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PREFACE

The 2001 Annual Early Warning Report–Bulgaria is the fourth annual report in a series that started in 1997 under the auspices of the Bulgarian Early Warning System, a project implemented by the Ministry of Foreign Affairs and supported by USAID, Open Society Foundation–Sofia and UNDP. The Report presents an overview of the systemic monthly monitoring and analysis of data aimed at anticipating the emergence of low-level conflicts and potential crises in the country. A key theme in the Report is the link between the existing risks arising from the development of the domestic and international environment, and the socio-economic and political stability of the country. The findings of the Report outline the potential risks, which Bulgaria may face in 2002. They are accompanied by projections and suggestions for possible prevention strategies, hoping in this way to help designing better policies for avoiding potential conflicts and crises, particularly those emerging from inadequate policies.

The analysis of Bulgaria's risk profile for 2001 posed a number of analytical challenges – 2001 was an election year with two important elections (parliamentary and presidential) and international developments, both globally and in the region, were unfavourable for the country. In the previous Annual Early Warning Report–Bulgaria 2000, the early warning team anticipated the possibility of changes in the political model and shifts in the balance of political power. The outcome of the parliamentary election confirmed this assumption.

The National Movement Simeon II won the parliamentary election and formed a coalition cabinet with the Movement for Rights and Freedoms. The new political force and the new cabinet entered Bulgarian politics with exceptional public support. However, the economic realities in the country forced the government to undertake a range of unpopular measures and renounce a number of pre-election promises. At the end of 2001, the failure to keep pre-election promises and to meet the high expectations for improved living standards led to mounting public disappointment and declining popularity and support for the National Movement Simeon II. The outcome of the presidential election confirmed once again the aspirations of Bulgarians for better living. The success of the socialist leader Mr. Georgi Parvanov at the presidential election indicated that the hardships of reforms have led to growing pro-left sentiments. This suggests that further reforms have to be accompanied by improving living standards.

Parallel to that the country faced a multitude of risks arising from the unfavourable external environment. The 2001 crisis in FYROM posed the threat of another ethnic war near Bulgarian borders. In spite of the pressure of the international community, the risk of a new major offensive of Albanian extremists in the region remains in 2002. In addition, the aftermath of the tragic 11 September 2001 events threatened to reduce the country's earnings from tourism and exports and to delay the recovery of the global economy, thus worsening growth prospects in both developed and emerging market economies. For Bulgaria's open economy, the unfavourable global and regional business climate means a longer period of lower export earnings and, because of the investors' enhanced risk aversion strategies, reduced foreign investment and capital inflows. All of these are bound to have adverse implications for economic growth and would prevent the country from alleviating poverty in the near-term perspective.

At the same time, in 2002 the country will continue to face the challenges of transition. This means that macroeconomic and fiscal stability have to be maintained and economic growth revived. The country has to continue economic and

administrative reforms and develop a functioning market economy along with the capacity to withstand competitive pressures in the light of the prospective accession to the EU. Altogether, these difficult tasks have to be carried out without further increasing social costs, but on the contrary, reform policies should be aimed at curbing poverty and unemployment.

Bulgaria can achieve these strategic objectives but undoubtedly this would require significant improvements in strategic policy planning, policy evaluation, risk assessment and early warning and prevention of possible domestic crisis. Future early warning analysis could help policy planning to avoid unnecessary tension down the road to a functioning market economy and accession to the EU, and if needed, could facilitate the design of bilateral and international economic assistance programmes supporting the on-going societal transformation of the country.

Associate Professor Atanas Gotchev, Ph.D.



National Project Co-ordinator

CHANGE OF THE MAIN EW INDICATORS: Consolidated Quarterly Trends

	Consolidated Trend Q1 2001	Consolidated Trend Q2 2001	Consolidated Trend Q3 2001	Consolidated Trend Q4 2001
Respondent Reported Nominal Household Incomes				
Income Expectations				
Inflation Expectations				
Liquidity in the Banking System				
Purchasing Power Trends				
Efficiency of the Social Security System				
Employment Status Dynamics				
Unemployment Levels				
Risk of Unemployment and Preparedness for Labour Mobility				
Labour Market Policies				
Labour Market Prospects				
Confidence in Parliament				
Confidence in Government				
Legal System - Confidence in the Courts of Law				
Confidence in President				
Confidence in Army				
Confidence in Police				
Public Optimism for the Future of the Country				
Ethnic Stability – Ethnic Turks				
Ethnic Stability – Roma				
Personal Security				

	Substantial Improvement
	Improvement
	No Change
	Deterioration
	Substantial Deterioration

EXECUTIVE SUMMARY

Political Stability

The political situation in 2001 was dominated by three major events – the entry of Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics, the parliamentary and the presidential elections.

- ☞ The entry of the former Bulgarian king, Mr. Simeon of Saxe-Coburg Gotha, in Bulgarian politics shook the post 1989 bipolar political model, dominated by the Bulgarian Socialist party (BSP) and the Union of Democratic Forces (UDF). However, the June 2001 parliamentary election did not bring to power radical, nationalist or undemocratic parties.
- ☞ The National Movement Simeon II (NM Simeon II), founded in April 2001, won the parliamentary election receiving 42.74% of the votes. The two main parties – the ruling (UDF) and the opposition (BSP) – received almost equal shares of the vote (18.18% and 17.15%).
- ☞ Although in the run-up to the presidential election the approval rating of incumbent President Stoyanov had remained high, the candidate of the Left, Mr. Georgi Parvanov, had an unexpected success at the first round of the election and won its second round, receiving 54.13% of the votes. This result by far exceeded the size of the BSP core electorate.

Public confidence and electoral support of the political parties was volatile, recording unexpected highs and lows.

- ☞ Public disappointment with the existing political model and the high expectations for change increased the popularity of NM Simeon II. Within only a few months after its establishment in April 2001, NM Simeon II gained higher electoral support than that of the established political parties.
- ☞ Within six months in power, the NM Simeon II lost a significant share of public confidence and support because of the need to implement unpopular measures and the inability to meet its pre-election promises for rapid growth of living standards. From August to December 2001, the electoral support for NM Simeon II contracted by 30 percentage points and dropped to 23.2% at the end of the year.
- ☞ From June to October 2001 public confidence in both BSP and UDF declined, shrinking to a meagre 14% in October 2001. Following the outflow of electoral support to NM Simeon II in the months immediately after the June 2001 election, the electoral support of both parties contracted to the size of their hard-core electorates.
- ☞ Unlike UDF, BSP managed to benefit from the declining confidence and support for NM Simeon II. In December 2001, the approval rating of the socialist party reached 25.5%, the highest level in the past five years, while its electoral support became almost equal to that of NM Simeon II. Furthermore, the socialist party improved its image and gained additional electoral support after the success of its leader Parvanov at the presidential election.
- ☞ The shifts in the electoral support of the parties represented in parliament, which occurred in the final quarter of 2001, changed the political situation. In the beginning of 2002, the combined electoral support of BSP (21%) and UDF (13.7%) was 13.6 percentage points higher than the electoral support of NM Simeon II (16%) and Movement for Rights and Freedoms (MRF) – (5.1%). Undoubtedly, the changed balance of electoral support will encourage the opposition parties to become more proactive and critical of government's policies.

The entry of Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics incited in-fights and divisions in the established political parties.

- ✍ Internal party tension and divisions were induced by factional rivalries, disagreements on appropriate coalition policies before and after the parliamentary election, as well as by the need for organisational restructuring in the new political situation. The nomination of the presidential candidates was another major reason for internal disagreements and party rifts.
- ✍ UDF experienced the most dramatic factional rivalries. They severely damaged the cohesion of the party and provoked internal fragmentation. Some of the heavyweight UDF leaders were forced to leave the party and founded their own political organisations.
- ✍ The registration of NM Simeon II as a political party became a serious organisational problem with significant importance for the political future of the movement. Without such registration, NM Simeon II would not be able to strengthen its positions in Bulgarian politics and would continue to lack sufficient international legitimacy. The main reasons for the delayed registration were the lack of consensus for the future organisational structure as well as the issue of future relations with the two parties that carry the mandate of the current political coalition NM Simeon II.

Mr. Simeon of Saxe-Coburg Gotha became the Prime Minister of the country after NM Simeon II won the parliamentary election.

- ✍ After lengthy negotiations with parties represented in the new parliament, the NM Simeon II formed a coalition cabinet with MRF, including also two BSP-affiliated cabinet ministers, acting as independents.
- ✍ The approval rating of the new government when it came to office was 51.9%. However, because of the inability to meet pre-election promises and the excessive public expectations that blossomed in the run-up to the general election, the NM Simeon II government lost a substantial share of public support within only a few months since it came to power.
- ✍ The government of NM Simeon II declared that it would guarantee continuity in foreign policy, namely accession to the EU and membership in NATO. However, the pace with which these strategic objectives have been fulfilled was one of the most frequently criticised aspects of cabinet activities. According to UDF, the EU accession negotiations have slowed since NM Simeon II came to power.

The new cabinet encountered difficulties and had to implement unpopular measures.

- ✍ The legacy of the previous cabinet created difficulties for the new administration in its first days in office. They stemmed from unbeneficial privatisation deals concluded in the last days of the old cabinet, from the sabotage of senior civil servants appointed by the previous regime, and finally from the irresponsible expenditures not backed by revenues, particularly in the period of power transition, which led to hidden budget deficits.
- ✍ The cabinet's tax policy and the growth of district heating and electricity prices were the main source of social discontent. Policies in healthcare and education also caused tension, albeit some of the contentious issues were a legacy of the previous administration.
- ✍ At the same time, in the spheres of crime, corruption and privatisation the public perceived the new cabinet as more successful than the previous administration.

The initial public perceptions of the new President were positive.

- ✍ The support for President Parvanov, albeit not as euphoric as the initial support for NM Simeon II after the June 2001 election, remained high (44.1%) and non-partisan, coming from groups with different political orientation. It is likely that with the future involvement of the President in the political process, the confidence in the presidential institution will continue to grow.
- ✍ The new president stressed that he would not take decisions based on partisan considerations. His first acts gave grounds to assume that he would not be satisfied with the limited presidential powers and would seek ways for a more direct impact on the domestic political process. In line with that, he emphasised the need for a better policy coordination in law making between the president, the executive branch and the legislature.
- ✍ President Parvanov stressed that membership in NATO and the EU would be his foreign policy priority. He also emphasised the need for improving relations with Russia, Ukraine and other traditional partners. Also, on his agenda are more active policies on the Balkans, as well as improved relations with the Arab world. The new foreign policy priorities are in line with the understanding that foreign policy should serve national economic interests and must help regaining some of the lost traditional markets.

The past year indicated once again that public optimism would continue to be related to welfare and aspirations for better living.

- ✍ The pre-election euphoria as well as the promises of all political parties contributed to the growth of public optimism and, in August 2001, the share of optimists reached a record high of 48.3%. The more sober assessment of the real situation in the country and the slower than expected improvement of living standards, led to a continuous decline of public optimism since September 2001.
- ✍ Bearing in mind the need for continuing economic restructuring and reforms in the social sphere, as well as the lack of significant prospects for welfare improvement, a growth of public optimism in 2002 could be hardly expected.
- ✍ Over the past year, protest actions were provoked primarily by delayed payment of salaries and disbursement of social welfare benefits, unbeneficial privatisation deals, tax policies and the crime situation in the country.

In 2002, the main political parties will aim at resolving existing internal problems.

- ✍ The NM Simeon II will continue the efforts to register as a political party. The new party will try to become an alternative to UDF and will try to dominate the right side of the political spectrum. At the same time, the contradictions and infighting in NM Simeon II are likely to persist. This gives grounds to expect mounting tension in the parliamentary floor group of the movement and possible defections of MPs.
- ✍ The major challenge for the UDF will be the cohesion of the party and the integrity of its constituency. UDF will try to resolve this problem at the XIII National Party Convention, scheduled for March 2002. The other challenge, faced by UDF is the “retribution” pressure of NM Simeon II, which may force it to intensify the attacks against the governing coalition.
- ✍ The leadership of BSP will continue the rehabilitation of the party. The expectations are that the new leader, Mr. Sergei Stanishev, will carry on the reforms towards transforming BSP into a European social democratic party. However, the ambiguous attitude of BSP to NM Simeon II may prevent the

socialist party from capitalising successfully on future public disappointment if the situation in the country continues to deteriorate.

- ✎ The MRF is likely to have a significant influence on the development of the political process in the country in 2002. Although the MRF is not interested in destabilising the coalition government, a possible deepening of voters' dissatisfaction in 2002 may force the party to adopt different political strategies that will allow it to continue playing the role of kingmaker in Bulgarian politics. This may cause tension in the governing coalition and could undermine the NM Simeon's II voting majority.

Real Economy and External Trade

The year 2001 was positive for the economy, which recorded a fourth year of consecutive economic growth.

- ✎ In 2001, the real GDP grew strongly until mid-year. Due to the combined effect of gradually weakening world demand and faltering private consumption, the real rate of increase decelerated moderately in the third quarter to 4.5% year-to-year, from 5.1% in the previous trimester.
- ✎ The sustained pick-up in investment activity helped keeping overall growth in the economy relatively strong at 4.7% year-to-year during January–September, albeit with an underlying downward trend after the high momentum of 2000 that had resulted in an annual output gain of 5.8%.
- ✎ Last year's moderation in the pace of economic recovery reflected largely a notable deterioration in external conditions that dampened markedly the country's export performance and was the main cause for the negative net trade effect.

The evolution of the driving forces behind GDP growth confirmed last year's shift of economic expansion from an export-led recovery to stronger growth in fixed investment.

- ✎ Among the components of final domestic demand, economic growth was almost exclusively driven by continuing strong increases in fixed assets investment that reversed the 2000 slowdown, whereas final consumption remained practically flat in the first nine months of 2001 as a result of offsetting quarterly developments.
- ✎ Viewed from the supply side, Bulgaria's overall output performance continued to be driven by steady Gross Value Added (GVA) gains in services and industry, although both sectors exhibited a recently decelerating tendency in the rates of increase.
- ✎ With the nine-month GDP outcome exceeding the revised official forecast for average growth of 4.5% in 2001, such a target still appears within reach.

Given the sharp deterioration of the external environment after the September 11, 2001 events, as well as the overall hesitant consumption dynamics, further deceleration in the rate of output expansion seems very likely.

- ✎ In spite of many signs that economic recovery has been progressing at a slackening pace, the odds are more for a continuing gradual slowdown, instead of a sharper downswing.
- ✎ The lesser probability of a steep fourth quarter decline in output growth supports the preliminary estimates for a full year's real GDP rise close to the reduced target of 4.5%. In the context of the current global slowdown, such an outcome would be rather satisfactory, albeit well below the country's long-term potential.

- ⌘ Bulgaria's short-term performance will likely continue to be constrained by weak external conditions and heightened risk-aversion among foreign investors.
- ⌘ If investment activity holds up and the prospective recovery in the world economy gathers gradually strength during the course of 2002, domestic growth could be sustained at the projected average of 4% this year, although the downside risks remain sizeable.

Financial Stability

The macroeconomic and financial stability were preserved due to abundant foreign exchange reserves and prudent fiscal policy. The banking sector was stable and generated continuous profits.

- ⌘ The banking system developed in a relatively stable domestic and external environment. It controlled risks effectively and continued to be profit generating. The overall credit portfolio of the banking system remained sound.
- ⌘ During the year foreign exchange reserves grew by more than 10%. They reached a level close to DEM 8 billion, which is sufficient to cover the export expenditures for 7 months.
- ⌘ The debut Eurobond issue of Euro 250 million was successfully concluded. The completed parameters of the issue (maturity of 5 years and yield of 7.1%) could be a favourable starting point for the next issues.
- ⌘ The previous three-year agreement with the IMF was successfully completed. The government and the IMF agreed on the framework of a new two-year standby agreement amounting to USD 300 million, which the IMF board is expected to approve in February 2002.
- ⌘ The stock market remained underdeveloped, with low market capitalisation and limited impact on the economy. Future opportunities for growth of the traded volumes are associated with listing of big Bulgarian companies and financial institutions with a real impact on the economy.

The fiscal sector continued to be the main pillar of financial stability.

- ⌘ The parliamentary election brought certain tension because of the pre-election expansion of the government's investment program by BGN 300 million. Municipal budget deficits exerted additional strain on the budget. Nonetheless, the State Budget Act was applied strictly due to increased budget revenues and highly restrictive budget expenditures in the last quarter of the year. The fiscal year 2001 will close with a lower than planned budget deficit.
- ⌘ Mostly under the IMF pressure, the new government was forced to undertake a range of unpopular measures, to drop some of its investment projects and to renounce the pre-election promises for lower taxes and "immediate and non-symbolic" increases in incomes, especially of pensions. In this way the financial stability was retained, but the paid social price led to rapid decline of confidence in the executive branch.

The balance of payments remained stable.

- ⌘ The deficit accumulated in the current account was moderate and manageable. At this point the financing of the deficit does not cause increase in the debt burden, but there is a potential risk, which must not be neglected.
- ⌘ The financial crisis in Argentina did not undermine the stability of the Currency Board Arrangement (CBA) in Bulgaria. The effects of the Argentinian crisis cannot be transposed on other countries with currency board re-

Incomes and Social Security Policy

gimes. Therefore, the speculations about possible abandoning the CBA are not based on sound arguments.

Regardless of the change of governments, the income policy was marked by the legacy of the past.

- ✍ The growth of nominal incomes was moderate and did not bring about a turnaround in the development of real incomes. The 27% growth of the minimum wage was most pronounced, followed by the average pension with a 19% increase. Real incomes improved only symbolically and the accumulated decline over the past years was not overcome even partially.
- ✍ The year 2001 did not see the solution of the problems with the overall low level of incomes, the low level of budget sector wages and the unfavourable ratio between budget and real sector wages. The income policies of the old and the new cabinet did not secure nominal increase of incomes that can compensate for the growth of the individual social security burden and the contraction of real incomes accrued since the beginning of the 1990s.
- ✍ The data from the Survey of Household Budgets towards the end of 2001 points to alarming signals for a drop of the overall household incomes down to BGN 340.76 from BGN 349.16 a year earlier and a slight decline of the average level of pecuniary incomes per household (from BGN 301.45 down to BGN 301.14). The signals indicate that the income policy pursued by the government has failed to improve the income status of Bulgarian households. The further preservation of these processes would mean a deterioration of the standard of living of the Bulgarian population.
- ✍ Given the low-income levels, Bulgarian households were compelled to starve out every strain on their budgets, caused by different seasonal factors. The higher prices of electricity and district heating, of telephone services and medicines, will have an additional adverse impact on the consumption of households throughout 2002.
- ✍ In this context, the caution of the government regarding the development of incomes in 2002 (a freeze of the minimum salary, and a phased-in increase of budget sector wages) will hardly lead to any significant improvements of the income status of households. The government income policy seems to primarily pursue objectives related to fiscal stability. Obviously, future income policies will require the design of an overall concept that has to synchronise objectives, tasks, principles, and policy mechanisms.

The continuation of the planned reforms is the most characteristic feature of the on-going change in the social security system.

- ✍ The amendments in the social security system were aimed at financial stabilisation of the pension system in the medium and long term and at reinforcing the relations between social security rights and social security contributions.
- ✍ In 2001, the retirement age increased by six months and became 61 years of age for men and 56 years of age for women. The nominal level of pensions was increased by 10% on the average. The number of pensioners marked a marginal decline of 0.18% – from 2,375,149 in 2000 to 2,370,797 in 2001. The average number of pensions rose from 2,503,773 in 2000 to 2,567,310 in 2002. This is mainly due to the increased number of second, third, and fourth social welfare pensions.
- ✍ In 2002, the pension system reform will continue in the direction of a further tightening of conditions giving access to pension rights by further increasing of the retirement age with additional six months. Although the amounts of

social security contributions for all categories of labour will decrease (approximately by three percentage points), the individual social security burden will grow because of the lower contributions made by employers. The pension reform also envisages the start-up of the statutory social security insurance in universal pension funds for those born after 31 December 1959 as well as fixing the amounts of social security contributions in absolute terms instead of pegging them to the minimum wage.

- ✎ In 2002, the development of the all elements of the new pension system in Bulgaria will continue. This includes further development of the three pillars of the pension system and balanced implementation of the principle of national solidarity. The social security burden will gradually decrease, which will have positive effects on the cost of labour, thus reducing the share of the grey economy. In addition, the system will enhance the inflow of additional capital in the economy, accumulated through the additional and voluntary social security contributions.

Household Incomes

In 2001, nominal per capita household incomes recorded marginal improvement and did not encourage significant changes in the economic behaviour of households.

- ✎ The recorded nominal increase of household incomes was slightly higher than the growth of the CPI. Hence, disposable incomes of households grew marginally, which could not generate effective change in expenditure patterns and in the economic behaviour of households.
- ✎ During the year a long-term trend of decline in reliance on home production of basic food supplies has been observed. This indicates a shift of household food consumption to the market, which should be regarded as a positive sign.

The shift of household food consumption to the market has increased the importance of incomes in determining everyday economic behaviour and political orientation.

- ✎ The year 2001 witnessed a gradual change of public perceptions of economic realities. At the end of 2001, in the eyes of the public acceptable (normal) income levels were higher than at the beginning of 2000. This means that although the overall economic situation of households is slowly improving, it is perceived in a more negative way because expectations have grown faster incomes.
- ✎ At the end of 2001, the dissatisfaction with income levels was much higher than in January 2000, when average per capita household incomes were significantly lower.

Provided that incomes do not grow as quickly as expected, public dissatisfaction with cabinet policies will continue to increase.

- ✎ In 2001, higher income expectations had become an important political factor. The promise to meet public aspirations for higher incomes mobilised considerable support for the NM Simeon II at the June 2001 election. Parallel to that income expectations reached peak values in July and August 2001. However, the lack of visible improvement of incomes led to deterioration of income expectations and a considerable public dissatisfaction with the economic policy of the cabinet.
- ✎ The mismatch between pre-election promises and the possibilities to radically improve the economic situation of Bulgarian households within a short period

of time is very likely to create serious political and public confidence problems for the government in the coming 2–3 months.

In 2002, potential hotbeds of social tension will remain in the spheres of incomes and social security policy.

- ✍ The continuing low level of personal incomes not showing signs of positive change towards increasing the purchasing power of households is likely to lead to a decline of consumer confidence.
- ✍ The combination of low incomes and higher prices of electricity, district heating, telephone services and medicines will deteriorate the structure of household expenditures and will lead to shrinking consumption, which may facilitate the emergence health hazards that are particularly detrimental for children.
- ✍ The low level of budget sector wages and their irregular disbursement (typical for the real sector as well) could act as a strong catalyst for industrial conflicts.
- ✍ The financial instability of the social assistance system, leading to irregular disbursement of social assistance benefits, as well as the possible review of eligibility requirements to such benefits, which may restrict existing privileges, is very likely to generate “hungry protests” of those in need, particularly in the ethnic minorities. The juxtaposition of economic and social characteristics (e.g. poor and/or unemployed) with ethnic or religious features could change the dimension of such protests from socio-economic to ethnic, which may have a highly destabilising effect on regional and national level.

***Employment
and Labour
Market***

The characteristics of the Bulgarian labour market changed throughout 2001.

- ✍ The average unemployment rate in 2001 was 17.52%, against 18.14% in 2000. In the first quarter of 2001 employment stayed at an exceedingly low level, while the unemployment rate was very high. Consequently, a turn-around was observed – employment started to rise and unemployment began to subside slowly under the favourable impact of seasonal factors and the decelerating rate of redundancies, induced by the structural reform in the public sector.
- ✍ In October–December 2001, the labour market plunged into an adverse phase once again. The situation was characterised by transition from a temporary stagnation to a slight decline of the economic activity of the population. The average number of unemployed in the last quarter was 652,195, while the quarterly unemployment rate was 17.1%, or 0.5 percentage points higher than in the third quarter of the year.
- ✍ The structural characteristics of unemployment were more favourable. In the last quarter of 2001, the number of unemployed university graduates was 16.8% less than in the same period of 2000, of unemployed women – 6%, and of unemployed young people – 7.8%. This indicates some upsurge on the labour market and higher demand for skilled labour. At the same time, the share of the long-term unemployed in the final quarter of 2001 rose by 18% year-to-year and continued to be a risk factor.
- ✍ Regional unemployment disparities, however, were substantial. In almost half of the administrative regions unemployment exceeded 20%. The share of municipalities with critical unemployment rates remained high, encompassing more than 40% of all municipalities.

The development of the labour market and the political situation influenced the subjective assessments of unemployment and the coping strategies in case of unemployment.

- ☞ After the June 2001 general election, the perceptions of job insecurity declined, while the expectations that the cabinet will rapidly resolve the issue of unemployment were very high. At the end of the year, however, the optimism that the issues with unemployment will be resolved declined strongly, despite the successful launch of the micro-lending scheme and the establishment of National Employment Agency.
- ☞ The prospects for the development of the labour market at the beginning of 2002 tend to be unfavourable. Consequently, with the coming of the active season and the implementation of more active labour market policies, employment will tend to rise and a gradual abatement of unemployment will be observed.

The labour market continued to generate a number of conflict potential issues with critical importance.

- ☞ Employment remains at almost the same level as before, and the number of unemployed grows or declines mainly because of seasonal economic cycles and the withdrawal of some of the workforce from economic activity.
- ☞ The share of the long-term unemployed is high, and the same refers to the unemployed in pre-retirement age. This burdens the government budget with additional expenditures for social assistance and creates tension in the pension reform.
- ☞ Opportunities for employment in the rural municipalities (especially during the winter season) are nearly absent. Unemployment “concentrates” in ethnically mixed regions (in the Northeast of Bulgaria) and in municipalities of predominantly Roma population (Rakitovo, Omourtag, Roman, Iskar, Kotel, etc.).
- ☞ Job insecurity perceptions are changing under the influence of the labour market situation and the state of the political environment in the country. The subjective expectations of the population often diverge substantially from the reality, which at a later stage gives rise to dissatisfaction and discontent.
- ☞ The coping strategies in case of unemployment are dominated by the compromise with the professional realisation at the expense of securing one’s subsistence. The readiness for territorial and occupational mobility is diminishing. The share of the discouraged, who would not be looking for a job should they become redundant, is relatively high as well.
- ☞ The increased share of the unemployed involved in employment programmes and training courses is far below public expectations for government policies in the sphere of employment and unemployment. Large groups of the population (mainly long-term unemployed and people in pre-retirement age) remain outside the scope of labour market policies and this limits their chances to make a transition to a job placement or to meet the retirement eligibility criteria.
- ☞ The base of the social security funds (both in terms of number of employed and overall amount of contributions) has been shrinking, while the deficit of the funds has been increasing.

To some extent the conflict potential of the outstanding labour market problems may be neutralised by the following policy actions:

- ☞ Labour market policies have to consider a wider coverage of unemployed, giving priority to people in pre-retirement age and long-term unemployed, particularly from ethnic minorities. The municipalities with critically high unemployment rates and without alternatives for employment should be in the focus of the active labour market policies. The effectiveness of active labour market policies and vocational training programmes has to be further increased;
- ☞ The cabinet have to find ways to counteract the discriminatory attitude of employers to certain categories of the unemployed – people in pre-retirement age, representatives of ethnic minorities, disabled individuals, etc.;
- ☞ The awareness of the population of the cabinet's new labour market policies should be enhanced in order to mitigate existing job insecurity and mistrust in the ruling coalition. A possible public relations campaign has to include evidence of the practical utility of labour programmes both for the unemployed and the employed facing a high risk of redundancy;
- ☞ Labour offices may consider designing mechanisms for removing from their records pseudo-unemployed (receiving income from undeclared sources) by implementing administrative and methodological solutions, which distinguish genuine unemployment from part-time employment, under-employment and pseudo-unemployment.

***Intraethnic
Stability***

The year 2001 was characterised by the lowest levels of protest readiness of ethnic minorities over the last four years.

- ☞ The protest readiness of the Turkish ethnic group reached its lowest level for the whole period since 1997. In 1998, the cumulative protest readiness index of the Turkish ethnic group was 15.6%, in 1999 – 18%, in 2000 – 16.9% and in 2001 it reached the lowest level of 12.5%.
- ☞ The low level of protest readiness can be explained by several factors. The first is the successful performance of the MRF in the June 2001 general election and the appointment of representatives of the Turkish minority in the executive branch for the first time since 1990. The second was the high growth of optimism of the Turkish population after the general election, which subsequently did not fall so sharply as was the case with the other ethnic groups. The third was the growth of incomes in the second half of the year, which also cut back the protest readiness of the Turkish ethnic group.
- ☞ In the parliamentary and presidential elections in 2001, the MRF achieved its greatest political success ever since 1990. Therefore, in the short run the political factors influencing the stability of the Turkish ethnic group could hardly provoke any serious tension.

The registered protests and incidents involving the Roma minority were considerably fewer than in the 1997–2000 period.

- ☞ The cumulative protest readiness index of the Roma ethnic group in a similar way as the Turkish ethnic group registered its lowest levels since 1997.
- ☞ The major explanation concerning this radical change can be found in the general and presidential elections in 2001. In the election run-up social assistance benefits were disbursed on time and all measures to collect electricity and other utility bills owed by the Roma were suspended. Despite the permanent financial shortfall experienced by the municipalities, local authorities

in most places preferred to disburse due social welfare benefits instead of taking the risk to face incidents at the time of the elections.

- ⌘ However, unlike the Turkish ethnic group, tension in the Roma ethnic group is likely to grow in 2002. The restructuring of the National Electricity Company will impose hard budget constraints on the new power distribution companies and they are likely to force the Roma population to pay for its electricity bills. This will increase the protest readiness of the Roma if appropriate social protection measures are not taken on time.

The preliminary data from the population census put an end to the numerous speculations about the size of the Turkish and Roma ethnic groups.

- ⌘ According to preliminary census data, the Turkish population in Bulgaria is 758,000, or 42,000 less (5.25%) compared to the previous population census in 1991.
- ⌘ The census data for the Roma ethnic group revealed just the opposite situation. According to this data, the size of the Roma ethnic group stands at 366,000 people, pointing to a growth of 53,000 people (16.9%) since the previous census in 1991. According to analysts, the registered growth could be attributed to a significant extent to the increased self-identification of the Roma population as belonging to the Roma ethnic group, which has been growing over the past five-six years.

Personal Security

The crime situation in the country displayed diverging trends. A sequence of crimes provoked a political crisis in the beginning of 2001.

- ⌘ The coincidence of serious crimes in January 2001 increased social tension and in the beginning of February led to demands for the resignation of the government.
- ⌘ The culmination of political instability was reached with the protest of the taxi drivers, after the child of one of their colleagues was murdered. The same day the parliament building was put under “siege” and social tension reached new heights, which created a possibility for the fall of the government.

According to the annual data of both the police registration of crime and the EW Victimisation Survey, as a whole the crime situation in the country has improved in 2001.

- ⌘ The analysis of the police registration of crime data indicates that in 2001 crime rates in almost all categories of crime have declined in comparison with 2000. The fall in the number of one of the most widespread crimes – property thefts – due to its high statistical weight contributed most to the improvement of the overall crime situation. The improved crime situation led in the end of the year to public perceptions for increased personal security.
- ⌘ Despite the positive changes, the Victimisation Survey showed that in 2001 the indicator for refusal of police assistance (measuring the number of people who did not resort to police assistance) reached 41%, which is the highest level for the past four years.
- ⌘ With the appointment of the new Chief Secretary of the Ministry of the Interior, Mr. Boiko Borissov, the police started to apply again some of the methods of police work, which were used in 1997–1998. The police presence became more visible. Almost 75% of the directors of the regional police departments have been replaced. The well-known criminals were detained periodically. It is very likely that this already tested approach will produce

Prospects and Potential Risks

short-term positive results, however, such methods usually affect only the surface layers of crime.

The NM Simeon II cabinet is bound to continue facing the challenges of transition, while preparing the country for membership in the EU and NATO. In 2002, these challenges could be strengthened by unfavourable domestic and external developments. The cabinet has lost a significant share of public support and will face growing opposition to the unpopular but at the same time inevitable reforms. The aftermath of the tragic events of September 11, 2001, resulting in delayed recovery of the global economy could curb the prospects for quick economic growth and rapid improvement of living standards. At the same time, the existing risk of a new round of the war in FYROM as early as the spring of 2002 could additionally impede the cabinet's efforts to effectively pursue its agenda.

⚡ **Stability of the NM Simeon II and the coalition cabinet.** Although the coalition cabinet of NM Simeon II and MRF has a comfortable majority to pass legislation through parliament, the cohesion of NM Simeon II and the coalition cabinet could become an issue in 2002. The uncertain political future of NM Simeon II because of its delayed registration as political party could create tension in its parliamentary floor group. This may induce defections of NM Simeon II MPs who may decide to become either independent or join a different parliamentary faction. Such a situation could make the support of MRF critical for the stability of the cabinet.

In the short term, tensions in NM Simeon II and the cabinet are likely to be muted down by resignations and replacements of cabinet members. New instances of friction within NM Simeon II may occur in April 2002, when the movement is expected to take decisions for its registration as a political party.

⚡ **The pressure of the opposition.** The declining public support for NM Simeon II undoubtedly will encourage the opposition parties to become more critical of government's policies. However, because of the deep ideological difference between UDF and BSP these parties are unlikely to behave as a united opposition.

UDF. After the parliamentary election in 2001, UDF went through a deep internal crisis that led to fragmentation of the party. If some of the newly founded smaller parties based on splinter groups from UDF, team-up in a centre-right coalition, they may become an alternative to UDF with real weight in domestic politics. Therefore, we expect the unresolved internal problems to deter UDF from provoking major destabilisation at least until the third quarter of 2002.

However, the "retribution" pressure of NM Simeon II and the "White Book" released by the cabinet at the end of 2001 focusing on corruption of the previous government, suggest a possibility for an all out attack against the top of the UDF elite. Such a situation is likely to make UDF adopt a much more aggressive political stance and intensify its attacks against the governing coalition. Furthermore, UDF may try to capitalise on the mounting public dissatisfaction with the social and economic policy of the cabinet, in a similar way as it did in 1996 during the Videnov cabinet.

BSP. The socialist party may have to become more critical of the ruling coalition, because of the growing public disappointment with the cabinet. However, the adoption of a more critical stance is vulnerable as the party risks accusations of inconsistency and duplicity, given the fact that it has a presence in the cabinet. Thus, BSP may not be able to capitalise successfully on future public disappointment if the situation in the country continues to deteriorate. In a similar way as UDF, BSP is still not ready to take over the governance of the country.

Given the weakness of BSP and UDF, their opposition pressure will be largely determined by narrow party objectives and is not likely to provoke an early parliamentary election in 2002. Another factor, deterring both BSP and UDF, is the insufficient level of their electoral support at the beginning of 2002, which will not allow either of them to secure voting majority in parliament.

☞ *The pressures of economic restructuring and social reforms* will confront the cabinet with an additional set of challenges.

Privatisation programme. The privatisation programme of the cabinet for 2002 envisages the sale of the remaining large state enterprises, the sale of majority and minority stakes in 349 fairly large enterprises, left over from the mass privatisation, as well as the sale of residual stakes in 315 privatised companies. Although increasing economic efficiency, the completion of privatisation will lead to a significant unemployment shock. The number of redundancies would be comparable with the mass lay-offs at the beginning of economic restructuring. In addition, as of the beginning of 2002 the new regulations for dividend payments from state property increase three times the amounts due to the budget. This will lead to decapitalisation of enterprises by BGN 800 million, will restrict investments and, therefore, will lead to additional loss of job placements.

Reforms in the energy sector. Although the 10% price increase of electricity and central heating has been temporally suspended, the government will have to liberalise the energy sector, as household electricity and district heating appear to be still largely under-priced. Further liberalisation will entail another price increase of 20% in addition to the envisaged, but temporally suspended, 10% growth of electricity and heating prices. Given the high level of public dissatisfaction with the policy of the cabinet, this is bound to be a very unpopular move and could provoke a wave of protests in the next heating season. The growth of energy prices, therefore, has to be gradual and would probably require income adjustment measures, particularly for the underprivileged groups of the population.

Restructuring of the Railway sector. In the line with the IMF and World Bank programmes, the cabinet has to improve efficiency and reduce the losses of the Bulgarian State Railway Company (BDZ). Given the fact that in December 2001 the unions threatened to strike over Christmas because of unpaid wages for October, the cabinet may be faced with a number of problems in the future restructuring of BDZ. If the cabinet decides to comply with IMF objections to budget subsidies and meet the claims for cost reduction, it may not be able to satisfy the demands of the unions and could be entrapped in a difficult situation as a national strike of the railways could effectively destabilise the political situation in the country.

Reforms in the Public sector. The cabinet will have to press for reforms in education, the healthcare system and the army. The reform in these spheres will entail reduction of the number of teachers and downsizing of medical personnel. In a similar way, the army reform will lead to large redundancies of military staff, amounting to 12,000 people. This may require the implementation of targeted adaptation and vocational training programmes for the employees released from these spheres.

Tax policy. Changes in taxation improved the business climate for large corporations but were not so beneficial for small businesses and households. The increased license (patent) fees, particularly in the sectors of services and tourism, the higher local fees and taxes, and the growing prices of energy and telephone calls undermined the economic position of small and family businesses and worsened the situation of a number of Bulgarian households. This may translate into

contraction of consumer demand and a possible wave of closures of small and family businesses, which may pose medium-term risks to socio-economic stability. For this reason, the cabinet may have to reconsider part of its taxation policies in order to improve the business climate for small and medium sized enterprises.

Social Assistance and Social Insurance. The combination of low incomes and the prospects for higher prices of electricity, district heating and telephone services will lead to a deteriorating structure of household expenditure, shrinking consumption (estimated at 8% for 2002) and further impoverishment. As the social assistance system could not secure full coverage and perfect targeting, this situation may create short-term risks for social tension. For this reason, the cabinet has to secure the financial stability of the social assistance system and prevent irregularities in the disbursement of social assistance benefits.

⚡ *Ethnic Tension.* The socio-economic situation in 2002 could encourage interethnic tensions. As noted in previous EWRs, one of the forms of hidden assistance to the Roma was the uncollected utility charges, owed by Roma households to state companies. In 2002, power distribution companies will have either to collect from the Roma all outstanding amounts or transfer this liability to regular customers by increasing prices of electricity. Obviously, this situation is bound to induce significant tension in areas with large Roma settlements. Tension will grow within the Roma community, if it is left without utilities, and between the Roma and other communities, if the latter are forced to incur higher costs for utility services. For this reason, the cabinet has to revise its energy assistance strategy and target it more accurately.

The high unemployment rate within the Roma ethnic group is another major problem. According to data from the 2001 polling surveys, 64% of the Roma determine themselves as unemployed in comparison with 16% of the Bulgarians and 41% of the Turks. Despite the slight improvement of the situation in comparison with 2000, which had been the most difficult year in terms of unemployment, with 66% of the Roma identifying themselves as unemployed, Roma unemployment will continue to pose short and long term risks to domestic stability. In the short term, unemployment will increase tension in the Roma group and could lead to a sequence of conflict incidents. In a longer-term perspective, high unemployment rates will leave a substantial part of the Roma outside the social insurance system in future.

For the first time in 2001, there was a subtle evidence for growing tension between the Roma and the Turkish communities. MRF participated in the June 2001 parliamentary election in coalition with the Euroroma Party and received a significant number of Roma votes. As a junior partner in the coalition cabinet, MRF received a number of important appointments in the executive branch, while the Roma ethnic group remained without representation in the legislative and executive branches. This has caused a growing disappointment among Roma leaders. They began to accuse the MRF of taking advantage of its power position to the detriment of the Roma community by reallocating and diverting assistance programmes primarily to the Turkish community. The only reason that this issue has not yet provoked significant tension are the conflicts among the Roma organisations and the lack of unity of the community in pressing political demands. However, an increased cohesion of Roma organisations in 2002 may channel Roma protests more effectively, which could lead to increased tension between the Roma and the other ethnic groups.

⚡ *The situation in the sub region.* In spite of the pressure of the international community and the concessions made by the FYROM government, the risk

of a new major offensive of Albanian extremists in the region remains. Another armed conflict near Bulgarian borders may have serious negative implications for the country. Apart from the threat of a massive flow of refugees, a new war will destabilise the region and would impede again trade and investment, thus restricting the opportunities for economic growth in the country. Therefore, the cabinet has to pursue an active foreign policy in the sub-region and maintain a dialogue with the governments of the major powers aimed at extending additional support for stabilising the countries in the region.

1. POLITICAL STABILITY¹

1.1. Main Trends in Domestic Politics

The entry of Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics, the parliamentary and the presidential elections dominated Bulgarian

Throughout 2001, unexpected change and high dynamism characterised the Bulgarian political environment. Public confidence in the main state institutions and political parties was volatile, recording unexpected highs and lows (Table 1.1). Three major events dominated Bulgarian politics in 2001: the entry of the former Bulgarian king, Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics (April 2001), the parliamentary election (June 2001) and the two rounds of the presidential election in November 2001.

Table 1.1. Indexes of Trust of the State Institutions, Political Parties and Public Optimism²

	Jan. 2001	Feb. 2001	March 2001	Apr. 2001	May 2001	June 2001	Average H1 2001	July 2001	Aug. 2001	Sep. 2001	Oct. 2001	Nov. 2001	Dec. 2001	Average H2 2001
Parliament	-0.489	-0.535	-0.506	-0.546	-0.574	-0.509	-0.526	-0.026	0.205	0.088	-0.130	-0.287	-0.279	-0.071
President	0.312	0.272	0.231	0.251	0.161	0.301	0.255	0.408	0.435	0.360	0.266	0.035	-0.162	0.224
Government	-0.379	-0.427	-0.453	-0.458	-0.507	-0.376	-0.433	-0.109	0.367	0.275	0.090	-0.113	-0.043	0.078
Local Government	-0.025	-0.101	-0.069	-0.071	-0.071	0.030	-0.051	0.068	0.089	0.025	-0.045	-0.074	0.018	0.014
Police	-0.149	-0.273	-0.213	-0.160	-0.187	-0.100	-0.180	-0.090	-0.051	-0.077	-0.081	-0.072	-0.040	-0.069
Army	0.198	0.180	0.185	0.212	0.281	0.285	0.223	0.346	0.392	0.310	0.330	0.234	0.250	0.310
Prosecution	-0.339	-0.447	-0.368	-0.398	-0.386	-0.352	-0.382	-0.257	-0.194	-0.301	-0.327	-0.313	-0.381	-0.295
Courts of Law	-0.348	-0.425	-0.358	-0.389	-0.361	-0.333	-0.369	-0.257	-0.217	-0.311	-0.329	-0.338	-0.394	-0.308
BSP	-0.460	-0.436	-0.476	-0.440	-0.549	-0.467	-0.471	-0.507	-0.468	-0.458	-0.504	-0.503	-0.266	-0.451
UDF	-0.350	-0.365	-0.414	-0.405	-0.471	-0.337	-0.390	-0.469	-0.500	-0.545	-0.506	-0.520	-0.475	-0.503
NM Simeon II	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.451	0.350	0.131	-0.044	0.034	0.184
Optimistic Perceptions	-0.262	-0.450	-0.423	-0.457	-0.358	-0.233	-0.364	0.151	0.266	0.109	-0.130	-0.287	-0.248	-0.023

The entry of Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics led to a substantial change in the post-1989 bipolar political model, resting on two pillars – the Bulgarian Socialist Party (BSP) and the Union of Democratic Forces (UDF) – and balanced by the Movement for Rights and Freedoms (MRF). The model changed because of the overwhelming parliamentary election victory of the National Movement Simeon II (NM Simeon II), popularly known as the “king’s movement”, which received 42.74% of the vote. The former ruling coalition (UtDF) and the main opposition party (BSP) attained the worst election results since the beginning of transition to democracy – UDF received 18.18% of the vote, while BSP received 17.15%. These election results indicated clearly the exhausted potential of the bipolar political model to secure effective governance of the country.

Some observers expected that the general election might lead to a difficult to predict political change, which could threaten the future stability and integrity of

¹ Unless otherwise indicated, the data in the tables and figures is based entirely on the BBSS Gallup monthly surveys.

² For details about the indexes of trust in Table 1.1 see *Political Stability* in the Glossary. The values of these indexes range from +1 to -1. Positive values indicate that trust perceptions are prevailing, while negative values are indicative of prevailing perceptions of mistrust.

the country. However, in spite of the disappointment of the public with the established political parties, the election did not bring to power radical, nationalist or undemocratic parties.

The outcome of the November 2001 presidential election gave grounds for speculations that the Bulgarian electorate was rapidly acquiring a pro-left orientation, and that the socialist party would be coming back to power. The leader of BSP, Mr. Georgi Parvanov, won the second round of the presidential election, receiving 54.13% of the votes, a result that exceeded by far the votes of the BSP core electorate. The success of BSP in the presidential election led to substantial gains in electoral support. In December 2001, the electoral support of the socialist party in a hypothetical election was almost equal to that of NM Simeon II.

1.2. Major Developments in the Main Political Parties

Public Confidence and Electoral Support for the Parties Represented in Parliament

Prior to the election in June 2001, BSP's and UDF's public confidence and electoral support had reached the lowest levels since the beginning of the transition.

In 2001, public dissatisfaction with the bipolar model, which had dominated Bulgarian politics over the past ten years, led to a drastic decline of popularity and support for the two main parties – UDF (ruling party until June 2001) and BSP. The lowest levels of support were recorded in the period June–October 2001. Since 1992, public confidence in these parties has equalised periodically but on progressively lower levels. For instance, in January 1993 the approval rating of the two parties equalised at 28%, in July 1996 – at 25%, in May 2000 – at 18%, while in October 2001 the parity was reached at the level of 14%.

In December 2001, public approval of the socialist party gained 11 percentage points and reached 25.5% (a record high level for the past four years), while the approval rating of UDF remained almost unchanged, and was 9 percentage points lower than that of BSP (Figure 1.1).

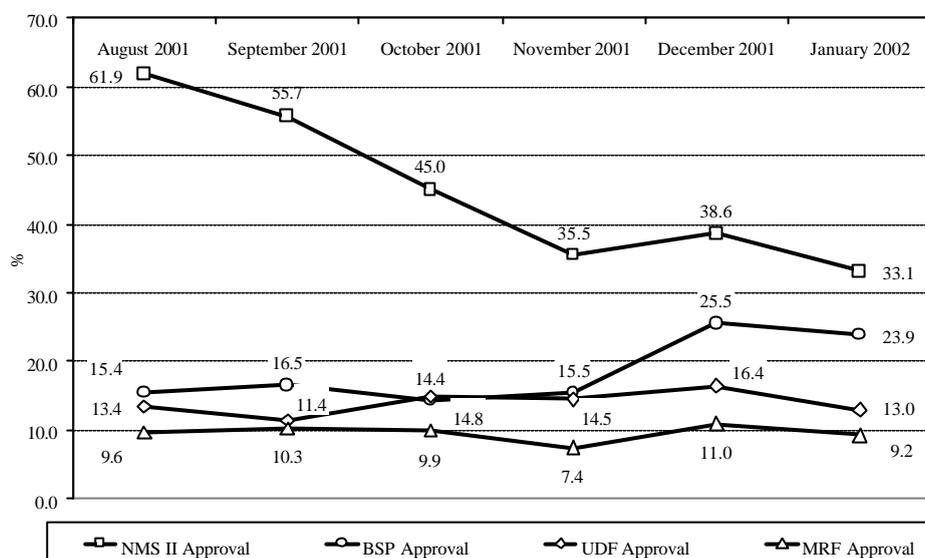
The electoral support of UDF and BSP had been contracting throughout 2001 and dropped to levels approximately equal to the share of their core constituencies. At the June 2001 parliamentary election, each of the two parties received approximately equal share of the vote (UDF–18.18% and BSP–17.15%). In September 2001, the electoral support for UDF declined to 9.5% and to 10.3% for BSP (Figure 1.2).

Only a few months after the entry in Bulgarian politics, the movement led by Mr. Simeon of Saxe-Coburg Gotha won the parliamentary election, receiving an overwhelming share of the vote.

Another evidence of the strong disappointment with the bipolar political model was the wide support for the National Movement Simeon II (NM Simeon II), the political formation of the former Bulgarian king, Mr. Simeon of Saxe-Coburg Gotha. Within only a few weeks after its establishment in April 2001, the movement gained equal presence in Bulgarian political life, receiving electoral support comparable to that of the established main political parties (Figure 1.2). After the Sofia District Court refused to register NM Simeon II as a political party under the Political Parties Act, the NM Simeon II participated in the general election through an ad hoc coalition based on two registered parties – the Party of Bulgarian Women and the Movement for National Revival “Oborishte”. The NM Simeon II won the parliamentary election, receiving 42.74% of the vote. Two main factors determined the election victory of NM Simeon II. The first one was the “protest vote” motivated by the disappointment with the existing political model and the readiness of the public to support a political alternative. The second one was the personality of the former Bulgarian king, in whom the public entrusted its hopes for economic revival and aspirations for better living. The higher

public expectations for better living increased the voter turnout to 67%, or 18 percentage points more than in the 1999 municipal elections.

