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BULGARIA STRATEGY FRAMEWORK

1996-2000

Office of the USAID Representative

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INTRODUCTION

In early 1994 USAID/Bulgaria prepared a retrospective on the first three years of U.S. assistance and suggested some course changes to reflect realities on the ground. This 1994-96 Assistance Strategy Update recommended a two-pronged approach: 1) support for local government public participation and local development, and 2) a more critical, restrained funding of activities at the national level. Those program foundations remain sound, and should be the continued basis for our strategy in Bulgaria. Our fundamental emphasis remains on democratic initiatives and assisting progress towards a market-based economy.

However, various new pressures--and opportunities--have become more apparent in the past year that suggest the need for somewhat more refinement and focus in the Bulgaria program. Perhaps most significantly, national elections late last year, have enfranchised the Bulgarian Socialist Party as the majority party in Parliament. The new Government has moved aggressively to take charge, but it is faced with many economic and social challenges caused primarily by the incomplete transition to a free market economy. The U.S. development assistance program globally and in the Central/Eastern Europe and New Independent States region has been the target of budget rescissions and likely long-term cutbacks in future year program and operating expense resources. There is also an unforeseen need to meet large funding targets for the AUBG and BAEF programs through 1997. In addition, the President's announcement of a 'South Balkan Initiative' may have both funding and staff implications for our program. USDH personnel levels in Bulgaria and in Washington are likely to remain flat, at best, indefinitely. Many programs started in the early nineties, as well as newer starts, are in full implementation. Total units of management are currently at 36 activities, and field staff attention will be diffused and suboptimum without further concentration.

Over the past six months, we have also conducted a series of intensive analyses in development sectors of present or potential future interest. These topics included the environment, energy, agriculture, municipal development, and the financial sector/privatization areas. The findings and recommendations have been extensively discussed with Bulgarian counterparts in and out of government and with our American assistance partners here.

The four key funding priorities set in the 1994 strategy were reevaluated in view of the recent "target setting" exercise, the need to have measurable impacts from our program, and the above key events. This revised strategy proposes a renewed effort to focus our assistance program, reflecting these developments. Some ongoing initiatives will be deemphasized, or subordinated to a limited set of strategic (program) objectives. Indeed, we intend to consolidate the portfolio from the current 36 to less than 30 activities by the end of FY97, and to concentrate activities under four principle strategic objectives to help assure measurable impact. All of our program through the balance of this decade will be better integrated: a web of linkages purposefully will tie together the four strategic objectives at the core of the Bulgaria program.

A few of the watershed events that have affected the direction of our strategy are worth mentioning briefly here. We have considerably refined the decentralized approach to municipal governance described in last year's strategy. The Local Government Initiative paper, jointly developed with local beneficiaries, argues for geographic focus on 10 reform-minded municipalities supported by association building and policy dialogue. A new emphasis on supporting civil society is also a cornerstone of the revised strategy in recognition of the key part it plays in realizing our other objectives.

We have moved away from attempting to measurably impact the macro economic and financial reform areas. Our tools in these areas are too limited, and the World Bank and IMF are fully engaged in these sectors. Moreover, at least until now the various Bulgaria governments have not been receptive of our advice and little reform has taken place. Our role in privatization also must be carefully reconsidered. There has been no breakthrough in this area over the past year and although we will continue to pursue privatization at the municipal level and although there may be some emerging opportunities for our support, our role will clearly be marginal to the EU PHARE and IBRD. We have also refined our approach in the Environmental and Energy areas focusing more on the policy elements of these as important areas for future emphasis.

We believe that greater thematic coherence discussed in this strategy document will enhance the prospects for sustained impact of U.S. assistance, and better prepare Bulgaria to meet critical challenges as it enters the 21st century. Indeed, we have stretched the time frame of the strategy to meet the year 2000, and have speculated on possible transition activities for the outyears.

The strategy has been reviewed and endorsed by the Ambassador and the Country Team.

Part I Assistance Environment

A General Background and Overview

The reform process in Bulgaria has proceeded in fits and starts. During the early years of post communist Bulgaria and particularly from late 1990-mid 1992 a number of rapid political and democratic reforms were undertaken. The underpinnings of a free market economy were established by the liberalization of most prices, trade liberalization measures, the adoption of a constitution which provided the right to private property, initiation of land restitution and liberal laws on privatization, a legal framework for competition and foreign investment. Over 200 basic reform laws and resolutions were enacted between 1991-1992.

However, more recent reform performance has slowed considerably in comparison with the early years. The collapse of the democratic coalition government in late 1992 led to the non-party Berov government which depended on the ethnic Turkish party (the Movement for Rights and Freedoms - MRF) for its mandate. Progress on democratic and market reforms was dependent on support from the Bulgarian Socialist Party, the MRF, and elements of the Union of Democratic Forces. Plans for mass privatization languished in Parliament without a clear mandate, and critical economic restructuring measures in the banking sector, asset based privatization, energy price restructuring and progress in restituting rural land all suffered from the lack of political will to move forward. Tax reform was one of the few bright spots and Bulgaria launched a VAT in April 1994, which has had good results for revenue collection.

The new Socialist Government has the political strength to continue the reform process, but the question of political will is still very much relevant. Indeed, proposed amendments to the land law move the country backward toward collectivization of the Agricultural sector. The Government did not have the will to raise electricity prices this year to be more in line with costs, and the energy sector continues to be highly subsidized. Privatization remains bogged down despite the Government's early announcement of its commitment. Bulgaria is currently out of compliance with IMF standby conditionality and cannot access World Bank FESAL funding of \$ 150 million because of poor progress on structural reform.

Another factor that will affect the overall reform environment is the upcoming municipal elections in late Fall of 1995. Although recent reform progress at the central level has been disappointing, a number of dynamic local mayors and municipalities have been putting increasing pressure on the center for greater authorities to mobilize and manage resources in order to better serve their constituents. This local drive could be affected either negatively or positively by the local elections.

In this uncertain and unstable environment it is important that SEED assistance options remain flexible to take advantage of appropriate targets of opportunity within a general strategic framework. Also, it would be inappropriate to unconditionally commit resources to long term programs without a thorough testing of local resolve, and without providing for "escape hatches" from time to time. We committed significant resources to privatization during the Berov Government with almost no impact. We must be more cautious in the commitment of funding in the future.

