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Bulgaria's economy 1989–2019 – an open-ended story of structural changes

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Abstract:

Based on an analytical narrative, and utilizing macroeconomic and new institutional economic theory, this exposition studies the Bulgarian economy during the decades after 1989. The three decades are placed in the context of the century-and-a-half-long Bulgarian development and convergence dynamic. They are then presented in terms of clearly defined sub-periods, and each sub-period is analyzed in detail. The analysis for each period focuses on three sets of issues: macroeconomic developments, microeconomic developments, and institutional changes. The exposition ends by applying the insights from the analysis to the question of whether the state of the economy in Bulgaria as of 2019 gives grounds for pessimism (Bulgaria will continue the cycles of unsuccessful convergence) or for optimism (Bulgaria will achieve an unprecedented degree of convergence in the coming decades). The answer is that at present both expectations can be supported by sets of serious arguments.

Keywords: Bulgaria, convergence, economic development, EU accession, EU membership, predatory entrepreneurship

Introduction

The overview of the Bulgarian economy during the three decades spanning the turn of the millennium presented in this exposition has two main goals. The first is to put, from a macroeconomic perspective, these three decades into the context of the already-existing longer mapping of the overarching macroeconomic processes characterizing the country over the last century and a half. The second is to get a footing on this broader context and attempt to analyze features and specifics of the most recent three decades to see if there are any qualitatively different aspects to them in comparison to the preceding period of more than a century.

The method applied to achieve these two goals will be analytical narrative¹ grounded in macroeconomics and new institutional economics. With the insights from these two large areas of economic theorizing in mind, the main facts of the Bulgarian economic developments in the decades surrounding the turn of the century will be analyzed, put in the perspective of the longer-run economic development of the country, and used as a basis for reaching inferences about the periodicity, main characteristics, and modes of unfolding of economic processes over the last three decades.

The facts used to ground the analytical narrative are mostly macroeconomic. While macroeconomic data are not exempt from methodological and empirical problems, they are sufficient in terms of quality and relevance for the purposes of the exposition herein. There is also a set of microeconomic as well as political facts from the three decades covered by the overview. The latter two types of facts will be mostly used to supplement, illustrate, and provide analytical density to the narrative.

¹ For a theoretical exposition and empirical application of this method see Bates et.al. 1998. For an application to the Bulgarian case see V. Ganey 2007.

Bulgaria's macroeconomic performance in the long run²

The relevance of the long run for understanding Bulgaria's economy

The context of a relatively less developed country trying to catch up to the developed European leaders is an aspect of the Bulgarian economy which has generated sustained interest in the international economics research community throughout its existence as an independent country. Examples of such research interests include Gerschenkron (1962), Lampe (1986), and Palairt (1997). In all these cases Bulgaria has been viewed from two perspectives: its long-run arc of catching up, or of failing to do so, to the developed European models as well as the comparison of its arc to the ones of other European economies following similar catching-up trajectories. On the part of Bulgarian researchers, the first of these perspectives has most consistently been pursued by Avramov (2001 for the 20th century as a whole, 2007 for the pre-1945 period), with specific aspects of the economy also discussed in Daskalov (2005) and Ivanov (2012).