Figure 1.1. Approval Rating of the Parties Represented in Parliament



The NM Simeon's II loss of electoral support in the final quarter of 2001 was far more significant than usual for post election situations in Bulgaria.

The inability of the cabinet to meet the excessive public expectations for quick improvement of living standards, fuelled during the June 2001 election campaign, was the major reason for the NM Simeon's II high rate of loss of public confidence and electoral support. Bearing in mind the unrealistic initial expectations, some loss of confidence and electoral support is normal. However, the rate of loss in the final quarter of 2001 was far more significant than usual for post election situations in Bulgaria. The substantial decline of public confidence also mirrored the unpopular policy measures, which the new cabinet had to implement after it came in office. Within only six months, the approval rating of NM Simeon II plunged from 61.9% in August 2001 to 33.1% in January 2002 (Figure 1.1). In spite of the substantial decline, NM Simeon II continues to enjoy the highest approval rating, followed by BSP.

The electoral support of NM Simeon II recorded a significant contraction as well. At the end of the year, the electoral support of NM Simeon II was almost equal to that of BSP, while in the beginning of 2002 it was already 5 percentage points lower than that of the socialist party (Figure 1.2). In December 2001, the combined electoral support of the ruling coalition (NM Simeon II and MRF) was 13.6 percentage points lower than the combined electoral support of the two opposition coalitions (UtDF and the BSP-led Coalition for Bulgaria).

BSP benefited from the declining confidence and support for NM Simeon II.

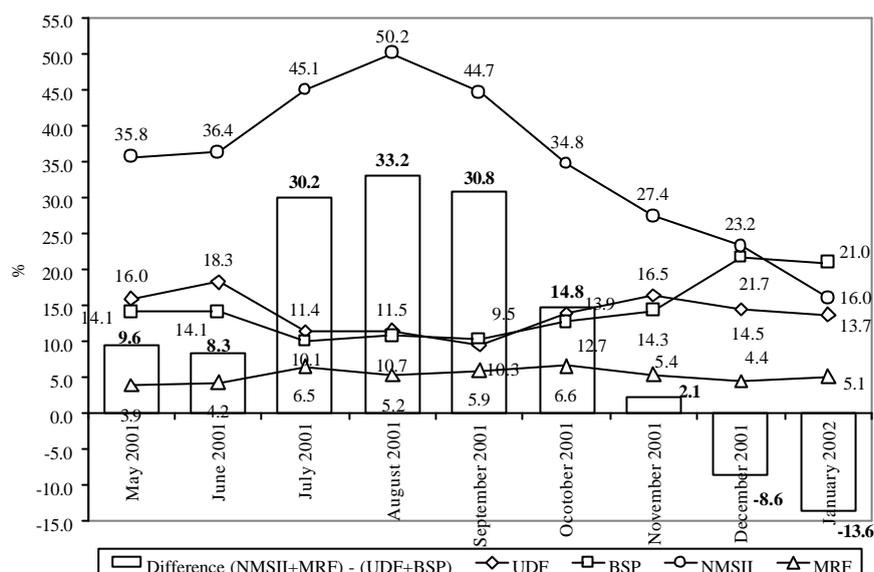
The socialist party benefited from the growing public dissatisfaction with the socio-economic policies of the new government. BSP turned to be the main winner that managed to capitalise on the declining confidence and electoral support of NM Simeon II. BSP improved its image and gained additional electoral support after the success of its leader Parvanov in the presidential election.

MRF did not lose public confidence and electoral support.

The MRF was the only party represented in parliament that did not lose public confidence and electoral support because of public disillusionment with the existing political model and the euphoria caused by the entry of Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics. In December 2001, the approval rating of the party reached the record high 11% (Figure 1.1). Its electoral support grew from 3.9% in May to 6.6% in October 2001 (Figure 1.2). One of the reasons is that in

2001 the MRF gradually changed its image of being a mainly ethnic party of the Turkish minority. An evidence of this was the growing membership of ethnic Bulgarians in the movement. MRF included famous personalities and professionals in its parliamentary election ballots who were not ethnic Turks and members of the party. In addition, the MRF managed to strengthen its image as a centrist liberal party by maintaining an equal distance from UDF and BSP in the parliamentary election campaign, and until the end of the first round of the presidential election.

Figure 1.2. Electoral Support for the Parties Represented in Parliament



Main Issues Faced by the Political Parties in 2001

The entry of Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics incited in-fights and divisions in the main political parties.

The entry of Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics incited in-fights and divisions in the main political parties. The public exposure of infighting was one of the major reasons for the loss of popularity and electoral support for the established political parties. Internal party tensions and divisions were induced by factional rivalries, disagreements on coalition policies before and after the parliamentary election, as well as by the need for organisational restructuring in the new political situation. The nomination of the presidential candidates was another major reason for internal disagreements and party rifts.

Key figures in party elites challenged the official line of party leaderships.

Factional Rivalries. Conflicts among party factions have affected all parties represented in parliament. In most cases, such conflicts involved key figures in the party elites, which on a number of issues had different views from those of the party leadership. The disagreements on coalition policies before and after the parliamentary election were the most acute.

National Movement Simeon II (NM Simeon II). With the entry of NM Simeon II in Bulgarian politics, it became evident that several major factions fight for influence and control. One of them is the group around the NM Simeon II parliamentary floor leader, Mr. Plamen Panayotov, known popularly as the “jurist lobby”. Mr. Stoyan Ganev, former foreign minister and Prime Minister’s *chef de cabinet*¹ (called locally *eminence grise*), dominated the other group. The younger and educated in Western universities cabinet ministers and deputy ministers appear to represent a third group of concentration of interests. The tussles, albeit not

¹ In February 2002, Prime Minister Simeon of Saxe-Coburg Gotha forced Mr. Stoyan Ganev to resign from this position.

always explicit, were over several issues – the arrangement of the MP lists for the general election, the future organisational structure of NM Simeon II as a political party, the appointments of regional governors and the nomination of the presidential candidate of the movement.

The differences in opinions, although creating certain tension, did not damage the unity and cohesion of the NM Simeon's II parliamentary floor group until the end of 2001. However, the evidence of such disagreements had a negative effect on the popularity and the public support for NM Simeon II as a ruling party. As noted, within only a few months in power the approval rating and the electoral support of NM Simeon II declined substantially, which raised the question about the future political influence of the ruling coalition. Without visible changes in line with the pre-election promises and given the unclear political future of the movement as its registration as a political party was postponed until April 2002, the NM Simeon II can hardly recover the loss of electoral support to levels close to that in June 2001. Nonetheless, in a near term perspective NM Simeon II will continue to be the major factor in Bulgarian politics.

Union of Democratic Forces (UDF). UDF experienced the most dramatic factional rivalries, which severely damaged the integrity of the party. The main issues which caused serious rifts between UDF's leadership and the internal party opposition focused on: (i) possible election alliance with MRF; (ii) relations (possible coalition) with NM Simeon II after the parliamentary election; (iii) the management style of the former UDF leader, Mr. Ivan Kostov.

Some of the heavyweight UDF leaders left the party and founded their own parties.

In February 2001, because of pro-monarchist sentiments and lobbying for closer cooperation with MRF, the Chief Secretary of UDF and then *eminence grise*, Mr. Hristo Bisserov, was expelled from the party and from the parliamentary floor group of UDF. He established the Conservative Alliance "Ekip", which was joined by a number of dissatisfied parliamentarians from the parliamentary floor group of the UDF.

At the end of 2001, Sofia mayor Stefan Sofianski left UDF, while the leader of the UDF party organisation in Sofia and former deputy prime minister, Mr. Evgeni Bakardziev, was expelled from the party and the parliamentary floor group of the UDF. Both of them disagreed with the management style of the party leadership and favoured cooperation with the ruling NM Simeon II. They also founded their own political parties – Union of Free Democrats (Sofianski) and Bulgarian Democratic Union–Radicals (Bakardziev). Although the new parties did not offer ideology and programmes different from that of UDF, their establishment increased the centrifugal tendencies in UDF and harmed the unity of the party. The damaged image of UDF led to fragmentation of its constituency and provoked a deep party crisis, the overcoming of which will be a long and difficult process.

Bulgarian Socialist Party (BSP). As in the case of UDF, the internal party opposition challenged most of all the coalition policy of the leadership. The main proponent of criticisms and diverging opinions was the faction "Open Forum", led by Krasimir Premyanov. The infighting in BSP, however, did not provoke open conflicts and internal disagreements had not led to substantial loss of public confidence and electoral support.

The election of a new party leader (after BSP leader Parvanov became president of the country) did not lead to internal strife as anticipated by many analysts. Expectations were that the election of a new party leader would provoke a clash between the younger generation (supporting the reformist line of Parvanov) and the older generation of socialists. The overcoming of internal conflicts and the

balanced political behaviour contributed to the gradual recovery of public confidence in the socialist party.

Movement for Rights and Freedoms (MRF). The disagreements on coalition policy after the elections were overcome quickly and did not affect MRF unity and party discipline. For instance, in October 2001, the deputy leader and member of the Operative Bureau of MRF, Mr. Osman Oktai, resigned from his positions because he did not accept the framework of the coalition agreement between MRF and NM Simeon II for mutual governance of the country. The subsequent expulsion of Mr. Oktai from the party, motivated by “corruption and financial embezzlement”, however, did not damage the popularity of MRF and did not have a negative effect on its electoral support.

Coalition policy was the most contentious issue in internal party discussions.

Coalition Policy. Appropriate coalition policy before and after the parliamentary election was the most contentious issue in internal party discussions. The major objective of coalition policies before the June 2001 election was the identification of suitable partners that may secure additional votes. In pursuing this objective, the main parties relied on different strategies.

From the extra-parliamentary parties, only **the newly established NM Simeon II** had sufficient electoral support to participate independently in the election. On the eve of the election, because the court refused to register it as political party, the NM Simeon II was forced to participate in the election via an ad hoc coalition based on two almost unknown parties – the Party of Bulgarian Women and the Movement for National Revival “Oborishte”.

After long deliberations and controversies, **UDF decided to use the formula of United Democratic Forces (UtDF)**, a coalition of centre-right parties that was successful in the previous general election. The UtDF coalition included Bulgarian Agrarian National Union–Peoples Union (BANU–PU), the Democratic Party, the Bulgarian Social Democratic Party of Yordan Nihrizov and the National Movement for Rights and Freedoms of Gyuner Tahir.

The **Bulgarian Socialist Party** opted for a broad coalition (Coalition for Bulgaria), which comprised of 15 left parties and organisations. The main objective of this mega coalition was to consolidate the centre-left political forces and their constituencies. It claimed that in this way the Left could guarantee a governing alternative, which would receive wide international support from the European socialist and social democratic parties.

The **Movement for Rights and Freedoms (MRF)**, although more interested in options for coalition alliances after the elections, entered into electoral alliance with another ethnic party “Euroroma” (Tsvetelin Kanchev). The explanation for this unanticipated alliance, formed immediately before the election, was that the entry of NM Simeon II and the expected higher electoral activity increased the doubts whether MRF would be able to pass the 4% threshold barrier for entry in parliament.

Another major problem of the coalition policy of the established political parties before the general election was the arrangement of the MP’s election lists. The joint lists of coalition partners in many cases ignored the preferences of local voters (most typical for UtDF), which led to outflow of votes, mainly to NM Simeon II.

After the June 2001 election, the main issue in the coalition policy of the parties represented in parliament was the attitude to NM Simeon II. Although NM Simeon II won the election with a near-absolute majority, it opted for consensus and cooperation in the future governance of the country. However, most of the parties in parliament were not prepared to follow the governing programme of the

NM Simeon II, announced before the election. After prolonged and difficult consultations, UDF refused to cooperate with NM Simeon II. The UDF's coalition partners from UtDF supported this decision as well.

The outcome of the NM Simeon II efforts to form a governing coalition was a coalition cabinet of NM Simeon II and MRF with the participation of two BSP members acting as independents.

Organisational Restructuring. After the election, the parties represented in parliament faced different organisational and structural problems. These issues were most important for NM Simeon II as they concern the political future of the movement.

The main organisational issue of **NM Simeon II** continues to be its registration as a political party. Following the failure to register the movement as a political party before the June 2001 election, its leadership has periodically tried to initiate restructuring of the movement and to review its charter and organisational principles. In spite of that, the registration of the movement has been delayed until the beginning of April 2002. The reasons for the delay are the lack of consensus for the future organisational structure (e.g. a broad movement, featuring an electoral type of party with minimum number of registered members vs. a party with wide membership) as well as the issue of the legal definition of the relations of the new party with the two parties that carry the mandate of the current political coalition NM Simeon II. The opponents of the transformation of NM Simeon II into a party point out the danger that the new party will lose its wide support as the public will begin to perceive it in a similar way as the already established political actors. Furthermore, the new party will have to develop bureaucratic structures, which are likely to begin struggling for power and positions by adopting regulations for control and suppression of dissenters, similar to those in other Bulgarian parties.

In its turn, **UDF** also faces serious organisational problems. They stem mainly from the fragmentation of the party after the parliamentary and presidential elections. In an attempt to prevent further rifts, the UDF began to replace local and regional party leaders with caretaker leaderships, which were loyal to the central headship of the party. It could be expected that UDF will overcome its major organisational problems at the XIII National Convention, in March 2002.

BSP also went through organisational tension, albeit minor, because of the need to elect a new leader after the chairman of the party, Mr. Georgi Parvanov, had won the presidential election. This issue was quickly resolved and BSP preserved its unity, electing on 15 December 2001 Mr. Sergei Stanishev as party leader.

MRF seemed to have been the only party represented in parliament, which did not have major structural and organisational problems in 2001. MRF appears to be a largely consolidated party, which exerts a very strong "gravitational" pull on the alternative Turkish ethnic party (NMRF of Gyuner Tahir), formed by MRF dissenters. An evidence for that is the discussion in the regional NMRF party organisation in Razgrad to return in MRF. This would probably mark the end of the attempts for splitting MRF and suggests that the UDF's effort to make the NMRF an alternative to MRF has failed for the time being.

Development of the Main Political Parties and Their Role in Domestic Politics: Outlook for 2002

NM Simeon II. The movement will continue the efforts to register as a political party as the registration is crucial for its political future. The registration will help

the movement to strengthen its organisation and will reinforce its positions in Bulgarian politics. In addition, as a registered party NM Simeon II will acquire international legitimacy. The new party will try to become an alternative to UDF that can dominate the right side of the political spectrum. This has been evidenced by the adoption of the values of the European Peoples Party.

The contradictions and infighting in NM Simeon II are likely to persist.

In light of the need to follow tight budget deficit targets, which will continue to provoke the dissatisfaction of voters, the contradictions and infighting in NM Simeon II are likely to persist. Divisions will continue to arise because of the ongoing struggle for power and influence within the movement. Internal clashes could intensify if the leadership of the parliamentary floor group does not change the management style, which has been increasingly criticised by NM Simeon II parliamentarians.

The MPs of the ruling coalition may intensify their criticisms for the slow work of the cabinet. On the other hand, Prime Minister Simeon of Saxe-Coburg Gotha is likely to put pressure on parliamentarians by demanding resignations of those not abiding to the principles of the movement. This gives grounds to expect mounting tensions in the NM Simeon II parliamentary floor group, which may lead to defections of MPs.

The UDF will strengthen its criticism of the legislative and government activity of NM Simeon II.

UDF. The former ruling party will be facing the difficult task of recovering its popularity and positions after the devastating loss of the parliamentary election in June 2001. Its transition from a ruling to an opposition party was ridden with internal discord, fragmentation and destabilisation, which provoked a deep internal crisis. Another setback to the integrity of the party was the establishment of alternative centre-right parties by Sofia mayor Sofianski and former Deputy Prime Minister Bakardziev. Towards the end of the year, however, UDF displayed some signs of consolidation, which might strengthen after the party National Convention in March 2002. Nonetheless, the UDF continues to face a number of challenges.

The major challenge **is the integrity of the UDF's constituency**. As a result of internal strife, UDF continues to lose support and so far has been unable to take advantage of the public disillusionment with NM Simeon II. In addition, if the newly founded smaller parties based on splinter groups from UDF (those of Sofianski, Bakardziev, Bonev and Bisserov) team-up in a centre-right coalition, they may become an alternative to UDF with real weight in domestic politics. Furthermore, some of the leaders of the smaller parties have significant influence among UDF supporters at local and regional levels. This creates a potential for outflow of UDF supporters to the new parties, which may cause rifts and splits in UDF's regional and local structures.

BBSS Gallup opinion poll data for November 2000 – January 2002 suggest that in a hypothetical election the combined electoral support of these parties may range from 2.5% to nearly 4%. In early 2002, the party of Sofianski alone enjoyed electoral support of 1.5%. This gives grounds to assume that such parties have the potential to become important players in the centre-right, further downgrading the role of the UDF.

The second challenge is the **“retribution” pressure** of NM Simeon II on the UDF. In line with its pre-election promises to fight corruption, in October 2001 NM Simeon II has signalled unambiguously its determination to expose and punish corrupt civil servants from previous administrations. In December 2001, the government published a “White Book”, which described in detail the corruption in the previous government. Although the publication was downplayed by the media and totally dismissed by the previous government, it blamed the Kostov cabinet of

ruthless plunder. Such allegations may mean an all-out attack against the top of the UDF elite. Following its “retribution” strategy, the NM Simeon II could blame the previous ruling party for the current hardships and could get the needed excuse for not kept pre-election promises.

UDF may intensify the attacks against the governing coalition.

The “retribution” pressure is likely to make UDF to adopt a more aggressive political stance and force it to intensify the attacks against the governing coalition. In 2002, the UDF may try to capitalise on the mounting public dissatisfaction with the social and economic policy of the cabinet, in a similar way as it did in 1996 at the time of the Videnov cabinet. An indication of this was the unsuccessful vote of no confidence for the government, demanded by UDF in January 2002. However, it can be forecasted that UDF will not aim at real destabilisation of the cabinet and NM Simeon II at least until the last quarter of 2002, as it is not yet ready to take over the governance of the country.

In order to recover its constituency, which has been shrinking because of the constant outflow of supporters and local activists, UDF is likely to simplify the application procedures for membership in the party. UDF may also amend and make more liberal article 10 of its charter, which regulates the grounds for expulsion from the party.

The new BSP leader will carry on the reforms aimed at transforming BSP into a European social democratic party.

BSP. It could be expected that the rehabilitation of BSP will continue and the position of the party will be strengthened. The expectations are that the new leader, Mr. Sergei Stanishev, will carry on the reforms towards transforming BSP into a European social democratic party, in spite of the opposition of the conservative wing of the party. The new leader has the necessary qualifications and professional skills, which bodes well for continuing the reform line of former leader Parvanov. In addition, Mr. Stanishev has the support of the European socialist parties. However, the reforms of the new leader may be challenged at the party congress in May–June 2002.

Although remaining in opposition, BSP has two cabinet ministers, acting as independents. The ambiguity of such a situation, which is currently in favour of BSP, as it earns dividends by being in power while at the same time criticising the cabinet and benefiting from public disappointment, may become a problem in the medium term. BSP may have to become more critical to the ruling coalition, because of the hardships, experienced by its electorate. However, the adoption of a more critical stance is vulnerable as the party risks accusations of inconsistency and duplicity, given the fact that it has a presence in the cabinet. Thus, BSP may not be able to capitalise successfully on future public disappointment if the situation in the country continues to deteriorate. In the same way as UDF, BSP is not yet ready to take over the governance of the country.

MRF. The importance of MRF in domestic politics increased after its success in the parliamentary election. The MRF has already received a number of important appointments in the executive and legislative branches and as anticipated in earlier reports¹, received appointments in the presidential administration. The admission of MRF into the European party of the Liberals, Democrats and Reformers will increase the international weight of the movement.

The MRF is likely to have a significant influence on the development of the political process in the country.

In the few months after the presidential election, the MRF managed to successfully play the role of corrective to the policy of NM Simeon II. Given the existing balance of political power and the strengthened position of the movement,

¹ E. Simeonova. ‘Political Stability’, in: Gotchev A. (ed.) *Early Warning Report – November 2000*. UNDP: Sofia, p. 13.

the MRF is likely to have a significant influence on the future development of the political process in the country.

In the short and medium term perspective, the most important aspect of this influence will be the MRF's behaviour as a junior partner of NM Simeon II in the governing coalition. Although the run-up to the presidential election caused some friction between coalition partners because of the NM Simeon's II last minute decision to back Mr. Stoyanov for his second term of office, for the time being MRF is not interested in destabilising the coalition government. A collapse of the coalition cabinet, apart from being detrimental for the development of the country, will deprive the MRF from its positions in the executive branch and could damage the reputation of the movement as a factor of stability in the country.

The possible deepening of voter's dissatisfaction in 2002 because of the tight control of government expenditures, may force MRF to adopt different political strategies that will allow it to continue playing the role of kingmaker in Bulgarian politics. This may cause tension in the governing coalition and undermine the NM Simeon's II voting majority. A period of such tension could be expected towards the third quarter of the year, when the Turkish ethnic group will again begin to experience the impact of the reduced opportunities for seasonal employment.

1.3. Government

Public confidence

The government of UtDF, led by Mr. Ivan Kostov was the first democratically elected government that carried out its full term of office and stepped down after a scheduled election in line with the constitutional process of the country. The average approval rating of the Kostov government for its whole term of office (May 1997–July 2001) was 32.4%. The cabinet of Simeon of Saxe-Coburg Gotha began its term with approval rating of 51.9%, which was identical to the approval of the Kostov cabinet at the beginning of its term (51.0% in May 1997) and higher than the initial approval rating of the Videnov cabinet – 45% in January 1995. The comparison of the average approval ratings of the three cabinets for the first seven months of their term of office suggests that the government of Mr. Simeon of Saxe-Coburg Gotha has lost more public support than the other two governments (Figure 1.3). The UtDF government was losing popularity gradually and approval ratings reached critical levels towards the end of the cabinet's mandate.

Because of the unmet excessive expectations that blossomed in the run-up to the general election, the NM Simeon II government lost a substantial share of public support within only a few months since it came to power. The decline of the approval rating of the NM Simeon II cabinet was even faster than that of the Videnov cabinet (Figure 1.4).

The Kostov government was the first government since 1990 to carry out a full term in office.

The drastic decline of public confidence in the new cabinet was caused by the collapse of the excessive expectations for quick improvement of living standards.

Figure 1.3. Average Values of Electoral Support of Videnov, Kostov and Simeon of Saxe-Coburg Gotha Governments in Their First Seven Months in Office

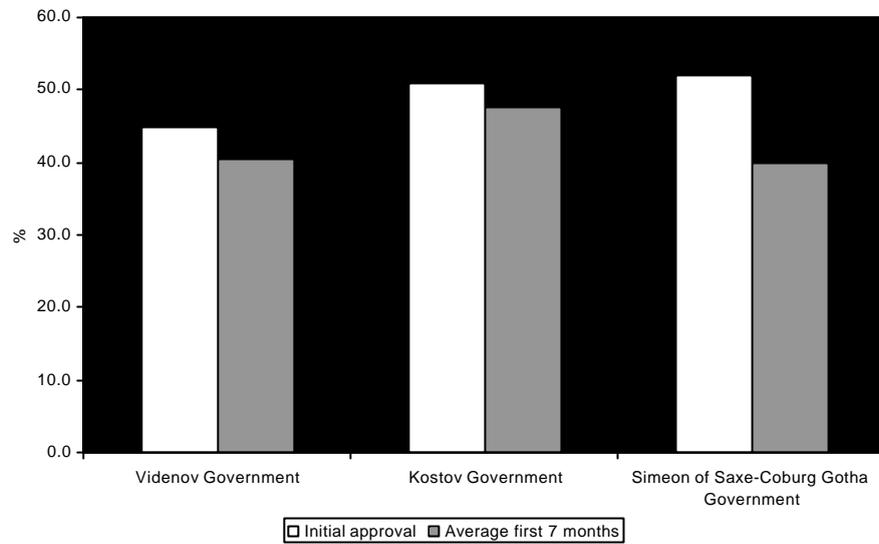
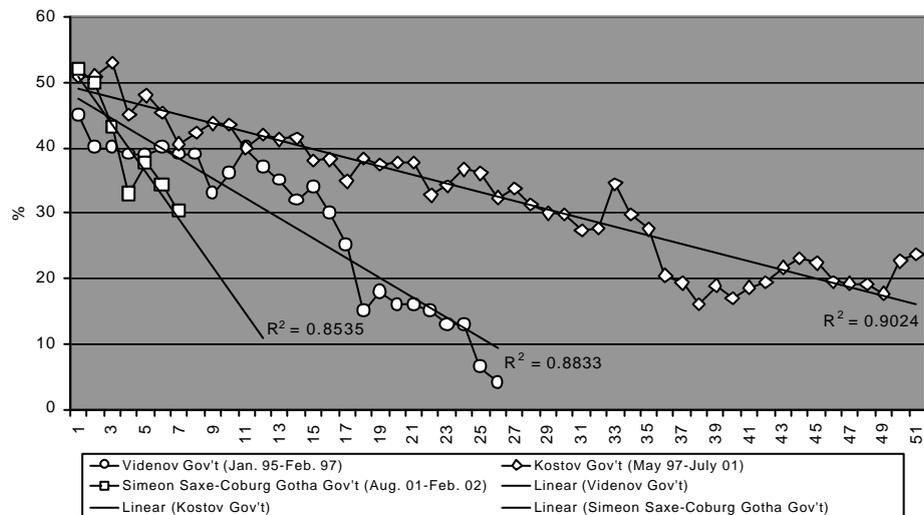


Figure 1.4. Approval Ratings of Videnov, Kostov and Simeon of Saxe-Coburg Gotha Government (Actual Data and Trend Lines)

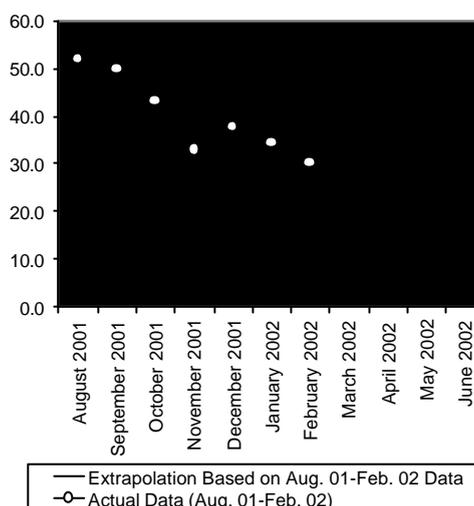


Although the governments of UtDF and NM Simeon II both had to implement a number of unpopular measures in the beginning of their terms, the effect on the popularity and public confidence in the two governments was entirely different. Apart from the unmet expectations that led to very quick public disappointment, the media as well as the publicised analyses of experts played a major role because they shaped very different public attitudes and perceptions of the two cabinets.

In spite of the criticisms and the mounting allegations of corruption, the government of UtDF was perceived as one without alternative until almost the end of its term of office. Largely because of this, the rule of this government was not seriously challenged even in periods when its approval rating was approaching the critical level of 20%.

The situation with the NM Simeon II cabinet was very different. Regardless of the euphoric public support in the run-up to the parliamentary election and the overwhelming election victory of NM Simeon II, the media remained largely hostile to the new cabinet. A number of factors determined the unfavourable attitude of the media, but perhaps the most important one was the lack of adequate PR strategy that could provide timely and sufficient information on the policies of the cabinet. Furthermore, in their public statements senior government executives frequently contradicted each other. As a result, many media reports and analysis were based on assumptions rather than on accurate information because the cabinet failed to provide it. Thus, the media coverage of government activities created perceptions that the new cabinet is incompetent and disorganised, and therefore doomed to fail. Such perceptions also contributed to the drastic loss of popularity and public support. For the first six months in power, the NM Simeon II cabinet lost 17.6 percentage points of its approval rating, which plunged down to 34.3% (Figure 1.5).

Figure 1.5. Government Approval Ratings – Trend Line Projections and Actual Data



The extrapolation of the cabinet's approval rating suggests that if the domestic situation does not change, and given the absence of major counterbalancing factors, public support for the cabinet may reach critically low levels of 20% in May–June 2002. Although some loss of public support is normal (given the excessively high initial expectations), the decline has been so significant that it may pose risks to political stability if the trend is sustained.

However, according to political analysts, such dramatic depletion of public support is a relatively rare phenomenon. As already noted, in this case the main reason was the collapse of the excessive expectations for quick improvement of living standards. After the shock from the new taxes and fees fades away, it is possible that the support for the cabinet could stabilise towards the end of the spring and remain in the current range of 30%. In addition, a stabilising factor is the high popularity and public approval of the prime minister. The public approval rating of Mr. Simeon of Saxe-Coburg Gotha towards the end of 2001 was in the range of 50–55%, or 20 percentage points higher than that of the cabinet.

Domestic Politics: Main Issue and Achievements

UtDF government. The government of the UtDF operated in a relatively favourable political environment as long as the main opposition party (BSP) was discred-

ited and had lost its political influence for a long period. The lack of real opposition and the developed public perceptions that an UtDF cabinet is the only governing alternative determined the lasting support for the ruling coalition.

The government of Ivan Kostov was the first democratically elected government to undertake and achieve real results in the needed but long-delayed structural reforms. It managed to attain macroeconomic and financial stabilisation and to complete a substantial portion of privatisation. Part of the problems faced by the government in the spheres of real economy, the labour market and social sector were additionally complicated by external factors – the strong US dollar, the growth of fuel prices on international markets, as well as the unfavourable situation in the sub-region.

Economic restructuring and reforms required a number of unpopular measures. The hardships caused by the economic reforms neutralised the achieved positive results in the eyes of the public and reduced support for the government. The reforms of the social sector and the healthcare system reduced additionally the popularity of the Kostov cabinet. Furthermore, the cabinet did not manage to launch some of the envisaged large-scale infrastructure projects and employment programs, which increased unemployment and social tension.

In addition, government support suffered from the growth of crime, embezzlement and corruption on all levels of the administration, as well as the lack of transparency in privatisation. The logical outcome of these setbacks was the failure of the UtDF in the parliamentary election in June 2001.

NM Simeon II government. Unlike UtDF, the NM Simeon II took over the governance of the country in an exceptionally hostile media environment, characterised by insinuations and suspicion for the “real” intentions of the former Bulgarian king. The vacuum of power during the transitional period in June–July 2001, when the new cabinet was not appointed as well as the attempts of the former ruling party to discredit the new government increased political tension immediately after the parliamentary election.

The legacy of the previous cabinet created certain difficulties for the new administration in its first days in office. They stemmed from unbeneficial privatisation deals concluded in the last days of the old cabinet, the sabotage of senior civil servants appointed by the previous regime and by the irresponsible expenditures not backed by revenues, particularly in the period of power transition, which led to hidden budget deficits and deteriorating budget indicators.

Furthermore, the cabinet had made a number of pre-election promises, which created unrealistic expectations for rapid economic revival and a quick improvement of living standards. However, the economic situation of the country when NM Simeon II came to power, although stable, was characterised by high unemployment, low living standards of the majority of the population and crisis in a number of sectors of the economy. The global economic recession as well as the aftermath of the 11 of September 2001 terrorist attacks on the US additionally complicated the situation and limited the chances for rapid economic revival.

In addition, the degree of freedom in policy making had been constrained by the requirements of the IMF and the need to conform policy measures with objectives for accession to the EU. Because the cabinet was keen not to upset relations with international financial institutions, it was forced to undertake a range of unpopular measures, to drop some of its investment projects and to renounce the pre-election promises for “immediate and non-symbolic” increases in incomes, especially of pensions.

Among the main priorities of the government programme for the 2002–2005 period were the achievement of high and sustainable average annual economic growth of 5–7% and attracting significant foreign investment amounting to USD 1–1.2 billion annually for the years 2002–2005. The programme specified five priority areas for the sustainable development of the economy – communications and high technologies, the energy sector, tourism, agriculture and forestry, and the transport sector. Given the existing situation in the country, the achievement of the targets of the programme is bound to be slow, and the government will not be able to keep most of its promises for quick improvement of welfare standards.

The tax policy of the cabinet and the growth of prices have provoked wide spread discontent.

The cabinet's tax policy and the growth of district heating and electricity prices, which have a direct impact on living standards, were the main sources of social discontent. Policies in healthcare and education also caused tension, albeit some of the contentious issues were a legacy of the previous administration. At the same time, in the spheres of crime, corruption, privatisation and foreign relations the public perceived the new cabinet as more successful (Figure 1.6). In spite of that, the Cumulative Governance Index of the cabinet dropped to values which suggest that in the perceptions of the public a different government will be more capable of dealing with the existing societal problems (Figure 1.7).

Figure 1.6. Governing Potential of NM Simeon II in Selected Social Spheres¹

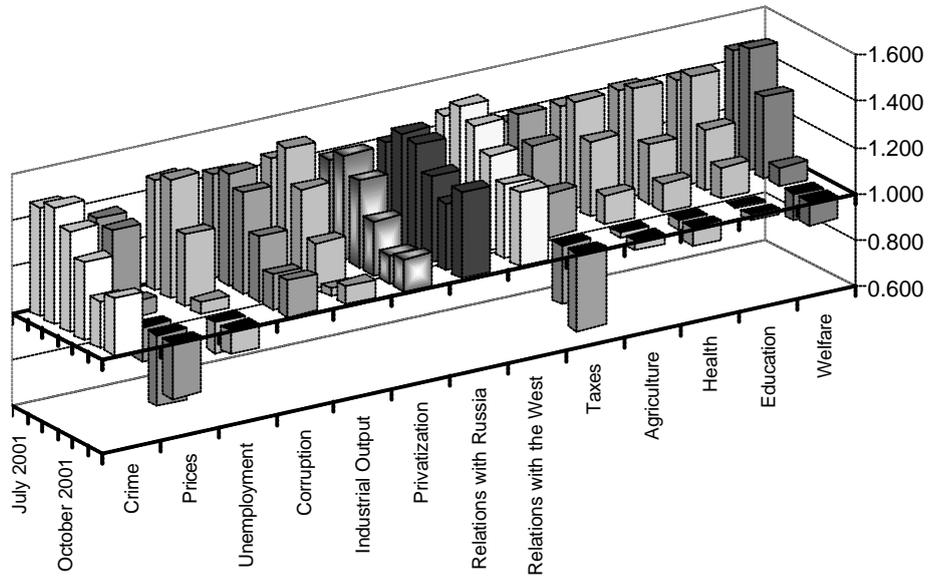
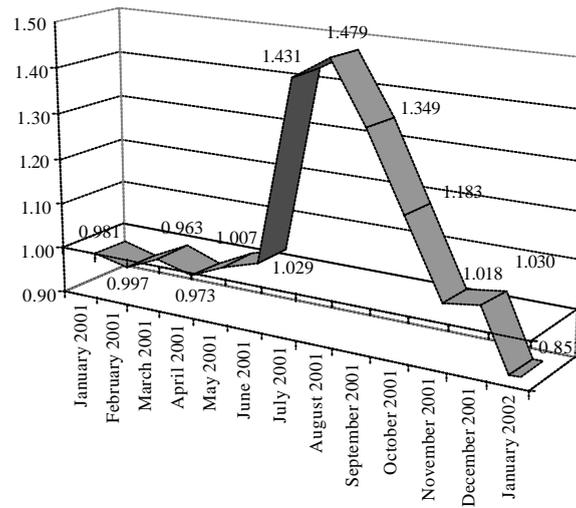


Figure 1.7. Cumulative Governance Index – Governing Potential of UtDF and NM Simeon II²



Foreign Policy: Main Issues and Achievements

The invitation for EU membership negotiations and the removal of Bulgaria from the Schengen visa list was a notable success of the Kostov cabinet

The UtDF Government. The foreign policy of the UtDF government was very successful and had wide public support. The Kostov cabinet received an invitation for EU membership and started accession negotiations. Another success of the foreign policy of the cabinet was the removal of Bulgaria from the Schengen visa

¹ The methodology for calculating the index is described in the Glossary. Values above one (1) indicate public confidence that the regime is more capable than the opposition to deal with existing issues, while values lower than one (1) suggest public attitudes that the opposition will find better solutions for the existing problems.

² The methodology for calculating the index is described in the Glossary. The Cumulative Governance Index represents the average value of the governing potential in all spheres, presented in Figure 1.6.

list, which allowed Bulgarian citizens to travel without visas in EU countries, that are members of the Schengen agreement.

During the Kosovo crisis, in line with its foreign policy priorities the Kostov cabinet supported NATO, a position which did not enjoy popular support. This increased political tension, from which the opposition tried to earn dividends, albeit not very successfully.

The inadequate development of relations with Russia and the spy scandal involving the expulsion of three Russian diplomats from the country was another foreign policy issue, criticised strongly by the main opposition party (BSP).

In March 2001, the situation in the sub region was very tense because of the armed clashes between Albanian extremists and the FYR of Macedonia security forces. The position of the Bulgarian government evolved from an initial spontaneous readiness for all-out assistance to the view that in order to avoid possibilities of extension of the conflict to neighbouring countries, assistance should be rendered only in the framework of a coordinated effort of the international community.

As an additional guarantee to national security, in March 2001 the government concluded a bilateral agreement with NATO. The agreement arranges the interaction between Bulgarian authorities and NATO for transit or stationing of NATO forces in Bulgaria.

The government of NM Simeon II declared that it would guarantee continuity in foreign policy.

The NM Simeon II Government. The government of NM Simeon II declared that it would guarantee continuity in foreign policy, namely accession to the EU and membership in NATO. However, the pace with which these strategic objectives have been worked toward was one of the most frequently criticised aspects of cabinet activities. According to UDF, the EU accession negotiations have been slowed since NM Simeon II came to power. The progress of the EU accession negotiations will depend inter alia on the speed of the reform of the judiciary, the administration and the economic reforms of the cabinet.

Unlike its predecessor, the NM Simeon II cabinet aims at reviving contacts and trade with Russia and will try to settle the outstanding issues in bilateral relations. In this respect, the January 2002 visit to Moscow of the Minister of the Economy, Mr. Nikolai Vassilev, has been very encouraging.

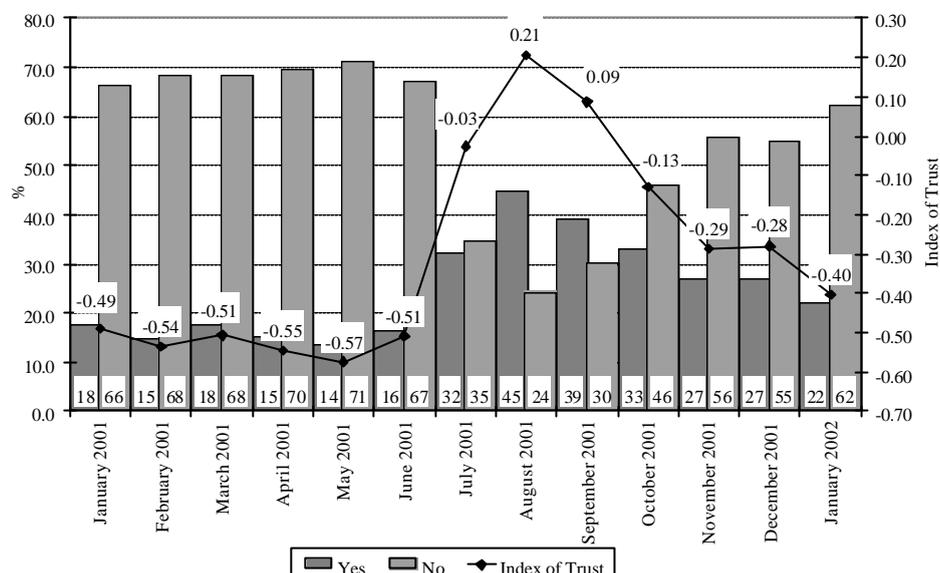
A notable foreign policy success of the new cabinet was the turnaround in the trial of Bulgarian medics in Libya, who are charged with deliberately infecting hundreds of Libyan children with HIV. After nearly three years detention in a Libyan prison, they were transferred to house arrest in February 2002, and the People's Court of Libya downgraded the trial, saying that the case did not warrant a state security hearing. The case will be taken back to the Chief Prosecutor and the hearing will take place in an ordinary criminal court, where charges carry lighter sentences. This development became possible because of the highly successful diplomacy of foreign minister, Mr. Solomon Passy. He managed to engage the chairman of the "Qaddafi" foundation, Mr. Seif al-Islam as observer of the case, who is son of Libya's leader Muammar Qaddafi.

1.4. Parliament

The 38th National Assembly was the first one since 1990 that carried out its full term. However, the public confidence and approval for the legislature was very low, particularly in the last two years of its mandate. The main reason for the low popularity of the legislative branch was its failure to become an effective check and balance to government policies. In the eyes of the public, it did not contribute to the improvement of the welfare of the population. The lowest levels of public

confidence in the 38th National Assembly (13.8%) were registered towards the end of its term in April–May 2001 (Figure 1.8).

Figure 1.8. Approval (Yes) / Disapproval (No) Ratings and Index of Trust in the Parliament



The expectations that after the election the new parliamentary majority will adopt legislation that will improve living standards were reflected in increased public confidence in the 39th National Assembly. In August 2001, a month after the constitution of the new National Assembly, its approval rating was 44.9% or 31.1% percentage points higher than the approval of the previous parliament at the end of its mandate.

Towards the end of 2001, the public approval of the legislature declined dramatically and dropped to 27% in December 2001. In January 2002, it contracted by additional 5 percentage points, reaching its lowest level of 22%.

The main reason for that is, on one hand, the overall decline of confidence in the ruling majority and, on the other hand, the ineffective work of the legislature and the lack of parliamentary discipline.

1.5. President

In his five years in office, former President, Mr. Petar Stoyanov made significant efforts to act as a check and balance to both the executive and legislative branches. The index of trust in the presidential institution remained very high until the end of his term (Figure 1.9).

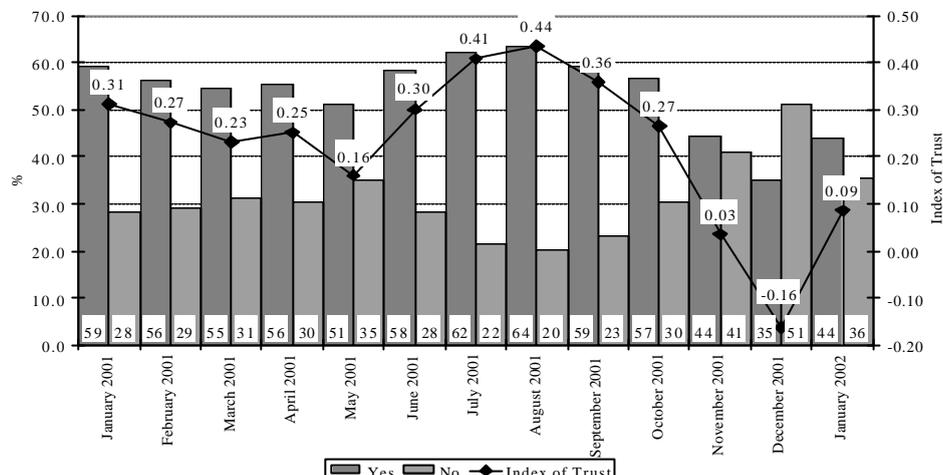
The negative presidential campaign of Stoyanov as well as the televised spiteful confrontation of the presidential candidates in the week before the election disappointed the electorate and backfired on incumbent President Stoyanov. The situation favoured the BSP candidate, Mr. Georgi Parvanov, who led a more restrained campaign and managed to distance himself from the “slander” war of his opponents. Mr. Georgi Parvanov, had an unexpected success at the first round of the election and won its second round on 18 November 2001, receiving 54.13% of the votes with a voter turnout of 55.04%.

The public positively perceived the first public acts of the new president. The support for Parvanov, albeit not as euphoric as the initial support for NM Simeon II after the June 2001 election, remained high and non-partisan, coming from groups with different political orientations. In January 2002, the approval

The initial public perceptions for the new President were positive.

rating of the president was 44.1% (Figure 1.9). It could be assumed that along with the more active involvement of the President in the political process, the confidence in the presidential institution will continue to grow.

Figure 1.9. Approval (Yes) / Disapproval (No) Ratings and Index of Trust in the President



The new president stressed that he will not take decisions based on partisan considerations.

The effort of the new president to secure wide support was demonstrated in the selection of his advisory team. President Parvanov ventured on diversity of opinions, appointing mainly experts as advisors, regardless of their political affiliation. This has been interpreted as additional evidence that unlike the former president, Mr. Parvanov is determined not to allow partisan biases and to act as President of all Bulgarians.

The first acts of the new president give grounds to assume that he will not be satisfied with the limited presidential powers and will seek ways for a more direct impact on the domestic political process in the country. This is in line with the declared intention for better policy coordination between president and parliament in law making. For instance, he has already reached an agreement with the Speaker of Parliament, Mr. Ognyan Gerdzikov, to receive all important draft legislation before it is scheduled for floor discussion and vote. A similar understanding was reached with the prime minister. In this way, the head of state will have the ability to influence more directly the legislative making process.

In the spheres of security and defence, the pre-election promises and the first statements of President Parvanov suggest that he and Vice President Angel Marin will use their influence and all constitutional powers to control the appointments of the heads of security services and to monitor and influence the reforms in the Army.

President Parvanov stressed that membership in NATO and the EU would be his priority in the area of foreign policy. His first overseas official visit was to Brussels, which signalled once again that this issue is at the top of the agenda.

President Parvanov also emphasised the need to improve relations with Russia, Ukraine and other traditional partners. Also on his agenda are more active policies on the Balkans, as well as improved relations with the Arab world. All of these new foreign policy priorities are in line with the understanding of President Parvanov that foreign policy should serve national economic interests and must help in regaining some of the lost traditional markets.

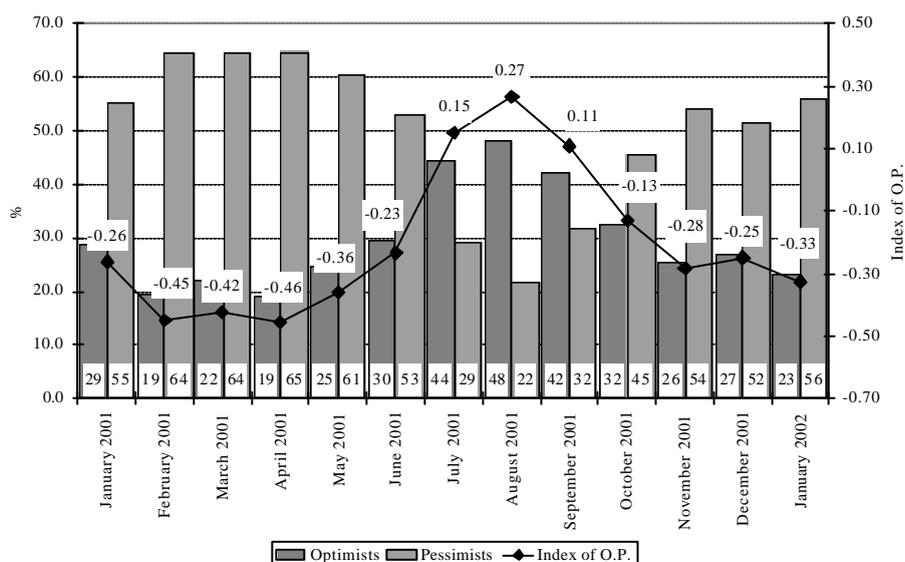
Given the relatively limited presidential powers, the degree of influence of the president on the political process will be related to the specific context of the future domestic and external situation.

1.6. Public Optimism

The level of public optimism is strongly related to the level of welfare and public expectations for better living. In the first four months of 2001, public optimism was declining, reaching its lowest levels in April. The pre-election promises of all political parties influenced public optimism and in May 2001 the share of optimists for a better future of the country grew by 5.7 percentage points. After the parliamentary election, the share of optimists reached the record high of 48.3%. This reflected euphoria caused by the expectations that the new ruling party will be able to secure a better future for the country.

The more sober assessment of the real situation in the country and the slower than expected improvement of living standards, led to the decline of public optimism in September–October 2001. In the beginning of 2002, the share of optimists for a better future of the country was 23.2%, or 25 percentage points lower than in August 2001 (Figure 1.10).

Figure 1.10. Shares of Optimists and Pessimists and Index of Optimistic Perceptions (O.P.)



Bearing in mind the need for continuing economic restructuring and reforms in the social sphere, as well as the lack of significant prospects for welfare improvements, a growth of public optimism in 2002 could be hardly expected. Most likely, this will be reflected in declining support for NM Simeon's II policies in 2002.

