

An interesting idea has come from Georgi Angelov from OSI and Simeon Dyankov, an economist in the World Bank.[6] They suggested a 7.5% decrease of payroll taxes from the current 31.3% to 23.8%. According to their estimate, this measure would bring about 130.000 newly created or preserved jobs, a 0.5% increase of growth and would only cost 0.52% of GDP. Such a reform would have three advantages: a) it will not be liable to corruption, b) it offers direct incentive to every-

[6] Ref. http://osi.bg/?cy=16&lang=2

body in the formal economy, and b) it is easy to implement and has an immediate effect. This is theoretically correct, but it can only lead to the described outcome if employers and employees would declare income and thus pay social security in full. Regrettably, precisely in this instance the reality is "grey" – frequently only minimum salaries are reported and social security is paid only on these. In reality, a reduction in payroll taxes would apply only to minimum wage levels and would most probably not have the envisaged effect.

The economists from the Institute for Market Economics (IME)[7], on the other hand, warn against a "political economy" of government programmes ahead of elections spending and emphasize that this will not necessarily bring success, as evidenced by the elections in 2005 when the government of Simeon Saxe-Coburg-Gotha considerably increased government spending before the elections and yet was not re-elected. IME sees the Bulgarian government alarmingly close to the camp of the new American President Barak Obama, whose economic programme they seem to reject as well. Their neo-liberal mantra remains "lower taxes, less government" and they keep referring to the "Wall Street Index for Economic Freedom" where Bulgaria is rated only as "moderately free".

9. Crisis and Corruption: Mutually Amplifying Scourges

The "Corruption Index 2008" of Transparency International puts Bulgaria last, behind all other EU member states. The latest report of the Center for the Study of Democracy (CSD) titled "Crime Without Punishment"[8] shows the extent to which corruption is intertwined with politics and how deeply the entire Bulgarian economy is marked by corruption. Local "businessmen" secure tenders through influence in state institutions and political parties. Ahmed Dogan, leader of the Movement for Rights and Freedoms (MRF), publicly stated that there was nothing wrong with the so-called "ring of businesses" which support his party and get public contracts in exchange. In a symptomatic way, Dogan represents the amalgamation between economic and political interests, and the far too obvious attitude towards it, shared by a large number of Bulgarian politicians.

Some 30 oligarchs and their clans control the entire economic and political life of Bulgaria. In Bulgaria this may not be as simple as it is in Russia because the domestic market cannot be fully isolated from foreign companies. However, on local level the oligarchs are very powerful. Groups of 2-5 individuals or families often control not just local authorities but also representatives of central government, police, revenue authorities, courts and prosecution. Public tenders and concessions are the main channels of corruption. Legal prosecution of corruption is very low and 80% of the investigated suspicions never lead to an indictment. In the period 2005-2008 the number of charges went down by more than 30%, which, however, does not mean any lesser number of offences!

Against this background, it is easy to understand the warning signals coming from observers and experts when looking at the government's plans. The global crisis may lead to a further boom in the Bulgarian "corruption industry". When foreign investment is going down and the money flow from abroad is drying up, and when public spending and public tenders will increase as a countermeasure, "corruption pressure" in the public institutions will grow stronger. And on top of all, billions of Euro from the EU funds need to be spent in a relatively short time!

This is a win-win situation for the corruptive networks in politics and in the economy. A politician increases his popu-

[7] For more information Ref. http://ime.bg/en/
[8] Ref. http://www.csd.bg/fileSrc.php?id=2650

larity because he can distribute favours, his business partner wins lucrative contracts and is in turn generous to the politician and his party. What share, though, of these funds will really end up in construction, investment, equipment and ultimately create jobs and a better livelihood for the people remains a big question. Apart from that, every politician or entrepreneur who is not a part of the network most likely will stay empty-handed.

In short, the crisis may lead to bigger corruption in Bulgaria, certainly a most undesirable effect. Millions from the economic programme of the government or from the EU funds might be, in part at least, diverted and thus be lost for the main objective – overcoming the crisis. Economic programmes will not help alone. What is needed in addition are effective and real structural reforms, simpler and more transparent calls for tenders, abridged decision-making in project selection procedures, a functioning judiciary, etc. These are exactly the same issues, which are constantly raised by the European Commission in its reports and to which it demands quick solutions. The government, however, still fails to show significant progress in this regard. "Crime without punishment" still pays well!

10. Crisis and Elections: Fertile Soil for Populists

Bulgarians will vote twice this summer: first, on June 7th they will elect their members of the European Parliament, and shortly after the National Assembly.

Public trust in state institutions is alarmingly low. In December the approval of the government was at 10%, of the parliament at 7%, of the courts at 12% and of the prosecution at 14%. The fear of economic crisis and the mistrust in politicians may bring old, subliminal tensions to the fore and provoke an abrupt change in public perceptions. Only very recently, on the rather polemic and scandalous website "Frog.bg", an "emigrant" was openly calling for a military regime which should "clean up the mess".

