

Privatization and Economic Restructuring, December 1996

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I. PRIVATIZATION UP DATE

1. Political Context

The political situation in Bulgaria for the period under review was unfavourable regarding the continuance of the economic reforms so necessary for the country. The urgent and decisive measures for reaching macro-economic stability and speeding the market reforms have been once again postponed by the announced for the end of October '96 presidential elections and the will of the governing Bulgarian Socialist Party to win those elections at all costs.

On October 27, 1996 the candidate from the pro-market opposition party, the Union of Democratic Forces, won the presidential elections. Although the President of Bulgaria has a rather representative function, results are interpreted as being a rejection to the socialist government, which politics brought about the worse economic crises this country has ever witnessed since 1989.

The loss of the presidential elections increased the tension between fractions in BSP and as a result senior party officials as well as the minister of foreign affairs resigned. The announced for December extraordinary congress of BSP was expected to provide answers to the numerous questions concerning the future of the party and the country as well as the prospects for constructive reforms in the governing of the left party.

Since November 1996 the political life has been mainly focused on IMF's idea of introducing currency board in Bulgaria. Economic and political aspects of the problem are closely interrelated and the taken decision by the government in favour of the currency board variant will continue in the next few months to strongly influence the political situation in Bulgaria.

The currency board will force both government and Parliament to execute the necessary legislative and regulatory reforms, which would guarantee the transition to market economy in Bulgaria. They include full liberalization of all markets, simplifying bankruptcy procedures and rapid sale of insolvent companies and banks, as well as explicit refusal on the part of the state to cover any longer the liabilities of enterprises and banks.

In November 1996 the Parliament passed a bill draft for amendments to the Act on economic activity of foreign persons and protection of foreign investments. "Economic activity" has been omitted in the formulation of the Act and substituted with "for promotion and protection of foreign investments", which however does not change the substance of the Act. In fact, amendments provide more restrictions rather than preferences for the foreign investments. This has been the reason for the President to put a veto on the Act and return it for a reconsideration in the Parliament.

2. Economic Framework

The last months of 1996 have still more intensified the negative tendencies in Bulgarian economy, which had prior been observed: crucial decrease in production and exports, liquidity crisis in the banking system, high inflation rates, constant devaluation of national currency, unemployment increase, and impoverishment of the population that reaches the extent of physical survival.

Government assurances that Bulgarian economy will soon improve have been devalued beyond worth by so much repetition. In a last minute attempt to halt the Leva's free fall and a run on the banks, Bulgarian National bank hiked its key interest rate to an annual 300% in late September 1996. (The annual inflation is running around 300 %.) Wages are now less than . The government quickly put nine private and state banks under special supervision and 15 major state companies up for sale. IMF has stalled the second tranche of a 0 million standby loan, explicitly citing sluggish privatization and insolvent banks.

Overall the economy is expected to contract by some 10% in 1996; both exports and imports have fallen. As of now the government has no way to meet the ,4 billion in foreign debt repayment due in 1997.

A certain improvement has been achieved in the restructuring of enterprises from industry earmarked for liquidation and isolation from the banking system. Five of the companies were successfully sold off. They continue to work and have started repaying their debts; employees keep their jobs; new investment is made making possible new products and technologies. Bankruptcy procedures were launched for ten enterprises and they are no longer in operation. The condition of the remaining (approximately 50 in number) companies is directly observed and controlled by the Ministry of Finance as different variants have been considered: declaring insolvency, privatization or partial liquidation.

3. Privatization

Being pressed by the serious economic problems and by the IMF's recommendation as a condition of continuing negotiations, the government took decision for quick privatization of 17 large industrial enterprises not included in the annual program for privatization. On this basis, revenues for about 1 billion USD are to be expected, which will be purposely used to reduce the internal debt and to finance the State Protected Deposits Fund. In fact, by the end of 1996 no enterprise from this list has been sold, mainly because of the unwillingness on the part of government to apply the Law on Concessions.

As of December 13th '96, there are 444 transactions for privatization of state enterprises, out of which 132 are for entire enterprises. Only 50 per cents of the contracted payments have been effectively received. These qualitative and financial results are better compared to last year, yet the problem of revenues from privatization will be hard to solve, because of the instability of the banking system.

Along with the urge of the government to sufficiently speed up the privatization process, there have also been observed cases of competition restrictions and preferential treatment of certain clients, lack of openness and manipulated privatization transactions. Delayed privatization is better than none, but public opinion in Bulgaria as well as the international financial institutions are concerned about these negative tendencies.