B Significant macroeconomic trends

Bulgaria is still very much in the throes of transition from the Communist era. Major economic forces still have not worked themselves fully throughout the economy. Inflation, which was running

at an annual rate over 120% in 1994 has abated somewhat but is still high fueled by Bulgarian Government budget deficits. The bulk of these budget deficits arise from off budget support to state-owned enterprises (SOE s), most of which remain to be privatized. Production in virtually all economic areas has dropped often by 50% or more, since 1989. Growth last year was at or near zero percent actually an improvement from past years, this suggests at least a temporary levelling in the economy's fall as the small business subsector gets more active¹

The exchange rate of leva against the dollar has been relatively stable, enabling foreign exchange reserves to build up but ensuring nominal interest rates of over 50%. Bulgaria should be able to make major IMF payments and London Club payments becoming due toward mid-1995. [The relative stability of leva may have a perverse effect, as the GOB may be tempted to resist IMF conditionality on monetary and economic stabilization.] One virtue of the stable exchange rate is that capital flight from Bulgaria has not been an apparent problem.

Despite a good investment code, there has been a very low level of foreign investment. Investors have held back in the face of uncertain government policy, bureaucratic constraints and resistance to incomplete privatization and the growing influence of mafia-like elements who resent the competition that foreign capital represents.

Perhaps, the most alarming macroeconomic trend is the growing inequality of income distribution. Those able to capture assets in the breakup of the old regime have become extremely wealthy, while the savings of the average citizen have dwindled. This creates the potential for serious socioeconomic tensions over at least the medium term.

C. Significant sociopolitical trends

The foundations for political democracy have been rapidly created in the past five years. Elections are fundamentally free and fair, and seen to be a transparent, monitored process which the Bulgarians are likely to sustain without intensive international assistance. But local institutions and governments--the bedrock of governance in Bulgaria--are weak, underfinanced, and often untutored. Unable to provide the services the people need and demand, and on unequal footing with the central government. A vigorous civil society remains a dream, in a country characterized by skepticism, caution and apathy. Development of the civil society, reflected in strong local governance and vocal and coherent interest groups of stakeholders, is of paramount importance.

The initial euphoria with the overthrow of the Zhivkov dictatorship has been tempered in subsequent years by a fear of change and frustration with the lack of progress in finding a new equilibrium. This disappointment was manifested in the last election in two ways: with older elements of the populace finding solace in the message of the Bulgarian Socialist Party (BSP)--the winners--and younger voters showing their apathy and disaffection by not voting at all. Deep-seated values and attitudes of many still incline toward the 'cradle to grave' social safety net of communism. As in other countries in central and eastern Europe, the "liberal democrats" have lost power to a reorganized socialist party. This trend is likely to continue in the upcoming municipal elections and new BSP majorities could be a test of the broad support for U.S. assistance to local government.

A number of important social and political constraints continue to affect economic development. The

¹Latest EBRD estimates: 4% growth rate in 1995 with inflation falling to 70%

years of being a 'closed society' have left their mark on values and attitudes and suspicion of foreigners (including foreign investment) impedes reform and investment. There is still resistance from some quarters to private ownership particularly of land and other real property, as evidenced by the ongoing debates on land restitution and privatization programs. There are still restrictions on the formation of political parties perceived as having a 'non Bulgaria' constituency. Attitudes in these areas change slowly but they must change if a sustainable transition to a democratic society and market economy is to occur.

More broadly, Bulgarian nationalist sentiments are reasserting themselves. Cultural prejudices against religious and ethnic minorities seem to be more manifest within the past year, although the general human rights record of Bulgaria has been acceptable.

On the plus side, the new socialist government--with a solid electoral mandate--is in place, and various logjams (eg privatization, economic reform) may finally break. Other donors are getting better geared up to take the lead in certain economic sectors, permitting the U.S. to take a more supportive role.

D. The development challenge constraints and opportunities

Bulgaria has some distinct pluses, and some continuing minuses, in its prospects for growth and development into the next century.

The populace is well educated, with a literacy rate of 98%, which together with low labor rates would make it attractive for assembly operations based close to western European markets.

There are no population pressures. In fact, a historically low birth rate has led to a high dependency ratio of a type USAID is not used to--the active labor force must support a population more than one-third of which is over the age of 60. Therefore, rapid and extensive capital formation will be required to maximize productivity and raise incomes.

Bulgaria has a good natural endowment, with strong potential especially in export agriculture. The country is, however, vulnerable to external economic shocks since there are virtually no internal energy resources outside of low quality, polluting lignite. Exploiting export markets in Europe at least in the near term, will also be difficult with the Bosnia civil war and Serbian sanctions in place. More specific challenges in the economic, democracy and social sectors are explored below.

1. Economic restructuring

GOB economic policy and institutions currently present a mixed picture. Externally-oriented policies such as trade liberalization, investment codes and freeing up of exchange controls are in place. Internal policies and processes, such as in establishing a modern business enabling environment and *de minimis*--yet effective--regulatory regime, lag behind. Despite rapid progress in urban areas in restituting property, about half of rural real property has been 'restituted' to prior owners but actual title has been restored to only a fraction. Tendencies for *ad hoc* protectionism continue. However important regulatory and fiscal reforms have taken hold in the past year--a VAT system has raised substantial revenue and a bankruptcy law has been passed.

Capital/financial markets are either fragmented (there are more than half a dozen stock exchanges) or incomplete. The banking system is in a perilous state with enormous non-performing assets. A

major shake-out appears inevitable

Energy prices are still way below world market levels and waste is endemic. Low energy prices were seen as an 'entitlement' in the past, and the new socialist government is under much pressure from its constituents to keep prices low. Notwithstanding, the Government realizes it must curb the worst energy/environment nightmares, which provides some basis for sector rationalization. European concerns also lead the crucial debate over the future of nuclear power in Bulgaria. International financial institutions also are making a firm commitment and action to bring electricity prices up to actual cost - a litmus test of the government's resolve to carry out economic reform.

