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## BULGARIAN STRENGTHS AND WEAKNESSES ON THE VERGE OF THE EU ACCESSION\*

### SNAGE I SLABOSTI BUGARSKJE NA PRAGU PRIDUŽIVANJA EU

**ABSTRACT:** *The article argues for the necessity of catch-up economic development in Bulgaria over the next years and decades. Characteristics of normal and accelerated catch-up development and their driving forces are given. 15 strengths on the verge of the EU accession, along with more than 40 weaknesses are identified and briefly characterised in economic terms. Some suggestions for future policies regarding most of the weaknesses are made. The article demonstrates that the weaknesses of the Bulgarian economy have been accumulated for many decades and that it is not dully prepared for proper EU accession. However, the article supports the accession and proves that there is no alternative to the EU accession and the catch-up develepoment. Unrolling the two processes in parallel corresponds in the best way to Bulgarian vital national interests.*

**KEY WORDS:** *Bulgarian economy, EU accession, catch-up development*

**JEL Classification:** F15; F43; 019; 052; P52

**APSTRAKT:** *U članku se ističe potreba ubrzanja ekonomskog razvoja Bugarske u narednim godinama i decenijama. Predstavljaju se karakteristike normalnog i ubrzanog razvoja u pristizanju nivoa EU, kao i njihovi uzročni faktori. Identifikovano je 15 snaga i više od 40 slabosti, koje su ukratko objašnjene ekonomskim terminima. Učinjene su izvesne suetije za buduću ekonomsku politiku u vezi sa većinom iznetih slabosti. U članku se pokazuje da su slabosti bugarske ekonomije akumulirane tokom više decenija i da ona nije sasvim pripremljena za pravo pristupanje EU. I pored toga, daje se podrška pristupanju i pokazuje da nema alternative pridruživanju EU i razvoju kojim se pristizhe njen nivo. Slediti uporedo oba ova proces na najbolji način predstavlja vitalni nacionalni interes Bugarske.*

**KLJUČNE REČI:** *Bugarska privreda, pridruživanje EU, pristizanje razvojnog nivoa*

\* Excerpt from: Ivan Angelov et al. (2006), *The Economy of Bulgaria and the European Union. Catch-up Economic Development – Strategy and Reality*, Institute of Economics of the Bulgarian Academy of Sciences and Friedrich Ebert Foundation, Bulgarian Academy of Sciences Press, Sofia, 460 p. The full text in Bulgarian could be read at: [www.iki.bas.bg/CVita/angelov/index.htm](http://www.iki.bas.bg/CVita/angelov/index.htm), title № 71 in the publication list. Prof. Angelov is a team leader and major contributor to the study.

## **Introduction**

Bulgaria joined the European Union on January 1<sup>st</sup>, 2007. For us, this was a memorable event the importance of which will be realised and assessed only in the future. Such fundamental assessments need the distance of time.

Prior to accession we must be aware of both our strengths and weaknesses on the basis of which we will face the challenges of the catch-up economic development as an EU member. This allows firstly, stabilising our strengths and increasing their contribution to the speeding up of development; secondly, mitigating part of the impact of our weaknesses and turning some of them into advantages. Thus we will increase the chances of successfully overcoming the challenges of catch-up development in the following years and decades in the European Union.

### **1. Catch-Up Economic Development**

Catch-Up Economic Development is a complex process. It depends on a full set of external and internal conditions. There are no guarantees that all these conditions will be in place in Bulgaria in the next years and decades. However difficult it may be to achieve catch-up development, it is possible and indispensable for Bulgaria's integration into EU. Integration is feasible only between relatively similar economic entities in terms of level of development. Between highly developed and backward ones only assimilation is possible but not integration. This depends on us, to a great extent. We have to create these pre-conditions within the Community where the integration should take place. The EU membership will make it easier for us to accomplish that exceptionally difficult task.

Some colleagues doubt the expediency of emphasising the catch-up nature of our development. They might think that thus our country dooms itself to catching-up with the others *ad infinitum* in terms of production, structural patterns, technologies and institutions, and will never equal the developed countries.

The catch-up type of Bulgaria's strategy for economic development is not a matter of caprice. Bulgaria hardly has another choice given the fact that we are among the last in Europe in terms of GDP per capita, productivity, competitiveness, employment rate, income and all major economic, technological, scientific, social, institutional, health care, environmental, hygiene and other indicators. Obviously, the last should move at a quicker pace to catch-up with the more advanced. The statements of some Bulgarian politicians that we are well prepared

for the EU membership and that we have been a part of Europe for a long time are not substantiated and do not deserve attention. In terms of geography we are part of Europe, but it is not so in social and economic terms.

*Catching-up means closing the gap* between Bulgaria and the other countries regarding the key economic, social and other development indicators. It does not necessarily lead to levelling and does not mean automatically copying economic, social, institutional, cultural and other characteristics of the more developed countries. The nature of the catching-up depends on the specific economic, cultural and other conditions in the respective country, on the strategic goals chosen by this country and on the intensity of its development.

If the speed of catching-up is moderate, it might last for decades and achieve only narrowing of the gap but not levelling with the average economic and social indicators in the EU. If the pace of catching-up is very high it leads to levelling and even surpassing of the average EU indicators. This type of catch-up development is possible only through mobilisation of the extensive (resource based) and intensive (productivity based) factors of development of the economy. Japan demonstrated such type of development after the WWII. Ireland has shown that it is possible also in Europe under its unique circumstances.<sup>1</sup> Some Western European medium- and small-sized EU member countries might achieve such catch-up development.

The big question is whether Bulgaria has or can provide in the future such conditions and achieve similar full mobilisation of resources! For the time being it is too early to embark on such prognoses. What could be said now with a high level of probability is that accelerated catch-up development for Bulgaria is possible only by being a member of EU. This would be unthinkable outside the Community.

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<sup>1</sup> There are some frivolous aberrations in Bulgaria to transplant the Irish model to our economic development without taking into account its unique and unrepeatable nature. On the grounds of Irish uniqueness lays the combination of appropriate geographic location between North America and Europe; the presence of big Irish Diaspora in the North American financial and other influential circles; huge inflows of foreign direct investments from North America and liberal domestic economic policy, combined with intelligent Government interventions. These happened under the conditions of the Irish membership in the then European Economic Community. Achieving such unique combination and repeating the Irish model in Bulgaria is not possible. It is indicative that Greece, Portugal and Spain did not succeed in repeating the Irish model although they wished to do so and possessed more favourable conditions in place than we have.

An alternative to the catch-up development strategy is the *overtaking development strategy*. At present and in the foreseeable future it would be an adventure to set outstripping strategic goals at macroeconomic level for the next years and decades. Bulgaria could only suffer damages from formulating such unrealistic strategic goals and from the policy resulting from them. This would resemble the burlesque policy of the “Chinese leap” that was unsuccessfully imitated in our country in the beginning of the 1960’s. Bulgaria might consider an overtaking strategy for economic development only after several decades provided that most of our present weaknesses are turned into strengths in the meantime, and if a successful catch-up development is achieved.

The general catching-up nature of the strategy does not exclude the existence of overtaking elements in it. It even presupposes setting of such strategic goals in selected fields where it is realistic. The successful catching-up even requires getting ahead in the development of certain fields, so called “niches”, in comparison with the countries that are ahead of us. It is neither possible nor desirable for all sectors and sub-sectors of the economy to be developed at the same speed and catch-up steadily in the next years and decades.

The traditional sectors will develop more slowly, some of them will fade away or even disappear and the modern ones will grow with higher speed. New products will appear and new sub-sectors will emerge that will develop even faster. Thus the sub-sector and product pattern of the economy will be modernised. Without catch-up development in individual areas at manufacturing or branch level with potential for the future, it would be hardly possible to catch-up with the more advanced economies at macro level. This also means that catching-up has nothing to do with automatic copying.

