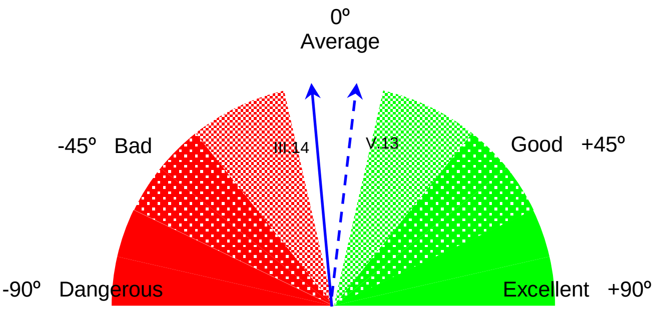
Issue 14 March 2014

expat compass

20 March 2014

EXPAT CURRENCY BOARD WATCH



OUTLOOK: STABLE

We are not worried about the currency board and see no immediate danger of devaluation. The political landscape is stable in the medium term. Public finances are in a moderately good shape.

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EDITORIAL COMMENT

Esteemed readers,

First of all, we would like to apologize for not having published a new issue of Expat Compass since 8 May 2013. Over the last several months, we received numerous inquiries when the next issue would come out. The 'pause' has not been because we are not planning to publish it anymore. The main reason for this is actually positive. In the meantime, I wrote a second book – this time dedicated to economic policy. The working title of the book is 'Menu for Reformers' with a subtitle 'A Vision for Modern Economic Policies'. The book of c. 360 pages presents my views about economic policies and does not express any political preferences. Certainly, it will promote reformist economic policies – just like our Compass. As soon as the book is published, I will inform you in more detail.

Some of the materials in this 14th issue were written in the summer and the autumn of 2013, which makes them somewhat outdated. Still, we have decided to present our assessment of the work of the caretaker cabinet in the spring of 2013.

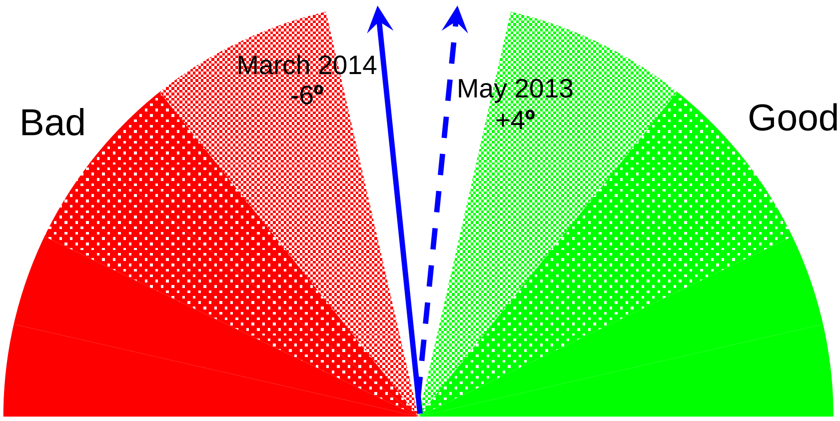
In this issue, we have included a brief analysis about the economic policy in the energy sector, as we fear that the main risks for the stability and the budget in the coming years lie there.

In short, our assessment of the situation in Bulgaria is as follows:

- The government is more stable and is likely to have a full term
- Moderate budget deficit of -1.8% for 2013 and 2014 (planned)
- Deflation
- Chance for GDP growth over 0%
- Almost no FDI
- Huge rally of the stock indices
- No major reforms

Nikolay Vassilev

OUTLOOK: STABLE



Plamen Oresharski's government started its mandate under difficult circumstances: shaky support in parliament, daily street protests demanding its resignation, worries about future economic policies. The situation is now more stable.

Economic policies are mixed, in our view. On the one hand, business sentiment has improved, public finances have not deteriorated significantly, as we had feared. On the other hand, the government is continuing with deficit spending [albeit moderate] and borrowing, with dangerous populist policies in the energy sector, with plans for 'state reindustrialization' – whatever that means. If this remains mainly rhetoric, the risks might be moderate.

We are not worried about the currency board and see no immediate danger of devaluation. We will be watching the policies of the government.

We will continue to monitor constantly the development of the relevant economic indicators in order to assess the health of the currency board and potentially to predict any negative events, should they ever occur.

It is becoming more difficult to draw all the arrows and the dates in the picture. That is why we are also providing a table (see the next page) with all the historical data. The measure is angular degrees (º). The reading of the Compass can change between +90º (horizontal to the right, Excellent) and -90º (horizontal to the left, Dangerous). 0º is a neutral (vertical upwards, Average) reading.

Date	Reading of the Compass (Angular Degrees)	Change	Comment
2005	+64º		Currency board very stable
2008	+44º	-20º	Deterioration due to current account concerns
Jan 2010	+20º	-24º	Deterioration due to budget and recession concerns
Mar 2010	+9º	-11º	Deterioration due to budget and reforms concerns
Jun 2010	0º	-9º	Deterioration due to budget and reforms concerns
Oct 2010	+4º	+4º	Improvement due to exports growth
Feb 2011	+8º	+4º	Improvement in many economic indicators
May 2011	+10º	+2º	Smaller concerns about the budget
Aug 2011	+12º	+2º	Small budget and trade deficits
Dec 2011	+14º	+2º	Conservative 2012 budget, some pension measures
Feb 2012	+20º	+6º	Troubles in the Eurozone; good 2012 budget
May 2012	-5º	-25º	Fiscal reserves falling sharply. Intentions to spend the Silver Fund
Nov 2012	+5º	+10º	Successful Eurobond; good budget; Silver Fund forgotten
Jan 2013	+15º	+10º	Almost balanced 2012 budget
Feb 2013	0º	-15º	Government resigns; fiscal reserves depleted; pre-election populism
May 2013	+4º	+4º	Good caretaker government; no street protests; rising fiscal reserves
Jul 2013	NOT PUBLISHED -10º	-14º	Unstable government; increased 2013 budget deficit; populism
Nov 2013	NOT PUBLISHED -8º	+2º	More stable government; better public finances
Mar 2014	-6º	+2º	Stable government; better public finances; watch the energy sector

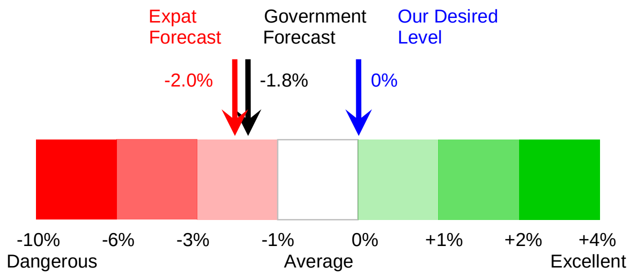
How to assess the stability of the currency board and to predict any danger of devaluation? We suggest the following check-list of 16 questions and provide our answers:

ISSUE	OLD	NEW	COMMENTS
I. Political issues			
1. Does the government support the currency board?	++	++	Major parties support it
2. Does the Central Bank support the currency board?	+++	+++	Yes, absolutely
3. Do the European institutions (EC, ECB) support Bulgaria in joining the ERM II and the Eurozone?	--	--	Not much
II. Budget and debt			
4. Budget balance	-	-	Deficit risks for 2014
5. Budget spending	-	-	Moderate, rising
6. Government debt	++	+	Very low, rising
7. Foreign liabilities of the private sector	--	--	High, falling
8. Fiscal reserves	-	-	Improved a bit
III. Economic cycle related issues			
9. GDP growth	-	-	Just above zero
10. Inflation	++	+++	Very low, deflation
11. Unemployment	--	--	Average, rising
12. Strength of the banking system	+	+	Average
IV. External balances			
13. Current account deficit, trade deficit	-	-	Stable
14. Foreign direct investment	--	--	Low
15. Revenues from international tourism	++	++	Good
16. Foreign exchange reserves	+++	+++	High

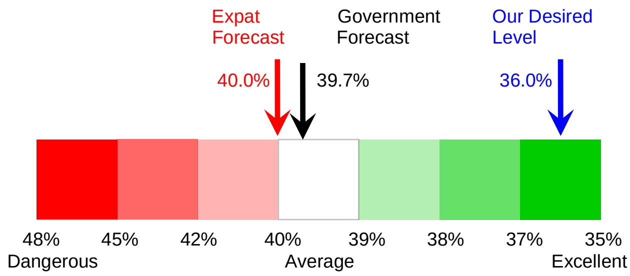
Legend: Good Bad

INDICATORS, 2014

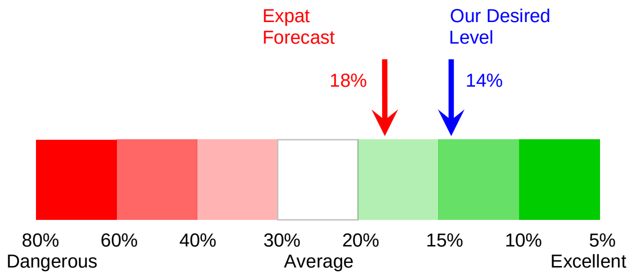
I) Budget Surplus/Deficit, % GDP, 2014



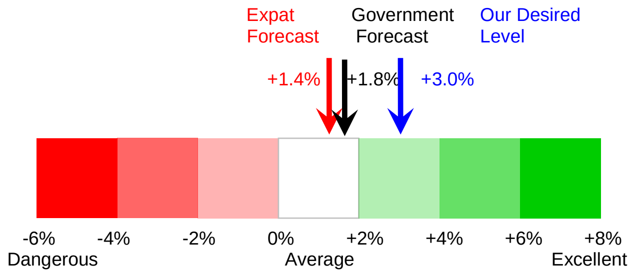
II) Budget Spending, % GDP, 2014



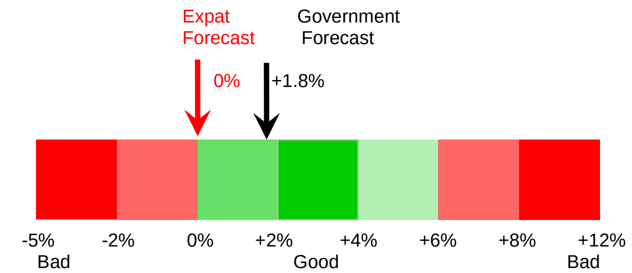
III) Government Debt, % GDP, 2014, Year-End