1.7. Readiness for Protest Actions

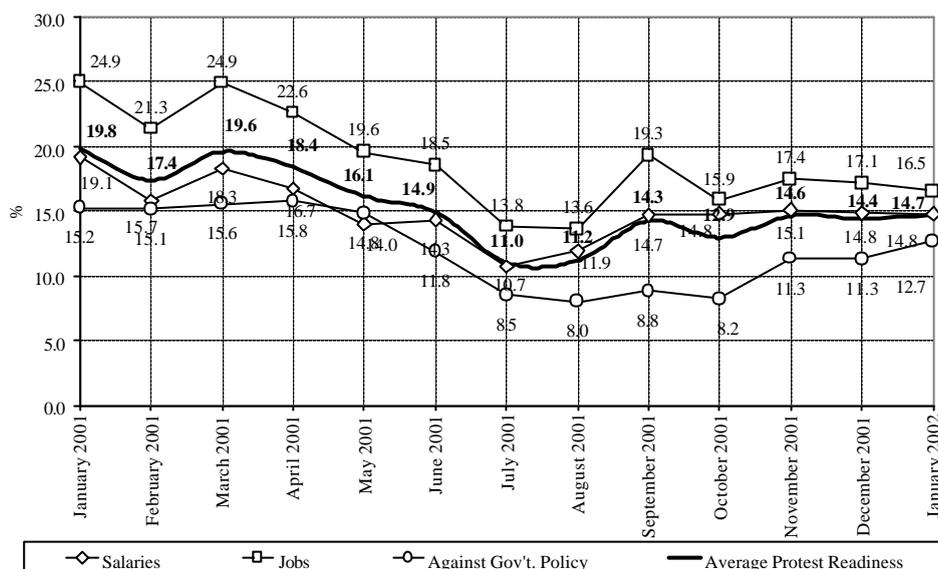
Although the level of protest readiness did not record substantial changes throughout 2001 (Figure 1.11), the past year witnessed a number of social protests.

Part of the protests were provoked by unbeneficial privatisation deals, for instance the protests of the employees of the national carrier, Balkan Bulgarian Airlines, the flights of which were temporarily discontinued by the majority owner (Zeevi Group). Protests with demands for termination of privatisation deals were

seen in other key enterprises with significant importance for the national economy – “Plama” in Pleven, and the KZM non-ferrous metallurgical works in Sofia.

In November 2001, taxi drivers and liquid gas suppliers staged a number of protests and blocked major roads because of the increased excise tax on liquid gas. There were also periodic protests for delayed payments of salaries (for instance in the Bulgarian Railway Company) and delayed disbursement of social assistance payments, all of which increased the social tension in the country.

Figure 1.11. Propensity to Protest (Positive Answers)¹



In the last two months of 2001, the two main syndicates – the Labour Confederation “Podkrepa” and the Confederation of the Independent Trade Unions in Bulgaria – became more active and intensified their criticism of the NM Simeon II government. They issued warnings that they will plan and carry out protests in different sectors of the economy, which may additionally increase social tension and impede the work of the cabinet in 2002.

1.8. Prospects and Potential Risks

The NM Simeon II cabinet is bound to continue facing the challenges of transition, while preparing the country for membership in the EU and NATO. In 2002, these challenges could be strengthened by unfavourable domestic and external developments. The cabinet has lost a significant share of public support and will face growing public opposition to the unpopular but at the same time inevitable reforms. The aftermath of the tragic events of 11 of September 2001, resulting in delayed recovery of the global economy will curb the prospects for quick economic growth and rapid improvement of living standards. At the same time, the existing risk of a new round of the war in FYROM as early as the spring of 2002 could additionally impede the cabinet’s efforts to effectively pursue its agenda.

Domestic Challenges

Stability of the NM Simeon II and the coalition cabinet. Although the coalition cabinet of NM Simeon II and MRF has a comfortable majority to pass legislation through parliament, the cohesion of NM Simeon II and the coalition cabinet could

¹ Based on the survey question “Are you ready to strike for: 1) Higher salary; 2) Against unemployment; 3) Against the policy of the government.”

become an issue in 2002. The uncertain political future of NM Simeon II because of its delayed registration as a political party could create tension in its parliamentary floor group. In addition, the declining electoral support for NM Simeon II (at the beginning of 2002 it was 5 percentage points lower than that of BSP) and the depletion of public confidence in the cabinet increase the risk of tussles among MPs of the movement and cabinet ministers on the issue of who has to bear the responsibility for the setbacks in the governance of the country. This may induce defections of NM Simeon II MPs who may decide to either become independent or join a different parliamentary faction.

Such a situation could make the support of MRF critical for the stability of the cabinet. However, the need to continue unpopular reforms that will affect the constituency of the Turkish ethnic party may reduce the willingness of MRF to support unconditionally its partner in the coalition cabinet, and MRF may demand additional strengthening of its positions in the administration. This may cause tension in the governing coalition. In the worst case, such tension could undermine the NM Simeon II voting majority on issues where it has differences with the MRF. Evidence of this has been the MRF criticisms on the envisaged scheme for privatisation of Bulgartabac Holding Company, which has crucial importance for the employment of a substantial part of the Turkish ethnic group. A period of tension in coalition relations could be expected towards the third quarter of the year, when the Turkish ethnic group will begin to experience again the impact of the reduced opportunities for seasonal employment.

In the short term, tensions in NM Simeon II and the cabinet are likely to be muted down by resignations and replacements of cabinet members, who will have to assume the responsibility for some of the unpopular cabinet measures¹. New instances of friction within NM Simeon II may occur in April 2002, when the movement is expected to take decisions for its registration as a political party.

The pressure of the opposition. It should be noted that the shifts in the electoral support of the parties represented in parliament have changed the political situation. In the beginning of 2002, the combined electoral support of BSP (21%) and UDF (13.7%) is 13.6% higher than the electoral support of NM Simeon II (16%) and MRF (5.1%). Undoubtedly this will encourage the opposition parties to become more critical of government's policies. However, because of the deep ideological difference between UDF and BSP they are unlikely to behave as a united opposition. This was clearly demonstrated at the UtDF-tabled first vote of no confidence for the NM Simeon II cabinet, abstained from the socialist party.

UDF. After the parliamentary election in 2001, UDF went through a deep internal crisis that led to fragmentation of the party. If some of the newly founded smaller parties based on splinter groups from UDF (those of Sofianski, Bakardziev, Bonev and Bisserov) team-up in a centre-right coalition, they may become an alternative to UDF with a real weight in domestic politics. Therefore, it can be expected the unresolved internal problems to deter UDF from provoking major destabilisation at least until the third quarter of 2002.

This assumption holds true only if NM Simeon II keeps its "retribution" pressure to limits which UDF can tolerate. However, the "White Book" released by the cabinet at the end of 2001, describing in detail the corruption of the previous government, suggests a possibility for an all-out attack against the top of the UDF elite. Such a situation is likely to make UDF adopt a much more aggressive politi-

The opposition is not likely to press for early election until the end of 2002.

¹ The first precedent was in February 2002, when Prime Minister Simeon of Saxe-Coburg Gotha fired the deputy ministers of the economy, finance and culture.

cal stance and intensify its attacks against the governing coalition. Furthermore, UDF may try to capitalise on the mounting public dissatisfaction with the social and economic policy of the cabinet, in a similar way as it did in 1996 during the Videnov cabinet.

BSP. The socialist party may have to become more critical to the ruling coalition, because of the growing public disappointment with the cabinet. However, the adoption of a more critical stance is vulnerable as the party risks accusations of inconsistency and duplicity, given the fact that it has a presence in the cabinet. Thus, BSP may not be able to capitalise successfully on future public disappointment if the situation in the country continues to deteriorate. In a similar way as UDF, BSP is still not ready to take over the governance of the country.

Given the weakness of BSP and UDF, their opposition pressure will be largely determined by narrow party objectives and is not likely to provoke an early parliamentary election in 2002. Another reason, deterring both BSP and UDF, is that given the levels of electoral support at the beginning of 2002, none of them will be able to secure a voting majority in parliament. At present, in a hypothetical early election, BSP may expect to receive up to 90 seats, NM Simeon II – approximately 55–60, UDF – around 45–50 seats and MRF (and possibly another party) – 40–50 seats.

The pressures of economic restructuring and social reforms will confront the cabinet with an additional set of challenges in 2002.

Privatisation programme. The privatisation programme of the cabinet for 2002 envisages the sale of the remaining large state enterprises (e.g. the Bulgarian Telecommunication Company, Bulgartabac Holding, DZI Insurance Company, etc.), the sale of majority and minority stakes in 349 fairly large enterprises, still remaining from the mass privatisation, as well as the sale of residual stakes in 315 privatised companies. Although increasing economic efficiency, the completion of privatisation will lead to a significant unemployment shock. The number of redundancies would be comparable with the mass lay-offs at the beginning of economic restructuring. For instance, estimates suggest that within a year after the completion of the privatisation deal, the Bulgarian Telecommunications Company is expected to release approximately half of its 25,000 employees. The privatisation of the other large enterprises as well as the sale of majority and minority stakes will have a similar impact. In addition, the new regulations for dividend payments from state property increase three times the amounts due to the budget as of the beginning of 2002. This will lead to decapitalisation of enterprises by BGN 800 million, will restrict investments and therefore will lead to additional loss of job placements.

Reforms in the energy sector. Although the 10% price increase of electricity and central heating has been temporarily suspended, the government will have to liberalise the energy sector, as household electricity and district heating appear to be still largely under-priced. The liberalisation of the energy sector involves separation of the power generation companies from distribution companies, which have to be privatised in 2002, as well as removal of all forms of subsidies. This measure will entail another price increase of 20% in addition to the envisaged, but temporarily suspended 10% growth of electricity and district heating prices. Given the high level of public dissatisfaction with the policy of the cabinet, this is bound to be a very unpopular move and could provoke a wave of protests in the next heating season. For this reason, the growth of energy prices should be gradual and would probably require income adjustment measures, particularly for the underprivileged groups of the population.

The completion of privatisation and reforms in the public sector may increase unemployment.

Restructuring of the railway sector. In the line with the IMF and World Bank programmes, the cabinet had to improve efficiency and reduce losses of the Bulgarian State Railway Company (BDZ). Towards the end of the year, the cabinet has finalised the planned restructuring measures, dividing BDZ into two separate companies – one for operation of the infrastructure and one for provision of transportation services. However, this can hardly cover the losses without additional subsidies and/or closure of loss-making routes. Given the fact that in December 2001 the unions threatened to strike over the holiday season because of unpaid wages for October, the cabinet may be faced with a number of problems in the future restructuring of BDZ. If the cabinet decides to comply with the IMF claims and impose hard budget constraints, it may not be able to satisfy the demands of the unions and could be caught in a difficult situation as a national strike of the railways could effectively destabilise the political situation in the country.

Reforms in the Public sector. The cabinet will have to press reforms in education, the healthcare system and the army. In the sphere of education, the school network has to be rationalised, bringing down the number of schools due to lower enrolment caused by demographic factors and the need of alignment of the student/teacher ratios to OECD standards. In the area of healthcare, the cabinet will have to carry out the delayed privatisation of hospital care. The reform in these spheres will entail reduction of the number of teachers and downsizing of medical personnel. In a similar way, the army reform will lead to large redundancies of military staff, amounting to 12,000 people. This may require the implementation of targeted adaptation and vocational training programmes for the employees released from these spheres.

Tax policies may lead to deteriorating structure of household expenditure, shrinking consumption and closures of small and family businesses.

Tax policy. Changes in taxation improved the business climate for large corporations but were not so beneficial for small businesses and households. The increased license fees, particularly in the sectors of services and tourism, the higher local fees and taxes, and the growing prices of energy and telephone calls undermined the economic position of small and family businesses and worsened the situation of a number of Bulgarian households.

The deteriorating situation of households makes them increasingly pessimistic about the country's general economic situation and their personal financial status, which may translate into contraction of consumer demand. This and a possible wave of closures of small and family businesses may pose medium-term risks for socio-economic stability. For this reason, the cabinet may have to reconsider part of its taxation policies in order to improve the business climate for small and medium-sized enterprises.

Social Assistance and Social Insurance. The combination of low incomes and the prospects for higher prices of electricity, district heating, and telephone services will lead to a deteriorating structure of household expenditure, shrinking consumption (estimated at 8% for 2002) and further impoverishment. As the social assistance system could not secure full coverage and perfect targeting, this situation may create short-term risks for social tension. For this reason, the cabinet has to secure the financial stability of the social assistance system and prevent irregularities in the disbursement of social assistance benefits.

The cabinet should assess the coverage of the social insurance system and design mechanisms securing future protection of the underprivileged and marginalised groups, for instance the unemployed from ethnic minorities. The existing gaps in the coverage of the social insurance system create long-term risks for social tension and a higher social assistance burden in the future.

Ethnic Tension. The socio-economic situation in 2002 could encourage interethnic tensions. As noted in previous EWRs, one of the forms of hidden assistance to the Roma was the uncollected utility charges, owed by Roma households to state companies, providing utility services. With the separation of power generation from power distribution, distribution companies will have either to collect from the Roma all outstanding amounts or transfer this liability to regular customers by increasing prices of electricity. Obviously, this situation is bound to induce significant tension in areas with large Roma settlements.¹ Tension will grow within the Roma community, if it is left without utilities, and between the Roma and other communities, if the latter are forced to incur higher costs for utility services. For this reason, the cabinet has to revise its energy assistance strategy and target it more accurately.

An increasing likelihood of interethnic tension?

For the first time in 2001, there was a subtle evidence for growing tension between the Roma and the Turkish communities. MRF participated in the June 2001 parliamentary election in coalition with the Euroroma Party and received a significant number of Roma votes. With the constitution of the coalition cabinet of NM Simeon II, MRF became the junior coalition partner and received a number of important appointments in the executive branch, while the Roma ethnic group remained without representation in the legislative and executive branches. This has caused growing disappointment among Roma leaders. Some of them are becoming increasingly vocal, accusing the MRF of taking advantage of its power position to the detriment of the Roma community by reallocating and diverting assistance programmes primarily to the Turkish community. The only reason that this issue has not yet provoked significant tension are the conflicts among the Roma organisations and the lack of unity of the community in pressing political issues. However, an increased cohesion of Roma organisations in 2002 may channel Roma protests more effectively, which could lead to increased tension between the Roma and other ethnic communities.

External Challenges

Relations with EU and NATO. Although Bulgaria received an overall positive assessment in the annual progress report of the European Commission, it is unlikely that the country will be invited to join the EU in the first wave of new entrants at the end of December 2002. The reasons will be the unconvincing economic performance and the slow alignment of national legislation with the EU law (*acquis communautaire*).

In a similar way, in spite of the positive development of relations with NATO, strengthened in 2001 by the support of the cabinet for the military operation in Afghanistan and the commitment to destroy the SS-23 missiles, the low technical preparedness of the army may impede Bulgaria's admission in NATO at the next summit of the alliance in November 2002.

The cabinet may face a hypothetical situation of double membership rejection.

Thus, at the end of 2002 the cabinet may face a hypothetical situation of double membership rejection. This is bound to have a negative effect for the image of the country because the rejection would be interpreted as lack of sufficient international support. Although the blame for possible rejections could not be put entirely on the current cabinet, such a situation is likely to be used by the opposition, which may demand resignation of the government in early 2003.

¹ In February 2002, Roma households in Stolipinovo (Plovdiv) were left without electricity, which provoked civil unrest.

Relations with IFIs. On the positive side is the development of relations with international financial institutions. After the discouraging start in September, at the end of 2001 the cabinet and the IMF agreed on a new financing agreement for a standby loan of USD 300 million over a period of two years.

The World Bank made a commitment to extend the maximum amount under its USD 220–750 million Country Assistance Strategy (CAS) for Bulgaria. The CAS envisages loans, supporting the balance of payments as well as programmes for fighting poverty by development of human capital through reforms in education, healthcare, social protection and social insurance.

The situation in the sub-region. In spite of the pressure of the international community and the concessions made by the government of FYROM, which in the summer of 2001 stopped the armed conflict, the risk of a new major offensive of Albanian extremists in the region remains. Another armed conflict near Bulgarian borders may have serious negative implications for the country. Apart from the threat of a massive flow of refugees, a new war will destabilise the region and would again impede trade and investment, thus restricting the opportunities for economic growth in the country. Therefore, the cabinet has to pursue an active foreign policy in the sub-region and maintain a dialogue with the governments of the major powers aimed at extending additional support for stabilising the countries in the region.

It seems that in 2002 both the domestic and external environment carry substantial risks for the stability of the country. Most of these risks have significant potential for tension that could lead to political destabilisation. Although the opposition is not united and not yet ready to take over the governance of the country, further deterioration of the existing negative trends in 2002 could tempt the opposition parties to table a sequence of no confidence votes. The arguments will be concentrated on unemployment, impoverishment, the insufficient provision of social services, problems in education and healthcare, as well as a foreign policy issue, such as the failure of the country to join the first wave of new entrants in the EU and/or NATO.

2. REAL ECONOMY AND EXTERNAL TRADE DEVELOPMENTS

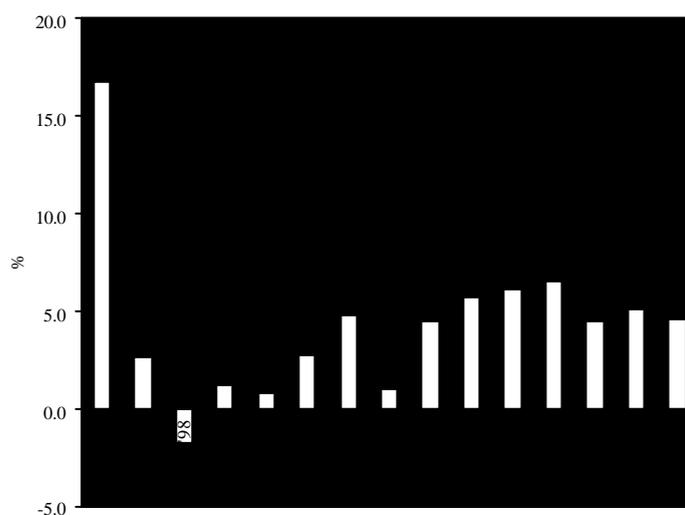
2.1. Output and Expenditure

Bulgaria's GDP rose 4.5% in the third quarter of 2001 from a year ago despite the recent contraction of final consumption and steadily weakening world demand.

According to preliminary national accounts data, the Bulgarian economy continued to grow rather strongly in the first nine months of 2001 even as overall output moderated its pace of expansion largely as a reflection of gradually deteriorating external conditions and faltering private consumption. While the country's recent GDP performance would still appear fairly respectable in the context of the current global slowdown, economic growth showed an underlying downward trend after having peaked at 5.8% for the full 2000. Compared with the same quarter one year earlier the rate of output growth fell to 4.5% in July–September from 5.1% in the second quarter of 2001, which was mainly attributable to the negative net trade effect, and a renewed weakness in consumer demand. Thus, following a first half of 2001 aggregate increase of 4.8% year-to-year, real GDP rose by 4.7% during January–September from a year ago as the strengthening of domestic activity in the second quarter of 2001 turned a short-lived phenomenon that was reversed by a subsequent third quarter slowdown.

Although the nine-month outcome was still above the reduced forecast for average growth of 4.5% in 2001, it seems most likely that a further deceleration in the rate of output expansion will show itself in the final trimester of the year given the sharp deterioration of the external environment, as well as volatile consumption dynamics. Yet, the economy is widely estimated to have grown by between 4 and 4.5% last year, or close to the revised target, even as economic recovery has been lately progressing at a slackened pace. The general expectations are for a continuation of the period of slower growth well into 2002, with the annual rise in real GDP being projected at 4% based on the assumptions of a sustained upturn in investment activity and a second-half pick-up in exports which appear, however, to be both surrounded by a considerable margin of uncertainty in light of the present cyclical downswing in the world economy and the little likelihood of a quick turnaround.

Figure 2.1. Quarterly GDP Growth (Year-to-Year % Change)



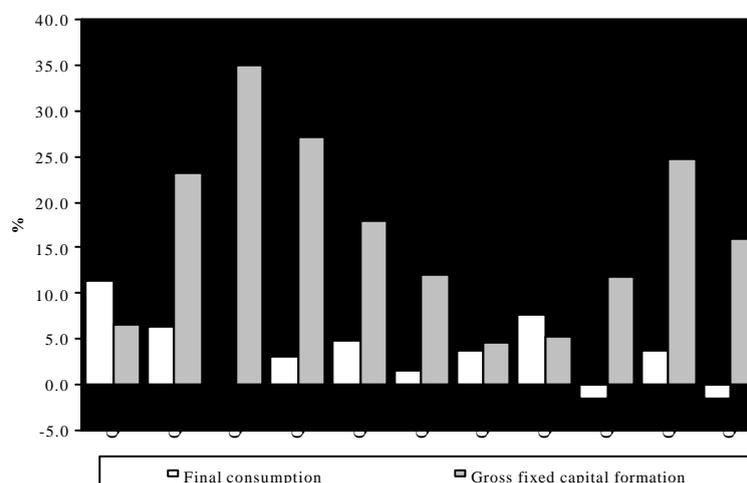
Source: National Statistics Institute.

While the slowdown in overall output expansion during July–September was largely attributable to the continued softness in export sales that coupled with a

surge in imports, the third quarter of 2001 witnessed some notable shifts in the respective contribution to GDP growth of the individual domestic demand components. In comparison with the previous trimester, a most striking feature of the recent developments in domestic demand was the contraction of final consumption, albeit a rather moderate one, which reflected year-to-year drops in both major expenditures categories. The effect of declining real consumption was, however, largely offset by a nearly 16% increase in gross fixed capital formation that confirmed last year's shift in the balance of the ongoing economic expansion from an export-led recovery to stronger growth in investment.

In contrast to its rapidly slackening dynamics in 2000 that resulted in a relatively modest 8.2% annual rise, fixed assets investment started to grow again at double-digit rates from the beginning of 2001. The trough of the slowdown in the pace of increase of this domestic demand component had been reached at 4.6% year-to-year in the third quarter of 2000 and, although the subsequent reversal of the downward trend was rather tentative at first, investment activity gathered strong momentum already in the first quarter of 2001 with a real gain of 11.9%. During April–June, gross fixed capital formation more than doubled its growth rate to 24.7% year-to-year, securing a robust 20% rise for the first half of 2001. Despite a third quarter of 2001 deceleration to 15.9% growth from a year ago, fixed assets investment remained the most dynamic demand-side factor, boosting the economy in January–September. The aggregate 9-month increase amounted to 18.2% and helped to push the share of gross fixed capital formation to 16.5% of GDP, up 14.8% from previous year and 16.2% in 2000 as a whole. This ratio will likely exceed 17% for 2001 even as fixed investment growth is expected to moderate further in the final trimester of the year, though leaving the annual gain in the double digits.

Figure 2.2. *Consumption and Fixed Investment Growth*



Source: National Statistics Institute.

The breakdown of how the 9-month real GDP increase was achieved shows that, among the components of final domestic demand, economic growth was mostly driven by a sustained pick-up in fixed assets investment, whereas final consumption remained practically flat during January–September. Moreover, the development of both individual and collective consumption had been very volatile throughout the period under review, increasing thereby the uncertainties about their course in the future. A worrying feature of the third quarter of 2001 out-

come is that while gross fixed capital formation climbed by close to 16% year-to-year, final consumption dipped 1.5% from a year earlier.

To a large extent, the latest contraction of the main component of domestic demand came as a result of a renewed downturn in individual consumption expenditures, although collective consumption declined as well. Following a tiny real gain of 0.2% in the first half of 2001 that reflected a temporary second quarter strengthening, individual consumption fell 1% year-to-year in July–September due entirely to sliding households' expenditures. The latter's recent downswing combined with a somewhat larger drop in the first quarter of 2001 to offset the effect of a rather strong second quarter rebound, bringing the aggregate 9-month outcome to slightly below the level of the corresponding period of 2000. This, in turn, provoked a 0.2% year-to-year decline in total individual consumption during January–September, despite robustly growing expenditures incurred by non-profit organisations on households' consumption.

While being of a very limited magnitude so far, the overall contraction in individual consumption expenditures compares unfavourably with a 1.8% year-to-year increase in January–September 2000, pointing to a considerable slowdown in the growth rate for the full 2001 at best. It should also be noted that the annual gain for 2000 had come at 3% due to a sharp fourth quarter upsurge which makes a "technical rebound" in the final trimester of last year very unlikely. Besides, the third quarter of 2001 downturn in real consumption of households might appear rather surprising as most short-term indicators did not suggest a reversal of the tentative upward trend. All this makes the preliminary estimates for the fourth quarter of 2001 highly uncertain, although the expectations for a full year's flatness of individual consumption seem quite realistic at present.

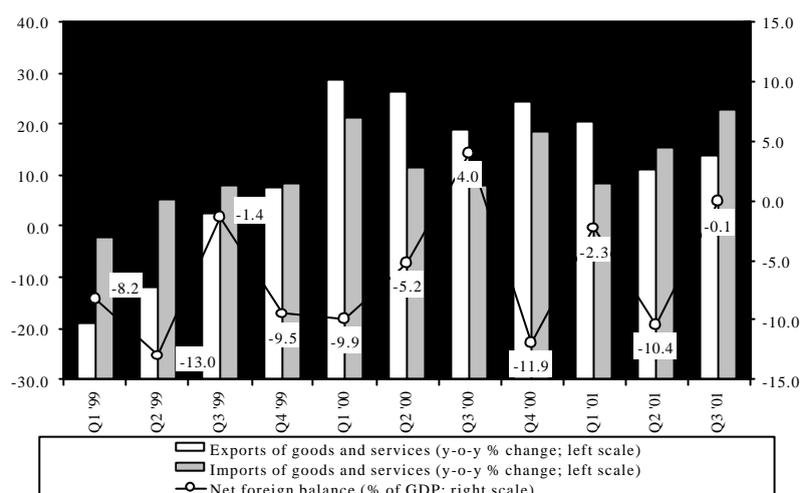
The third quarter of 2001 steep fall in collective consumption expenditures added to the effect of declining individual consumption, exacerbating the negative change in the composite index of the main domestic demand component. In contrast to its steady and robust growth throughout 2000, collective consumption exhibited a hectic pattern in January–September 2001, recording a modest 3.4% year-to-year aggregate gain, down from 20% for the previous year as a whole. The positive 9-month outcome masks sharp quarterly ups and downs, which left no room for the emergence of a clear trend. After having climbed 22% year-to-year in the final trimester of 2000, collective consumption expenditures posted a slight first quarter of 2001 fall of 0.5%. This was followed by a strong, albeit short-lived, resurgence in growth to nearly 19% during April–June but a renewed downturn occurred in the third quarter of 2001 when collective consumption slumped 5.8% from a year ago.

In spite of these offsetting developments, the overall result for the first nine months of 2001 showed an increase that turned sufficient to prop up final consumption to barely positive growth. Due to a 3.8% real rise in the second quarter of 2001, total final consumption grew a tiny 0.2% during January–September as both the first and the third quarter witnessed year-to-year drops of 1.5% each. Thus, while the relatively moderate deterioration in the country's GDP performance during July–September was partly attributable to the recent weakness of the main domestic demand component (its third quarter decline subtracted more than 1 percentage point from the quarterly rate of economic growth), the achieved slight 9-month gain still made a positive contribution to the current output expansion. However, the sustained increase in total domestic demand that helped broadly maintain the pace of economic recovery in January–September reflected

largely last year's pick-up in investment growth, as well as recently intensified stock-building.

Although the upturn in investment activity remained the main driving force of output expansion through the third quarter of 2001, changes in inventories also contributed significantly to overall growth in the economy, with their share rising to 3% of GDP for the 9-month period, up from 0.4% in 2000 as a whole. The effect of restocking on output growth appeared to be especially pronounced during July–September when the share of inventories jumped to 5.3% of GDP as a result of decelerating final demand that coupled with increasingly dampened export opportunities.

Figure 2.3. Net Foreign Demand Dynamics



Source: National Statistics Institute.

Last year's shift in the balance of the ongoing economic expansion was also attributable to a combination of markedly slower export growth and steadily rising imports. In line with gradually softening world demand and prices, Bulgaria's export performance deteriorated notably in 2001 after the robust recovery of 2000 that had largely underpinned the record-high rate of real GDP growth. Following an annual increase of 24.2% in 2000, exports of goods and services climbed a revised 12.4% year-to-year in the first quarter of 2001.¹ Export growth decelerated further to 11.1% during April–June, which was the slowest quarterly rate since the start of 2000 and pushed the first half of 2001 rise down to 11.7% compared with a 27.5% gain in the same period of the previous year. Although a moderate pick-up in the pace of export recovery occurred in July–September mainly due to strong tourism receipts, the 9-month outcome still showed a rate of increase reduced by nearly a half from a year ago. Exports of goods and services rose by 13.8% year-to-year in the third quarter of 2001, resulting in 12.5% growth during January–September, down from 24.1% in the year-earlier period.

In contrast to the general slowdown in export sales, imports continued to rapidly gather speed throughout the first nine months of 2001. After having briefly decelerated to 8.2% in the first quarter of 2001, the annual rate of import growth almost doubled to 15.6% during April–June before strengthening further to 22.9%

¹ Following a reclassification of items, the first quarter of 2001 growth rate of exports was revised down from 20.4% to 12.4% year-to-year as the receipts from the sale of the second GSM license were excluded from the services account and added to capital transfers.

in the third quarter. This resulted in an aggregate 15.8% year-to-year gain, up from 13.1% in January–September 2000 and 14.6% for the whole of the previous year. The sustained strong acceleration in import growth boosted nine-month imports of goods and services to the equivalent of 68.8% of GDP, up from 64% in the corresponding period of 2000. Thus, while the ratio of exports to GDP also climbed from 61.1% to 63.3%, the country's trade deficit widened to 5.5% of GDP during January–September. Most notable would appear, however, the shift in the contribution to overall output growth resulting from net exports. Reflecting largely last year's deterioration of the external environment, the net trade effect turned negative, dragging down the rate of GDP increase in stark contrast to the pronounced export-led economic recovery of 2000. Although the slowdown in outward trade was much in line with preliminary expectations, the third quarter of 2001 differential between export and import growth proved unexpectedly high and dampened considerably the three-month outcome. Even as this spread narrows somewhat in the final quarter of the year it will likely remain significant, with net exports accounting for a large part of the 2001 deterioration in GDP growth.

Viewed from the supply side, the third quarter of 2001 outcome was underpinned by Gross Value Added (GVA) increases in all major sectors of economic activity as even agriculture managed to log positive quarterly growth for the first time in almost two years. The recent moderation in the pace of overall output expansion appeared to be, however, largely attributable to a slowdown in the service sector, although the recovery of industrial output slackened as well. Following a short-lived upturn in the growth rates to 8.2% in the second quarter of 2001, services posted a modest 3.1% year-to-year rise in GVA during July–September, or even slightly lower than in the first trimester of the year. Still, the 9-month real gain came to nearly 5%, down from 8.8% in the corresponding period of 2000. In spite of last year's slowdown, the share of this sector in total GVA rose one point to 56.7% in January–September, confirming the services' key role for the overall growth of the economy.

While exhibiting a marked deceleration in the rates of increase, industry remained the fastest growing sector that contributed considerably to the aggregate GVA rise of 5% during the first nine months of 2001. After having recorded an annual improvement in GVA of 15.3% in 2000, industrial output climbed 9% during January–September as its pace of year-to-year growth slowed to 11.6% in the first quarter of 2001 and fell further to single digits in the following two trimesters. There was, however, a moderate third quarter pick-up in the rate of increase to 8.7% that, together with recent monthly production figures, point to a stabilisation in industrial activity and a fairly strong full year's outcome.

In contrast to the fluctuating quarterly developments, albeit with an underlying downward bias, in both services and industry, the agriculture sector showed steady signs of a prospective recovery after the severe slump since the fourth quarter of 1999 had bottomed out in early 2001. Following a nearly 15% year-to-year contraction in GVA during January–March which was the sharpest drop in the latest period of declining output, the sector posted a moderate second quarter fall of 3.7% before returning to positive growth in July–September. While the downward trend in agricultural production appeared to have been brought to a halt by a 2.4% real gain in the third quarter of 2001, the 9-month outcome remained some 2% below the level of the year-earlier period, still marking a notable improvement over the 10.1% drop for the full 2000. In spite of the recently strengthening performance of agriculture, the year-to-year rates of private sector growth continued to follow a moderately decelerating pattern, although with an

While last year's real GDP growth is widely estimated to have come close to the revised 4.5% forecast, the trend in economic activity will likely continue to follow a gradually decelerating pattern in the short term, with economic growth being projected to slow down further to 4% in 2001

aggregate GVA increase of 8.7% during January–September the latter proved once again to be the driver of the overall economic expansion.

Against the backdrop of the recent negative external developments and hesitant consumption dynamics, the slackening trend in the rates of economic growth is generally expected to have become more detectable in the final trimester of 2001, although there were still a number of contradictory signals. Given the fact that the pace of economic recovery had started to loosen gradually steam even before there were appreciable effects from the September's events, the country's GDP performance appears set to deteriorate further in the fourth quarter of 2001. While many early indicators have so far supported the expectations for a pronounced weakness towards the end of last year, the extent of the slowdown is difficult to foresee as economic data overall were rather inconclusive. In the context of rapidly falling export demand and faltering final consumption, the economy is thought likely to have grown during October–December at the slowest rate in two years. Yet, there seems to be no firm evidence that the pace of economic expansion has slowed dramatically in the fourth quarter of 2001. Looking at the supply side, the general picture remained rather mixed, thereby raising the possibility that the deterioration in output growth might have continued to be a more gradual slide than the steeper downturn suggested by the recent trends in important demand-side factors. Such an outcome would appear in line with most preliminary estimates for 2001 growth that are in the 4–4.5% range since the economy has to expand by less than 1.9% year-to-year in the final quarter to push the cumulative increase below the 4% threshold.

Table 2.1. Selected Real Economy Indicators

	1999	2000				2001		
	Jan.– Dec.	Jan.– Mar.	Jan.– Jun.	Jan.– Sept.	Jan.– Dec.	Jan.– Dec.	Jan.– Mar.	Jan.– Jun.
Real GDP	2.4	4.5	5.1	5.5	5.8	4.5	4.8	4.7
– Final consumption	4.7	4.8	3.1	3.3	4.5	-1.5	1.2	0.2
– Gross fixed capital formation	25.3	18.0	14.2	9.8	8.2	11.9	20.0	18.2
Industrial production	-12.5	5.2	3.2	3.3	2.3	2.5	1.7	2.2
Industrial sales	-10.5	7.0	3.9	5.4	4.6	5.1	4.0	2.7
Receipts from industrial exports	-13.3	30.6	29.2	28.8	26.1	8.4	3.3	0.7
Retail sales	-6.0	6.7	3.7	3.1	0.6	2.2	2.3	2.5

Source: National Statistics Institute.

Although a sharp slowdown in the GDP rate of growth in the fourth quarter of 2001 could not be totally excluded in the context of markedly deteriorated external conditions (this had happened in late 1999, with the pace of output recovery falling steeply to 1% year-to-year in the fourth quarter from 4.8% during the previous quarter), the overall development of key short-term indicators still point to a relatively moderate deceleration. However, the information coming from the supply side appears quite contradictory as a whole, increasing the uncertainties about the actual outcome. Monthly statistical data continued to show a rather confusing picture of recent industrial activity, with sales figures following a steady downward path since mid-year, whereas output numbers have been indicating a sustained stabilisation. Especially contrasting were the November developments as the decline in total receipts from sales in industry accelerated to 5.8% year-to-year, the fastest one-month drop since December 1999, while production climbed

1.3% from a year ago, more than reversing the tiny 0.7% fall of the previous month.

The falling trend in industrial sales reflected largely the increasing weakness of exports from March onwards, although it coupled with some moderate contraction in domestic sales during August–October. The latter have, however, held up rather well since the February resumption of positive growth after a nearly three-year spell. Moreover, domestic sales posted an encouraging year-to-year rise of 2.2% in November, reinforcing expectations for a full year's positive outcome which is likely to help keep the real volume of total sales in industry at slightly above its 2000 level. In stark contrast to their robust recovery of the previous year, export sales fell 1.3% during January–November 2001, following a gradually accelerating pace of decline since last August. In November alone, receipts from industrial exports sank 17.8% year-to-year, a rate of contraction last seen in mid-1999. Meanwhile, production figures have been showing signs of continued stabilisation, with the aggregate output growth being broadly maintained between 2% and 3% during the course of the year.

In light of recent dynamics of other early cyclical indicators, the general picture of the fourth quarter of 2001 evolution in domestic activity would also appear rather mixed, albeit with an underlying downward tendency. The aggregate business climate index, which was released by the NSI for the first time in December, showed a somewhat precipitated fall from the mid-year heights, but seen over a longer perspective, it remained exceptionally strong. After having deteriorated moderately in October and November, losing half a percentage point and a full point respectively, the indicator dropped further by 2.5 points in early December, while standing well above its long-term average. It should be noted that this downward development of the composite business climate indicator was largely the reflection of negative changes in the sub-indexes for retail trade and construction, with the former exhibiting an overall fourth quarter weakening and the latter recording a sharp December fall. January saw, however, a strong improvement of the climate in the construction sector (the sub-index rose more than 5 points from the previous month) that combined with a modest increase in industry to push the aggregate indicator up 1.5 points from its December level.

In contrast to the recent fluctuations in construction and the overall downward trend in retail trade, business climate in industry had managed to regain already in December its October value, climbing near to the all-time peak of last September. Moreover, the industrial index went up further by half a point in January after a 3 percentage points rise in the previous month, with the latest two gains being mainly attributable to more optimistic business expectations for the next six months. Such a sustained improvement in the “future expectations” component, even as it might appear somewhat surprising in the currently uncertain international climate, raises hopes for a gradual recovery in 2002.

The chances of a relatively quick pick-up in industrial activity this year seem, however, rather remote given the continued deterioration of the confidence indicator and more precisely the fall in its December reading due to lower future production expectations. Yet, the rate of decline in industrial confidence decelerated markedly by early December (close to one percentage point versus some three points in November) that, together with more favourable recent assessments of the current production trends and the level of manufacturing orders from abroad, increases the probability of a moderate fourth quarter slowdown in output growth.

While rapidly weakening external conditions have clearly been at the heart of the 2001 slackening momentum in the pace of economic recovery and will likely

continue to drag down GDP growth at least in the short run, the outlook for domestic demand appears to be also clouded by the recent trends in its main component. From the point of view of domestic demand, the economy seemed to be delicately poised between a sustained strong growth in fixed investment and stagnating final consumption. With no statistical confirmation of a possible fourth quarter of 2001 upturn as of yet, the prospects of the latter would appear rather unfavourable, although there are sizeable uncertainties surrounding both domestic factors of economic growth. Assessing the current strength of consumer demand proves to be a particularly challenging task at present given the recently volatile consumption dynamics, as well as the discrepancies between the actual development on the expenditure side of national accounts and the one suggested by most early indicators. The third quarter of 2001 outcome provided a fine example in this respect since there had been hardly any preliminary indications of a year-to-year drop in private consumption. Retail sales had even strengthened their real rate of growth to 2.5% in January–September from 2.3% during the first half of 2001 and 2.2% in the first trimester, although this pick up seemed to be partly influenced by the strong performance of the tourist industry.

Markedly lower 12-month inflation had supported rising real incomes even as the third quarter average salary had remained nominally unchanged on a quarter-to-quarter basis, while maintaining an year-to-year pace of increase of over 4% in real terms. The sustained, albeit rather moderate fall in registered unemployment had also pointed to recovering households' consumption together with a sharp increase in imports of consumer goods (the year-to-year growth rate of this commodity group rose to 34.1% during July–September from 24.1% in the second quarter of 2001 and 18.7% in the first quarter of 2001). All this had suggested that consumer demand was stronger than the recent national accounts data finally indicated.

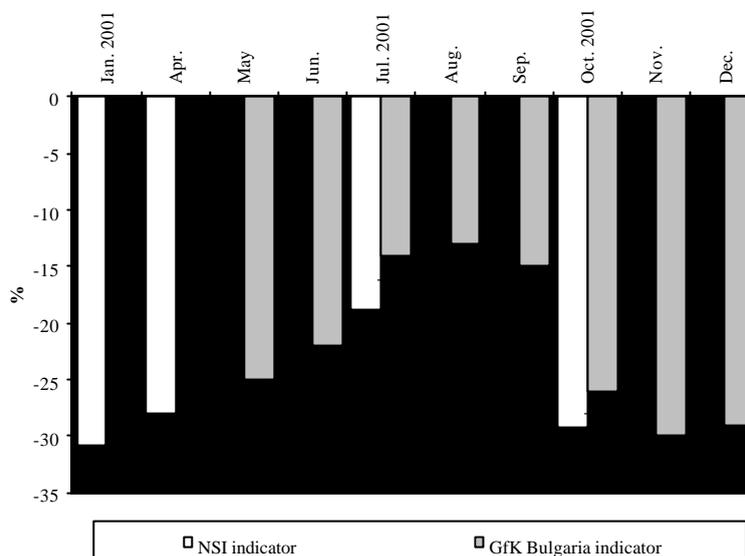
In this context the short-term prospects for the development of individual consumption remain highly uncertain, with some contradictory early 2001 fourth quarter signs further confusing the picture. While the fourth quarter figures for the average nominal pay in the economy are unavailable as of yet, they are expected to show little change in comparison with the previous trimester. Moreover, the latest NSI survey data revealed a November drop of 2.4% year-to-year in the total income of households (its pecuniary amount stayed flat in nominal terms) and a tiny 0.9% fall in their consumption expenditures.

The uncertainties about consumption prospects stand out also against the fourth quarter of 2001 reversal of the downward trend in the unemployment rate, although the annual average level will likely post a half-point improvement over the 2000 record high of 18.1%. However, preliminary foreign trade figures showed further acceleration in import growth of consumer goods (an exceptionally robust 55.8% year-to-year rise in October followed by some moderation to 32.3% in November), confirming their last year's leading position as the fastest growing commodity group.

Credit to households strengthened markedly its pace of increase as well (from slightly over 37% year-to-year nominally in September to nearly 45% in December), while the overall amount of outstanding claims on the private sector recorded an annual rise of some 25%, up from a 12-month rate of 13.8% in September and 11.2% at the end of 2000. These gains in credit aggregates look even more impressive in real terms as year-end inflation fell to 4.8% from 11.4% in 2000, underpinning at the same time an overall recovery in the real disposable incomes of the population. Still, the circumstantial evidence of fourth quarter of

2001 consumption dynamics seems to be generally mixed and the available early indicators might once again turn to be a rather inaccurate guide to the current developments in the main domestic demand component.

Figure 2.4. Consumer Confidence



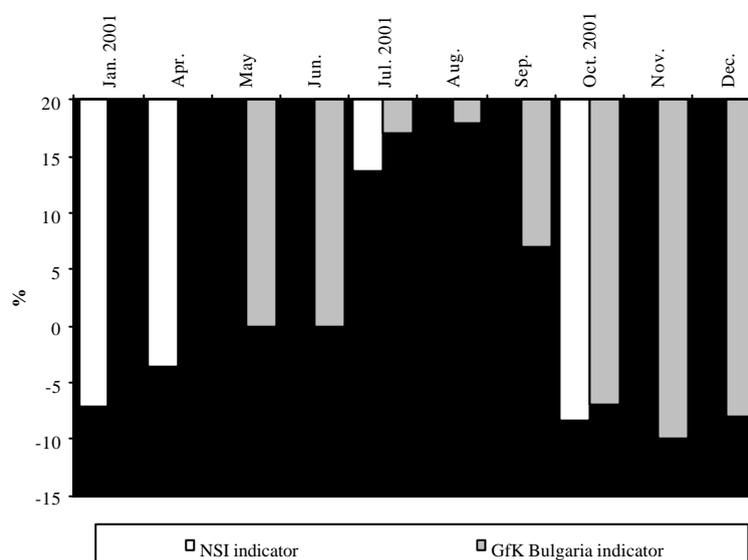
Source: National Statistics Institute, GfK Bulgaria.

With a sharp 2001 third quarter upturn, consumer confidence indexes had also diverged with the recently falling trend in individual consumption expenditures shown by national accounts data, while their subsequent speedy deterioration joined the row of many contradictory signals about the short-term outlook. Following some moderate improvement in April, the NSI indicator of consumer confidence climbed by more than 9 percentage points to reach a high of -18.9% by mid-July. This strong pick-up reflected, however, a short-lived outburst of optimism as already the October quarterly survey revealed a broadly-based deterioration in consumers' assessments and expectations. Led by considerable negative changes in the balances of the latter, the NSI index fell to -29.3% , or close to its level of early 2001. Monthly data collected by GfK Bulgaria confirmed this highly volatile pattern of consumer confidence dynamics as the pronounced third quarter of 2001 improvement was reversed by a subsequent steep fall. After having reached an August peak of -13 , the GfK index eased slightly in September before dipping to -26 in October. While November witnessed a sequential drop of a rather moderate scale and a tiny improvement occurred in December, the latest reading of the indicator was 4 points below the value that had been recorded at the onset of the survey last May.

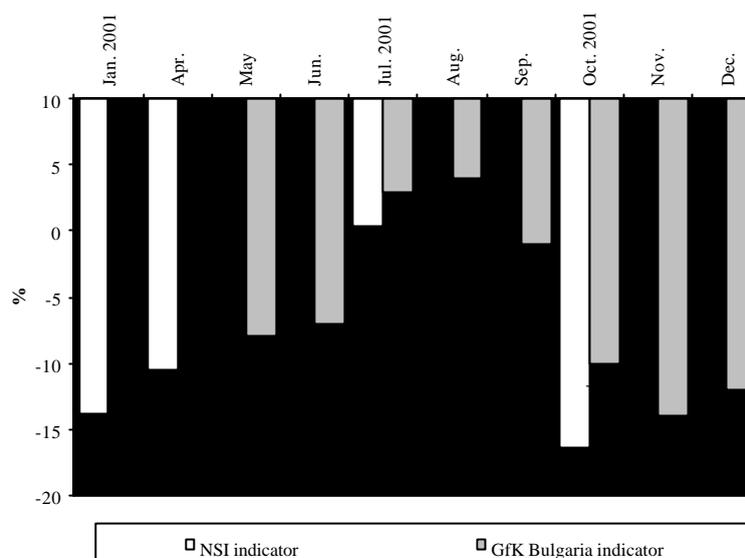
The most worrying feature of the recent offsetting developments in consumer confidence was the speed with which the sub-indexes measuring future expectations had weakened. According to NSI data, the balance of the expectations for the general economic situation over the next twelve months fell 22.1 points in October from the July peak, whereas the assessments for past one-year period deteriorated by 7.8 points. The expected financial situation of the households also turned to be overwhelmingly gloomy (a 16.8 points deterioration as compared to the July value of the sub-index) in contrast to only a moderate negative change in the opinions of the personal circumstances during the past 12 months (an October loss of 3.8 percentage points). The "expectations" compo-

nents of the GfK composite index followed a similar path, albeit at a narrower differential with the pace of decline in the assessments of the situation in the near past. After reaching their lowest values in November, the latter have remained rather flat recently, while the December balances of the expected general situation and personal circumstances each showed 2 point improvement in December. These tentative signs of stabilisation at the end of last year might appear encouraging but need to be further confirmed in order to conclude that the decline has been definitely halted. It should be also noted that, despite the overall sharp deterioration of both aggregate indicators of consumer confidence in the fourth quarter of 2001, the intentions to save and make large expenditures (e.g. for the purchase of a car, household appliances and other items for long-term use, a new flat or the refurbishment of the old one) showed little change, though staying at stubbornly low levels that had been observed over a longer period.

Figure 2.5. *Consumers' Expectations for the Development of the Overall Economic Situation*



Source: National Statistics Institute, GfK Bulgaria.

Figure 2.6. *Expected Financial Situation of Households*

Source: National Statistics Institute, GfK Bulgaria.

While providing useful information about people's perceptions and views of the current and future economic developments, the surveys of consumer confidence, placed in the local context, seem to be of questionable value as a tool for revealing the trends in consumption and investment behaviour. Yet, recent survey data clearly showed that consumers at large have been getting increasingly pessimistic about the country's general economic situation and their personal finances. It is, however, doubtful that this will translate into an outright contraction in consumer demand given the existing consumption and saving patterns. Furthermore, these negative changes appeared to be largely a reflection of the heightened global risks in the wake of September's events, as well as speedily evaporating high hopes and overoptimistic expectations that had blossomed in the context of last year's general elections in the country.

Seen over a longer perspective, the NSI index remained close to its typical levels, exceeding by far the extremely low values at the time of the financial crisis in late 1996 – early 1997. Nonetheless, there are still well-reasoned concerns about the potential duration and magnitude of the weakness in consumer demand. Although it would be premature to declare a definite stagnation in final consumption solely based on the recent disturbing trends and the overall contradictory early signals, last year's performance of this GDP component is likely to have been rather flat as a whole. Barring the distant possibility of a second successive year-to-year drop in the fourth quarter of 2001 that could push aggregate growth into negative territory, the expectations for a modest yearly gain in real consumption seem reasonably realistic at present. With the 9-month dismal outcome containing the full year's increase to perhaps 1%–2%, however, the annual growth rate of the main domestic demand component would be more than halved in comparison with 1999–2000. Moreover, the 2002 outlook appears to be for a continuation of the overall subdued recovery in final consumption given the expected further deceleration in economic activity, the existing BOP constraints and the uncertain effects of the recent fiscal moves.

In contrast to the notable slowdown in consumption expenditures, investment activity has gathered high momentum during 2001 and will most likely remain the main driver of output expansion in 2002 as well. There are, however, many uncer-

tainties and non-negligible risks to the base-line scenario of continuing strong growth in fixed investment that have to be weighed up carefully. While capital spending strengthened markedly in the first nine months of last year after a rather tame 2000 aggregate rise, some slackening in the year-to-year growth rates had already occurred in the third quarter of 2001. Besides, the possibility of a further moderation in the pace of increase during October–December seems quite distinct against the background of the expected adverse effects of the September's shock and a number of early indications.

