ICRA BULLETIN
Money & Finance
JULY–SEPT. 2001

Bulgaria: Legacy, Transition and the Soft Underbelly of Macroeconomic Stability*

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Credit market failure and the constraints imposed by the currency board agreement on the government and central bank's ability to pursue expansionary fiscal and monetary policy are pushing Bulgaria towards another disaster.

Abstract

At the turn of events in Central and Eastern Europe in 1989, Bulgaria inherited a weak economy whose woes were aggravated by the dissolution of the COMECON trade agreement, and the sanctions imposed on traditional trading partners like Iraq and Yugoslavia. At the same time, it avoided the bloodshed and the wars that left their mark on many of the Balkan and CIS countries. Many of the post-1989 years were frittered away by successive Bulgarian governments, and the 1990–96 period saw decline in industrial output, negative GDP growth, and fairly high inflation rates. Matters came to a head in 1996-97 and resulted in a financial-currency crisis leading to a sharp devaluation of the currency and bankruptcy of banks. The government responded by ushering in a currency board agreement that has eliminated the government's ability to incur fiscal deficit, the soft budget constraints enjoyed earlier by the banking sector, and the Bulgarian National Banks's ability to pursue an expansionary monetary policy. As a consequence, the Bulgarian government runs a fiscal surplus, inflation and interest rates remain low, and the currency remains pegged to the German mark. The paper argues that these signs of macroeconomic stability are misleading, and that credit market failure and the constraints imposed by the currency board agreement on the government and central bank's ability to pursue expansionary fiscal and monetary policy are pushing Bulgaria towards another disaster.

* The research for the paper was undertaken with financial support from the GRP project which is administered by CERGE-EI, Prague, Czech Republic, with funding from the World Bank. The author would like to thank Ivona Jackimova Simon Commander and Saul Estrin for their comments. Most of the data used in the paper was taken from IMF publications and a publication of ING Barings. The usual disclaimers apply.

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Non-Technical Summary

In 1989, Bulgaria was somewhere in the middle of the road. It was not in as advantageous a position as its Central European neighbours like Poland and Hungary which were poised to benefit by virtue of their larger domestic markets, proximity to EU countries like Austria and Germany, and quicker transitions to a stable form of democracy. But it was better endowed in most ways than countries like Albania, Belarus, and Moldova, and was also immune to the potential chaos that eventually befell Yugoslavia. The inheritance of Bulgaria can perhaps be summarised as follows:

- A weak economy whose industrial sector was incapable of competing with the more efficient industries of Western Europe, and an agricultural sector which was in disarray because abandonment of collectivised agriculture did not give way to widespread private commercial farming. The banking sector was burdened with bad loans from the pre-1989 era and their relationships with the SOEs saw them pile up even greater volume of NPAs.
- Unlike Romania and, to an even greater extent, Yugoslavia, the transition to democracy was smooth in Bulgaria. But the delicate balance of power between the BSP and the UDF led to an impasse that had an adverse impact on policy making. As a consequence, both the SOEs, the banks, and the government continued to work within the paradigm of soft budget constraints, and important policy decisions like those concerning privatisation were postponed indefinitely.
- The literacy rate was high, thereby according Bulgaria a major advantage over many other developing nations. But the population was aging, and the literacy rate did not accurately reflect the extent to which the labour force was in cognisance of the "best practice" that renders Western companies efficient. At the same time, the shrinking population and skewed income distribution denied Bulgarian companies the luxury of enjoying economies of scale based on the size of the domestic market.

Bulgaria's efforts at stabilising its macro economy were sketchy at best during the early years of transition. While inflation declined sharply from 238.6 percent in 1991 to 59.6 percent the following year, the threat of hyperinflation was never quite eliminated, the inflation rates for 1994 and 1995 being 72.7 percent and 64.1 percent respectively. The basic interest rate of the Bulgarian National Bank (BNB), the benchmark rate, increased steadily from 55.5 percent in March 1991 to 101.2 percent in December 1994. Over the same period, the currency depreciated from 0.0152 (new) levs per USD to 0.0660 (new) levs per USD. Matters came to a head in November 1996 when, banking sector crisis, fall of a government, and the expectation of high inflation led to a run on the currency between November 1996

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and February 2000. The lev depreciated from 0.3499 (new) levs per USD to 2.0455 (new) levs per USD, and the inflation rate rose from an already high 122.9 percent in 1996 to a whopping 949.1 percent in 1997. In response to the crisis, by July 1997, Bulgaria had in place a currency board with the German mark as the reserve currency. The currency board traded off flexibility of monetary policy to ensure price stability.

According to all stylised measures, Bulgaria today has a reasonably stable macro economy, at least as compared with the transition economies in Eastern Europe, and the former Soviet republics. The inflation rate is low, and so correspondingly are the domestic rates of interest. The fiscal position of the government is sound with the government budget running into surplus for four consecutive years. The rate of growth is not remarkable, but a positive growth rate of the order of 5 percent per annum is not negligible, and is remarkably good for a country that has registered negative growth rates for most of the post-transition years. There is only one macroeconomic measure that can colour one's view of the Bulgarian economy which otherwise epitomises stability in a region that is marked with macroeconomic instability: the current account deficit which has remained in excess of 5 percent of GDP for two successive years.

As we have already seen, the high current account deficit is a manifestation of export woes. The problem is set to be exacerbated by the decline in foreign direct investment (FDI) in the aftermath of the completion of big-ticket privatisation, thereby reducing significantly the FDI component of the current account deficit financing, and the decline in capital inflows that can offset current account imbalances, owing to decline in the availability of valuable equity and bonds with acceptable risk-return ratios. The ability of the capital account to offset deficit in the current account would be further limited by the foreseeable increase in the quantum of debt repayment obligations in the near future. The sub-par export performance and the absence of significant capital inflows, in turn, highlight the state of the majority of the Bulgarian companies: their inability to compete in the global market, and their inability to muster adequate economies of scale because of the low level of internal demand. Given the limited capability of the private sector to generate adequate demand at this stage of Bulgaria's economic development, the onus of generating demand lies squarely with the Bulgarian government, even as, in this respect, the government's hands have been tied by the currency board agreement.

At the same time, there is *de facto* credit market failure in Bulgaria. Private sector lending amounts to 12 percent of GDP, compared with 17 percent in transition economies, 49 percent in the USA, and 120 percent in the UK. IMF estimates suggest that given Bulgaria's per capital GDP, the private sector credit to GDP ratio should be about 30 percent. Most of the lending is secured either by government guarantee or by collateral in excess of 125 percent of the value of the loan. The capital market, on the other hand, is in its infancy and is incapable of generating funds for the industrial sector for medium or long term investment. Hence, technology upgradation and industrial activity, which can make Bulgarian products more competitive in the global market and attract FDI, are virtually absent, thereby aggravating the problem of the current account deficit.

The hands-off approach of the government and the Bulgarian National Bank (BNB), a consequence of the currency board agreement, is poised to threaten the very institution that the government and the BNB view as sacrosanct: the agreement itself. If Bulgaria emulates Argentina in the near future, which it might very well in the absence of concentrated international efforts to protect its currency board, the only economic capital it has in the global market, namely, macroeconomic stability, would be compromised, and the consequences of that might be disastrous.

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1. Background

The Republic of Bulgaria is located in Southeast Europe, bordering the Black Sea. It shares international borders with Romania (608 km), Serbia-Montenegro (318 km), FYR Macedonia (148 km), Greece (494 km) and Turkey (240 km). Its coastline is 354 km long. The total area of the country is 110,910 sq. km of which bodies of water account for only 360 sq. km. About 43 percent of the land is arable, and about 38 percent of it hosts forests and woodland.

Bulgaria was "liberated" from the Ottoman empire in 1878, after nearly 500 years of Turkish colonialism. Subsequently, in early twentieth century, it was involved in two Balkan wars in 1912 and 1913, and became associated with Germany during World War I. In the aftermath of the war, communists and monarchists struggled for influence, and the period between the two great wars was marked by political and economic uncertainty. Bulgaria again associated itself with the losing axis coalition during World War II, with King Boris III facing the unenviable task of having to choose between Stalin and Hitler. In 1946, monarchy was abolished—King Simeon and his family were exiled in the early 1960s—and the country emerged as a People's Republic and remained a part of the "Soviet block" until 1989. In 1989, Todor Zhivkov was removed from power through a palace coup that is popularly known as the velvet revolution, and the country moved towards a two-party democracy where the Bulgarian Socialist Party (BSP) (i.e. the reformed communists) and the Union of Democratic Forces (UDF) (i.e., the reformers) were the dominant forces.[1] However, the 2001 general elections saw the emergence of a monarchist party as

[1] There are several small political parties in Bulgaria, and in the event of hung Parliament, parties like the Business Block and the party that aims at protecting the rights of the Turkish minority typically held the balance of power.

the dominant force in Bulgarian politics, thereby making the dynamics of Bulgarian politics even more complex.[2]

The population of Bulgaria, as estimated in March 2001, is 7.97million indicating a drop of about one million over a 15-year period. It has been argued that about two-thirds of the decline can be attributed to negative population growth while the other one-third can be attributed to migration. As of July 2000, about 68 percent of the population fell within the working age bracket of 15 and 64 years, while 16 percent of the population was older than 64.[3] The population growth rate was negative 1.16 percent, the birth and death rates being 8.06 and 14.63 (per thousand) respectively. During the past decade, the total fertility rate for Bulgaria was 1.13. The sex ratio was estimated to be 1.06 (males per female) at birth, 0.97 for the 15-64 age group, and 0.74 for the older section of the population. The values of the sex ratio across the age cohorts reflect the fact that women live much longer than men, the life expectancy at birth of men and women being 67.45 and 74.56 respectively.

About 83 percent of the population are Bulgarian Orthodox Christians, while about 13 percent are Muslims. Ethnically, about 83 percent of the population identify themselves as Bulgarians, 8.5 percent as Turks, and 2.6 percent as Roma (popularly known as gypsies).[4] Bulgarian remains the national (and official) language, but the minority ethnic groups also speak languages such as Roma.