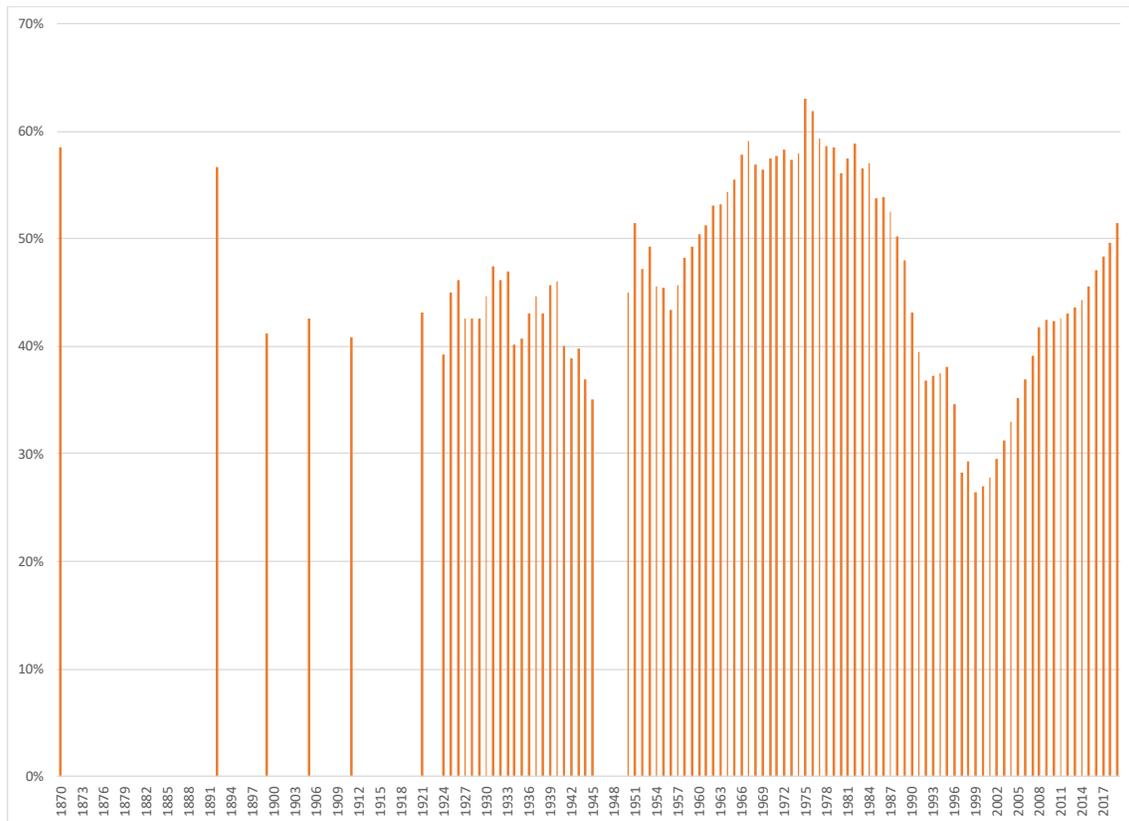
No research from this perspective has been conducted for the Bulgarian economy for the first two decades of the 21st century. All available overall development-encompassing studies have been relatively narrower in focus. Hristova et. al. (2004) focus on the first 10-15 years of transition with very limited mention of the pre-1989 development. Yotzov et. al. (2017) and Ganev (2017) concentrate on the decade after Bulgaria's EU membership, and have a focus on developmental (and catching-up) issues, but they extend no further back than 1999. Finally, Ganev (2018) extends a number of indicators into a relatively consistent series back to the 1960s, but lacks the comparison with the developmental models to which the country has been trying to catch up. The purpose of the remaining exposition is to fill at least to some extent this gap in the analysis of the Bulgarian longer-run macroeconomic dynamic from a developmental point of view.

² The exposition in this section owes a significant debt to Avramov (2001, 2007, 2008).

A long story in a single graph

The purpose of this first part of the overview of Bulgaria's economy is to put the most recent three decades of its development, spanning the turn of the millennium, in the longer-run perspective of the last century and a half. The simplest, yet analytically rich way to embark on this path is with a single image in the form of a graph, presented as Figure 1.

Figure 1. Bulgaria: real income per capita as percentage of West Europe 5* 1870-2019.



*Population-weighted average real income per capita for Germany, UK, France, Italy and Netherlands

Sources: for 1870-1945: Maddison project database;³ for 1950-2019: Total economy database;⁴ own calculations

Before discussing the significance of the image in Figure 1, its use as a starting point needs to be justified. The five countries, against which the performance of the Bulgarian economy is juxtaposed, are selected based on three criteria. First, the countries need to represent, to a sufficient degree, the highest level of economic development throughout the period for which a comparison is made. Second, the countries need to be large enough to exhibit a relatively stable dynamic and be less likely to be subject to idiosyncratic upward or downward spurts. Third, they are chosen from Europe, since throughout the period covered by the discussion here it is Europe which is the relevant achievement horizon for Bulgaria. Thus the idea is to show Bulgaria's relative, not absolute, performance compared to a representative sample of the highest European performers throughout the period under study.