With the adoption of the amendments to the Law on Privatization in October 1996 the number of the members of the Supervisory Board of the Privatization Agency was reduced from 11 to 7 in order to ease the work of this controlling authority. As a matter of fact, this has been an attempt to eliminate the tension between the Supervisory Board and the Executive Director (respectively the government). This thesis has also been supported by the submitted short time earlier resignation of the Chairman of the Supervisory Board together with the collective resignation of his colleagues. A new Supervisory Board has not been appointed by the end of 1996, which has impeded the work of the Privatization Agency and as a result numerous contracted transactions could have not been approved.

Relatively without problems and according to the affirmed plan have the following stages of the first round of mass privatization been held: licensing and registration of the privatization funds and first centralised auction for obtaining stocks, the results of which were announced in the end of the year. A priority comes to be the problems of post-privatization enterprise management, the mass privatization shares trading and protection of the rights of the individual shareholders. There is insufficient information on these matters as well as legally undefined questions in Bulgaria. The Center for the Study of Democracy may very efficiently intermediate foreign experience and initiate wide public discussion with the participation of all interested parties.

II. ACTIVITIES

For the first report period (September 16 - December 15, 1996) Project Team's efforts were pointed to identify the activities, defined in the project and to plan them in time. The first three-month period has covered all major components of the project in their preliminary stage. Some of the activities were finalized and they have concrete practical results.

1. Facilitating Public Policy Debate

1.1. Acquaint the Public with Top Economists Findings: International Conference 'Restructuring of Economies in Transition', October 11-14, 1996

The conference was a meeting of policy makers, bankers, managers of enterprises and investment funds on one side to get the understanding of the problem from a practical point of view and of researchers bringing to the conference the results of several years of research work on the challenges of the transitional period and the consequences for restructuring the economies in the 90's.

The international conference on "Restructuring Economies in Transition in the 90s: Enterprise Behavior and the Role of Financial Intermediaries" was organized jointly by the Center for the Study of Democracy and the East-West Economic and Financial Center with the financial support of the EU Program for Scientific Cooperation in the Field of Economics.

The conference was attended by eminent experts and researchers of the economies in transition from Austria, Great Britain, France, Italy, Greece, Canada, the U.S., Albania, Macedonia, the Czech Republic, and Bulgaria. Among them were Saul Estrin (London Business School), Jean-Louis Brillet (National Institute for Economic Studies and Statistics-France), Ioanis Katzulakus (Athens Institute of Economic Research), Robert Kennedy (Harvard Business School), etc. The conference host country was represented by Gancho Ganchev (Ministry of Economic Development), Zdravko Balyozov (Bulgarian National Bank), Christian Tanushev (Securities and Stock Exchange Commission), Garabed Minassian, Mariela Nenova, and other institutions and experts. (See Appendix 1)

During the conference, a number of issues related to the enterprise restructuring and the economy as a whole were discussed. They encompass generally the relationship between privatization and enterprise restructuring, the trends in the capital markets development and the banking sector reform. The highly professional reports and materials prepared in advance served as a basis for discussions. They contain a great quantity of empirical results and major theoretical conclusions from all notable studies on these topics over the past several years. A method widely used in the conference was the comparative analysis of achievements and failures in the transition to a market economy in the countries in Central and Eastern Europe.

The prevailing opinion of the participants was that the conference had been very timely in light of the upcoming structural reforms in Bulgaria. It provided a possibility for a fruitful exchange of ideas and information and turned into a kind of assessment of the results from the economic reforms in the region. The conference was also a challenge for the Bulgarian participants to use to the highest degree the shared experience and its lessons in order to achieve rapid and notable results in privatization and economic restructuring.

1.2. Promoting SMEs Sector Growth: The Agenda for Implementing Policy Change

In October 1996 the Center for the Study of Democracy initiated a process aimed at producing a recommendation paper addressing the policy and legal constraints facing small and medium size enterprises (SMEs) in Bulgaria, and identifying a set of possible solutions designed to encourage the growth of this key sector of the economy. The main purpose of the paper was to set out a specific and comprehensive agenda for an assistance program in this area.

Building upon this experience, and its extensive network of contacts, CSD started a process of development of the SME policy paper consisting of two stages of consultations. Each stage was completed by a public discussion at CSD. The first stage included the initial drafting of the paper and consultations at the expert level.

The second stage aimed at providing bi-partisan political support for the policy agenda outlined in the paper and endorsement of its priorities by policy makers from across the political spectrum. (See Appendix 2)

With a view of adopting a comprehensive approach in the paper, CSD contacted a number of Bulgarian and international institutions, involved in the development of SMEs, with a request for providing suggestions and comments to the paper. As a result, the paper reflected a variety of the viewpoints and experience thus ensuring a consensus on its recommendations.