The latest of the NSI biannual surveys of investment intentions in industry, conducted in the second half of October, showed considerable downward revisions in the plans from the beginning of 2001. According to recent survey data, business investment in the sector was expected to fall last year some 2% below the 2000 level, whereas a nearly 21% increase had been envisaged in April. This shift was largely attributable to the revised investment plans of public enterprises, curtailed by more than one third as against the April intentions, although private businesses' early estimates also underwent a 8% cut. In spite of the overall reduction in last year's expectations to slightly negative levels, the latest revision appeared to be of a far smaller scale than that of October 2000 when the planned 63% annual rise had been lowered down to only 10%. It should be also noted that part of the intended investment at the beginning of 2001 was postponed for 2002, with the preliminary forecasts being for an increase of over 8% this year. Another point which needs to be considered is the scope of the survey data covering only the industrial sector, although the worries about the magnitude of a possible slowdown in gross fixed capital formation still remain given the recent weakening of business climate in other domains of economic activity.

The expectations for decelerating growth in fixed assets investment during the fourth quarter of 2001 appear to be further supported by markedly lower FDI that could couple with possibly reduced public spending by the end of last year as a result of the intentions to curb the fiscal deficit to around 0.9% of GDP. Under preliminary BOP figures, the influx of FDI for the first eleven months of 2001 was some 37% below the level from a year ago, although the recently growing negative difference reflected in part a high base-period effect, which had been largely associated with the sale of the biggest commercial bank in September 2000.

The fourth quarter 2001 inflows of foreign capital are, however, thought to have been adversely affected by the heightened risk-aversion globally. The uncertainties about short-term investment dynamics also stand out against generally deteriorated sales prospects and continuing large margins of spare capacity in industry, despite a fourth quarter pick-up in utilisation rates. Yet, on the back of the robust 9-month performance in gross fixed capital formation, last year's real rise will likely come out at around 15% even as the recovery of investment activity slackens its pace further in the final trimester.

Although at present the 2002 outlook appears to be rather clouded by the uncertain international climate, investment demand is widely expected to remain the driving force of the economy. The share of gross fixed capital formation is projected to rise to 19% of GDP, following the continuation of the rapid growth phase underpinned by a sustained strong increase in business investment that is being targeted by this year's tax cuts, a forecast pick-up in FDI to at least USD 850 million for the full 2002, as well as budgeted public capital expenditures to the total amount of slightly over BGN 1 billion. In view of the current uncertainties, however, the likelihood of some deceleration in the annual growth rates of this

domestic demand component still seems considerable. The eventual impact of the recent tax changes is a matter of dispute and many analysts are doubtful that they will overall stimulate the recovery in investment by the private sector. In the context of the most risk-averse environment since 11 of September, the threat to foreign capital flows also remains sizeable, although the government's commitment to sound macroeconomic policies and the reform process is apparently the best line of defence against waning investor interest. The latter has been reflected in the country's recently upgraded credit ratings and is likely to help revive FDI growth as the present global uncertainty gradually recedes.

International Context

With last year's steep deterioration of the external environment standing largely to be blamed for the slackening growth in the domestic economy, the prospective 2002 global recovery appears to be crucial to the country achieving the targeted 4% real increase in GDP. In spite of some early encouraging signs, the prospects for the world economy still remain rather precarious at present even as the risk of a larger international downturn has distinctly abated recently. The general expectations are for a global recovery during the course of 2002 but the biggest unknown relates to its timing and strength.

External conditions will remain rather unfavourable for Bulgaria's GDP performance.

Most economists rule out any significant upturn in the first quarter of 2002 and expect the revival of activity to be quite a slow process as the events of 11 of September had prolonged the current cyclical downswing phase, delaying growth to perhaps around the middle of this year. Therefore, at least in the short term, external conditions will conceivably remain rather unfavourable for Bulgaria's GDP performance given the depressing effect of slowing exports and faltering investor interest. In this context, much of the hopes for a gradual resurgence in output growth seem to be pinned on a second half of 2002 pick-up in export demand and rapidly fading global uncertainty. If these hopes are shown to be misplaced, however, this year will likely see a sharper slowdown in the rate of GDP increase below the 4% threshold.

Yet, in contrast to the heightened fears of a global recession in the immediate aftermath of the September terrorist attacks, the prospects for economic recovery this year appeared to have gradually strengthened in late 2001 and early 2002. However, all growth forecasts continue to be surrounded by an unusually high degree of uncertainty as the risk of a rather protracted weakness in the major developed economies injects a sizeable element of caution into the general expectations for recovering activity.

In its latest update of the *World Economic Outlook* (December 2001), the IMF forecast global growth of 2.4% in 2002, the same as the revised projection for 2001 but sharply down from 4.7% in 2000. While warning that there was still a significant possibility of a continued global slowdown, the IMF cited three fundamental reasons in support of its base scenario for a 2002 recovery in the world economy, namely: the combination of interest rate cuts and fiscal stimulus measures in most industrial countries, the stabilisation of oil prices at markedly lower levels, as well as the generally sounder position of both developed and emerging markets economies in terms of public finances, inflation and external debts. This cautious optimism has been recently reinforced by early data, signalling that the decline in the US and Eurozone's growth rates might have already bottomed out. Only a slow and moderate turnaround in the course of the first half of 2002 is, however, widely expected, with the pace of the suggested recovery this year be-

ing heavily dependent on the effect of the monetary and fiscal policy actions taken so far.

Although world economic activity seemed to have weakened further in the fourth quarter of 2001, some signs of a prospective recovery began to emerge already by the end of last year. Moreover, from the evidence available it would appear that, despite the impact from the September's events, a steep downturn in the final trimester of 2001 has been avoided, following a lesser-than-expected scale of third quarter contractions in the main developed economies. While industrial production has continued to decline through November–December, albeit at a decelerating pace in many cases, survey data showed a gradual recovery in overall economic sentiment, pointing to a less severe fourth quarter slowdown than that feared earlier.

Rather unexpectedly, preliminary figures also indicated that the recovery in the largest world economy might have even begun during the final trimester of last year as the US Commerce Department reported that seasonally adjusted real GDP grew at an annualised rate of 0.2% in the fourth quarter helped by strong consumer and government spending.

According to Eurostat latest data, industrial output in the Eurozone fell in November for the third month in a row which contrasted with ample evidence that consumer confidence across the region was recovering after the September shock. The closely-watched Reuters–NTC index of the Eurozone's service sector activity recorded its third consecutive monthly rise in January 2002, passing the threshold of 50.0, which is interpreted as a sign that the region's economic downturn has probably reached its lowest point in the fourth quarter of 2001. In light of the suggested improvement in the important service sector that accounts for approximately 60% of the 12 countries' aggregate output, the Eurozone economy appeared to have avoided falling into outright recession in spite of a pronounced weakening in GDP performance. Until very recently the overall output in the zone was generally thought to have contracted slightly in the fourth quarter of 2001 but most recent preliminary estimates seem to be centered around 0.1%–0.2% quarter-to-quarter growth after 0.1% during July–September.

Meanwhile, the performance of individual economies in the euro region has continued to be rather varied. The Bank of France estimated economic growth in the country at about 2% last year, whereas the first official estimate of Germany's GDP showed a full year's real increase of only 0.6%, sharply down from 3% in 2000 and well below the average of 1.5% for the period since 1992. Yet, the poor outcome in the Eurozone's biggest economy turned slightly lower than the generally expected 0.7% rise and, while it reflected continuing weak output in the second half of 2001, recent survey data indicated a possible turnaround during the first semester of 2002. The results of the business confidence polls have been overall encouraging lately which raised hopes that the recession in Germany might turn into a recovery by spring. Both the IFO business climate index and the ZEW institute's indicator of economic sentiment rose in January for the third consecutive month, pointing to a gradual revival of economic growth. However, further evidence is needed before concluding that the recovery of the German economy is firmly under way which, according to many analysts, is unlikely to happen until the second quarter of 2002 and then only moderately. In this context, the annual increase in real GDP will conceivably remain below the 1% threshold, albeit near to the recently lowered official target of 0.75%, down from 1.25% previously.

With most of the recent signs, indicating that the foundations for an economic upturn in the Eurozone are being currently established after the trough of the

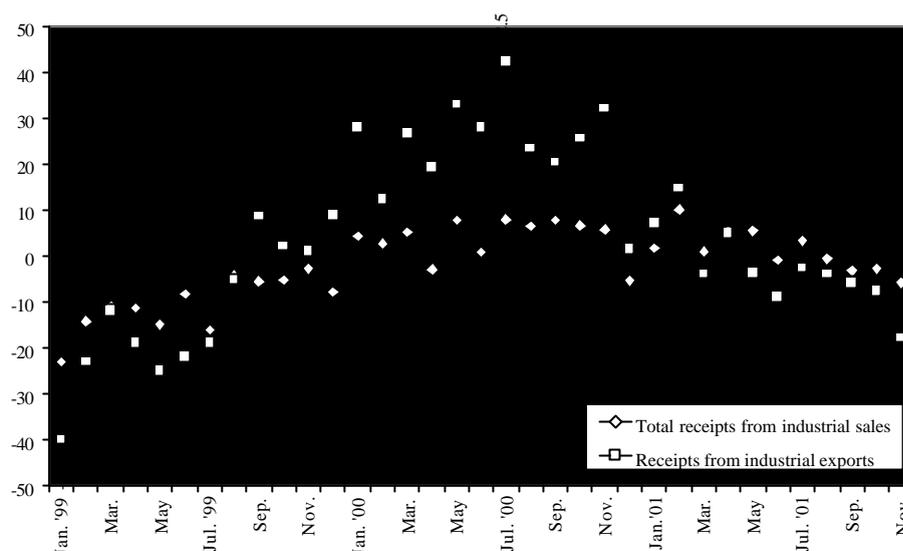
slowdown has apparently been reached in the fourth quarter of 2001, a gradual recovery in the course of 2002 could reasonably be expected but its full speed will likely become noticeable by the year-end. According to the latest EC forecast, economic activity in the Eurozone is seen to be accelerating only moderately in the first quarter of 2002 and the region's GDP is projected to grow by between 0.1 and 0.4% on a quarterly basis, following an estimated fourth quarter of 2001 outcome in the range of -0.3% to 0.1%.

Amid growing signs of a turning point in both consumer and business confidence, many economists expect Eurozone growth to be led largely by domestic demand and not dependent on a US lead. In the context of the recent policy responses, however, the recovery in the region would appear set to lag behind that in the US as suggested by the existing fiscal constraints and the scale of monetary easing undertaken so far by the ECB. On his part, the FED chairman has also recently warned against excessive optimism in the strength of the US recovery, citing the rather limited upside potential for consumer spending, despite last year's unprecedented string of 11 interest rate cuts that had brought the cost of short-term borrowing to its lowest level in 40 years. While acknowledging that the US economy might have already hit the bottom, A. Greenspan expressed the opinion that the eventual recovery will not likely be very strong. Against this background, world economic conditions could be expected to remain relatively weak in the short run, delaying a more notable pick-up in export demand to the latter part of the year at best.

2.2. Production and Capacity Utilisation in Industry

In spite of the steep decline in export sales, recent production and capacity utilisation figures point to an overall stabilisation in the industrial sector, although last year's pace of the recovery appeared to have slackened in line with weakening

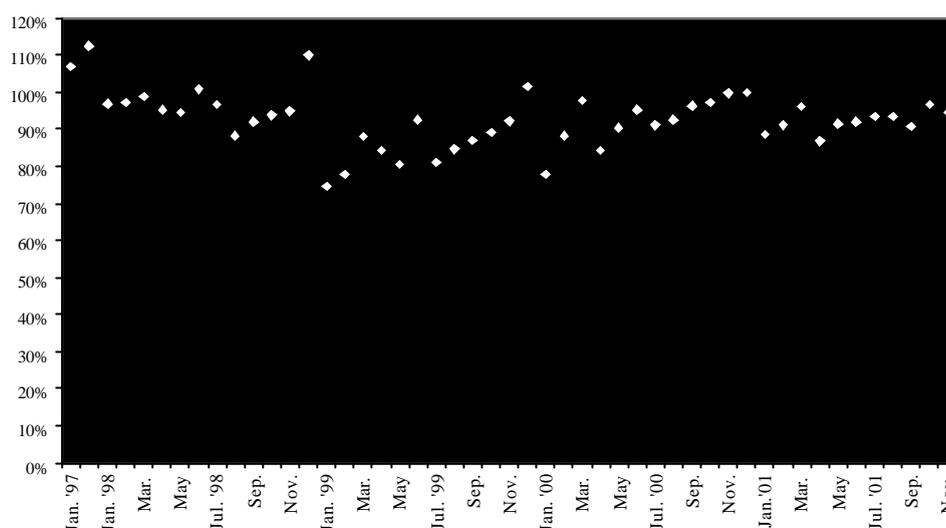
While being adversely affected by last year's external developments, the overall performance of Bulgarian industry still appeared to have remained satisfactorily strong, extending a period of positive growth after the prolonged decline from 1997–1999. A marked shift in the balance of the ongoing industrial recovery occurred, in 2001 however, due to a pronounced deterioration of global cyclical conditions that resulted in gradually decelerating sales growth. The effect of rapidly declining exports was only in part offset by a long-awaited pick-up in domestic sales, although the latter helped to keep industry on a path of expansion for the second consecutive year. Except for a tiny October drop, monthly production in the sector continued to record steady year-to-year gains from February onwards, pointing to a sustained stabilisation of activity even though at somewhat lower levels than in 2000. In the fourth quarter of 2001, a surprisingly robust increase in capacity utilisation rates provided additional evidence of industrial activity holding up relatively well in the aftermath of the September's events. Yet, the overall picture remained rather mixed, with total sales figures exhibiting a clear downward trend in the second half of 2001, while output aggregate growth have been broadly maintained within the range of 2% to 3% throughout the year.

Figure 2.7. Growth of Industrial Sales and Exports

Source: National Statistics Institute.

Following an annual rise of 2.3% in 2000, production in industry climbed 2.4% year-to-year during January–November 2001, suggesting that the 12-month outcome will likely be much of a repeat of the performance from the previous year. In spite of the rather moderate magnitude of the sustained increase in output, last year's growth should be interpreted against the background of the sharp slowdown in the world economy that notably worsened the external environment. The turnaround in the once favourable conditions that had decisively underpinned the 2000 recovery dealt a heavy blow on the performance of a sector highly sensitive to global cyclical developments. In this context, even the continuation of the positive growth rates in industrial production could be regarded as an achievement *per se*.

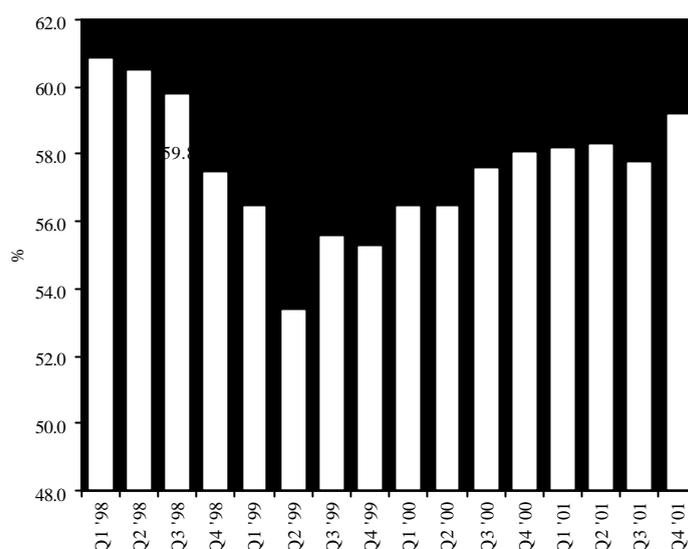
While exhibiting considerable monthly fluctuations, last year's output dynamics managed to broadly sustain the underlying upward trend even as the signs of slackening became more pronounced after the September's shock. After a first quarter of 2001 aggregate rise of 2.5% year-to-year, production growth moderated to 1.7% in the first half but strengthened again to 2.2% for the 9-month period to September. October saw a slight 0.7% year-to-year fall that was reversed by a subsequent yearly gain of 1.3% in November, bringing the cumulative increase to 2.4% for the first eleven months. This compares with 3.6% growth during the same period of 2000, with the moderate slowdown in last year's pace of recovery being provoked by generally weaker monthly rates lately. The latter was largely attributable to the increasingly softening performance of the processing industry, in turn, associated with sharp falls in the production of tobacco, lumber and metals. However, led by continuing strong gains in telecommunications equipment and apparel, the manufacturing sector still posted a 1.8% year-to-year increase during January–November, down from 3% for the full 2000. Despite a nearly 12% rise in November, output of mining continued to contract, falling 6.6% during the first 11 months of 2001 after a 8.3% annual drop in the previous year. Production and distribution of electricity, heating power, gas and water also picked up robustly by some 20% year-to-year in November, boosting the 11-month outcome to 9.5%, up from the 2000 growth of 4.5%.

Figure 2.8. *Index of Industrial Sales*

Source: *National Statistics Institute.*

Contrary to many initial expectations, the pace of recovery in total industrial sales was overall sustained during the first five months of 2001 but their growth faltered by mid-year and showed a clear decelerating trend from August onwards. After having climbed 4.6% in 2000 as a whole, the volume of sales in industry recorded a 2001 first quarter gain of 5.1% year-to-year, a rate of increase that was maintained through May, with the effect of weakening exports being fully offset by a notable pick-up in domestic demand. Although the robust rally in domestic sales continued through July, total sales growth started to slacken by mid-year due to steadily declining export receipts. The latter's monthly rates of increase have firmly remained in the negative territory since last May, following a March year-to-year drop for the first time in eighteen months. In line with rapidly deteriorating global conditions, the decline in sales for export accelerated sharply to 17.8% in November that resulted in an 11-month contraction of 1.3% from a year ago in stark contrast to the 26% annual gain of 2000.

While industrial exports experienced a steep slowdown to negative growth as a reflection of lower world demand and prices, domestic sales managed last year to stage a long-awaited turnaround after a period of prolonged slump. Despite some recent signs of loosening momentum, industrial sales on the home market broadly sustained their recovery since the resumption of positive growth in early 2001. Following a nearly three-year spell, domestic sales rose 7% year-to-year in February and remained on a clear rising path for the next five months. Although their subsequent pattern has become hesitant, the aggregate increase came out at 2.3% during January–November, still a marked improvement over the 2000 fall of 7%. The short-term prospects seem, however, rather uncertain even as the yearly drops in August–October proved of overall moderate magnitude, whereas a November resurgence to 2.2% growth signals a tentative stabilisation in domestic demand. Meanwhile, its recent softening combined with increasingly dampened external demand to push the year-to-year growth rates of total industrial sales to negative levels since August. Thus, the aggregate volume of sales receipts in industry posted only a modest rise of 1.4% during the first 11 months of 2001 and the 2002 outlook appears to be heavily contingent on a prospective recovery in the world economy to strengthen the performance of basic export-oriented sub-sectors.

Figure 2.9. Capacity Utilisation in Industry

Source: National Statistics Institute.

After having remained rather flat during January–September, the estimates of capacity utilisation in industry unexpectedly showed strong improvement in the fourth quarter of 2001 that might appear surprising given the recent sharp deterioration in sales prospects. According to NSI survey data, industrial enterprises were running at an average of 59.2% of their full capacity during October–December, up from 57.8% in the third quarter of 2001. The latest pick-up in utilisation degrees contributed largely to last year’s overall improvement of this indicator, although the process of recovery appeared to have moderated its pace in comparison with 2000. While following a somewhat uneven pattern, industrial capacity utilisation rates have continued to exhibit an underlying upward tendency since their decline bottomed out at 53.4% in the second quarter of 1999.

However, the high momentum from 2000 was not fully sustained last year mainly as a reflection of a temporary third quarter downturn that reversed the meagre gains of the first half of 2001. After climbing to 58.1% in the final trimester of 2000, capacity utilisation rates rose only marginally by 0.1 point in both the first and the second quarter of 2001. This was followed by a half point loss during July–September, raising fears of a turning point in the general direction of the indicator in line with rapidly weakening global conditions. The pessimistic expectations were not confirmed by recent data showing a rather robust fourth quarter rise of 1.4 point that brought utilisation degrees near to the levels last seen in mid-1998. Despite such a marked strengthening in capacity utilisation, the annual average value of the indicator gained 1.2 point over 2000 when the improvement had come at 2 points. Yet, the utilisation rates in industry managed to reach a 13-quarter peak by end 2001, which is another positive sign in the overall mixed picture of recent developments in the sector.

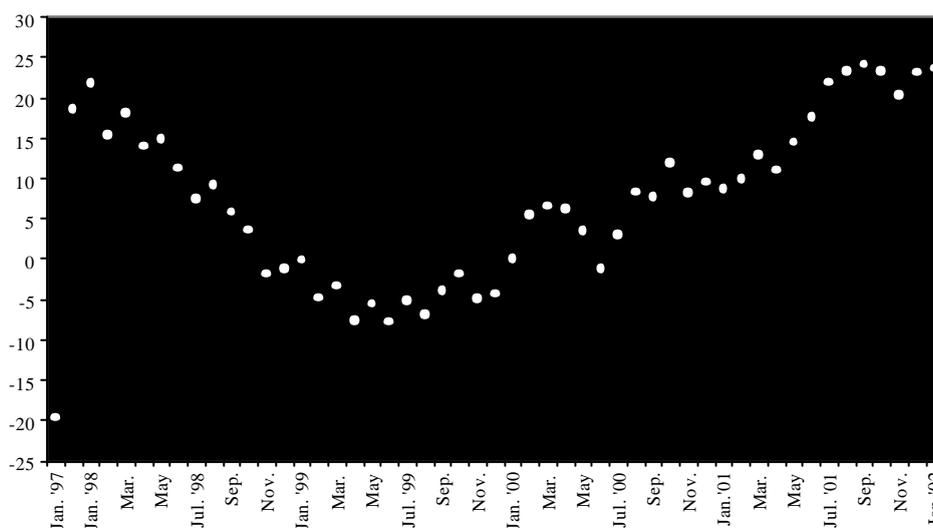
2.3. Business Surveys

The year 2001 witnessed an overall strong improvement in business cycle indicators largely as a result of robust third quarter gains that followed a two-year period of gradual, albeit occasionally rather hesitant strengthening. Reflecting steadily increasing optimistic assessments among industrial firms, the average value of the business climate index gained more than 4 percentage points already during the first half of 2001 over the previous semester. While broadly maintaining its

underlying upward trend, industrial confidence continued to be more volatile as its modest first quarter improvement was reversed by a subsequent weakening that resulted only in a tiny average rise in the first half of 2001.

The pace of the recovery in both business cycle indicators switched, however, to a markedly higher gear at the start of the second semester, with survey data showing a sharp upturn in industrial sentiment. To a large extent, such a robust pick-up was associated with the general outburst of optimism in the wake of the June general elections and by early October the first signs surfaced that the seemingly overoptimistic expectations had started to loose ground to more sober assessments. Also compounded by rapidly growing fears of a global recession, the dynamics of the composite indexes faltered in the fourth quarter of 2001, although the overall improvement of cyclical conditions appeared to have been broadly sustained through the rest of 2001 even as industrial confidence eased for three consecutive months to December. While the picture has become rather mixed lately, the indicators of business climate and confidence in industry staged an exceptionally strong rally last year, with their annual average values recording increases of 11.8 and 6.2 points respectively. Moreover, in spite of some weakening during the final trimester of last year, both composite indexes still remained near their third quarter heights, signalling that industrial sentiment has held up generally well in the immediate aftermath of the September events.

Figure 2.10. *Business Climate Indicator*



Source: National Statistics Institute.

The third quarter of 2001 sharp improvement in business cycle indicators appeared to have been broadly sustained in late 2001 and early 2002

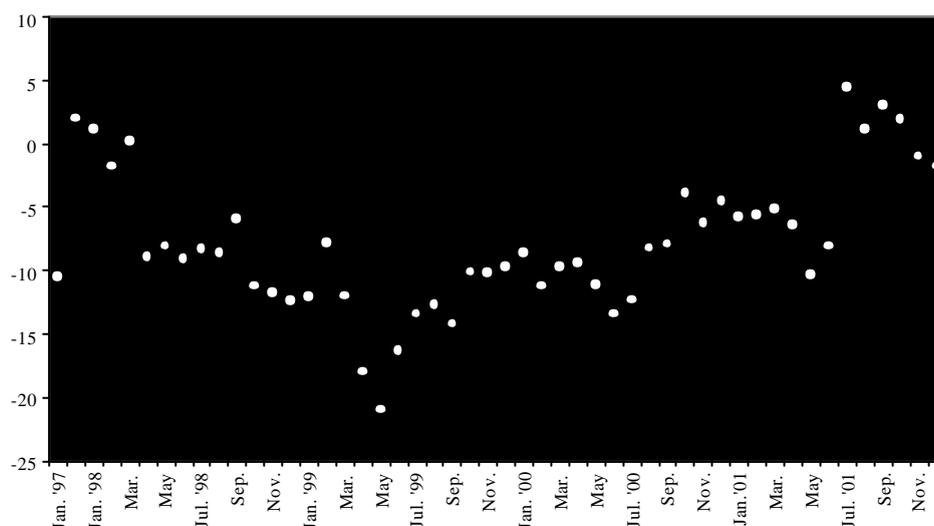
With an annual average value of 17.5% and an all-time peak of 24.1% reached in September, last year's improvement of the business climate indicator¹ turned most impressive, extending a period of quite a rapid strengthening from 2000. The underlying upward trend gathered strong momentum in early 2001 and, except for a brief April drop, the index continued to post steady monthly gains through September, beating its former record-high values on three successive occasions. Reflecting a marked increase in the balance of the future business situation assessments, the composite index climbed to 21.9% in July, outperforming the previous peak of 21.7% that had been recorded in November 1997. The subse-

¹ The business climate indicator is the geometrical mean between the balances of the current business situation indicator and the balances of the business situation expectations indicator.

quent further rise of the business climate indicator to new record heights was, however, almost entirely attributable to more favourable assessments of current conditions. Thus, while the entrepreneurs' future expectations stayed practically unchanged at their already high mid-2001 level, the composite index jumped to 23.2% in August before reaching a historic peak of 24.1% in September which was the highest level since early 1994 when the surveys were launched. A breakdown of the NSI data showed that these two gains reflected a robust pick-up in the current situation component that climbed to an all-time high of 17.5%.

In line with the sharp deterioration of global prospects after the terrorist attacks in the US, the steady rising path of the business climate indicator was reversed by a moderate October easing and a more pronounced fall in November due to increasingly pessimistic future assessments. The latter proved, however, to be a rather short-lived downswing as the sub-index rose some 5 points in December, bringing the aggregate indicator back to its October reading. While the development of the future situation component was sustained for the second consecutive month both in direction and scale, the business climate in industry improved only by half a point in January 2002 as the balance of the assessments of current conditions deteriorated by nearly 4 points from the previous month. Despite the latest offsetting developments, the business climate indicator has managed to recover rather rapidly and is currently standing close to its historic peak which points to a stabilisation in the industrial sector with a tentative upward bias.

Figure 2.11. *Confidence Indicator*



Source: *National Statistics Institute.*

The 2001 dynamics of the confidence indicator¹ confirmed its rather volatile pattern, albeit with an underlying upward tendency, which has been exhibited since the second half of 1999 turnaround in industrial sentiment. Yet, last year's recovery of the index also appeared to have gathered pace moderately, with positive values being reached during the third quarter for the first time in almost three and a half years. The overall improvement in industrial confidence continued to be, however, a much slower process than that of the business climate due to sig-

¹ The confidence indicator is the arithmetic mean of the balances of the order portfolio indicator, the production expectations indicator and the level of finished products indicator, the latter taken as a negative sign.

nificant monthly fluctuations and changes in the short-term direction. Both the second and the fourth quarter witnessed offsetting developments that reversed the gains from the previous quarters and lowered the average annual outcome to -2.7%, up from -8.9 and -13.1% in 2000 and 1999 respectively.

In spite of the generally slow restoration of confidence in industry and the rather hesitant path of the index during the first half of 2001, mid-2001 marked the beginning of a strong rally that was broadly sustained till the year-end even as November and December saw the return to slightly negative levels. After having improved modestly to around -8% in June, the confidence indicator skyrocketed to 4.4% in July, which was close to its all-time best of 5.2% recorded in August 1997. This robust monthly gain reflected a nearly 19 percentage points increase in the future expectations component that combined with a fall in the assessments of stocks of finished products to largely offset the continued drop in the manufacturers' order books. Although the latter component showed a rather strong improvement in August, the composite index deteriorated briefly to 1.1% as a result of a negative change in the balance of stocks assessments.

Led by a September strengthening of the future production expectations, the confidence indicator managed to regain nearly two percentage points but a subsequent fall in the same sub-index provoked an October deterioration of the overall indicator to slightly below 2%. Also compounded by lower domestic orders, the composite index dipped to a negative value in November, losing some three points from the previous month. This was followed by a further weakening, albeit of a less than one point, to around -1.8% in December, due to more pessimistic assessments of production activity over the next six months. Thus, the signals have become rather mixed as the recent weakness in industrial confidence stood in contrast to a relatively quick improvement in the business climate. However, the latest moderation in the scale of the decline in overall confidence together with better assessments of manufacturing orders from abroad are still raising hopes for a prospective recovery in line with gradually strengthening global conditions.

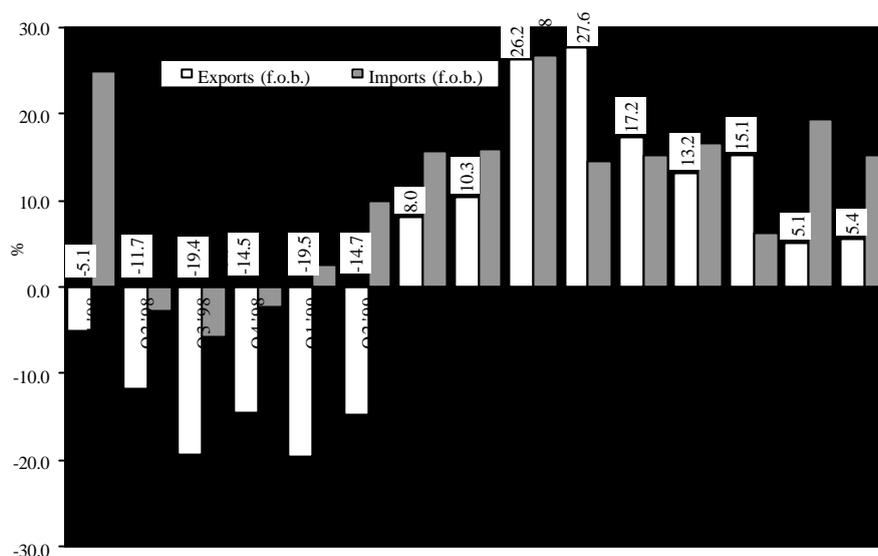
2.4. Foreign Trade Developments

With import growth largely outpacing that of exports, Bulgaria's merchandise trade deficit rose sharply to USD 1,425 million (at f.o.b. prices) in January–November 2001, up nearly 39% from a year ago.

Following an underlying slackening trend, Bulgarian exports recorded a rather moderate aggregate increase during January–November that stood out in sharp contrast to the robust upturn of the previous year and were largely to be blamed for the recent deterioration in the country's merchandise trade balance. Albeit at a slower pace in comparison with 2000, imports grew at double the rate of exports, contributing as well to the widening of the 11-month deficit, which turned by nearly 39% higher than in the year-earlier period. This points to a rather dismal full year's outcome in line with most pessimistic recent expectations for a trade deficit in excess of USD 1.5 billion after a USD 1,175 million gap in 2000.

Indeed, the depressing effect of the global slowdown on Bulgaria's export performance had already suggested at an earlier stage some further deterioration in the trade balance for the fourth consecutive year but the external environment turned much weaker than initially expected, while imports picked up markedly during March–August. According to the revised forecasts, the 2001 deficit was at around 11.7% of GDP, which still appears within reach given the 11-month ratio of 10.6%. Based on the assumptions of a gradual recovery in the world economy to revive export growth, as well as continuing moderation in the rates of increase in imports, the country's trade deficit is projected at 11% of GDP this year, although the overall prospects remain rather uncertain at present.

Figure 2.12. Quarterly Growth of Exports and Imports (Year-to-Year % Change)



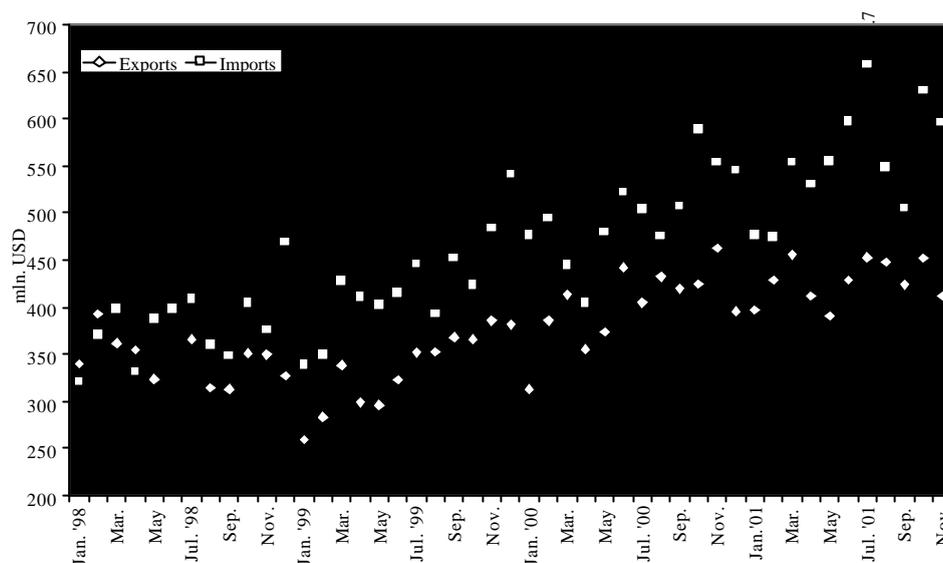
Source: National Statistics Institute.

The first half of 2001 witnessed offsetting developments on both the export and import side, with the second quarter turnaround getting further confirmation during the second semester even as monthly trade figures continued to exhibit quite a volatile pattern. In spite of gradually weakening cyclical conditions worldwide, exports grew at a rather brisk pace in the first four months of the year. The rate of increase in outward trade did strengthen somewhat to 15.3% year-to-year in the first quarter of 2001 from 13.2% in the final trimester of 2000 and a second half of 2000 average of 15.1%.

The sustained pace of export recovery turned to be, however, a rather short-lived phenomenon as the yearly gain of 15.8% in April was followed by a sharp May deceleration and a 3.2% year-to-year contraction in June for the first time since the resumption of positive growth in August 1999. This steep fall reduced the second quarter of 2000 increase to 5.1% from a year ago, marking the lowest rate in eight consecutive quarters. Although the June drop was more than reversed by a subsequent pick-up of nearly 12% year-to-year in July, the faltering export growth continued through the remainder of the year.

Reflecting a rapidly softening of world demand and prices, the second quarter sharp slowdown was duplicated in the next three-month period with the little difference of a tiny 1% rise in September instead of an outright contraction. While this resulted only in a slight improvement in the growth rates to 5.4% year-to-year during the third quarter of 2001, the October figures provided some tentative signs that Bulgarian exports were still holding up in the immediate aftermath of the September's shock.

However, the gain of 6.5% in October was followed by an 11% fall in November, suggesting that the decelerating trend in outward trade has been far from bottoming out. Yet, helped by last year's marked strengthening in sales of consumer and investment goods, the total value of exports during January–November reached USD 4,703 million, up 6.2% from a year ago. Given the considerable upward revisions of preliminary monthly figures that have been occurring lately, the slowdown in the annual growth of exports will likely be contained at around 6%, although it would still represent a major deterioration in comparison with the 2000 high of 20.4%.

Figure 2.13. *Monthly Exports and Imports (F.O.B. Value)*

Source: National Statistics Institute.

In contrast to the sustained rather strong export performance during the first four months of 2001, imports showed considerable fluctuations already from the start of the year. After two successive year-to-year drops of a rather small magnitude in January and February, import growth rebounded sharply in March and an underlying strong upward tendency was clearly observable through August, despite some differences in the monthly rates of increase. With the March pick-up of 24.5% reversing the previous contractions of early 2001, the first quarter of 2001 aggregate rise came out to 6.3%, which was the lowest rate in two years. Such a slowdown proved, however, to be of a temporary nature as imports continued to record double-digit year-to-year gains until September when a slight fall occurred again.

Import growth accelerated markedly to 19.6% during the second quarter of 2001 largely as a reflection of an exceptionally robust April rise of 31.1%, the fastest for the whole period under review. While July also witnessed a brief strengthening in the monthly rates to over 30% year-to-year, the pace of increase in inward trade moderated to 15.2% in the third quarter of 2001 and slowed down further to around 7%–8% in October–November.

Nonetheless, total imports climbed 12.6% year-to-year during January–November to USD 6,128 million at f.o.b prices and USD 6,648 million on a c.i.f. basis as all major commodity groups posted rather strong gains with the only exception of falling energy deliveries. With import growth largely outpacing that of exports, Bulgaria's trade deficit widened to USD 1,425.3 million (f.o.b/f.o.b.) in the first eleven months of 2001, up USD 399.7 million or 38.97% from the year-earlier period. Against the backdrop of the poor 11-month outcome and continuing weak external conditions, the full year's gap will likely rise to around USD 1,570 million at f.o.b. prices, while the 2002 prospects remain highly uncertain.

The continued slackening in outward trade during January–November reflected mainly an underlying falling trend in the most important raw materials category and a steep deceleration in energy exports to barely positive levels. At the same time, sales of consumer and investment goods gathered pace markedly, reversing their overall poor performance in 2000. To a large extent, these contrasting dynamics could be attributed to a combination of weakening world prices

for basic commodities and declining import demand on key markets in the EU and neighbouring Balkan countries. After an initial fourth quarter of 2000 slowdown, exports of raw materials posted a modest 4.1% year-to-year rise in the first half of 2001 and their growth dipped to negative values during the second part of the year as the adverse impact of external trends became increasingly felt. This rapid deterioration pushed the 11-month outcome down 2.6% from a year ago, with the sharpest declines occurring in the sales of tobacco (down 21.2% year-to-year), cement (-19.8%), as well as ferrous and non-ferrous metals (down 10.8% and 12.7% respectively). In spite of the aggregate contraction that contrasted sharply with a robust 26.8% gain for 2000 as a whole, raw materials remained the most important category of Bulgarian exports even as their share of the total fell to 40.6% during January–November 2001.

Although energy exports saw a more moderate decline in their relative weight to 13.7% of total outward trade, the 2000 leading performer in terms of growth rates last year exhibited an overall slowdown of a far greater scale. Following an annual rise of 90% in 2000, this commodity group recorded tiny 0.1% growth during January–November as continuing strong electricity sales (up nearly 73% year-to-year) barely offset a 16% fall of refined oil products (the latter was entirely due to lower prices since exported volumes rose 3.5 % from the same period of the previous year).

The other two main categories of exports managed to strengthen their performance even in the context of last year's deterioration of global economic conditions. After a rather moderate 2000 increase of 7.1%, consumer goods became last year's growth leader, gaining 20.1% in January–November largely as a reflection of a sustained pick-up in sales to EU and CEFTA countries. The share of the whole group rose to 33.6% of total exports, boosted by a 30.2% year-to-year jump in sales of clothing and footwear (the largest single category of exports with a relative weight of 20% currently), as well as strong increases of over 27% in both furniture and foodstuffs.

Table 2.2. Exports by End-Use

	Jan. – June 2000		Jan. – Sept. 2000		Jan. – Dec. 2000		Jan. – March 2001		Jan. – June 2001		Jan. – Sept. 2001	
	y-o-y % change	shares in % of total										
Consumer goods	11.0	30.1	6.7	30.0	7.1	29.8	18.3	31.7	16.6	31.9	19.4	33.1
Raw materials	35.0	44.6	33.0	44.9	26.8	44.2	4.8	41.2	4.1	42.2	-1.1	40.9
Investment goods	-8.3	12.4	-9.3	11.7	-9.8	11.5	10.8	11.8	6.1	11.9	11.5	12.1
Energy products	152.3	12.9	111.6	13.4	90.0	14.5	54.3	15.2	19.3	14.0	12.7	13.9
Total exports (f.o.b)	26.9	100.0	23.3	100.0	20.4	100.0	15.3	100.0	10.1	100.0	8.4	100.0

Source: Bulgarian National Bank.

However, last year's solid recovery staged by exports of investment goods seems rather more impressive as it reversed a 9.8% contraction in 2000. While the share of this key export category still remained rather low at 12.1% of total outward trade, the 11-month aggregate increase amounted to 11.8% which was most encouraging against the backdrop of the general slowdown in exports. Moreover, the 2001 recovery in exports of capital goods turned to be broadly based, with all subgroups contributing to the positive outcome.

Table 2.3. Exports by Main Regions

	Jan. – June 2000		Jan. – Sept. 2000		Jan. – Dec. 2000		Jan. – March 2001		Jan. – June 2001		Jan. – Sept. 2001	
	y-o-y % change	shares in % of total										
EU countries	26.4	54.3	22.7	52.9	18.4	51.3	11.7	54.8	13.0	55.8	13.7	55.5
Other OECD countries	48.8	14.7	51.1	15.0	47.9	15.2	18.2	13.6	4.5	13.9	2.6	14.2
Balkan countries	177.2	9.9	87.3	10.2	65.2	10.8	11.7	9.8	-15.3	7.6	-25.1	7.1
CEFTA countries	-3.5	3.3	13.1	3.6	8.3	4.0	43.7	4.6	66.0	5.0	39.2	4.6
Former USSR countries	-27.0	5.9	-23.5	5.9	-18.2	6.1	4.3	5.6	10.6	5.9	6.6	5.8
Other	9.4	12.0	5.4	12.4	6.9	12.6	31.0	11.6	8.4	11.8	12.3	12.8
Total exports (f.o.b.)	26.9	100.0	23.3	100.0	20.4	100.0	15.3	100.0	10.1	100.0	8.4	100.0

Source: Bulgarian National Bank.

In comparison with the notable shifts in last year's commodity structure of exports, the changes in the direction of Bulgaria's outward trade would not appear as considerable, although there was still a reversal of trends in some particular cases. While exhibiting a moderate slowdown from the 2000 growth of 18.4%, sales on the EU markets have been broadly sustained in the course of 2001 that helped to push the region's share markedly up to 55% of all exports. EU-bound exports posted an overall 13.4% year-to-year rise during January–November that reflected a tamer first quarter of 2001 performance and a sharp November deceleration, whereas the second and the third quarter did even see a gradual, albeit rather modest pick-up in the rates of increase to nearly 15%.

Sales dynamics to individual markets within the region also varied significantly. Italy and Germany remained the major destinations of Bulgarian exports but recorded 11-month growth below the average, with the latter witnessing a slight strengthening from the previous year, while in the case of the former the rates were more than halved. However, sales to Spain grew some 67% after a 6.4% drop for the full 2000 and exports to Austria and France rose around 26% each (the pace of increase in sales to the latter was broadly sustained from the previous year, whereas the upturn in exports to Austria followed a period of flatness). In contrast, export sales to Belgium plummeted 14.7% during the first 11 months of 2001, after having grown robustly by 70.6% in 2000 as a whole.

The same precipitated fall occurred in Bulgarian exports to the Balkan countries, which had seen the fastest rise of over 65% in 2000 but contracted 27.6% last year due to a 40% plunge in sales to Yugoslavia. Led mainly by steadily declining sales to Turkey, the group "Other OECD countries" also experienced a major slowdown to slightly negative growth in January–November from nearly 48% during the previous year.

Another reversal, although with the opposite sign, surfaced in exports to the CIS and Baltic countries that, despite large monthly fluctuations, managed to post a 3% year-to-year gain after an annual fall of 18.2% in 2000. Most encouraging were, however, the signs that the prolonged decline in sales to the Russian market might have been close to bottoming out as the 11-month drop was reduced to only 0.7% from over 37% for the full 2000.

Albeit at a recently slowing pace, exports to the CEFTA countries logged by far the highest growth last year with an aggregate increase of nearly 30% that was largely attributable to a 55% rise in sales to Romania.

Table 2.4. Imports by End-Use

	Jan. – June 2000		Jan. – Sept. 2000		Jan. – Dec. 2000		Jan. – March 2001		Jan. – June 2001		Jan. – Sept. 2001	
	y-o-y % change	shares in % of total										
Consumer goods	9.9	15.9	7.1	15.3	5.2	15.3	18.7	17.3	21.5	17.1	25.5	16.8
Raw materials	10.8	33.0	15.6	33.3	16.4	33.0	25.3	34.9	25.8	36.6	21.4	35.6
Investment goods	10.2	24.9	7.8	25.3	6.7	24.4	-9.1	21.6	4.8	23.2	10.0	24.4
Energy products	61.6	26.2	46.6	26.1	43.8	27.3	-6.3	26.2	-0.7	23.1	6.5	23.2
Total imports (f.o.b.)	20.4	100.0	18.5	100.0	18.0	100.0	6.3	100.0	12.9	100.0	13.7	100.0

Source: Bulgarian National Bank.

Last year's fall in crude oil prices contributed largely to the moderate easing of the growth rates in inward trade, although its effect was in part offset by upturns of varying degrees in all other major import categories. Reflecting mainly the sharp contractions in energy imports during September–November, the 11-month outcome of this commodity group dipped 6.4% below the level from a year ago. This contraction followed the 2000 robust pick-up of 43.8% and was mainly the consequence of a 19.6% fall in the value of crude oil deliveries due, in turn, to lower prices and volumes (the latter decreased by 8.6% year-to-year). Following last year's downturn, the share of energy products fell four and a half percentage points to 22.6% of total imports in January–November, although last year's drop reflected as well the gains that occurred elsewhere.

Among them, most notable was the acceleration in the growth rates exhibited by the group of consumer goods. After having lagged well behind the rest of commodity groupings with an annual rise of 5.2% in 2000, consumer goods imports gathered the fastest momentum last year, climbing 29.3% year-to-year during January–November. Moreover, this sustained strengthening that resulted in a 17.5% share of total imports was underpinned by double-digit gains in all sub-groups, with the strongest push being provided by yearly increases of over 30% in apparel, medicines and cosmetics, as well as passenger cars.

Though of a more moderate magnitude, deliveries of raw materials and investment goods also showed higher growth rates than in 2000. Following a first quarter of 2001 short-lived contraction, the latter gained rapidly speed, maintaining an average rate of increase of around 20% throughout the remainder of the year. While the 11-month outcome came at 11.9%, investment goods imports strengthened markedly from 6.7% growth in 2000 as a whole. Boosted mainly by a 62% gain in electrical machines, the relative weight of this commodity group rose to 24.6% of total inward trade. In spite of an overall second half of 2001 deceleration, raw materials posted a 20.3% year-to-year rise during January–November, extending a period of rather robust growth with a 2000 average of 16.4%. This reflected the high import component of Bulgarian industry, with last year's sustained pick-up in deliveries of non-ferrous metals, ores and textile materials proping up the share of the largest commodity group to 35.3% of total imports.

In contrast to the 2000 rather balanced growth in imports, last year saw significant changes in the dynamics of the deliveries from almost all regions. The group "Other OECD countries" seems to be the notable exception as it broadly maintained the pace of increase from the previous year even as a moderate up-

ward tendency was observed largely as a result of strengthening deliveries from Turkey.

Table 2.5. Imports by Main Regions

	Jan. – June 2000		Jan. – Sept. 2000		Jan. – Dec. 2000		Jan. – March 2001		Jan. – June 2001		Jan. – Sept. 2001	
	y-o-y % change	shares in % of total										
EU countries	7.8	44.6	9.1	44.9	7.4	44.0	20.2	46.6	23.7	48.8	23.3	48.7
Other OECD countries	0.5	7.3	16.3	7.9	10.7	7.5	12.3	7.5	27.6	8.3	12.3	7.8
Balkan countries	23.7	0.9	35.3	0.9	22.9	0.8	-37.4	0.5	-34.3	0.6	-27.0	0.6
CEFTA countries	58.7	8.1	66.1	8.5	60.7	8.8	19.3	8.3	11.5	8.0	3.0	7.7
Former USSR countries	64.0	26.5	38.4	26.2	39.1	27.8	-5.7	26.0	-3.1	22.7	4.4	24.0
Other	1.3	12.6	-0.8	11.6	1.3	11.1	-16.5	11.1	4.2	11.6	9.4	11.2
Total imports (f.o.b.)	20.4	100.0	18.5	100.0	18.0	100.0	6.3	100.0	12.9	100.0	13.7	100.0

Source: Bulgarian National Bank.