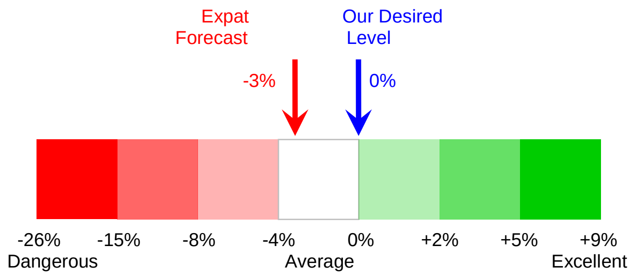
IV) Real GDP Growth, %, 2014



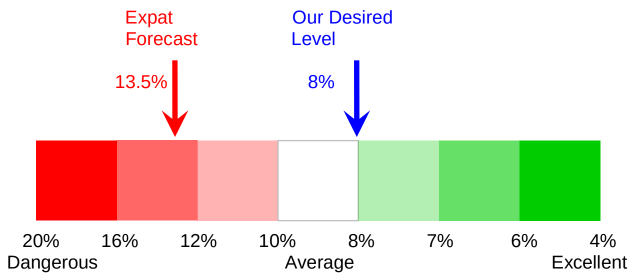
V) Inflation, %, 2014, Year-End



VI) Current Account Deficit, % GDP, 2014



VII) Unemployment, %, 2014, Year-End



AFTERMATH OF THE 2013 CARETAKER GOVERNMENT – DECENT JOB, NO REFORMS

Again, let us start by restating our intention to avoid expressing political preferences.

In the previous pre-election issue of Expat Compass, we promised to assess the work of the caretaker cabinet as soon as there is a new government. Then, we outlined 3 priorities for Marin Raykov's interim government:

1. Calm down the street protests – SUCCESSFUL
2. Follow a conservative budget policy – SUCCESSFUL
3. Organize fair and transparent parliamentary elections – UNSUCCESSFUL, in our view

1. The tension in the society decreased in the spring of 2013

In the winter, many observers were worried that the consecutive resignations of heads of agencies, of a deputy prime minister, and of a prime minister were not enough to stop the street protests and to convince the people in the streets to go home.

The caretaker prime minister Marin Raykov and his team managed to bring the country back to normality. The warmer weather and the lower electricity prices (they were lowered by some 8% in the spring) must have helped as well. 1:0 in favour of the government.

2. The budget deficit fell to zero

Having inherited a surprisingly large deficit of around BGN800m for the first 3 months of the year, the interim cabinet limited the spending. Tax collection improved in the spring as well. As a result, the next government began its mandate with a small budget surplus – a nice start. 2:0 in favour of the government.

3. The elections were not well organized, to say it mildly

We will not make comments about the behaviour of the different parties. From the organization point of view, our comments are the following:

- For the first time since 1990, a large public scandal broke out as the public prosecution and the national security agency found a large number of ready-to-use election ballots in a printing shop, which should not have been there.
- The government made no comments on the case. We consider this hands-off position inappropriate, as the Council of Ministers itself was responsible for the procurement of those ballots. The comments of Chief Secretary of the Council of Ministers that anyone could print ballots and use them as wallpaper were especially inappropriate. This behaviour strengthened the public impression that there was something wrong with the preparation of the elections.
- Probably for the first time after 1990, the winner of the elections (GERB), as well as some smaller parties, officially filed an appeal in the Constitutional Court against the election results. From the very beginning, we did not expect the court to declare the results invalid and throw the country into an ever bigger mess. The Court confirmed the results, but the bitter feeling will stay.
- The organization of the post-election night at the National Palace of Culture was also far from good. First of all, there was no representative of the government there at all – strange. Second, the representatives of some marginal parties took over the presidium and the microphones and spoke on all TV channels for a long time, uninvited. All this left the impression that the country had no government.

Thus, our score is 2:1.

Still, the overall impression about the government was rather positive

In the previous issue of Expat Compass, our expectations for the actual work of the interim cabinet were set quite low. Thus, as long as nothing went especially wrong, which it did not, we would be happy. We also mentioned the old joke, "Feed the animals and do not touch anything".

The audit of the energy sector can be useful for the future

One of the few things which the government did and were worth remembering, was the presentation of the report of the World Bank. The bottom line was that the energy sector needs deep reforms, and the annual deficit in the sector has a magnitude of BGN1bn.

The findings in the report can be used as a good basis by the new minister and his team. However, we are skeptical that a left-wing government will make the necessary steps to reform the sector. They would involve, among other things, a series of increases in the electricity prices. However, Borisov's government unexpectedly fell precisely due to the protests against the high electricity prices. This looks like a vicious circle.

Well, someone has to be very brave to cut the Gordian knot, but this is not our prediction. Rather, keeping the status-quo is likely. See the analysis on page 11.

The reforms or measures which did not happen – expectedly and unfortunately

1. The privatization deal for BDZ Freight Services (half of the state railway company) was postponed for 10 July 2013 – so that the new cabinet can stop it, which it did. We would have supported a privatization deal in April-May 2013, but did not expect that anyone would be brave and decisive enough to do it. It is a pity – a missed opportunity.

2. No progress in the renewable energy sector

The next several years are likely to be a mess. The future will be a combination of large losses for the investors and banks, legal disputes, and policy swings.

3. No clarity about the fairness of the electricity bills for December and January

We would still like the population to know whether there was any large-scale fraud with the electricity bills in the winter. Apparently, no one else wants to know.

4. Our suggestion to the caretaker government that the Sofia Airport should be cleaned up were not heard

We have made the same suggestion to the new team at the transport ministry. We expect results, or the lack thereof.

HOW WELL DID WE PREDICT THE 2013 ELECTION RESULTS?

In the previous issue, we made our own forecasts for the election results and for the composition of the future government. They turned out to be partially true. Here are our conclusions:

1. We were wrong that a 5th party would enter the parliament

We expected the "Bulgaria of the Citizens" lead by Meglena Kuneva to enter the parliament with a 5% share of the votes. However, the party ranked 6th with a 3.25% result. Their absence actually deprived GERB, the winners, of the opportunity to possibly form a government.

2. We predicted correctly the ranking of the first 4 parties

The parties ranked as follows: GERB (97 MPs), BSP (84), DPS (36), Ataka (23).

GERB actually got +4 MPs more than our prediction, DPS +2. BSP has -1 less than we thought, and Ataka -5. The bottom line is – GERB surprised us on the upside, and Ataka on the downside.

3. Our Scenario 1 for a new government did NOT materialize

As you can see in our previous 13th issue of Expat Compass, our first scenario was a GERB-led [possibly minority] government. This could have happened if:

- either GERB or Ataka got just one more seat, so that together they had at least 121 out of 240 – certainly, it is not clear whether Ataka would have supported GERB at all, but we think the answer might have been Yes
- or 'Bulgaria of the Citizens' entered the parliament

So, for the first time since 1989, the largest party in the Bulgarian parliament could not take part in a government.

4. Our Scenario 2 for a new government DID materialize

As described in the previous 13th issue of Expat Compass, we considered a BSP-DPS government possible. Certainly, no one could have predicted a hung parliament with 120:120 seats for the two more likely coalitions.

Thus, a government was formed by BSP and DPS, with the so-called 'logistic' support of Ataka. Ataka's group votes against the government in the parliament, but is physically present there. If Ataka had followed GERB's example to boycott the parliament, it would have been impossible to form a government, and the National Assembly would have been unable to work at all.

THE ISSUES WHICH WE ARE NOT PLANNING TO ANALYZE

With apologies to our respected audience, we are planning to continue with our style of not expressing political and party preferences. Thus, we are not intending to mention:

- the behaviour of the parties inside and outside the parliament
- the quality of the individual appointments made by the new majority
- the daily protests against the government, as well as the counter-protests in favour of the government
- the potential creation of a new right-wing political formation, as well as of other parties

These issues are very well covered by all national media, as well by some international publications.

Instead, we will continue analyzing economic policies and other important economic issues.