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Bulgaria has emerged as a country whose transition has been marked by misfortunes and missed opportunities. Its geographical territory covers a strategic place linking Europe with Asia, thereby making it the possible choice for a trade route linking the two continents. However, the Gulf War and the ethnic-political problems in the former republics of Yugoslavia led to considerable erosion of the value of the Asian-European trade route that can pass through Bulgaria. Similarly, despite experiencing one of the smoothest transitions from socialism to democracy, it failed to achieve political stability during the earlier part of its transition. Indeed, largely because of the political uncertainty, and its (adverse) impact on economic policy and governance, Bulgaria continues to be one of the least developed parts of post-transition Eastern and Central Europe. An exploration of the various aspects of this country, both at the micro and macro levels, would, therefore, be both fascinating and instructive.

[2] The monarchist party is led by "King" Simeon II who had lived in exile in Spain until the change of guard in Bulgaria in 1989.

[3] The demographic data, as well as the data on religious and ethnic mix, have been obtained from the *The World Factbook 2000* published by the Central Intelligence Agency of the USA.

[4] Not *all* Bulgarians are Orthodox Christians. Some Bulgarians were converted to Islam during the Ottoman times, and their descendents continue to be believers in that faith/religion.

The aim of this paper is paper is to provide a glimpse of Bulgaria's legacy at the time of the "velvet revolution" in 1989, describe its experience during the process of transition, and offer a prognosis for the health of the economy which has been hailed for macroeconomic stability in the aftermath of the currency crisis in 1996-97. Section 2 of the paper highlights the economic policies of the port-war socialist regime in Bulgaria, and their impact on the Bulgarian economy. Sections 3 and 4 describe the social, economic and political legacies of the socialist era, as well as the early years of the transition, following the political changes in Eastern and Central Europe in 1989. Sections 5 through 11 describe the process of economic transition, government policies associated with transition, the macroeconomic crisis witnessed by Bulgaria during the nineties, and the state of key economic institutions like the credit and capital markets. Finally, section 12 argues that the macroeconomic stability achieved by Bulgaria is fragile, and that, therefore, the government and the central bank would be well advised to delink fiscal and monetary policy from the shackles of the exchange board system which severely limits the ability of the policymakers to pursue counter-cyclical and/or expansionary fiscal and monetary policy. Section 13 concludes.

2. Central Planning: The Post-War Years

2.1 Soviet Style Plans and Targets

Since the end of World War II, which by and large coincided with the ascendancy of the Bulgarian Communist Party (BCP) to power in 1944, until the "velvet revolution" of 1989, Bulgaria closely followed the Soviet economic principles which included five year plans, collectivisation of agriculture, and increased government investment on the industrial sector, especially on heavy industries. However, while industrial production was by and large concentrated within the public sector, off and on the BCP also tried to usher in "reforms" that aimed at improving productivity and efficiency of the Bulgarian private sector. Overall, though, central planning in Bulgaria was marked by policy swings and uneven economic growth.

Bulgaria has always been a resource-poor country, with respect to both quality and quantity of natural resources. Its main indigenous mineral resources are coal, copper, iron ore, lead and zinc. In so far as energy and fuel are concerned, the country was (and continues to be) very dependent on imported petroleum and related products like natural gas. At the same time, Bulgaria has faced a shortage of human resources, at least in terms of quantity, since the late 1960s. During the 1950s and much of 1960s industrialisation was sustained by the influx of labourers into the industrial sector from the agricultural/rural sector, owing to collectivisation of agriculture and nationalisation of the artisan shops. The situation was further aggravated in 1974, when the working week was shortened from 48 hours to 42.5 hours. In other words, the Bulgarian economy faced severe constraints with respect to

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both natural and human resources, and these constraints played a significant role in determining the growth path of the Bulgarian economy.

In the aftermath of World War II, with soldiers returning from the war taking up jobs in small factories and enterprises owned and operated by local artisans, the industrial sector decentralised steadily. The small enterprises which dotted the country and competed with larger state owned enterprises (SOEs) for natural resources and skilled labour, were the antithesis of the large (usually heavy) industries that were the hallmark of industrialisation in the Soviet Union. In September 1947, it was decided at the meeting of the Communist Information Bureau that industrialisation should be given a fillip by way of nationalisation of industrial units. Soon after that, in December 1947, about 6,100 private enterprises were nationalised and government monopolies were established for all markets involving retail trade. At the same time, all banks were merged with the Bulgarian National Bank (BNB), and banking "reforms" were introduced to freeze all bank deposits above the limit of 20,000 levs.

The rapid pace of industrialisation envisaged by the 5-year plan called for large scale migration of labour from the agriculture to the industrial sector, and yet the productivity of the agricultural sector could not be compromised.

The first full 5-year plan period of Bulgaria, which started immediately after the 2-year plan of 1947-48, targeted an increase in gross industrial output to the extent of 119 percent: envisaged growth rates were 220 percent for heavy industries and 75 percent for light industries.[5] This was to be achieved by way of significant (and lopsided) government investment in the industrial sector—47 percent as opposed to 17 percent in the agricultural sector—and investment of 25 percent of the country's national income into economic infrastructure. The rapid pace of industrialisation envisaged by the 5-year plan called for large scale migration of labour from the agriculture to the industrial sector, and yet the productivity of the agricultural sector could not be compromised. The plan targeted 59 percent cumulative growth for the agricultural sector, the drivers of growth being collectivisation and mechanisation.

Despite the emphasis on industrialisation, the performance of the Bulgarian industrial sector remained patchy during the first two plan periods. Available net material product (NMP)[6] estimates indicate that the NMP growth rate achieved by the industrial sector was 20.7 percent during the first plan period. [7] However, during the second plan period (1953-57), the growth rate achieved by the industrial sector fell sharply to 12.7 percent. Indeed, the relatively small marginal decline in the growth rate of overall NMP from 8.4 percent to 7.8 percent was

[5] These growth rates indicate targeted rates of *cumulative* growth over the 5-year period.

[6] The NMP took into consideration production of only goods and not services, thereby making it practically impossible to compare the performance of the Bulgarian economy during the pre- and post-1989 years.

[7] All growth rates mentioned in this paragraph are annual average growth rates.

largely on account of the increase in the growth rate of agriculture from negative 0.9 percent during the first plan period to 4.9 percent during the second plan period.[8] In the absence of the sharp growth in agricultural production, the decline in the growth rate of NMP would have been much more substantial.

Perhaps as a consequence of the experience accumulated during the first two plans, the third plan set itself relatively modest targets. However, in 1959, Bulgaria sought to emulate Mao Zedong's "Great Leap Forward": it was envisaged that industrial output would grow by 200-300 percent between 1957 and 1965, and that agricultural production too would increase by about 200 percent between 1957 and 1961. The plan emphasised the growth of processed agricultural products, chemical fertilisers and electrical equipment whose production within the COMECON block was to a large extent Bulgaria's responsibility. The BCP declared in 1960 that the plan's targets had been met well in advance, a claim that has always had little credibility.

2.1 "Reforms" in the Communist Era

The BCP introduced the "new system of management" (NSM) in 1964, a system which was implemented during the fourth 5-year plan. In June 1964, about 50 enterprises, largely from the textiles and consumer goods sectors, were co-opted into the new system. The investment funds of these SOEs, and the wages and bonuses of their employees, were linked to the profitability of the enterprises, and the SOEs were allowed to retain up to 70 percent of the profits. At the same time, the enterprises were encouraged to seek funding from the banking sector, and depend less on the budgetary subsidies.[9] As such, the NSM aimed at delinking the government and the industrial sector to an extent, thereby alleviating incentive problems of the management and the labourers as much as possible. The experiment was a success, and the profits of the enterprises co-opted by NSM were double the profits earned by the other industrial units. Further, by 1967, the NSM firms accounted for two-thirds of the industrial output.

However, despite the success of the NSM, Bulgaria swung back towards central planning towards the end of 1960s, possibly as a consequence of the 1968 events in Czechoslovakia and internal conflicts within the BCP between the reformers and the hardliners.[10] But the rollback of reforms did not affect the agricultural sector's move towards

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[8] During the second plan period, the share of the agricultural sector in Bulgaria's overall NMP exceeded the share of the industrial sector for the first time in its economic history.

[9] In 1965, subsidies accounted for 63 percent of enterprise investment funds, while bank credit accounted for 7 percent. In 1970, the respective figures were 27 percent and 39 percent, while retained earnings accounted for 34 percent of the total.

[10] The latter factor might have played a more dominant role. For example, in July 1968, a month before the events in Czechoslovakia, the unique 3-tier price system in Bulgaria, which allowed for flexible price for some products, was eliminated.

greater efficiency by way of technology enhancement, specialisation of the labour force, and simplified process for the negotiation between the collectivised farms and the Ministry of State Planning. In the industrial sector, decentralisation survived in the form of more decision making power for the associations comprising a number of firms, at the expense of the relevant ministry.

The jettisoning of the NSM coincided with the emergence of the industrial-agricultural complexes in Bulgaria. The aim of this exercise was to increase the value added of agricultural production, reap the (envisaged) benefits of returns to scale, and streamline the channels of information flow. Associations continued to act as holding companies with significant decision making powers, especially with respect to new investments, bank credit and budgetary subsidies. Larger enterprises were free to enter into contracts with suppliers on their own, while smaller enterprises were completely dependent on the associations. In other words, decentralisation at the ministry-association level was being acted upon by increasing centralisation at the association-firm level.

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The post-NSM policies, which failed to generate the level of economic growth to the anticipated level, soon gave way to the "new economic model" (NEM) which was initiated in 1981. The NEM aimed at improving the collective technological ability of the Bulgarian industrial enterprises, and at making Bulgarian products more attractive for hard-currency export markets, thereby making gross profits of enterprises and technology enhancement the focal points of central planning. The enterprises were allowed to decide on the levels of their investment by way of negotiation with the BNB, and promoted self financing of investment projects at the expense of bank financing and budgetary subsidies.[11] Within the enterprises, groups of labourers (or brigades) were allowed to set input requirement targets for the planned level of output. The labourers were allowed salary increases only if there was an increase in labour productivity, and the salary rise could not exceed 50 percent of the rise in productivity. Further, management salaries could be cut by as much as 20 percent if an enterprise did not meet profit targets. In brief, the government was trying to introduce accountability to the production system with the help of the proverbial rod and the carrot.