The paper was presented to over 50 experts at government agencies, business associations, research NGOs, trade unions, international and foreign donor organizations, and individual SMEs. The input from the experts included suggestions as to the structure, additional action line items, and clarification of certain recommendations.

Stage 1: The Policy Workshop

The first stage of consultations was completed by a policy workshop held on November 20, 1996 at CSD. Following an introductory plenary session, the workshop continued in two separate sessions - on economic policy and on the legal and institutional environment.

Following the workshop discussions, members of the task force groups and CSD experts held individual meetings with a number of policy makers who had been invited to participate in the forum. The draft paper, amended as a result of the expert discussion, had been circulated in advance together with some background information about the objectives of the forum. During the meetings, the experts provided additional clarification on the action lines as well as on the overall context of the drafting exercise.

Believing that in order for the paper to provide an agenda of a feasible long term assistance program it needs to enjoy widespread support among politicians and the business community, CSD invited representatives of the major parliamentary parties, the government, the governor of the National Bank, leaders of business associations and trade unions to comment on the paper and take part in the forum discussions. By enlisting the support of key political figures and institutions CSD managed to build a consensus for the agenda which is a key prerequisite for its successful implementation.

Throughout the process CSD also held several rounds of consultations with representatives of USAID who provided general guidelines for the expected output.

Stage 2: The Policy Forum

The policy forum was held on November 29 at the conference hall of CSD. Following some introductory remarks by CSD's President, Dr. Ognian Shentov, Mr. John Tennant, USAID Representative, and Ms. Rose Likins, Charge d'Affaires at the US

Embassy presented the Implementing Policy Change Program. In his introductory remarks, Mr. Petar Stoyanov, President-elect of the Republic of Bulgaria, expressed his support for a program encouraging the development of the private sector in Bulgaria, and particularly SMEs. CSD's President, Dr. Ognian Shentov informed the audience about the letter of support on behalf of CIPE.

The first session of the forum was chaired jointly by Mr. Atanas Paparizov, Minister of Trade and Foreign Economic Cooperation and Dr. George Prohaski, Executive Director of the Open Society Fund-Sofia and discussed the economic policy recommendations of the paper. The second session, dealing with the policy and legal environment for SMEs was chaired by Mr. Atanas Zhelezchev, Deputy Chair of the National Assembly. The concluding part of the forum included a presentation by Mr. Alexander Stoyanov and Professor Zahari Karamfilov, Chairman of the National Institute of Statistics on a system monitoring both the state of the SME sector and the implementation of the policy agenda outlined in the paper.

2. Mass Privatization and Business Climate Research

2.1. Tracking the Progress of Mass Privatization: Survey "Public Preferences and Attitudes Towards Mass Privatization "

In October 1996 The Center for the Study of Democracy conducted a national opinion poll survey, dealing with the problems of denationalization , and mainly with how common people felt about mass privatization. A total of 1096 respondents from all parts of the country, of ages above 18 were interviewed. The sample of respondents was compiled from the names of the voters listed in the municipal election lists (October, 1995).

The poll results were disseminated among the circle of professionals and the general public in the form of a series of articles in the Cash weekly, always dealing with current problems of mass privatization and the people's opinion about them. (See Media Coverage) An analysis of these results, accompanied by a complete set of data, including numerous tables and charts has been provided to the experts of the Center for Mass Privatization upon their request.

This poll was part of one of the Center's long-term programs, which aimed at identifying the overall opinion towards the process of privatization in each one of its phases, as well as at following the change in the social attitudes.

The main goals of the survey were:

- to identify the preferred ways of taking part in the privatization with investment vouchers;
- to collect information about the expected results, the social and economic consequences of this stage of the mass privatization.

The data collected provides us with information about the reasons people choose to participate in the mass privatization by themselves or through privatization funds,

about their preferences towards specific sectors for investment, about their trust in the information provided on the privatization funds and on the enterprises, about the expected results from the mass privatization, the periods in which profit is expected following the participation in the mass privatization, the groups of people and the institutions which are expected to benefit the most from the process of mass privatization.