SOME ENCOURAGING IDEAS OF THE NEW GOVERNMENT

Let us start with our conclusion that the political problems and turmoil in the country have not been so much a result of the actions of the new cabinet, but rather a consequence of the behaviour of the political parties.

Oresharski is a good expert. Whether he is a visionary will have to be seen

In the last issue of Expat Compass, we said positive words about Plamen Oresharski in his capacity as the Socialist nominee for prime minister. Today, we continue to believe that:

- Prime Minister Oresharski would not make any extreme moves such as large-scale nationalizations, major tax hikes, excessive budget spending, and large budget deficits
- the currency board will stay until Bulgaria joins the Eurozone – not soon, in our view
- there might be some pro-business policies as well, such as: fewer regulatory regimes, lower administrative fees, and a smaller public administration

The quality of the government's team is above our [low] expectations

Most people would argue that the quality of the people in the new government is bad, pointing out a few controversial appointments which were then reversed. A deeper analysis, however, might show that:

- The 'quality' of the ministers is actually better than that of some governments in the past.
- A large proportion of the government members, including all 3 deputy prime ministers, are not people directly related to the 2 coalition partners. Many of them, including the prime minister, have a clear right-wing and reformist background.
- Unlike any other time in the past 23 years, every single appointment is very critically looked at by the opposition and the public. This refers to positions as low as deputy regional governors. In the past, few people would have even noticed who some deputy ministers were.

So, the real problem should not be that the cabinet members are incompetent or incapable.

There are some positive intentions expressed by the government. Implementation is uncertain, however

We would outline the following new policies of the new cabinet, which we would support:

1. Reduction in the size of the state administration

In the past, we repeatedly expressed our skepticism that the previous government reduced the administration by up to 10%, as they often claimed. We never saw any convincing numbers. As it now turns out, that same government apparently increased the size of the public administration by some 10,000 people in 2012. Why are we not surprised?

Oresharski has started his mandate with the positive intention of reducing the number of employees in the administration. We would welcome any achievement in this direction. Some of the ministries have already started this process.

In addition, the 2014 budget envisions a 10% reduction in the administration. However, we are moderately skeptical that these numbers will materialize fully.

2. Simplification and removal of regulatory regimes

Every previous government started its mandate with the same rhetoric, but only one of them actually achieved something: 177 regimes were abolished or simplified in 2002-2004. Almost none since.

The new government has expressed its intention to make a breakthrough in this area. We would support any such moves. Some regimes have been simplified already. We will keep you informed in the future.

3. More transparent public procurement

Some suggestions about how to achieve this have been made by Deputy Prime Minister Daniela Bobeva. However, we expect that most of the efforts will be directed towards relatively unimportant issues in the Public Procurement Law, which will not improve transparency at all.

SOME DISCOURAGING AND NON-REFORMIST POLICIES OF THE NEW GOVERNMENT

For the first nine months of the cabinet's mandate, we would point out the following [economic] policies which we do not support:

1. The 2013 budget was amended – unnecessarily, in our view

Let us remind you that the caretaker government left office with a budget surplus for January-May. Remarkable.

In such a situation, the new cabinet should have said 'thank you' and should have finished the year with the existing budget which envisioned a -1.3% deficit. We think this would have been important for 2 reasons:

- Economically, there was no need to amend the budget. The 2013 budget was the largest in the country's history – in both nominal and real terms. We would have preferred to see efforts for improving tax collection and for cutting spending, if necessary. The c. BGN1bn planned deficit would have provided enough room for maneuvering in H2 2013.
- The second reason is even more important. Strategically, it would be important for the country to show that there is continuity between governments in election years. From 1997 to 2009, three very different consecutive governments never amended the budgets. Bulgaria's economic situation in 2013 is not worse than in the period of 1997-2000. Incomes and the nominal GDP are many times higher today, to start with. Then, Borisov's government amended the budget twice within a short period of time – at the end of 2009 and the beginning of 2010. This set a bad precedent, which we disapproved of in our very first issues of Expat Compass. Now Oresharski did the same in 2013, which has made amending the predecessors' budgets a tradition. Later, someone else will amend this cabinet's budget, and so on.

Instead of saying 'thank you' to the caretaker government for the budget surplus it left, Oresharski started his mandate with the statement that 'the situation has never been this bad before'. While we acknowledge the numerous problems of the Eurozone and the world during the last several years, we strongly disagree that Bulgaria has never been worse before. Bulgaria was in a terrible economic crisis in 1996-1997. But Oresharski should know that very well as he was a respected deputy minister of finance in Kostov's government in 1997-2001, as well as a successful minister of finance in 2005-2009.

How was the 2013 budget amended?

The new finance minister Petar Chobanov increased the budget deficit from -1.3% to -2.0%. The actual year-end deficit was lower at -1.8% – good. No big deal, most people from Athens to Dublin and from Washington to Tokyo would agree. The difference of below 1% of GDP really looks academic compared to what is going on around the world. Mathematically, we would not disagree.

However, economically and strategically, we think the opposite. In all the 14 issues of Expat Compass so far, we have repeated our support for balanced budget policies for the following reasons:

- We have seen no evidence in the last decade that budget deficits have increased growth in the world or in any individual country.
- On the contrary, we have seen that the enormous budget deficits in dozens of countries have piled up astronomical amounts of public debt, have made countries go bankrupt (Greece), suffer a lot (Latvia), destroy the banking system (Cyprus), fall into deep recession (Spain, Italy, Portugal), weaken their global strategic position (the US).
- We have expressed our admiration for Merkel's Germany. That country has been one of the very few pillars of normality and economic stability lately. Have balanced budgets made Germany weaker? Certainly not, and rather the opposite.

The widening deficit has had a negative signaling effect

Investors, analysts, and business are likely to be worried about the following:

- Is this the last budget amendment, or is this only the beginning of a new spending trend?
- Will direct taxes be also raised in the future in order to finance the new higher expenses? *We have always favoured the current low direct tax rates, and would painfully oppose any change thereof.*
- Will the government forget its pre-election promises to improve tax collection and fight the massive smuggling of cigarettes, fuel, etc.? So far, we have noticed no major improvements.
- Will Bulgaria forget its status of a very-low-public-debt country?
- Will people forget that there is a word 'surplus' in the Bulgarian language? Bulgaria ran very high budget surpluses during all years when Oresharski was finance minister.
- Will interest rates and risk premium rise?
- Will Bulgaria's good credit rating be downgraded in the future?
- Is there hope for any reforms at all?

2. What privatization?

It should come as no surprise that leftist governments are not about privatization. First of all, the deal for BDZ Freight Services (the more attractive half of the state railways) was stopped in June. Second, the new economy minister said that his mission would be to 'save' the Maritsa-East Mines (coal) and VMZ Sopot (a large defense manufacturer) from privatization. Thus, we could easily place our bets on zero privatization deals during this government's term.

Disappointing to us, but our expectations have not been high anyway. Let us hope at least that no one would actually start nationalizations. Needless to say, we believe that the governments are not good at running companies at all, and that all state-owned firms should be privatized. In another century, may be.

3. Nationalizations are the new trend. Awful and dangerous

Under the motto of 'reindustrialization', the economy ministry is planning 2 real nationalizations of troubled private companies – Chimco (a fertilizers manufacturer in the town of Vratsa) and Remotex (a supplier of the East-Maritsa Mines).

Whatever the arguments, we have deep distrust in the government's ability to run industrial companies successfully. We favour the private sector. We are afraid that the final result of these exercises will be enormous losses for the taxpayer and benefits for some private entities – definitely close to the political class.

4. Pouring money instead of reforms

From day one, the new cabinet has faced urgent problems to solve. One of them was the situation at the above-mentioned VMZ Sopot which was ready to declare bankruptcy. We would have preferred to see an effort to sell the company. Instead, the government poured some BGN27.5m to temporarily pay the salaries. But what next? Taxpayers should prepare for the next 27.5 million soon.

The state railways would probably require over BGN100m. The energy sector – a billion. Annually.

4. The energy sector – cut prices first, ask questions about bankruptcies later

Populism is likely to dominate the energy sector in future years. After Borisov's government fell in early 2013, household electricity prices were reduced by 8%. In the summer, an additional 5% decrease followed.

The above-mentioned World Bank report has stated that the annual deficit in the electricity sector (mostly state-owned) is about 1 billion levs. This has to come from somewhere:

- either from consumers – but Borisov's cabinet resigned after protests triggered by the high electricity bills,
- or from generation companies, from electricity transmission companies, from renewable energy producers, from coal mines – but all of them are in a bad financial shape already,
- or from the state budget – but it is already in a deficit, too.

The problem seems to have no positive mathematical solution.

The government has chosen to do the following:

- reduce the household prices by 5% as a starting point – this would widen the deficit further
- promise even higher coal prices to the miners – this would also widen the losses of the generation companies
- create a 2-tier price structure whereby smaller consumers (i.e. probably poorer families) would pay a reduced price for electricity – we see this new policy as neither a major problem, nor a major solution, but energy experts and the regulatory body seem to disapprove
- eliminate some of the massive abuses in the sector – GOOD, if really implemented
- abolish the transmission fee which has destroyed exports in the last year – GOOD

We admit the economic and energy ministry is facing a difficult task. However, we do not think the correct long-term solution would be to make all the companies in the sector suffer enormous additional losses in order to provide cheaper energy to the households. A better policy would be to set the price where it should be – following the economic logic. Then, the government could support certain social groups, but not all consumers.