Not unsurprisingly, therefore, the NEM too did not have the required impact on Bulgaria's economic performance. Indeed, further reforms (in 1982-83) in the form of income- and export-oriented targets and more penalties for failure to meet these targets, failed to stimulate the economy. The annual average growth rate of NMP during the eighth 5-year plan period (1981-85) was 3.7 percent, the lowest in the post-World War II period. In other words, Bulgaria was poised to enter

[11] The BNB provided credit only when it was deemed necessary, and the apex bank was allowed some flexibility in so far as the lending rate is concerned.

the transition years as a weakened economy whose micro institutions like enterprises were plagued by incentive problems, and whose economy had paid the price that is associated with frequent policy changes and government intervention in the production process. At the same time, its export potential had been weakened by the years of negligible competition for its products on account of intra-COMECON understandings.[12] Even at best, its process of transition promised to be difficult.

3. Initial Conditions and the Early Years of Transition

In 1989, the "new" Bulgaria emerged with a mixed bag of fortunes. Its political transition was one of the smoothest among countries of Eastern and Central Europe and the former Soviet republics. Even as simmering ethnic rivalries burst into the open in former Yugoslavia, Ceausescu was killed in Romania, and anarchy reigned in Russia and many of the former Soviet Republics, Bulgaria made a quick and relatively smooth transition to democracy. As mentioned earlier, the BSP and the UDF (which is popularly known as CDC, derived from its Bulgarian name) emerged as the two major political blocks, as the country adopted parliamentary democracy to replace the one party rule of the socialist era.

The transition on the economic front, however, was not as smooth. As the changes in Eastern and Central Europe and the Soviet Union brought an end to the COMECON trading arrangement between the Soviet Union and its client states, the Bulgarian economy came under severe pressure. In addition, Bulgaria was no longer able to trade with Iraq, which faced economic sanctions in the aftermath of the Gulf War, and the Yugoslav republics that were engulfed with ethnic wars. Indeed, by 1991, Bulgarian exports to COMECON countries had declined by about 60 percent, and its exports to other countries by about 25 percent. The immediate impact of the shock was that the already fragile Bulgarian economy shrank significantly. Industrial production alone fell by about 13 percent in 1990, and about 27 percent in 1991, and in 1991 more than half of the SOEs were operating at less than 60 percent of their capacities. Consequently, there was a nearly 40 percent decline in living standards during the first years of the transition.[13]

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[12] The share of COMECON countries in Bulgaria's imports was 85.6 percent in 1950 and it had increased to 89.1 percent by 1980. The corresponding figures for exports are 91.9 percent and 70.8 percent respectively. Much of the move away from COMECON markets, however, was by way of an 85-fold increase in Bulgaria's exports to developing countries over the 30 year period.

[13] It is difficult to quantify the economic change experienced after the watershed year of 1989, relative to the pre-1989 years because of lack of comparable data. The *International Financial Statistics* published by the International Monetary Fund (IMF), for example, does not provide much data about the pre-1991 years.

The economic problem was aggravated by the political uncertainty prevailing in Bulgaria. The BSP won the first post-transition general election in 1990. But its government was brought down by a general strike in late 1990, and a coalition government was sworn in to oversee the transition of the country to "full" democracy. In November 1991, the UDF won the "fully democratic" general elections in partnership with the Movement for Rights and Freedoms (MRF). The coalition, however, collapsed in 1992, and the country was governed by a team of technocrats until 1994 when the BSP returned to power and remained in power till 1997. The frequent changes in government led to an impasse whereby major policy decisions were either not taken or were not implemented.

Despite Bulgaria's early move towards recognition of private entrepreneurship, the basis for any privatisation programe, the Privatisation Agency was not set up until May 1992, and the agency's early attempts at privatisation remained dubious at best.

Perhaps the biggest evidence of the adverse impact of political uncertainty on governance can be found in the context of privatisation. As early as 1987, a consensus favouring privatisation was making its presence felt in Bulgaria, feeding on the economic revival plan endorsed by the 13th Congress of the Communist Party in 1986. The process received further impetus in 1989 with the dismantling of the agro-industrial complexes, and with official recognition of small entrepreneural ventures. Despite this early move towards recognition of private entrepreneurship, the basis for any privatisation programe, the Privatisation Agency was not set up until May 1992, and the agency's early attempts at privatisation remained dubious at best (Bhaumik, Jackimova and Kelleher, 2000).

Overall, the country faced daunting challenges at the inception of the transition process, and was unable to consolidate on its few advantages during the early years. The collapse of trading relations with traditional trading partners, together with the small size of the domestic market, implied that the country had to improve industrial efficiency through rapid privatisation. Not only was Bulgaria unable to effect this transition in its industrial sector, but it also frittered away the advantage it had over neighbouring countries by way of its fertile soil. Problems pertaining to land redistribution and credit crunch led to decline of the agricultural sector, and forced the country to import foodgrains from countries like Greece, with adverse implications for both price levels[14] and balance of payments.

Finally, Bulgaria's geographical location was clearly a double-edged sword, and at the end of the day the adverse factors had a

[14] Economic theory suggests that imports would increase the supply of a commodity within a country and would, *ceteris paribus*, lead to a decline in prices. In other words, at first glance, the rise of food prices within Bulgaria, subsequent to food imports, would sound counterintuitive. However, one would have to take into account the fact that import of food from European Union (EU) countries violated an important (implicit) assumption of the above theory, namely, that the imported and domestic foodgrains are qualitatively homogeneous. Indeed, the food imported from the EU countries marked a significant improvement in the quality of food available in Bulgaria. Higher average domestic price thus reflects greater weights of better quality products in the food basket.

greater impact on its economy than the favourable ones. While it could not consolidate on its advantage of being at the crossroads of Europe and Asia owing to external factors, its neighbourhood ensured that it remained at a disadvantage in so far as much needed foreign investment was concerned. While Romania in the North competed with Bulgaria for foreign finds, the latter country was bounded by an imploding Yugoslavia, Turkey which itself faces economic and political crises at regular intervals, and Greece which was among the poorest members of the European Union. Since proximity to countries which are net investors in transition and emerging economies is an important determinant of the extent of foreign investment (Estrin, Bevan and Smith, 2001), Bulgaria was clearly a loser in this respect.

4. Social, Political and Economic Inheritance

The economic inheritance of Bulgaria at the onset of the transition process was clearly unenviable. The socialist era industrial sector was not capable of competing in the global markets. The agricultural sector, one of Bulgaria's biggest assets, was hamstrung by absence of well defined property rights and lack of adequate funding. Exports had collapsed, and the possibility of increase in capital account inflows was bleak, even as Bulgaria's external debt stood at over USD 8 billion. Finally, the banking sector was fast sinking under the pressure of non-performing assets, thereby eliminating the possibility of effective financial intermediation. In brief, Bulgaria was staring at a crisis in the face.

On the political front, Bulgaria inherited a fractured polity such that neither the BSP nor the UDF were able to consolidate on their respective election victories, plunging the country into political chaos with monotonic regularity. The resulting non-performance of the governments further eroded the credibility of the political parties, and thereby eroded whatever support might have existed for harsh yet necessary economic policies and programmes. At the same time, however, Bulgaria was endowed with an ethnic mix that ruled out any major ethnic conflict and civil war, by virtue of the overwhelming majority of the Bulgars.[15]

The changing political equations in Central and Eastern Europe also gave Bulgaria the ability to settle past disputes that had plagued its historical relation with its neighbours, and to downsize its military which was a drain on its exchequer. Further, with the end of the Cold War, Bulgaria was poised to gain from its historical relationship with Germany. Indeed, Turkey today is one of Bulgaria's largest trading partners, while Greece is one of the largest investors in Bulgaria, and Germany is both the largest trading partner and the second largest investor in the country. At the same time, the government's

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[15] In any case, Bulgaria has historically been a tolerant nation. It protected the lives and rights of its Jewish population even after aligning with Germany during World War II.

expenditure on the nation's military fell from about USD 2.5 billion in 1988 (i.e., 18.5 percent of the government's budget) to about USD 274 million in 1991 (i.e., 4.4 percent of the budget).

Demographically and sociologically too, Bulgaria had had a mixed inheritance. It had a small and aging population that limited both the size of its domestic market, and the potential size of the labour force. The aging population also potentially translated itself into large demand for old age pensions and care, which had adverse implications for the government's budget. At the same time, however, 45 years of socialism had institutionalised gender equality, thereby increasing the participation of women in the labour force across professions. Further, with a higher than 95 percent literacy rate, the country's average human capital endowment was much higher than that in developing countries.

In 1989, Bulgaria was somewhere in the middle of the road. It was not in as advantageous a position as its Central European neighbours . . . But it was better endowed in most ways than countries like Albania, Belarus, and Moldova, and was also immune to the potential chaos that eventually befell Yugoslavia.

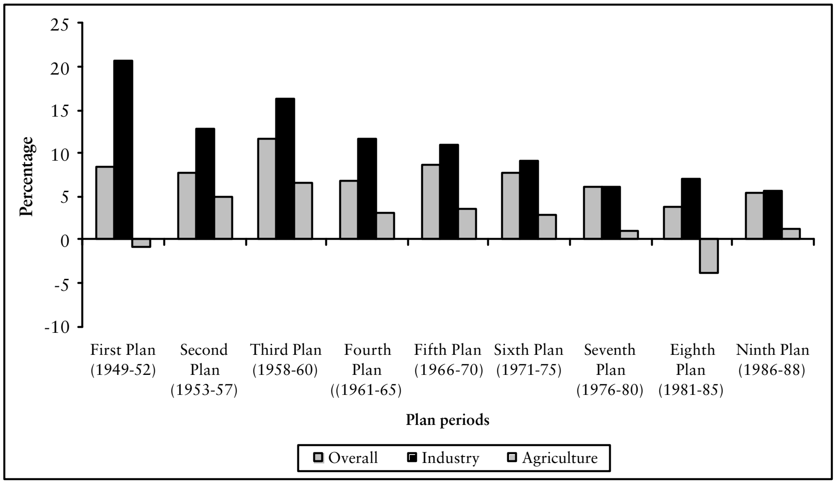
In 1989, Bulgaria was somewhere in the middle of the road. It was not in as advantageous a position as its Central European neighbours like Poland and Hungary which were poised to benefit by virtue of their larger domestic markets, proximity to EU countries like Austria and Germany, and quicker transitions to a stable form of democracy. But it was better endowed in most ways than countries like Albania, Belarus, and Moldova, and was also immune to the potential chaos that eventually befell Yugoslavia. More than ten years down the road of transition, it still is somewhere in the middle. It would certainly not be part of the first wave of countries that are expected to join the expanded EU in 2004. At the same time, it has stabilised key macroeconomic variables, privatised a significant part of the economy, and has clocked positive GDP growth rates, at least for the time being. Perhaps there is an element of path-dependence in the process of Bulgaria's transition, but more likely than not the relative status quo is the consequence of missed opportunities. The data, described in the following sections, will have the final say.