As noted above, privatization of the vast bulk of SOE's, either through "market" (cash, or asset-based) privatization or through "mass privatization" (essentially a voucher system), has been stalled. The present government has restated its commitment to privatization, and has stated that vouchers will be issued as soon as this year and the first auctions perhaps in early 1996. The government's latest thinking is that enterprises will be privatized through some combination of 'market' and 'mass' techniques. However, considerable skepticism is warranted in view of the poor progress in privatization during previous governments despite optimistic pronouncements.

Indeed, privatization may resemble a cocktail of junk, with a few cherries on top', as one analyst recently put it. Most SOE's have negative net worths, so management or investment fund takeovers may not be any salvation in the absence of an infusion of new capital. Mafia-like elements could also attempt to rig the outcome of both cash- and voucher-based auctions. Perhaps a deeper concern is whether the post-privatization landscape will be conducive to the emergence of new, competitive private enterprises. Clearly, more work needs to be done in fleshing out the economic enabling framework.

2. Democracy and governance

Bulgaria has benefitted from a series of fair elections since 1989. Impartial election monitoring, helped by past U.S. assistance, seems to have been well established. A proportional representation system is used which for a period of time gave the Turkish ethnic-dominated Movement for Rights and Freedoms (MRF) the balance of power in the government. That ended with BSP's 51% plurality in the last election, an apparent solid mandate. In theory, this parliamentary plurality should provide a strong basis for the Government to accomplish its agenda.

Political party machinery, like the central government itself, is highly centralized. Parties draw up countrywide 'party lists', with little apparent feedback from below, i.e. at the community level. Embedding political representation and democratization will require institution building at grassroots party structures.

Local governments remain dependent on the central government, with a weak revenue base and unclear powers. Municipalities are dependent on central government budget allocations for much of their revenues and are dependent on central authorities for many services such as health care, police and education. On the bright side, a Mayors' Coalition, with Country Team assistance, has found ways to collectively express frustration with the lack of authority at the local level, and is proposing legislation to promote devolution of authority.

Other important segments of Bulgarian society are finding their voice. The judiciary is becoming more independent, as reflected in the Constitutional Court decision supporting municipal governments assuming expanded decision making powers. The print media is lively, but press professionalism remains an ideal little embraced by Bulgarian reporters and editors. The government controls radio and television licensing and licensing decisions are issued based on no written regulations and without explanation. National radio and television remain under government control and are unchallenged by private broadcast media in the fields of political and ideological programming. Private media, largely because they need to survive financially, concentrate on entertainment. Non-governmental organizations (NGOs) and professional associations are growing in strength and number, although Bulgarian cautiousness in joining up needs to be overcome. Somewhat disquieting is the fact there is no law protecting NGO independence, in fact, the government has programmatic authority over NGO's, although this power is not used.

3 Social sector restructuring

Health and welfare programs have been greatly stressed by the economic downturn and fall in government revenues. Safety nets for the average citizen such as public health are decrepit or non-functioning, and pensions have been largely wiped out by inflation. New systems of management and finance will have to fill the gap at central and local authority levels.

Most feel the key to rebuilding a new social policy is based on rapid political and economic transition. Completing the transition, of course, may bring new pressures such as layoffs of middle managers and workers as industries downsize, restructure, or simply fade away. Dynamic jobs growth in new, competitive enterprises may take up much of the slack, but with official unemployment at 18% and underemployment at least double that, concern is palpable. Labor will have to be retooled--or retool itself--through a process that is more than likely to be highly disorderly.

E Other donors

World Bank group, EBRD, and the European Union (under its PHARE program)--and to a lesser extent, several bilateral programs--are well represented in Bulgaria. Their programs intersect at many points with USG activities.

A large, new EBRD lending program in **nuclear safety** has just been announced. EBRD and EU on-going programs in nuclear safety, at \$45 mil combined, are complemented by modest USG efforts. The World Bank's Energy I and II programs (\$150 mil) are conditioned on price rationalization. New USG technical assistance in energy policy will similarly complement these efforts, helping Bulgaria properly cost out the marginal cost of energy.

The World Bank (\$85 mil) and the EU (\$62 mil) are carrying out or planning major investments in **employment, labor markets, health care reform** and other social sectors. The USG's present work in labor market reform, due for completion in 1996, has helped prepare the groundwork for greater investments in this sector by other donors.

The **financial** sector will be getting the World Bank's largest single project--the \$150 mil Financial and Enterprise Structural Adjustment Loan (FESAL) sector adjustment program--once the Bank and the GOB agree on financial sector restructuring targets and timetables.

A total of \$34 mil from the European Investment Bank (Lux), \$32 mil from the EU, and \$100 mil

from Japan has been committed for **small/medium** enterprise lending. Disbursements have lagged however as bankable projects are pulled together. U.S. programs have done pioneering work with SMEs precisely aimed at developing intermediate financial mechanisms, strengthened industry associations and highly replicable lending opportunities--with backward and forward linkages to primary producers and markets respectively--that will greatly raise effective demand for these donors' lending programs. Proposed U.S. grants to CARESBAC will leverage EBRD funds on a matching basis.

The World Bank has offered \$50 mil for **agriculture**, in agricultural credit, and the EU committed a total of \$43 mil in the early nineties. American assistance successes in the dairy industry and in fruit processing will provide models for additional donor programs.

Finally, the USG is able to collaborate with several donors in assisting **local government**. The EIB and UNDP are anticipating programs and the EBRD has already committed \$44 mil to town market infrastructure, and the British Know-How Fund and the EU have been working in this area for years. Building up the municipalities' capabilities in management and finance--the focus of USG efforts--are necessary preconditions to substantially greater flows of other donor capital assistance.

F Lessons learned

Despite the 'false starts', so far, in privatization and the dramatic decline in economic output, the highly entrepreneurial small and medium enterprise (SME) sector has become a vibrant, job-creating engine of growth. For USAID (and USDA, through a Sec 416 program), this has become one area where assistance has had tangible benefits. Our efforts, however, should not be diffused, such as by lavishing technical assistance on a scattered and unfocused firm-by-firm basis. Better concentration needs to be achieved by focusing on selected industry groups, by selecting model firms for replication potential, and by working through industry associations and financial intermediaries.