People's fear of losses they may incur in the crisis combined with the still strong reflex of the former socialist countries to call on the state will enhance chances of those politicians who promise protection and immediate action, i.e. an active state policy. In the world presently the tide goes against the pure neo-liberal doctrine and in favour of stronger state control and responsibility. This is a potentially strong card for left or pro-state socially-minded parties, while it puts on the defensive the proponents of a pure market doctrine. Bulgarian conservative right-wing parties evidently belong to the latter category. The IME laid down economic policy guide-lines for them, including for the GERB Party (Movement for European Bulgaria) led by the Sofia mayor Boiko Borissov who leads in all opinion polls for the forthcoming elections. Interestingly enough, he recently hinted that some parts of the economic programme of the government are not bad at all and announced that he may include some similar points in his election platform.

On its small political stage, Bulgaria resonates the most important question in Europe now regarding the future of the project of a common European house, namely the swing of the economic policy pendulum away from a large and free economic space towards (or back to) a tendency favouring a protectionist national welfare state. In Bulgaria, too, there is a danger that short-term electoral tactics will remove fundamental questions of economic efficiency from the agenda in favour of preferences for more statehood and protectionism.

But not only markets can fail – governments can too. And one can only hope that the fear and anger of the citizenry will not catapult some populists into power. Volen Siderov and his nationalist, xenophobic, euro-sceptic party Ataka are already sensing a fair wind.

11. The Optimistic Scenario: the Crisis as a Chance for Reform

The crisis offers opportunities as well: where everybody runs away, others see their chance. Local investors will play a bigger role when foreign investors disappear. Even when conditions are more difficult, a well developed project always has a chance of realization. The exceedingly high profit rates in the past few years offer the possibility for scaling down the margins. Expectations need to be reassessed because Bulgaria is still underdeveloped and has great potentials for growth.

Another potentially positive side-effect of the crisis may be that some investors will decide more cautiously and might want to avoid the risks of distant new markets and rather invest closer to home, preferably in the EU. And in this respect especially Bulgaria and Romania have many advantages. Indeed some big companies such as Siemens have already announced that they intend to expand their operations in Bulgaria.

Others see the crisis as an opportunity to mobilise strong pressure to enforce structural reforms, to ensure a transparent and efficient absorption of EU funds, to create new "green collar" jobs and to turn Bulgaria into a power-house of innovation. Many civil society organizations and other non-state actors are mobilizing their supporters to take the global crisis as an argument in the forthcoming elections and demand new policies and new politicians - in all parties.

12. The Ugly Scenario: the Crisis as Regression into Morass

At the 10th Economic Forum on South-Eastern Europe in Sofia on November 5, 2008 Steve Hanke, Professor at John Hopkins in Baltimore, US and "father" of the Bulgarian Currency Board, stated apodictically: "The party is over" and explained that what we have seen so far will not be repeated again. He was, of course, referring to the big international "party" of the finance jugglers.

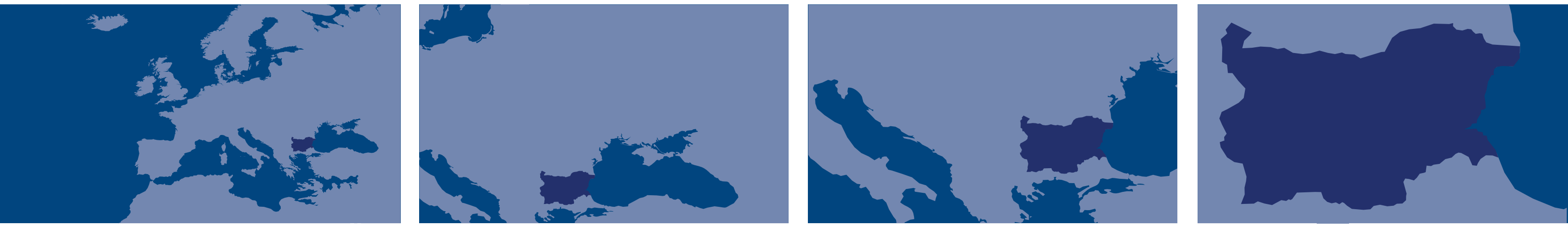
The cynical answer of Bulgaria's corrupt elites may well be: "Fine, then let's continue the party at home!" Right now, at the time of crisis they are moving together, closing their own circles and sharing the loot among themselves. All efforts to hold fair and free elections in the coming months risk to be thwarted by their resistance. Moreover, the apprehensions that "vote buying" or "vote pressure" will become a common feature in these elections may come true.

And then, in the worst case, the victorious political and economic mafiosi - of all parties - will join forces after the elections and lead Bulgaria regressing ever more deeply into the morass of corruption.

Reality will probably find the middle way between these two scenarios. The extent to which the world financial and economic crisis will impact Bulgaria will, in turn, determine whether and how significantly certain social and political parameters will be affected. The chance is still there.

About the author

Marc Meinardus studied economic and social sciences at the University of Erlangen-Nuremberg and received his doctoral degree from the Free University of Berlin. He has been working for the Friedrich Ebert Foundation since 1990. In 1995-98 he started and built up the FES Regional Office for the Balkans as its first director. In January 2008 he returned as country representative of the foundation in Bulgaria.



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