5. Economic Growth during Transition

The growth rate of GDP and the growth rates of the various sectors of an economy are assumed to be reasonably good indicators of a country's economic health. This assumption could not have been more correct than in the Bulgarian context. Between 1991 and 2000, GDP growth rate of Bulgaria was positive in only five out of the ten years. Indeed, growth rates of negative 10.9 percent and negative 6.9 percent were experienced as late as 1996 and 1997, and despite the low base, average growth rate for the 1998-2000 period was about 3.73 percent. The average growth rate for the entire decade was an abysmal negative 2.3 percent.

However, as always, averages do not bring out two important features of Bulgarian GDP growth. First, while the Bulgarian economy shrank continually during the 1991-93 period, the rate of shrinkage declined over the years, and in 1994 and 1995 Bulgaria had registered

FIGURE 1
Growth Rates of Net Material Product



Source: United States Library of the Congress web site.

FIGURE 2
Comparison of 1989 and 1999

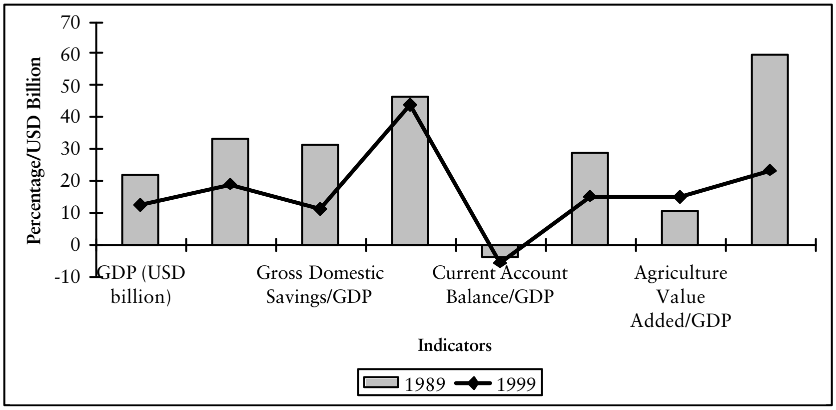


FIGURE 3
Relative Importance of Private Sector

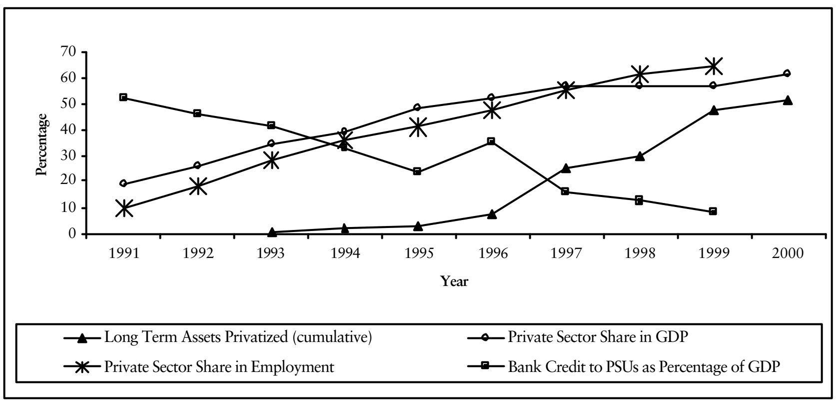
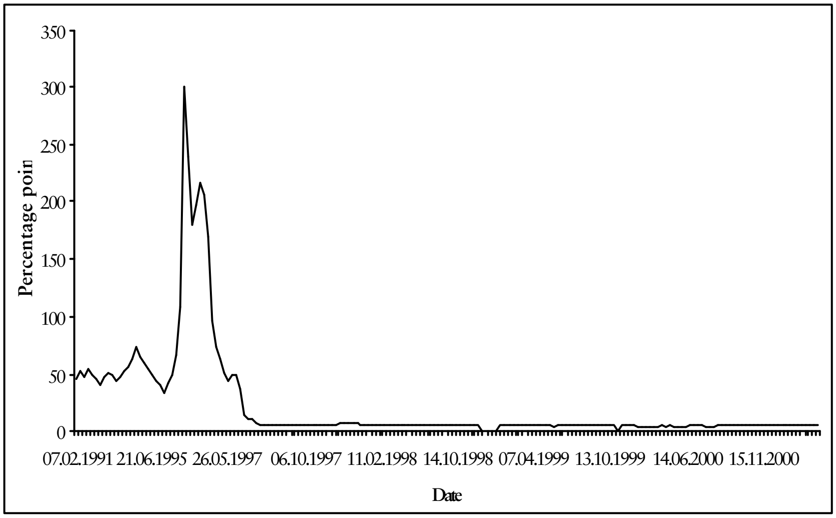
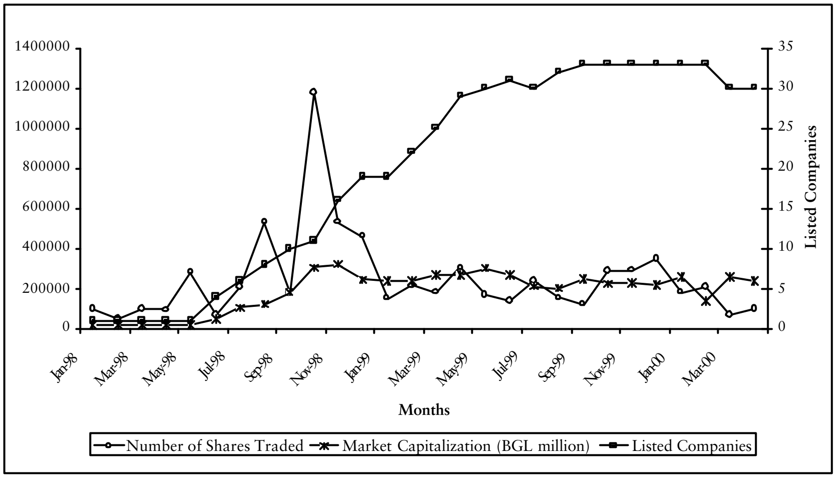


FIGURE 4
Base Interest Rate



Source: Bulgarian National Bank

FIGURE 5
Official Market: Bulgarian Stock Exchange



positive GDP growth rates. In other words, there is prima facie evidence that the decline of the Bulgarian economy was bottoming out towards the middle of the decade, and that the economy was poised for a turn around. This recovery was brought to an abrupt end by the crisis of 1996-97. Second, in the aftermath of the crisis, the Bulgarian economy has grown continually,[16] the growth rate of 2000 being a respectable 5.3 percent. The impact of macroeconomic stabilisation—

[16] Indeed, a simple graphical analysis would indicate that the post-1997 growth of the Bulgarian economy is clearly above the long term trend, the trend being based on the economy's performance during the nineties.

which will be discussed shortly—on economic growth, at least in the short run, is apparent.

The pattern highlighted by GDP growth rates was also reflected by the sectoral growth rates. To begin with, all three sectors—agriculture and forestry, industry, and services—fared better during the second half of the nineties compared with the first half. The average growth rates for the sectors were negative 3.36 percent, negative 6.62 percent and negative 9.22 percent respectively, during the 1991-95 period, and 2.4 percent, negative 2.24 percent and negative 2.4 percent respectively, during the 1996-2000 period. However, these averages once again hide the fact that the agricultural and the industrial sectors had staged a turnaround in 1994 with growth rates of 9.4 percent and 5.9 percent respectively, and that, by and large, all three sectors have experienced growth in the aftermath of the 1996-97 crisis.

However, this scarcely means that the Bulgarian economy has finally turned around and embarked on a sustainable growth path. Year-on-year growth rates, while useful as indicators of economic health, say precious little about the capability of a country to sustain growth in the long run. It is now a stylised fact that growth in the long run depends on the extent of capital formation in an economy and the country's technological abilities. The investment-GDP ratio in Bulgaria has stagnated at the 13-14 percent level, and the commercial banks remain wary about advancing credit to the private sector enterprises.[17] At the same time, while the share of capital goods in Bulgaria's imports has increased from 19.6 percent in 1995 to 24.6 percent in 2000, the high share of fuels and intermediate goods in the imports basket—27.2 percent and 33 percent respectively, in 2000—implies that there is not much scope for further increase in the share of capital goods. This, together with the fact that the ability to increase the volume of imports itself in the short run, and thereby run up a current account deficit, is restricted by Bulgaria's currency board agreement,[18] makes the prognosis for the sustainability of Bulgaria's year 2000 GDP growth somewhat bleak.

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6. The Crisis of 1996-97 and Macroeconomic Stability

Bulgaria's efforts at stabilising its macro economy were sketchy at best during the early years of transition. While inflation declined sharply from 238.6 percent in 1991 to 59.6 percent the following year, the threat of hyperinflation was never quite eliminated, the inflation

[17] The (private sector) credit to GDP ratio in Bulgaria was a low 12 percent at the end of 1999, and although the situation has eased since then, it is still lower that the 30 percent level that is consistent with its per capita GDP level (IMF, 2000). The consequence is that Bulgarian firms face severe financial constraints (Budina, Garrestsen and de Jong, undated).

[18] In principle, higher imports can be sustained by way of high export growth. However, given Bulgaria's record with respect to exports, it is difficult to make such an assumption.

rates for 1994 and 1995 being 72.7 percent and 64.1 percent respectively. The high rates of inflation can be traced back to high growth rates of broad money. Even at its lowest in 1995, broad money growth was 39.6 percent, the average for the 1992-95 period being 54.85 percent.[19]

As a consequence of the runaway inflation, the domestic interest rate remained high, and the nominal exchange rate of the lev declined steadily over the years. The basic interest rate of the Bulgarian National Bank (BNB), the benchmark rate, increased steadily from 55.5 percent in March 1991 to 101.2 percent in December 1994. Over the same period, the currency depreciated from 0.0152 (new) levs per USD to 0.0660 (new) levs per USD.[20]

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In 1995, things started to look up as the rate of inflation declined from about 120 percent in December 1994 to about 60 percent towards the middle of the year. Paradoxically, this later contributed to a major macroeconomic crisis. As the inflation rate fell, the deposit rates of the banks declined from about 101 percent to about 66.5 percent, and yet there was a 25 percentage point increase in the real rate of interest. Hence, currency holdings fell by about 5 percent in real terms, while deposits with banks increased by about 12 percent over the same time period. The rise in the real rate of interest and the increase in the volume of deposits, together with the fact that the banks had few profitable yet relatively safe ways to generate interest income, added to the fragility of the banking system. Many banks were forced to cash in their foreign exchange reserves to stay afloat.