The increasingly sophisticated needs of the SME sector requires continued attention to creating a favorable legal/policy/regulatory enabling environment for continued growth. More general U.S. advice and assistance on macroeconomic management, the "rule of law", and energy and environmental policy--so valuable in the immediate post-Zhivkov era--needs to be supplemented by more narrowly defined expert assistance aimed at overcoming specific obstacles to competition and investment.

The first half-decade of USG assistance also has had some success in supporting democracy and heightening environmental awareness. However, basic values change slowly, and until there is broad understanding and acceptance of key democratic principles, sustainability is in question. Bulgarian advances in these areas need to be consolidated and deepened. Various aspects of our program are therefore targeted at democratic initiatives. This includes expanding the concept of "civil society"--the active participation of all elements of society in expressing their views and needs and ensuring accountability by authority at all levels. NGO development and building professional associations will be central to achievement of the civil society.

Concomitant with the growth of a more vigorous civil society, and the continued economic and social sector dislocations of transition, local governments and institutions need to be strengthened in order to take on increased authority and responsibility. The most efficient means of sustaining this development appears to be through concentrating on a limited set of municipalities and ensuring that the success stories are disseminated and replicated across Bulgaria through means such as

intergovernmental information networks

At mid decade, the U S needs to husband its resources and concentrate its energies to deal with the second-phase issues of the Bulgarian transformation

Finally the Bulgarian "demand" for assistance must be tempered by what is doable and an objective assessment of local commitment Experience has taught that quick acceptance of assistance is no guarantee of success and as USG resources to Bulgaria are increasingly scrutinized, we must be increasingly prudent in our choices for support

Part II *Proposed Strategic Objectives*

A *Program Goal and Subgoals*

Consistent with the SEED Act, and the critical development issues of Bulgaria today, the U S development assistance team in Bulgaria has as its program goal the effective, sustainable transition of Bulgaria to a democratic society and a free market economy "Sustainable" in this context should be explained We do not anticipate that all political and economic institutions will be fully formed or fully effective by the Year 2000--the timeframe of this strategy Rather, we seek to support an irreversible process of dynamic change that would and could continue after U S assistance begins to wind down

The Country Team has chosen two subgoals for its overall program

1 Support for the transition to transparent and accountable governance and the empowerment of citizens through democratic processes, acceptance of democratic values, and full support for human rights

2 Foster emergence of a competitive, market-based economy in which the majority of economic resources are privately owned and managed

Inclusion of subgoals is considered important in characterizing the program The SEED Act, and ENI's program as a whole, embraces these two all-encompassing objectives as well as enhancing the quality of life in Central and Eastern Europe through social sector restructuring We have taken a hard look at the manageability, and potential effectiveness, of working in all three assistance areas and concluded that social sector restructuring--while obviously important in Bulgaria as vulnerable groups are butteted by economic and political transition--is of secondary importance to what must be the U S program's main preoccupations at this time Furthermore the potential for undertaking a set of focussed strategic objectives in social sector restructuring is minimal While very useful work could continue to be done in labor market adjustment, for example, the potential for having broad strategic impact is simply not there without a much more intensive program Furthermore, as noted in the previous section, other donors are moving into this important area

Common themes and approaches will be found in the U S assistance approach to Bulgaria Heavy emphasis will be placed on creating linkages within and between strategic objectives, to reinforce the limited resources we can bring to bear on Bulgarian development problems Building on successful experience to date, our general tactical approach to reaching our objectives is characterized by the following principles

- (1) Whenever possible we should serve as a catalyst for development not as a resource

transfer agent

- (2) We should promote the development of successful models at the local level that are both sustainable and that have good potential for replications
- (3) While we do not have the resources to widely replicate successful models, we should assure that an institutional framework and/or process is established to facilitate replication and that the legal/regulatory environment is conducive to this
- (4) We should be prepared to move on to other areas when we have satisfied these principles for any activity
- (5) We will endeavor to ensure that better information on workable solutions also flows upward to the central government, to garnish their support on broad replication of development models

We also are determined to reduce the number of management units in the program with a goal of less than 30 activities by FY97. A number of our projects have succeeded well in demonstrating new technologies, approaches, and modalities to Bulgarians. They will be wound down, having achieved their purposes. We will move to consolidate activities, but by applying rigorous tests of relevance. Creation of a core strategy around principle four strategic objectives will be central to this process.

B "Democracy" Subgoal

The Country Team has chosen to embrace two principle democracy strategic objectives (ENI 'program objectives') among the five laid out in the ENI democracy/governance program: local government and civic participation. Developing competitive and fair political processes is considered a supporting objective to the other two.

- Strategic Objective #1 Strengthen local government to make it effective, responsible, and accountable to its local citizens

U.S. assistance will concentrate its efforts on strengthening 10 demonstration municipalities, targeted to have maximum potential for success and geographic and institutional spread effect throughout Bulgaria. A second tier of cities--members of local government associations--will receive some assistance also, and to encourage healthy competition, cities in the second tier may become demonstration municipalities if administrative performance and public participation is particularly strong. (Conversely, lower performers among the original 10 could drop to the second tier.)

Many USAID programs are now working at the municipal level, but have started up and been implemented on an uncoordinated basis. Early efforts at the municipal level arose with the housing, energy, and environment programs, with activities flowing to regional areas where specific sectoral needs were greatest. The locality-by-locality agglomeration of programs was *de facto* rather than any conscious effort, at least at the onset. Emphasis now will be placed on building a rational intergovernmental framework, amongst local governments and upwards to the central government.

Stronger interest in working with local government reflects in part a political phenomenon. Many of

the mayors and municipal councils presently in power are from the reformist democratic elements that acceded to power nearly five years ago. They have strong visions for empowerment and government responsiveness. It is uncertain whether these reformist mayors/councils will survive the coming late-1995 local elections. However, by supporting vigorous governance and civil society (e.g. association and NGO-building) programs now, we can provide a momentum--and mandate--that will carry forward into succeeding municipal administrations, regardless of what political party holds office.