The image in Figure 1 is significant, because it is a concentrated representation the most important aspects of Bulgaria's macroeconomic story: it does not seem to be able to consistently and sustainably catch up with the standard of living in Western Europe.

There is a lot to be said about this simple finding. The first relates to the its most likely proximate cause. In the long run economic wellbeing is determined by the ability of people in society to satisfy human wants with the available, scarce, resources. This ability is a direct function of the

³ The 2018 version of the database, downloaded from

<https://www.rug.nl/ggdc/historicaldevelopment/maddison/data/mpd2018.xlsx>

⁴ The April 2019 version of the database, downloaded from [https://www.conference-](https://www.conference-board.org/data/economydatabase/TED1)

[board.org/data/economydatabase/TED1](https://www.conference-board.org/data/economydatabase/TED1)

amount of capital goods in all their forms available to human labor to transform resources into satisfied wants by using some technological production process. Thus the accumulation of capital⁵ determines the standard of living of a society in the long run. So, Figure 1 actually reveals a chronic failure of Bulgarian society to accumulate capital of sufficient quantity (amount of capital goods per worker) and quality (capital goods, in all their forms, embodying the global edge of technological knowledge). For a small open economy like Bulgaria this failure has two faces: a failure to domestically generate savings to finance capital formation, and a failure to attract capital from abroad.

A second message from Figure 1 is that the chronic inability of Bulgarian society to catch up with the rich countries in Western Europe goes through cycles. Periods of visible falling behind are followed by seemingly promising periods of catching up, yet the catching up almost never reaches above 60%. It seems that something is always lacking for Bulgaria to make a crucial step through its ceiling. It is as if something is always missing. The word “without” seems to emerge systematically in the available academic pictures of the Bulgarian economy. The subtitle of Michael Palairet’s (1997) insightful economic history of the Balkans in the long 19th century, including Bulgaria, is “Evolution without development”. The title of the second part of the first volume of Avramov’s (2007) monumental history of Bulgaria’s first capitalism is “Capitalism without capital”. The very title of Ivanov’s (2008) history of economic endeavors during the communist period is “Reformism without

⁵ To keep the clarity of the argument, here technological knowledge is considered as a part of society’s capital stock, in terms of being both a part of human capital (technological knowledge and skills of specific economic agents) and of social capital (the overall level of technological knowledge achieved by a society). Technology, as the term is understood here, encompasses not only modes of physical transformation of raw resources into satisfied human wants, but also organizational, institutional, and contractual aspects of production. Technological innovation and improvement happen in all these spheres. Here they are included in the term “capital accumulation”.

reforms". It seems that the Bulgarian long economic story is that the missing ingredients necessary for a sustainable catching up to the rich West define the dynamic of economic processes in the country as a sequence of efforts to catch up, bouncing off the ceiling, and falling behind, followed by another effort. Avramov (2007) has captured this regularity aptly in the already-mentioned second part of the first volume by using the Sisyphus metaphor for describing both the internal and external aspects Bulgaria's economic dynamic.

A third message hidden behind Figure 1 is that for a century and a half Bulgarian society has actually achieved an absolute increase in living standards.⁶ The figure shows the ratio of real incomes in Bulgaria relative to the five rich countries in Western Europe, and inasmuch as they have become significantly richer over this time period, so has Bulgaria. So Bulgarians have been able to form some capital and internalize some of the global economic achievements, even though only up to a point. With time, developing technologies, production practices, and new products from the most highly developed and rich parts of the world do manage to enter Bulgaria, together with some capital and entrepreneurial transfers, which consequently raises the absolute standard of living in the country. This seems to be a regular finding for other peripheral countries like Bulgaria as well.

Some other important aspects of the long Bulgarian development, which are not directly reflected in Figure 1, also deserve a specific mention to build a deeper understanding of its context. Bulgaria is geographically situated in Southeastern Europe and throughout the last century and a half it has been its specific relations with the rest of the continent, especially with its most developed and richest part, which have defined its economic dynamic. Even during periods when Bulgaria was following a developing strategy opposing the adoption of the economically successful models in the rich Western European countries, it has been their growth which pushed the economic possibilities frontier to be chased.

⁶ The more direct evidence for this increase can be found in Ivanov (2012) and Ganev (2018).