Much more pronounced was last year's pick-up in imports from the EU countries and the grouping "Others" given the recovery from overall low growth levels. Especially strong was the former's come-back to the leading positions in terms of growth after a rather tamed gain of 7.4% in 2000 which had been the lowest among the major regions, reflecting in part the euro's weakening. Imports from the EU area climbed a robust 25.3% year-to-year in the first eleven months of 2001, with all countries recording growth rates near to the average, barring the flatness in deliveries from Austria. The share of the EU countries rose some 5 points to 49.3% of total imports as they became last year's growth leader, while the 2000 front runners saw their relative weight diminishing due to a reversal of trends.

Following a 39% increase for the full 2000, imports from the CIS and Baltic countries fell nearly 3% year-to-year in January–November, shadowing the decline in crude oil deliveries both in value and volume.

The fall in deliveries of oil derivatives was also the prime cause for the sharp contraction in imports from Romania that accounted mainly for the aggregate 2.1% drop recorded by the CEFTA countries after a record high 60.7% rise in 2000. However, last year's imports from the Balkan countries contracted, the most, falling 19.3% year-to-year in January–November to offset the 2000 gain.

2.5. Outlook and Key Issues

✎ The sustained upturn in investment activity helped keep economic growth relatively strong at 4.7% year-to-year during January–September 2001, although the underlying moderately slowing trend got further confirmation in the third quarter as a result of weakening world demand and hesitant consumption dynamics. In spite of the signs that economic recovery has been lately progressing at a slackening pace, the full year's increase in real GDP will likely come out close to the revised 4.5% estimate. In the current context of heightened global uncertainty, however, overall output expansion is generally expected to remain constrained below the long-term potential, with GDP growth being projected to slow down further to an average of 4% in 2002.

✎ After an annual rise of 2.3% in 2000, industrial production grew further by 2.4% year-to-year during January–November 2001, despite the recent mod-

eration in the monthly rates of increase that was largely attributable to steadily declining exports. The latter combined with recently faltering domestic demand to push total industrial sales on a fast decelerating path in contrast to the apparent stabilisation in output and a fourth quarter pick-up in capacity utilisation degrees. Adding to the picture of a broadly sustained recovery in industrial activity was the overall development of business cycle indicators that, while presenting some mixed signals, showed entrepreneurs' sentiment holding up relatively well in late 2001 and early 2002.

- ✍ Bulgaria's merchandise trade balance deteriorated sharply in January–November 2001 due to a combination of markedly lower export growth and a broadly sustained pace of increase in imports. Against the background of continuing weak external conditions, last year's trade deficit will likely turn out well in excess of USD 1.5 billion at f.o.b. prices, while the 2002 prospects remain highly uncertain.

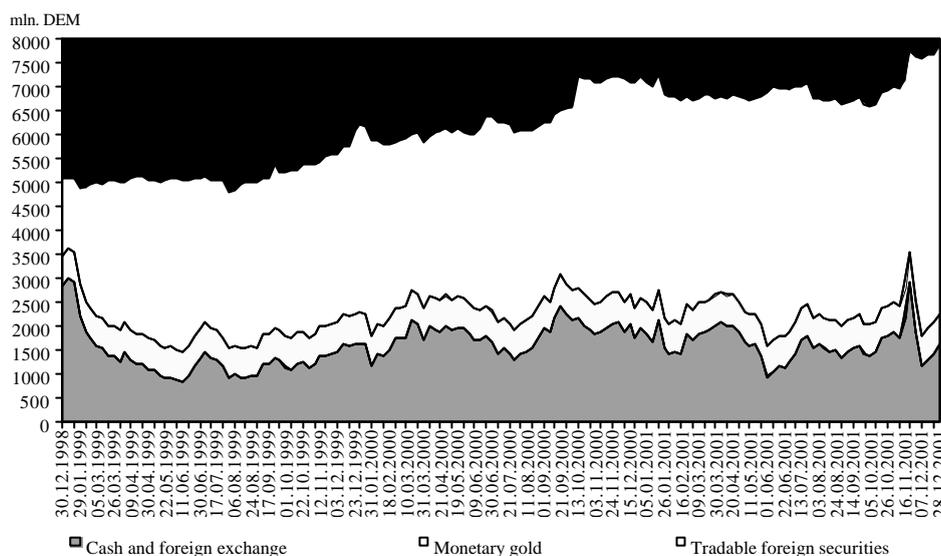
3. STABILITY OF THE FINANCIAL SYSTEM

3.1. Foreign Exchange Reserves

Over the past year, foreign exchange reserves were highly volatile. The Euro-bond issues led to a record high growth of foreign exchange reserves.

In 2001, the official foreign exchange reserves of the country remained sufficient for the smooth functioning of the economy under the Currency Board Arrangement (CBA), however, they displayed high volatility (Figure 3.1). In nominal terms, foreign exchange reserves varied between BGN 6.6 and BGN 7.9 billion. Despite the growth at the year-end by almost 10% against the beginning of the year, during most of the year they remained below BGN 7 billion in nominal terms.

Figure 3.1. Foreign Exchange Reserves



Source: Bulgarian National Bank.

This was determined both by the growing negative foreign trade account and the fulfilment of the agreement with the IMF – its last tranche was reimbursed in June 2001. The absence of big privatisation deals also contributed to foreign exchange reserves reduction. This trend continued until October 2001 and was becoming alarming at some points. However, in the last quarter this negative trend was radically changed, mainly as a result of the successful Eurobond issue amounting to euro 250 million. In December 2001, unusually high sales were recorded for the currencies participating in the euro basket. BNB net currency purchases for December only surpassed euro 80 million. This brought the foreign assets to a record high level.

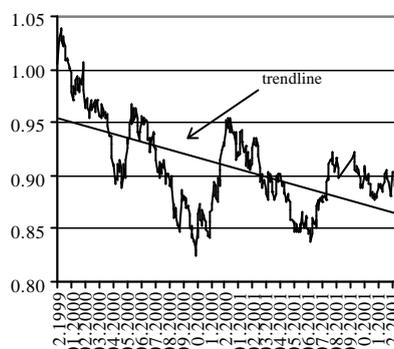
The depreciation of the euro continued in 2001. In the end of the period, the USD appreciated by 8.7% compared to the beginning of 2001, while its average yearly value grew by 3.2% (Figure 3.2).

The year started with optimistic expectations even for reaching exchange rate parity between the two worldwide international currencies most often used. During the year, it became quite clear that 2001 would not be the year of the euro, but the year of the US dollar. The expensive dollar, however, did not exert a strong negative impact on the Bulgarian economy and domestic prices did not rise substantially. This was not so much a result of changes in the regional structure of Bulgaria's foreign trade but rather of the lower interest rates on international money markets, which eased the foreign debt service. The decline in world crude oil prices, especially in the last quarter of 2001, also contributed to restraining pro-

The BGN depreciated against the US dollar but this did not increase inflation pressure.

duction costs. As a result, the overall effect of the depreciation of the euro was neutral, and even positive for the economy, as far as it reduced the pressure on the real effective exchange rate and allowed preserving of the competitiveness level.

Figure 3.2. Euro / USD Exchange Rate



Source: Bulgarian National Bank.

3.2. Monetary Aggregates

Money supply followed the dynamics of foreign exchange reserves. The demand for money in the economy remained relatively stable and compatible with the growth of economic activity.

The dynamics of the different monetary and credit aggregates stayed within its usual limits and was in line with the rules of the CBA (Table 3.1).

Table 3.1. Monetary Aggregates (Mln. BGN)

	12.97	12.98	12.99	12.00	03.01	06.01	09.01	12.01
Broad money (M3)	6018.6	6597.2	7351.1	9290.7	9481.7	9678.7	10302.6	11594.1
BGN	3394.5	4013.0	4475.5	5181.9	5183.8	5502.4	5821.5	6629.9
Foreign Exchange	2624.1	2584.1	2875.6	4122.1	4297.9	4176.3	4481.0	4964.2
M2 (M1 + QUASI MONEY)	5750.7	6180.6	6914.0	8920.2	9203.9	9371.8	10003.2	11226.1
M1	2290.3	2755.6	2996.6	3640.3	3555.0	3834.0	4029.9	4664.7
Currency Outside the Banks	1314.1	1742.0	1957.4	2372.4	2225.2	2427.2	2601.3	3080.6
Demand deposits	976.2	1013.6	1039.3	1267.9	1329.7	1406.9	1428.6	1584.1
QUASI MONEY	3460.4	3425.0	3917.4	5279.9	5648.9	5537.8	5973.2	6561.4
Time Deposits	804.9	776.4	924.8	962.7	1054.9	1056.8	1171.4	1268.0
Savings Deposits	226.9	292.3	387.9	450.2	472.4	489.5	510.9	548.5
Foreign Exchange Deposits	2428.6	2356.3	2604.7	3867.0	4121.6	3991.6	4290.9	4744.8
NET FOREIGN ASSETS (net)	4950.2	5499.0	6150.6	7861.9	8090.4	8361.9	8086.3	9245.2
DOMESTIC ASSETS (net)	1068.4	1098.2	1200.5	1428.9	1391.3	1316.9	2216.3	2348.9
DOMESTIC CREDIT	5136.5	4227.0	4237.4	4654.4	4865.2	4514.4	5307.9	5471.1
CLAIMS ON GOVERNMENT (net)	1641.6	509.8	156.0	487.5	853.3	96.2	717.4	442.3
CLAIMS ON NONGOVERNMENT SECTOR	3494.9	3717.2	4081.4	4166.7	4141.5	4418.2	4590.5	5028.8
Claims on nonfinancial state-owned enterprises	1254.1	945.6	713.1	421.9	342.1	356.1	333.5	342.3
Claims on private enterprises	1982.2	2253.2	2788.8	3116.4	3131.5	3286.4	3404.9	3774.6
Claims on nonbank financial institutions	89.0	38.0	47.1	24.3	22.4	29.5	33.2	35.5
Claims on the public	169.6	480.5	532.4	604.0	645.5	746.3	818.8	876.5

Source: Bulgarian National Bank.

The decline in reserves during the larger part of the year did not bring about shrinking of the supply for money because it was entirely due to the cutback in the deposit of the government. The specific design of the CBA in Bulgaria¹ allows for stability of the monetary aggregates even in case of declining reserves, if this decline affects only the deposit of the government. Although this is a departure from the traditional design of a CBA, this feature also provides for interest rate stability as far as the interest rate is the only balancing factor.

At the time of the peak of the crisis in Argentina, the discussion about the CBA sustainability was revived again. There were even appeals for dismantling the currency board and adoption of a crawling peg, to avoid the potential danger of a financial crisis in Bulgaria. The main argument against the CBA was that it impedes economic growth because it restricts the growth of the currency in circulation. It was argued that economic growth starts with the revitalising of the domestic market, or with quicker growth of the domestic turnover and investments compared to the foreign ones. However, the CBA causes a shortage of money supply in the country because the currency has to be generated based on the foreign trade and investment.

This argument has its grounds. In case of sustainable divergence in the dynamics of the external and the domestic sources of growth, and in case the latter are dominant, the demand for money will grow at a quicker pace compared to the money supply. This will cause an increase in the interest rates and will subsequently hinder economic growth. The reaction to this “deficit for money” is to increase foreign borrowing. Such processes took place in Argentina in the past couple of years when the foreign debt increased by over 60%. In fact, for this reason the CBA is not recommended for countries with a low share of foreign trade in GDP.

As it can be seen in Table 3.1, the net foreign assets of the Bulgarian economy grow at a higher rate compared to the net domestic assets. This means that the increase in the foreign exchange reserves and the money supply respectively, is more rapid compared to the domestic demand for money for transactional purposes. This is reflected in delayed rate of increase in the domestic credit and a preference on the side of commercial banks to re-deposit abroad deposits which are mobilised locally. This trend is definitely not favourable, but at the same time, its effect is opposite to the “limited money supply” effect.

3.3. Stability of the Banking System

Liquidity and Interest Rates at the Money Market

The liquidity of the banking system, measured by the dynamics of the excess reserves, displayed normal cyclic changes throughout the year (Figure 3.3). Interest rates moved in line with the relatively stable levels of bank reserves. Interest rate fluctuations (measured on a monthly basis) were not significant. Most often, they were kept at the level of 4% to 5% – these levels are compatible with the move of the base interest rate. The fluctuations of reserves and interest rates measured on a daily basis were better pronounced.

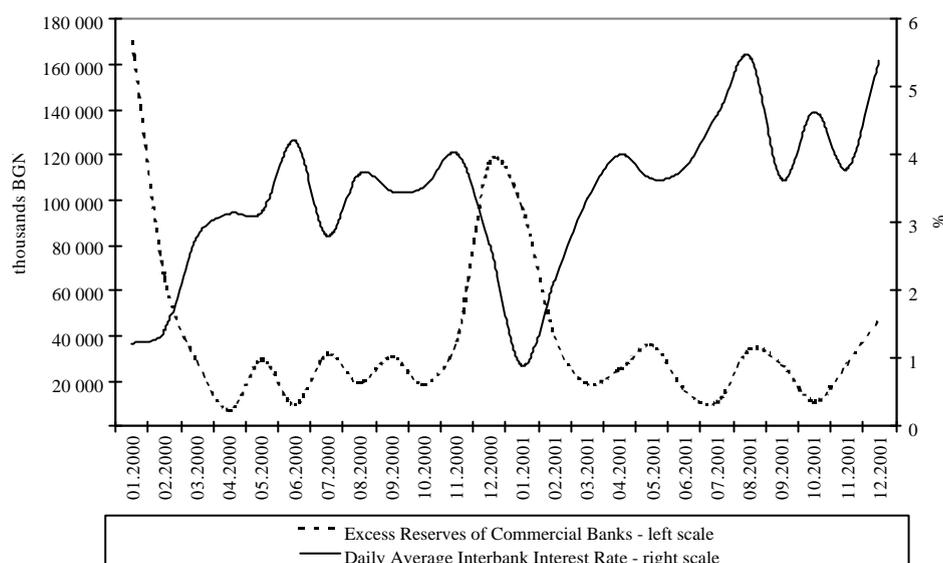
Figure 3.4 reveals that two times during 2001, the interbank interest rate increased dramatically compared to its normal levels and almost reached 20%.

The banking system remained stable throughout the year and recorded high profits. The short-term liquidity problems of some of the commercial banks were quickly resolved.

¹ In compliance with the Law for BNB foreign exchange assets cover all monetary liabilities including the government’s deposit in the liability side of the Issuing Department balance.

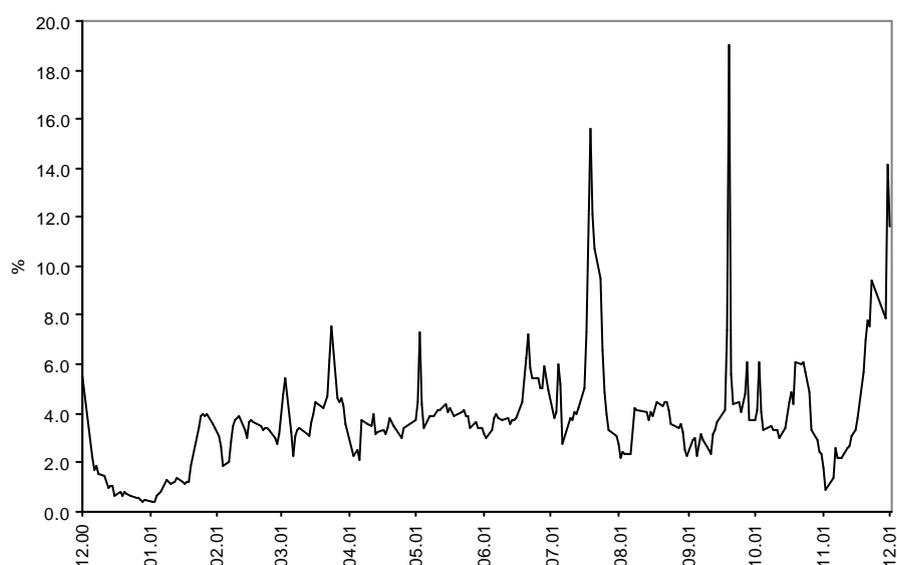
These “mini-crises” can be explained with purely subjective errors when taking decisions on how to manage liquidity at bank level and with the still very high dependency of commercial banks on the financial flows to and from the state budget. Under the CBA, the central bank does not dispose of an instrument for short-term lending to commercial banks (the so-called standing facilities). As a result, the money market transactions are the main short-term liquidity management tool. The liquidity problems also follow from the banks’ drive towards credit activity expansion. Thus, fewer resources remain in the form of excess reserves on the commercial bank accounts with the BNB. The deficiencies of the money market are demonstrated also through the wide range of interest rate fluctuations within short-term periods, even within one working day.

Figure 3.3. *Excess Reserves and Interest Rates*



Source: Bulgarian National Bank.

Figure 3.4. *Inter-Bank Money Market – Daily Data*

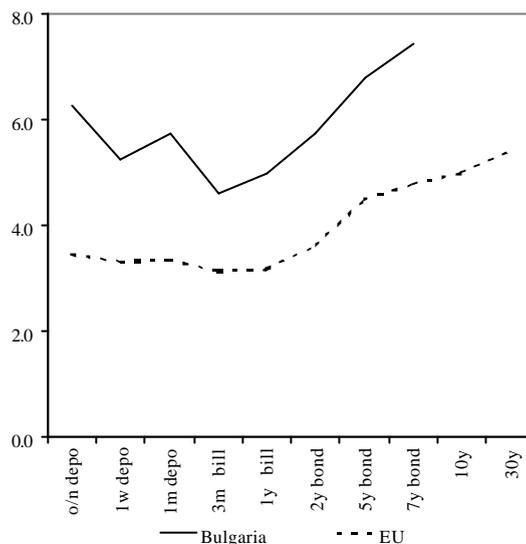


Source: Bulgarian National Bank.

In order to facilitate commercial bank liquidity management, as of 11 November 2001 BNB allowed execution of sale/purchases transactions with reserve currency in the same working day. The outcomes of this measure are positive – after its introduction, the interbank money market did not experience sharp fluctuations in the traded volumes and the interest rates.

The narrowing of the yield curves for Bulgaria and the Eurozone continued throughout 2001 (Figure 3.5). Despite the gap in nominal levels estimated at 150–200 base points depending on maturity, there is an evident approximation trend, most strongly expressed at the longer-term end of the curve.

Figure 3.5. Yield Curve for Bulgaria and the Eurozone

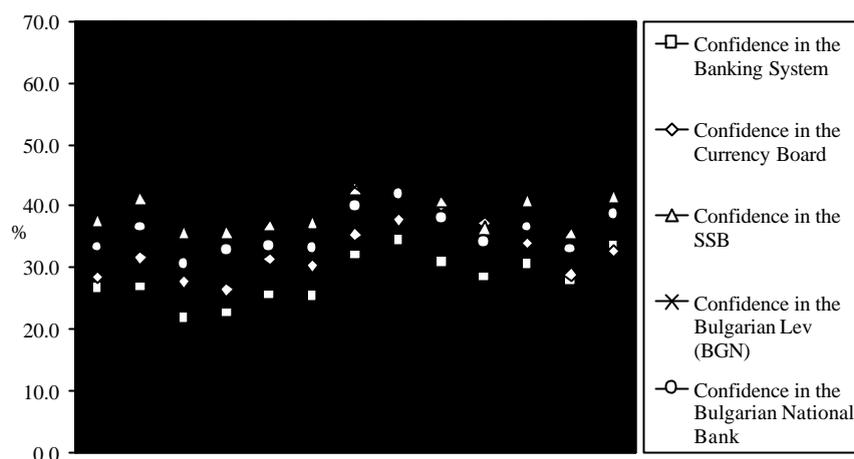


Source: Bulgarian National Bank, European Central Bank.

Confidence in the Financial System

The overall confidence in the financial system grew during the past year and remained closely determined by political considerations.

The trust in all monitored financial institutions grew in 2001, and for all of them the confidence levels reached at the end of 2001 were higher compared to the ratings registered at the end of 2000 (Figure 3.6). In the middle of the year the record high levels of trust were reached, while in July and August 2001, for the first time in the record of the EW surveys, all monitored institutions displayed a positive rating.

Figure 3.6. Confidence in the Financial System

Source: BBSS Gallup Monthly Surveys.

Despite the public hesitance, which was at times substantial, several general trends could be outlined:

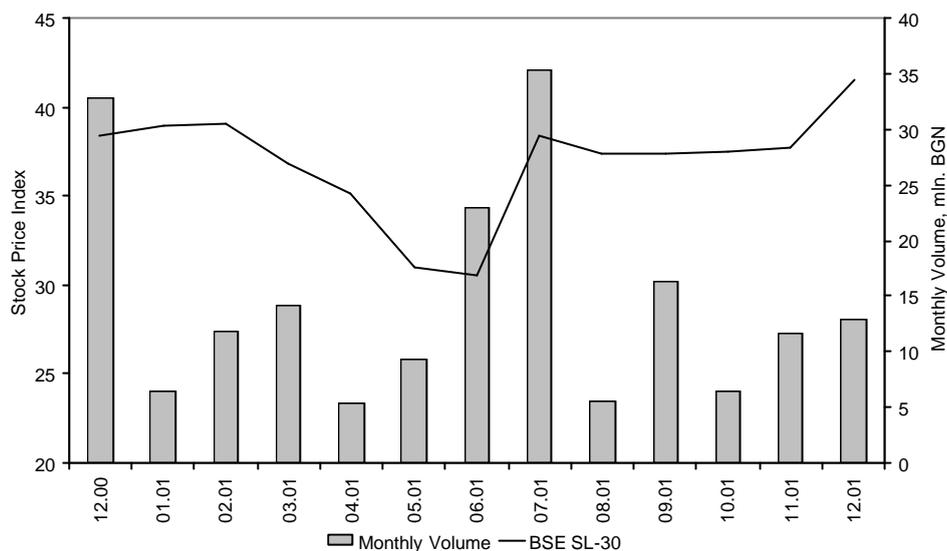
- ✎ In the second half of the year, the confidence in the national currency became the strongest, replacing DSK Bank, the institution that traditionally enjoyed the highest rating, from its leading position. As far as the growing confidence in the national currency is in line with the trust in the Central Bank, this is further proof for the enhanced financial stabilisation in the country. Another possible explanation is related to the waiver of the state guarantees for the citizens' deposits with DSK Bank, which deprived it from its special status of "population's bank" and converted it in a regular participant in the banking services market.
- ✎ As a whole, the level of confidence in the banking system remains low. Only in the summer months of July and August 2001 was the rating positive. As long as the population has no capacity to distinguish between the state of the banking sector and the overall economic performance and trends, these ratings can be regarded as indicative of the assessment of the overall economic policy. To some extent, the low nominal rating levels for the banking system are influenced by the memories of the previous banking crisis and the closure of 16 commercial banks.
- ✎ Data shows that all monitored indicators of confidence change in the same line. One of the explanations is that the respondents are not in the position to clearly identify the different institutions. The other one is most probably related with the association of the monitored indicators with both economic and political developments in the country. The rapid growth of confidence immediately before and after the parliamentary election could hardly be qualified as a random event. At that point, it was clear that a new political force will come into power and this was associated with hopes for the future. This also explains the decline in the level of trust that followed in the autumn, without other underlying reasons.
- ✎ If the outlined hypothesis is true, one can expect negative trends in the dynamics of public trust in the financial institutions in the first months of 2002. This will follow the introduction of higher communal fees, patent taxes, VAT on the medicines and higher prices of electricity and district heating.

3.4. Capital Market

The average daily traded volumes of stocks increased marginally, but remained low. The price indexes displayed high volatility and an overall

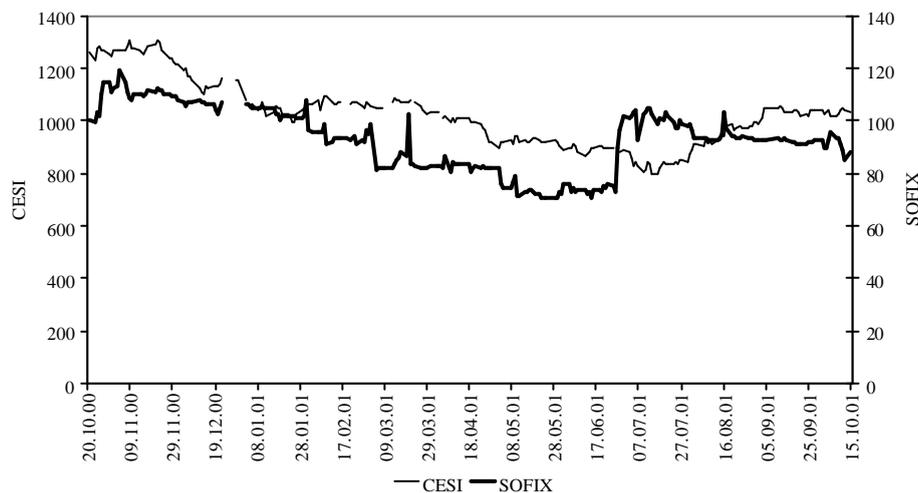
In 2001, the stock market again failed to start playing an economic role. The market capitalisation of the listed companies is low (around 1% of GDP) while the prices of the traded stocks fluctuate broadly depending on the transaction volumes (Figure 3.7). The economic agents regard the stock exchange as an “exotic market” for speculative deals, but not as a serious instrument for business project financing.

Figure 3.7. Monthly Volumes of the Traded Stock and Stock Price Index



Source: Bulgarian Stock Exchange.

Figure 3.8. Stock Price Indexes for SOFIX and CESI



Source: Bulgarian Stock Exchange.

In 2001, the cautious and even negative attitude towards stock transactions was not overcome. For the time being the banking sector remains as the only funding source. Despite the fact that average daily trading increased by 22% (from BGN 518,000 to BGN 633,000), the traded volumes are still so low that they can hardly sustain the operational costs of the Bulgarian Stock Exchange. The expectations for expansion of the stock trade and for increased confidence in it because of the BDR issues did not materialise.

Certain market expansion can be expected after the announcement of the government's plans to privatise 80% of Bulgartabac Holding, instead of selling separately each of its 27 subsidiary companies. At this point, the state controls over 93% of Bulgartabac. Private companies and individuals own the remainder. At the Balkan regional economic forum, held in Sofia in November 2001, plans were announced for listing between 15% and 30% of the shares of 15 big Bulgarian state owned enterprises. This is conditional to changes in the Public Offering Act. Along with Bulgartabac Holding, companies nominated for listing include the Bulgarian Telecommunication Company (BTC), the Black Sea and Danube Marine, DSK Bank and several companies from the energy sector.

One of the important events in 2001 was the signing on 9 April 2001 of the Memorandum of Understanding and Cooperation in the area of stock trade between the Bulgarian Stock Exchange – Sofia and the Athens Stock Exchange. The Memorandum aimed at enhancing the efforts of the stock market participants towards harmonisation of the domestic rules with those of the EC and at improving the investment climate in South Eastern Europe.

3.5. Fiscal Sector

The official release of the 2001 state budget data is delayed, but it is already known that the actual deficit will be lower than the one envisaged in the 2001 State Budget Act. The budget for 2002 will

In mid-February 2002 final official data on the 2001 state budget execution is still unavailable. It is expected that the deficits planned in the republican budget and the consolidated fiscal program will not be achieved (Table 3.2).

In 2001, as in previous years, the fiscal sector continued to be one of the pillars of the financial stability in the country. Despite the pre-election expansion of the government's investment program by BGN 300 million and the municipal budget deficits, the State Budget Act was applied strictly due to increased budget revenues and highly restrictive budget expenditures in the last quarter of the year. Mostly under the IMF pressure, the new government was forced to undertake a range of unpopular measures, to drop some of its investment projects and to renounce the pre-election promises for "immediate and non-symbolic" increases in incomes, especially of pensions. In this way, the financial stability was retained, but the paid social price led to rapid decline in the confidence in the executive branch.

Table 3.2. State Budget Execution

	2000	March 2001	June 2001	Sept. 2001	Oct. 2001	Nov. 2001	State Budget Law – 2001			State Budget Law – 2002	
							BGN mln	% of GDP	Execution	BGN mln	% of GDP
Republican Budget (BGN mln – Accumulated)											
Revenues	6 018.7	1 550.6	3 358.3	4764.9	5322.4	5 816.6	6 276.5	22.2	92.7%	6 981.9	22.7
Expenditures	6 205.2	1 774.1	3 524.7	5323.9	5732.0	6 225.0	7 133.4	25.3	87.3%	7 528.1	24.5
Balance	-186.5	-223.5	-166.5	-559.1	-409.6	- 408.3	-856.9	-3.0	47.7%	-546.2	-1.8
Consolidated Fiscal Program (BGN mln – Accumulated)											
Revenues	11 062.0	2775.9	6 062.1	8 711.3	9 708.8	10 617.7	11 427.0	40.5	92.9%	12 462.2	40.5
Expenditures	11 330.6	2897.2	5 895.1	8 854.8	9 709.1	10 620.7	11 850.7	42.0	89.6%	12 719.4	41.3
Balance	-268.6	-121.3	167.0	-143.5	-0.3	-3.0	-423.7	-1.5	0.7%	-257.2	-0.8

Source: Ministry of Finance.

There are signs of social unrest following the introduction of unpopular fiscal measures.

In the course of the negotiation of the new agreement with the IMF, and under the pressure of the mounting current account deficit, the government gave up a number of tax concessions widely announced in the election campaign. The only

step that has a tangible effect remained the reduction and unification of corporate taxes, while the new personal income taxation scale would have a most visible positive impact on the individuals with the highest incomes. In parallel the VAT was introduced on medicines and tourist services, and patent taxes, local taxes and fees were increased.

Excise duties increased substantially, especially those levied on tobacco, and as a result, the general perception emerged that the population would pay more instead of enjoying the promised tax concessions. The administrative increase of the prices of electricity, district heating and telephone services add to the reasons for social unrest. Social tensions were not determined solely by economic factors as Bulgarians have had a more difficult life in previous periods, but by not thoroughly thought out pre-election promises, which made a big part of the population feel let down again.

The measures taken by the cabinet definitely have sound economic rationale and comply with the international fiscal policy standards. A significant part of the unpopular policy measures were introduced as preliminary performance benchmarks for the signing of the new Standby Agreement with the IMF. The latter will open the access to World Bank financing, which could reach up to USD 750 million in the next 3 years.

As far as the 2002 budget is concerned, it does not depart substantially from the approach, structure and nominal figures of the budget for the previous year. In its aggregated format the main income and expenditure line items are more or less the same as GDP share. This means that the redistribution role of the state and its dominant position in the economy will remain similar in 2002.

3.6. Balance of Payments and Foreign Trade

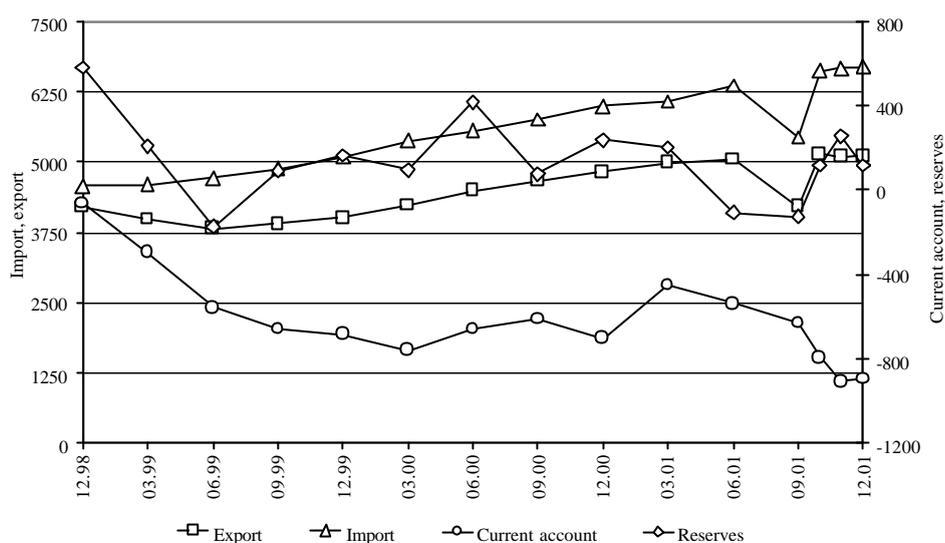
The foreign trade and current account deficits increased. Foreign exchange reserves grew because of the Eurobond issue and guarantee stock buy-backs.

The current account continued to deteriorate throughout 2001 and the deficit reached USD 900 million or 6% of GDP. This is attributed mainly to the persisting deterioration of the foreign trade account and the negative net yield which could be only partially counterbalanced by the growing positive services balance and net current transfers (Figure 3.9).

After the successful summer tourist season, the foreign trade deficit could not be counterbalanced as effectively. This increased the current account deficit. The expenditures for dividend payments to foreign investors grew as well, the main reason for that being the high share of foreign investments in the Bulgarian banking system.

For the time being, the unfavourable developments of the current account do not inflict foreign exchange reserve losses because the capital account makes up for the gap. The positive capital account is determined by a number of factors:

- ✍ Shrinkage of the deposits of domestic commercial banks with foreign financial institutions following the decreasing export revenues and the increased import payments, as well as the world-wide decline of interest rates;
- ✍ Expansion of the foreign currency deposits of the population with domestic commercial banks following the increased confidence in the banking system and the ongoing withdrawal from circulation of the individual currencies of the European Monetary Union member countries;
- ✍ Substantial increase in the investments of non-residents in Bulgarian debt instruments subsequent to the first Eurobond issue.

Figure 3.9. Main Components of the Balance of Payments

Source: Bulgarian National Bank, preliminary information.

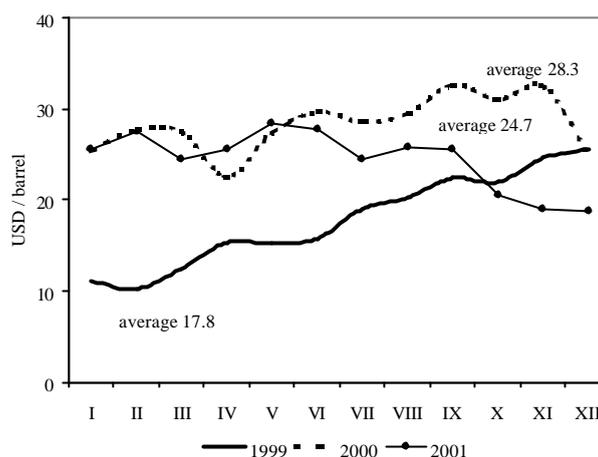
The direct foreign investments are considerably lower compared to 2000 and compared to the target values of the macroeconomic framework for 2001. This could be attributed to the high basis for comparison¹ and to the delay and even failure to accomplish some of the big privatisation deals (BTC, Bulgartabac, Biochim Bank) due to the parliamentary elections in the country. Direct investments would have been even lower in case of failure with licensing the second GSM operator where the sales amount reached USD 130 million².

The overall balance of payments was positive at the end of 2001, which came as a result of the Eurobond issue, and the increased foreign currency purchases by BNB related to the launch of the euro. The buy-backs of DISC Brady bonds in September and their subsequent cancellation allowed the sales of the immobilised collateral. This also contributed to increasing the foreign exchange reserves of the central bank. According to the forecasts of the leading investment banks, the global industrial output continues to decline and the recession is spreading over almost all markets. It affects even countries which do not rely on foreign trade as an economic growth factor.

In the last quarter of 2001, the world crude oil prices were stabilised in the price corridor of USD 17–21 per barrel (Figure 3.10), or under the upper end of USD 22 per barrel, which the OPEC countries have established as their target market price. Because of the growing fears of preserving the low crude oil prices and the weak demand for crude oil, OPEC countries started negotiating an agreement to cut down crude oil extraction worldwide by 1.5 billion barrels per day. The agreement was enforced as of 1 January 2002. The desired price rise will probably come into effect only in the second half of the year in parallel with the recovery of the world economic growth. This gives grounds to believe that a new inflationary pressure caused by the rising energy prices and similar to the one experienced in Bulgaria in 2000 is not very likely.

¹ In 2000, privatisation proceeds were substantial due to the sale of Bulbank.

² In the beginning, these proceeds were accounted for in the current account as revenues from services, but in September 2001, the accounting methodology was changed and they were transferred to the direct investments category.

Figure 3.10. World Prices of Crude Oil (Brent)

Source: World Bank.

3.7. Conclusions, Short Term Trends and Forecasts

- ✎ The past year will be remembered as the year of the elections. The economy did not experience fundamental transformations. The macroeconomic stability and the moderately high economic growth continued despite the deteriorating world economic conditions. The year did not feature execution of big privatisation deals with substantive economic impact. The political change has not affected the business activity for the time being. The credit rating of the country was upgraded and this facilitated the debut Eurobond issue.
- ✎ During the last three quarters, the world economic conditions deteriorated. The effects of the global recession quickly spilled over all countries and regions through the international trade channels. The rapid increase in insecurity following the September 11 terrorist attacks against the USA undermined consumer confidence and caused a collapse of consumer demand. Nonetheless, in December 2001 the first signals of revival of the industrial production emerged, mainly in the information technology domain. This means that the world economy will start overcoming the recession as early as the first quarter of 2002.
- ✎ The expectations for 2002 are moderately optimistic. Under the conditions of worldwide stagnation, economic growth strategies should not rely only on external factors. Bulgaria is in a position to revert to economic growth registering lower growth rate compared to the previous years at the expense of domestic growth sources, and mainly because of the growth of investment demand.
- ✎ The restrictive budget does not encourage inflation pressures initiated by increased government spending. Under the CBA, the money supply is determined by the foreign exchange reserves and this excludes monetary effects on price levels. As far as no changes of prices of structural importance (crude oil, metals, chemicals) are expected, in 2002 the inflation will be determined by the changes of the prices determined in an administrative way and by the long-term processes of re-alignment of domestic prices to the EU price levels. This follows from the use of the euro as a reserve currency.
- ✎ Financial stability will continue to be one of the distinctive features of the economy and will determine the macroeconomic stability. Following the forthcoming privatisation of Biochim Bank, the banking sector will become

entirely dominated by foreign banks, which will own close to 90% of the banking system assets.

- ✎ One of the most widely disputed events in the end of 2001 was the financial crisis in Argentina. The economy of Argentina collapsed mainly due to wrong fiscal policy, corruption and inconsistencies in the CBA design. Argentina's example confirmed that economic liberalisation is a precondition for the smooth functioning of the fixed exchange rate regime and of the CBA. Argentina's case is indicative of the mistakes that need to be avoided when managing an economy under a currency board regime.

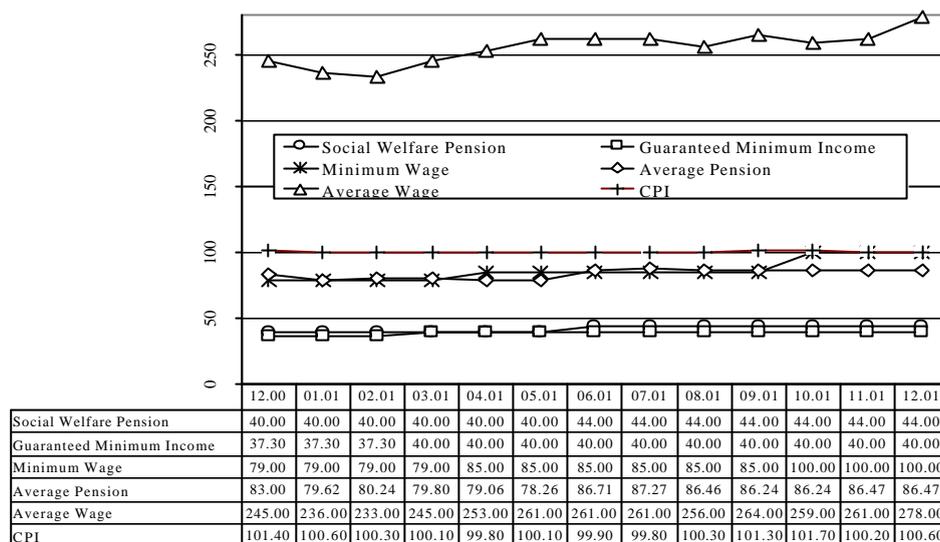
4. INCOMES AND SOCIAL SECURITY POLICY

4.1. Development of Personal Nominal Incomes

The moderate development of nominal incomes was in conformity with the previously announced government policy and followed the established trends.

Nominal Income Development. Figure 4.1 below illustrates the major features characterising the development of nominal incomes in the period January–December 2001:

Figure 4.1. Development of Nominal Personal Incomes (December 2000 – December 2001)



Source: Ministry of Labour and Social Policy. Since the beginning of 2001, the National Statistical Institute has begun providing monthly data on average wages (for the country and by sectors and sub-sectors) at the end of every quarter, rather than on a monthly basis as the practice was until the end of 2000.

The development of nominal incomes can be characterised in the following ways:

First, in comparison with December 2000, all incomes under observation have risen. Unlike 2000, however, when the average pension marked the biggest increase (1.19 times), followed by the minimum wage (1.18 times), in 2001 it was the minimum wage with the biggest increase (1.27 times), followed by the social welfare pension (1.1 times), and the guaranteed minimum income (GMI) for social assistance (1.07 times).

Second, The level of the GMI was modified for the first time after January 1999. Given the considerable time span, the increase could have hardly restored, and even less, improved the level of social safety and protection for the poor individuals and families.

Third, what is observed is a lack of synchronisation or rather a lag both in time and “phase” with which the minimum (or so-called “protected”) incomes were increased. Thus for instance, the GMI level was increased in March 2001, and the minimum wage – in April and October respectively. The levels of all pensions were updated in June. After difficult negotiations with the IMF, the new cabinet managed to increase the minimum wage, which was envisaged by the previous government. Thus the level of the minimum wage as of the fall of 2001 reached BGN 100.

In this way the development of nominal personal incomes retained its step-like nature, which was observed in previous years as well. The lack of synchroni-

sation (in the two above-mentioned aspects), however, distorts the coordination of income.

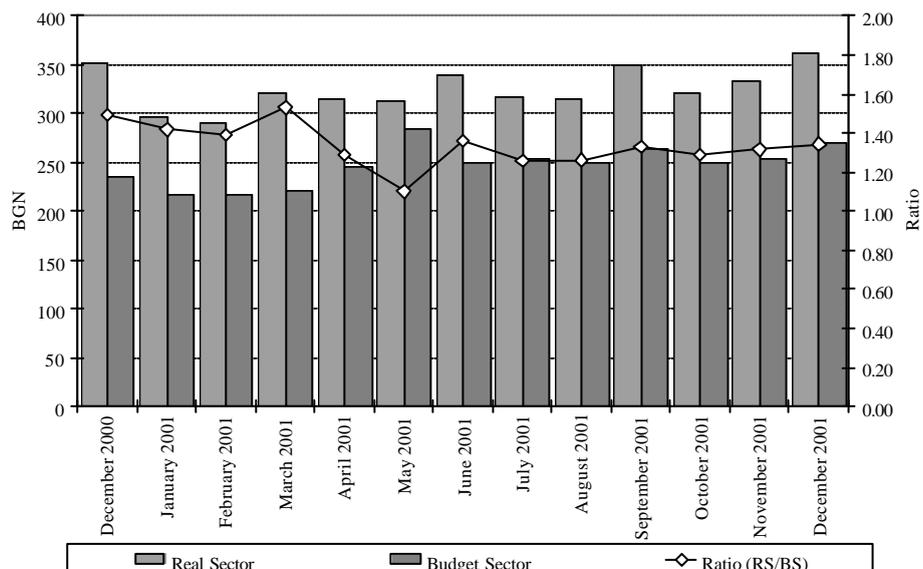
Fourth, unlike in the previous year, government agencies limited the use of one-off additional payments as a tool providing anti-inflationary protection to incomes. At the end of 2001, only pensioners received an additional flat Christmas disbursement of BGN 25. The budget sector employees did not get an additional 13th salary. This fact had a negative impact not only on the amount of households' disposable income, but also lowered the envisaged revenues of the National Social Security Institute.

Fifth, as in 2000, the increase of nominal personal incomes in 2001 served a dual purpose: to serve as an anti-inflationary tool, and with respect to wages in particular, to make up for the decline of net incomes, which followed from the growth of individual social security contributions (Table 4.1). The increase of the minimum wage and the budget sector wages, however, was incapable to compensate sufficiently the combined impact of inflation and the growth of the individual social security burden.

Sixth, the development of average wages preserved the quarterly cyclical pattern, which has been observed over the past few years, where the peak at the end of the quarter is followed by a decline, usually during the first month of each quarter. The following factors underlie these fluctuations: the unstable labour productivity and seasonal factors, such as hiring in the summer of lower-skilled and worse-paid labour force in the sectors of construction, agriculture, forestry, and tourism. At the same time what stands out in the development of average wages is their slight increase in comparison with 2000.

Seventh, budget sector wages continue to lag significantly behind real sector wages (Figure 4.2). This means that the problem with “closing the gap” between the levels of remuneration in these two sectors of the economy will continue to be a challenge for the income policy of the government.

Figure 4.2. Real and Budget Sector Average Wages: Levels and Ratios (September 2000 – September 2001)



Source: Ministry of Labour and Social Policy.

Disturbing signals about the level of Bulgarian household incomes were observed.

Eighth, the data from the Survey of Household Budgets for November 2001 contain disturbing signals including: (a) the decrease of the overall household in-

come down to BGN 340.76 in comparison with BGN 349.16 a year earlier; and (b) a slight decline of the average level of pecuniary income per household, from BGN 301.45 to BGN 301.14. These signals indicate that the income policy of the government did not improve the income status of Bulgarian households. The retention of these processes would act as a factor for deterioration of the standard of living of Bulgarian households.

Unfavourable trends have been observed on the expenditure side of household budgets as well:

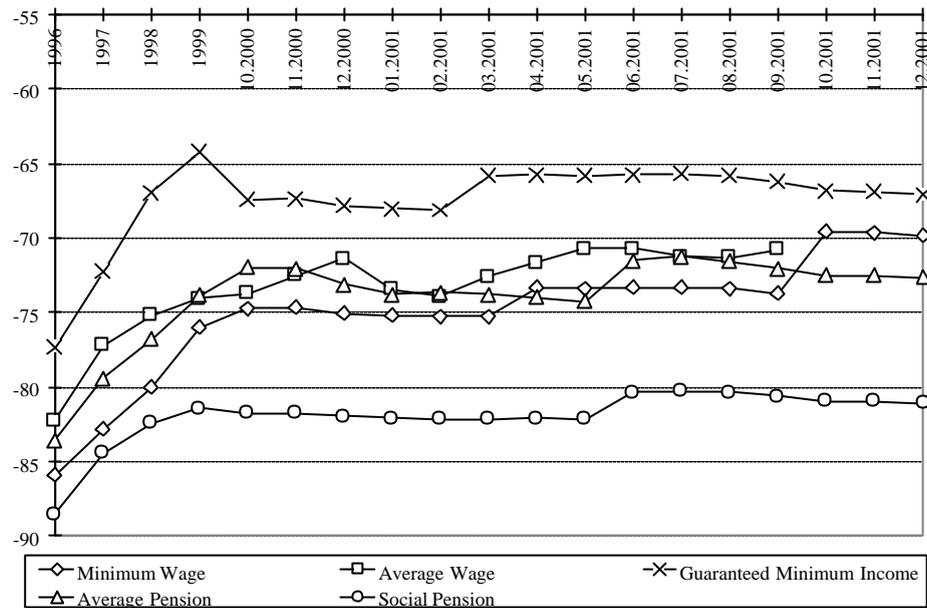
- ⌘ The share of food expenditures throughout 2001 has remained relatively high – between 41% in January and 46% in July;
- ⌘ The structure of this side of household budgets marks instability during the various months and seasons of the year. The summer structure of expenditures reflects the preparation of some households to survive the winter months (expenditures related to home made food and personal farm plots increase, and so do expenditures on consumption of fresh fruits and vegetables). The autumn structure of expenditures reflects the beginning of the school year with increased expenditures on both clothing and footwear and on education-related goods. This increase, however, is at the expense of shrinking food expenditures. The winter structure of expenditures is marked by an increase of heating costs (up to 15–17%, in comparison with 11% in the summer season) and these expenditures are made again at the expense of shrinking consumption of food, clothing, and footwear.

The conclusion is that, given the low level of their incomes, Bulgarian households are compelled to starve out each and every strain in their budgets, which stems from various seasonal factors: heating, the beginning of the school year, higher healthcare costs in winter, etc. It can be presumed that the new increases of electricity and heating bills, of telephone calls and medication, of certain fees and direct taxes levied on the population (mainly property taxes) will have an additional detrimental impact on household consumption and expenditures in 2002.

Real incomes increased symbolically.

Development of Real Incomes. At the end of 2001, the real levels of the majority of incomes under observation rose in comparison with the end of 2000 (Figure 4.3). The improvement, however, was symbolic, because the level of incomes in real terms at the end of December 2001 still remained far behind that at the beginning of the 1990s: minus 70% for the minimum wage (compared to minus 75% at the end of 2000), minus 81% for the social welfare pension (compared to minus 82% at the end of 2000), minus 67% for the guaranteed minimum income (compared to minus 68% at the end of 2000). This situation, which has been characteristic for the past few years, is only an additional argument in favour of the above made conclusion about the effectiveness of income policy pursued by Bulgarian governments.

