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АНАЛИЗ НА ФИНАНСОВО-ИКОНОМИЧЕСКАТА КРИЗА В БЪЛГАРИЯ

ANALYSIS OF THE FINANCIAL-ECONOMICAL CRISES IN BULGARIA – PROBLEMS AND PROSPECTS

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Abstract: Bulgarian economics got in recession in 2009. The decrease in the demanding lead to firms' bankruptcies, which caused a great amount of unemployment and even greater decrease in demanding. The recession in Bulgaria is expected to continue during the whole year of 2010. The policy and the measures taken to the present moment, in order to control the recession and its consequences, does not give result, so they need to be reconsidered and corrected. The aim of this study is to examine the problems of the Bulgarian economics, which derived from the financial-economical crises and prospects of dealing with them. Object of this study is Bulgarian economics' development for the period 2008-2010. Methods used in the present study are: systematic approach, documents research; observation, collecting, processing and analyzing data; systematic, comparative and logical analysis and others.

Key words: economics, policy, measures, economic security, international financial-economical crises.

Introduction

Bulgarian economy entered recession in 2009. Reduction in demand led to a number of business bankruptcies, which on the one hand caused significant unemployment and on the other, even greater drop in demand. It is expected recession in Bulgaria to continue during the rest of 2010.

Bulgaria is at risk due to crisis consequences in several aspects: running account deficit, fixed exchange rate, and inflation. There is an appalling budget issue that is being worsened by the ongoing crisis by the day. Fiscal reserve at the end of June 2010 has been diminished to about BGN 6 billion¹ while it is expected to melt to about BGN 4.5 billion, the sanitary minimum being BGN 4.0 billion.

The economic (business) policy that has been conducted so far has failed to achieve the cherished results for overcoming the crisis, which enforces its reconsideration and reapplication.

The **aim** of this paper is to explore Bulgarian economy's issues due to the financial-economic crisis and the possible prospects for a positive outcome.

The **target** of the current paper will be Bulgarian economy for the 2008-2010 time period.

The **methods** that have been applied in this article are systematic approach, document research; observations, accumulation, processing and data analyses; systematic, comparative and logical analyses, etc.

Bulgarian Economy Analysis

The classical model of Bulgarian recession can be represented by a continuous sales drop as well as delayed payments to businesses, which invoke significant issues related to meeting one's own expenditure including payments due to suppliers. They (suppliers) delay their payments too, and this is how the vicious circle is completed. Companies start laying off employees due to decreased revenue, which leads to shrinking of demand due to lack of income, which leads to another

¹ Ministry of Finance Data as of 30.06.2010, <http://www.minfin.bg/>.

market drop and cuts companies' revenue even further.

During 2009 Bulgarian economy dropped 5 % (for the first time in eleven years in a row), and it marked a 3.6% drop for the first quarter of 2010 on an annual basis. Despite gruesome Bulgarian GDP data until recently it is expected for it to rise up to 0.2 % for 2010 on an annual basis.¹

Imports for the first two months have declined to 15 % compared to the same period in 2009.² In January and February 12.7% less import duty, excise, and VAT money has entered the treasury or BGN 133.5 million less than the same last year period.

For the recent years the redistributing role of the state has grown as budget expenses increased to 37.9 % of the GDP in 2008 to 39.5 % in 2009 and 42.3 % in 2010. The budget deficit has grown accordingly hitting as high as 3.7 % of the GDP for 2009 at a maximum EU allowed value of 3 %. At the end of the first half of 2010 the budget deficit amounts to 2.3 % of the GDP by Ministry of Finance data and is expected to hit about 4 % of the GDP by the end of 2010 as estimated by Standard and Powers³ and about 4.8 according to KNSB estimates⁴. Despite discouraging data on this index, Bulgaria ranks fifth among the countries with lowest deficit in the EU.

The 2010 current account deficit prognosis predicts a decline from 9.6 % of the GDP in 2009⁵ to 5.5% of the GDP in 2010 and according to Standard and Powers it could drop to as low as 2 % of the GDP⁶.