Catch-up development presupposes continuous outpacing of the more advanced countries at 2.5 to 3 to 3.5 times higher development pace to close up the gap between them and us in terms of the key aggregate indicators. Otherwise, the gap will remain as it is and could even grow bigger.

The present article does not aim at detailed analysis of our strengths and weaknesses at the start in relation to the catch-up development. Such analysis would require hundreds of pages. Here we will satisfy ourselves by only listing them, providing brief economic descriptions and suggesting some ideas for future economic policy.

## 2. Strengths at the start

- The technological gap between the leading and the less developed countries is the “great hope” for the latter, writes the historian of economics A. Gerschenkron, because it provides them an opportunity to imitate the more modern technologies applied elsewhere. This is true also for the economic, social and other policies, for the institutions and methods of governance. Bulgaria is a beginner in its modern economic, scientific and technical development. It should learn from the experience of the advanced countries and should not repeat or repeat fewer of their mistakes. This will help speed up the catch-up development;
- For 10 years already there has been a financial stability in Bulgaria. This creates favourable climate for investment and other economic activities at different levels – from family to national economy. Financial stability is a very important though insufficient prerequisite for successful economic development. There are domestic conditions for this stability to continue also in the years after the accession. As an EU member Bulgaria will be less vulnerable to external shocks and there will be prerequisites available for strengthening its internal financial stability. This will be favourable for the integration of our economy into the EU and for the catch-up development;
- As an EU member Bulgaria will adopt EU legislation, will enforce the order, rules and discipline of the community for introduction of more order, rule of law and discipline in our economy and society at large. Bulgarian economy will perform by virtue of EU laws. Our national legislation will be adjusted to the EU legislation and subjected to it. The benefits for Bulgaria in this regard may even be bigger and more important than the EU grants from the structural and other funds. This is indispensable for us to achieve catch-up development;
- The Bulgarian economy will work under the pressure of competition on the demanding EU internal market. This pressure will compel to rationality and competitiveness in the name of survival and prosperity not less than the nature of ownership. Inexorable fair competition is even more powerful factor for economic progress than the availability of private property. Under normal competition the private and the public sectors operate under equal economic environment and only those with more rational economic and social behaviour prosper. The result is objective natural selection without subjective interventions on the part of individuals or institutions, which are usually biased and risky. Some sort of normal competition is possible also without private property, but normal functioning of private property for public benefit is not feasible without

competition. There is nothing scarier than the private monopoly. If it was not an EU member, Bulgaria would not be subjected to such constructive pressure by the competition, would develop more slowly, would be catching up longer and less successfully;

- As an EU member Bulgaria will implement the European social model. This model combines economic efficiency and social equity, looks for a balanced compromise between the interests of the society, labour and capital. This generates a favourable climate for stable accelerated development, as cooperation among social partners is constructive instead of confrontational. The path to people's welfare goes through high competitiveness and social equity. A society could not sustain competitiveness if it is not just. By just society we do not mean one based on egalitarian distribution (which we are familiar with from the recent past), but one with moderate income and property stratification that builds motivation for entrepreneurship and technical and scientific creativity, not permitting social polarisation or breakage of the social ethnic peace. And vice versa – uncompetitive society could not be just. Unlike just welfare, just poverty is not acceptable by Bulgarian people in XXI century;

- Due to the challenges by USA, Japan and now China and India, the enlargement to the East, the development of the Common internal market in the services as well as due to the new technologies, quicker development of EU is expected in the next years and decades. This will produce even stronger traction for economic development of Bulgaria, whose key strategic goal is to catch-up with EU in terms of major economic, social, institutional and other indicators. The quicker development of EU will be a gravitational power for even more accelerated development of Bulgaria in the following years and decades, as we will strive to catch-up with the faster moving target whose task is to catch-up and even surpass USA by the level of economic development;

- As members of EU, Bulgarian companies will have more opportunities for production specialisation and cooperation with big European companies. Within the framework of the “international strategic alliances” with European and other companies, our companies would find “niches” to achieve international standards of productivity and competitiveness and will be successfully exposed to the competitive European and international markets. This in turn would lead to even more accelerated development;

- As an EU member, Bulgaria will be granted large financial, technical, scientific, institutional and other support from the structural, social, cohesion,

agrarian and other funds, as well as from the community institutions that cannot be expected from other international sources. For 2007-2013 alone, the planned transfers from the EU funds to Bulgaria exceed 11 billion Euro. If one deducts the Bulgarian membership fee for this period amounting to 2.5 billion Euro, the potential net transfers to us amount to 8.5 billion Euro. In the next years the problem will not be the lack of financial resources, but the shortage of administrative, technical and managerial capacity to utilise the funding provided by the Community. What remains to be seen is how successfully we will utilise it. That would strengthen investment activity for structural, technological and institutional modernisation of the economy, for growth of GDP, for increasing working capacity, for modernisation of the country and society at large and thus for accelerated catch-up development. Behind the 8.5 billion-Euro stand not only money but also scientific, technical, managerial, institutional and other expertise that we are badly in need of. That makes it even more valuable and disciplining;

- As an EU member (and a NATO member before that) Bulgaria is more stable and more predictable for the international financial community. In our society a discussion is going on whether the transition to a market economy is completed or not. We think the transition is not completed yet, but it is already totally irreversible. This creates favourable conditions for inflow of direct foreign investments and for other forms of economic activity by foreign legal entities and individuals in our country or for Bulgarian citizens abroad.<sup>2</sup> Bulgaria becomes a more reliable political and economic partner. The trust on the part of the international financial community will be an important factor for accelerated catch-up development.
- The predominant part of Bulgarian economy is already in the private sector. With its intrinsic entrepreneurial spirit, rationality and dynamism, the private sector could push the economy to higher management rationality, competitiveness

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<sup>2</sup> According to the data from the European Bank, the cumulative inflow of foreign direct investments to Bulgaria from 1989 till the end of 2005 amounts to 10.3 billion USD or 1,327 USD per capita. (EBRD, Transition Report Update, May 2006, p. 21).

What also matters is the composition of these investments. According to the data from the Bulgarian National Bank, in 2006 out of the 4,015 million Euro of direct foreign investment, much of the foreign capital in our country was invested in operations with real-estate and renting activities – 1,211 million Euro; in financial mediation – 627 million Euro and in the manufacturing industry – 777 million Euro. While the total amount of direct foreign investment increased slightly more than four fold and in manufacturing – 2.5 times compared to 2001, the increase of investments in real-estate was nearly one hundred times for the same period. From the point of view of the Bulgarian interests in accelerated catch-up development, this is hardly the most appropriate composition of direct foreign investments.

and accelerated catch-up development. Especially, if this sector functions in a competitive environment.

- Bulgaria has an educational system that was relatively well developed in the past and a system for qualification and re-qualification of the manpower that are now partially destroyed. In the presence of traditions of many years and solid grounds, with the support of the Western partners, the educational system could be quickly modernised according to the European standards while preserving the most valuable from the national traditions in this field. This would allow it to upgrade its efficiency and prepare appropriate cadres with higher and secondary education for the economy and other sectors.
- Bulgaria has a well qualified, by East European standards and at the same time, cheap labour capable of achieving higher productivity under appropriate corporate management. Combining the available skilled and cheap labour with modern corporate management provided by Western partners, it could boost outsourcing of capacities from the West European countries with expensive labour to Bulgaria and other East European countries. This would help achieve quick increase of output and productivity. This would also help reduce emigration of skilled labour from Bulgaria and facilitate the catch-up development.
- When put in an appropriate market environment abroad, Bulgarians become hard-working, innovative, modest and entrepreneurial. As an EU member, this Western European environment will become accessible also for Bulgarians. Besides, such a stimulating market working environment will be gradually created also in our country and Bulgarians would not need to look for it abroad in order to show entrepreneurial spirit. In the presence of such working environment in Bulgaria, there are big chances for successful catch-up development.
- There is a favourable climate in Bulgaria as a place to live, for modern agriculture and international tourism. The combination of valleys, mountains and sea coast along with the pleasant moderate climate and virgin land (due to less chemical fertilizers and pesticides used in the last decades) could turn into an incentive for Bulgarians, living now in other countries to settle down in Bulgaria, as well as for immigrants from abroad to move here. This may boost production of environment friendly agricultural products and development of international tourism. All that in a package could become a powerful factor for accelerated development and a partial indemnity for the demographic crisis.