Closely related to the above observation is another one: similarly to several other Eastern European countries within the last century and a half Bulgaria has radically changed its development model twice. After a sort of capitalism between achieving political independence in 1878 and 1945,⁷ Bulgaria became one of the strictest and most orthodox planned economies in the communist bloc, which consistently refused to permit even the smallest traces of markets and individual entrepreneurship. Then, when this radically different model, opposing the very core of Western economic development, failed, Bulgaria joined the other countries from the communist bloc in a new attempt to integrate into the capitalist world. Thus between the end of World War II and the beginning of the 21st century the Bulgarian economy underwent two transitions – one from a sort of capitalism towards a communist planned and command economy, and then back to a type of capitalism with private property in the means of production and markets as the major coordinating mechanism. It is precisely this second episode which is has been known as “the” transition since 1989.

Two constants in Bulgaria’s long developmental fluctuations

Regardless of the specific and unique features of each period of the long Bulgarian economic development, so far the last century and a half can be characterized by two constants. The first is the already mentioned lack of capital and inability to generate it domestically in sufficient amounts, resulting in the economic dynamic of the country always being dependent of flows from abroad. The second is the fact that the various models of economic development over the period, regardless of how radically different they may have been, were also imported from abroad and transplanted into the Bulgarian context.

⁷ On the half-heartedness of this attempt at introducing capitalism see the ample evidence in Avramov 2007.

The combination of these two constants in the long Bulgarian economic dynamic has two consequences. The first is well-known and discussed and relates to the insight, most famously championed by the new institutional economics school of thought, that the deep local context is a major determinant of the effects of any transplanted model or institutional framework. The second consequence, however, has been routinely overlooked, even though its implications may be at least as momentous. The importation of foreign development models, whether capitalistic markets or communistic plans, coupled with lack of sufficient domestic savings and capital generation inevitably means an extremely elevated role of the state in the development process in Bulgaria. The state has been the main agent, propagator, and arbiter in the development process. The flip side of this state of affairs is the weakness of any existing or potential authentic local individual engines and agents of significant capital accumulation and technology transfer. For the capitalistic episodes in Bulgaria's economic history this means that there have never been conditions for the emergence, growth, and strengthening of a sufficiently large and sustained group of Bulgarian market entrepreneurs who have provided the main leverage for the unprecedented growth in productivity and in the living standards in the West.

Therefore, a market economy without entrepreneurs can be adequately added to the other "withouts" listed above, with which Bulgarian has been facing its long-run development endeavor. It must be stressed that the observation here is not that there have been literally no genuine entrepreneurs in Bulgaria's past or present. It is rather that, first, there have never been a large enough number of authentic market-based and market-using agents of capital formation and accumulation and technological improvement. And, second, that there have always been a significant number of power-based and government-hierarchy-using agents of predation. This second type of predatory entrepreneurs exhibits, at least in the case of Bulgaria, a strong proclivity to gravitate around government power and its hierarchy and to use it for enrichment, which, however, in the long run adds nothing to the productive capacity of the economy as a whole.

It is in this general long-run context that the most recent transition period in Bulgarian economic history has been unfolding. Continuing with the seemingly simple but highly informative look at Figure 1, the last three decades conform to all the basic long-run features of the Bulgarian economic development outlined above, and yet also exhibit some specific and unique features. The post-1989 period has seen relative levels of real income per capita in Bulgaria ranging between one quarter and one half of the comparator five rich West European countries. The data also show the continued presence of cyclicity with a period of relative decline, a bottoming-out, and a period of relative catching up. While it is true that in the early 1990s the underlying processes behind the data involve dramatic transformations in crucial spheres such as the economic system, politics, and the institutional framework, it is also true that there have been similar periods in the past. Three such periods are the decade after political independence in 1878, the decade after World War II, and, with some qualifications, the interwar period.

Given the clearly visible similarities of the post-1989 dynamic of Bulgaria's real income per capita relative to the rich West European countries with previous historical episodes, however, Figure 1 exhibits two historically unique features of the period. First, the ratio of Bulgarian real incomes at one quarter of the incomes in comparator rich countries reached in the late 1990s is a historical minimum. Second, the speed of catching up during the two decades following this minimum is a historical maximum and, as of 2019, is still ongoing.