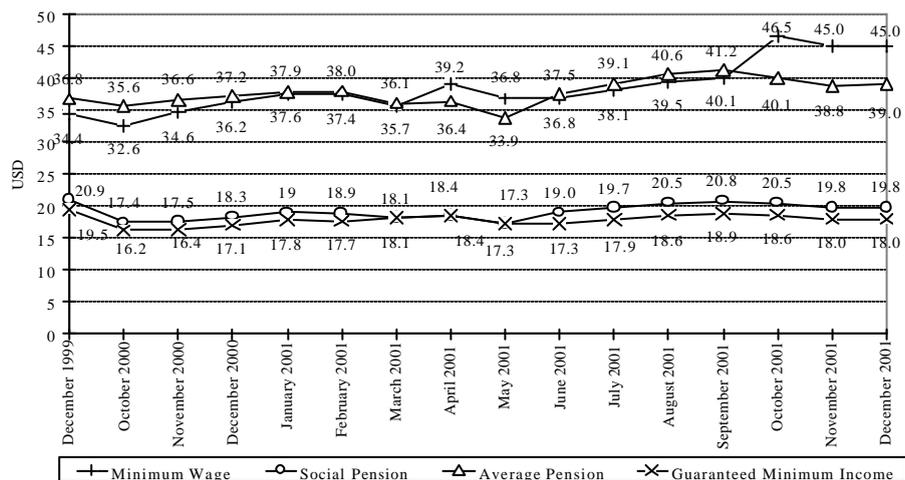
Figure 4.3. Real Personal Incomes Dynamics for the Period 1996 – December 2001 (the End of 1990 Equals 100 in Percentage Terms)



Source: Ministry of Labour and Social Policy.

As in 2000, the monthly fluctuations of the US dollar equivalent of the major types of incomes can be characterised as moderate (Figure 4.4). Given the relatively stable exchange rate of the Bulgarian currency to the US dollar, changes almost entirely depend on the development of nominal personal incomes. The preservation of the status quo in this respect reproduces the low level of the US dollar equivalent of minimum incomes that has existed for years.

Figure 4.4. US Dollar Equivalent of the Major Types of Incomes (December 1999 – January 2002)



Source: Ministry of Labour and Social Policy.

Income policy in 2002 will be cautious.

The average wage for the country in 2002 is expected to mark a nominal growth of approximately 9%, and a real growth of approximately 4.5%. The increase of budget sector wages envisaged by the government budget for 2002 will be in two steps of 5% (as of 1 January 2002 and as of 1 of July 2002). This increase, however, is not likely to resolve the issue of the differences in the level of

pay in the real and budget sectors. No rise of the minimum wage has been envisaged, which is likely to be consequently adjusted in compliance with the changes in the average pay in the budget sector. The caution towards income development in 2002 does not give rise to expectations for major improvements in the income status of Bulgarian households.

In the medium run, the major objective of the Government Programme in the area of incomes for the period up to 2005 is for incomes to be raised with a view to the integration of the country with the European Union on the basis of attaining sustainable economic growth and low inflation. In the business or real sector, the government envisages pursuing an income policy in line with the changes in labour productivity. In the budget sector, it will strive to tie the rise of real incomes with the rate of economic growth. In this way, the rise of incomes and their purchasing power is based on economic factors and is logically bound with the extent and direction of their impact. A positive fact is the intention to create a reliable mechanism, which will guarantee the disbursement of all due wages by the end of 2002, as this issue has not found a stable solution so far. A shortcoming of this part of the Programme is the lack of explicit attention to the need for closing the gap between the levels of pay in the real and budget sectors, and this is a problem that has been repeatedly subject to discussion in the Early Warning Reports. From the point of view of the necessary funds in this connection, and from a psychological point of view, serious arguments can be put forth against the declared intention to introduce an official poverty line in the country. At the same time, however, the tasks and actions, which make the abatement of poverty one of the major priorities of the government, should be assessed as positive, timely, and very necessary.

4.2. Effectiveness of the Social Security System

The reform of the pension system continues.

In 2001, several major changes took place in the legislation concerning the social sphere. The results of these changes have marked the further stages in the ongoing reform of the social security system:

- ✍ The retirement age increased by six months and became respectively age 61 for men and age 56 for women. The total sum of the respective person's age and the years of socially insured employment (or the so-called "points"), which makes one eligible to an old-age pension rose from 98 to 99 for men and from 78 to 88 for women.
- ✍ In June 2001, pensions were increased by an average of 10%. Thus, at the end of the year, the average pension amounted to BGN 87, the minimum social welfare pension – to BGN 44, and the maximum pension – to BGN 176.
- ✍ The number of the socially secured persons declined from 2,306,259 in 2000, to 2,193,887 in 2001. The major reason is the growth of the unemployment rate, which in the winter months of 2001 exceeded 18%. A positive development, on the background of the existing high unemployment, was the increased number of free-lance and independent workers, who made social security contributions on their own for all social security risks (without on-the-job occupational accidents), up from 77,548 to 92,286. To some extent this indicates a certain change in the social security behaviour of the Bulgarian work force.
- ✍ The number of pensioners marked a slight decline from 2,375,149 in 2000 to 2,370,797 in 2001. The average number of pensions rose from 2,503,773 in 2000 to 2,567,310 in 2002. This is mainly due to the increased number of second, third, and fourth social welfare pensions for the disabled.

Table 4.1. *Changes in the Social Security Burden After the Enforcement of the Mandatory Social Security Code as of January 1st 2000 in Percentage Terms*

Social Security Contributions:	Up to 31.12.1999		From 01.01.2000		From 01.01.2002	
	Employer	Employee	Employer	Employee	Employer	Employee
Social Security						
1 st category labour	49.7	1.0	43.7	7.0	39.7	8.0
2 nd category labour	44.7	1.0	38.7	7.0	34.7	8.0
3 rd category labour	34.7	1.0	28.7	7.0	24.7	8.0
National Health Insurance Fund (NHIF)						
1 st and 2 nd category labour	–	3.0	4.8	1.2	4.5	1.5
3 rd category labour	3.0	3.0	4.8	1.2	4.5	1.5
Vocational Training and Unemployment Fund (VTUF)					Unemployment Fund	
All categories of labour	3.5	0.5	3.2	0.8	3.0	1.0
Total Social Security Burden						
1 st category labour	53.2	4.5	51.7	9.0	47.2	10.5
2 nd category labour	48.2	4.5	46.7	9.0	42.2	10.5
3 rd category labour	41.2	4.5	36.7	9.0	32.2	10.5

Source: Based on previous and current social legislation.

Forthcoming changes in 2002. The envisaged changes are in line with the strategy for the pension reform adopted in 1999. The more important among them can be summarised in the following way:

First, since the beginning of 2002 the retirement age has increased by new six months and now stands at age 61.5 for men and age 56.5 for women. Thus, the so-called “points” (the sum of the respective person’s age and the years of socially insured employment) now stand at 100 for men and 90 for women. This measure aims at further tightening of eligibility requirements to pension rights, limiting at the same time the expenditures of the pension system. It will contribute to the expected increase of the number of socially secured persons from 2,193,887 in 2001 to 2,290,531 in 2002. The measures laid down in the Government Programme for increasing the employment rate are also expected to have an impact in the same direction.

Second, the amount of the contributions payable to the social security system for all categories of labour has been declining (Table 4.1). This together with the retained levels of contributions payable to the National Health Insurance Fund and the Unemployment Fund determines the decline of the overall social security burden in 2002 in comparison with 2001¹.

Third, the social security burden continues to be restructured. The significant rise of the share of individual social security contributions (more than two fold for three years) is accompanied by a reciprocal decrease of the social security burden borne by employers. Thus, the contribution amounts, which until the end of 2001 were shared by employers and socially secured persons in a ratio of 80:20, since 1 January 2002 are shared in a ratio of 75:25. The scheme mapping out the increase of individual contributions envisages equal sharing between employers and employees (50:50) not later than 2007.

¹ The increase of the overall social security burden for persons working in the conditions of 1st and 2nd category of labour in the year 2002 is due to the introduction of 3% contributions for their statutory insurance at the National Health Insurance Fund at the expense of employers.

The last two changes are an important factor determining the cost of the labour force by which Bulgarian authorities aspire to limit the scope of the shadow economy, in line with all other measures undertaken in this respect.

Fourth, until the end of 2001 the amount of social security income was determined within the limits between 2 and 10 minimum wages. Since the beginning of 2002, the range of the social security income has been freed from this dependence and Parliament will determine its absolute amount on an annual basis. For 2002 it will range between BGN 170 and BGN 850.

The purpose of this change is to ensure a higher degree of flexibility in the elaboration and enforcement of policies in the area of social security and minimum incomes. The presence of a ceiling of the social security income aims at releasing incomes (i.e. financial resources) for the development of the third pillar of the social security system (the voluntary social security insurance). On the other hand, however, this approach makes the less skilled and worse paid labour force more expensive for employers, thus increasing the relative competitive advantage of highly skilled and better-paid professionals in the labour market. The ceiling of the social security income will also automatically restrict the maximum possible level of pensions and will act as a tool controlling the expenditures of the social security system.

Fifth, the most significant change in the area of mandatory social security (the so-called first and second pillars) is the differentiation of the social security contributions (only!) for people born before 31 December 31 1959 and those born after that date. The differentiation stems from the introduction of a different regime for statutory additional social security in universal pension funds for the people belonging to the two age brackets, according to which only those born after 1 January 1960 are subject to additional statutory social security (Table 4.2).

Thus, the beginning of 2002 marked the introduction of all the elements of the new pension system in Bulgaria in their entirety, based on the concept of the three pillars (mandatory social security, additional statutory social security, and voluntary social security). Its design separates and combines at the same time in a better way the functions of the social security system, which are connected with the distribution and redistribution of incomes, and the incentives for saving and investment.

For the first time the social security legislation in Bulgaria makes it possible from 2002 on to recognise longer socially secured employment for people who have worked simultaneously a full-time job and on an additional job contract or who have been paying social security contributions on their own. Upon retirement, a four-year length of service will be counted for five years of 3d category labour during the time in which a person has worked a full-time job on a labour contract and simultaneously: (a) has worked on an additional or a part-time second labour contract, the work time duration of which is not less than 3 hours daily; (b) has worked as a sole proprietor, owner or partner in a business enterprise; (c) has worked on a free-lance basis or as an independent worker, (e.g. artisan).

In addition, the National Social Security Institute announced its intention to raise all pensions by 6% as of 1 June 2002. Thus, the social welfare pension will become BGN 46.64, and the maximum pension – BGN 186.56. The average monthly pension is expected to reach BGN 100.62. This amount will be 49% of the forecast net social security income for 2002, having in mind that this percentage was 47% for 2001. In other words, the coefficient of replacement will maintain a growth tendency. In this way, the real growth of pensions will be 5.9%,

In 2002, nominal and real growth of pensions is envisaged.

given the fact that the forecast average annual inflation rate for 2002 stands at 4.2%.

Table 4.2. *Changes of the Social Security Burden in the Sphere of Mandatory Social Security for the 1999–2002 Period in Percentage Terms*

	Mandatory Social Security				Additional Statutory Social Security			Total (column 4 + column 7)
	For pension	For general ailment and maternity leave	For industrial accidents and occupational diseases	Total for the Mandatory Social Security (columns 1+2+3)	For Statutory Additional Social Security Contributions to a Professional Pension Fund	For Statutory Additional Social Security Contributions to a Universal Pension Fund (for those born after January 1 st 1960)	Total for the Statutory Additional Social Security (columns 5+6)	
	Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7	Column 8
Overall Social Security Burden for a Person Secured under the Conditions of 3rd Category Labour								
1999	-	-	-	35.7	-	-	-	35.7
2000	32	3	0.7	35.7	-	-	-	35.7
2002	29 ⁽¹⁹⁵⁹⁾ 27 ⁽¹⁹⁶⁰⁾	3	0.7	32.7 ^{(1959)*} 30.7 ⁽¹⁹⁶⁰⁾	-	- 2 ⁽¹⁹⁶⁰⁾	- 2 ⁽¹⁹⁶⁰⁾	32.7
Overall Social Security Burden for a Person Secured under the Conditions of 2nd Category Labour								
1999	-	-	-	45.7	-	-	-	45.7
2000	35	3	0.7	38.7	7	-	7	45.7
2002	32 ⁽¹⁹⁵⁹⁾ 30 ⁽¹⁹⁶⁰⁾	3	0.7	35.7 ⁽¹⁹⁵⁹⁾ 33.7 ⁽¹⁹⁶⁰⁾	7	- 2 ⁽¹⁹⁶⁰⁾	7 ⁽¹⁹⁵⁹⁾ 9 ⁽¹⁹⁶⁰⁾	42.7
Overall Social Security Burden for a Person Secured under the Conditions of 1st Category Labour								
1999	-	-	-	50.7	-	-	-	50.7
2000	35	3	0.7	38.7	12	-	12	50.7
2002	32 ⁽¹⁹⁵⁹⁾ 30 ⁽¹⁹⁶⁰⁾	3	0.7	35.7 ⁽¹⁹⁵⁹⁾ 33.7 ⁽¹⁹⁶⁰⁾	12	- 2 ⁽¹⁹⁶⁰⁾	12 14 ⁽¹⁹⁶⁰⁾	47.7

* The figures in brackets mean that the data refer to the people born by the end of 1959 and after the 1st of January 1960 respectively. The lack of brackets means that the data refer to both groups of socially insured persons.

Source: Based on previous and current social legislation.

The number of pensioners in 2002 is also expected to increase by 0.3% in comparison with 2001, reaching 2,378,000. This is mainly due to pensioners, receiving disability pensions, as well as to retired military staff, which in turn leads to a higher number of pensions, because of these people's eligibility to second, third and fourth pensions according to the Mandatory Social Security Code (MSSC). The number of pensioners and pensions from the other categories will be decreasing, including pensioners eligible to old age and respective length of service pensions.

The conclusion is that the stricter conditions for gaining access to old age pensions "re-channels" a number of people to retire under the conditions of disability due to a common ailment, where the MSSC is more liberal in comparison with the previous legislation in the area of pension eligibility. These processes confirmed the preliminary expectations of the experts who took part in the preparation of the pension reform about a certain restructuring of the flows of new pensioners. A part of this restructuring is connected with additional expenditures

for the pension system, but alternatively, it helps people accept less painfully the changes introduced in the country's pension policy.

However questions arise in connection with the requirement social security contributions to be paid on the funds for social expenditures made by employers. The institutional capacity of the National Social Security Institute will probably need further re-enforcement and consolidation, in order to become fully capable of coping with the possible additional administrative obligations ensuing from the detachment of the Unemployment Fund. The envisaged growth of pensions is within the financial means of the pension system, which, however, will continue to generate deficits, which will have to be covered by a subsidy from the central republican budget. Irrespective of the envisaged growth, pensions will remain at a low level.

Welfare support is in the grips of a constant financial deficit.

The changes made thus far. On the eve of the 2001–2002 winter season, the government amended the secondary legislation governing the enforcement of the Social Assistance Act. The amendments are geared at improving the targeted energy assistance for poor individuals and families by increasing the amount of the support. The level of welfare support for the disabled, connected with their balneological treatment, free of charge telephone calls, and energy assistance, has been increased. The Ministry of Labour and Social Policy is ready to disburse energy assistance to socially deprived individuals and families based on the new higher district heating and electricity prices. The funds allocated for the current heating season will allow the government to provide monthly support to an average of 630,000 households.

At the end of 2001, the government made an additional targeted transfer of funds to municipalities. It was aimed at enabling the municipalities to disburse all unpaid social assistance benefits, accrued by the end of October 2001. The fulfilment of this commitment contributed to the financial stabilisation of this segment of the social protection system (the deficit of which amounts to BGN 45 million) and mitigated to some extent the social tension among the poorest strata of the population that had been simmering for months.

Social welfare support in 2002. The intentions of the government, expressed in its Programme, about the differentiation of social welfare support by groups of people eligible to social assistance benefits can be qualified as positive. The Programme envisages active measures for social protection and puts an emphasis on the development of social services and their decentralisation, bringing them closer to consumers as well as privatisation of these services. The analysis of this part of the Programme, however, indicates that it contains neither clearly outlined strategic objectives and priorities, nor any concrete links between the proposed aims and tasks. Other objectives contained in the Programme, such as the goal of “even distribution of institutions providing social services of various profiles on the territory of the country” seem if not unrealistic, then at least poorly formulated. All this can prove to be a factor conducive to instituting an unbalanced policy, which can lead to unfocused policy actions in the social sphere.

In 2002, another positive step towards creating a financially more stable social assistance system is the commitment of the government to secure 75% of the planned expenditures on social welfare benefits (given the fact that the percentage secured so far has been 50%). The planned expenditures, however, are well below the actual needs and in practice the system starts with an already existing deficit. The preservation of the current principles of funding of the social assistance system in the course of the current year will most probably continue to gen-

erate deficits. This is a problem, which has traditionally indicated the financial instability of the second safety net providing welfare protection.

4.3. Major Conclusions and Policy Assessment

Income Policy

- ✍ Irrespective of the mid-year change of governments in 2001, the overall income policy has been pursued so far within the framework of the preliminary intentions declared by the former government, which is a good sign of continuity. Exceptions were made in connection with the additional traditional disbursements at the end of the year of 13th salary and pension that so far were used for inflationary protection of incomes. This decision of the new government had an effect both on personal incomes and on the revenues of the National Social Security Institute.
- ✍ The traditional issues that remained unsolved in 2001 were: the overall low level of incomes, the low level of budget sector wages, the unfavourable ratio between budget and real sector wages, the inability to secure a nominal increase of incomes, which could manage to compensate: (a) the increase of the individual social security burden, and (b) the decline of real incomes, which has been accruing since the beginning of the 1990s.
- ✍ Given the low level of incomes, Bulgarian households are compelled to starve out every strain and pressure on their budgets, stemming from various seasonal factors. The higher prices of electricity and district heating, of telephone services and medicines, and the increased direct taxes will have an additional adverse impact on the consumption and expenditures of households throughout 2002.
- ✍ This is the context within which the caution announced by the government with respect to the development of incomes in 2002 (a freeze on the minimum wage, and a phased-in increase of budget sector wages) will hardly lead to any significant improvements in the income status of households. The government policy in this sphere seems to have remained subordinated to fiscal stability. The need for the design of an overall concept concerning the objectives, tasks, principles, and mechanisms of a future income policy is obvious.

Social Protection and Welfare Policy

The conclusions about the most important changes, which took place in the sphere of social security and social assistance in 2001, and the possible changes that may take place over the coming months, can be summarised as follows:

- ✍ The amendments to the pension system and the results from its functioning mark the continuation of the reform in the social security system, which is being accomplished on an ongoing basis within the framework of the strategy adopted in 1999.
- ✍ Some of the results achieved are related to the growth of the nominal and real levels of pensions, the increase of the retirement age, and the decrease of the number of pensioners. These results are geared to the financial stabilisation of the pension system in the medium and long run, and also to reinforcing the relationship between social security rights and social security contributions, alongside the improvement of the characteristics of the pension system.
- ✍ The pension system reform in 2002 continues to further restrict the access to pension rights by further increasing of the retirement age. The amounts of

social security contributions for all categories of labour will decrease, however, the individual social security burden will grow because of the lower contributions made by employers. The pension reform also envisages the start-up of the statutory social security insurance in universal pension funds for those born after 31 December 1959 as well as fixing the limits of social security contributions in absolute terms instead of pegging them to the minimum wage.

- ✍ In 2002 the development of the all elements of the new pension system in Bulgaria will continue. This includes further development of the three pillars of the pension system and balanced implementation of the principle of national solidarity. The social security burden will gradually decrease, which will have positive effects on the cost of labour, thus reducing the share of the grey economy. Besides, the system will enhance the inflow of additional capital in the economy, accumulated through the additional and voluntary social security contributions.
- ✍ One of the major problems, which the system for welfare support will be facing in 2002 as well, is its financial stability and securing the legal rights of all beneficiaries eligible to social assistance. The main reason for the persisting problem of financial instability of the social assistance system lies in the adopted funding mechanism. The way of accumulating and channelling the funds for social welfare support (currently secured at the expense of the overall tax revenues) does not correspond to the nature of social assistance claims and does not secure transparency and correct targeting of revenues. What is necessary for overcoming the contradiction between the nature of claims and the way of their funding is the introduction of targeted tax revenues meant for social assistance support only, an objective that has to be accomplished in the future.

The analysis of the development of incomes and social security policy make it possible to identify the following *potential hotbeds of social tension in 2002*:

- ✍ The remaining low level of personal incomes without sign of positive changes towards increasing the purchasing power of households is likely to lead to a decline of consumer confidence.
- ✍ The combination of low incomes and higher prices of electricity, heating, telephone services and medicines will deteriorate the structure of household expenditures and will lead to shrinking consumption, which may facilitate the emergence health hazards that are particularly detrimental for children.
- ✍ The low level of budget sector wages and their irregular disbursement could act as a strong catalyst to industrial conflicts.
- ✍ The financial instability of the social assistance system, leading to irregular disbursement of social assistance benefits, as well as the possible review of eligibility requirements to such benefits, which may restrict existing privileges, is very likely to generate “hungry protests” of those in need, particularly in the ethnic minorities. The juxtaposition of economic and social characteristics (e.g. poor and/or unemployed) with ethnic or religious features could change the dimension of such protests from socio-economic to ethnic, which may have a highly destabilising effect on regional and national level.

5. INCOMES, INCOME STRATIFICATION, AND INCOME EXPECTATIONS¹

5.1. Income Levels and Socio-Demographic Stratification of Incomes

The average monthly nominal per capita incomes for 2001 increased marginally.

The average monthly nominal per capita incomes for 2001 increased marginally (Table 5.1). In the first half of the year the stagnation trend observed in 2000 was discontinued. However, after reaching a peak level in August 2001 per capita incomes dropped back to approximately BGN 95. The main explanation for the August 2001 level is that additional bonuses were paid prior to the parliamentary election. The higher incomes in December 2001 are due to the payment of end-of-year bonuses (13th salary and a supplement to pensions). Most probably incomes for January 2002 will drop back to the BGN 95-96 level and this will be in line with the stagnation trend that started in September 2001.

The change in the average salary (excluding the last three months because official data for the last quarter is still not available) is more positive. The “slow growth” model of the average salary confirms that the economy is not evolving as fast as necessary to match public expectations and does not provide any substantial opportunities to increase substantially the purchasing power of the Bulgarian households. The level of the CPI has been relatively low during the year. The overall average (4.8%) shows that income growth is slightly higher than inflation. The result was a marginal increase of disposable incomes.

Table 5.1. Average Per Capita Income (as Reported by BBSS Respondents) and Average Salary (BGN)

	Average reported per capita income in households	Average salary	CPI
January 2000	75.1	183.4	102.0
January 2001	87.3	236.0	100.6
February 2001	86.1	233.0	100.3
March 2001	86.0	245.0	100.1
April 2001	90.6	253.0	99.8
May 2001	96.3	261.0	100.1
June 2001	96.0	261.0	99.9
July 2001	95.1	256.0	99.8
August 2001	101.6	256.0	100.3
September 2001	95.0	264.0	101.3
October 2001	94.8	259.0	101.7
November 2001	94.6	261.0	100.2
December 2001	99.5	278.0	100.6

Source: BBSS Gallup 2001–2002 monthly surveys; National Statistical Institute.

¹ The technical details related to the analysis of this section are discussed in the Glossary under the heading *Incomes, income stratification and income expectations: technical notes*. See the Annual Early Warning Report – 2000.

In 2001 the dynamics of income levels by socio-demographic groups demonstrates marginal positive change. In terms of ethnic groups, a more stable growth has been observed for Bulgarian households.

The marginal growth of incomes in real terms suggests that the overall income situation of households has been improving very slowly. Marginal improvement has not generated any notable change in living standards and spending patterns.

Overall, the dynamics of income levels by socio-demographic groups demonstrates marginal change for 2001. That is why it is difficult to identify any specific patterns of the incomes of specific social groups (Table 5.2). The more important conclusions that could be made in this respect are:

- ✍ Per capita household incomes for people in all types of residence areas have improved marginally. More stable improvement has been observed for villages, towns and cities. Incomes of Sofia households have however been fairly volatile. In the end of 2001 they are actually lower than in January 2001.
- ✍ The average per capita income of people by levels of education have also demonstrated serious month-by-month fluctuations. The highest fluctuations have been observed for people with higher educational levels. The main reason for such dynamics is that people with university education (and especially living in larger cities and the capital) rely on multiple sources of income, which tend to be irregular and unstable.
- ✍ In terms of ethnic groups, a more stable positive change has been observed for Bulgarian households. Their incomes have steadily grown from BGN 89.7 in January 2001 to BGN 106.2 in December 2001. The incomes of Roma and Turkish households have assumed a month-by-month “deterioration-improvement” model of evolution growing marginally over the whole period. Overall their incomes tend to be fairly unstable which is most probably due to unstable/temporary employment.

Table 5.2. Income Levels by Socio-Demographic Groups (BGN)¹

	Jan. 2000	Jan. 2001	Feb. 2001	March 2001	Apr. 2001	May. 2001	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001	Nov. 2001	Dec. 2001
1. Average per capita income in households by TYPE OF RESIDENCE AREA													
Village	53.01	67.60	66.30	67.60	68.80	67.90	71.00	75.50	72.30	68.60	76.80	68.50	76.80
Town	77.37	73.80	76.50	74.90	81.00	85.30	88.50	88.60	88.50	89.30	87.40	94.80	92.50
City (Regional centre)	79.57	97.30	96.20	99.00	94.70	108.30	109.30	104.50	113.50	112.60	107.30	102.30	113.50
Sofia	112.98	145.00	145.40	124.70	170.30	161.50	144.40	143.00	180.80	127.30	126.50	142.30	138.00
2. Average per capita income in households by EDUCATION													
University	134.46	120.10	141.90	137.20	152.70	175.50	148.70	138.00	171.10	140.70	143.90	155.30	139.70
Semi-higher	87.29	98.31	96.30	93.20	107.80	125.90	115.50	131.40	138.70	118.50	112.00	123.30	106.30
Secondary	81.51	90.69	93.50	93.20	96.00	99.70	104.20	102.00	104.50	101.80	102.50	99.30	107.00
Primary	57.41	64.13	68.40	63.50	67.60	63.70	70.90	71.60	72.00	71.50	70.50	69.30	77.80
Lower than primary	37.98	50.18	48.10	49.10	47.30	54.10	58.60	58.00	48.50	67.20	58.80	54.30	60.40
3. Average per capita income in households by ETHNIC GROUP													
Bulgarian	82.89	89.71	94.50	94.60	100.70	105.50	103.10	101.00	109.90	101.90	101.40	100.90	106.20
Turkish	51.06	57.69	51.90	51.90	59.20	51.70	63.30	74.30	72.40	57.10	63.60	60.90	63.70
Roma	24.69	23.74	32.60	36.70	26.00	33.60	38.80	34.30	30.00	36.30	41.80	39.20	43.70

¹ The table contains the average values and percentage breakdowns for the period from January 2001 to December 2001. For the three indicators (1, 2, and 3) the figures in each cell represent the average per capita household income for the respective social category.

Source: BBSS Gallup 2001–2002 monthly surveys.

5.2. Stratification of Incomes by Financial and Social Status of Households

The distribution of respondents along subjective income status groups has changed negatively in comparison with previous periods.

The distribution of respondents along income status groups – by self-identification (Table 5.3, indicator 1) – has changed negatively in comparison with previous periods. The aggregate trend for 2001 shows that the proportion of people identifying themselves in the “Normal” category has decreased from a level of about 29% in January 2000 to a level of about 16% in December 2001. While the “Very good” and the “Hard” categories tend to be stable, the “Just makes ends meet” category has increased from 21.1% in January 2000 reaching 34.0% in December 2001. In the context of a marginal but positive growth of incomes over the period January 2000–December 2001, this observation shows clearly that people’s expectations have grown and respectively that dissatisfaction with the pace of improvement is growing. The model “slow growth–stagnation” is no longer considered satisfactory.

Incomes by subjective financial status groups (Table 5.3, indicator 2) tend to be volatile, especially for households with higher incomes. Improvement (though marginal) is most stable for the households describing their financial status as “Hard” and “Just makes ends meet”. Quite evidently the income levels, which people associate with their financial statuses, tend to grow faster than the incomes, which households have at their disposal. This contradiction generates tension and has been an important factor for the outcome of the last parliamentary election. In view of the observed marginal change of incomes, income related tension is likely to grow and could become a serious political problem in the coming 3–4 months.

The conclusion about the mismatch of financial status perceptions and disposable household income is further confirmed by the dynamics of the indicator reflecting the relationship between income and expenditures (Table 5.3, indicator 3). The aggregate trend for all groups in 2001 shows no change. Compared to January 2000, however, this indicator shows that the group of households indicating that incomes are lower than the required expenditures has grown by approximately 5 percentage points.

Table 5.3. *Distribution of Households by Subjective Financial Status and Per Capita Household Income*

	Jan. 2000	Jan. 2001	Feb. 2001	March 2001	Apr. 2001	May. 2001	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001	Nov. 2001	Dec. 2001
1. Distribution of households by subjective financial status (%; BBSS Survey)													
Very good	0.8	0.5	0.2	0.8	0.0	0.4	0.7	0.7	0.4	0.5	0.0	0.6	0.3
Normal	29.4	22.6	18.3	21.5	18.8	20.7	21.1	19.8	22.0	22.0	20.7	20.1	15.7
Hard	48.8	47.4	46.0	43.6	47.0	42.0	42.7	46.7	47.7	47.3	61.8	46.7	50.0
Just makes ends meet	21.1	29.4	35.6	35.0	34.3	35.8	35.8	31.5	32.0	30.2	17.5	32.6	34.0
2. Average per capita household income (BGN) by levels of subjective financial status (respondent)													
Very good	192.1	NA	NA	-	200.8	NA	NA	217.3	NA	NA	256.7	NA	NA
Normal	105.2	147.0	135.7	138.8	155.7	164.4	150.4	150.2	158.9	140.7	143.7	149.3	158.4
Hard	69.2	89.5	89.5	91.1	89.9	96.2	96.5	99.7	99.7	91.8	96.8	98.5	102.5
Just makes ends meet	43.4	57.5	57.7	55.6	56.6	58.0	61.3	58.6	60.0	56.5	61.8	62.2	66.4
3. Relationship between income and expenditure													

Matching and a surplus remains	1.8	2.5	2.4	1.8	2.0	1.6	2.1	2.1	2.7	1.9	2.0	2.3	1.7
Matching normal expenses	19.4	15.5	17.7	19.8	16.1	18.0	15.0	14.7	15.3	17.6	15.2	17.7	15.3
Income less than normal expenditures	71.8	73.3	72.1	71.1	74.0	71.3	76.1	76.8	75.3	72.5	77.6	72.9	74.6
Practically no income	7.0	8.7	7.8	7.4	7.9	9.1	6.7	6.4	6.6	8.0	5.2	7.1	8.4

Source: BBSS Gallup 2000–2002 monthly surveys.

The share of food expenses for all categories of households has been high and constant throughout the year (Table 5.4). The marginal changes of incomes have not been able to generate any substantial differences in this respect. Stable reduction of food expenditures could not be observed for any of the household groups or sub periods (Table 5.4, indicator 1). This observation has been confirmed by data of the National Statistical Institute, which suggests a worsening structure of household consumption (see section 4). The lack of change should be regarded as a negative development as the population has high expectations for improvement of incomes.

Table 5.4. *Food Expenditure by Financial Status of Households (%) and Home Production of Food Supplies*

	Jan. 2000	Jan. 2001	Feb. 2001	March 2001	Apr. 2001	May. 2001	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001	Nov. 2001	Dec. 2001
1. Food expenses in households by subjective financial status (%)													
Very good	57.2	NA	NA	-	57.8	NA	NA	NA	NA	NA	47.1	35.7	52.8
Normal	58.2	56.0	56.0	56.4	59.1	59.3	56.8	58.0	57.3	57.3	55.0	58.3	54.4
Hard	67.0	61.3	62.2	61.3	62.5	65.7	62.4	64.2	60.9	62.1	62.7	61.7	62.8
Just makes ends meet	75.9	63.7	64.6	68.8	67.8	69.7	68.4	69.4	68.0	67.8	67.9	66.9	64.4
2. Share of respondents producing their own food supplies by types of products (%)													
Meat	35.0	30.5	29.6	29.0	25.6	26.4	27.9	24.7	24.3	23.4	24.4	24.4	24.5
Milk	25.6	22.7	25.1	23.1	23.4	23.6	26.6	24.2	24.6	21.4	20.2	20.3	18.9
Yoghurt	27.5	20.8	24.9	22.4	21.8	23.5	27.2	24.5	25.8	21.0	19.5	19.6	18.9
Cheese	23.5	16.8	17.1	17.9	17.0	18.1	21.0	18.7	19.6	17.9	15.4	15.5	12.7
Eggs	42.7	36.7	38.0	39.4	39.6	39.2	40.3	38.2	39.2	37.5	36.4	34.9	32.8
Potatoes	47.1	44.0	41.6	41.7	40.9	42.5	46.7	45.1	45.2	46.2	44.1	39.5	36.4
Fruit and vegetables	47.1	37.0	36.1	36.6	33.0	37.3	41.8	40.9	41.7	38.9	40.1	35.4	32.3
3. Share of home produced food in household food production (%)													
None (does not produce)	NA	36.4	35.4	34.1	35.6	33.2	34.9	34.7	38.5	35.4	37.1	38.8	42.4
Insignificant part of the food (0%)	40.6	15.9	18.4	19.7	17.6	20.6	18.0	22.4	17.1	20.3	19.5	20.0	18.7
Less than half of the food (25%)	14.4	15.4	12.4	11.2	11.9	13.4	11.0	10.7	12.0	11.2	12.2	12.0	10.7
About half of the food (50%)	13.7	12.7	14.2	13.6	15.5	12.7	11.9	11.4	12.5	12.9	13.4	11.8	11.3
More than half of the food (75%)	17.0	10.6	12.3	12.4	10.6	10.7	12.2	10.7	12.1	11.1	9.7	9.7	9.0
Most of the food (100%)	8.7	7.5	5.1	6.1	6.2	6.9	8.4	7.5	5.8	6.4	5.7	5.0	5.2
Don't know	5.6	1.4	2.2	2.8	2.6	2.5	3.4	2.6	2.1	2.7	2.7	2.6	2.7

Percent of households producing 50% and more of the food they consume	39.4	32.2	33.6	32.1	32.3	30.3	32.5	31.6	32.4	30.4	28.8	26.5	25.5
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Source: BBSS Gallup 2001–2002 monthly surveys.

In 2001, the share of households that produce some basic food supplies themselves (Table 5.4, indicator 2) slowly declined. This becomes even clearer if comparing the January 2000 levels with the December 2001 levels of home produced foods. The trend suggests that household food consumption tends slowly to turn to the market rather than rely on home produced foods. As a whole the situation still shows a clear picture of consumption, based on household production of foods. The high levels of this indicator indicate that consumption of home-made foods is one of the basic strategies of households to cope with low incomes. On average, about one third of households rely on home production to supplement the household budget.

In 2001, the indicator of the share of home produced food in household food consumption (Table 5.4, indicator 3) points to stable decline of the share of households that produce more than half of the food they consume. This is due mainly to the marginal increase of the share of households that do not produce any food. On the whole the share of households that produce 50% and more of the food they consume has declined from 39.4% in January 2000 to 25.5% in December 2001.

In 2001, there was a stable decline of the share of households, which produce more than half of the food they consume.

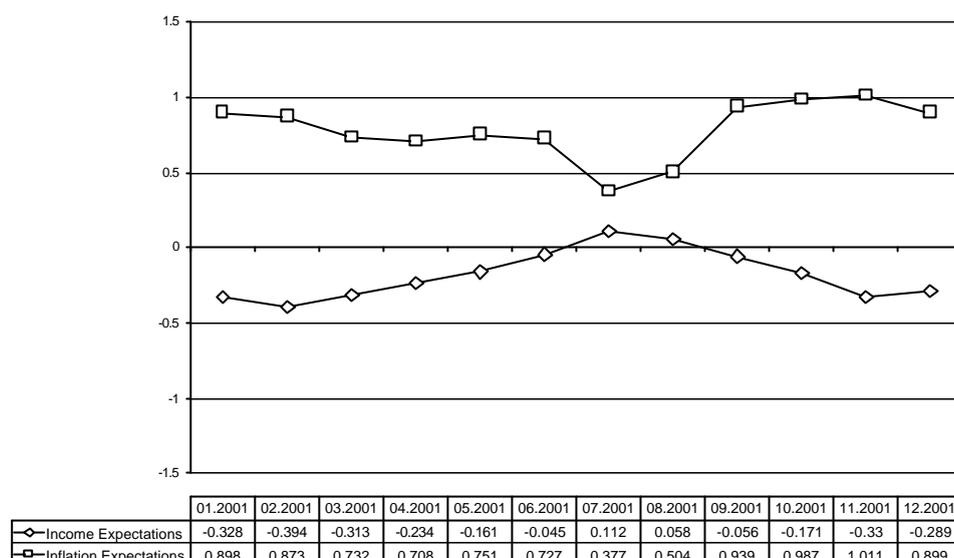
The development in home production of foods should be considered positive as it points to a gradual shift to market based supply and is a sign of the modernisation of the “home economy”. However, it also shows that incomes are becoming more important for an increasing number of households and this could make public dissatisfaction, provoked by low incomes a stronger destabilisation factor.

5.3. Income and Inflation Expectations

Income and inflation expectations for 2001 (Figure 5.1, Table 5.5) have demonstrated the highest dynamics since the beginning of the EW observations. They have not been directly linked to the evolution of per capita incomes or CPI levels, as has been the case in previous years. The main factor that has generated the positive shift of expectations was the parliamentary election. In this respect the program of the National Movement Simeon II and the statements of Mr. Simeon of Saxe-Coburg Gotha have had the most important impact. Peak positive levels of both income and inflation expectations were registered in July and August 2001. Within a very short period (from August to November 2001), income and inflation expectations returned to the previous values of January 2001.

Expectations for higher incomes had cooled down and created an atmosphere of public dissatisfaction. This has created considerable instability and is a serious sign of alert for the cabinet.

The average value of income expectations in December 2001 (minus 0.289) shows that expectations are for incomes to drop. The average value for inflation expectations in December 2001 (0.899) reveals that expectations are for “slow rise of prices”. These values, suggest that respondents perceive the economic situation as unfavourable and their personal economic position as relatively insecure.

Figure 5.1. Income and Inflation Expectations

Source: BBSS Gallup 2001–2002 monthly surveys.

The sharp drop of income and inflation expectations is maybe the most serious development in the sphere of incomes in 2001. High expectations and the confidence that NM Simeon II would be able to keep its promises were among the main factors for its success at the election. However, high expectations have cooled down within 2–3 months and have created the opposite atmosphere of distrust and dissatisfaction. This situation has created considerable instability and should be regarded as a serious sign of alert for the government. Negative expectations tend to stabilise and this undermines the confidence and public support for the economic policy of the cabinet. The first serious protests in this respect have already been witnessed and in the short-term they are very likely to continue.

Table 5.5. Income and Inflation Expectations and Coping Strategies

	Jan. 2000	Jan. 2001	Feb. 2001	March 2001	Apr. 2001	May. 2001	June 2001	July 2001	Aug. 2001	Sept. 2001	Oct. 2001	Nov. 2001	Dec. 2001
1. Expectations													
Income expectations	-0.329	-0.328	-0.394	-0.313	-0.234	-0.161	-0.045	0.112	0.058	-0.056	-0.171	-0.33	-0.289
Inflation expectations	0.937	0.898	0.873	0.732	0.708	0.751	0.727	0.377	0.504	0.939	0.987	1.011	0.899
2. Basic coping strategy to be employed, if incomes are not sufficient (%)													
Refraining from things we are used to	44.2	33.9	34.2	38.0	38.9	38.0	37.5	39.3	36.0	38.1	39.9	38.5	36.9
Additional income	31.8	32.1	32.2	28.4	28.1	31.3	32.6	29.2	31.1	31.5	30.9	28.0	29.6
Spending of savings	2.4	2.8	2.4	2.7	3.7	3.2	3.2	3.8	2.2	3.3	2.5	4.3	2.9
Borrowing money	3.8	11.8	13.2	11.3	13.2	11.2	13.3	12.0	13.9	12.4	13.5	13.5	15.1
Selling durables and real estate	1.5	2.1	2.0	2.7	3.2	3.1	3.9	2.3	3.4	2.5	2.5	3.3	3.1
Other, don't know	16.4	17.3	16.0	16.8	13.0	13.1	9.5	13.3	13.4	12.1	10.7	12.4	12.3

Source: BBSS Gallup 2001–2002 monthly surveys.

Regarding coping strategies of households (employed if incomes are not sufficient) observations for 2001 show relative stability. Given the marginal change of all indicators such a finding seems logical. Longer-term comparison (January 2000 vs. December 2001) shows that the major change is the gradual reduction of

the “cut expenses” strategy and the increase of the “borrowing money” strategy. This shows higher confidence in the overall macroeconomic stability of the country. Again, however, this increases the importance of faster improvement of incomes.

5.4. Conclusions

- ✍ With respect to the overall economic situation of Bulgarian households 2001 has not been as eventful as expected. Per capita incomes have grown marginally. Observed income growth has been slightly higher than CPI levels. Disposable income has changed marginally and therefore no effective change in expenditure patterns and the patterns of economic behaviour have been objectively possible
- ✍ About 30% of Bulgarian households still tend to rely on home production of foods, and food expenditures still comprise the main part of the household budgets. However, during 2001 a long-term trend of decline on reliance on home production of basic food supplies has been observed. This process of “marketisation” of the household economy has put additional importance on income levels as a factor determining everyday economic behaviour patterns and political orientations.
- ✍ Although marginal, in 2001 a gradual change of perceptions of the economic realities had been witnessed: in the end of 2001 income levels considered as normal were higher than in the beginning of 2000. This means that although the overall economic situation of households is slowly improving it is perceived in a more negative way. This shows that expectations evolve faster than objective realities and that in the end of 2001 dissatisfaction with incomes is notably higher than in January 2000 (when average per capita incomes were much lower).
- ✍ The developments described above have substantially affected income and inflation expectations and their political importance. The promise to “bridge the gap” between expectations and reality attracted considerable support for the NM Simeon II and pushed expectations up to peak positive values in July and August 2001. However, the evident inability of the cabinet to deliver as much as the public expected has led to a sharp negative development of expectations and a considerable public dissatisfaction with the economic policy of the government.
- ✍ The mismatch between public expectations and the economic reality, which poses limitations on meeting pre-election promises for radical improvement of the economic situation of Bulgarian households, is very likely to create political and public confidence problems for the government in the coming 2–3 months. The way out of this situation should ideally include a combination of economic policy and political measures aimed at fine-tuning of the income policy agenda and increasing the scope of social programmes. A main objective should be the outline of realistic perspectives, which could temper the existing excessive expectations. The failure to achieve these objectives in the coming 3–4 months could create substantial political instability.

6. EMPLOYMENT AND LABOUR MARKET

6.1. Employment Status Dynamics

The insignificant growth of employment did not increase economic activity.

The expected 4.5% GDP growth for 2001 had a marginal effect on employment. The economic model based on macroeconomic and fiscal stability led to an insignificant annual employment growth. In 2001, the average number of the full-time employed per month was 34.3% of the population over 15 years of age, compared to 34.2% in 2000 and 36.5% in 1999. The average number of the part-time employed was 4.3% (3.8% in 2000 and 4.1% in 1999). The economic activity of the population, however, remained at a relatively low level with the exception of those months when both pensioners and students entered the labour market. The average monthly number of unemployed in 2001 was 21.4% of BBSS Gallup survey respondents, in comparison with 18% in 1999 and 20.3% in 2000.

The analysis of the economic status of the population has revealed unfavourable trends. Employment has remained at a low level, while the unemployment rate¹ has increased. In 2001, the beneficial effect of the seasonal economic cycle on employment was delayed until the end of spring and the beginning of summer. At the same time, the unemployment rate was very high throughout the whole year. The benchmark indicator “Economically active population and high employment economy” also marked a clear trend of deterioration (Table 6.1). The average level of this indicator in 2001 was 10.30, whereas it was 6.98 in 1998, 8.73 in 1999 and 9.89 in 2000.

Table 6.1. Population Groups by Economic Activity Status

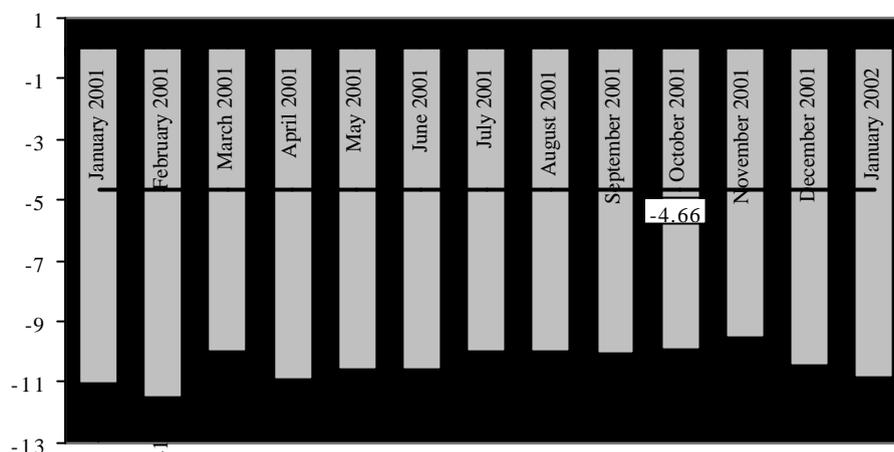
	Full- and Part-time Employed		Unemployed	Economically Inactive Population	Economically Active Population and High Employment Economy Benchmark Indicator
	Full-time Employment	Part-time Employed			
January 2001	32.3	4.3	22.7	40.7	-11.04
February 2001	31.2	5.0	23.6	40.2	-11.47
March 2001	32.9	4.4	20.5	42.2	-9.98
April 2001	33.3	4.2	22.5	40.0	-10.92
May 2001	34.5	3.7	21.9	39.9	-10.61
June 2001	36.3	3.5	21.9	38.3	-10.57
July 2001	34.5	4.3	20.6	40.6	-9.98
August 2001	37.3	4.3	20.8	37.6	-10.00
September 2001	33.7	4.7	20.7	40.9	-10.04
October 2001	34.0	4.5	20.5	41.0	-9.94
November 2001	36.6	3.7	19.8	39.9	-9.56
December 2001	34.7	4.0	21.6	39.7	-10.46
January 2002	32.7	4.4	22.3	41.8	-10.86
Target Levels	45.0	5.0	10.0	40.0	- 4.66

Source: BBSS Gallup monthly surveys.

¹ The unemployment rate represents the share of registered unemployed in the overall number of the economically active population.

In this way the level of the “Economically active population and high employment economy” benchmark indicator diverges from the target values of 50% employment of the population over 15 years of age, unemployment of 10% and economically inactive population within the range of 40% (Figure 6.1).

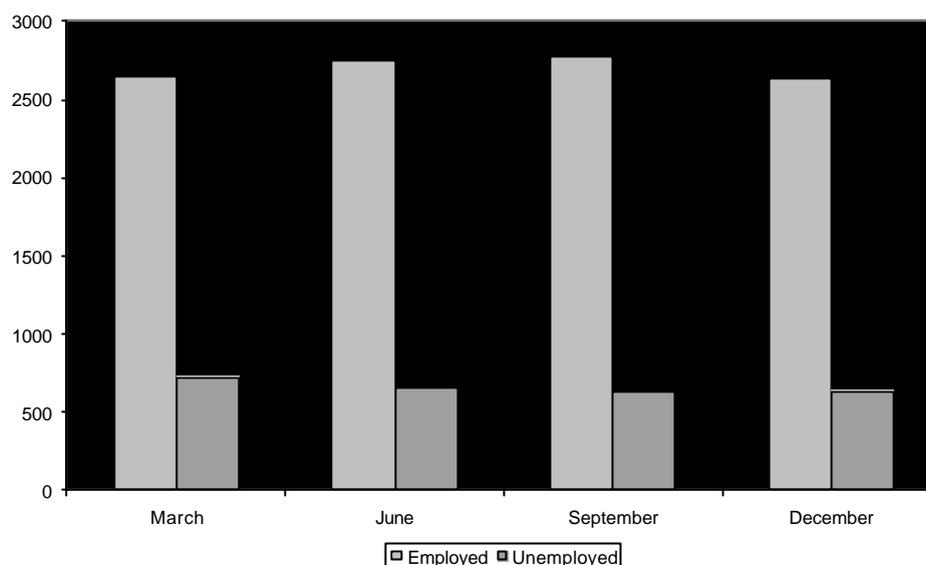
Figure 6.1. *Real and Hypothetical Target Values of the Benchmark Indicator “Economically Active Population and High Employment Economy”*



Source: BBSS Gallup monthly surveys.

Data from the workforce survey, held by the National Statistical Institute, outline almost the same trends in employment and unemployment (Figure 6.2). They also indicate that employment is influenced by seasonal economic cycles. Thus for instance in March and December the number of the employed was about 30,000 less in comparison with June and September. The number of the unemployed marked a decline by about 90,000 people, but at the same time the group of people in the age bracket of the 15–64 years old, who for various reasons are not actively looking for jobs, marked an increase. In December 2001, according to the results of the survey, 513,700 people or 14.6% of the population in this age bracket was outside the group of the economically active population.