- Bulgaria has a favourable geographic location on a territory through which many important international communication channels from West to East and from North to South pass and will pass. Their importance has just begun to grow. Their construction and/or modernisation are to be done in the future. We mean speedy railway lines and highways, the water way through Danube, oil and natural gas pipelines, channels for distribution of products, electric transmission networks, telecommunication channels, etc. This will help for the development of local infrastructure, for improvement of our connections with other parts of Europe and the Middle East and for reducing costs for economic, social and cultural communication. This in turn would become a pre-requisite for acceleration of economic development.

### 3. Weaknesses at the start

- Bulgaria will be the country with the lowest GDP per capita, the lowest labour productivity<sup>3</sup>, the lowest competitiveness<sup>4</sup>, the highest poverty rate<sup>5</sup>, the most inefficient administration and unfavourable other economic, social, demographic, institutional, healthcare, hygiene, environmental and other indicators among the countries that has accessed EU so far. Bulgaria still has to go a very long path of catch-up modernisation in the economy and other sectors to achieve economic and social development comparable to the one in EU. This will require not only years but decades - many decades.
- Under the pressure of the International Monetary Fund, the World Bank and other external institutions, *a model of accelerated criminal and semi-criminal privatisation* was implemented in Bulgaria and became the core of the criminal transition to a market economy. The privatisation method shaped the criminal model of Bulgarian transformation to a market economy. Of course, the international institutions did not order openly the privatisation to be criminal. They imposed it indirectly – by insisting privatisation to be conducted quickly

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<sup>3</sup> GDP per capita in 2006 is 33% of EU – 25, and labour productivity is 34%.

<sup>4</sup> According to the evaluation of the World Economic Forum in Davos in the last Global competitiveness report 2006-2007, Bulgaria even steps back from its positions on competitiveness of its economy in comparison with the previous year and goes down from 61<sup>st</sup> to 72<sup>nd</sup> position. In terms of competitiveness ahead of Bulgaria are not only all EU member states, but also 20-25 developing countries from Africa, Asia, Latin America and the Caribbean. This is very alarming given the aggregate nature of this key indicator.

<sup>5</sup> Most recent data of the Research Institute of the Bulgarian trade unions of April 2007 confirm that 39% of the population lives below the poverty line.

and on a large-scale. Quick and massive privatisation could not be anything else but criminal or semi-criminal. Because the speedy transfer of enormous volume of assets from one hand to another creates multiple irresistible temptations. Especially, in a less developed country such as Bulgaria – with weak institutions subservient to external masters and without democratic traditions. This is confirmed by the entire international experience. The leaders of the international institutions and of the great powers knew this in advance. Thus the IMF, the World Bank and other foreign institutions assisted to the birth of a freak private sector<sup>6</sup> in Bulgaria and are co-responsible for its present and future behaviour. The nature of this private sector is a logical product from the methods of its inception. The private sector established in such a way does not possess the civilised balanced dynamism, characterising the private sector in the old EU member countries with centuries long history. Given its conception, not a small portion of our private sector aggressively pursues its own interests and overbears without excuse the interests of the society, the state and its economic and social partners. It is not loyal to the state and society, does not pay taxes, does not abide by the laws, and breaks severely hygiene, veterinary, environmental, labour, insurance and other standards. It does not hesitate to step over corpses to get quick and big profits. It is not inclined to compromise between its own interests and the interests of the society and social partners and to assume its part of the economic, social and public responsibility. The criminal part of the Bulgarian private sector knows and respects no other model of behaviour but the brutal overbearing of the laws and interests of its partners and would abide by it as long as possible. The civilised countries' principle that "*the private property is both a right and a responsibility*" is not applied in Bulgaria<sup>7</sup>. What matters is only its first part. Decades need to pass before the "manufacturing defects" of this freak private sector are overcome and it is civilised. This will have a long lasting negative impact on the economic development of the country. Increased efficiency of the judiciary system could accelerate the process of forceful civilisation of the criminal part of the Bulgarian private sector. The judiciary however has not performed that function so far. This

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6 Of course, this does not apply to the entire private sector. In Bulgaria there are also many private entities with normal market behaviour and loyal to the state and society. The problem is that the share of the criminal or semi-criminal private sector is substantial.

7 It is indicative that the private company "Bulgarian River Transport" refused to join the cleaning of the Danube from pollution with oil products in the beginning of 2006 for purely commercial reasons. The owners of old private buildings that are cultural heritage monuments intentionally destroy them in order to build in their place new commercial buildings that will bring them high revenues. There are many other similar cases. The state institutions remain unconcerned in such cases.

would be achieved with difficulties and will take many years as the ghost was released from the bottle intentionally 15-17 years ago.

- *Even more aggressive and unscrupulous in their behaviour are some foreign investors* mainly from neighbouring countries. They cross all borders of modern standards of civilised treatment of their staff. Privatised financial and non-financial enterprises suddenly start accumulating losses while shortly before they used to be profitable as public entities. Parts of them falsify their accounts, hide their actual revenues, transfer them abroad and do not pay taxes. In some cases revealed by the media, the treatment of Bulgarian staff at the low levels on the part of foreign managers and their Bulgarian assistants is on the verge of the situation of slaves during the Middle Ages. Contributing factors are also the slaves' attitudes of the Bulgarian workers in these enterprises, feared of losing their miserable wages, as well as the passiveness of Bulgarian trade unions. Most often the Bulgarian authorities are unconcerned witnesses of these severe violations of financial and labour legislation and basic norms of human relations. It is difficult to achieve catch-up development under such conditions.

- Bulgaria's development after 1989 has happened in *a climate of intentionally weakened governance, intentional devaluation of law and order*, space for crime and corruption opened by the authorities, tolerated and even encouraged by some public institutions. Lawlessness and stealing of public property turned into a synonym for democratisation and transition to a market economy. Even though there were some decent laws, they were not enforced by the law-enforcement institutions. Under the influence of lobbyist interests, members of the Parliament intentionally left gaps in legislation, which facilitated stealing of public property and other forms of crime. Texts incriminating encroachment on the state and public property were revoked from the Penal Code operating at the time. Only encroachment on private property that had been proclaimed sacred and inviolable was regarded as crime. This opened a legal space for unpunished stealing of public assets amounting to billions of Euro with direct involvement of government institutions and high-ranking individuals. During the final phase of stealing some top leaders of the judiciary system called for amnesty for criminals. Big financial crimes involving hundreds of millions of Euro committed by collective decisions of management bodies (Government, boards and others) were intentionally declared not subjected to prosecution. Judicial institutions lacked order, organisation and discipline and reacted with indifference when facing obvious evidence of crime. The subdivisions of the judiciary system (institutions of the Ministry of Interior, investigation, prosecution and courts) wasted their energy in internecine fights, instead of cooperating in the actions against crime

and corruption. High-ranking individuals from the law enforcement agencies maintained improper relations with criminals and mafia guys. The corruption that has encompassed all levels of governance did not spare the law enforcement institutions. The judiciary system (courts, prosecution and investigation) became not only independent, but also unaccountable to the public. Its independence transformed into demonstrative irresponsibility. The judiciary became a capsulated and self-serving institution. A rotation of magistrates at the highest levels of the judiciary system and the Constitutional court was introduced, encompassing a small group of magistrates that constitute a circle of friends. The magistrates' full immunity and the lack of mechanisms for accountability to the public made them irresponsible and fuelled their self-confidence of impunity. The public trust in the judicial system was reduced to an absolute minimum. The measures introduced by the new leadership of the prosecution raise hopes for improvement, especially if they expand to the other subdivisions of the judiciary system.