A recent USAID evaluation pinpointed the greatest municipal government needs: strengthened revenues and complementary fiscal/financial capability, planning and management, and 'scaling up the market base of the local economy' principally by carrying through on municipal privatization.³

Local governments in Bulgaria are currently financed through a combination of transfers from the central government, shared revenues, and own-source revenues (e.g. fees, property taxes). Shared revenues are falling as the central government turns over more and more responsibility to the local level, and the proceeds of the new VAT go entirely to Sofia. U.S. local government advisors will help develop for each target municipality a long term business plan providing a strategy for administrative and financial viability. The new Harvard Institute for International Development (HIID) advisor will focus explicitly on the financial mechanisms for coal-to-gas heating plant conversions, as a practical model for financial problem solving. Assistance to the Ministry of Regional Development will help assure that the central government is exposed to successes through workshops and observation tours, and that a sustainable replication process is facilitated. The U.S. will also assist the municipalities to establish a facilitating legal framework to allow them greater authority in revenue generation and in fiscal/financial management.

Capacity building will also focus on providing local administrations with management tools, techniques, procedures and information systems for better accounting, citizen/media relations, tax administration, service delivery and human resources development. An expanded assistance package, the Local Government Initiative, will provide, at the national level, an American expert to coordinate the flow of specialized, short term expert public administration/city management services from the U.S. It will be this advisor's job to be sure that disparate elements are pulled together, and that information passes smoothly. This will be augmented by a competitive grants program under the Public Administration Project that will provide up to \$50,000 for quick impact projects that 'chalk up successes', such as improved (perhaps privatized) municipal service delivery and forming citizen advocacy groups around an issue of local interest [see also S O #2, below].

The USG has also been supporting municipal privatization, with about 200 small retail shops, bakeries, and the like auctioned off in 10 municipalities in a transparent, replicable procedure. In phase two, new municipalities will be added and manager/employee buyouts in large companies attempted. We will also explore with the municipalities the potential for privatizing more traditional urban government services such as trash collection and health services. (Medical services often eat up to 70% of municipal budgets.) This has been a confidence-building experience, demonstrating that development and redistribution of assets can be done fairly and openly. A promotional program for municipal privatization is about to start to ensure successes and lessons learned are widely disseminated.

A paradigm for a coordinated USAID model at the local level may be found in the Stara Zagora city

³Local Government Program Evaluation TSS Evaluation Team March 1995

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and region. Ongoing or new programs include environmental awareness building through voluntary organizations, conversion of district heating plants and facilities from high-polluting lignite to natural gas, municipal privatization, sponsorship of the rights of minorities, stimulation of agro-industry for export production, and organization of farmer groups. Municipal employees are sharpening their skills under the PIET participant training program and by in-country outreach programs organized by University of Delaware. Peace Corps volunteers, with small project funds, have been important catalysts. An early USAID program entrant in Bulgaria, the housing sector program, continues providing assistance to the municipality in budgeting and analysis of cost of services, as well as in demonstrating public-private housing relationships, and procurement procedures, *inter alia*. Another USAID program in Stara Zagora--WEC's waste minimization project-- will soon begin showing Stara Zagora government and industry staff the means to cope with industrial energy/environment waste issues. World Resources Institute will continue working in Stara Zagora, developing the basis for environmental reform with citizen groups.

Across all sectors, in fact, information sharing is a major problem. Municipalities and citizen groups throughout the country are isolated, ignorant of the vast commonality of interests. Disseminating information on local problems, and solutions, through seminars, workshops, and training sessions will be a **core** part of our democracy and governance strategic program, since better and more timely information is a crucial part of the breakdown of monopolistic and autocratic power. The U.S. program also will place major emphasis on building local government associations, initially regional in scope but with the long range goal of a national federation to speak with one voice⁴. A long term advisor is already working with five associations and a recently formed national coalition.

- **Strategic Objective #2 Promote active participation of Bulgarians and NGO's in political and economic decision making**

Developing local governance capacity is unsustainable if not undergirded by a populace demanding efficiency, effectiveness, and accountability. Public inertia is a bigger problem than in most CEE countries, and so the effort must be especially deliberate and comprehensive if local government is not to remain simply an extension of the [often unresponsive] central government.

The American University of Bulgaria at Blagoevgrad (AUBG) -- one of the USG's two highest priorities in Bulgaria -- is a key program for building a free and open civil society. Through its US style liberal arts approach, it is instilling the value of critical thinking and adherence to free market principles. It will produce hundreds of Western-oriented university graduates as catalysts for change throughout the country. Preparing AUBG students to assume positions of leadership in business and government will help ensure that democratic concepts are permanently rooted in the Bulgarian body politic. Already, AUBG interns are working with local municipalities on a range of management, technical, and financial problems. A program of accelerated USG funding - \$ 20 million in FY95-96 is planned in conjunction with private support, so that the U.S. will complete funding for AUBG by 1997 leaving a sustainable institution in place. However, if this program does not materialize, because of problems with mobilizing necessary private resources, or if additional resources are subsequently found to be necessary because of family projections, the U.S. must be prepared to stay the course with this critical institution until sustainability is assured.

⁴Bulgaria Municipal Development Strategy February 1995

The Democracy Commission in Bulgaria headed by the U S Ambassador, coordinates all USG efforts on democracy and political development. The Commission has asked the new ENI Democracy Network, supporting the development of public policy-advocacy NGOs, to focus on civic participation, information sharing, and minority integration at the grassroots. Together with activities under the Local Government Initiative, this program aims to draw Bulgarian citizenry away from Communist-era distrust of "voluntarism"--critical attitudinal changes required to sustain a civil society. Similar to our work in municipal government, these programs will develop financial and managerial skills, up/down and sideways communication channels, and a more supportive legal framework for NGO activity. The focus under the "Democracy Network" program will be to develop sustainable and effective NGOs, thus assuring long term impacts. The Commission will also provide seed money for high visibility successes over a shorter time horizon through the Commission's small grant program.

ABA work in the rule of law is focusing on training judges, lawyers and officials engaged in the local administration of justice. This will include developing a judges/prosecutors association seeking, *inter alia*, the creation of an independent, impartial judiciary.