1 IMF data, <http://www.imf.org/external/country/bgr>.

2 Ministry of Finance Data as of 07.03.2010 r., <http://www.minfin.bg/>

3 Vesti Electronic Magazine data, <http://www.vesti.bg/>

4 Confederation of the Independent Trade Unions in Bulgaria (KNSB) data, <http://www.knsb-bg.org/>

5 Ministry of Finance data, <http://www.minfin.bg/>.

6 Vesti Electronic Magazine data, <http://www.vesti.bg/>

2010 inflation rate is expected to maintain a moderate level of 2.2 %⁷ having reached 2.4 % on an annual basis.

The economic policy regarding social and health insurance in times of crisis is full of paradoxes. Mandatory insurance⁸ rates' absolute amount has been hiked despite a decline in the corresponding (relative) percentile?!

The number of persons employed above the age of 15 is 3,072 thousand for the second quarter of 2010, which is a drop of 228 thousand compared to the same period in 2009.

The highest unemployment growth was observed in November and December in 2009 and in January 2010. In February 2010 unemployment dropped slightly to reach 10.26 % or a 0.36 % less than January⁹ but compared to the 2009 levels it is by 3 percentage points higher. The unemployed number 342,200 for the second quarter of this year and the unemployment coefficient is 10 percent. Compared to the same quarter of 2009 the unemployed figure rose with 119,600, and the unemployment coefficient – with 3.7 points considering that a significant portion of the employed have not even filed for unemployment benefits.

According to KNSB data one of the reasons for the high unemployment is the delayed payments to businesses, which has led to the loss of 250,000 jobs, and the Bulgarian Industrial Association's unemployment percentage prognosis for the end of 2010 amounts to 20 %. Unemployment gruesome prediction has been materialized through the number of businesses' bankruptcies – as little as 0.9 % in 2009 according to official statistics but if we add the ones that had "disappeared"

7 NSI data. Annual inflation for the February 2009 - January 2010 period compared to the February 2008 - January 2009 period is 2.2%, and 2.4% as of July of the same year, <http://www.nsi.bg/>

8 Social Security Code, Health Insurance Act, Budget and Governmental Public Insurance Act, updated as of 01.01.2010

9 Employment Agency data, <http://www.az.government.bg/>.

(the ones not functioning that is), then their percentage points hit 17 percent, the number of non-financial businesses being 276,715 according to NIS1.

If we summarize the data up to this point these will lead us to the conclusion that market is shrinking, profits drop, expenditure is due for optimization.

The situation seems clear, however the most important factor is missing – debts including the increased share of inter company indebtedness and the rise of bad credit.

Bulgarian GDP as of February 2010 was € 37.011 billion², of which € 4.240 billion is publicly secured and € 32.770 billion is privately secured. As of February 2010 the government secured debt share to GDP amounts 12.3 % and as of July 2010 it has risen to 14.8 % of the GDP but is still among the lowest in the EU – second low after Estonia's 9.9 %.

A great deal of Bulgaria's deficit arises from banks (85 % foreign ownership). In 2009 bankers' debt reached € 8.4 billion (about 1/4 of the GDP). If foreign bankers cease to finance their Bulgarian branches, the Bulgarian banking system will collapse.

The main challenge Bulgarian banks face is the absorption of growing bad credits. Officially bad credit reached 3.2 % at the end of 2008 and the 2009 prognosis predicted 8 – 9 %³. The BNB statistics for 2010 shows clearly that bad credit has risen to about BGN 5.7 billion for a year as of May 31st 2010 compared to BGN 1.8 billion a year ago, i.e. it has tripled and represents 1/6 of banks' financing. The greatest share of problematic credits belongs to consumer financing – 15.6 %, followed by business – 14.8 %, etc. The last few months however mark an increase of the problematic mortgage financing, which has been in good shape until recently. That share has risen to 13.2 % and a year ago it was barely 3 %.

IMF prognosis is that bad crediting in Bulgaria will hit a level of 10.5 % of all crediting, BNB figures showing 10 %.

The greatest problem of domestic economy remains the inter company indebtedness. In 2007 it amounted to BGN 122 billion and in 2008 – BGN 160 billion, and at the end of 2009 it reached BGN 200 billion figure, i.e. if one BGN per GDP equaled to BGN 1.42 debt, in 2008 it was BGN 2.40, and in 2009 – BGN 3.084. In 2010 private credit registers approximate companies' debt to be within the BGN 120 and 220 billion margin. These figures seem quite contradictory and we have to wait for NIS data that will be announced in the autumn of 2010. The bigger concern here is that companies' share of payments long due has increased dramatically.