- *The complex polarisation* (by income, property, access to education, access to health care, digital as well as regional and ethnic) grows more and more acute. Its components strengthen and sharpen each other through the synergy effect. The income polarisation induces and increases property polarisation. This, in turn, strengthens polarisation by access to healthcare and education. They boost the regional, ethnic, and digital polarisation. In reverse, the digital polarisation strengthens the forms of polarisation that have induced it. And so on ad infinitum. There is no efficient policy for social inclusion in Bulgaria. The declared policy is only on paper and social alienation increases. People's alienation from the national ideals grows too. They enclose themselves more and more in the narrow cells of the family and circle of friends. In such climate, it is not possible to achieve sustainable growth in competitiveness and catch-up development.
- *The combined socio-ethnic polarisation* grows dangerously in society. In the background of the general average polarisation, it is particularly painful for the Gypsy (Roma) population, most of whom live in degrading misery. Due to the lack of alternatives, this population has turned larceny in its major source of income for miserable living. If efficient measures are not implemented for mitigation of this form of polarisation, in the near future Bulgaria could witness events similar to the ones that occurred in the suburbs of Paris and other French towns in November 2005. This may have a negative impact on the capacity for economic and social development.

- Bulgarian *infrastructure is underdeveloped and poorly maintained*. This applies to transport, telecommunications, electric transmission, water collection, water supply, water-protection, anti-erosion, environmental protection, technical, social and other infrastructure.<sup>8</sup> It is impossible to achieve higher growth rates, larger imports and exports, better quality of output, effective irrigation and drainage systems, protection against flooding and big summer fires, large transit flows, high competitiveness and catch-up development with such poor infrastructure.
- *Health care, education and science are neglected*. Without these sectors it is not possible to develop modern human capital, while the development of knowledge-based economy is unthinkable. Accelerated development, higher productivity and competitiveness are not feasible. In a broader sense, with such poor health care and education it is not possible to improve the quality of life of the people. The common view among the general public that we have competent, hard working and disciplined labour force does not match the reality. Though this might have been closer to the truth 15-17 years ago, the gap between expectations and reality is growing more and more over time due to the insufficient concern on the part of the government for these sectors. Health care, education and science are not modernised and properly funded. The authorities have justified the insufficient funding in the last 10-15 years with the lack of reforms in the above sectors and the irrational usage of the allocated resources. Indeed, these sectors are not sufficiently reformed and their resources are not used rationally. However the responsibility and the power for their reformation belongs to the same public institutions that decide on their funding – the Parliament and the Government. Instead of constantly repeating the cliché of the unreformed sectors, it would be more appropriate to go ahead quickly with radical reforms, more rational utilisation of appropriations and provision of sufficient funding.
- *The labour resources are used irrationally* – the coefficients of economic activity and of employment are low. There is high unemployment rate of predominantly uneducated and unskilled people. The working time during the working day and working week is not used efficiently. During the last 10-15 years Bulgaria has witnessed enormous waste of skilled labour resources. This dissipation is still going on.

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<sup>8</sup> In the above-mentioned competitiveness report of the World Economic Forum, Bulgaria is at the 65<sup>th</sup> position by the quality of its basic infrastructure. Besides all member states and EU accession countries, there are some 15 developing countries that are ahead of us.

- *Labour productivity is very low*<sup>9</sup>, labour and working discipline is unsatisfactory. Labour intensity is low as well. Labour productivity grows very slowly – the lowest rate among the new EU member countries. There are wide spread violations of labour legislation by employers (and by the employees) and the public institutions passively observe them without reacting. Especially brutal are the violations by foreign employers – mainly Greek and Turkish. The sanctions applied by the authorities in case of violation of labour legislation are soft.
- *The contract discipline between the economic entities is unsatisfactory.* Court proceedings between arguing economic partners last for years. The interests of creditors are not protected properly. There are a number of cases when economic disputes between partners are arranged violently through setting fires and using bullets. The overdue debts among companies; the overdue tax, insurance, bank and other payments constitute enormous quasi-budgetary deficit that has already reached about 150% of GDP.
- *The internal labour mobility in Bulgaria is traditionally low.* Good in itself as an indicator for the quality of life, the high percentage of families possessing a house or apartment of their own<sup>10</sup> limits the labour mobility. Also contributing to this are psychological factors, underdeveloped transport infrastructure, difficulties to find housing, jobs for other family members, school and kindergarten for children, necessity to take care of elder relatives. In the next few years it is unlikely for the internal labour mobility to increase. This will have a negative effect on the employment, productivity and growth.
- *Bulgaria suffers a demographic crisis*, which will certainly sharpen in the next decades if the state does not implement measures for its gradual mitigation. The control over it is hardly possible in the foreseeable future. That will reduce the labour resources; will deteriorate age and professional structure of the work force; will limit its entrepreneurship and dynamism; will worsen the ratio between the employed and people supported by them; will increase the budgetary burden with costs for pensions and medical care for elderly. In such demographic conditions, it is hard to achieve high labour productivity and accelerated catch-up development.
- *There is a massive emigration of young and skilled people* with entrepreneurial spirit that cannot and must not be restricted through administrative measures.

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<sup>9</sup> 33-34% of the average for EU-25.

<sup>10</sup> More than 90% of the families.

But economic measures will produce results only in the distant future. The implications of the emigration are controversial for Bulgaria. So far it was useful as a partial outlet for high unemployment and as a source of foreign exchange transfers from Bulgarian workers abroad<sup>11</sup>. However under normal conditions the results in the future will be different. There are already some negative consequences of the emigration of skilled personnel. Though the official statistical unemployment rate is still high (9.50%), the shortage of skilled personnel for the enterprises is growing more and more acute. There are already strong voices for importing skilled workers from Asian countries. The unemployed, as it has been mentioned above, are mostly illiterate people without education and skills. The net results from emigration for a longer period of time are expected to be negative and will be grave, multiple and hard. Though the total number of annual emigrants will gradually decline for obvious reasons, emigration of highly skilled labour force to developed EU and other countries will persist for many years to come. As a net result, this will be an additional bottleneck for the economic development of Bulgaria for the years to come.

- *Sectoral, sub-sectoral and product patterns are primitive and obsolete.* This will be an obstacle for the large-scale intra-manufacture intra-branch specialisation and sustainable intra-branch production co-operation between companies from Bulgaria and EU member states. The primitive manufacturing patterns predetermine the same type of export patterns with low added value. Raw materials and primarily processed goods as well as material-intensive, energy-intensive, capital-intensive and unskilled labour-intensive goods are 85% of the total non-energy exports of Bulgaria. This is typical for a developing country composition of exports. We export mainly low technology, limited amount of medium-technology and symbolic volume (2-3%) of high-technology goods.<sup>12</sup> Modernisation of manufacture and export structures is a very complicated process, which calls for strategic imagination, efficient economic policy, enormous resources and many years, even decades. This modernisation is attainable only through attracting leading international companies in the respective fields by providing low taxes and other long-term beneficial conditions and state guarantees on our part. It also presupposes much more efficient health care, education, science and innovations policies. Automatic market mechanisms do not possess future structures recognising and developing properties, especially in backward countries such as Bulgaria. It is indispensable to have appropriate

<sup>11</sup> According to official information for 2006, approximately 1 billion Euro and with the informal transfers probably twice as much, which makes it 10-12% of GDP.