In 1996, the BNB had to refinance two ailing banks to the tune of about USD 300 million. At the same time, the BNB's intervention in the foreign exchange market increased the foreign exchange reserves with the central bank by about USD 500 million, thereby increasing the volume of high powered money. The consequent increase in the supply of broad money once again stoked inflation. The BNB was unable to contain the growth of money supply through sterilisation and increase in the reserve ratio from 10 percent to 12 percent. Even worse, it was not able to wholeheartedly pursue a tight money policy because a high real interest rate would have further weakened the banking system.

The real rate of interest was nearly zero by the end of 1995, and there was a sharp decline in the demand for bank deposits. At the same time, the decline in the foreign exchange reserves of the commercial banks generated fear about the ability of the banks to pay back the owners of foreign currency deposits. This, together with the closure of a private sector bank, led to a run on the banks and lev denominated deposits of the commercial banks fell by about 30 percent while the volume of foreign currency deposits fell by about 25 percent. The lev

[19] Since 1991 was clearly an outlier with a 3-digit inflation rate, it would be prudent to look at the average for the more "normal" years.

[20] The "new" *lev* was introduced in 1997 with the exchange rate between the "old" and the "new" being 1000 "old" *levs* per "new" *lev*.

withdrawals were channelled into the foreign exchange market, and the lev started to depreciate sharply against the USD. It fell from 0.0705 (new) levs per USD in December 1995 to 0.2020 (new) levs per USD by the end of August 1996, the rate of depreciation being 53 percent just during the May-July 1996 period. This depreciation was despite an increase in the reserve ratio by 1.5 percentage points, and a rise in the benchmark interest rate to 108 percent. The beleaguered BNB attempted to stem the slide, and its interventions in the currency market reduced its foreign exchange reserves to USD 573.4 million, i.e., about 5.5 weeks' import cover. Bulgaria was poised for a run on its currency.

In September 1996, BNB raised the benchmark interest rate to 300 percent, and the lev stabilised momentarily at about 0.2300 (new) levs per USD. But as the government fell, and realisation dawned that the 9 percent (of GDP) fiscal deficit would almost certainly have to be monetised, the crisis came to a head and between November 1996 and February 2000 the lev depreciated from 0.3499 (new) levs per USD to 2.0455 (new) levs per USD. The impact of the monetisation and currency depreciation on the inflation rate was even more spectacular, and the inflation rate rose from an already high 122.9 percent in 1996 to a whopping 949.1 percent in 1997.

The crisis stirred the government into action, and by July 1997 Bulgaria had in place a currency board with the German mark as the reserve currency. The currency board traded off flexibility of monetary policy to ensure price stability. The BNB was no longer in a position to increase money supply without the explicit backing of foreign exchange reserves. This move also ensured that the government did not run up high deficits with the expectation that the deficit can be monetised, and it prevented the BNB from refinancing fragile banks without the explicit backing of foreign currency inflows.[21] Further, the currency board helped restore some faith in the national currency by promising to exchange one (new) lev for one German mark at all times.

The currency board traded off flexibility of monetary policy to ensure price stability. The BNB was no longer in a position to increase money supply without the explicit backing of foreign exchange reserves.

Since the introduction of the currency board, the Bulgarian macroeconomy has shown a remarkable degree of stability. The (new) lev remains pegged to the German mark with a 1:1 exchange rate. The fiscal balance of the government turned positive in 1997 and the government has enjoyed a fiscal surplus since. The improvement in the fiscal health of the government has had a salutary impact on the growth rate of money supply and hence on the inflation rate. The inflation rate declined sharply from 949.1 percent in 1997 to 22.2 percent in 1998, and has remained below 5 percent since. Consequently, the benchmark interest rate has stabilised at the 4.5 percent level.

However, Bulgaria remains very vulnerable to yet another round of macroeconomic instability. Its current account deficit remains high at over 5 percent of GDP, despite the fact that the country's import

[21] Further details about the currency board can be found in Miller (1999), Dobrev (1999), Nenovsky and Hristov (1998) and Avramov (1999).

bill grew at modest rates of 3.48 percent and 7.7 percent respectively, in 1998 and 1999. In the immediate aftermath of the crisis of 1996-97, rapid privatisation led to capital account inflows that, together with inflows from the IMF, had stabilised the balance of payments of the country, leading to an increase in the country's foreign exchange reserves. Indeed, the country's stock of foreign exchange reserves jumped from a mere USD 325 million in 1997 to USD 2,731 million in 1998, and stood at USD 3,339 million in 2000.

But Bulgaria now faces crunch from two different directions as the decline in its exports, with an average growth rate of negative 5.38 percent during the 1996-99 period, coincides with payment obligations of its external debt which increased from USD 9,602 million in 1996 to USD 10,371 million in 2000. As a consequence, external debt service requirement has reached about USD 1 billion per year, and the debt service ratio has increased from 14.2 percent (of exports) in 1997 to 18.4 percent (of exports) in 2000. At the same time, capital account inflows on account of privatisation has stagnated, with net inflows on that account increasing only marginally from USD 806 million in 1999 to USD 817 million in (January-November) 2000.[22] In other words, the big question is whether Bulgaria would be able to meet its debt repayment obligations, maintain the currency board and the peg to the German mark, and not drive up domestic interest rates to stratospheric levels all at the same time. Observers like ING Barings (1999) have concluded that Bulgaria would be able to stave off a balance of payments crisis in the medium run only with active support from the international financial institutions, and the European Union. That is certainly very disturbing news about the health and prospects of an economy.

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7. External Sector

The domestic market of the Bulgarian economy is small, its GDP in 2000 being 17,937 million (new) levs (i.e., about USD 8.5 billion). Hence, it has a small domestic market.[23] At the same time, owing to efficiency considerations, as a small country it has little option but to specialise in the production and export of goods and services in which it has comparative advantage, and have a relatively high trade-GDP ratio. In other words, there is little option for Bulgaria but to look at overseas markets for industrial and economic growth, as well as greater efficiency with respect to allocation of resources, and

[22] Net portfolio investment has actually declined from USD 8 million in 1999 to *negative* 69 million in 2000 (January-November).

[23] The per capita GDP of Bulgaria, which puts it at par with middle income countries, does not accurately reflect the purchasing power of a vast majority of the population. Even though the average monthly earnings in Bulgaria has increased by about 26.44 percent between 1998 and 2000, it still stands at 263 *levs* (i.e., about USD 125). Even this average has been skewed by the average monthly income in a handful of sectors like financial services where the average monthly income is much higher. At the same time, unemployment rate has risen from 11.1 percent in 1995 to 17.9 percent in 2000.

ironically it is the decline in exports that has emerged as a major concern for Bulgarian policymakers. Importantly, the source of Bulgaria's export related woes does not seem to be its exchange rate, given that the real effective exchange rate has not deviated significantly from 120 since December 1997, but rather the composition and direction of its exports.

Between 1995 and 2000, the share of 9 EU countries in Bulgaria's exports increased steadily from 38 percent to 50.3 percent. Much of this 12 percentage point increase was at the expense of 8 former Soviet block countries. Indeed, Germany and Turkey have emerged as Bulgaria's largest export markets, while the shares of USA and Japan in Bulgaria's exports have remained more or less stagnant over the 5-year period. In other words, Bulgaria's export growth is very closely connected with the economic fortune of the EU countries and Turkey. Given that the Euro-zone economy is unlikely to grow at faster than 2 percent per annum in the foreseeable future, and given that Turkey's economy has become even more vulnerable to negative economic shocks after the currency crisis of 2001, the future of Bulgaria's exports is not bright.[24]

Further, Bulgaria's export performance is becoming increasingly dependent on its ability to sell textile and mineral products in the international market. The shares of these two groups of commodities in Bulgarian exports increased from 12.7 percent and 9 percent respectively, in 1995 to 23.4 percent and 16.8 percent respectively, in 2000. At least in textiles, Bulgaria faces steep competition from Turkey for the EU market, and from Southeast Asian countries, China and India for the US and other markets. Hence, not only Bulgaria's direction of exports but also its export composition makes it vulnerable to export slowdowns.

Perhaps the best way to alter the export basket, and reduce the extent of competition Bulgaria faces from other transition economies and emerging markets is to move up the value chain and produce and export high value added products in niche markets. This requires upgradation of technology. However, as has been mentioned before, even though the share of capital goods in Bulgaria's imports has recorded a 5 percentage point increase between 1995 and 2000, there is little scope for any further increase given Bulgaria's dependence on import of fuel and intermediate goods. The panacea for Bulgarian exports in the foreseeable future seems to be a rebound in the world's economic fortunes, one that would spur growth in its major constituents like the EU.

There is little option for Bulgaria but to look at overseas markets for industrial and economic growth, as well as greater efficiency with respect to allocation of resources, and ironically it is the decline in exports that has emerged as a major concern for Bulgarian policymakers.

[24] It may be argued that given the relatively low cost of production in Bulgaria, its products would remain attractive to consumers in other countries. In other words, the low cost of production, and hence low prices, may make consumers substitute products from other countries with Bulgarian products. However, there are two caveats to this line of argument. First, in order for the substitution effect to work over time, the relative costs of production would have to move further (and continually) in Bulgaria's favour. Second, in the foreseeable future, the income effect associated with a global slowdown is likely to dominate the aforementioned substitution effect, even if the latter effect were in Bulgaria's favour.

8. Government and Fiscal Policy

In a transition economy like Bulgaria, the most important role of the government is often to put in place transparent rules and uphold the rule of law. Indeed, this is often the focus of the literature on transition (Hellman and Schankerman, 2000). However, one cannot ignore the fact that a country in transition is like any other country in the sense that the government has a role to play in reversing adverse cyclical movements and economic downturns. Indeed, the government can play this role in the short run using Keynesian fiscal policy tools like taxes and government expenditure, and in the long run by investing in the physical and human capital of the economy.