5. The pension reform has been stopped

We disapprove.

Borisov's government started a modest change in the pension system (we do not think it would qualify for the word 'reform') by increasing the retirement age by 4 months every year. However, the new government stopped this automatic mechanism. Expected. This, however, would deepen the structural problems within the pension system. We are skeptical that anything would improve during this government's term.

THE ENERGY SECTOR – POPULISM, CHAOS, AND FINANCIAL DISTRESS

Over the last 12 months, the energy sector and electricity prices have been a major political issue. Here are our brief comments.

1. The high electricity bills toppled Borisov's government

The mass protests in early 2013 were triggered by the wide-spread perception that the December-2012 and January-2013 electricity bills were either deliberately overstated or very high anyway. The protests surprisingly led to the resignation of Boyko Borisov's cabinet and to early parliamentary elections.

2. No one has answered the question whether the bills were overstated or not

We have repeatedly urged the Energy Ministry to analyze the situation and clarify which answer is true:

A. The bills for electricity and central heating were not fraudulently overstated. The population's perceptions thereof were due to other technical reasons such as:

- the possibly colder weather compared to previous years
- the fact that the annual bills were adjusted and equalized for the whole year in December
- the actual December billing period might have been longer than 31 days due to the holiday period around Christmas and New Year
- the prices of electricity and central heating had been increased steeply in 2012, and the all-time-high bills came in the colder months of December and January

AND/OR

B. The electricity distribution and the central heating companies engaged in wide-spread cheating and fraudulently overstated the bills of some customers.

As of today, we believe that Answer A is definitely correct, but we have no reasons to exclude Answer B completely. For example, at the height of the crisis, one of the electricity distribution companies admitted that some 1.3% of the bills were 'wrong', whatever that meant. We would like to know whether the 1.3% is not 51.3%, and how even one bill can be wrong, not talking about tens of thousands. Wrong by how much? How were they corrected? Will this happen again? Has anyone been fined or punished?

The lack of any explanation is disappointing. It seems that the politicians do not care, and the public has forgotten the issue. For now.

3. Electricity prices have been decreased instead of increased

The policymakers have responded in a populist way. We are not experts on energy pricing, but we had expected additional price increases of, say, another +10%, or more. Instead, the electricity prices for the population have been reduced, Hungarian-style, on 3 occasions for the last 10 months – in March and August 2013, and in January 2014. The decrease differs for the 3 regions of the country, but our assessment is for an average cumulative price reduction of -13%. Thus, a price gap of some 26% has opened. For the time being, the population seems content.

4. The energy sector is accumulating losses. Fast

Anecdotal evidence suggests that the cumulative losses of the electricity sector are some BGN1bn per year, c. 1.2% of GDP. This is an enormous number, which brings us to several conclusions:

A. the current situation is financially unsustainable

B. the future outcome will be:

- the companies in the sector will go bankrupt within a couple of years *and/or*
- electricity prices will have to be raised by 20-30% – the sooner, the better, *and/or*
- the budget will have to subsidize the sector at the expense of an ever-larger budget deficit.

5. The renewable energy sector is a mess

This issue deserves a separate article or a whole book. Here, we present our summarized opinion. In our view, the governments' policies for the last 5 years have been deeply flawed:

- Developing renewable energy has been in line with EU's goal that each country should generate 20% of its electricity from clean sources (water, wind, solar) by the year 2020. Within just a few years, Bulgaria has clearly made significant progress by installing a lot of new capacity, especially solar. On the one hand, fast progress has been good news as it is not nice to always lag behind the leading countries in all sectors.
- With hindsight, however, a wiser policy would have been to wait for 5 years for 3 reasons: a) to see what the other countries would do and what mistakes and policy swings they would make; b) to wait for the industry to mature so that the prices of solar panels and wind propellers go down sharply; c) a country does not need a whole decade to fulfill the 20% goal. 3 years could be completely enough. These could have been 2017-2019.

Bulgaria acted too fast and too chaotically. Thus, it got the worst of all worlds:

- Installing capacity too early has meant that the investment per MW has been too large due to the high initial prices of solar panels and wind propellers.

- As a consequence, the buy-out price per MW from wind and solar, which the government has committed to, has been too high.

- This high buy-out price has strongly pushed up the weighted average price for households and for businesses.

- Due to the bad economic crisis after 2009, people's purchasing power is low. Thus, paying high energy bills is tough. As many people said during the 2013 winter protests, not energy prices are too high, but salaries are too low.

- Bulgaria's policies did not include any quantitative quotas, auctions, or any other form of planning for the total renewable generation capacity. Instead, the state, through the theoretically independent (but not in reality) energy regulator, set the annual buy-out prices at a high level every year, and left the numerous investors install as much capacity as they wanted.

- It is widely believed that some people at the state energy companies and the people above them developed a successful 'business' of approving and connecting the new capacity to the national grid.

The results are: excess capacity; sharply rising electricity prices which the public does not want or is not able to pay.

The policy response has been belated and indecisive:

- The government has decided to renege on its promises for purchasing the electricity from renewable sources at the high fixed prices for 25 years. This has led to the unpleasant conclusion that the government does not honour its contracts.

- The latest measure has been to introduce a special 20% fee on the revenues. Its constitutionality is questionable, so the Constitutional Court might turn it down. In such a case, the government is expected to look for other ways to tax the sector.

- The sector is highly leveraged, and has become financially unsustainable. On the one hand, developers and equity investors have suffered a lot. On the other hand, the banks (usually Bulgarian) might lose tens or hundreds of millions of euro, too.

- A number of lawsuits have followed and are likely to continue.

Our conclusions:

1) Although many people around us were investing massively in renewable energy, 4 years ago our company made a conscious decision to pass on this opportunity.

   Other people's arguments were that 'this business is like buying a government bond'. We begged to differ. We said that we did not want to trust that national governments and Brussels would pay excessive prices for energy for a long period of 25 years. Voilà.

2) There is no easy way out of the current mess. The government should either:

   - Honour its contracts and pay very high electricity prices to renewable energy producers at the expense of a) very high prices for the consumers, or b) very large subsidies from the budget, *or*

   - Find a way to punish the renewable energy investors, and pass the gains to the consumers for populist political reasons. This, however, would hurt investors dramatically, would hurt banks, would prevent future private sector investment in the energy sector, would hurt foreign direct investment in the country in general.

6. There has been more populism in the energy sector

Let us give 3 examples:

1) The minister has promised to 'save the state-owned Maritsa-East coal mines from privatisation'. As you know, we favour the policy of privatisation instead of running a state-owned communistic economy.

2) The minister has increased the prices of local coal in order to increase additionally the salaries of the miners and avoid protests. The miners are some of the most highly paid workers in the country.

3) The minister has stated: 'Miners are dearer to me than the renewable energy sector'. This does not sound like 21st century and like market economy to us. How about the environment?

7. Conclusions

1) The energy sector is being run in a populist way – no privatisations, lower-than-necessary electricity prices, higher-than-necessary coal prices.

2) The policies towards the renewable sector are discriminatory and would lead to bankruptcies and lawsuits.

3) The level of transparency in the state-owned sector has always been low, to say it mildly.

4) The future of the 2 nuclear power plants (Belene and the 7th reactor at Kozloduy) is messy and unclear.

5) The future of the Southern Stream gas pipeline is similarly unclear.

6) We expect difficult years and cases of financial distress in the near future.

THE $9 TRILLION SALE
ECONOMIST MAGAZINE, JAN 2014

Imagine you were heavily in debt, owned a large portfolio of equities and under-used property and were having trouble cutting your spending – much like most Western governments. Wouldn't you think of offloading some of your assets? Politicians push privatisation at different times for different reasons. In Britain in the 1980s, Margaret Thatcher used it to curb the power of the unions. Eastern European countries employed it later to dismantle command economies. Today, with public indebtedness at its highest peacetime level in advanced economies, the main rationale is to raise cash.

Taxpayers might think that the best family silver has already been sold, but plenty is still in the cupboard. State-owned enterprises in OECD countries are worth around USD2trillion. Then there are minority stakes in companies, plus USD2trillion or so in utilities and other assets held by local governments. But the real treasures are 'non-financial' assets – buildings, land, subsoil resources – which the IMF believes are worth three-quarters of GDP on average in rich economies: USD35trillion across the OECD.

Some of these assets could not or should not be sold. What price the Louvre, the Parthenon or Yellowstone National Park? Murky government accounting makes it impossible to know what portion of the total such treasures make up. But it is clear that the overall list includes thousands of marketable holdings with little or no heritage value.

America's federal government owns nearly 1m buildings (of which 45,000 were found to be unneeded or under-used in a 2011 audit) and about a fifth of the country's land area, beneath which lie vast reserves of oil, gas and other minerals. America's 'fracking' revolution has so far been almost entirely on private land. The Greek state's largest stock of unrealised value lies in its more than 80,000 non-heritage buildings and plots of land. With only one holiday home for every 100 in Spain, Greece should be able to tempt developers and other investors at the right price. Analysts at PwC reckon Sweden has marketable state-owned property worth USD100-120bn. If that is typical of the OECD, its governments are sitting on saleable land and buildings worth up to USD9trillion – equivalent to almost a fifth of their combined gross debt.