This means that the general look at the long picture of Bulgaria's economic development allows for a range of possible interpretations of the most recent three decades in terms of outlining possible predictions for the future. The two extremes in this range are the pessimistic and the optimistic one. The most prominent exponent of the pessimistic interpretation is Avramov (2001, 2007). His main point is that all periods of relative catching up involve foreign conditionality imposed on Bulgaria from outside and it is precisely this conditionality which disciplines the Bulgarian society into taking into account the longer-run perspective, including institutional reforms and capital

accumulation. And consequently whenever this foreign conditionality is relaxed, often due to its own success, gradually institutions, policies, and performance begin to deteriorate until a new moment of crisis is reached creating the necessary environment enabling the imposition of a new set of foreign developmental conditions.

The optimistic interpretation will be developed in more detail below. The gist of it is that the first two decades of the 21st century constitute an unprecedented set of developments which hold a promise of enabling the Bulgarian economy to break from the cycle of failure and to converge more substantively towards the standard of living of richer countries. The technical arguments in favor of this more optimistic view are both macroeconomic, involving the possibility that the domestic capacity to generate savings and form capital may have discernibly increased, and institutional, involving an international position of the country making the foreign conditionality more constantly and consistently applied.

Naturally, at present both the pessimistic and the optimistic scenarios remain possible. The task of the next section of the exposition, focusing more deeply on the last three decades, will be to provide a more elaborate understanding of the factors which to a large extent may determine whether the Bulgarian economy will continue with its cycles of convergence and falling behind, or will embark on a more promising convergence path.

The 1989–2019 period in Bulgaria's economy

To enter the analysis of the last three decades of Bulgarian economic development in an orderly manner, it seems useful to introduce some sub-periodization in this relatively long timeframe. Macroeconomically, from the perspective of real growth per capita also clearly visible in Figure 1, three periods of approximately equal (as of 2019) length clearly stand out.

The first about 10 years are a period of absolute and relative macroeconomic decline. This is the decade which brought Bulgaria to its historical bottom in terms of the ratio of its real per capita income to the real per capita income in the rich European countries. The second decade, framed by a complex nexus of events and processes at the very end of the 20th century (see below) and the global economic crisis known as the Great Recession of 2007–2009, is one of fast absolute and relative growth. In absolute terms, the decadal rate of growth of real per capita income during this decade is the second fastest since 1887,⁸ while in relative terms the decadal rate of convergence towards the rich European countries is the fastest (Figure 1). The third decade, at the end of which the present exposition takes place, is marked by a continuation of absolute and relative growth but at significantly reduced speed compared to the previous decade. Both the fact that growth continues, and the fact that it is slower have importance in the analysis below. What follows in this section of the exposition is an in-depth analytical look at each of these three approximately decade-long sub-periods.

Bulgaria's first post-1989 economic decade: decline, decapitalization, and crisis

The first decade after 1989 in Bulgaria is characterized by an ongoing crisis. It does have a macroeconomic dimension in terms of real income per capita, which dropped by more than 25% between 1988 and 1997, of unemployment which shot up from non-existent to between 15 and 20%, and of inflation which was never below 25% on a 12-month basis and reached hyperinflationary levels in the spring of 1991 and the winter of 1996/7.⁹ As imperfect as the data for this period are,

⁸ The first is the decade spanning the mid-1950s to the mid-1960s, or the second, third, and fourth five-year plans of Bulgaria's communist economy. The data are from the Total Economy Database, see Footnote 4.

⁹ All data are from the National Statistical Institute, latest available revisions for the respective years. It needs to be mentioned that most standard indicators of the economy, including GDP, the

they also indicate a true meltdown in the process of capital formation in the Bulgarian economy. The available measurements¹⁰ indicate that gross fixed capital formation cumulatively plummeted by more than two thirds. In fact, the Bulgarian economy was severely decapitalized throughout this decade and was in effect constantly losing whatever little competitive productive capacity it had left after the communist period.

The crisis of the first decade after 1989 also has an internal and external microeconomic dimension. Internally, this was the dissolution of the communist plan, the breaking up of chains of production and trade channels, the unclear prospects facing the state-owned enterprises with respect to their status in the new situation, and the very slow emergence of private economic entrepreneurs. Externally, this was the breaking up of the communist system of international trade, coordination, and division of labor, leaving in a very short span of time many Bulgarian industrial branches such as textiles, food processing, pharmaceuticals and cosmetics, tractors and electric trucks without viable external markets.