The PIET participant training program is being reorganized to prioritize training through sector assistance working groups. Under the new strategy, potential PIET participants will be screened for relevance to directly supporting the U S strategic objectives.

Within its larger program, the University of Delaware's management training and economics education program will focus on upgrading the skills of municipal administrators and business managers in the 10 demonstration municipalities.

- ***Develop competitive and fair political processes***

This objective encompasses two programs, (media and political organizations) that, while relatively small and arguably fitting within the above strategic objective, are very important to the overall democracy objective. We consider this as a general supporting objective to the democracy subgoal, not fully standing on its own because of the small size of its two components, but clearly essential to the viability of the other democracy objectives. (Note: The activities in the budget are shown under S O 2.)

A healthy media is required as much or more at the local and regional level. Heretofore, most of the USG's efforts at developing an independent media has had only limited success and has largely been focussed on Sofia. More attention is needed to assure a professional press corps that embraces the principles of balanced, objective reporting. We are increasing funds for media training to deal with this issue. While national issues and national-level political leaders get an airing, regional government and interest groups complain that local events and concerns are ignored. A proposed new media grant will attempt to redress the balance through the creation of an "Interfax"-type news service with representation regionally, so that regional and municipality groups will be able to keep in touch. USAID plans a further expansion of Internet-based electronic mail, already very successful in keeping city fathers in touch through the Mayors' Coalition, local associations and NGOs are and will be benefitting from these links as well. Elements of other activities such as journalism training at AUBG will further reinforce the media program.

Bulgaria's relative success in establishing the "first-generation" objective of promoting competitive fair political processes, as noted in the latest State Department Human Rights Report on Bulgaria, means that less emphasis can be placed now on this ENI focus. More, of course, needs to be done,

and additional budgetary resources above and beyond present levels would allow fine tuning in these sectors

USG activities at the national level in elections and monitoring can be refocused over time. The work of the National Democratic Institute and the International Republican Institute will be refocused at the countrywide 'grassroots' level in selected regional cities and municipalities, but with attention to transferring successes and lessons learned to the national level. There also will be a need over the next few years, at least, to assure that work done with the Central Electoral Commission to assure free and fair elections is sustained.

C "Free Markets" Subgoals

The two most critical 'free market' objectives for Bulgaria for the foreseeable future must deal with improving the enabling environment for private sector growth to assure a legal/regulatory environment conducive to entrepreneurs, with linkages to inputs (including technical expertise) and markets for smaller businesses who provide the most promise for economic growth and employment.

- Strategic Objective #3 Establish legal, policy, and regulatory framework conducive to broad-based competition and private sector growth

The legal, policy and regulatory environment is a critical support system for private sector growth. Initiatives begun by ABA/CEELI in bankruptcy and collateral law are being expanded to include assistance from Deloitte Touche in the area of bankruptcy and IRIS in the area of collateral law. Bankruptcy procedures provide legal structures and means to restructure companies for efficiency and clean off the balance sheets of financial institutions. A collateral law, currently in the drafting stage will also provide a means for borrowers to access credit without the collateral with the financial institution --a critical problem especially for small firms. Adequate bankruptcy and collateral laws and procedures are important to building foreign investor confidence as well. The ABA will also be approaching the legal framework from the human resources standpoint. Professional associations of lawyers and judges will be developed to greatly enhance Bulgarian competence in Western-oriented commercial practices.

The U.S. Treasury has also been assisting on fiscal reform, especially tax modernization, to assure a transparent and adequate tax system. Treasury advisors helped establish the VAT and are assisting with the income tax system. This program will wind down. The recently-arrived HIID advisor will help the Ministry of the Environment (MOE) develop policies that mobilize additional financial resources for environmental investments--both domestic and international--through debt swaps, environmental funds, and other mechanisms. The HIID program should have spread effects throughout the fiscal and monetary wings of the government in developing methodologies for "bankable projects" in the private sector, and in quantifying environmental concerns.

The underpriced energy sector will receive continued attention from U.S. assistance. Subject to adequate assurances of GOB commitment, we will work to help promote more realistic pricing of electricity which is an important condition for World Bank and IMF structural reform objectives. Bulgaria's cheap gas agreements with Russia run out in 1997 and this will likely put strong upward pressure on energy prices. After 1996, when more general tariff, legal, and regulatory reform assistance winds down, the U.S. will focus on narrower energy pricing and regulatory issues with a direct bearing on private sector growth and opening up competition in energy, such as promotion of private sector power.

While all of the above are central elements in the legal and policy environment for business development the framework is insufficiently complete to ensure meeting the strategic objective of broad-based competition and private sector growth This is especially true if the Bulgarian Government proceeds with mass transfer of state owned assets into private hands Without a more complete regulatory, "watchdog" capability, anticompetitive forces and interests are almost certain to increase over time stifling the emergence of new businesses large and small New, or greatly strengthened, regulatory powers and institutions would seem to be needed in capital markets oversight, antitrust, and fair trade practices

The Bulgarian Government now may be committed to quickly moving forward with privatization and has explored the possibility of near-term U S assistance Expert USAID consultants have suggested that the American contribution would be most useful in mass privatization's "supply side" (essentially readying state enterprises for transfer) and in the arena of public awareness (e g mass advertising of the process) The U S is prepared to assist if we can be assured our assistance will make a qualitative difference and when we have concrete assurances that the privatization process is on track Any USG participation in the privatization area would be predicted on firm assurances of GOB commitment and our own judgement that there will be reasonable likelihood of success We do not want or expect to take the lead, Bulgarians must take full ownership of the process, with support of the World Bank as the lead donor

There are risks attendant even in limited U S involvement Privatization would inevitably proceed at a pace much faster than the institutionalization of competent Bulgarian regulatory regime, with the possibility that anticompetitive forces would gain considerable momentum For this reason, we believe it is imperative to counterbalance this program with direct business promotion from the bottom up to develop the constituency and the economic muscle to influence government policy