Get on with it

Governments seem strangely reluctant to exploit these revenue-raising opportunities. That is partly because privatisation always faces opposition. Particular sensitivities surround land, as Ronald Reagan discovered when his plan to sell swathes of America's West were shot down by a coalition of greens and ranchers who enjoyed grazing rights, and as the British government found in 2010 when environmentalists scuppered its attempt to sell Forestry Commission land.

In recent years the big transactions, apart from reprivatisations of rescued banks, have mostly taken place in emerging markets. Activity is starting to pick up in Europe: the British government sold Royal Mail last year, and is setting a good example both in transparency over its land and property holdings and in its readiness to sell them. But, overall, caution rules. Italy, for example, carries a public-debt burden of 132% of GDP, yet its privatisation plans are timid – even though the state has proportionately more to sell than most other rich countries, with corporate stakes worth perhaps USD225bn and non-financial assets worth as much as USD1.6trillion. Now that markets have regained their composure, it is time to be bolder.

There are ways of encouraging sales. Data collection on public property is shockingly poor. It is patchy even in Scandinavia, where governments pride themselves on their openness. Governments need to get a better idea of what they hold. Effective land registries, giving certainty to title, are essential: Greece's registry remains a mess. Too many governments use a flaky form of 'cash basis' accounting that obscures the costs of holding property. Too few produce proper balance-sheets. Better beancounting would make it easier to ascertain what might be better off in private hands.

Governments also need to sweat whatever remains in state hands. There is no single model for managing public assets, but any successful strategy would include setting private-sector-style financial benchmarks, replacing cronies with experienced managers and shielding them from political interference. Not only is this good in itself, but it can also lead naturally to privatisation. That was the case in Sweden a decade ago, when creating a professionally managed holding company for state assets revealed many to be non-core, leading to a selling splurge by a left-leaning government.

Where are the successors to Thatcher and Reagan?

Privatisation is no panacea for profligate governments. Selling assets is a one-off that provides only brief respite for those addicted to overspending (though, once sold, assets – from ports to companies – tend to generate far more business). It also has to be weighed against lost revenue if the assets provide an income stream: oil-rich Norway gets a quarter of its government revenue from well-managed state companies. Selling when markets are depressed is generally a bad idea.

Governments also need to learn from mistakes made in past waves of privatisation. Without robust regulation, sell-offs enrich insiders and lead to backlashes. That happened in Britain (over rail and utilities) and emerging markets (telecoms, banking and more). The Royal Mail sale was a reminder of the political risks: price an asset too high and the deal might flop; price it too low and the taxpayer feels cheated. Nevertheless, for governments that are serious about bringing their spending in line with revenues, privatisation is a useful tool.

It allows governments to cut their debts and improve their credit ratings, thus reducing their outgoings, and it improves the economy's efficiency by boosting competition and by applying private-sector capital and skills to newly privatised assets.

Thatcher and Reagan used privatisation as a tool to transform utilities, telecoms and transport. Their 21st-century successors need to do the same for buildings, land and resources. Huge value is waiting to be unlocked.

FUNNY CRYING ABOUT THE CURRENCY BOARD

BISSER MANOLOV

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The article was published in the author's blog – www.bissermanolov.com

The currency board was adopted in Bulgaria on 10 June 1997. We may definitely say that this is the birth date of a new start in the Bulgarian financial history. For the younger audience, I would like to give the following details. In the period 1990-1997, the inflation in Bulgaria was 210%. After the introduction of the currency board, until 2002 inflation was reduced to bellow 6% on an annual basis. The average decrease of GDP in 1990-1997 was around 4.6%. After the introduction of the board until 2002, the average annual growth of the economy reached 4.1%.

The above-mentioned numbers are not accidental. The currency board usually becomes a popular topic at a certain period of the year. In one way or another, there are always some known and unknown experts who forecast the 'falling of the board', basing their opinion on rumours that there will be yet another robbery of the nation, while a group of mythological businessmen with an enormous amount of credits have an interest in dissolving the board, so that these credits can be depreciated. Exactly in this manner I was asked which currency should be preferred by the end of the year – the euro or the Bulgarian lev. I asked what the problem was. The answer was that a well-known politician was talking about the 'falling of the board'. I took a moment to think and asked the question: 'Have you ever heard me talking about fire safety?' The answer was: 'No, of course not.'

Yes, we, Bulgarians, are 'professionals' in all matters in striving for breaking the boat, in which we are all together, provided the boat is in the middle of the sea. We make the hole in the middle of the boat and the same time we scream: 'Help, safe us!'

More and more often, I think that in addition to the law for the currency board the parliament should pass a law prohibiting politicians from talking about the board. The result is a typically Bulgarian paradox. With just small exceptions, no macroeconomist with deeper knowledge about the currency board doubts its stability, while political leaders in the most irresponsible way tackle the topic and make stressful forecasts. Well, there is a small nuance between the effective management of public finances and the stability of the currency board, which I will address later. The public space is saturated with populist speeches.

As I have mentioned many times, Bulgarians have no more resistance against pain. Poverty has reached levels unfamiliar in Europe. Exactly the misery all over us has taken away the rationale in the thinking and creates a fertile ground for populism and nationalism. Namely these widely spread tendencies are the deadly foe of democracy. In such a situation panic comes easily. 'The board will fall in three months!' I heard this spell at least 2-3 times in each of the last six years. Well, it has not. In 2014 and in 2015 it will not fall either. You don`t believe that?

Let us make a somewhat more serious analysis of the currency board. In the Bulgarian National Bank there are three departments – Issue Department, Banking Department, and Banking Supervision. Basically, if we speak physically about the currency board, this is the Issue Department. On 17 December 2013, the assets available there amounted to BGN27.8bn. These are the so called currency reserves of the BNB. These funds are invested strictly conservatively as deposits, predominantly in first class national banks in other countries, monetary gold, and government bonds issued by A-rated issuers. In the law on the currency board it is explicitly stated that the assets of the central bank cannot be invested in Bulgarian government bonds. Straightly speaking, the BNB is prohibited by law to lend money to the government. For this reason, we can say that the assets of the currency board are guaranteed in the best way.

What covers theses funds? The liabilities of the Issue Department include the banknotes and coins in circulation, which by 17 December amounted to BGN9.9bn, the minimal required reserves, which by the same date were BGN6.3bn, government money known widely as the fiscal reserves, by the last date being BGN5.0bn, the funds of national enterprises with BNB amounting to BGN1.5bn, and conditionally speaking the money of the bank itself, which totals BGN5.0bn.

When we speak about ‘the fall of the currency board’, let the politicians please concretely say what exactly will fall? Maybe it is a matter not of falling, but of disappearing altogether, not of funds, but rather of thinking processes.

As a member of the European family, and in this case speaking about the central bank, it should be mentioned that it has a credit window with the ECB for attracting resources at emergency moments. At the current moment, the BNB has no limits in trading euro with the commercial banks. If we hypothetically assume that someone wants to ‘push’ the board, this someone needs to have the resources to buy EUR15bn. If some of you knows this someone, you probably know one of the richest persons on the planet. Or if this someone does not have the BGN30mln in cash and needs to borrow it to speculate. The question is where from? The money market in Bulgaria is of a closed type. All Bulgarian levs are in circulation within the country. Obviously, the strategy of ‘pushing the board’ is absurd.

The illiterate talking about this topic is dangerous and harmful. Certainly, the export oriented companies are not satisfied, nevertheless, what is more important for the country – financial stability, which is one of the main prerequisites for attracting foreign investment, or solely maximizing the efficiency of exporting companies. Put another way – absolutely no one at the moment has interest in ‘pushing’ the board. This is the shortest way to creating financial and social chaos. Isn’t the political chaos enough? Some politicians allow themselves to express unprepared opinions on the topic, and this is worrying. Didn`t I suggest a law against politicians expressing opinion on the topic of the currency board? I bet people will welcome it at 100%.

Bulgaria will walk its way to full membership in the Eurozone with the currency board. I do not doubt that. There are different views on when this should happen. My personal view is that it should happen right away, although we are not fully prepared.

Of course we first need to go through the so called waiting room of the Eurozone. This is a guarantee that regardless of which political party is in power, financial discipline will be a must. Discipline is the missing part to reach prosperity in the country. I mean discipline at all levels. Diogen was resting in the sun in Kranion when Alexander the Great came to him and asked: ‘Ask me anything’, Diogen responded: ‘Don`t cloud my sun.’ I hope you get me.

3 POSITIVE AND 3 NEGATIVE FEATURES OF THE LARGEST BUDGET IN OUR NEW HISTORY

VLADIMIR KAROLEV, CFA

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The article was published in Dec 2013 in 24 Chasa Daily

The budget for 2014 was adopted a week ago. A week after that we already see highly conflicting comments, most of them highly politicised. Supporters of the government say that Budget 2014 is radically different from previous budgets during GERB's mandate and focuses on the economic recovery, while the opposition says the budget will deteriorate the economic environment.

Again as in previous years we hear how the 2014 budget was 'miserable' and how the money was less and less. The truth is that Budget 2014 will be the largest in the history of Bulgaria – the expenses will be over BGN32bn, more by BGN7bn than in 2008, the best year in economic terms for Bulgaria of the XXI century so far. And all budget sectors in 2014 will receive more money than in 2013. This means that everyone gets something.