The latest figures show this share to have been 57 % in 2009, i.e. every third company, and this year's percentage has reached 62 %. This directly impacts business activities and due to uncollected money firms go even deeper into debt.

Despite huge issues with debt in Bulgaria in July 2010 Standard and Powers confirmed Bulgaria's credit rating to be "BBB stable"⁵. Another international rating agency, Fitch Ratings Ltd.⁶ has reconfirmed Bulgaria's credit rating – long term "BBB", short term foreign currency "F3" and local currency long term "BBB". Perspectives regarding long term credit tend to be far from positive but an eventual return of stable growth and reducing risk from outside shocks could lead to a positive outcome.

Macroeconomic analysis for the 2009-2010 period highlights a contradictory situation – there are positive symptoms emerging concerning actual business on the one hand, and budget worsening on the other. The 2011 prognosis is that deficit will drop under 3 % of the GDP.

1 NSI website, <http://www.nsi.bg/>
2 BNB data, <http://www.bnb.bg>
3 BNB website data, <http://www.bnb.bg/>

4 BIA data and information.
5 Standard and Powers data, <http://www.standardandpoors.com/>
6 Fitch Ratings Ltd. Data, <http://www.fitchratings.com/>

Despite steady governmental finances, the huge private sector debt jeopardizes the country's financial stability. Low inflation helps keeping actual income but shrunk consumption shows that households restrain from consuming due to uncertain future prospects and expected unemployment rise and shrunk consumption leads to decreased budget.

The above analysis of the state of Bulgarian economy and the accompanying issues for the period 2009-2010 urges me to suggest a few possible solutions (steps) for coping with those issues and outlining a short-term perspective for development.

Steps

In times of economic crisis a traditional recommendation would be government's interference to stimulate domestic economy. A possible step in this direction would be an increase of budget spending on infrastructural projects or job-generating businesses.

Preparing an adequate strategy corresponding to the actual state of things will guarantee a successful economic policy of our country during economic crisis.

That strategy will be successful if it focuses on:

- Stepping up administrative reform would result in a cheaper and more effective management that would achieve a more rational budget spending. Governmental administration and management authorities are extremely inflated and do not correspond to actual demand. I am not recommending an all-out cuts for cuts' sake but only after a careful assessment of the effectiveness of every position, however it is an undeniable fact that administration has grown dramatically during recent years.

- Besides carrying out the administrative reform it is imperative to complete the structural reforms in the health, retirement, and educational sectors¹

in order to prevent EU Commission sanctions.

- Health reform needs to improve effectiveness and quality in the health care system as well as to create informational systems at the Ministry of Health and the National Health Insurance Fund for a better money management. One of the huge NHIF issues is the failure to collect mandatory health insurance, which a great deal of the population (around 1.2 million) refuses to pay or underpays and this leads to almost a BGN billion annual deficit.

- Retirement reform is imperative since retirement money is always short despite the steps that have been made. The reasons for that lie in the inherited social insurance system, the demographic crisis, and the global financial-economic crisis. When faced with the alternative to either increase retirement age or retirement payments perhaps one would rather choose higher retirement payments, otherwise if retirement age is increased at an average life expectancy of 69 years for men and 74 years for women in Bulgaria, who will actually be able to enjoy retirement at all?! One should consider as well the second and third stages of retirement plans (if they work) for the people born after 1960. If the actual work time is increased and retirement age is kept at the current figure, the persons who graduate from colleges and universities will not be able to retire.

- Education reform cannot wait either. It is true that Bulgaria's population is declining, which enforces closing out and restructuring secondary and higher education schools and universities via budget financing. There are 52 higher education schools in Bulgaria at a population of 7.6 million that tends to decrease. Domestic higher education lacks

been singled out - health, administrative, retirement, and the educational systems, as well as reforms to improve the effectiveness of spending and budget management. The EC supports the reforms in the judicial system and police", "Where an impulse for reform is being observed", Commentary of Georgi Angelov, Open Society Institute in "Trud" newspaper, July 2010.