The conclusions of the poll had been confirmed by the factual data available at the moment, which showed that the greater number of the people, who had bought voucher booklets, transferred their investment vouchers later to one or more privatization funds. This situation is accounted for by the fact that people felt they did not have sufficient information to participate individually in the process of privatization and opt for surrendering their right to the competent organizations. The relative share of people participating in the auctions by themselves is small. We should also mention the fact that a significant number of the respondents stated they were not going to take part in the process of privatization. (See Appendix 3)

If we were to consider the goals of the survey we can conclude the following:

- The privatization through investment vouchers is perceived as a useful and necessary for the country process, whose consequences and results are usually seen as positive in a personal, as well as in a general for the economy way.
- The favored way for participation in the mass privatization was through privatization funds. The main reason for this is the fact that the people have little knowledge about the process of privatization.
- The leading motive in selecting a privatization fund is for it to be recommended by proficient individuals as well as the trust in its founders.
- In general, the people who will be participating in the auctions on their own do not count on the information about the enterprises they are given.
- A relatively large number of the respondents refuse to predict the results of the process of privatization.
- People have shown considerable curiosity for the investment activities of the privatization funds, despite the low attendance level in the founding meetings.
- For the people who opted to participate individually in the mass privatization, the combination of prospering enterprises from the light industry, trade, and/or tourism sectors seemed to be the best for their choice of investment.
- The process of privatization is seen by the people as an opportunity to restructure the economy, raise the efficiency of the enterprises, and develop an investment culture in the general population
- It is expected that the economy will begin to improve in about 6-10 years, whereas individually, the people expect profits in 1-5 years.

2.2. Monitoring Business Attitudes towards Government Economic Policies and Practice

The qualitative survey *Business Climate in Bulgaria* was conducted in October simultaneously with the representative sociological survey. It included interviews with 100 presidents and directors of private companies in small, medium, and large towns around the country. The companies were selected according to the number of people they employed - under 50, 50-200, and over 200 employees. This survey was requested by the World Bank Resident Mission in Bulgaria and its final results will be used in the preparation of the World Development Report 1997.

The goal of this survey was to collect information about the evaluation and opinion of the managers of the direction the economic reform in Bulgaria is taking, their attitude towards the process of distributing state property and the basis for the development of entrepreneurship.

In general, the opinion of the leaders of the private enterprises about the result of the economic reforms in Bulgaria is categorical - their evaluation is either totally negative or mostly negative. Their evaluation about the pace at which the economic reforms are taking place in Bulgaria is even more categorical - 91.8% of the respondents said the reforms were going too slow.

According to more than half of the presidents and directors interviewed (69.5%), virtually all enterprises ought to be privatized. It is the largest relative share consisting of those who said that the privatization will contribute *somewhat* to the restructuring of the economy and the improvement of its effectiveness (41.8%). Despite the fact that most managers of private firms think all enterprises should be privatized, one out of four respondents stated that the privatization will contribute only little to the development of the economy. Furthermore, 11.2% of the respondents think that the privatization will not help to improve the effectiveness of the economy in the least.

The initial liberalization of the business community was not followed by any clear and coordinated activities for process of distributing state property and the basis for the encouragement of entrepreneurship. Additionally the constant instability in the legal, institutional, and financial systems undermines the economic situation. According to the representatives of private business most laws cannot be adequately applied in practice, and corruption is growing in a frightening manner.

3. Introducing the Corporate Governance Concept and Practices to Bulgarian Experts

3.1. Corporate Governance Agenda for Bulgaria

As one of the pioneer organizations, CSD envisages to prepare and implement a long-term program for dissemination of information and training of the population and of selected professional groups in Bulgaria on the problems of corporate governance. As a prerequisite for the successful start of the program in the framework of the

Privatization and Economic Restructuring in Bulgaria project, a CSD team consulted a group of core experts on its content and time framework for implementation.

The good CSD institutional contacts, as well as its continuous research and advocacy work on privatization issues, allowed the Center, in a mediator's role, to contribute for the achievement of an expert level consensus, supported by all concerned institutions as regards the corporate governance agenda for Bulgaria and the corresponding action plan. As a result of the expert discussion (November 27, 1996) with the participation of representatives from the Center for Mass Privatization, the Securities and Stock Exchanges Commission, the Bulgarian Stock Exchange, the privatization funds, as well as of researchers and consultants, the following thematic trends were decided upon to be included in the Corporate Governance Program. The agenda envisages the following activities:

- working out and dissemination of an acceptable work definition of "corporate governance" in Bulgarian;
- research and analysis of the specific problems of corporate governance in the privatized enterprises and privatization funds;
- common activities with the privatization funds' associations;
- study of the foreign experience on the problems of shareholders' rights protection, and introducing it to the Bulgarian public.

3.2. Securities Safe Custody and Administration in a Central Depository seminar (December 12-13, 1996)

The idea for this seminar belongs to the CSD, and it was carried out with the support of the *Fordergesellschaft für Borsen und Finanzmärkte in Mittel- und Osteuropa mbH* (Germany). (See Appendix 4)

The conclusion of the first centralized auction of mass privatization, and the transition to a secondary market of the privatized enterprises' shares, make the matter of building of the Central Depository in Bulgaria especially urgent. With the purpose of supporting its successful functioning, and giving answers to some unsolved legal matters, the Center for the Study of Democracy and the Institute for Market Economics organized a seminar on the above theme.