This first decade of the last 30 years also has an institutional dimension, related to the change in the property rights framework of the economy and to the establishment of an institutional framework based on private property and market interaction. At the highest constitutional level the transition was initiated with the 1991 Constitution,¹¹ which introduced private property in the means of production, and provided guarantees for private entrepreneurial activity, contracting, and production. However, in fact, the Bulgarian economy was very slow to privatize, with the state-

unemployment rate (ILO methodology), and the consumer price index only started to be measured in Bulgaria in the early 1990s.

¹⁰ They are included in various editions of the annual NSI publication Main Macroeconomic Indicators.

¹¹ See Hristova et.al. 2004:28-47.

owned sector dominating throughout this first decade. Attempts at privatization were half-hearted and large-scale privatization did not happen during this sub-period. The establishment of some essential institutions of capitalism such as the capital market, a functioning and predictable framework for contract enforcement and bankruptcy, various market regulations as well as regulation of public procurement never reached a significant degree during these first years.¹²

All these macroeconomic, microeconomic, and institutional problems during Bulgaria's early transition define the decade as particularly negative, but it would be factually erroneous to claim that the problems started with it. In addition to Figure 1, Ganev (2018) demonstrates that for both absolute and relative real income per capita, for the level of employment, and for at least one important social indicator, longevity, the year 1989 does not constitute a significant break in the dynamic of the time series. The crisis processes had started much earlier – in the case of the economy at least in the mid-1980s, in the case of demographic processes as early as the late 1960s. Another clearly problematic legacy from the preceding terminal crisis of the Bulgarian planned communist economy is the very high public debt, mostly to private Western creditors. In early 1990 the Bulgarian government unilaterally refused to continue servicing this debt, which led to the exclusion of Bulgaria and Bulgarians from the international capital markets and effectively blocked a major channel for capital inflows.

Bulgaria also adopted extremely loose monetary and fiscal policies throughout the period. Budget deficits were rampant, and when coupled with implicit budgetary guarantees and subsidies the official and quasi-fiscal deficits were clearly unsustainable in the long run (Avramov and Sgard 1996). The central bank, institutionalized as the pillar of a two-tier banking system only in 1991, proved both highly ineffective in supervising the banks, most of which were still state-owned, and highly prepared to uncritically refinance them by issuing monetary base whenever they exhibited any

¹² Ibid., 48-67.

problems. Finally, the external situation of the country was also not favorable in this period, mostly due to the post-Yugoslav conflict and the accompanying sanctions which seriously impeded trade flows and also provided favorable conditions for criminal embargo-breaking activities.

Under these circumstances a very important development took place. Circumspectly and insightfully described in V. Ganev (2007), the phenomenon of large-scale predatory entrepreneurship flourished in the early 1990s in Bulgaria. Predation was mostly concentrated on the body of the state and aimed towards state assets, since the economic resources of the country were dominantly owned by the state. The state was deliberately weakened and a variety of projects aiming at enrichment from and through the state unfolded. They actively used both sets of soft budget constraints – in the budget, always ready to cover the losses of state-owned enterprises, and in the monetary system where the central bank always proved ready to cover losses from bad credit. The first ten years of post-communist economic transition in Bulgaria were the kingdom of predatory entrepreneurship, when this type of strategy was both successful and capable of severely impeding its competitor – the productive, value-adding entrepreneurs who naturally found the situation in Bulgaria at that time quite adverse and unattractive.

All facts presented above allow for an outline of the model followed by Bulgaria in this decade: absence of privatization, lack of substantive structural reforms, superficial institutionalization of the financial system, extremely loose fiscal and monetary policies, very low levels of trade with the world, and blocked access of foreign capital to the country. The flip side of the same model was an extremely heavy involvement of the state, very often as a monopolist, in entrepreneurial and managerial activities, soft budget constraints and severe deficiencies in enforcing private property rights.¹³ All of this ensured extremely favorable conditions for private (but politically well-connected)

¹³ For an insightful description of the main facets of this model by a contemporary, see Avramov 1994.

predatory projects and an extremely adverse environment for Bulgarian and foreign productive and value-adding entrepreneurs and capital. It is very difficult to formulate with any level of precision exactly what model of economic development aimed at long-run improvement of the standard of living of people the Bulgarian ruling elite was trying to implement in this period, but it definitely had nothing to do with capital accumulation, productive entrepreneurship, and markets.