The Bulgarian government's ability to counteract negative economic shocks and economic downturns has been severely restricted by the currency board arrangement that has effectively capped the government's ability to run budget deficits. This has led to fiscal prudence, and the government has run a fiscal surplus since 1997. At the same time, a reduction in the volume of the government's debt relative to the GDP has reduced the government's interest payments obligations from 46 percent of total expenditures in 1996 to 10 percent in 2000. However, the tightening of the government's expenditure has coincided with stagnation in the proportion of the expenditure on education and health. The share of capital formation in total expenditure, which rose sharply from 2 percent in 1996 to 11 percent in 1999 too seems to have stagnated at the latter level. Given that the rising unemployment rate and the aging population are likely to lead to ever expanding claims of social security payments on the government's expenditure,[25] the shares of expenditure on health, education and capital formation might not increase significantly in the medium run. In other words, the only plausible way for the government to spend more on social and physical capital, which would involve an increase in the overall level of the government's expenditure, is to raise more revenues.[26]

The Bulgarian government's ability to counteract negative economic shocks and economic downturns has been severely restricted by the currency board arrangement that has effectively capped the government's ability to run budget deficits.

[25] The pension system in Bulgaria faced two different problems. First, the retirement age of 56 was unsustainable given the declining and aging population. Indeed, the demographic trend rendered unsustainable the pay-as-you-go (PAYG) system itself. Second, there was no link between the extent of contributions and the extent of benefits, and hence the incentive to contribute to the pension system was low. The Bulgarian government decided to address these problems by strengthening the PAYG system, as well as by introducing a fully funded pension system. Participation in the latter system would be mandatory for the new employees. Strengthening of the PAYG system included an increase in the retirement age, and the establishment of a link between contributions and benefits.

[26] In principle, investment in human capital can be loan financed, and such loan financing is sometimes desirable, especially because it has favourable implications for the long term growth of the economy. However, the government in Bulgaria has preferred to maintain fiscal surplus, and use the surplus to reduce its debt-GDP ratio, a move that is widely believed to be consistent with the government's political agenda of facilitating EU accession by the end of the decade.

After a decade of privatisation, the ability of the government to generate significant non-tax receipts by way of privatisation is limited. The average income level in the country does not make it easy for the government to raise revenues through income taxes, and the limited number of profitable enterprises makes it difficult to raise revenues through corporate taxation. The problem has been further aggravated by the reduction of the effective rate of direct taxes from 40.16 percent in July 1997 to 34.3 percent by the end of 1999. Indeed, the share of income and corporate taxation declined steadily from a high of 34 percent in 1997 to 23 percent in 2000. At the same time, reduction of average tariff rates over the years has reduced the potency of customs duties as a source of tax revenue. The onus of generating revenues, therefore, has fallen on value added tax (VAT) and excise duties. The share of VAT in tax revenues increased from 11 percent in 1992 to 23 percent in 1997 to 31 percent in 2000. But the ability of VAT and excise duties is dependent on the quantity and quality of goods and services produced in the economy, which, in turn, are dependent on the technology level and Bulgaria's ability to penetrate the global market. One, therefore, comes a full circle without being able to devise a way in which the Bulgarian government could embark upon an expansionary fiscal policy within the ambit of the currency board agreement.

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9. Structural Reform: Privatisation

The first attempt at streamlining the functioning of public sector enterprises aimed at granting greater autonomy to these firms through abandonment of price controls, and by allowing directors of these enterprises to decide the pattern of transfer of shares to the employees (Rock, 1992). Decree 56 of 1989 also made legal privatisation of retail and distribution outlets and tourism companies, and sale of used vehicles and farm machinery. At the same time, limits were imposed on the ability of the SOEs to raise money wages, in an attempt to harness their costs of production. However, owing to lack of support for such measures among the labour force, and employment related considerations, hard budget constraints were never imposed on the SOEs. The firms continued to receive support from the public sector banks, which subsequently contributed to the burden of these banks with respect to non-performing assets (NPAs). Even though the efforts to streamline the functioning of the SOEs were unsuccessful, however, it is interesting to note the emergence of some consensus about the need for private entrepreneurship.

The privatisation process itself had its roots in the Privatisation Law which was approved by the Bulgarian Parliament in May 1992. The agenda was to privatise firms using either market privatisation or mass privatisation programmes. The municipalities were deemed responsible for the (market) privatisation of small scale companies, while the privatisation of larger SOEs was the responsibility of the central government and the Privatisation Agency. The structure of the

Privatisation of the Bulgarian industrial sector, and the liberalisation of the economy have led to an increase in the levels of productivity. However, for a number of industries, much of the productivity gains has been attributed to greater competitive pressures rather than firm level restructuring.

mass privatisation programme was more complex and included, among others, the Council of Ministers, the Ministry of Finance, the Centre for Mass Privatisation, the Securities and Stock Exchange Commission, and the Auction Committee.

Prior to the crisis of 1996, the municipalities took the lead in the privatisation process. Indeed, of the 4,830 privatisations effected in the municipal sector, 4,225 were completed by the end of 1996. On the other hand, only 1,052 out of the 4,418 privatisations undertaken by the Privatisation Agency and the central government were completed during the same period. The crisis gave a fillip to privatisation, a key component of the structural reforms, and the central government alone completed 506, 769 and 994 transactions during 1997, 1998 and 1999 respectively. During 1999, privatisation included large companies like Expressbank, Hebros Bank, oil refinery Neftochim, steel giant Kremikovtsi, fertiliser producer Agropolichim, and the national carrier Balkan Airlines. As a consequence, by 2000 the share of long term assets (of the government) privatised rose to 51.5 percent, and the share of the private sector in GDP rose to 61 percent.

Privatisation in Bulgaria has contributed to the inflow of foreign capital in the form of foreign direct investment. Industry, trade and finance, which have experienced inflows of USD 1,537 million, USD 494 million and USD 694 million respectively, have accounted for about five-sixths of the inflow. The distribution of the assets in terms of the acquiring countries was more equitable. Belgium was the single largest investor with the acquisition of about USD 327 million in assets. Germany, the USA, the Netherlands, and Cyprus accounted for more than USD 200 million each, while Greece, the UK and Austria accounted for USD 150-200 million each.

Recent studies indicate that the privatisation of (a large part of) the Bulgarian industrial sector, and the liberalisation of the economy have led to an increase in the levels of productivity. However, for a number of industries, much of the productivity gains has been attributed to greater competitive pressures rather than firm level restructuring.[27] While inadequate improvements in corporate governance may be one of the reasons for the relative importance of enhanced competition in driving productivity gains, inadequate access to funds that can throttle technological improvements might have also contributed to inadequate internal impetus to productivity growth. Indeed, as we shall see in the subsequent sections, bank financing of investments in Bulgaria remains woefully inadequate, and the capital market is as yet in its infancy.

[27] In other words, competitive pressure forced the firms to opt for an *optimising* behaviour—as opposed to target oriented production with little importance ascribed to cost of production, typically accompanied by large scale lay offs, without necessarily addressing the incentive-corporate governance structures within the firms.

10. Banking Sector and the Credit Crunch

At the inception of the process of transition, the Bulgarian banking sector consisted of the BNB, its branches all across the country, the State Savings Bank which was the repository for all household deposits, and the Foreign Trade Bank which was responsible for all international transactions. The soft budget constraints of the SOEs, and the government ownership of both banks and the firms led to huge accumulation of NPAs on the balance sheet of the public sector banks. In 1991 and 1992, the non-performing liabilities of about 120 companies were converted into government bonds, in an attempt to purge the banks' balance sheets of NPAs. Eventually, by way of the Law on the Settlement of Non-Performing Credits Negotiated Before December 31, 1990, government bonds called ZUNKs were issued to replace all remaining debts on the banks' balance sheets that were in arrears for over 180 days. The nominal value of lev denominated ZUNKs amounted to USD 1 billion by the end of 1993, while the value of USD denominated ZUNKs amounted to USD 1.8 billion.

The soft budget constraints of the SOEs, and the government ownership of both banks and the firms led to huge accumulation of NPAs on the balance sheet of the public sector banks.

During the process of transition, the Bulgarian banking sector was faced with three different but mutually reinforcing problems (Jackimova et al., 1997). First, even though the non-performing assets were removed from their balance sheets, the yields of the ZUNKs were low, thereby affecting the cash flow and interest income of the banks adversely. Second, given the state of the Bulgarian industrial sector, the banks de facto did not have the option of raising their income and returns on assets through corporate lending. Most banks did not have enough resource to lend, given that more than 75 percent of the deposits base was concentrated among the nine largest banks. Further, banks which did have a significant corporate exposure during the early part of transition acquired more NPAs. Third, as the branches of the BNB emerged as independent banks, Bulgaria faced a glut of banks with 70 banks in 1990 and as many as 78 by the end of 1991. Even though bank failures and consolidation reduced the number of banks to 45 by the end of 1994, there were still far too many banks compared to the size of the Bulgarian credit market, many of them heavily undercapitalised. Competition affected the profitability of the banks adversely, and contributed to an increase in the fragility of the banking system.

The net losses of the banking sector were BGL 5 billion in 1993, and rose to BGL 7 billion in 1997. The crisis exploded in 1995 when the accumulated losses of Bulgarian banks reached BGL 100 billion by the end of the year. In 1996, nine out of the ten public sector banks, which accounted for over 80 percent of the banking sector's assets, reported negative capital. In May of that year, following the introduction of bankruptcy procedures for the banks, 14 banks, accounting for 24 percent of the banking sector's assets, were put under conservatorship. The BNB was forced to recapitalise the banks by printing money, and this precipitated the financial crisis that has been described in the earlier sections. Thirty-three banks survived the crisis, and at the end of 1997 a total of 34 banks were in operation.