<sup>12</sup> While the export of high technology goods from EU member states amounts to 20-25% of their total exports.

intelligent involvement of the state, in close co-operation with the business and science communities, taking into account the present and expected future market environment. This is proved by the past experience of all developed countries. In the absence of such prerequisites it is not possible to develop modern manufacturing patterns, larger and competitive exports and accelerated catch-up development in the future.

- *Innovations were neglected during the last 10-15 years.* The R&D facilities that existed till the end of 1980's were destroyed and plundered instead of being adjusted to the new market environment. The lack of such facilities now limits the possibilities for quick import, dissemination and use of technical and other innovations, as well as for the development of our own modern innovations.<sup>13</sup> The links between science, universities and enterprises are loose. Science and technology clusters are non-existent. Patent activity is very weak. Without a modern innovations system it is not possible to attain competitive large-scale production and exports and accelerated economic development.

- *Not much is being done for the development of ICT, biotechnologies, nanotechnologies, technologies for new materials, environmental-friendly technologies, new sources of energy and other most up-to-date scientific and technical fields of activity.*<sup>14</sup> In terms of spending on scientific research (0.40 % of GDP compared to 1.88% an average for EU-25) Bulgaria is among the last. The spending on research by the private sector is insignificant. Without R&D capacities, it is not possible to successfully acquire and disseminate imported or locally developed innovations and to achieve technological modernisation, higher competitiveness and accelerated catch-up development.

- *The hygiene and veterinarian standards are low, unacceptable by EU criteria.* The predominant parts of Bulgarian producers of dairy and meat products are not granted permits to export to European markets unless they implement significant hygiene improvements in their manufacturing environment. There

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<sup>13</sup> According to the abovementioned competitiveness report of the World Economic Forum, Bulgaria has gone down over the years in its ranking by technological development (to 68<sup>th</sup> position) and innovation capacity (to 87<sup>th</sup> position). Here again we are the last among the EU member states and accession countries. A big number of developing countries are also ahead of us.

<sup>14</sup> In the global report of the World Economic Forum on information technologies in 2006, Bulgaria is at the 72<sup>nd</sup> position. Before us are all member states and EU accession countries, and also 15-20 developing countries. This is especially alarming given the fact that nowadays lagging behind in ICT means lagging behind in everything.

is insufficient reliable hygiene and veterinarian border control as well as quality control over the internal consumption. There are large-scale violations that affect people's health. The control by the public institutions is not efficient and is amenable to temptations of corruption. This erodes the capacity for healthy accelerated development.

- There is *limited capacity for internal saving and investments*. Equally modest are technical and administrative capacities for quick absorption of large inflows of external financial resources including transfers from EU funds. *A large portion of the pre-accession EU funds is not being utilised*. The same will probably happen with the transfers from the EU structural and other funds in the years immediately after accession due to insufficient training of Bulgarian administrative, technical and management personnel. However paradoxical it may look, it is very likely that Bulgaria's payments to EU in the first year after accession (mainly annual membership fee of 320 million Euro) will exceed the actual transfers from EU to Bulgaria. We will probably be a net payer to EU budget this year due to the lack of proper project proposals for funding. The blame for this goes to the Bulgarian authorities. This will constrain our abilities to integrate in EU and achieve accelerated catch-up development.
- There is *a lack of appropriate regional development policy*. There is considerable lagging behind and even depopulation of some mountain, semi-mountain and village regions, which the state does not take care of. At the end of 2005, there were 147 dead villages – without a single dweller - and hundreds half-dead ones with a few elderly dwellers at the age of 65-70 or more, that will be depopulated in the next years. Bulgarian regional experts expect that out of 5000 villages 1000 may vanish during the next 10 years. Under the conditions of catch-up economic growth, the regional differences will grow. Several growth centres (Sofia, Varna, Plovdiv, Burgas and others) will develop faster due to better infrastructure, skilled manpower and other prerequisites, while the rest of the country will develop at much slower pace. Thus the discrepancies among the regions will increase. The authorities do not recognise this danger yet, and do not implement measures for its mitigation. Regional economic and social tensions will increase and will reduce the potential for accelerated economic growth.
- *There is no efficient environmental policy*, especially in the big cities and their adjacent areas. The development of the transport infrastructure, especially the massive development of the road transport is not in compliance with the environmental requirements. The environmental standards are not adhered to in the field of water-collecting, water-supply and irrigation, drainage and cleaning

of the sewage water. Most of the medium-sized and small-sized towns in Bulgaria do not have sewage and modern cleaning equipment for the sewage waters, which leads to poisoning of population. The situation in the villages is even more difficult. There are thousands of unregulated dumps near the villages and smaller towns. Underdeveloped and incompatible with the modern environmental standards is the collection, preservation and utilisation of waste, especially in the big cities and most of all in the capital city of Sofia.

- *There is a weird management style in Bulgaria.* As a rule, many of the acute problems in this country are known and are been publicly discussed for years without taking appropriate management decisions. Something tragic has to happen (innocent people die, flooding, fires, transport or environmental disasters) in order to awaken public opinion and incite management actions to be taken. After noise is made for some time (several weeks or months), all gets quiet again and is forgotten until the next tragedy happens. The management decisions, often half-way or insufficiently funded, come after, rather than before the events to prevent them. The right decisions made are often not implemented and the responsible officers are not held accountable. With such management style it is hard to achieve expediency, rationality and catch-up development.
- *The microeconomic policy is neglected* at the expense of blindly exaggerated role of macroeconomic policy. There is no understanding that without stable micro-economy it is not possible to sustain macroeconomic, financial, social, ethnic and political stability. The link between the microeconomic and macroeconomic systems is broken. The economic policy implemented for years sets them against each other instead of complementing and mutually strengthening them. Under such conditions it is not possible to have sustainable accelerated economic development.
- The Bulgarian authorities are proud of financial stability over the last ten years under a Currency board arrangement initiated on July 1<sup>st</sup> 1997. Inflation is relatively low, the budget is with surplus, the fiscal reserve is large enough and the exchange rate is pegged to the Euro (DM). This provides seeming financial stability. The above however does not explain the complete picture. The deficits in the trade balance and the current account are increasing dangerously fast and are becoming close to unbearable. The same applies to the quasi budget deficit. The gross external debt is growing beyond control. The indebtedness of physical and legal entities to the banks is also growing quickly. The national currency appreciates steadily and depresses the competitiveness of the economy. The authorities are desperately looking for solution for the current account problems

applying extremely restrictive budgetary, monetary and income policies. This suppresses the real income and consumption and generates growing discontent and social tension. Thus *the continuous abuse of financial stability is destroying social stability*. Both of them however are equally needed to the society, as social destabilisation, in turn, threatens with financial collapse. Moreover, the long lasting abuse of financial stability undermines the financial stability itself. If expedient measures are not taken for higher growth of output, of exports and increasing competitiveness, and through them – for reduction of the deficits in the trade and current accounts, and stabilisation followed by reduction of the external debt, *Bulgaria may face new financial destabilisation*.

- For many years, by insistence on the part of IMF, *a giant confusion between goals and means of economic policy has taken place*. The improvement of the quality of people's lives is not in the focus of economic policy. Instead, an absolute emphasis is put on low inflation, surplus budget, current account balance, fiscal and foreign exchange reserve, interest rates, monetary aggregates of the Central bank, etc. They are very important tools of economic policy but are wrongly turned to fetishes and ultimate ends of this policy. The minister of finance publicly declares that “financial stability is the main economic goal of the Government”. Notice - the main goal is not the quality of life of the people but the financial stability! There is no understanding that financial stability in itself does not automatically lead to higher growth and improvement in the quality of life. During the last ten years under Currency board arrangement, there has been a classic financial stability, but visible improvement in growth and in the life of the majority of people did not occur.<sup>15</sup> During the last 17 years Bulgarian governments showed notable overdoing in implementing the requirements of IMF. Bulgaria is the only CEE country that, by its own initiative, extended the existing agreement with the Fund and joined EU on January 1<sup>st</sup> 2007 with a binding agreement with the Fund. All this undermines the capacity for medium-term and long-term competitive growth.