¹ „The European Commission opens a procedure against us because of lack of reforms and lack of will for reforms. Important public systems have

the potential to offer the competitiveness and adaptability of its alumni to meet the business needs of contemporary developed society. Higher education institutions that suck money out of the budget is highly unbalanced to actual national demand, which imposes closures and/or restructuring or a total reconsideration of higher education financing. The money that government allocates for science and education not always makes it to the beneficiary, which calls for and increased control in that area.

- The second direction of reform has to affect economic policy. Government should be extremely successful if it tried not just to reduce losses due to the crisis, but if it were capable of making Bulgaria's economy actually work. In times of crisis it is recommendable to keep relative and absolute taxation burden or its decrease if possible without exposing the normal budget functioning and the system of mandatory insurance at risk. Countries with developed market economies increase the progressiveness of their tax systems in order to achieve a more balanced redistribution of the impact of slowed production and reduced demand. Decreased tax revenue needs to be compensated by expenditure cuts. Reduced budget spending looks better than tax hikes. Optimization of current administration support expenditure has to be done without hampering the normal functioning of the system.

The economic program should include the following steps:

1. Stepping up to ensure budget realization in times of economic crisis in order to accumulate additional revenue;

2. Steps could be made to better business climate, which could be related to bureaucracy reduction, a decisive action should be taken against the widespread gray economy and corruption¹, against illegal contraband and VAT frauds;

¹ Schneider, Fr., "Shadow Economies around the World During 1999-2007", "...Bulgaria ranks third among 37 countries regarding shadow economy

3. Steps in the social sector should guarantee social stability and protection of Bulgarian people.

The inter company indebtedness can be dealt to in the following possible ways: increment installment plans; services/goods exchange for debt; creation of a clearing system under government (budgetary) supervision.

The radically changed economic situation demands a new approach to the spending portion of the budget as fiscal spending should be directed towards stimulating of demand and supporting the structural adaptation of the economy.

The third part of the measure package stress on our commitment to the EU. Bulgaria needs to start a process of equalizing work compensation with that in the other EU members on a productivity basis along with the macroeconomic criteria the country has to follow.

Perspectives

The government hopes to enjoy a 0.3 % GDP growth at the end of the year. According to the World Bank estimates and Standard and Powers (issued at the end of July 2010), Bulgarian economy will mark a growth of 0.2 % in 2011. Governmental sources (the minister of finance) plan a 3 % growth, a budget deficit of 2.5 % of the GDP, and 1.8 % inflation for 2012. It is true that the two estimates differ but the government hopes that all Bulgarians should work hard to make their estimate come true.

Conclusion

There is little doubt that the government's actions so far lead to deeper crisis, shrunk consumption, and undermined the revenue portion of the budget. The steps I have outlined above that need to be taken to get us out of the

volume. It represents 37 % about of the GDP this year...", The Economist, August 2010, <http://www.economist.com/>.

2 Vestī Electronic Magazine, <http://www.vesti.bg/>

bog as well as to generate economic growth must be such as to support businesses, households, employment, poverty reduction¹ and fiscal position. Some of the steps that government suggests represent a danger zone where business could transfer to the gray sector; others lack any fiscal effect whatsoever, for example sending people to an “economic vacation” and some are pro crisis, such is the idea of VAT hikes and increasing mandatory insurance payments, which is why one has to consider those extremely cautiously as well as their impact on domestic economy.

A chief factor of getting rid of the crisis and generating economic growth is the intensity of carrying out reforms and the

progress in acquiring EU funds. Steady economic recovery involves much more than GDP growth readings and practically begins when the economy resumes creating jobs.

Dominating expectations of regaining the former growth model contradict global trends. A new world model is being shaped by the amplified involvement of the state as regulator.

Economic crisis deepening demands additional budget spending (that includes fiscal reserve) as well as EU funding and projects, and as a final resort international financial institution financing instead of making short term decisions with a vague effect.

1. „Bulgaria ranks third on the poverty scale in the EU. This is what an Eurostat research reveals, according to which poverty remains among one of the most significant issues in the EU. 21% of people’s income at home is below the existential minimum.”, Eurostat Research “Fighting Poverty and Social Exclusion”, <http://epp.eurostat.ec.europa.eu/>

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