The hyperinflation and the sharp depreciation of the lev during the crisis contributed to an improvement in the health of the surviving Bulgarian banks. Revaluation of their foreign currency denominated assets increased the extent of their capitalisation, while the hyperinflation significantly reduced the real value of their lev denominated bad or doubtful assets. By December 1997, the combined capital adequacy ratio of the Bulgarian commercial banks was 26.9 percent, reached the peak of 41.8 percent in December 1999, and stabilised at around 35 percent by the end of 2000. As indicated by an IMF study (2000) using panel data, the Bulgarian banking system is oligopolistic, and is therefore able to maintain high spreads between the deposit and lending rates. As a consequence, the return on assets (ROA) of Bulgarian banks is higher than both the 1.4 percent average of the healthiest Central European banks, and the 0.45 percent average of the West European banks (ING Barings, 1999).

The high ROA and capital adequacy ratio mask the fact that a substantial part of this continued health can be attributed to the slow growth of bank lending in Bulgaria in an effort to keep bad and doubtful assets off balance sheets.

The high ROA and capital adequacy ratio mask the fact that a substantial part of this continued health can be attributed to the slow growth of bank lending in Bulgaria in an effort to keep bad and doubtful assets off balance sheets. Indeed, at the end of 2000, 91.8 percent of the assets of the Bulgarian commercial banks were standard assets. At the same time, private sector lending in Bulgaria amounts to 12 percent of GDP, compared with 17 percent in transition economies, 49 percent in the USA, and 120 percent in the UK. IMF estimates suggest that given Bulgaria's per capital GDP, the private sector credit to GDP ratio should be about 30 percent. Most of the lending is secured either by government guarantee or by collateral in excess of 125 percent of the value of the loan. The investment crunch in Bulgaria, therefore, is very real, and, as seen in the following section, the capital market is not yet in a position to alleviate the situation.

11. Capital Market

As early as 1992, Bulgaria played host to small and unregulated stock markets. But trading volumes and the number of listed companies were insufficient, and the lack of regulation was a major cause for concern. The emergence of the large privatisation funds in the aftermath of the mass privatisation programme increased the need for a larger and better organised stock market, and the government responded by merging the smaller stock exchanges to create the consolidated Bulgarian Stock Exchange (BSE) in 1995. However, the financial crisis of 1996 and 1997 led to suspension of trading on the BSE, and normal trading was subsequently resumed in October 1997.

Today, the capital market in Bulgaria consists of the BSE, a Central Depository that facilitates transaction of dematerialised shares, and the Securities and Stock Exchange Commission. BSE is a joint-stock company with the state as the largest (37.6 percent) shareholder. The remaining shares are held by banks, investment intermediaries, financial brokerage firms, insurance companies etc, the cap for each individual non-state owner being 5 percent. At present, 56 investment intermediaries and 22 banks, of which 5 and 7 respectively are foreign owned, are members of the BSE. A member of the BSE cannot be the member of any other stock exchange in Bulgaria, has to hold at least 1000 shares at BSE, and be a member of the Central Depository. In addition, (s)he has to be a party to full or part time contracts with at least two stock brokers, through whom (s)he can execute trades on the BSE.

Stocks can be traded in the official market or the free market, listings in the former market being subject to some criteria.[28] The official market itself has been sub-divided into segments A, B and C. In order to be listed in these segments, a firm must have a history of audited financial statements of at least 5, 3 and 1 year(s) respectively,[29] the corresponding minimum requirement for market capitalisation being BGL 2 billion, BGL 1 billion and BGL 500 million respectively. Further, a minimum of 25 percent of the shares of segment A companies must be sold through public issues, and each of them should have a minimum of 500 shareholders. The corresponding numbers for the segment B and C companies are 10 percent and 250 respectively.

The Bulgarian stock exchange has been a prey to two different problems. First, many of the major companies that have been privatised have been sold to foreign investors who do not have to raise capital from the Bulgarian stock market. Apart from the fact that this may have lowered the average quality of the firms that can be listed on the BSE, this phenomenon has also capped the number of large companies listed on the BSE to a relatively low level.[30] The problem has been further aggravated by the fact that a large number of the privatisation funds are not listed on the BSE because, by their very nature, they are unlikely to raise fresh capital in the foreseeable future. This has had adverse consequence for the width of the market. Second, given the health of the Bulgarian economy, specifically its industrial sector, ownership of Bulgarian companies is a risky proposition. The consequent dilemma for potential owners has been further (adversely) affected by the fact that the limited number of participants in the official market has had a limiting effect on the liquidity in the secondary market.

Given the health of the Bulgarian economy, specifically its industrial sector, ownership of Bulgarian companies is a risky proposition.

[28] Needless to add, the regulations pertaining to listing have played a role in determining the split of companies between the official and the free markets. Whereas the official market has not witnessed more than 33 listings, shares of about 800 companies are traded in the free market even in the aftermath of the Russian crisis.

[29] In addition, segment A companies must show profit for at least 3 years prior to listing, the corresponding requirement for segment B companies being 1 year. Segment A listed companies must also declare dividend for at least one of the 3 years prior to listing.

[30] Indeed, after an initial growth in the number of listed companies between May 1998 and June 1999, the number of companies listed on the BSE has stagnated by and large since.

The lack of width and depth of the market, together with the uncertainty caused by the Russian crisis, has resulted in a declining trend for the number of shares traded on the BSE since October 1998, both in the official and free market segments. This decline has coincided with a fall in the total market capitalisation of the listed companies on the official and free markets, a process that has been aggravated by the net negative foreign portfolio investment to the extent of USD 142 million, USD 199 million and USD 126 million in 1998, 1999 and 2000 respectively. Together, the declining liquidity and market capitalisation make it very difficult for Bulgarian companies to raise money by way of public issues, thereby relegating the equity market to the fringes of the investment financing vista in the medium run.

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The market for debt securities in emerging markets is typically not as active as the market for equities, and the debt market in Bulgaria is no exception. Much of the trading in the bond market involves government securities. This market too is dwindling, as the government runs budgetary surplus, thereby reducing the stock of debt from 24.4 percent (of GDP) in 1997 to 19.8 percent by the end of 1999. The corporate debt market has thus far experienced only one floatation in the form of the securities of Prosoft, a computer company. This is despite the facts that the requirements for issuing a debt security through the BSE are more lenient than the requirements for an equity listing,[31] and that the spread between the borrowing and lending rates of banks continues to be 1000-1200 basis points. It is fairly obvious that the risk associated with Bulgarian companies, and the informational asymmetry that persists in the absence of intermediaries like credit rating agencies, would hinder the development of the bond market in Bulgaria for some time to come, thereby limiting its role as the provider of funds for investment.

12. The Soft Underbelly of Macro-Stability and Policy Options

According to all stylised measures, Bulgaria has a reasonably stable macro economy, at least as compared with the transition economies in Eastern Europe, and the former Soviet republics. The inflation rate is low, and correspondingly so are the domestic rates of interest. The fiscal position of the government is sound with the government budget running into surplus for four consecutive years. The rate of growth is not remarkable, but a positive growth rate of the order of 5 percent per annum is not negligible, and is remarkably good for a country that has registered negative growth rates for most of the post-transition years. There is only one macroeconomic measure that can colour one's view of the Bulgarian economy which otherwise epitomises

[31] A company can place a debt security for sale on the BSE if it has a track record of three years, if the nominal size of the issue is BGL 100 million, and if at least 25 percent of the bond is publicly offered.

stability in a region that is marked with macroeconomic instability: the current account deficit which has remained in excess of 5 percent of GDP for two successive years.

As we have already seen, the high current account deficit is a manifestation of export woes. The problem is set to be exacerbated by the decline in FDI in the aftermath of the completion of big-ticket privatisation, thereby reducing significantly the FDI component of the current account deficit, and the decline in capital inflows that can offset current account imbalances, owing to decline in the availability of valuable equity and bonds with acceptable risk-return ratios. The ability of the capital account to offset deficit in the current account would be further limited by the foreseeable increase in the quantum of debt repayment obligations in the near future. The sub-par export performance and the absence of significant capital inflows, in turn, highlight the state the majority of the Bulgarian companies: their inability to compete in the global market, and their inability to muster adequate economies of scale because of the low level of internal demand. Given the limited capability of the private sector to generate adequate demand at this stage of Bulgaria's economic development, the onus of generating demand lies squarely with the Bulgarian government, even as, in this respect, the government's hands have been tied by the currency board agreement.

Further, since internal demand can pick up only in the longer run, and even then would be somewhat limited given the size of the Bulgarian population, the need of the hour is to render the Bulgarian companies competitive in the global market. Anecdotal evidence suggests that a significant part of this lack of competitiveness results from the inability of the firms to upgrade their technology, technology being a key determinant of productivity, which translates itself into cost competitiveness, and product quality. As discussed in the previous sections, the financial resources necessary for technology upgradation can be obtained neither from the nascent domestic capital market nor from the global market that is wary of transition economy debt since the Russian default in 1998.[32] The onus for providing the required financial resources, therefore, lies with the domestic banks which might not be averse to lending per se; net (new) lev credit to the private sector in Bulgaria nearly doubled from BGL 1,281 million in 1998 to BGL 2,186 million in 2000. However, the low investment-GDP ratio suggests that the credit off-take has to increase further, perhaps substantially, and that therefore pro-active government/BNB policy would have to be in place as soon as possible.

What policy options does, therefore, the new Bulgarian government have? First, it is perhaps imperative to move away from the currency board agreement that stifles the government's abilities to act

It is perhaps imperative to move away from the currency board agreement that stifles the government's abilities to act in a counter cyclical manner in times of downturn, and to augment domestic aggregate demand if the private sector is incapable of doing so.

[32] The problem has been further aggravated by recent events in Argentina and Turkey.

in a counter cyclical manner in times of downturn, and to augment domestic aggregate demand if the private sector is incapable of doing so. It is easy to argue that abandonment of the agreement might once again lead to government profligacy, and its corollaries like high inflation rate. However, this line of argument pre-supposes that no government in Bulgaria is capable of providing good governance, and, if so, the economy and the country are doomed anyhow, thereby rendering moot any debate about economic policy.

Second, the government and the BNB have to ensure the functioning of the credit market, which may function better if the informational asymmetry between the banks and the firms is reduced or eliminated, and if the banks are able to have some control over the end use of the funds lent to the industrial sector. At this stage of Bulgaria's development, some form of main bank-firm relationship, which reduces informational asymmetry and provides banks with some control over the firms' actions, might not be an anachronism (Bhaumik, Jackimova and Kelleher, 2000). This line of argument, of course, pre-supposes proper implementation of the bankruptcy law that was enacted in 1997, and the accompanying laws concerning foreclosure, and ignores the gap between *de jure* and *de facto* legal conditions in Bulgaria. However, a reduction in the gap, once again, is an issue that lies outside the domain of economic policymaking, and takes us to the realm of politics and governance issues that lie beyond the scope of this paper.