- *The budgetary policy is one-dimensional*. It is based only on financial criteria and neglects basic national values such as health, education, science, hygiene standards, personal and public safety, environmental protection and infrastructure. A policy of budgetary surplus is being applied at the expense

<sup>15</sup> According to the 2006 Transition report of the European Bank, Bulgaria is among the most slowly developing economies in Central and Eastern Europe. The volume of GDP in 2005 compared to the pre-reform 1989 is 133% in the countries of Central Europe, 104% in Romania, 98% in Croatia and 94% in Bulgaria (EBRD, Transition Report Update, May 2006, p.15).

of the abovementioned national values.<sup>16</sup> Thousands of people die prematurely every year due to the lack of access to reasonable health care and medicines. The infrastructure, environment and hygiene are in poor conditions and at the same time the budget closes with a large surplus.<sup>17</sup> Solutions compromising between the high national values (the fundamental development goals) and relative budgetary equilibrium (one of the important tools for economic development) were not sought after. The Bulgarian authorities still do not understand that the long-term abuse with financial stability at any price jeopardises the social and political stability and has quite heavy negative series of consequences. In addition, the authorities do not comprehend that long lasting misuse of financial stability undermines the very financial and macroeconomic stability by increasing the current account deficit and the gross external debt beyond control<sup>18</sup>. Consistent accelerated catch-up development is not possible under such conditions. The negative consequences from this self-destructing policy will be felt especially strong in the medium- and long-term perspective.

- *In the management of the fiscal reserve* unconditional priority of financial criteria is assigned at the expense of health, education, security and life of the people. A country could proceed with repayment of public external debt ahead of schedule if it has solved its most severe internal problems and has some free resources. Bulgaria is not such a country. Painful internal economic, social and other problems have waited to be solved for years and have even deteriorated (healthcare, education, infrastructure, science, culture, environment, etc.), while the resources from the fiscal reserve are being used for ahead of schedule

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16 Together with Estonia, Bulgaria is the only CEE country with sustainable budgetary surplus in recent years. In the Reuters newsletter in the beginning of March 2006, it was underlined that Bulgaria implements the most restrictive budgetary policy in Europe. This is hardly a reason to be proud in the European Union, which during the last ten years has been implementing systematic policy of moderate budgetary deficits up to 3% of GDP according to the Maastricht criteria! Moreover, the policy of budget surplus is being followed consistently by Bulgaria - the poorest EU member country with so many unresolved pressing acute problems.

17 The 2006 surplus in the general Government budget of Bulgaria was 1.81 billion BGN – 3.7% of GDP. At the end of 2006 the fiscal reserve was 5.8 billion of BGN, i.e. 2 times more than necessary.

18 The deficit in the foreign trade balance for 2006 was 22% of GDP, and in the current account 16% of the GDP. The data for January-February 2007 are even more alarming. The deficit in the trade account is 927.2 million Euro (300.1 million Euro more than the same period of 2006). The deficit in the current account is 912.7 million Euro (262.3 million Euro more than the same period of 2006).

repayment of external debt.<sup>19</sup> It is impossible to achieve catch-up development in such a climate.

- *The deficit in the current account is alarmingly large and steadily increasing*<sup>20</sup>. That is due to the small output, even smaller exports with primitive composition and low competitiveness<sup>21</sup>. The solution of the problem of the current account deficit is not in the super-restrictive budgetary policy, as believed by the Government. The sustainable solution lies in speedy and massive structural and technological modernisation of the economy with the involvement of leading world companies, fast expansion of modern infrastructure, active innovation policy, modernisation and better financing of healthcare and of education, training of highly qualified labour force. This would lead to an increase of the export volume, modernisation of its composition, upgrading of its competitiveness and in addition – more flexible budgetary policy and equally flexible exchange rate policy. As a result from all these, the production and exports will grow, the competitiveness of Bulgarian goods will increase, the deficit in the trade account will decline. Ultimately the current account deficit will turn downwards to be followed by a reduction of the gross external debt. The sustainable high current account deficit will be an obstacle to accelerated catch-up development. An economy cannot coexist peacefully too long with very high external debt<sup>22</sup>.

- *The enterprise culture is low, and enterprise management is mediocre.* A significant part of the companies are not loyal to the state, society, citizens and even to their own personnel. There are large-scale violations of tax, customs, social insurance, and borrowing discipline. In terms of quality of the companies'

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19 At the very end of 2005 after ahead of schedule repayment of debt of 340 million Euro to the IMF and the World Bank, the public external debt of Bulgaria amounted to 4.6 billion Euro or 19.9% of GDP. The average public debt of the EU-25 in the end of 2005 amounted to 63.4% of GDP and the countries from the Euro-Zone – 70.8%. Some member countries from the Euro-Zone (Italy, Greece and Belgium) have public debt of 95-110% of GDP.

20 As stated above, 16% of GDP for 2006, compared to 11.8% in 2005. If it goes with the pace of January-February, the annual results for 2007 will be much worse than those of 2006.

21 Bulgaria has the lowest GDP per capita among the member countries and 32% of the EU-25 average. In addition, Bulgaria exports per capita 6 times less than Slovenia, 5 times less than the Czech Republic and 4 times less than Hungary.

22 The gross external debt of Bulgaria was \$10.6 billion in December 1989; \$17.9 billion in December 2005 and \$25 billion in December 2006. The total volume of GDP over the three dates was comparable. Thus from 1989 to 2005 the external debt has grown by \$7.3 billion, while only for 2006 increased by \$7.1 billion. The numbers speak for themselves.

management, Bulgaria is among the most backward countries.<sup>23</sup> Accelerated catch-up development is impossible in such microclimate.

- *There is a permanent tendency in the micro economy to accumulate debts*, which makes the increase in competitiveness difficult, even threatens the survival of the companies. After the de-capitalisation of the public companies, their plundering and intentional abandonment by the state in 1990's and after the criminal privatisation, a large portion of the Bulgarian enterprises have not been stabilised yet. They have not implemented structural, technological, personnel, management and market modernisation. They lack financial resources and competent management and are not ready for efficient economic performance in compliance with contemporary standards. The business climate is not appropriate. In such microclimate it is difficult to sustain accelerated economic development.
- *State, municipal and other institutions are not efficient*. The state and municipal administration are too large, insufficiently skilled, politically involved, inefficient, with uncertain future, poorly paid and inclined to corruption. With such administration it is difficult to achieve accelerated economic development.
- *The financial system is poorly developed*, including banking and non-banking financial institutions. Though they are almost entirely possessed by foreign capital<sup>24</sup>, the banks and other financial institutions are not modernised and their activities are far below the European and international standards in the respective fields. The saving instruments applied in Bulgaria are much more limited than those in the advanced countries. The prevailing saving instrument is the banking deposit. Mutual, investment, pension funds and other modern instruments are making only the first steps. The coverage of insurance activities is also limited. The money market is not deep enough. Their modernisation is also delayed by the low saving, insurance and financial culture of the Bulgarian public. There is high level of centralisation of the budgetary system. The budget performs only fiscal functions and neglects the stimulating and suppressing functions. The policy of budget surplus oppresses economic growth. The situation in the field of corporate

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<sup>23</sup> According to the abovementioned report of the World Economic Forum on global competitiveness, Bulgaria is in the 83<sup>rd</sup> position by enterprise performance. By quality of the business environment in the enterprises we are in the 81<sup>st</sup> position and by quality of enterprise operations – in the 95<sup>th</sup> position among 125 countries, covered by the survey. Here again Bulgaria is the last among the EU members and EU accession states and 35-40 developing countries are ranked better than we are.