If you read on the Ministry of Finance's website which the three main messages for the 2013 budget are, you will see that they are three: continuation of the policy of fiscal consolidation, which will ensure the preservation of the macroeconomic and financial stability of the country; prioritizing of the expenses to sectors which promote economic growth; poverty fighting and the protection of the most vulnerable groups of the population. According to me, these three basic messages are preserved again in Budget 2014, but the real question is whether they can be met and whether economic growth should be encouraged through the budget.

As a result of the generous campaign promises and their media messages in the discussions of the budget, the ruling coalition put huge public expectations on Budget 2014 – to stimulate consumption, to restart economic growth, to reindustrialize Bulgaria, to reintroduce the role of the social state (which has not been reduced, so that it should now be reinstated) and so on. Entirely in the spirit of the previous budgets of GERB's mandate, we can be relieved that the many promises made in the media space will not be realized – the main tax rates shall be kept at least till 2016, and the budget will not take more funds from the citizens and businesses (the proportion budget/GDP will be kept). The established best practices in the management of the state debt are retained, although it will be increased for another consecutive year, since the budget is with a planned deficit which is likely to be extended because of lower tax collection than planned.

In connection with the latter, the budget has adequate buffers, especially the BGN5bn planned for capital expenditure, which can be cut, if (when) revenues begin lagging behind. In short, the risk of a sharp left turn is off for now and at least in the near future there are no prospects that politicians will have more of our money.

Again fully in the spirit of the previous budgets of GERB's mandate, the negative sides are connected with the almost complete refusal of reforms, moderately overstated budget revenues, and the harmful accompanying PR. The government said it would not carry out reforms in the coming months – the pension reform under the pressure of the trade unions and the left wing in BSP is frozen, the social reform is at the stage of very good intentions expressed by minister Ademov, healthcare is, as always, nowhere, although in several media appearances minister Andreeva expressed readiness for reforms. The argument is that time is needed to gather the public and political energy for reforms. But the recent history of Bulgaria indicates that it is better to do reforms at the beginning of a term. Because then local elections come, and serious reforms become politically very difficult to be marketable to the electorate which still thinks more about what it can take from the state, instead of focusing on what one can do for himself and his family without aid from the budget.

That is, if we do not do the reforms next year – year and a half, the likelihood that this government will flow with the stream just like the previous one becomes huge.

I think the revenue side of Budget 2014 is moderately overstated. The expected growth in tax revenues of BGN1.5bn (the expectations for revenue growth of excise duty are especially unrealistically ambitious) is unlikely to happen.

I also expect more of the planned decrease of revenues from income tax after the introduction of, mildly said, the strange way of income tax rebate to a part of the population. Strange because anyone who has a salary of BGN341 to 377 in 2014 will receive less than those who get the minimum wage of BGN340. The political rhetoric about Budget 2014 is particularly harmful.

As it was with Dyankov's budgets, the explanations in public totally disagree with reality. In the past 4 years, the politicians were convincing us that Dyankov was leading a totally restrictive policy, but the reality is that in each year of GERB's mandate the budget expenditures were more than they were in the previous – BGN26.7bn in 2010, BGN26.9bn in 2011, and BGN27.9bn in 2012. And now, politicians assure us that this budget is 'loosening the belt' for the first time, so people could 'breathe', that the government should help the reindustrialization of the country, etc. There are elements of this rhetoric about which it is not certain whether they could turn into a harmful fiscal policy.

Such populist rhetoric now comes from the far-left wing of the Socialist Party and Ataka and gravitates around ideas about renationalization of the privatized EDCs, about organising a referendum on the nationalization of Sofiyska voda, even about starting the bankrupted Kremikovtsi with government money. I hope such populist appeals will be forgotten now, when the adoption of Budget 2014 is a fact. And let them remain in the no-one-can-give-you-what-a-populist-can-promise-you category.

GUEST COMMENT

IT IS NOT THE FLAT RATE'S FAULT

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The article was published in Trud Daily

Recently, the flat tax rate has become a favorite target for a political-ideological attack. It was attributed all kinds of sins – from the failure of the transition from communism to democracy to the creation of oligarchs and at the same time, impoverishment of the population during the economic crisis. It is almost as if the flat income tax rate is the sole cause of each and every problem we have faced in the last 25 years, even though it was introduced just a few years ago.

Higher rates

Denouncing the flat rate does not mean abolishment of income taxes. In fact it may turn out to be just the opposite. The government budget cannot afford to lose the BGN2.3bn which it receives from the flat rate tax. Therefore, a new income tax is most likely to be implemented, and with higher rates at that.

In Bulgaria, before the implementation of the flat tax rate in 2008, a so called progressive income tax with rates between 20 and 52% was in order. Since this progressive taxing method is usually less effective in collecting revenues, it has significantly higher rates so that it can achieve an acceptable level of income. Indeed this is the reason why in all the years from the beginning of the transition period to 2008 the tax rates were significantly higher, which led to the expansion of the gray sector in the country.

The supporters of Marxist ideas are trying to persuade us that removing the flat rate and putting more tax pressure on individuals with higher incomes would bring about a paradise of social justice, equality and prosperity. Now wouldn't that be nice? However, practice and in fact our own Bulgarian experience as an economy shows quite the opposite results.

Before the introduction of the flat rate, we had exactly the same system as proposed by the supporters of the progressive tax rate. Taxes were levied in accordance with the income levels. This was especially true in the 90s. For example, in 1993 there were 9 different income tax levels – the lowest of which was at 20%, while the highest was 52%.

Even though the number of different tax rates was reduced, there were still similar high and progressively increasing rates throughout the whole decade. It is interesting to see what the results were. Exactly in the 1990s, Bulgaria suffered a long period of stagnation, fell into recession, hyperinflation, and defaulted on servicing its debt. What is more – it was in the 90s that social inequality was at its peak, a significant gray sector in the economy was created, and oligarchs emerged.

If you actually think about it, it was the failure of the progressive tax system that brought about a tax reform, which reduced the number of different rates and ultimately introduced a universal rate of 10%. Thus, revoking our current tax policy would ultimately bring us closer to problems of the 90s.

The Balance

After 20 years of experiments, fiscal policy makers finally found the balance between the needs of the government budget and the weight on taxpayers. On the one hand, there was the government's urge to increase tax rates in order to boost revenues. On the other, higher tax rates would have negative effects on the economy and provide incentive to evade taxes. In the end, high taxation would have the opposite effect and bring less revenues to the budget.

The flat tax rate is a good compromise between these contradicting goals. It is low enough, so as not to put too much weight on taxpayers, while at the same time it collects enough revenues for the budget. Even recently, in the years of economic turmoil, when most businesses registered a decline, the flat tax rate proved its efficiency by bringing in more revenue year after year. One might go as far as to say that if other tax policies were as efficient, we would not have any budget issues or need for additional resources to fund our public service sector at all. The efficiency of the flat tax rate sets an example that must be followed by the other types of tax policies in the country.

Flat tax and the rich

The revenues received from the income tax have not decreased as percentage of GDP since the implementation of the flat rate. This is an even more impressive achievement if we take into account the significantly lower rate and the fact that taxes were collected in an environment of a global financial and economic crisis. At the same time, the data show that more and more individuals are now willing to declare higher incomes and pay their taxes.

In the 90s, the tax rates were high for the rich, but in truth no one declared high income and through different means avoided paying the higher rates. In short, the effect of these higher taxes for the rich was nil. The results, however, were quite the opposite with the decrease of rates between 2001 and 2005 and the subsequent implementation of the flat income tax in 2008. This change brought about a tremendous increase of the number of people who declared their actual income and paid taxes.

With the high-rate progressive income tax in 2001, barely 8 people have declared income above BGN1mln per year, while in 2011 about 227 people declared such an income. Indeed, the flat income tax succeeded in making the rich pay – a phenomenon unseen before. Ultimately, the flat income tax did not reduce taxation on those who were well off, but instead shifted the burden from the poor.

Flat income tax and poverty

Some say that if we change the flat income tax with progressive rates, we will reduce inequality between the rich and the poor. Such claims, however, can only be made by someone who is not familiar with the Bulgarian tax system.

Unlike some other countries, in Bulgaria income taxes are paid solely by the employed. Everyone else is free from income tax, including pensioners, unemployed, and those living in poverty. From next year on, people receiving the minimum wage will also be free form income tax. In other words, about two thirds of the population is free from income tax, including the most impoverished.

According to statistical data, the largest concentration of people living in poverty is among the pensioners and the unemployed, in other words people excluded from income tax levy. Thus, it should be clear that whatever changes in income taxation are made it could not reduce poverty since the majority of the poor are not affected by income taxation.

The actual fight on poverty requires economic growth, job creation, and investment in education. None of these factors can be improved by a change to a progressive income tax. In fact it may be a blow to those who are driving the economy, with high level of expertise, such as doctors, IT specialists, engineers, etc. Higher taxes may prompt these groups to leave the country, which will most certainly be bad for our economy.