The seminar gave the Bulgarian participants (privatization funds, stock exchanges, state institutions) the opportunity for detailed acquaintance with the organizational structure and practices of the stock exchange and Central Depository in Germany. The representatives of the Bulgarian institutions - the Center for Mass Privatization, the Securities and Stock Exchanges Commission, the Bulgarian Stock Exchange, and the Central Depository, together with the rest of participants, discussed a number of specific problems, connected with the functioning of the capital market in Bulgaria. They explained the enforcing of some texts from the Securities and Stock Exchanges Law, and gave examples of forthcoming changes in the normative regulations.

4. Privatization Monitor

In the period under review, the regular publishing and distribution continued of the *Monitor of Privatization and Foreign Investment*, based on publications in the Bulgarian press, on statistic data, and on CSD research findings and advocacy achievements. With the successful start of the 1996-97 project, the *Monitor* is now released via the Internet too, once a month in Bulgarian and once in two months in English, on CSD's WWW server.

III. MEDIA COVERAGE

A greater part of the publications, reflecting the activities on the *Privatization and Economic Restructuring in Bulgaria* project, treat strictly professional problems of the capital markets and corporate governance. For the dissemination of this information, specialized economic periodicals, having circulation around 5-10 thousand, have been chosen. A part of the activities found coverage in brief reports in the electronic media as well, the strongest accent being put on the Policy Forum *Policy and Legal Environment for the Growth of the SME Sector in Bulgaria*. The Forum was covered by both channels of the National Television in the evening of the same day. Four major dailies: *24 hours*, *Democratsia*, *Continent*, and *Pari* - published articles about the Forum on the following day.

The list of publications is as follows:

1. How To Create an Investment Portfolio, Nikola Hristovich, Member of CSD Advisory Board, *Ikonomicheski zhivot* weekly, October 9, 1996.
2. Achieved and Expected Profitability of Enterprises (Risks for the Privatization Fund), Nikola Hristovich, Member of CSD Advisory Board, *Ikonomicheski zhivot* weekly, October 16, 1996.
3. Different Models of Corporate Governance in USA, Germany and Japan, Geoffrey Mazullo, Member of CSD Advisory Board, *Ikonomicheski zhivot* weekly, October-November 1996.
4. Calculate Well Your Bid for an Enterprise, Lidya Shuleva, Member of CSD Advisory Board, *Cash* weekly, October 17, 1996.
5. Interests and Procedures Slow Down Foreclosures of Enterprises, Vesselin Pashev, Member of CSD Advisory Board, *Cash* weekly, October 24, 1996.
6. The Investor's Ideal: A Profitable Firm (CSD's survey results), *Cash* weekly, October 24, 1996.
7. Mass Privatization Does Not Always Create a Capital Market, *Banker* weekly, November 4, 1996.

8. Mass Privatization: Procedures and Institutions (CSD's survey results), *Cash* weekly, November 7, 1996.
9. By December 15 the New Owners Will Be Known (CSD's survey results), *Cash* weekly, November 28, 1996.
10. Management And Safe Custody Of Securities (CSD seminar), *Pari* daily, December 1996.
11. If the Process Fails, the Reason Will Be the Force Methods of Government, Vesselin Pashev, Member of CSD Advisory Board, *Ikonomika*, September 1996.
12. Progress in Mass Privatization, Petkan Iliev, Member of CSD Advisory Board, *Ikonomika*, October 1996.
13. Mass Privatization and the Forming of Middle Class, Petkan Iliev, Member of CSD Advisory Board, *Ikonomika*, November 1996.
14. Structure of the Privatization Funds' Portfolios, Dimitar Batchvarov, Member of CSD Advisory Board, *Capital Market*, November 1996.
15. Bulgaria: Summing Up Privatization, Maria Prohaska, Occasional paper, CSD: October 1996.

IV. FINANCING

All project activities during the period under review were covered by CIPE funds. Some activities (1.1., 2.2 and 3.2) were covered by matching grants too.

APPENDICES

Appendix 1. Restructuring Transitional Economies in the 90's (International Conference, October 11-14, Sofia)

Appendix 2. Implementing Policy Change Program

Appendix 3. National Opinion Poll Survey "Public Preferences and Attitudes Towards Mass Privatization"

Appendix 4. Seminar "Securities Safe Custody and Administration in a Central Depository" (December 12-13, 1996)