<sup>24</sup> Above 90% of the assets.

finances, as stated above, is also difficult. With such financial system accelerated catch-up development is not possible.

- *The exchange rate is pegged* (since July 1<sup>st</sup> 1997) under the conditions of moderate inflation and very slow increase of labour productivity. The inflation accumulated in Bulgaria for the last 10 years surpasses by far - with 80% the accumulated inflation in Germany and the Euro-Zone for the same period. Most CEE countries apply managed floating exchange rates while Bulgaria is one of the few with long lasting pegged rate under the conditions of a Currency board. This appreciates the Bulgarian currency, generates additional difficulties for the GDP growth and competitiveness.
- *The average price level is very low* (around 44%) compared to the one in EU. For tradable goods the discrepancy is smaller, while for non-tradables is much larger. The objective integration processes dictate gradual conversion of prices among the member states. Bulgaria cannot be exempt from these processes. In the years after accession, it is normal for prices in Bulgaria to rise faster than those in the Community. This has been confirmed by the experience of Greece, Portugal and Spain in the years before and immediately after their accession to the European community. Bulgaria will repeat their trajectory in one way or another. The full levelling of prices will take 20-30 years or more. It is better if the biggest part of the gap closing happens before our joining the Euro-Zone, because then starts the inflation restriction (according to the Maastricht criteria) that will make the harmonisation of our prices with those in EU difficult.<sup>25</sup> The abovementioned objective processes are neglected by the Bulgarian authorities that stick to the low inflation policy at any price. Low inflation is desirable in principle, but it is not advisable under the present Bulgarian circumstances with much lower average price level compared to the EU level. If this policy goes on unabated, time will come when bigger inflation pressure will accumulate. The control over it will become more difficult and the negative consequences from the long lasting pegged rate on the competitiveness of Bulgarian goods will be even more negative. In the initial stages the rising of prices will be quick, difficult to control and incompatible with the requirements of the Euro-Zone. This will be an additional difficulty for the economic development and may have grave social consequences. The future rise of prices in Bulgaria as an EU member state is inevitable. We could choose only the way it happens – gradually or as a shock. The controlled moderate inflation leading to gradual equalisation of prices is

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<sup>25</sup> The average inflation should not be more than 1.5% points above the inflation in the three member states with the lowest inflation rates one year before the review.

preferable than the levelling through uncontrollable shock inflation. Permitting the latter will be another obstacle to accelerated economic development.

- *The lack of respect for the rule of law, order and discipline* is a century-long feature of our national psychology. It is so in the field of contract discipline in the economy, but also in interpersonal relations. As mentioned above, the positive impact of European rule of law, regulations, order and discipline for all is even more important for Bulgaria than the EU financial support. Quick shifts in national psychology are not possible. It will take generations. The planned strengthened control on the part of the European commission could accelerate this process and therefore it is useful for us. In the absence of these preconditions accelerated economic and social development is not possible.
- *The shadow sector in the Bulgarian economy is too big.* According to some assessments it is 20-30%, and to others – more than 40%. If this is true, one cannot trust statistical information about the economic status and development. We do not know the true economic world in which we live. Given that, it is very difficult to design an economic policy as the number, intentions, interests and behaviour of thousands of shadow economic agents are unknown and therefore unpredictable. Irrational economic behaviour of these grey agents has a demoralising effect on the behaviour of economic subjects in the open sector of the economy.
- There are *high levels of crime and corruption* that are severely counter-productive to normal economic activities<sup>26</sup>. An important part of the economic activities in Bulgaria are criminalised. This gives the impression that the crime is passively tolerated by some public institutions. As we already stated, there are improper relations between high-ranking magistrates and criminal groupings. Since the favourable conditions for their flourishing were created in 1990's, the recuperation of control over domestic crime and corruption will require great efforts. The criminal offences committed by our citizens in Western Europe undermine Bulgaria's image in the eyes of the citizens and authorities in these countries. This has a negative impact on economic and other relations with Bulgaria and is an obstacle to accelerated economic development.

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<sup>26</sup> The Bulgarian Centre for Studies on Democracy assesses that corruption payments in 2006 were around 1 billion Euro – more than 4% of GDP. The incurred losses from corruption were larger than expected annual net transfers from the EU funds to Bulgaria. In addition to all other taxes paid, the average Bulgarian is charged 150 Euro per annum as “Corruption” tax. This is equal to an average monthly wage. 55% of the Bulgarians consider corruption as the most important social problem, more alarming than poverty, unemployment and crime. Political corruption is growing faster than the administrative one.

- Our *geographic location has also important weaknesses*. Unlike the Czech Republic, Poland, Slovakia, Hungary, Slovenia and Croatia, we are far from the big economic, scientific, technical and cultural centres of Western Europe. We lack centuries-old traditions of active economic and cultural exchanges with them and even the closeness of the everyday life with their nations unlike the abovementioned countries. The big distances mean also more time and larger transport expenses for economic exchanges. This is one of the reasons for Bulgaria to be in the economic margins of Europe. If there are not strong enough measures to overcome the other weaknesses, the geographic location will put even stronger peripheral imprint on our future economic development.

#### **4. Conclusion**

There are many unresolved problems in Bulgaria that pre-determine our economic and social backwardness. Enlisting so many weaknesses at the start is not a pleasant job for a researcher. *But it is better to face the truth than to close our eyes* before it! Science should speak the language of facts no matter if they are pleasant or not! Otherwise, science would not serve the national interests and would turn into a servant to partisan or corporate interests. We have to face the unpleasant truth in order to comprehend it and transform it into something positive.

The list of weaknesses at the start is not only a product of the last 17 years of transition. It is also a result of a *long lasting “accumulation” of insufficient development*; low economic rationality, inadequate public policy; insufficient material, financial, human and management resources, inefficient use of these resources. It is also a product of external circumstances imposed by the big powers and by the international financial institutions on Bulgaria in the past and at present. However, the major factors for our backwardness are of internal origin for which we are responsible, and nobody else should be blamed.

*All this has been accumulated for more than 100 years* and kept us at the rear of the European progress. Bulgaria is now among the last in Europe by level of economic and social development, where we were 50 or 100 years ago. During this time we have achieved development but so have the other European countries too. And they did it even better than us. The statements of some of our politicians that immediately before the WWII Bulgaria was among the most advanced European countries are false.

*If we manage to turn an important part of our weaknesses into advantages or at least to mitigate their negative impact, we will achieve catch-up economic development. If we do not succeed – we will continue vegetating among the last on the social and economic margins of Europe. So far, we have been on the margins of a divided Europe. In the future we could stay on the margins of a united Europe, if we don't act radically and expediently. There is hardly a big difference between the two situations from the point of view of our comparative positions with the other countries in Europe.*

The abovementioned weaknesses reveal our *insufficient preparedness for the EU accession*. So far the attention of the Bulgarian authorities and of the European Commission during the pre-accession negotiations was fully focused on the judiciary system, crime and corruption. As stated above, Bulgaria has grave weaknesses in these fields indeed but they are neither the only ones, nor the most difficult to solve. The lack of preparedness of our economy for the EU accession was strongly underestimated and unspoken both at home and in Brussels. Strictly speaking, Bulgaria does not have a normally functioning market economy or even less - a competitive economy capable of coping with the challenges of the competitive pressure from the internal European market. These were the major economic criteria for accession, known as the Copenhagen criteria. If one speaks professionally, we did not meet these criteria.