Bulgaria is now in the danger of putting itself in a policy straitjacket, by way of the currency board agreement, and by adopting a hands-off stance for the government despite the limited ability of the private sector to bring about export growth and induce capital inflows.

13. Concluding View

In 1989, Bulgaria inherited a weak economy, and the collapse of the COMECON, as well as the war in Yugoslavia, proved to be major hurdles in its path to economic development. The problem was compounded by internal political strife, the resultant lack of coherent and pro-active policies, and the fragility of the financial system. The financial-currency crisis of 1997 proved a watershed in the economic history of its transition, and Bulgaria has achieved the enviable goals of low inflation, fiscal discipline, stable currency and widespread privatisation (i.e., structural changes). However, it is now in the danger of putting itself in a policy straitjacket, by way of the currency board agreement, and by adopting a hands-off stance for the government despite the limited ability of the private sector to bring about export growth and induce capital inflows. The hands-off approach, in turn, is poised to threaten the very institution that the government and the BNB view as sacrosanct—the currency board agreement—by way of stifled industrial and export growth, and hence ever-expanding current account deficits. If Bulgaria emulates Argentina in the near future, which it might very well in the absence of concentrated international efforts to protect its currency board, the only economic capital it has in the global market, namely, macroeconomic stability, would be compromised, and the consequences of that might be disastrous.

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TABLE 1

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDP Growth Rate	-11.70	-7.30	-1.50	1.80	2.10	-10.90	-6.90	3.50	2.40	5.30
Of which growth of										
Agriculture and Forestry	4.30	-14.80	-30.20	9.40	14.50	-7.40	32.90	1.40	0.60	-15.50
Industry	-21.00	-6.40	-6.20	5.90	-5.40	-11.80	-11.30	4.30	-4.40	12.00
Services	-26.90	-20.70	0.60	-3.10	4.00	-9.30	-19.30	0.50	5.80	10.30
Gross Fixed Investment/GDP	18.10	16.20	12.90	13.80	15.30	13.60	10.80	13.20	15.90	14.80
Real Lev Credit Growth Rate	-66.70	-18.60	2.10	-40.60	14.90	-61.40	-75.50	29.00	-26.00	34.30
Of which										
Net Lev Credit to Private Sector (BGL million)	13.00	18.00	25.00	38.00	106.00	139.00	595.00	1281.00	1703.00	2186.00
Fiscal Balance/GDP	-4.20	-5.70	-12.00	-4.80	-5.20	-15.40	2.10	2.70	1.50	0.40
Broad Money Growth Rate	110.00	53.60	47.60	78.60	39.60	124.50	359.30	9.60	11.40	17.20
Inflation Rate (GDP Deflator)	238.60	59.60	15.10	72.70	64.10	122.90	949.10	22.20	3.10	4.70
Real Interest Rate on Time Deposits (year end)	57.70	45.30	53.60	72.30	25.30	348.50	3.00	3.30	3.20	3.30
Average Monthly Earnings (BGL, State Sector)						14.00	142.00	208.00	229.00	263.00
Unemployment Rate	11.10	15.30	16.40	12.80	11.10	12.50	13.70	12.20	16.00	17.90
Labour Force Participation	83.10	80.90	81.30	78.70	78.10	79.30	77.60	76.20		
Export plus Import/GDP			0.78	0.82	0.76	0.94	0.92	0.72	0.73	0.89
Simple Average MFN Tariff Rate					17.40	17.20	16.80	18.10	15.20	13.76
Current Account Deficit/GDP			-10.40	-0.30	-1.50	1.70	10.30	-0.50	-5.60	-5.10
Gross External Debt (USD million)					10,147	9,602	9,760	10,274	10,204	10,371
Debt Service Ratio (percent of exports)					15.50	17.10	14.20	20.00	16.80	18.40
Foreign Currency Debt Rating (Moody's)						B3	B2	B2	B2	B2
Net Foreign Assets (millions of USD, year end)	-33	-491	-713	740	1,001	325	2,731	3,148	3,079	3,339

TABLE 2

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Fiscal Balance/GDP	-4.20	-5.70	-12.00	-4.80	-5.20	-15.40	2.10	2.70	1.50	0.40
Tax/GDP	39.10	34.30	30.50	33.80	30.90	27.70	28.50	31.20	31.80	30.20
Percentage of tax revenue from										
Income Tax		0.17	0.17	0.14	0.14	0.15	0.15	0.15	0.15	0.14
Corporate Tax		0.21	0.08	0.11	0.13	0.16	0.19	0.13	0.11	0.09
VAT		0.11	0.12	0.23	0.23	0.25	0.23	0.27	0.28	0.31
Excise Duties		0.08	0.13	0.09	0.09	0.06	0.08	0.10	0.10	0.13
Customs Duties		0.06	0.10	0.09	0.08	0.08	0.08	0.06	0.04	0.03
Percentage of government expenditure										
for Pension and Unemployment Benefit		0.25	0.25	0.23	0.21	0.18	0.20	0.24	0.23	0.26
Education		0.13	0.11	0.10	0.10	0.09	0.11	0.11	0.11	
Health		0.12	0.10	0.09	0.09	0.08	0.11	0.10	0.10	
Defence		0.09	0.08	0.08	0.09	0.07	0.11	0.12	0.11	0.10
Subsidies		0.05	0.04	0.03	0.02	0.02	0.02	0.06	0.04	0.03
Capital Expenditure		0.07	0.04	0.03	0.03	0.02	0.03	0.08	0.11	0.11
Interest Payments		0.15	0.19	0.30	0.34	0.46	0.24	0.12	0.10	0.10

TABLE 3

	1995	1996	1997	1998	1999	2000
Export plus Import/GDP	0.76	0.94	0.92	0.72	0.73	0.89
Export Growth Rate		-4.52	2.62	-12.90	-6.75	
Import Growth Rate		-5.42	-3.03	3.48	7.70	
Composition of exports (f.o.b)						
Metal Products	19.00	17.90	21.40	19.50	16.30	20.30
Chemical Products	**18.10**	**19.70**	**18.40**	**14.80**	**12.40**	**13.10**
Textiles	12.70	15.00	16.40	20.20	23.80	23.40
Machinery and Equipment	14.40	14.90	14.40	15.80	14.70	11.30
Animal and Vegetable Products	22.30	18.80	14.10	16.20	15.80	10.20
Mineral Products	9.00	9.20	10.60	8.30	11.60	16.80
Composition of imports (c.i.f)						
Metal Products	5.10	5.00	5.80	6.10	5.30	6.10
Chemical Products	13.80	11.90	11.90	14.60	12.30	11.40
Textiles and Footwear	11.50	11.80	14.50	15.30	14.40	14.20
Machines, Transport Equipment, and Tools	22.20	19.60	18.30	23.50	31.30	27.70
Food and Agro-Products	6.60	8.10	8.20	7.60	6.20	5.40
Mineral Products and Fuel	35.80	39.40	37.30	28.40	26.40	31.20
Direction of exports						
EU-9*	38.00	39.30	42.20	48.60	50.30	50.30
Japan	0.40	0.80	0.70	0.80	0.60	0.40
United States of America	3.30	2.40	2.70	2.60	3.70	3.90
CMEA-8**	24.50	22.70	17.30	15.20	16.20	16.90
Turkey	7.60	8.00	9.10	8.00	7.30	10.30
Source of imports						
EU-9*	35.50	32.80	35.30	42.20	44.70	41.10
Japan	0.80	0.60	0.70	0.80	1.20	1.00
United States of America	2.30	2.50	3.80	4.00	3.50	3.00
CMEA-8**	37.70	41.30	37.40	29.70	28.90	35.40
Turkey	1.70	1.60	2.00	2.60	3.60	3.00

* Austria, Belgium, France, Germany, Greece, Italy, Netherlands, Spain, United Kingdom

** Czech Republic, Hungary, FYR Macedonia, Poland, Romania, Russia, Serbia/Montenegro, Ukraine

TABLE 4
Foreign Direct Investment (USD million)

Sectors	*1995*	*1996*	*1997*	*1998*	*1999**	*2000**	*Total*
Industry	95	172	458	311	373	128	1537
Trade	20	32	46	177	134	85	494
Finance	32	15	64	72	60	451	694
Tourism	10	23	6	18	0	0	57
Telecommunications	0	1	4	23	7	8	43
Transportation	1	5	3	6	2	6	23
Construction	1	1	6	6	49	23	86
Agriculture	0	1	5	0	2	4	12
Other	3	5	44	6	110	112	280
Source Countries							
	1995	*1996*	*1997*	*1998*	*1999**	*2000**	*Total*
Belgium	10	1	264	31	3	18	327
Germany	16	53	31	56	46	23	225
United States of America	16	21	47	39	49	44	216
Greece	30	15	16	3	10	90	164
The Netherlands	1	46	11	41	88	28	215
Cyprus	1	8	21	109	101	25	265
United Kingdom	14	7	16	59	36	13	145
Switzerland	8	23	31	7	10	11	90
Spain	0	0	50	57	0	1	108
South Korea	0	22	23	2	2	7	56
Luxembourg	14	7	10	24	3	0	58
France	5	7	1	3	78	18	112
Austria	1	12	12	47	76	40	188
Turkey	0	0	12	23	30	23	88
Others	51	32	311	111	203	475	1183

* January-November

TABLE 5
Quality of Credit Portfolio of Commercial Banks

	Dec-97	*Dec-98*	*Jun-99*	*Dec-99*	*Jun-00*	*Dec-00*
Total (BGL billions)	3806.00	5945.00	4428.10	5041.70	6347.60	7395.10
Of which						
Standard (percent)	78.80	86.60	83.10	86.20	88.90	91.80
Watch (percent)	3.70	3.60	4.70	4.40	3.20	2.80
Substandard (percent)	2.70	1.90	3.70	1.40	0.90	1.20
Doubtful (percent)	2.00	0.60	0.90	0.90	1.40	0.80
Loss (percent)	12.90	7.30	7.70	7.20	5.60	3.40
Provisions (percent)			11.80	10.00	8.30	6.50

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