- **Strategic Objective #4 Stimulate development of private sector enterprise**

The Bulgarian-American Enterprise Fund (BAEF) is the U S 's largest and most important program for targeting resources on the private sector It has been progressively moving more resources toward the SME sector through the Kompass program and through its popular Nachala Foundation program, with loans at the microenterprise end of the scale Nachala is able to bundle together micro projects and reaching to a level uneconomic for BAEF The goal for OI/Nachala is to demonstrate broadly how NGOs can rediscount grassroots lending to larger banks and financial institutions BAEF's direct program, meanwhile, is also growing rapidly towards the agreed financing level of \$55 million -- meeting this funding target is an important priority in this sector

CARESBAC will continue to meet an important niche need for equity (as well as limited loan) investment in SME's, as part of providing the spectrum of financial and managerial support that nascent Bulgarian SME's require Its investments in agribusiness, complemented with technical assistance have been well-coordinated with VOCA activities

From the inception of USAID's program in Bulgaria, there has been special interest in directly promoting private business formation through volunteer programs USAID has taken a hard look at all these volunteer programs and proposes to cut some of these that appear redundant and/or ill-suited to our SME strategy Peace Corps, IESC, and the MBA Enterprise Corps have had volunteers on the ground assisting individual enterprises and business associations, often as a catalyst VOCA/ACDI have been active with agro-processing sectors, initially meat and baking/flour and more recently in fruits and vegetables The Citizens Democracy Corps (CDC), already active in tourism, light industry, and construction, will sharply increase efforts in agribusiness The University of

Delaware/New Bulgarian University Business Development Center will offer short courses for SME entrepreneurs and more advanced studies at the Certificate level for industrial managers

The strategy update will continue and deepen the enthusiasm for SME development as the major focal point for enterprise development. To better focus the program for more impact we envision using certain "screens" to select SMEs for future assistance. First of all, we are selecting priority SME sectors for focus. An SME strategy, unfortunately delayed until after this document, will provide the sector focus based on potential for success, and will also identify types of support activities that appear most productive. An agricultural subsector strategy has already identified food processing as one of our target industries.

In selecting SME's for attention, the U S assistance program will look for firms with established managerial capacity, macroeconomic comparative advantage and a defined market niche and potential for substantial growth. SME candidates must be able to demonstrate that their success is not a "one off" case, but can be adapted and imitated throughout an entire subsector or region. Generally enterprise start-ups will be avoided. We will filter both individual private enterprise and industry assistance requests and grant proposals to ensure they fit these criteria.

In approaching all direct SME assistance programs, we will expand the "diagnostic" tool recently introduced amongst an E-mail connected network of U S contractors and grantees and Bulgarian partners. Essentially, this involves referring each potential SME industry subsector, or grouping to scrutiny by these players, who then interactively develop a tailored, integrated menu of assistance. We have experienced great success with this networking approach since its introduction in 1994, ensuring timely and broad sharing of information on SME needs.

In the past year, since USAID/Bulgaria's last strategic assessment when investments in Bulgarian agriculture appeared questionable, SME development in agribusiness has made impressive gains. Especially noteworthy is Land O'Lakes successes in dairy farming/processing. ACDI has also successfully helped establish a meat processors association that has developed a clear policy agenda. A USAID Agricultural assessment earlier this year recommended we support the food processing sector as a productive point of entry in Agriculture. Accordingly, we are giving this sector new priority under our program. This strategy is not without its risks. Land tenure is still problematic, farmer and processor associations are weak, and quality standards (especially to the EU market) daunting. More complete subsector assessments in livestock, fruits and vegetables, and dairy need to be done, with ENI assistance, although the Agricultural assessment indicated that these are the most appropriate areas for program emphasis within the food processing umbrella.

The United States Department of Agriculture's Extension Service, in cooperation with EU-PHARE has been working closely with the Bulgarian Agricultural Academy, the Bulgarian Ministry of Agriculture, and subordinate local institutes to develop a national agricultural extension system. The USDA objective is to help to design and to provide initial assistance in establishing a service that will be oriented towards private farmers. The system is to begin work in April, 1995. If the National Government clearly supports developing such a system -- as opposed to one primarily aimed at servicing state agricultural entities -- the USDA-ES could provide operational assistance at both the national and local levels. This program could potentially assist with the backward linkages from our food processing focus.

D Global and Other Special Objectives

The preceding strategy presents a demanding agenda for the U S assistance team in Bulgaria. With staffing and budget limitations, and in recognition of the need for the U S only to undertake activities within its manageable interest, a number of attractive assistance areas contained in the overall SEED program will be addressed to the extent resources permit. They support CEE regional goals, reflect global U S commitments, or can be reoriented to support the core strategic objectives of the Bulgaria program.

- **Promoting fiscal reform** More and more, the Bretton Woods institutions are providing counsel and advice to the Bulgarian Government on fiscal reform, when advice is sought. U S Treasury macroeconomic advisory assistance to the Ministry of Finance will be phased out at the conclusion of the present advisor's contract.
- **Financial markets development** Again, the Bretton Woods institutions have primary responsibility amongst the donors. Experts have recommended one area in which the U S may have some comparative advantage: capital markets formation. Capital markets, such as stock markets and other secondary liquidity mechanisms, will be a critical component if privatization really gets underway. Assistance could fall into any of the areas of broker associations, securities registration, clearinghouse functions, and government oversight (such as in the SEC model). At this time, we would prefer only to consider possible assistance in capital markets oversight, as part of an overall strengthening of key Bulgarian regulatory capabilities in the business enabling environment.
- **Sustainable use of natural resources** General institutional strengthening at the National Electricity Corporation (NEK) has been ongoing since 1991. Our central priority in the energy sector now must be to rationalize prices. Similarly, assistance to the Ministry of Environment will focus on creating viable environmental management and financing techniques at the local level, and helping to establish a pollution abatement fund. The U S commitment to the Global Environmental Facility for a biodiversity activity will end in FY97. EPA's future role should be limited to support for the Environmental Action Plan model. Consistent with international commitments, U S support for the nuclear safety program will continue.
- **Social sector restructuring** Social safety net issues continue to be problematic in Bulgaria, and could well become more severe in the aftermath of extensive privatization. Activities with the Ministry of Labor will be refocused on strengthening worker transition programs directly related to the impact of privatization and economic restructuring. The Health Markets program will direct its efforts to assisting municipalities and local authorities develop financial and service alternatives.