Despite all this, I am for a quicker EU accession. *I welcome the decisions of the European institutions for Bulgarian accession* not because Bulgaria was well prepared, but because only by being a member of the Community, the strict EU rules will start working in our country and more favourable environment for social and economic development will be created. Under the direct supervision and control of the EU institutions, radical reforms will be implemented in the fields of economy, health care, education, environment, judiciary system, etc. Thus we will achieve accelerated catch-up social and economic development only as a member of the Community. This would not be possible outside EU, if it had depended only on the political will and capabilities of the Bulgarian authorities. The fast development of Bulgaria is good both for us and for the other EU members. EU is keenly interested in a prospering Bulgaria.

*The strongest opponents of the severe measures for monitoring and control of Bulgaria, declared by the European Commission with the decision on our accession, are criminal and other groups' interests for which, under the new conditions, it will be more difficult to abuse the law for their own benefit. The strengthened supervision on Bulgaria could touch some sensitive national chords,*

but objectively it is useful for our future development. However incredible it is, the EU institutions seem to be more interested and concerned for our successful development than the Bulgarian authorities themselves. After all, good for us is anything that improves the quality of life of the people in Bulgaria.

*The experience from recent years is instructive.* Most of the changes in our country happened as a result of the pressure of the European Commission during pre-accession negotiations, often resisted by some Bulgarian institutions and vested interests of domestic criminal groups. In the absence of this external pressure, the reforms would not have happened, including the reforms in the judiciary system and the changes in the Constitution. The speed and radicalism of the reforms in Bulgaria as an EU member will be much higher than outside the community. This will be a major factor for our accelerated development.

Consequently, *Bulgarian EU accession is not so much an act of acknowledgement for the accomplished conditions for membership.* It is an expression of good will on the part of EU and aims at creating in advance appropriate conditions for radical reforms and catch-up development within the Community. We have to take advantage of this golden opportunity.

*The good will of EU however is not an expression of pure altruism* on their part. We are also indispensable for them, mainly due to strategic and geopolitical reasons, and also as a market for their goods and investments. We supply them with trained and skilled experts in different fields of knowledge, but also with unskilled labour for jobs in sectors that are not attractive to the citizens of the old member states. We provide them with an opportunity to outsource manufacturing capacities from their countries with expensive labour to our country with relatively skilled and much cheaper labour.<sup>27</sup> The citizens of the old member states could buy real-estate here at very low prices for their living standard and spend a significant part of their lifetime in our favourable climate. We will introduce cultural diversity in the Community too, which is an indirect factor for accelerated development.

*Increasing economic and social coherence* is an objective development rule of every modern integration community. Such community does not tolerate foreign substance in its own organism just as the human body does not. As an EU member Bulgaria has to speed up its development to overcome as soon as possible

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<sup>27</sup> The labour expenses in Bulgaria are the lowest among the EU countries. The average wage per hour here is 1.62 Euro, in Romania – 1.90 Euro, and in Denmark – 32 Euro.

its backwardness and must not provide grounds for the EU members to think of us as a foreign body that has somehow landed there by chance.

*This is a giant task.* Its accomplishment is possible only through comprehensive structural, technological, financial and institutional modernisation of the economy, healthcare, education, science, innovations and infrastructure. It calls for combining efficiency and social equity, limiting social polarisation, environmental protection, reconstructing the broken relationship between the macro- and microeconomic systems. This requires also flexible macro- and microeconomic policy free from ideological dogmas, drastic measures against crime and corruption, i.e. policies quite different from the present ones.

*Our specific recommendations on these policies in 15 perspectives* are in the second chapter of our research that has been published recently and to which we referred in the beginning. This study is a logical follow up on our strategy for catch-up economic development of Bulgaria by 2020 published more than four years ago<sup>28</sup>.

In the recent years *Bulgaria has maintained a big budgetary surplus* that is justified with an enormous and continuously growing deficit in the current account. The authorities do not seem to understand that such short-sighted policy only deepens the problems of the current account and delays its normalisation. This is because budget restrictions slow down economy's modernisation, rise in output, productivity and competitiveness. It is not by chance that this deficit has increased during the last ten years after the introduction of the Currency board arrangement. The long-term solution lies in the flexible policy of accelerated total modernisation suggested by our team that leads to high rise in output, competitiveness, exports, lower deficit in the trade balance and ultimately in the current account.

In the years immediately following the accession, some negative effects of the integration processes sharpened by our insufficient preparedness will be felt stronger. Positive effects however will prevail in the medium-term and especially in the long-term perspective.

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<sup>28</sup> *The Bulgarian economy and the European Union. Strategy for catching-up economic development by 2020*, Institute of Economics of the Bulgarian Academy of Sciences and Friedrich Ebert Foundation, Sofia, November 2003, 354 pages. The full text in Bulgarian and an expanded Summary of the Main Conclusions and Recommendations (76 pages) can be found on internet on the following address [www.iki.bas.bg/CVita/angelov/index.htm](http://www.iki.bas.bg/CVita/angelov/index.htm), title № 43 in the publications list.

*Our society is not aware of the serious economic and social problems that we will face in the years immediately following the accession.* There are predominant naïve expectations of welfare granted to us by the European Union, without us changing our life- and working style.<sup>29</sup> The key to welfare is in higher productivity. Bulgaria could achieve higher productivity more quickly only as a member of the Community. Due to the Euro-illusions cultivated by our politicians for years, there is a real danger that the present naïve Euro-optimism may transform into aggressive Euro-pessimism in the next years.

We should be aware of these challenges and be prepared to overcome them. Especially the challenges in the years immediately after the accession: the most difficult period of our EU membership. In the beginning of 2005 I recommended to the President and to the Government to develop appropriate strategies and programmes backed up with resources for their implementation. The authorities did not do enough to prepare the society, business, trade unions and public institutions to face the severe economic and social challenges of the integration in the years immediately after the accession. There is much evidence for that.

It is enough to remind once more of the weak preparedness of the capacity for utilisation of the EU funds. All admit that we are not well prepared for their utilisation and that, during the first years after the accession, we will lose many unutilised funds. Large-scale radical measures for preparation of the required capacity are nevertheless missing. It is as if the authorities have accepted that this is inevitable in our country, as it has happened in other new member countries<sup>30</sup>. For this reason we risk to lose billions of Euro during the first years after the accession.

As we already stated in the beginning, in the present article we did not intend to provide a detailed analysis of each of the enumerated weaknesses and strengths. We review them in order to demonstrate the scale and complexity of the challenges related to the catch-up economic development of Bulgaria as an EU member. Part of the weaknesses and strengths were analysed in detail and recommendations were provided in our “Strategy for Catch-up Economic

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<sup>29</sup> In that sense, it is worth recalling the words of Hans-Gert Pötering in the European Parliament on 26<sup>th</sup> September 2006 where he addressed the peoples of Bulgaria and Romania. He said “accession to the EU does not mean accession to the heavens on the Earth”.

<sup>30</sup> In the 2007 budget only 20% utilization of the EU structural funds granted to us is envisaged.

As things stand now, even this may not be achieved.

Development of Bulgaria by 2020”<sup>31</sup>. For another part, analysis is already done in a series of other publications of ours in the recent years, and especially in our latest publication “Catch-up Economic Development of Bulgaria – Strategy and Realities” that was launched on the book market recently. There is still a lot to be done by the economic science.

Bulgaria could achieve catch-up economic development as an EU member in the following years and decades, *if it uses its strengths and turns part of its weaknesses into advantages*. This is not easy but it is not impossible! Though under different conditions, other countries and nations have achieved it. There is no reasonable alternative to the EU integration for Bulgaria. There is no alternative also to the accelerated catch-up development. The successful catch-up development of Bulgaria is possible only within the Community.

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<sup>31</sup> See pp. 77-131, 148-340.