A significantly higher rate of economic activity has been observed in cities and towns – 52.9% in comparison with villages – 37.5%. The distribution of economic activity by sex is 52.4% for men, and 44.0% for women.

Figure 6.2. Number of Employed and Unemployed in 2001

Source: National Statistical Institute.

The BBSS Gallup data on the economic status of the population and data from the workforce survey give grounds for following conclusions:

- ⌘ The low level of employment had been preserved throughout 2001 as well, despite the fact that restructuring in the real sector and the optimisation of employment in the public services were no longer that intensive. The unsuccessful cases of Management Employee Buy Outs (MEBOs) of big enterprises caused tension in regions where these enterprises are the only big employer;
- ⌘ The “Economically active population and high employment economy” benchmark indicator recorded lower levels in comparison with the previous year.

6.2. Dynamics and Structure of Unemployment

The unemployment rate declined slightly and the structure of unemployment was more favourable. The number of unemployed diploma holding graduates, as well as women and young people declined.

In December 2001, the number of unemployed registered at the labour offices declined by 20,500 people year-to-year. The average annual number of unemployed was 670,000 against 693,000 in 2000. In 2001, the quarterly unemployment rate fluctuated within a relatively narrow range. The first quarter was most critical with the number of unemployed exceeding 700,000 people. During the second and third quarters, the growth of unemployment was discontinued and the unemployment rate was declining for several months in a row. In the fourth quarter, however, the unemployment rate began to increase again.

A positive point in 2001 was the more tangible decline of unemployed diploma holding graduates, as well as women and young people. The share of the long-term unemployed had risen, although this group of unemployed also marked a decline at the end of the year (Table 6.2).

Table 6.2. Rate, Number and Structure of the Unemployed in Bulgaria

Registered Unemployed	Q4 2000	Q1 2001	Q2 2001	Q3 2001	Q4 2001	Q4 2001/ Q4 2000 (%)
1. Total number of registered unemployed:	680052	709060	680110	637075	652195	95.9
1.1. Unemployed Women	361124	36087	352704	360091	339618	94.0
1.2.	193219	202062	189668	174827	178226	92.2
1.3. (Registered for over a year)	281990	310546	338982	337900	333160	118.1
1.4. Unemployed Diploma Holders:						
Total	122732	124475	114256	108126	107479	87.6
University Graduates Included	47491	46174	42433	41581	39519	83.2
2. Unemployment Rate	17.8	18.6	17.8	16.7	17.1	- 0.7*

* Percentage points

Source: National Employment Service.

Regional unemployment disparities remained clearly expressed.

The average unemployment rate in 2001 was 17.52% against 18.14% in 2000. The unemployment rate reached critically high levels in the first quarter of 2001, and gradually started to subside. By administrative regions, the unemployment rate varied from 4-5% in Sofia City to 33% in the region of Targovishte. Throughout the year the unemployed exceeded 20% of the economically active population in more than half of the regions in the country. The share of municipalities with a high unemployment rate (over 30%) was also substantial. Critical unemployment rates (over 40%) were typical for municipalities located in the regions of Northwestern and Northeastern Bulgaria, as well as in the region of the Middle and Western Rhodopes. Most of the municipalities with high unemployment are located in rural and ethnically mixed regions.

The changes in the number, territorial scope and structure of registered unemployed in 2001 lead to the following conclusions:

- ⌘ The number of registered unemployed marked a slight decline, although it exceeded 700,000 people in the first quarter of 2001.
- ⌘ The structural characteristics of unemployment were more favourable, compared to the previous year. The number of unemployed diploma holders, women, and young people had diminished, but the share of the long-term unemployed grew. This indicates some upsurge on the labour market in 2001 as well as higher demand for qualified workforce.
- ⌘ Regional disparities in the unemployment rate, however, remained substantial. In almost half of the administrative regions it exceeded 20%. The number of municipalities with critical unemployment rates of more than 40% also remained high. The growing number of the long-term unemployed continued to be a risk factor.
- ⌘ The concentration of unemployment in ethnically mixed regions (in the Northeast of Bulgaria) and in municipalities with high share of Roma population (Rakitovo, Omourtag, Roman, Pelovo, etc.) also continued to be a risk factor.

6.3. Risk of Unemployment and Preparedness for Occupational Mobility

From January to December 2001, the total number of newly registered unemployed at the labour offices was 609,000 people, or a monthly average of 50,000 people. Throughout the year, the inflow of newly registered unemployed varied

Subjective perceptions of unemployment and possible coping strategies have been influenced by the ongoing political change.

between 40,000 and 70,000 people, whereas the outflow of unemployed in job placements varied between 10,000 and 20,000 people. In other words, the inflow of unemployed considerably outstripped the outflow of unemployed. The pressure on the labour market was within the range of 25 to 50 unemployed per vacancy. In this way, throughout the entire period the risk of unemployment was much higher than the likelihood of finding a job. The relative improvement observed in the second half of 2001 was mainly due to seasonal employment and to a lesser extent – to jobs created within the framework of various employment programmes.

The perceptions for the risk of unemployment and the respective coping strategies in 2001 were strongly influenced both by the situation on the labour market and the political environment. At the beginning of the year, about 60% of the respondents were definitely afraid of losing their jobs. The optimists (those that were sure that they would keep their job) were between 25% and 30% of the respondents. In mid year and especially after the general election, fears for job loss were replaced by optimism – the pessimists declined to 50–55%, and the optimists rose to 35% of the respondents. At the end of the year, however, job insecurity rose again. Regardless of the fluctuations in the perceptions of job security, the strategies in the event of unemployment were mainly passive. The majority of the respondents are ready to take up any job, including a lower-paid or less-skilled job, instead of changing their occupation or place of residence (Table 6.3).

The political environment in 2001 influenced the perceptions for the ability of political parties to cope with the problem of unemployment. At the beginning of the year, the public assessed the potential of the ruling majority and a possible alternative government to resolve the issues with unemployment in almost identical way – between 17% and 25% of the respondents thought that government or opposition would be able to solve this issue. The greater majority of the respondents, however, believed that the situation with unemployment would not change whoever ruled the country. With the appearance of NM Simeon II on the political scene and especially after the general election, the picture changed. Thus for instance, in August 2001, 55.2% of the respondents considered that the situation with unemployment was improving, and the opposite opinion (that the situation was getting worse) was shared by only 3.9%. At the end of the year, however, these assessments changed and in December 2001 only 11.2% of the respondents were of the opinion that the situation with unemployment was better during the governance of NM Simeon II, whereas 38.4% were of the opinion that the situation had deteriorated.

Table 6.3. Subjective Assessments of Unemployment

	Subjective Perceptions of the Unemployment Risk		Coping Strategies in the Event of Unemployment		
	Job Insecurity	Job Security	Readiness to Accept a Less Skilled Job	Readiness to Accept a Worse Paid Job	Readiness for Occupational Mobility
January 2001	61.8	26.9	55.6	51.3	31.1
February 2001	59.0	25.6	62.6	54.7	26.6
March 2001	50.3	36.2	58.4	52.1	29.0
April 2001	57.2	27.8	62.9	55.8	28.8
May 2001	53.2	31.1	62.4	55.4	31.8
June 2001	55.4	30.5	58.6	52.9	29.0

	Subjective Perceptions of the Unemployment Risk		Coping Strategies in the Event of Unemployment		
July 2001	49.7	34.6	55.8	51.0	30.7
August 2001	53.9	30.4	54.8	47.9	29.4
September 2001	52.9	35.6	63.1	56.3	35.0
October 2001	57.2	30.4	61.8	52.8	31.6
November 2001	54.3	34.1	56.6	52.1	29.6
December 2001	54.3	29.1	57.8	49.0	31.8
January 2002	59.3	26.7	56.1	55.7	27.7

Source: BBSS Gallup survey data, own calculations.

The conclusions on the risk of unemployment and preparedness for occupational mobility can be summarised in the following way:

- ✍ The perception of job insecurity is changing both under the impact of the situation on the labour market and the political situation in the country.
- ✍ The coping strategies in the event of unemployment are dominated by the compromise with the professional self-actualisation at the expense of securing one's subsistence. The readiness for territorial and occupational mobility is diminishing. The share of the discouraged, who will not be looking for a job should they become redundant, is relatively high as well.
- ✍ The initial expectations that NM Simeon II would be able to cope better with the issues of employment were very high. Consequently, however, these expectations have declined, and the perceptions were becoming more critical, regardless of the slight improvement of the situation on the labour market.

6.4. Labour Market Policies

Scope of Labour Market Policies

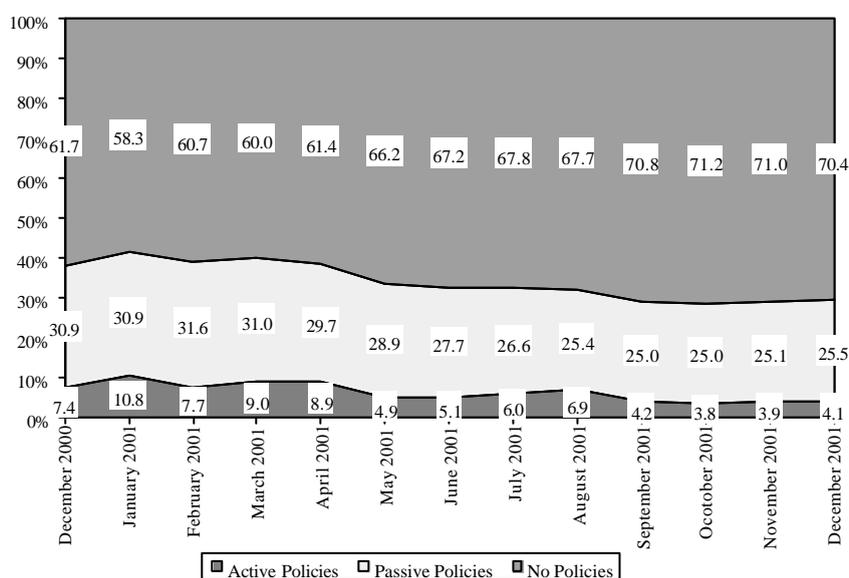
In 2001, labour market policies went through several critical moments. Because of financial constraints, especially during the last quarter of the year, the share of the unemployed involved in vocational training programmes and labour market policies dropped below 4%. On a monthly basis, between 30,000 and 50,000 unemployed were involved in various active labour market policies, and the scope of the new cabinet initiatives expanded as well. The share of the unemployed who received unemployment benefits amounted to approximately 30% of the registered unemployed at the beginning of the year but later dropped to 25%. The decline was due to the less intensive restructuring and privatisation of state-owned enterprises in 2001 (Table 6.4 and Figure 6.3).

Labour market policies were characterised by critical moments and a positive turnaround.

Table 6.4. Labour Market Policies

	Percentage of the Unemployed Involved in Labour Market Policies		
	Unemployed enrolled in employment programmes and vocational training courses	Unemployed receiving severance payments or unemployment benefits	Unemployed outside the scope of Labour Market Policies
December 2000	7.4	30.9	61.7
January 2001	10.8	30.9	58.3
February 2001	7.7	31.6	60.7
March 2001	9.0	31.0	60.0
April 2001	8.9	29.7	61.4
May 2001	4.9	28.9	66.2
June 2001	5.1	27.7	67.2
July 2001	6.0	26.6	67.8
August 2001	6.9	25.4	67.7
September 2001	4.2	25.0	70.8
October 2000	3.8	25.0	71.2
November 2000	3.9	25.1	71.0
December 2000	4.1	25.5	70.4

Source: National Employment Service.

Figure 6.3. Labour Market Policies

Source: BBSS Gallup monthly surveys.

At the end of 2001, measures aimed at improving labour market policies were undertaken. Within a short period of time, the micro-lending project was elaborated and given an actual start-up, whereby priority was given to the municipalities with the highest unemployment rate. A new law on encouraging employ-

ment was passed by parliament, and an Employment Agency was set up, the activity and programmes of which are funded by the government budget.

Major Conclusions

Labour market policies pursued by the two cabinets in 2001 can be characterised in the following way:

- ✍ The financial instability of the Professional Training and Unemployment Fund was a serious impediment for pursuing active labour market policies. In practice it was impossible to implement fully the envisaged by the law measures and programmes for encouraging employment.
- ✍ The limited opportunities for broader participation in training and re-training courses curtailed the chances of unemployed to make a transition to a new job.
- ✍ Large groups of the population (mainly long-term unemployed and people of pre-retirement age) remained outside the scope of labour market policies and this limited their chances to find a new job or to meet the retirement eligibility criteria.
- ✍ The rapid preparation of the pilot stage of the micro-lending programme and its targeting at the unemployed in municipalities with critically high unemployment had a strong psychological impact.

6.5. Labour Market Prospects and Recommendations

The labour market prospects for the first months of 2002 tend to be unfavourable. Later in the year, under the influence of seasonal factors and the implemented adjustments of labour market policies, unemployment will start to subside. The decrease, however, will not be substantial but it will improve the structural characteristics of unemployment – the number of the long-term unemployed will decline, and regional unemployment disparities may be mitigated to some extent.

The major conclusions about the state and development of the labour market and the unfolding situation in 2002 lead to the following **recommendations** :

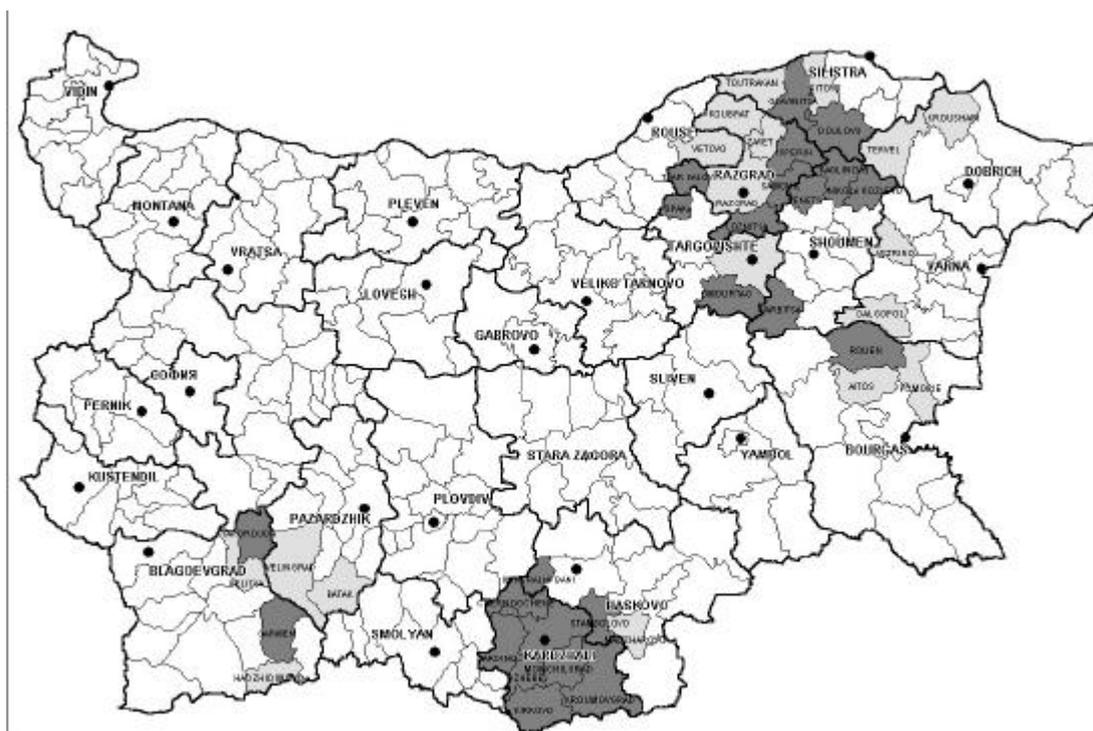
- ✍ Labour market policies should be able to encompass a higher number of unemployed, giving priority to people in pre-retirement age and long-term unemployed. The municipalities with a critically high unemployment rate and no alternatives for employment should be in the focus of active labour market policies. The effectiveness of active labour market policies and vocational training programmes has to be further increased;
- ✍ The discrimination of employers to certain categories of unemployed (people in pre-retirement age, representatives of the ethnic minorities, the disabled, etc.) should be counteracted;
- ✍ The awareness of the population about the new labour market policies of the cabinet should be enhanced, so that the existing job insecurity and the mistrust in the ruling coalition could be mitigated. A possible public relations campaign should include concrete facts of practical utility both for the unemployed and the employed facing a high risk of being made redundant.

7. INTRAETHNIC STABILITY

7.1. Turkish Ethnic Group

It should be noted that the Turkish ethnic group is territorially concentrated in two principal geographic locations, and that the behaviour of the population in these two areas is distinctly different. The first area encompasses the larger part of the municipalities of Kardzhali region. The Turkish minority from this area in a number of instances displayed different degrees of conflict behaviour in 1998 and 1999. The second area is located in Northeastern Bulgaria and it encompasses municipalities of the regions of Razgrad, Targovishte, Shoumen, Silistra, and partially Bourgas and Dobrich (Figure 7.1 and Table 7.1). No serious incidents have been registered in this zone since the beginning of the EW project. The major reason for this situation is the fact that the pressure of the economic crisis in this part of the country is weaker than the region of Kardzhali because of the higher opportunities for employment in agriculture and industry. However, the economic situation in Southern Bulgaria (in the regions of Kardzhali and Haskovo) in the 2000–2001 improved substantially with the opening of dozens of small enterprises by Turkish and Greek investors.

Figure 7.1. Geographic Distribution of the Turkish Population



* The dark grey colour denotes municipalities of more than 50% Turkish population, and the light grey colour denotes municipalities of between 20% and 50% Turkish population.

Source: Based on 1999 local election data.

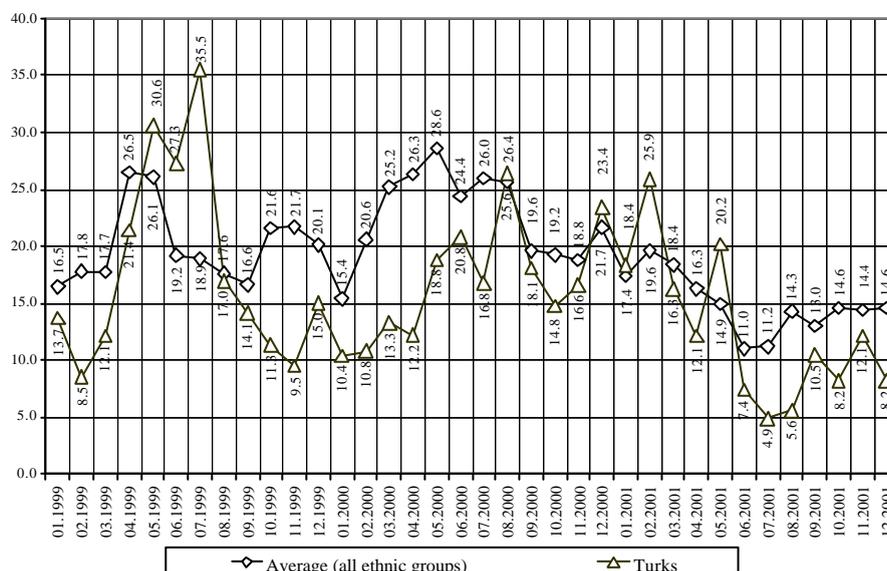
Table 7.1. *The Nine Regions with the Highest Concentration of Turkish Population*

Region	Total Population	Bulgarian Population	Turkish Population	Share of Turkish Population in %
Kardzhali	164 958	5 419	103 094	62.5
Razgrad	153 156	68 361	69 738	45.5
Targovishte	138 703	77 371	49 977	36.0
Silistra	142 815	87 001	48 141	33.7
Shoumen	205 198	120 676	62 020	30.2
Russe	267 618	213 210	38 794	14.5
Bourgas	426 028	338 139	60 613	14.2
Dobrich	217 012	163 824	28 643	13.2
Haskovo	279 067	227 568	30 744	11.0

Source: Based on the two-percent sample from the 2001 Census of the Bulgarian Population, National Statistical Institute.

The protest readiness index of the Turkish minority registered its lowest levels since 1997.

The Cumulative Protest Readiness index will be the starting point for the assessment of intraethnic tension in the country. The index allows annual comparisons as well as monthly estimates of the development of tension within the Turkish ethnic group (Figure 7.2). The year 2001 recorded the lowest levels of protest readiness of the Turkish ethnic group since 1997. For instance, in 1998 the average value of the Cumulative Protest Readiness index was 15.6%, in 1999 – 18.0%, in 2000 – 16.9%, and in 2001 – 12.5%.

Figure 7.2. *Cumulative Protest Readiness Index of the Turkish Population*

Source: BBSS Gallup monthly surveys.

The past year began with very high levels of protest readiness, which was related mainly to the evolving conflict in FYROM¹. This was followed by a sharp contraction of the index, which in the summer of 2001 reached its lowest levels

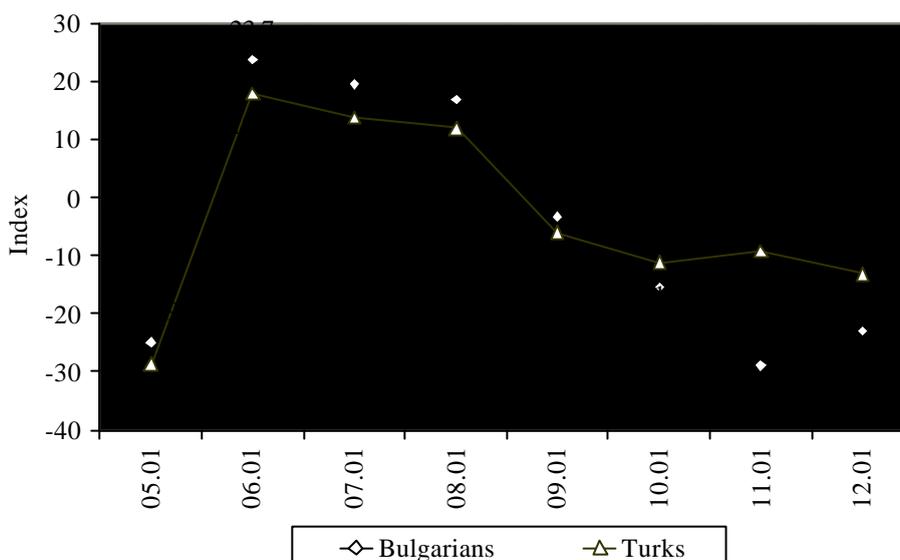
¹ Thus far, there have been no surveys attempting to explore the relationship between the ethnic conflicts in the neighbouring Balkan countries and the rise of conflict behaviour readiness of the Turkish ethnic group in Bulgaria.

since it was designed, and despite some growth in September and November, the index retained its low levels to the end of 2001.

The low levels of the index can be explained by several factors. First, this was the success of the MRF at the general election in June 2001 and the participation of representatives of the Turkish minority in the cabinet for the first time since 1990.

Second, a major factor was the sharp rise of the optimistic expectations after the general election, which subsequently did not decline so abruptly as was the case with the other ethnic groups (Figure 7.3).

Figure 7.3. *What Are Your Expectations for the Economic Situation of Your Family over the Next 12 Months?*



Source: BBSS Gallup monthly surveys.

Third, the analysis of incomes (see Section 5) indicates that during the second half of the year there was a real improvement in the income status of the Turkish households.

When analysing the past year, it is worth assessing the overall experience of the EW project in monitoring the protest readiness index of the Turkish ethnic group. This experience can be summarised as follows:

- ✎ The protest readiness index indicates that the Turkish minority is the ethnic group with the lowest average annual protest readiness in the country – 15.2 points against 18.4 points for the Bulgarian population, and 26.5 points for the Roma minority.
- ✎ The periods of heightened conflict propensity of the Turkish minority correlate as a rule with those of the Bulgarian population. The Turkish minority, however, often outstrips the conflict propensity of the Bulgarian population in terms of attained by protest readiness levels.
- ✎ For the four and a half years in which the index has been used, the Turkish ethnic group registered four periods of significant protest readiness growth. All cases of increased protest readiness have relatively clear underlying factors and explanations.¹

¹ The first period of increased conflict readiness was in the spring of 1998, when mass protests started in the region of Kardzhali as result of the delayed payment of the to-

The year 2001 was the most successful year in the history of the MRF, which in the short run makes unlikely any serious tension in the Turkish ethnic group.

☞ Much like the situation with the other ethnic groups, a decline of the index level of the Turkish ethnic minority is observed in the periods before and after local, general, and presidential elections.

Regarding the political factors influencing the stability of the Turkish ethnic group after the MRF¹ achieved its greatest election victory since 1990, our assumption is that in the short run serious tension is not likely to occur in the Turkish ethnic group. At the same time, it should be noted that throughout the year Ahmed Dogan's movement faced serious challenges, which had an impact on the overall political stability of the country. The involvement of Mr. Simeon of Saxe-Coburg Gotha in the domestic political process in April 2001 changed dramatically the position of the MRF on the political scene. From a political force, which was thought to be an almost certain participant in the future government of the country², the MRF was downgraded to the group of parties that faced the risk of remaining outside parliament. The major reason was the upsurge in the electoral activity of Bulgarian voters, which increased the number of minimum votes needed for overcoming the 4% threshold barrier for entry in parliament. Political observers regarded the scenario of MRF remaining outside parliament as a threat for the overall stability of the country. The main argument was based on the assumption that such development could lead to disintegration of MRF and radicalisation of some of its structures, which could have raised demands similar to that of the Albanian parties in the FYROM.

Another factor, which further aggravated the situation, was the outflow of Turkish voters to NM Simeon II³. At the same time, much like the situation at the 1999 local election, during the pre-election period and on the day of the general election there was a series of conflicts between the MRF and the then ruling coalition of the United Democratic Forces (UtDF). Initially, the MRF electoral coalition⁴ released several declarations about political incidents provoked by UtDF activists, the most serious of which was the assault and battering of a Roma leader in the town of Lom. Then followed the release of data about the collaboration of principal MRF politicians with the former secret services. The tension was additionally aggravated by the refusal of the Blagoevgrad Regional Electoral Commission to register the MRF party lists, which threatened the MRF with loss of a substantial number of votes.

bacco crop. The second period of a record high growth of conflict readiness was related to the Kosovo conflict in April–June 1999. The third period was caused by natural disasters in 2000, and the fourth can be connected to the conflicts in FYROM in the first months of 2001.

¹ Despite the fact that so far the MRF has been unable to achieve full control over the entire Turkish electorate, after the general election in June 2001 the major competitor of MRF in the 1997–2000 period (the NMRF of Gyuner Takhir) in practical terms disappeared from the political scene. The LM reports and the monitoring of the press indicate that there are processes of return of NMRF members to the MRF and attempts of rapprochement between the local leaderships of the MRF and the NMRF.

² The justification for such assessments is the almost equal number of the UDF and the BSP electorates (confirmed by the outcome of the June 2001 general election), and the remote chance for the 4% electoral barrier to be overcome by another political force with the exception of the MRF.

³ The changes in the attitudes of the Turkish voters were extremely dynamic. Initially NM Simeon II enjoyed almost no support among them, subsequently a readiness to support NM Simeon II of up to 40% was registered, and at the end of the election campaign a return to the MRF was observed once again.

⁴ The MRF ran the general election in a coalition with the Liberal Union and Euroroma.

Despite the numerous threats and incidents, some of which were mentioned above, the MRF managed to achieve one of its best election results since 1990 (Table 7.2), thus finding itself in an extremely privileged position in the negotiations for a coalition cabinet. For the first time in the new Bulgarian history, representatives of the Turkish ethnic group were appointed as cabinet ministers and deputy ministers, and the MRF had the opportunity to appoint its representative in various key institutions of the country.

Table 7.2. MRF Voters at the Post 1989 General and Local Elections

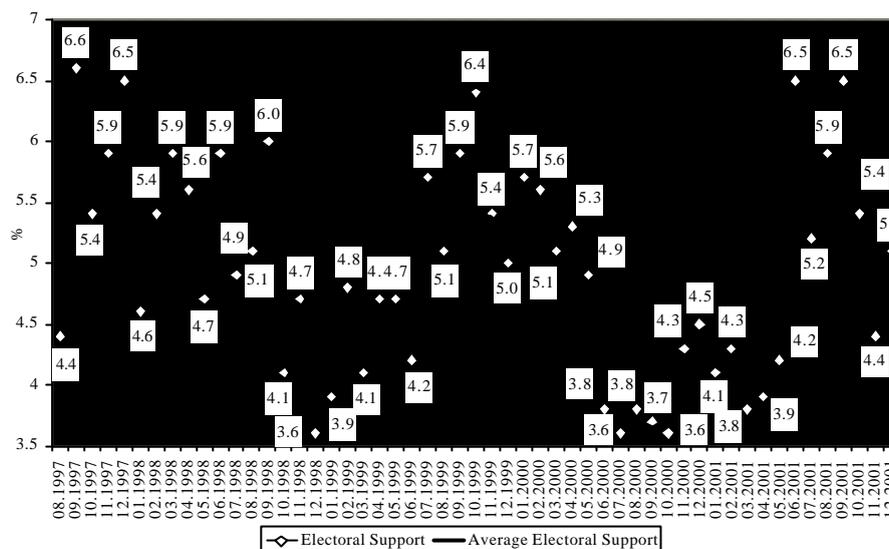
1990 General Election	1991 General Election	1994 General Election	1995 Local Election	1997 General Election	1999 Local Election	2001 General Election
368 929	418 341	282 711	244 317	323 429	210 000	340 395

Source: Central Electoral Commission.

During the presidential election, the MRF was faced with a difficult situation once again. It found itself involved in an unnecessary confrontation with its coalition partner NM Simeon II, after Prime Minister Simeon Saxe-Coburg Gotha gave his support for Peter Stoyanov's nomination as a presidential candidate. The victory of Georgi Parvanov with the support of the MRF in the second round of the presidential election, once again allowed the MRF to climb on the bandwagon and to press demands for appointments of its representatives in the foreign and security services on a quota basis.

At the same time, the outcome from the presidential election gave rise to speculations about rifts between the MRF leadership and its electorate. The analysis of the data from the two rounds of the presidential election suggests that the MRF did not manage to mobilise its voters to a sufficient extent. At the first round of the election, the MRF presidential candidate, former prime minister Reneta Indjova, received a substantially lower number of votes in comparison with the votes given for the Movement at the June 2001 general election. The analysis of the second round of the presidential election once again reveals a relatively low electoral activity in the ethnically mixed regions of the country. These results gave grounds to some political analysts to argue that despite the MRF's key role in Bulgarian politics, its electoral support has been adversely affected by its commitment to the ruling NM Simeon II coalition. The data from opinion poll surveys indicates that the fluctuations in the electoral support for the MRF has been typical for the last four years, but at the time of elections the MRF has always managed to mobilise its electorate (Figure 7.4).

Figure 7.4. MRF Electoral Support (“If the Elections Were Tomorrow, Whom Would You Vote for?”)



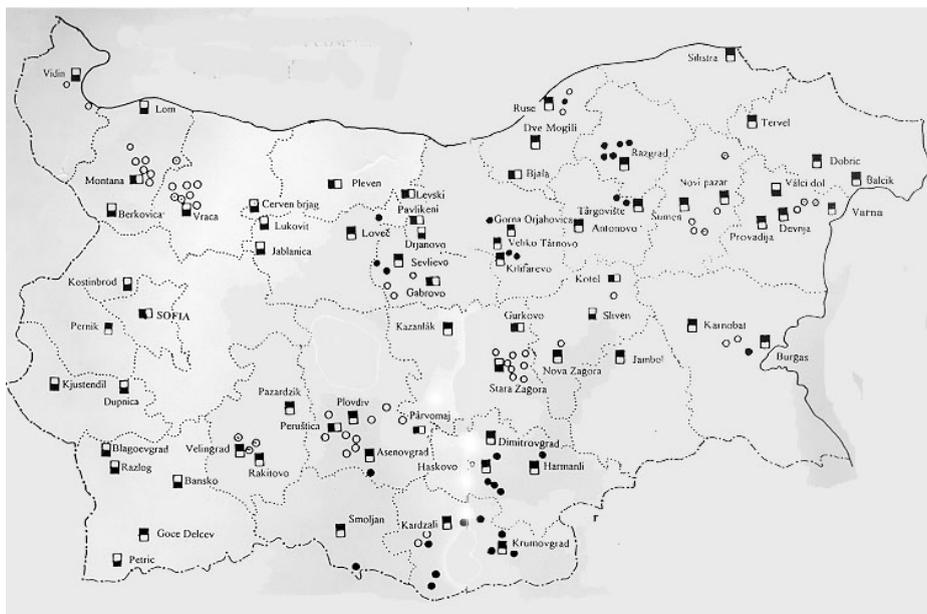
Source: BBSS Gallup monthly surveys.

In conclusion, in a medium term perspective the MRF will retain its power as a parliamentary political force and will probably continue to be a kingmaker in Bulgarian politics, despite the expected serious rifts within the NM Simeon II–MRF coalition cabinet.

7.2. Roma Ethnic Group

The Roma ethnic group, unlike the Turkish minority, is dispersed throughout the country (Figure 7.5). As the EWR analyses for the last four years indicate, this dispersion is one of the factors, restricting the impact of this group on the social and political stability of the country¹. In this sense, it is indicative that settlements, which were constant centres of incidents involving the Roma population in the 1997–2001 period, had almost no impact on neighbouring regions populated by large Roma communities.

¹ As a result of this dispersion, the major source of regular quantitative information (polling surveys) do not provide sufficiently stable data. The insufficient reliability of the results is related to the way by which national representative surveys collect information. Because of the relatively small sample (1100–1200 respondents), a monthly survey includes on the average 60–70 representatives of the Roma population. Due to the wide dispersion of the Roma population (Figure 7.5), in the various months the surveys cover towns and villages of a qualitatively different nature.

Figure 7.5. Geographic Distribution of the Roma Population

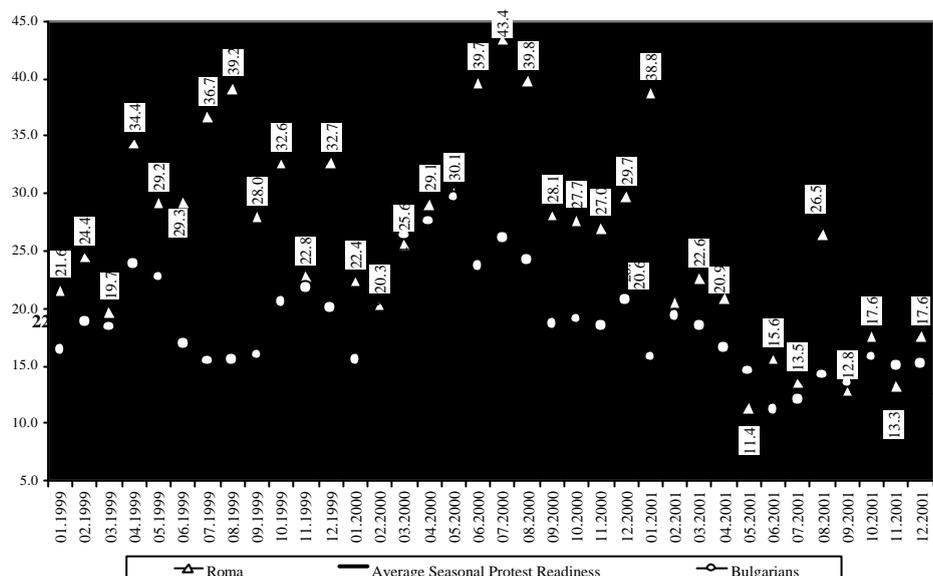
Source: Ilona Tomova, "The Gypsies".

In terms of incidents involving the Roma community, the year 2001 was the calmest in the past four years.

In terms of incidents involving the Roma community, 2001 can be assessed as the calmest year over the past four years. Throughout this period, the registered mass protests and incidents involving the Roma population were considerably fewer than those observed in the 1997–2000 period. Much like the situation with the Turkish ethnic group, the Cumulative Protest Readiness index¹ of the Roma population registered its lowest levels ever since October 1997 (Figure 7.6). With average levels of the index of 28.7 points for the 1997–2000 period, in 2001 the protest readiness index dropped to 19.3 points. It should be noted that 2001 discontinued the existing trend since 1997 of growing year-to-year annual index levels.

¹ This index has already confirmed its reliability as a tool measuring the tension within the Roma ethnic group. The history of the index begins with very high levels of protest readiness. It was related to the mass Roma protests in the town of Lom and tensions between the social welfare offices and the Roma community in a number of towns. The sharp decline of the index in November, followed by its lowest level in December 1997, coincided with the financial assistance granted by the EU through the Emergency Social Assistance Programme (ESAP), and with the disbursement of delayed social assistance benefits, which was secured by budget funds. The sharp rise of the index in May 1998 coincided with the termination of ESAP in April the same year. A similar picture was observed in 1999 and 2000 – high values of the protest readiness index in summer and a sharp decline after the disbursement of the (usually delayed) social welfare benefits at the end of the year.

Figure 7.6. *Cyclical Development of the Cumulative Protest Readiness Index of the Roma Population*



Source: BBSS Gallup monthly surveys.

The main reasons for the lower tension in the Roma community were the general and presidential elections in 2001.

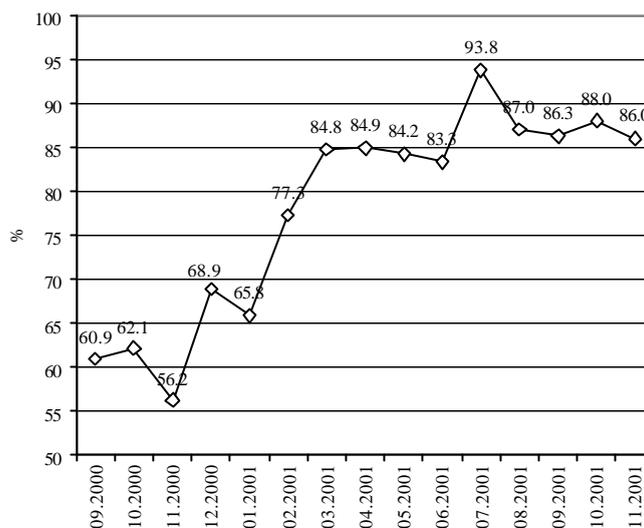
The cyclical pattern of low index values in winter and high index values in summer, observed over the last four years, was discontinued in 2001. In the summer of 2001, the levels of the protest readiness index were lower than the values registered in “the quiet winter period”¹ (Figure 7.6).

The major explanation for this radical change can be found in the general and presidential elections that were held in June and November 2001. As Local Monitors’ (LM) reports make it clear, before and during the election period social welfare benefits were disbursed on time and the attempts to collect the outstanding amounts for utility (water and electricity) bills were discontinued. According to experts, despite the permanent financial deficit of municipalities, the local authorities in most places would rather disburse the envisaged welfare payments than risk facing incidents at election time.

The EW analysis revealed that the comprehensive monitoring of the various forms of inequality affecting the Roma ethnic group, apart from the problems with delayed social welfare payments, should also take into account the access of the Roma community to healthcare and education. For this reason an experimental indicator was introduced, measuring to what extent the system for primary healthcare covers the Roma community. The first survey results in September–October 2000 indicated that the Roma population was in the worst position compared to the other ethnic groups: between 30% and 40% of the Roma respondents said they did not have a personal physician – general practitioner (GP). In the first months of 2001, however, the situation changed and the average share of those having access to personal primary healthcare (i.e. respondents declaring to have a GP) at the end of the year reached 86–87%² (Figure 7.7). The share for the Bulgarian population is 93–94%, and 90–92% for the Turkish population.

¹ As the chart shows, given that the average values of the index for the four-year summer period varied between 31% and 35%, in the summer of 2001 the value of the index was 17.6%.

² Experts explained the declining healthcare coverage of the Roma population after July

Figure 7.7. Share of the Roma Population Covered by Primary Healthcare

Source: BBSS Gallup monthly surveys.

At the same time, in periods of more intense demand for healthcare services or medical aid (in June–July and November–December), the dissatisfaction of the Roma population with their personal GPs rose sharply from an average of 6–8% to 14–15%.

As far as access to education is concerned, the Roma population is the ethnic group, which has been most severely affected by the crisis of mounting school dropouts. The average dropout rate of children from the Bulgarian and Turkish ethnic groups is between 2% and 3%, while for the Roma ethnic group it reaches 20%.

Contrary to preliminary assumptions, the 17 June 2001 parliamentary election did not bring about any serious tension affecting the stability of the Roma ethnic group. At the beginning of the year, some political observers expressed apprehensions that the approximate parity of the electoral bases of BSP and UDF would make Roma votes a decisive factor for winning the general election and that the battle for Roma voters (especially at the local level) would lead to violent incidents. Some Roma leaders also expressed similar opinions through the mass media and anticipated that the pre-election struggle would provoke mass conflicts in the largest Roma settlements. The situation underwent a qualitative turnaround after the involvement of Mr. Simeon of Saxe-Coburg Gotha in the general election. His political movement managed to receive a strong support from Roma voters and the political tension within the Roma ethnic group declined abruptly.

7.3. Issues for Additional Consideration

Preliminary data from the 2001 census of the population was released in the course of the year. The published results put an end to the numerous speculations about the size of the Turkish and Roma ethnic groups. According to these results, the Turkish population in Bulgaria is 758,000, or 42,000 less (5.25%) compared to the previous population census in 1991. This data suggests that the estimates of an annual emigration of about 20–30 thousand people to the Republic of Turkey have been strongly exaggerated. According to the opinion poll surveys used by

The participation of NM Simeon II in the general election weakened political rivalries in the Roma community.

The preliminary data from the population census put an end to the numerous speculations about the size of the Turkish and Roma ethnic groups.

2001 with the fact that right in the middle of the summer, because of the viral epidemics, the Roma population was actively seeking for medical aid.

the EW Project, the propensity for emigration to neighbouring Turkey has sharply subsided since the third quarter of 1999¹ and remains at a very low level (Table 7.3).

Table 7.3. *Share of the Respondents Who Have Expressed an Intention to Leave the Country in the Coming Month²*

	Q4 199 7	Q2 199 8	Q3 199 8	Q4 199 8	Q1 199 9	Q2 199 9	Q3 199 9	Q4 199 9	Q1 200 0	Q2 200 0	Q3 200 0	Q4 200 0	Q1 200 1	Q2 200 1	Q3 200 1	Q4 200 1
Bulgarians	1.4	1.9	1.5	1.8	1.8	2.0	1.5	2.0	0.7	1.1	1.3	0.9	0.7	0.8	0.7	0.8
Turks	4.1	3.1	4.2	3.4	4.5	2.8	1.8	1.3	0.3	0.7	0.7	0.7	0.4	0.6	0.7	0.3
Roma	2.6	1.4	5.6	4.5	3.4	4.8	2.1	1.4	1.9	1.0	0.4	0.0	0.0	0.0	0.6	0.0

Source: BBSS Gallup monthly surveys.

The smaller number of illegal crossings of the Bulgarian–Turkish border has confirmed this trend³. In this sense, the assumption of some politicians that emigration as “a factor that reduces Turkish influence”⁴ appears to be overstated.

The census data obtained for the Roma ethnic group revealed just the opposite situation. Over the past few years, the majority of Roma leaders, as well as independent experts, estimated the size of the Roma population in the range of 600,000–800,000 people. According to the data of the National Statistical Institute, the size of the Roma ethnic group stands at 366,000 people and has increased by 53,000 people (16.9%) since the previous census in 1991. It should be borne in mind, however, that some representatives of the Roma population, who belong to the Muslim religious denomination, identify themselves as part of the Turkish ethnic group. According to the data of the EW Project, these people are about 55–65 thousand. It should be noted that the process of concealing one’s Roma ethnicity has been discontinued over the last five or six years. In the opinion of some experts, the registered increase of 53,000 people may be due not so much to the population growth of the Roma ethnic group but to the increased self-identification of the Roma population in comparison with 1991.

With respect to the Turkish ethnic group, the events in the region of Blagoevgrad before the general election in June 2001 deserve special attention. There, the Regional Electoral Commission refused to include Ahmed Dogan as leader of the MRF party list after he had replaced a local leader, who was disliked strongly by the electorate⁵. The refusal to register the MRF in the Blagoevgrad electoral

¹ A number of explanations can be given in this respect: from the removal of visa restrictions for Bulgarian citizens, to the abrupt deterioration of the economic situation in Turkey. Unfortunately, genuine data that can confirm or deny these hypotheses is not available.

² The data represents the monthly values of propensity for emigration, re-calculated on a quarterly basis.

³ In 1992–1999, emigration to Turkey had become a routine issue in the mass media. Press releases of about 10 to 20 Bulgarian citizens apprehended weekly when attempting to leave the country were a typical news.

⁴ Since the middle of the 1990s, politicians from both BSP and MRF were declaring that quite soon the MRF would probably be unable to overcome the 4% electoral barrier because of the constant emigration of MRF voters to Turkey.

⁵ The MRF voters in the Western Rhodopes were strongly against the leader of the party election list in their constituency. This was made known to the MRF leadership, and Ahmed Dogan asked the leader of the election list to withdraw. This decision

district at that particular moment was interpreted by the movement's leaders as an attempt to prevent the MRF from attaining the necessary 4%, which qualify a party for entry in parliament. As a result, the tension escalated and the MRF leadership declared that civil disobedience was expected in 8 out of the 14 municipalities in the region. A series of statements were made containing analogies with the conflict in neighbouring FYROM¹. Rallies and demonstrations followed in 6 of the municipalities in the region. Later, when a compromise on the issue was reached, the conflict disappeared from the focus of public interest.

The Blagoevgrad case, however, raises a number of questions, which the political elites and experts chose to avoid after the normalisation of the situation. The major issue is to what extent the MRF and its leader would have brought the case to an extreme, if the Movement had not entered parliament. Not less important is another question – to what an extent the Turkish community would have followed a political force choosing to resort to non-peaceful methods? The experience from former Yugoslavia shows that the conflicts in “the successful models of peaceful ethnic co-existence” such as Bosnia and FYROM started with small incidents. In this sense the arguments that can be counter-posed to the disastrous scenarios for Bulgaria, are that there are several significant differences, which thus far have prevented the development of crisis situations.

In the first place, over the last 10 years the Movement for Rights and Freedoms has always been able to rid itself from radically minded members and has never permitted any form of violence. Some experts sympathising with the MRF even argue that the Movement acts as “a sanitary net” for its members with extremist orientation. According to this group of experts, because of the low efficiency of the security services, through its well developed local structures, the Movement has taken upon itself the role of restricting the risk of penetration of terrorist and radical Islamic organisations in the Bulgarian Muslim population.

The second argument pointed out by experts working in the area of ethnic conflicts is that, unlike in FYROM, in Bulgaria there is no ethnic rivalry and opposition on a communal level. There is no tension in everyday relations between Bulgarian and Turkish communities anywhere in the country. The situation in FYROM is just the opposite. Although the political elites in that country co-existed peacefully through various coalitions, at the same time sharp conflicts and clashes between the Albanian and Slav population were taking place on a daily basis².

The issue of MRF leadership relations with the political elites in Turkey also requires special attention. With the deterioration of the relations between the Kostov government and the Turkish government³, the relations between the latter and the MRF began to improve. The support of the Turkish government reached its peak during the June 2001 general election, when special arrangements were

gained the strong approval and gratitude of the local electorate, because “their opinion had been taken into account”.

¹ “This is especially important in a region bordering a conflict that raised entire Europe to its feet” is what the ad-hoc press release of the MRF press centre said on 14 June 2001.

² As can be seen from the EW Reports – UNDP Macedonia, before the autumn of 2000, violent outbursts and clashes between university (and high school) students were taking place in Tetovo on a daily basis.

³ The Movement restored its positions lost in the 1997–1999 period, when the high-ranking Turkish politicians avoided contacts with Ahmed Dogan because of their good relations with the Kostov government.

made to enable Bulgarian immigrants to vote in support of the Movement. Such close relations between the MRF and the Turkish political elites raised the issue to what an extent the Turkish government will be able to influence the political process in Bulgaria.

Within this context, it is worth mentioning that with the beginning of the financial crisis in Turkey and the start of Bulgaria's negotiations for EU accession, the attention of Turkish big businesses to this country rose abruptly. Up to 2001, Turkish businesses repeatedly said that they are subjected to discrimination in Bulgaria. The rapid penetration of Turkish investors¹, however, provoked the first reactions of nationalist organisations. Although Turkish businessmen create jobs, the accusations of nationalist organisations are that they hire labour led by ethnic and religious considerations. Such development could aggravate the existing good relations on communal level between the Turkish and Bulgarian population.