Unfortunately, instead of discussing real effective measures for fighting poverty and for economic growth, we are drawn into ideological disputes and ‘easy’ solutions such as the flat income tax, which is not the key to solving any problems. Is it not about time to realize that ideological fights never solve any problems – this is how problems are created.

ABSOLUTE LIMITATION WITH SPELLING MISTAKES

TEODOR TODOROV

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Can the absolute limitation text eliminate the figure of the eternal debtor?

The article was published in Investor.bg

Over the past year, there has been an ongoing discussion on implementing an institute of absolute limitation period for obligations of individuals. A new bill implementing a change in the Law on Obligations and Contracts was proposed. This ought to address the following issues:

- To cease the indefinitely continuing enforcement proceedings in which the creditor fails for years to collect his receivables from the debtor who is unable to provide any consideration and who is charged interest, fees and expenses in the process
- To solve the problem of the 'eternal debtor' and to introduce an absolute 10-year period for obligations of individuals as an alternative to the concept of personal bankruptcy which is alien to the Bulgarian law
- To set a clear and predictable period after which the right of the creditor to force collect his receivable from the debtor is voided
- To give debtors the chance to clear their credit history and be able to have a 'clean' start of their family's economy

However, the proposed script in its current state is unclear and unfinished and in no condition to solve the designated problems.

The possibility that the goals of the script are achieved is further reduced by the restrictions on the matter of absolute limitation. According to the bill, it does not apply in the following cases:

- Secured claims against individuals. The new provisions will not concern mortgage loans for house purchase, consumer loans with surety, and other secured claims. Financial institutions rarely lend without collateral, which means that for the vast majority of people with debts to commercial banks the absolute limitation may not apply
- Deferred liabilities. Often lenders such as banks, services suppliers and others offer debtors rescheduling. The debt is then remade and eliminated from the scope of the absolute prescription. It will not be difficult for the creditors to take advantage of this opportunity and convince their debtors to postpone or reschedule their debt. The latter (the debtors) due to lack of information or other impairment might be inclined to do so and thus limit themselves to the application of the absolute limitation period.

As a rule, the absolute limitation should be perceived as unconditional. How can it be absolute if there are provisions by which the prescription cloud be limited with ease? The authors of the bill must be more resolute. If they believe that the absolute limitation could be a solution to the described problems, they ought to remove the exceptions.

The limitation of liability issue is a clash between the principles of justice and the need to restart the civil and commercial relations. There are serious arguments in favour of both sides of this clash.

The civil turnover has no benefit from the 'eternal debtors'

Debtors who have no near-time perspective to pay their debts are of use neither to the economy nor to the treasury of the country. When an individual is faced with the prospect of living as a eternal debtor, he will most likely become a part of the gray sector of the economy. He will receive income 'under the table', not pay social and health insurance, neither any tax. After a certain point, these debtors should be able to receive their rehabilitation in the civil turnover and a chance to restart their family's economy. The absolute limitation should give a way out of this impasse and 'unblock' the system of civil turnover for the future.

We should not believe that the absolute limitation will benefit the debtor while leaving the creditor to suffer a loss. One should have in mind that the creditor has already had the opportunity to use all legal means to collect its receivables to a reasonable 10-year period. It is assumed that within such a period it should have become clear if a receivable could possibly be collected or not. If it is not collected, then what is the point of keeping the possibilities of enforcement?

Some people point that the indebted citizens will patiently wait for 10 years for their debt to expire and will again borrow with the intention of never repaying again. However, the question we should be asking is whether they would be able to borrow at all. Rather not. For this purpose it would be especially useful to create a register of such debtors. The introduction of the term 'credit history' will have a positive effect on civil and commercial turnover.

Absolute limitation would discipline creditors

The presence of a deadline till which the creditors must collect their receivables would have a disciplining effect. Furthermore, the absolute limitation would encourage them to explore more carefully the debtors before they lend to them. A positive consequence of this would be the reduction of bad loans. This would enable banks for example to strive to provide higher quality lending services, which would lead to an increased initiative of entrepreneurs and ultimately improve the general economic climate of the country.

The bill is vague and inaccurate

A significant problem is the ambiguity of the bill in the part stipulating to which obligations it shall apply. Under the proposed new Art. 112a, all unsecured claims against individuals are redeemed *'with the expiration of the 10-year limitation period from January 1st of the year following the year in which the debt became due'.* In this form of the script, two different ways of application of the absolute limitation might be distinguished.

On the one hand, if adopted, this change will come into force six months after its publication and will take effect in the future (ex nunc). Consider, however, the following hypothesis. In September 2010, the debtor ceases to repay the installments on his loan. According to the text, the proposed 10-year period for the loan starts from January 1st 2011. But by 2011 the absolute prescription was not accepted, and now the proposed rule does not provide for retroactive application (ex tunc). An internal contradiction arises, and that would lead to problems in law enforcement. It is not clear whether the scope of the absolute limitation covers the overdue debt from 2010 and, if so, when does the 10-year period for it begin. Assuming that the law will apply to liabilities to be repaid in the future (i.e. after the law comes into force), the potential positive effects of this legal institute will occur at the earliest after 10 years. This does not seem seen enough in view of the rising public expectations for a recent abolishment of the figure of 'eternal debtor'.

On the other hand, it could be assumed that the text of the bill regulates debt obligations which have arisen before its entry into force. The end of a limitation period is a judicial legal fact. Let us examine a reverse case, where we focus on the date on which the 10 year period has passed rather than the time when the obligation has raised. In this case, it could be assumed that the expiry of the time period (10 years) is a new and separate legal fact, and what should follow is stipulated in the currently active law. Let us discuss an obligation due on September 1st 2004. If legislative changes in the statute of the absolute limitation come into force provisionally on July 1st 2014, then the fact of the expiry of the 10-year limitation period for this obligation will occur on January 1st 2015, and the obligation will be prescribed on that date. This application of the law accepts the 'immediate effect' of the law – i.e. the absolute limitation would apply to existing cases.

It is not regulated clearly which of these two hypotheses will apply – neither in the transitional, nor in final provisions of the bill. The lack of certainty as to the effect of the absolute limitation could lead to very serious problems in the enforcement of this institute and to turmoil in the civil turnover.

The institute of the absolute limitation has merit and deserves a serious and thorough discussion. However, the conviction remains that the proposed bill would not achieve its goals and would even introduce uncertainties. This bill should be deprived of populism and should not be created in haste to serve a particular lobby. It is important that its architects are to be guided by the public interest and offer solid arguments in favour of the absolute limitation to ensure its statutory longevity.

THE RUTHLESS BATTLE FOR TALENTS

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The Bulgarian Ministry of Economy estimates that more than 2.5 million Bulgarians work abroad. The national media speculates with the frightening numbers of EUR18-20bn being lost as a result of the 'brain drain'. With the abolition of the last work restrictions for Bulgarians in the European Union, the expectations are that these amounts will be increasing in the future.

We are used to the image of belonging to one of the most intelligent and talented nations in the world. Young Bulgarians receive awards and recognitions around the globe in fields that vary from mathematics and robotics to biology and biochemistry. We are also used to being proud and feisty – Bulgarian students are active and loud, they work during their education and fight their way through life. Unfortunately, many of them leave the country to study abroad, and end up working in a foreign economy with the hopes for what seem to be endless opportunities and higher pay.

The InvestBulgaria Agency (BAI – part of the state administration) highlights the shortage of highly qualified workforce as one of the major challenges for big business in our country. An increasing number of large foreign multinationals enter the Bulgarian market precisely because of the workforce opportunities, but prefer to bring on senior management, engineers and designers from abroad. Considering the average annual unemployment rate of 11.3%, it seems that the supply of highly qualified jobs is larger than the demand – which begs the need for an answer to the catch-22 situation.

In an attempt to solve this good old problem, in the beginning of 2014, BAI initiated an active information campaign amongst the Bulgarians abroad, aimed at attracting investment and talent back to Bulgaria. Their tour covers 13 cities with an increasingly large Bulgarian immigrant population, where open meetings and discussions are held. The debates between the Agency and the few interested Bulgarians are often pretty heated. Solutions are sought not only from the government, but also from the private sector and its role in: higher education, incentives and talent development, and entrepreneurial encouragement.

Education

9,000 Bulgarians leave the country every year, and more than half of them are students. The universities in Germany, the UK and the US traditionally attract the largest number of young people, with technical majors, business and economics being the leading disciplines. This might sound surprising, considering the fact that Eastern Europe is recognized for its mathematics and exact sciences education. However, our students are not attracted by academics and their achievements, but rather by the opportunity to gain practical experience, which is encouraged and often compulsory. In times when everyone has a higher education degree, and new private schools come up every day, having good grades and following lectures is no longer enough.

As a result of the cooperation between universities and the private sector, the students work on real projects and case studies, go through practical internships and have the opportunity to investigate the industry from within. On the other hand, the companies use this collaboration to find and recruit talented young people. The most pro-active students receive job offers while still at university. Many firms work with the schools' career centres, which prepare students for interviews and forward their CVs to potential employers.

Such collaboration is not yet widespread in Bulgaria, but there are some organisations with pretty successful experience. Last year, the Bulgarian technology firm Telerik began the development of its own Software University, aiming to provide more practical higher education. Similarly, the real revolution will take place, when internships become compulsory for graduation; when the Bulgarian businesses start attracting young students with fresh ideas to work on projects every summer; and when companies turn to our large technical universities for support in developing new products (which might in turn revive our manufacturing industry).