Part III. Required Resources

U S assistance to Bulgaria will be going through a particularly dynamic period in the next two to three fiscal years, as major projects phase out or wind down to a lower level of sustained funding. At the same time, constraints and other second generation development issues are emerging that suggest at least some reorientation of our assistance, especially in the budget "outyears" of 1998 to 2000.

For the purposes of this planning exercise, we are assuming that resource levels--in program and OE funds and in staff levels--remains constant through FY 2000. We are assuming further that as we approach FY 2000, the Bulgaria program should be moving toward an assistance end-game, with the Bulgarians able to sustain initiatives either on their own or with the help of other donors.

Through concerted effort, the Country Team believes it can reduce total units of management from 36

to less than 30 by 1997, a reduction of about 20% This concentration is important to ensure impact and program manageability

Major budget impacts and resource requirements are discussed below under each of the four proposed strategic objectives

Strategic Objective #1 - Local Governance

The HIID/WRI program will be completed in FY 98, having institutionalized a municipal financing model for gasification based on the EAP pilot activity, helping to establish a pollution abatement fund and having demonstrated how other environmental initiatives can be financially sustained

The Local Government Initiative (LGI) will expand its competitive grants program to more municipalities As municipal absorptive capacity increases, we will explore whether the grants program also could be enlarged (raising the present \$50,000 grant limit) to target issues such as municipal services It would be administered on a national basis, either within the GOB or the emerging intergovernmental association The program would keep its "seed money" character, however, encouraging testing out of new financial and management models for municipalities U S assistance would explore establishing long term linkages with American cities and public administration centers of excellence Another possibility for LGI grant activity is in privatization of municipal health facilities, under an HMO approach Key would be serious Bulgarian municipal and U S HMO interest in sharing the costs of such an experiment

University of Delaware, our main in-country training modality, will be extended until the end of CY 98 to ensure institutionalization of public administration/management training capacity at the New Bulgarian University

ICMA activities in municipal finance and administration under the Housing Sector program is due for phase down after FY 98, with replicable models in place We will continue to review the potential for housing guarantee infrastructure assistance in FYs 98 and 99, either under SEED Act or HIG accounts, depending upon GOB interest in housing sector reforms, the Bulgarian inflation rate (which now prohibits long term lending), and, of course, trends in U S interest rates (see budget for S O #3)

The Country Team will explore the potential for revisiting Bulgarian local government structures, such as possible city manager style of government and full-time municipal councils, as part of an ongoing dialogue with all Bulgarian government levels Again, the LGI would be the modality for any new initiatives in this area

Strategic Objective #2 - Civic Participation/NGO's

The political organization programs can be gradually focused in the outyears toward outstanding national issues For example we plan to explore the potential for assisting Parliamentary management after FY 98, probably under a new mechanism

AUBG will receive a second tranche of \$10 million in FY 96 for its endowment Additional amounts (hopefully declining) of direct operational support will be provided in outyears

Democracy Network technical assistance to NGO's will crest in the next two years and culminate in

FY 98 Resources permitting, we propose that some sort of endowment be established for public interest NGO's which would give them core funding to carry out their activities after the end of formal U S assistance One model that might be considered is the Luso-American Foundation of the 1980's

Accepting that civil society begins with youth, we will undertake a needs assessment in the education sector, to determine whether U S assistance can play a modest role in instilling democratic values and developing "inquiring minds" This assessment would look at whether modest U S interventions could and should be made at any levels of the education pyramid in Bulgaria Modalities might include exchange programs, sister universities, modular teacher training, and curriculum modification

Strategic Objective #3 - Private Sector Growth Enabling

The HIID program would continue, but focus in budget outyears more on alleviating direct environmental policy and regulatory impacts on business growth This might include modalities for alternatives to pollution "fines" or on developing secondary markets for "pollution permits"

A provision for targeted assistance in privatization continues in the budget For the period after FY 97, there is the possibility of continuing U S assistance in strengthening and regulating the Bulgarian securities market, which should be under considerable pressure after thousands of large and small state enterprises are privatized

The ABA will continue its assistance in commercial law development after the IRIS and Deloitte Touche efforts in bankruptcy/collateral law is completed

The U S will consider a new "competition activity" to be launched in FY 97 or 98 that would consider assistance in developing Bulgarian capability to ensure an open, transparent, and competitive environment for business growth Modalities might involve government institutions and industry self-regulation

Energy assistance would be reduced after FY 97, as demand side management and efficiency activities develop replicable results Outyear activities could be focussed on the transfer of successful energy models to the private sector for wider replication

Strategic Objective #4 - Small/medium Enterprise Development

Completion of BAEF financing in FY 97 (assuming availability of supplemental regional funds in FY95 to make that possible) will provide considerable budgetary flexibility in the outyears The Country Team believes that building up Bulgarian management/business consulting capacity will be important in consolidating the U S 's technical assistance gains in SME development over the course of the program We will explore the possibility of such a program over the next year

We are proposing to cut resources in two volunteer programs under this strategic objective as a way to better consolidate limited funding for the remaining programs, that appear best suited for the SME and agricultural support consistent with the strategy Thus we have eliminated funding for IESC and MBA Enterprise Corps and consolidated funds around CDC and VOCA/ACDI

With the expected rapid growth of the private sector, from green field investment, restitution, joint ventures and licensing, and as a result of privatization, the need for transfer of approaches to

management will increase a great deal, in an area where the U S has a widely-acknowledged lead
We are accordingly considering a new marketing support activity for the outyears

Global Issues

Labor market transition, especially in dealing with the aftereffects of privatization, downsizing, and restructuring, likely will be an important social safety net issue for the balance of the nineties. We will, however, look to facilitate closer linkages to the large programs planned by other donors. An earlier USG exit from this sector should be possible if the IBRD develops a major program here. Activities in this area will be linked back closely to work under Strategic Objective #3.

GEF/biodiversity (national parks) activities will wind down in two years, having successfully provided two models for national parks, as will nuclear safety assistance under DOE and NRC PASA's.

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