In 2001, despite the considerably more favourable situation in the Roma ethnic group, the traditional zones of tension remained intact. It is beyond any doubt that the number one problem will continue to be the unemployment rate within this ethnic group. According to data from the 2001 polling surveys, 64% of the Roma determine themselves as unemployed in comparison with 16% of the Bulgarians and 41% of the Turkish ethnic group. However, there was a slight improvement of the situation in comparison with 2000, which had been the most difficult year in terms of unemployment, with 66% of the Roma identifying themselves as unemployed². The slight improvement can probably be explained with the expansion of the local and national temporary employment programmes. Experts in the sphere of employment have commented this positive development stressing upon the fact that 2001 was a year of elections.

At the same time, no changes occurred in 2001 with respect to legalising and regulating the grey and quasi-legal activities in which the Roma population takes an active part. Typical cases are the illegal employment in agriculture, the timber industry and woodcutting in particular, construction, and trade. Until now, there have been no estimates of the actual incomes of the Roma population derived from the shadow economy, which are considered to be equal to the social assistance benefits allocated and disbursed by the government budget.

Of a substantially more serious nature is the transition from "shadow economy employment" to "criminal activity". The typical cases of illegal woodcutting, thefts of ferrous and non-ferrous metals (reaching drastic cases such as disconnecting high voltage power lines and leaving entire towns without telecommunications) lead to significant financial losses and drain resources from the respective public companies. This type of activity, however, has begun to clash more frequently with private economic interests. After the restitution of forests, for instance, the opposition of private owners to illegal woodcutting has often led to open forms of violence. Such enmities could easily provoke ethnic tensions. A considerable number of Bulgarian households use "cheap wood" for heating purposes and it has been sold on a quasi-legal basis ever since the beginning of the 1990s. According to estimates made by the Ministry of Agriculture and Forestry, in 2000–2001 alone, about 3.5% of the Bulgarian forests were completely lost

¹ According to data of the Turkish Chamber of Commerce, a massive relocation of production facilities to Eastern Europe was observed as a result of the financial crisis in Turkey. Out of all the enterprises opened in Eastern Europe in the 2000–2001, one half of them are based in Bulgaria.

² Over the period 1997–1998, 54% of the Roma identified themselves as unemployed.

because of illegal woodcutting and forest fires, the later provoking numerous doubts of intentional arsons.

Another serious problem determined by economic factors is the “free” electricity consumption of the Roma. With the restructuring of the National Electricity Company (NEC), however, the huge losses sustained by the former local branches of NEC because of the illegal “free of charge” consumption of electricity became a very contentious issue. The Stolipinovo district in the city of Plovdiv, where 40,000 Roma people live, serves as an emblematic example. According to estimates made by the local administration, the outstanding amount owed to the NEC is in the range of USD 5–7 million. Bearing in mind that approximately three quarters of the electricity consumption is illegal and not accounted for in the owed amounts, the losses of the company are substantial. Similar situation can be seen in most of the bigger Bulgarian towns with large Roma settlements. It is obvious that these types of hidden state subsidies cannot be allowed in the future, bearing in mind the forthcoming privatisation of the NEC and the deregulation of the electricity sector.

The development of the Roma political parties also merits attention. Despite the attempt to set up a Roma political formation similar to the MRF, no particular success has been achieved in this respect. The relatively successful “Free Bulgaria” party (established by the Roma Tzar (“King”) Kiro), contrary to the preliminary expectations had a much weaker performance at the 1999 local election. The major determinant of this unsuccessful performance lies within the Roma community itself, which in Bulgaria consists of more than 20 sub-groups. The differences and contradictions between the sub-groups are stronger than their differences with the other ethnic groups. At the same time, in the June general election, the Roma politicians set up a successful coalition with the MRF and the Liberal Union, which succeeded in attracting a significant number of Roma votes. There is a considerable presence of Roma leaders in this coalition who through mobilising a number of Roma votes contributed to the MRF entry in parliament. Roma leaders expected that representatives of the Roma minority together with representatives of the Turkish minority would participate in central and local governance. When the cabinet was formed and regional administrations were appointed, it became clear that the Roma community would not be represented in the administration as initially expected. In 2002, this may provoke rifts between Roma leaders and the MRF.

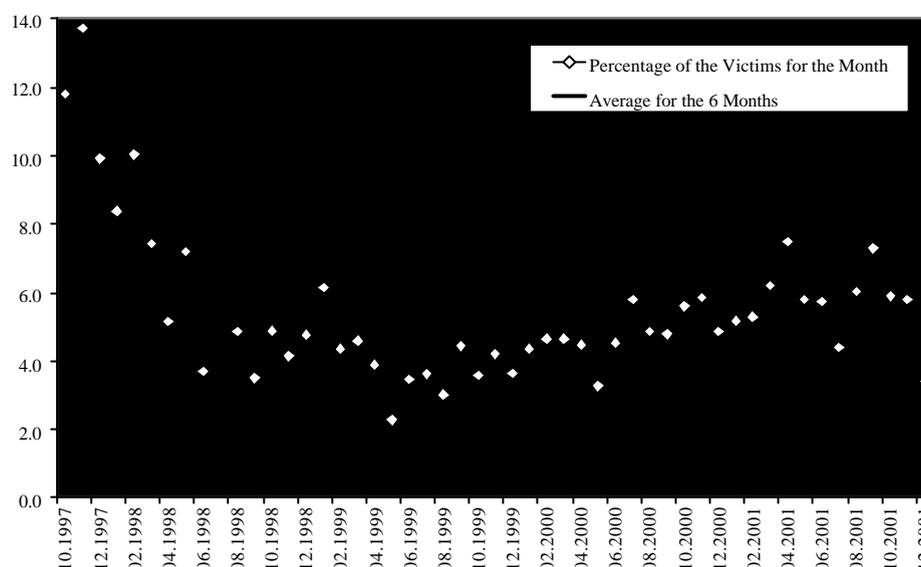
Finally, the review of the Roma political formations suggests that their power has been undermined by the criminal charges against their most well known leaders – Tzvetelin Kanchev (“Euroroma”) and Tzar Kiro (“Free Bulgaria”).

8. PERSONAL SECURITY

In 2001, lower crime rates improved the crime situation in the country.

In 2001, crime rates in the country were lower than in the previous year. This was recorded by both the police registration of crime and the Victimization Survey¹ (Table 8.1 and Figure 8.1).

Figure 8.1. Victimization Survey – Monthly Rates of Crime and Biannual Average Rates of Crime for 1998–2001, in %*



* Share of the respondents reporting that a crime has been committed against them or against a member of their family.

Source: BBSS Gallup monthly surveys.

Table 8.1. Overall Number of Crimes in the Last Ten Years

Year	Registered Crimes	Registered Crimes per 100 000 people
1989	59 642	663
1990	68 569	763
1991	176 189	2 042
1992	224 196	2 646
1993	220 767	2 606
1994	222 828	2 644
1995	206 103	2 446
1996	195 450	2 331
1997	241 732	2 898
1998	164 518	1 999
1999	132 897	1 622
2000	139 071	1 707
2001	127 000	1592*

* Calculated on the basis of the preliminary results of the 2001 population census, according to which the Bulgarian population is 7,973 million people. Data for other years is based on the previous population census.

¹ This block of questions has been introduced in October 1997 to facilitate the independent analysis of the crime situation in the country. At the same time, the Victimization Survey is experimental and cannot be compared in terms of precision and reliability to similar surveys, e.g. the National Crime Survey held by the US Bureau of Census.

Source: Police Registration of Crime.

The assessment of the crime situation in past 12 months should be made in the context of the previous four years. After the crisis months at the end of 1996 and the beginning of 1997, when the overall level of crime reached peak levels, a process of gradual normalisation began. The year 1998 registered a decline of the overall number of crimes by 31.9%, and in 1999 the decline was strengthened by additional 14.9%. In this way the number of crimes recorded by the police statistics reached its lowest level since the beginning of 1991 (Table 8.1).

Unlike 1998 and 1999, the crime situation in 2000 had strong political repercussions because of the forthcoming general election. In this sense, the year 2000 requires additional analysis. For the first time since 1997, the deteriorating crime situation had a direct negative impact on the overall political stability of the country¹. Growing crime rates pushed the issue of crime to the top of the agenda of the media and of the politicians. In November–December 2000, some serious crimes were turning into events carrying political instability. This tendency received a further and much sharper development in the first months of 2001.

The year 2001 merits special attention for two reasons: (a) the unique experience of the attempt to provoke political crisis, because of the worsening crime situation, and (b) the impact of political changes on public perceptions of crime. The analysis of the crime situation in 2001 requires the differentiation of three periods: (1) January–March; (2) April–September, and (3) September–December.

The first period started with a series of coinciding crimes, which at the beginning of February led to a public debate and demands for the resignation of the Kostov government. The culmination of political instability came with the protests of the taxi drivers, when a child of one of their colleague was murdered. On the day of the incident, the National Assembly was put under “siege”, there was an escalation of social tension, which could have led to the resignation of the government.

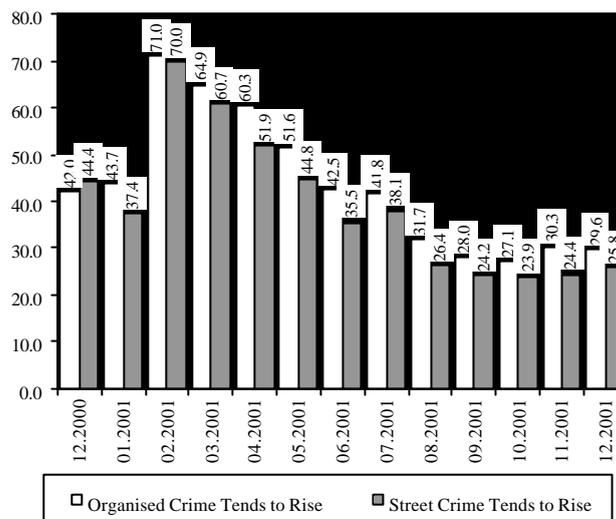
An outline of the causal relationships, which provoked the political crisis in January–March 2001, could be described along the following lines: (a) increased intensity of street crime and aggravated conflicts between criminal groups throughout 2000; (b) increased number of serious crimes, which in some periods reached extreme values for the size of the country and its population; (c) growth of anti-government sentiments among influential reporters and editors, which led to deliberate over-exposure of the issue of crime; (d) the periods with peak levels of serious crimes created an opportunity for opposition politicians to attack the cabinet in the prime time of electronic media and in the newspapers with the highest circulation; (e) there was either spontaneous or organised reaction on the “street”, which reached extremes such as blocking roads (public places) and the siege of important public institutions; (f) the crisis in the ruling majority created the possibility for a loss of power by a parliamentary vote, should more serious media or political pressure have been exerted.

¹ The explanatory framework (which has been empirically confirmed in the course of the EW Project) suggests that initially instabilities occur in other sectors of the EW monitoring framework. In this sense, the indicators measuring the impact of the crime situation can be described as “late and lagging” unlike the social, economic, and political indicators, which run ahead or coincide with the crises processes in society.

In the unfolding of this sequence of events, some political analysts “recognised” the events of January 1997¹. After the peak reached with the blockade of the parliament building and the subsequent settlement of the crisis, the tension caused by the growth of crime gradually started to subside.

The second period began with the entry of Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics on 6 April 2001. As a consequence, the issue of crime went low on the agenda of both media and politicians. Although the pre-election debate intermittently touched upon corruption in general, the issues of crime were mentioned only incidentally. As a result of this, the negative public perceptions on the crime situation marked a tendency of decline (Figure 8.2).

Figure 8.2. *According to You, Which Type of Crime Has Been Growing in the Last Few Months?*



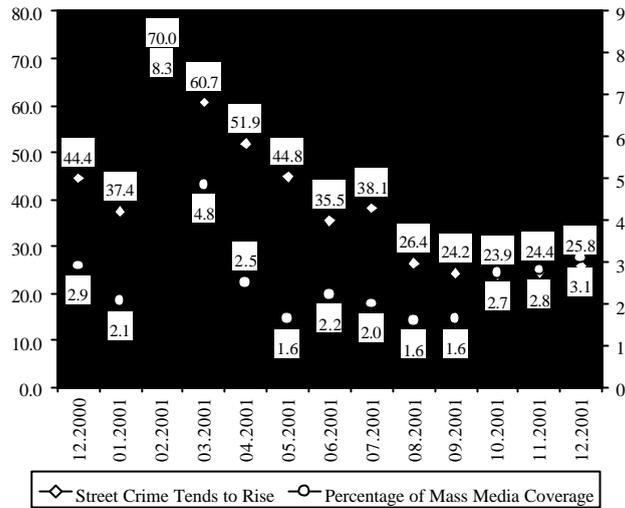
Source: BBSS Gallup monthly surveys.

The third period began with the appointment of Mr. Boiko Borissov as Chief Secretary of the Ministry of Interior. In this period, once again, political factors were more important than the development of the crime situation itself. During this period public perceptions that street crime grows approached the level they had before the general election. In our opinion, in the period after the June 2001 general election, the number of serious crimes provoking media interest sharply rose and it was only the exceptional public relations talent of the new Chief Secretary of the Ministry of the Interior that was able to hold down media attacks on the issue of crime.

In this connection it is necessary to note that the experience from the past one and a half year shows that there is an exceptionally strong relationship between public perceptions of crime and the coverage of crime in the media (Figure 8.3).

¹ For this reason, the cabinet regarded taxi drivers as “the organized nucleus” of the mutiny.

Figure 8.3. *Press Coverage of Crime as a Share of the Overall Number of Publications* and Positive Replies to the Survey Question that Street Crime Tends to Rise***

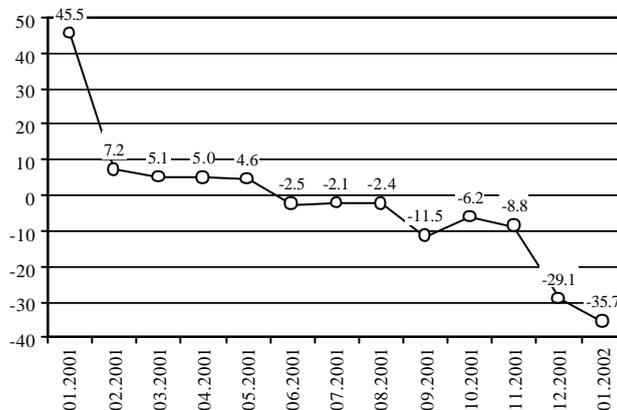


* Right-hand scale – press coverage of crime as a share of the overall number in all publications, in %.
 ** Left-hand scale – positive replies of respondents that street crime tends to rise, in %.

Source: Based on content analysis of press publications in the media database at www.online.bg and BBSS Gallup monthly surveys.

The decline of the overall number of registered crimes in 2001 is mainly due to the sharp drop of crime rates at the end of the year (Figure 8.4).

Figure 8.4. *Monthly Crime Rates in 2001**

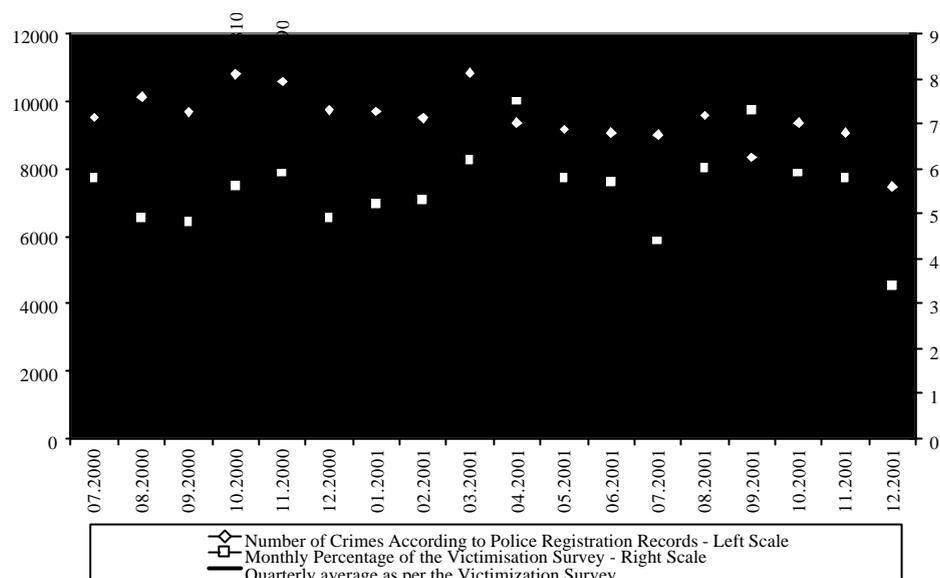


* Growth (in %) against the respective month of the previous year.

Source: Police Registration of Crime.

The improvement of the official crime indicators after changes in the political leadership of the country usually gives rise to suspicion. The Victimization Survey, which is an independent and alternative source of information for the EW project since 1997, indicates that the trend of decline in the overall number of crimes at the end of the year is genuine (Figure 8.5).

Figure 8.5. Comparison between the Victimization Survey and the Police Registration of Crime¹



Source: Police Registration of Crime and BBSS Gallup monthly surveys.

The data of the police registration of crime for 2000 and 2001 (Table 8.2) indicates that positive changes have taken place in the rates of almost all categories of crime. The overall improvement of the crime situation, recorded by the police statistics is mainly due to the decline of property thefts, which have the largest share in the total number of crimes.

Table 8.2. Crime Rates in 2000 and 2001

	2000	2001	Percentage Change
Murders	299	246	-17.7
Rapes	462	413	-10.6
Severe bodily injuries	97	62	-36.1
Robberies	3691	3265	-11.5
Property Thefts	73893	66811	-9.6
Fraud	3755	3241	-13.7
Car thefts	8831	9215	4.3
Arson of personal property	1919	1274	-33.6
Hooliganism	1706	1613	-5.5

Source: Police Registration of Crime.

Two other groups of serious crime, which indicate that there has been an improvement in the work of law-enforcement authorities on the level of mass crime, are robberies and arsons. After the wave of bomb assaults and arsons in 2000, the recorded drop of 33.6% in 2001 suggests a change in trends. It was only car

¹ The right-hand scale reflects the monthly percentage rate of respondents who have replied that they themselves or members of their families have been victims of crime. The left-hand scale shows the number of crimes registered by police statistics, on which the police continue to work, in other words these are the cases that have been acknowledged as crimes.

thefts that marked a slight increase, but in the last quarter of 2001, this category of crime declined as well. At the same time, it should be noted that car thefts have become an important indicator for the level of organised crime. In this sense, the changes in this category could be used as a possible criterion as to how successful is the fight of organised crime.

The indicator measuring the rejection of police assistance has increased its level.

Despite the positive changes, recorded by the Victimization Survey, the “refusal of police assistance” indicator (i.e. people who did not seek for police assistance)¹ in 2001 reached its highest level for the last four years and stayed at 41% (Table 8.3).

Table 8.3. Public Demand for Police Assistance²

	Average in 1998	Average in 1999	Average in 2000	Average in 2001
Yes, and I was satisfied	8.8	6.7	8.1	7.5
Yes, but to no avail	57.9	61.2	53.9	51.4
No, I did not	33.4	31.9	38.0	41.2

Source: BBSS Gallup monthly surveys.

8.3. Issues for Additional Consideration

The methods implemented in the fight against conventional crime in 1997–1998 have been used once again.

With the appointment of the new Chief Secretary of the Ministry of the Interior, Mr. Boiko Borissov, some of the methods implemented in the fight against conventional crime in 1997–1998 were used once again. The police was intensely patrolling the streets again and carried out frequent check-ups. Almost 75% of the heads of the regional police departments have been replaced. Criminals with multiple offences and pending sentences were detained on a regular basis³. It is highly likely that this already tested approach will produce short-term positive results, however, such methods usually affect only the surface layers of crime.

For the first time it was openly admitted that some law-enforcement officers cooperate with criminal groups.

The reason that some law-enforcement officers cooperate with criminal groups, as was openly admitted, is that organised crime “did not get its back broken” but rather underwent a process of “adaptation and transformation”. The fight against organised crime in 1997–1998 was reduced to formal closing down of “insurance companies” (dealing with extortion rather than insurance), formal closures of illegal production facilities by legal means⁴ and informal pressure on the bosses of organised crime to comply with legal requirements. It was at that time that the larger part of criminal groups entered the legal business by means of buying or building hotels, catering establishments, stores, and factories. The problem with such a “restructuring” is that “grey and black business” continues to function parallel to legal business activities. It can also be added that after the shock of 1997, the companies of the criminal groups managed to adapt to the changed environment and by 1999–2000 they had already established “good contacts” with the new police and political leaderships. Moreover, there are indications that many of the large criminal groups have consciously and purposefully placed “trusted people” in the police, the customs and tax authorities, and in other

¹ The experience with administering this block of questions indicates that the deviations are too abrupt and the data can only be used for longer periods of time.

² Based on the survey question “Did You Seek Assistance from the Police?”

³ The “handcuffs” action, which was launched at the beginning of 2002, is very similar to the patterns of police action employed in 1997 and 1998.

⁴ Emblematic in this respect are the examples of how the CD production lines are exported to Monte Negro, Moldova, and the Ukraine, and only “the distribution networks” remain preserved in Bulgaria.

“useful” government agencies. According to some journalist investigations, this process intensified during the period of change of political power, i.e. in March–September 2001. In this sense the statement of the Chief Secretary of the Ministry of the Interior, Mr. Boiko Borissov, that “there is not a single criminal group in the country that does not work with a policeman” is highly indicative but not very surprising.

Disclosed by various police officers information for the press showed how widespread is the networking of the law-enforcement and the criminal world. At the same time, the overall number of police and customs officers charged with offences is relatively small compared to the size of smuggling and corruption, registered by different studies. So far there appears to be no evidence of any serious improvements in this aspect of the work in the responsible departments and national services of the Ministry of Interior (Internal Investigation Department and the National Service for Fighting Organised Crime).

Only 2% of business disputes are settled in court.

Some of the most widely discussed crimes – bomb blasts, arsons, battering and assault, and contract murders – have been “nourished” not only by transformed criminal groups, but also by the overall situation of the economy and the judicial system. As the surveys on small and medium-sized business for 2000 showed, only 2% of all business disputes are settled in the courts of law¹. Within this context, the acute conflict between the various branches of the judiciary indicates that no matter what radical changes take place in the executive branch, business disputes will continue to be resolved by criminal means, unless the judiciary is not radically amended.

¹ The first forms of organised crime were “firms providing security and guards” (to both organisations and individual citizens), which also performed the function of collecting overdue receivables from defaulted debtors. At the time being this “form of justice” continues to exist.

GLOSSARY

Absolute poverty - refers to the position of an individual or a household in relation to a poverty line whose real value is fixed over time. The absolute poverty line is based on the cost of a minimum consumption basket, based on the food necessary for a recommended calorie intake. The poverty line is augmented by an allowance for non-food needs, consistent with the spending patterns of the poor.

Active (pro-active) labour market policy - measures directed at the stimulation of the active behaviour of unemployed and stimulation of employment.

Administrative information (statistics) - information from the National Employment Office, Ministry of Labour and Social Policy, National Social Insurance Institute, etc.

Assimilation - a strategy for accommodating ethnic minorities that gives individual members incentives and opportunities to subordinate their identities to the language, values, and lifeways of the dominant population group.

Balance of payments accounts - a record of transactions over a specific time interval between residents of a given country and the rest of the world.

Base minimum income (BMI) - category on the basis of which the monthly social allowance for poor individuals and families was calculated until December 1998. BMI was replaced by *Guaranteed Minimum Income (GMI)*, see also *Guaranteed Minimum Income*.

Basic coping strategies index - shows the percentage distribution of respondents who indicate that they would use the respective coping strategies, if their incomes are not sufficient

BBSS - British Balkan Social Surveys.

BGN - Bulgarian Lev (Bulgarian national currency). In the text BGN may appear interchangeably with *lev* or *leva* and *levs* (pl.).

BDZ - Bulgarian State Railways.

BNB - Bulgarian National Bank.

BSP - Bulgarian Socialist Party.

Borrowing - the change in the liabilities outstanding reported by a sector or unit in the economy over a specified time period.

Capital Adequacy - A level of capital that will allow the bank to absorb (loan) losses and still have adequate funds to maintain and operate the bank as going concern.

CBA - Currency Board Arrangement.

Coalition for Bulgaria – a BSP-led coalition established in 2001, comprising 15 leftist parties and movements.

Communal contenders - culturally distinct peoples, tribes, or clans in heterogeneous societies who seek a larger share of state power. Most African states are made up of numerous communal contenders and are governed by coalitions of these groups.

Consolidated state budget – a budget category which includes the republican budget (see also *republican budget*), the social insurance budget, the municipal budgets, the budget of the judiciary, as well as all extra-budgetary accounts and funds which are part of the fiscal reserve.

Coverage coefficient - the ratio of the total amount of the bids received to the nominal value of the offer in the primary market of government securities.

Coverage coefficient of the bids received - the ratio of the total nominal value of the bids approved to the total nominal value of the bids received in the primary market of government securities.

CPI - Consumer Price Index

Credit aggregates - (1) *Domestic Credit* = Claims on Government (net)+Claims on non-government sector; (2) *Claims on non-government sector* = Claims on non-financial state-owned enterprises + Claims on private enterprises + Claims on non-bank financial institutions + Claims on the public + Other items (net).

Credit (or Default) risk - the probability of being unable to meet the terms of a credit contract.

Crime rate - crime rates are computed by the following formula:

$$\text{Crime Rate} = \frac{\text{Number of reported crimes}}{\text{Total population}} \times 100$$

Cumulative Governance Index (CGI) – until July 2001, the index was based on the responses to the BBSS Gallup survey question “According to you, if UDF is not in power but another party, will the situation be better or worse in the areas of crime, prices, unemployment, corruption, industrial output, privatisation, relations with Russia, relations with the West, taxes, agriculture, healthcare, education, welfare?” Since July 2001, the index is based on the survey question “With NM Simeon II in power, the situation in the following areas (the as listed above) is better or worse?”

The index values are calculated in the following way:

$$CGI = \frac{? \frac{100 - (Y_i - N_i)}{100}}{n}$$

Where Y_i = “Yes” answers in each area

N_i = “No” answers in each area

n = total number of monitored areas

Thus, the index value for the month is the average of the scores in the specified areas. Index values can vary between zero (0) and two (2), one (1) being the neutral position. Values above one (1) indicate public confidence that the regime is more capable than the opposition to deal with existing issues, while values lower than one (1) suggest public attitudes that the opposition will find better solutions

for the existing problems.

Indexes for the governing potential in a specific policy area are calculated and interpreted in the same way as the CGI.

Discouraged workers - persons who wish to return to work and are available to start working but are not actively seeking for jobs because they believe that they will not find any.

Discrimination - deliberately maintained inequalities in ethnic **group** members' material well-being (**economic discrimination**) or political access (**political discrimination**) in comparison with those of other social groups.

Dominant minorities - numerically small ethnic groups that exercise a **preponderance** of both political and economic power within a society. Contemporary examples include South Africans of European descent and the Alawis of Syria.

Economically active population and high employment economy (indicator)

– The indicator records the inter-relation between the employed, unemployed and economically active population. The indicator is sensitive to different combinations of these population groups. When employment grows and unemployment declines, the indicator improves its values and vice-versa. A situation is possible, when employment and unemployment rise concurrently at the expense of a decline of the economically active population (when a portion of this population goes out at the labour market), the indicator could improve or deteriorate its values, depending on what grows faster – unemployment or employment. The reverse situation is possible – employment and unemployment to decline concurrently when a portion of the economically active population joins the economically inactive population. In this case, the indicator's values would improve if the employed population declines at a slower rate of the unemployed population. The indicator's values would deteriorate if the employed population declines at a faster rate.

The indicator is calculated in the following: $\frac{1}{2}$ of activity rate – (minus) $[1/2$ of employment rate + $(1 - \text{ratio of inactive to active population})]$. In case we get a positive number or zero, there is “Economically active population and high employment economy”. In practice this implies that all population above the age of 15 years is employed, and that the active population is more or equal to the non-active population. Values smaller than zero point to a state far away from “Economically active population and high employment economy”.

Employed persons - persons who carry out work, for which they are in receipt of remuneration in money or in kind, remuneration on the basis of a civil contract or other type of contract in public companies or for a private employer.

Employers - persons who either individually or in association with others manage their own enterprise (firms or companies), work on a lease basis or are engaged in any other independent activity employing one or more persons.

Ethnic conflicts and tensions - the analysis is based on the BBSS Gallup survey using the questions: (a) “*In your opinion is there a possibility for mass (large scale) protests in the area of your residence related to: (1) higher pay; (2) against unemployment; (3) for maintaining the welfare benefits; (4) for cleaner environment; (5) against the violation of civil rights; (6) against the politics of the government, and (b) "In which of those you would personally participate?"* and the range of answers is the same as the first question.

Ethnic groups - these are composed of people who share a distinctive and enduring collective identity based on shared experiences and cultural traits. They may define themselves, and may be defined by others, in terms of any or all of the following traits: lifeways, religious beliefs, language, physical appearance, region of residence, traditional occupations, and a history of conquest and repression by culturally different peoples. Ethnic groups are also called **communal groups**, **identity groups**, and **minorities**. The term **minorities** can be misleading, because some people so labelled, like Black South Africans and Shi'i Muslims in Iraq, constitute numerical majorities.

Ethnoclasses - ethnically or culturally distinct peoples, usually descended from slaves or immigrants, who have special economic roles. Examples from Western societies, like the Turks in Germany and African Americans in the United States, are usually of low status. Asian examples, like the Chinese in Malaysia and Indonesia, are often economically advantaged but politically restricted.

Ethnonationalists - large, regionally concentrated groups of people with a history of political independence or autonomy who seek to re-establish their independence or extend their autonomy. Those who want complete independence are called **separatists**.

Ethnopolitical groups - ethnic groups that have organised to promote their common interests. When their actions bring them into open conflict with states, the result is **ethnopolitical conflict**.

EW - Early Warning.

EWO - Early Warning Observation.

EWR - Early Warning Report.

Gross External Debt - the amount, at any given time, of disbursed and outstanding contractual liabilities of residents of a country to non-residents.

Guaranteed Minimum Income (GMI) - category on the basis of which the monthly social allowance for poor individuals and families is calculated, after a needs assessment, based on the evaluation of property, owned by these individuals. The amount of the base minimum income is determined by the Council of Ministers. GMI was adopted in December 1998, replacing the former category Base Minimum Income

Humanitarian intervention - reliance on force for the justifiable purpose of protecting the inhabitants of another state from treatment that is arbitrary and persistently abusive.

Incomes, Income Expectations and Income Stratification: technical notes

- The analysis of incomes is based on the monthly information of the National Statistical Institute (NSI) and the survey data provided by Balkan British Social Surveys (BBSS) Gallup. Survey data is collected in the beginning of every month and accounts for incomes received in the previous month (e.g. in the July 1999 survey incomes for June 1999 are reported, etc.). With regard to expectations and subjective perceptions, survey data refers and is reported for the same month.

In technical terms, the major issues for consideration are the relevance and adequacy of the data:

⌘ The fairly high share of the grey sector in the economy reduces actual income levels that are reported or accounted for. Most probably this also dis-

torts income structures. So far, it has not been possible to estimate the magnitude of these distortions and reductions;

- ☞ As international experience shows, it is quite possible that respondents do not report accurately their incomes. However, on the whole, it is relevant to assume that the reported distortions level each other out, and that the information obtained allows for fairly accurate estimates to be made on development trends of household incomes;
- ☞ The income levels reported in Table 5.1A, Table 5.1B, Table 5.2. and Table 5.4. reflect per capita households income and are calculated by dividing the total income of the household by the number of household members. In general, the obtained averages are consistent for the social groups that have a higher relative share in the population. However, data for smaller social groups tends to fluctuate considerably, being based on social categories, which represent 1% to 2% of the adult population (i.e. ethnic minorities, affluent households, etc.). Irrespective of that, these results are reported as they present the basic way of verifying and improving the methodology employed.

Income expectations index - includes the percentage of respondents who respectively expect their income to improve, to worsen, do not expect any change, or do not know. The included summary value for income expectations ranges between 1 (firm improvement) and -1 (firm worsening).

Indexes of trust – see Political stability indexes.

Inflation expectations index - the percentage of respondents who respectively expect prices to rise, fall, do not expect any change, or do not know. The included summary value for inflation expectations ranges between 2 (quick increase of prices) and -2 (quick reduction of prices).

Islamic fundamentalism - a movement that stresses the literal adherence to basic principles as written in the Quran, the Hadiths, and the Sharia (Islamic law), and its five schools of legal interpretation. There are four Sunni schools (Hanafi, Maliki, Shafii, Hanbali) and one Shi'i school (Ja'fari).

Interest rate differential - the difference between the domestic assets rate of return and the foreign assets rate of return after conversion in domestic currency.

Interest rate spread - the difference between the annual interest rate on credits and the annual interest rate on deposits.

Labour force - persons above the age of 15 who are employed or unemployed.

Labour force survey - a special survey (carried out by the National Statistical Institute) which provides information on several basic characteristics of the labour force. The survey is centred on the permanent population of Bulgaria above the age of 15, resident in normal family domiciles.

Legitimacy - the perception that a government, its leaders, and its policies are just and worthy of support.

Levels of analysis refers to the factors thought to influence the decision-making process; they range from individual preferences to roles, societal input, regime characteristics, regional relations, and traits of the world system.

Liabilities of the Issuing Department - The liabilities of the Issuing Department.

ment of the BNB consist of: 1) Currency in circulation; 2) Commercial Banks deposits and current accounts; 3) Government Deposits and Accounts; 4) Banking Department deposit (represent the net value of Issuing Departments' assets).

Liquidity - the ease with which an asset can be used in exchange or converted into a form that can be used in exchange.

LM - Local monitors provide additional expert assessments on problems and contentious issues on a local level by using standardised reporting formats.

LMS – includes the network of LMs and the database with LMs reports.

Long-term unemployed - unemployed person, who has been out of work for more than one year.

Mass lay-off - redundancy by one employer within a period of one month of more than 50 employees from an enterprise with personnel of more than 100 persons or of more than the half of the personnel from enterprises with staff between 50 and 100 employed.

Micronationalism - the demand for independent statehood by small communal groups.

Minimum reserve requirements - an amount of 11 % of the depository base of the commercial banks compulsorily kept at the central bank.

Mobilisation - the process by which leaders organise the energies and resources of their followers to pursue common political objectives.

Model - a simplified image of reality that describes the causes of any given phenomenon.

Monetary base - the sum of legal reserves in the banking system plus the amount of currency and coins held by the public.

Monthly crime rates - data in the report are on the basis of the Police Registration of Crime for the current month. In the central police computing office, data is received with a lag of two months because of the internal regulation for a maximum period of sixty days for investigation. This procedure explains the irregularity of incoming data from the local police departments to the central computing office.

Motor vehicle thefts - according to the Bulgarian legislation this group combines two types of crimes: *Motor vehicle thefts and Motor vehicle lifting*. This differentiation is a legacy from prior to 1989 when most of the cases were *Motor vehicle lifting*, which implied that vehicles were taken away not to be sold. In most of the cases this was done by juveniles who in the end were abandoning the vehicle. After 1990 almost 95% of the thefts are done for subsequent resale of the vehicle or parts of it. However, some of the local police departments continue to use the old category. In order to avoid confusion and to achieve comparability we have combined the two categories.

MLSP - Ministry of Labour and Social Policy.

MRF - Movement for Rights and Freedom.

NES - National Employment Service.

National Movement Simeon II (NM Simeon II) – an ad hoc coalition of two parties (the Party of Bulgarian Women and Movement for National Revival “Oborishte”), which facilitated the entry of Mr. Simeon of Saxe-Coburg Gotha in Bulgarian politics. NM Simeon II won the parliamentary election in 2001 and has 120 seats in 240-member unicameral National Assembly.

NSI - National Statistical Institute.

NSSI - National Social Security Institute.

Operationalisation - the process of defining concepts in a hypothesis so they can be measured in real quantities.

Passive labour market policy - measures connected with the social protection of the unemployed.

Peacebuilding - the ability to anticipate conflict in order to apply proper measures to create the conditions for peace.

Peacekeeping - the use of military personnel in non-combatant roles, such as monitoring cease-fires. Such activities require the consent of the **warring** parties.

Peacemaking (or peace enforcement) - enables peacekeeping forces not only to monitor a cease-fire but also to enforce it if it breaks down. Control over deployment and operation is exercised by the UN Security Council or can be delegated to a regional organisation.

Persons out of the labour force - persons who are neither employed nor unemployed, including all persons who are or on additional paid or unpaid maternity leave.

Plural societies consist of a number of ethnic groups, each with a distinct collective identity and interests, who are not ranked or **stratified** in relationship to one another. See also **stratified societies**.

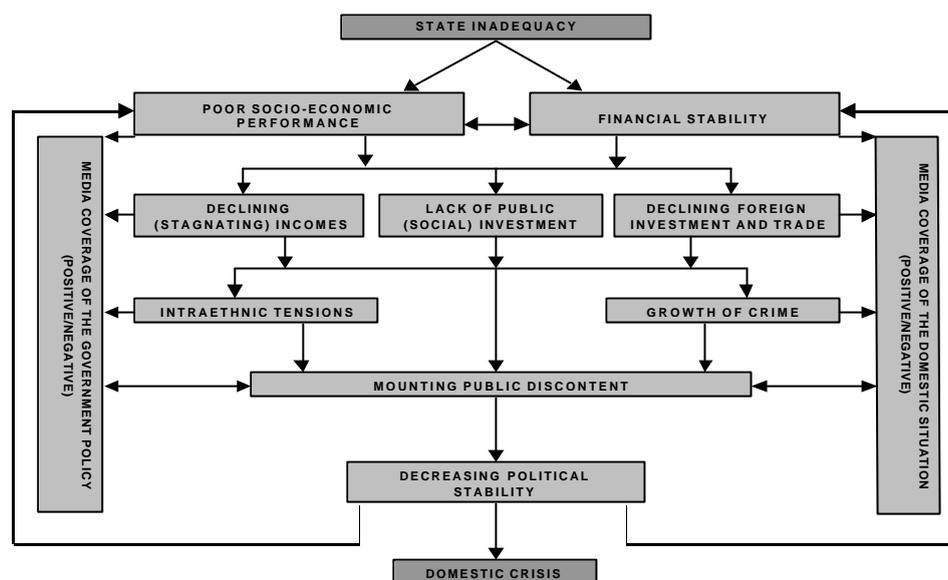
Pluralism – a strategy for accommodating ethnic minorities that recognises their individual and collective right to preserve their language, values, and lifeways in coexistence with those of the dominant group. Also see **assimilation** and **power-sharing**.

Police Registration of Crime or Police Record of Crime (PRC) - the methodology of the Bulgarian Police Registration of Crime can be compared to the *Uniform Crime Rate (UCR)* of FBI. The difference is that there are variations in the registration of the categories of crimes. The standard operating statistical procedure is that all categories of crimes are registered by the local police stations and are reported to the National Police Department of the Ministry of Interior. The Police Department reports the crime data to the National Statistical Office on an annual basis.

Political risk - the probability that changes in government laws or regulations will result in a lower rate of return of the investor or, in the extreme case, a total loss of invested capital.

Political stability (*Conceptual Framework*) - the basic assumption is that the overall stability in Bulgaria is predominantly dependent on social and economic issues. The analysis of the political stability section is based on the following analytical framework: (a) Political stability is regarded as dependent on economic and

social stability. In its turn, political stability becomes an important factor with impact on the overall stability of the nation in the event of crisis development. Thus, decreasing political stability is regarded as an accelerator that can lead to even worse performance in other economic and social areas. The diagram below indicates the assumption of the possible chain of causal relationships where state inadequacies can lead to state failure (see also **state failure**); (b) The alert levels for the indicators, measuring political stability are determined on the basis of the values of the last major Bulgarian political and socio-economic crisis in the end of 1996 and the beginning of 1997.



Political stability indexes (indexes of trust) - they reflect the dynamics in the proportions of approval / disapproval rates of the main state institutions and serve as composite measures of political stability. The critical (alert) values of these indexes are determined on the basis of the values of the last Bulgarian political and socio-economic crisis. Additionally, support / approval measurements are tested in conjunction with approval rates of the ruling political party. The assumption is that decreasing approval rates, restrict the options of the ruling party, which in crisis development can act as accelerator of general political instability. The critical values of these support rates are determined to be 20 percent support, which is a rough approximation of the number of firm supporters of the two main political parties in Bulgaria.

Political stability weighted indexes - they represent ratios of trust / mistrust. The indexes include the percentage of respondents who respectively approve, disapprove or do not have an opinion about the performance of the different Bulgarian Institutions. The summary values of these type of indexes range from +1 (firm trust) to -1 (firm mistrust). Positive values indicate higher trust than mistrust and, vice versa, negative values indicate higher mistrust rates. As critical values are considered those which are a result of trust rates of less than 20 per cent. Indexes, constructed on the basis of survey questions with more than three responses, are interpreted in a similar way. In cases of five different responses, for instance, firm disapproval, disapproval, approval, firm approval and lack of opinion, the scale of the index will range between -2 (firm disapproval) and +2 (firm approval). The EW report includes on a regular basis the following indices: (a) Indexes of Trust: Parliament, President, Government, Local Government, Army,

Police, Prosecution; (b) Index of Optimistic Perceptions. Depending on the BBSS Gallup survey data, the report includes periodically indices of perception for repression of diverging political opinions, of political opponents, of business and religious activity. Finally, the political section includes data on public and personal readiness for political action. The primary data is the same as the one used to measure Ethnic and Religious Tensions. Also see Ethnic and Religious Tensions.

Power-sharing - a strategy for accommodating ethnic minorities based on the assumption that ethnic identities and organisations are the basic elements of society. Political power is exercised jointly by these groups, each of which is represented in government and each of which has veto power over policies that adversely affect group members. Also see **assimilation** and **pluralism**.

PRC - Police Registration of Crime or Police Record of Crime. See the also the explanation of this category.

Primary [bank] liquidity - The share of cash and demand deposits in the total bank deposits - *see also secondary [bank] liquidity*.

Primary dealers - security firms that acquire securities from the government and other borrowers and make markets for those securities.

Primary markets - institutional mechanisms set up to trade newly issued loans and securities.

Protracted communal conflicts - conflicts between ethnic groups and governments over fundamental issues of group rights and identity that persist for generations unless and until the underlying issues are resolved. They usually involve recurring episodes of intense violence.

Public works - jobs which are created in areas of need in the local community; social services, construction, public utilities, preservation of historic monuments and sites, home care services and other such activities.

Registered unemployed - persons who are physically and psychologically capable for work within the legally established in the country working age who are registered at the labour offices as actively seeking jobs.

Relative Potential of the Regime to Resolve Societal Problem, Compared to the Opposition (Cumulative Index) - The cumulative index is based on the set of responses to the BBSS Gallup survey question "According to you, if UDF is not in power but another party is, will the situation be better or worse in the following areas: privatisation, prices, unemployment, relations with Russia, relations with the West, industrial output, welfare, taxes, agriculture, education, health, crime and corruption. The cumulative index values represent the average of the scores in the different issue areas, listed above. The scores for the individual issue areas are calculated in the following way: (100 minus the difference between better and worse answers) divided by 100. Values can vary between zero (0) and two (2), one (1) being the neutral position of the scale. Values above one (1) indicate public confidence that the regime is more capable than the opposition to deal with existing issues in the respective area. Values lower than one (1) indicate that the public thinks that the opposition will find better solutions for the existing problems than the current Government

Religious conflicts and tensions - the analysis is based on the BBSS Gallup survey question "*Does the government create obstacles to people with differ-*

ent religious beliefs?". Data are presented as a percentage ratio between respondents who think that the government does not create obstacles and those who think that it creates obstacles.

Republican budget – A budget category, which includes the central Government budget and the budget of state institutions (ministries, agencies, county administration and the auditing chamber).

Risk and risk premium - the probability that loss could be suffered and the remuneration for that probability.

Risk Exposures (risk assets) - were defined as total assets minus cash, balances due from Central Banks, and government securities.

SDR - Special Drawing Rights of the IMF.

Secondary [bank] liquidity - The share of cash, demand deposits and short-term Government securities in the total bank deposits - *see also primary [bank] liquidity*.

Self-employed persons - persons who individually or in association with other people manage their own enterprise (firms or companies) or are engaged in private free-lance practice or practice any other type of activity without hiring other persons. This group also includes members of manufacturers' co-operatives.

Social minimum - the money necessary for the purchasing of goods and services that satisfy minimum physiological, intellectual and social needs of the individuals, recognised by society. This category is normally used as an absolute poverty line. It is also interpreted as a "poverty ceiling". In technical terms the social minimum in Bulgaria is calculated according to the consumer basket method. The report refers to the social minimum based on the consumer basket of the MLSP, which includes 11 groups of commodities, services and expenses.

Social pension - the minimum pension granted to persons who do not have any accumulated insurance rights entitling them to receive pensions under the general order. The social pensions secure minimum incomes for: disabled persons without experience, aged people with very low incomes, etc.

SSB - State Savings Bank of Bulgaria (Bulgarian acronym is DSK).

State failure - Academic literature describes four conceptually distinct types of state failure: Revolutionary wars, Ethnic wars, Regime transitions, Genocides and Politicides. The meaning of "state failure" used in this report is close to the type described as "Regime transition" which includes "major, abrupt shifts in patterns of governance, including state collapse, periods of severe instability, and shifts towards authoritarian rule", see Gurr, T. (1995) "The State Failure Project: Early Warning Research for International Policy Planning", paper for the International Studies Association Annual Meeting, Chicago, 21- 25 February 1995, pp. 2-3. For the purposes of this report "state failure" is defined as the inability of the government to deliver the expected goods and services to the citizens and to ensure growing living standards. Some authors relate this type of "state failure" to "bad governance" or "government incompetence". For instance, Juergen Dedring regards "government incompetence" as "the phenomenon of governments increasingly falling short in their ability to deliver the expected goods and services to the citizens and residents, either due to fatigue after too many years in power or because the governing elite views its authority as an opportunity to enrich the people

at the top at the expense of the general population”, see Dedring, J., 1992. ‘Socio-political Indicators for Early Warning Purposes’, in Rupensinghe, K. and Michiko Kuroda (eds.), 1992. Early Warning and Conflict Resolution, New York: St. Martin’s Press, p. 200.

Stratified societies - status, power, and wealth are unequally distributed among groups according to their ethnicity. The socially maintained distinctions among groups in stratified societies are called **cleavages**. Also see **plural societies**.

Subsistence minimum - the heuristic role of this category is similar to that of the social minimum. The subsistence minimum is being interpreted as “a poverty bottom”. It is also calculated through the method of the consumer basket. This report refers to the subsistence minimum based on the MLSP basket which includes 9 groups of commodities, services and expenses, which are expected to secure the minimum conditions necessary for the physiological existence of the individuals.

T-bills (treasury bills) - short-term debt securities sold by the Ministry of Finance to raise cash in order to cover shortfalls of government funds.

Temporary employment program - direct job creation scheme adopted in 1992 by the Bulgarian government.

UDF - Union of Democratic Forces.

UtDF – United Democratic Forces, an UDF-led coalition.

Underemployed person - employees who are on compulsory leave or absence through no fault of their own or who work for less than 30 hours in the week.

Unemployed persons - persons above the age of 15 who at one and the same time do not have work, are actively looking for job and are available to start working.

Unpaid family workers - persons who work without pay for a company, enterprise or relation from the same household.

Victimisation survey - a survey that measures the extent of crime by interviewing individuals about their experience as victims. Victimisation surveys give information about crimes that are not reported from police. For instance, a similar survey is the National Crime Survey of the US Bureau of Census.

Visible minorities - a fairly recent term used in European and North American societies to refer collectively to resident minorities of African, Asian, and indigenous origins. It is replacing the older term *people of colour*.

Vulnerable groups - specific group of employed and unemployed persons which depending on their own qualitative characteristics and the condition on the labour market are more threatened by unemployment and long term unemployment.

Yield or rate of return - the ratio of the annual cash dividends or of the earnings per share of a stock to the market price.

ZUNK-bonds - bonds issued against the outstanding debt of state enterprises, according to the Bulgarian Law for the settlement of the outstanding debt of state enterprises.

LIST OF MAIN ACRONYMS

- BMI** - Base Minimum Income
- BBSS** - British Balkan Social Surveys
- BGN** - Bulgarian Lev (Bulgarian National Currency)
- BDZ** - Bulgarian State Railways
- BNB** - Bulgarian National Bank
- BSP** - Bulgarian Socialist Party
- CBA** - Currency Board Arrangement
- CB** - Currency Board
- CPI** - Consumer Price Index
- ECB** - European Central Bank
- ESAP** - Emergency Social Assistance Program of the European Union
- EW** - Early Warning
- EWO** - Early Warning Observation
- EWR** - Early Warning Report
- GDP** - Gross Domestic Product
- GMI** - Guaranteed Minimum Income
- GVA** - Gross Value Added
- LM** - Local Monitors
- MLSP** - Ministry of Labour and Social Policy
- MRF** - Movement for Rights and Freedom
- NES** - National Employment Service
- NSI** - National Statistical Institute.
- NSSI** - National Social Security Institute
- PRC** - Police Registration of Crime or Police Record of Crime
- SDR** - Special Drawing Rights of the IMF
- SSB** - State Savings Bank of Bulgaria
- T-bills** - Treasury Bills
- UDF** - Union of Democratic Forces
- UtDF** - United Democratic Forces