Career Development

Many Bulgarians abroad claim that the difference in pay is what keeps them from returning home. When it comes to experienced senior management staff, the difference is indeed striking – reaching 250-320% (according to the European Commission, in relation to EU-15). However, the relative salaries of young employees are much more comparable. In Western Europe, internships are often not paid, with the employer sometimes covering accommodation costs. Many young people start their first job at minimum wage. It is very common that young professionals cannot afford renting an apartment on their own, and often struggle with the high living costs.

The difference, however, comes from the attitude and opportunities within the workplace – and this is where Bulgarian businesses have a fighting chance. One of the strongest suits is the professional development programme – which should at least include mentorship from senior, more experienced colleagues. In addition, the companies must be incentivized to train their staff. The Bulgarian Ministry of Economy already runs programmes which cover 25% of the staff training costs for foreign companies in Bulgaria (companies such as Lufthansa Technik are already participating). Such incentives must be provided to Bulgarian companies as well.

One additional advantage of the Bulgarian market is the dominance of SMEs. This is a common picture in European markets; however, the diversity of sectors in Bulgaria, as well as the small market encourages close cooperation between companies. In this way, since the very first day, new employees are forced to communicate and build a network with partners and clients outside the firm – thus, developing skills and experience. Businesses start to realise that young specialists are not only good at making coffee – their fresh minds and ambition should be engaged in better uses, before someone else steals them away.

Entrepreneurship

In the past three years, Bulgaria has become the centre of entrepreneurial activity on the Balkans – at least when it comes to ICT. The two Sofia-based accelerators – Eleven and LaunchHub – have until today financed and kick-started more than 80 fast-growing technology companies. Our multi-talented programmers have been since lured away by investment and job offers abroad. The encouragement of entrepreneurial spirit and attitudes is seen by politicians and practitioners in Europe as the way out of the crisis. Entrepreneurship has somehow become a captivating buzzword, which sometimes loses its own meaning because of the hype.

This is not the case on a market like ours. Despite the fact that it is rich in small companies and initiatives, the Bulgarian economy still offers plenty of lucrative niches for starting a business. The small size of the market contributes to the creation of born-global companies. The tax incentives are already in place; however more needs to be done to develop trust in the finance system and government institutions. Such efforts would attract ambitious Bulgarians with great ideas and drive.

Bulgarian business could also benefit from the development of such high-growth companies, particularly in the field of manufacturing and electronics, which are dominated by foreign players. Such market development and opportunities for cooperation open the doors to a new pool of customers, even outside the country.

The government plays a key role in such entrepreneurial development, as it needs to create a favourable environment for new businesses. The other major part is played by the education system – the universities must develop curricula and programmes for the acquisition of entrepreneurial mind-set and skills. Such transferrable skills would not only be useful when starting and leading your own business, but also when working within an existing company with entrepreneurial nature, where initiative, creativity and risk-taking attitudes are encouraged.

Many of these strategies and methods for talent retention seem to be common sense, but even they will not work when it comes to industries which have limited to no potential for development in Bulgaria. It is usually the Bulgarians with education in the field of natural and humanitarian sciences, philology and philosophy that are the most reluctant to come back to their home country. At the various career fairs and events, such young people with 'unpopular' professions are encouraged to 'be flexible' and seek realisation in a different sector. This begs the question of whether the government should play a lead role when it comes to defining the sectors to boost competitiveness – should some industries be developed at the expense of others, or should some kind of balance be sought?

Regardless of the answer, it is important to realize that Bulgaria cannot afford to lose any more young talents. 2.3 million Bulgarians work inside the country, which is almost 10% less than our workforce abroad. We should not continue to wrongly believe that unequal pay is the only reason why our people move away. There are other ways to attract back – and also to retain – the talent, drive and ambition in Bulgaria.

SUCCESSFUL PEOPLE ARE THE WEALTH OF BULGARIA

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The article was published in Manager Magazine, March 2014

A century ago, at the time of the Great October Revolution, one revolutionary said that the ambition of his live was to extinguish the rich. His opponent's answer was that he would much rather extinguish the poor. We are not talking about physical annihilation, but rather about policies for fighting poverty, which would make them richer. Although 100 years have passed since then, the issue whether the rich are bad has not become obsolete – especially after the beginning of the latest economic crisis. The problem is Bulgarian as well.

Blaming the rich is a global phenomenon which brings negative consequences

Throughout the world, there are politicians who first condemned the bankers, then the businessmen and the rich, as well as foreign investors (calling them 'colonizers'), and lead a crusade against them. Here are some examples:

- The defunct Hugo Chávez did whatever he could to expel foreign businesses from Venezuela.
- Hungary nationalized the private pension funds worth EUR10bn and spent the money within just a year. The state punished the foreign banks and the electricity, water and telecommunications companies with devastating taxes and with economically unjustified reduction of the prices of their services. The goal was, using pressure, to make sure these foreign companies are bought on the cheap by local players close to the people in power. The result – the former favourite country of international business and the former champion of reforms in the region, Hungary, has turned into a strange phenomenon in the very heart of the European Union.
- France is introducing a devastating 75% tax on high incomes. The result – iconic persons such as Gérard Depardieu have thrown away their French citizenship for tax reasons. Now, people are talking about a 'brain drain' in France.
- Some European countries are introducing a tax on financial transactions known as the 'Robin Hood Tax'. The result – business will increasingly prefer the more perspective Asia and North America, while Europe will remain dyed-in-the-wool and bureaucratic. The Nobel Prizes will go mainly to Boston and California.

Dispelling the rich does not help the poor

We have seen similar things in Bulgaria as well. The vilification of successful people as bad to some extent may help reduce social tension but will not solve the economic problems. Helicopter pictures of houses with swimming pools, lists of people with yachts, pressure on businessmen in order to take away their businesses during recent years have led to a tendency for many of them to feel insecure and think of leaving the country with their families. Probably for good. In the end, Bulgaria might end up being populated by mostly elderly or poor people to whom there will be no one left to pay pensions or salaries. We would continue falling behind in all rankings of quality of life and education.

So how can we fight poverty? This can happen neither with spells and populism, nor by taking more loans, spending money, and giving away to people from the state budget. But it can happen through investment economic growth, and jobs. And investors are mostly successful Bulgarian and foreign companies. Today, the competition among countries to attract investments is severe, and the advantages of Bulgaria are very few. Neither our internal market is large, nor the institutions work well, nor our international image is good. Low taxes are our main and only advantage.

The 'wealth' tax in Bulgaria as a punitive action against successful people

Currently, we have only one obvious advantage – the simplified tax system with very low direct tax rates: 10% on personal and corporate income, 5% on dividends and 0% on capital gains from securities. Now, there is a proposition that the flat income tax be replaced by a progressive tax with a higher rate for monthly incomes above BGN2,700. It is strange to call this a 'wealth tax'. This is not about accumulated large assets such as yachts, plains, properties but about incomes of professionals from the middle class – lawyers, doctors, entrepreneurs, economists, etc.

While all individuals are valuable, the talented and enterprising ones are even more valuable

I am not saying that only entrepreneurs are valuable to the nation. On the contrary – I do say that everyone is valuable: scientists, intellectuals, artists, athletes, doctors, teachers, lawyers, economists, engineers, military men, policemen… Feel free to write in your profession, if I have missed it. I do believe, however, that entrepreneurship is a very important quality for any person, and it is in deficit not only in Bulgaria, but in Europe as well.

The current demographic crisis is caused by two negative tendencies: the low birth rate and the high emigration, especially of people of active age. It is bad for the future of our nation when our citizens are leaving the country. However, it is even worse when those that leave are the young, educated, enterprising, and successful. They will easily find professional success anywhere – from Vancouver through London to Sidney. There they expect that no one will envy their achievements or blame them for their wealth. If we do not want yachts in our ports on the Black Sea, then we will only watch them with envy in movies with Leonardo di Caprio in the opposite part of the world.

What should we do to keep the successful people in Bulgaria?

As a society, we should clearly declare that we value our entrepreneurs, our active, talented and educated people. We should speak more about business and investments, and less about European funds and government budget spending. We should stimulate the young to be creative and active and try to develop their skills in the private sector. We should make our roads, parks and hospitals better. We should solve the stray dogs problem. We should improve our international image, so that we are not constantly being quoted as the poorest and most corrupt country in the EU. We should do all we can to stimulate the birthrate. We should show some courage and ask ourselves: 'The pensioners or the grandchildren?', and answer clearly: 'The grandchildren'.

What we should not do?

We should forget about higher tax rates because we will all lose from them. We should stop pointing our fingers at people with businesses and properties as if they were criminals. The institutions should stop racketeering, and the politicians should stop trying to seize someone else's whole businesses.

Our nation will prosper, only if our community values its talents and rewards the brave, enterprising, and successful people. 'Nane' should not envy 'Vute' (Bulgarian folklore characters), but he should rather try to achieve more. Our students should dream of creating the Bulgarian Facebook instead of dreaming of a comfortable government job. A lot has already been achieved in this respect. It would be a huge mistake, instead of continuing on the path of modernization, to turn back.

THE TEAM

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