Perhaps not surprisingly this mode of existence of the Bulgarian economy proved unsustainable and starting in 1996 several changes took place, opening up the doors for the second sub-period of the last three decades. Chronologically, the list includes a push in privatization, mainly under the pressure and conditions of foreign institutional creditors of Bulgaria such as the IMF and the World Bank. This privatization took three main forms: mass voucher privatization, cash privatization, and worker-manager buyouts.¹⁴ Regardless of serious questions about the efficiency of this process, within several years the Bulgarian economy was *de facto* privatized and the share of the private sector in gross value added and in employment reached levels compatible with normally functioning market economies. Another change was the introduction of a specific monetary regime, the Bulgarian currency board arrangement, which anchored monetary base emissions to the Deutsche mark (later the Euro) at a fixed exchange rate,¹⁵ removed most discretionary powers from the hands of the central bank, and enhanced the supervision of commercial banks. Last but not least, Bulgaria embarked in a credible way on a path of accession to the European Union and NATO, clearly signaling that the country has made a decision in its civilizational orientation.

Bulgaria's second post-1989 economic decade: accession

¹⁴ On the broad variety of forms of privatization in Bulgaria see Hristova et.al. 2004:121-40.

¹⁵ Under such a regime, the central bank is not allowed to hold domestic government debt and to lend to domestic banks, and can issue new base money (cash or bank reserves) only when receiving the anchor currency at the legally specified exchange rate.

It is precisely the accession and integration effort, especially with respect to the EU, which defines the second decade of the post-1989 development in Bulgaria. Achieving membership criteria, especially in the economic sphere, was the major factor anchoring efforts, policies, decisions, and activities. Macroeconomically, this was an unqualified success, both in light of the very long path of Bulgaria's economic development and especially in comparison with the preceding decade. The requirements for and expectations about successful accession anchored economic decisions and had a profound real effect. Real per capita income nearly doubled; the unemployment rate fell from the high double digits down to about 5%; inflation decreased to low levels with occasional relatively small bursts related to international prices of fuels and foodstuffs.

Some other macroeconomic facts from this period also deserve a special mention. First, monetary stabilization, significant advances in privatization, and the clear prospects for joining the EU and NATO coupled with opening up of the country for international capital flows¹⁶ meant that it experienced a very large inflow of foreign, mostly Western, capital and that most of this inflow financed productive capital formation in the country. Thus, foreign savings were added to domestic savings as a source of gross fixed capital formation and the ratio of investment to overall economic activity reached historically record levels towards the end of this second post-1989 decade. Real gross fixed capital formation increased by a factor of close to 4. A closely related development was observed in the size and profile of Bulgaria's foreign trade. During the decade in question, Bulgaria's foreign trade turnover increased fivefold, and the geographical structure of the country's

¹⁶ An important role in this opening up is played by the resumption of servicing of the renegotiated Bulgarian foreign debt and by the implementation of EU membership requirements together with a series of agreements of Bulgaria with the IMF, all of which impose as a prerequisite opening up to international capital flows.

international trade shifted decidedly towards the EU,¹⁷ while its goods structure included an increase in higher value-added components in the exports and a very sharp rise in the share of investment goods in the imports.¹⁸

In terms of macroeconomic policies, the second decade after 1989 in Bulgaria is the exact opposite to the first. The budget was generally balanced with small deficits or surpluses. It has to be remarked that this fiscal stability was achieved while maintaining a policy strategy of significant decreases in direct tax rates with the goal of making the country more attractive for business and investment and making Bulgarian producers more cost-competitive. Monetary conditions were subject to the effective implementation of the currency board regime and were characterized by predictability and financial discipline.¹⁹ An important aspect of macroeconomic stability was political: after going through three parliaments and eight governments (with an average mandate of 11 months) in 1990–1997, between May 1997 and July 2009 Bulgaria experienced three consecutive full parliamentary and governmental mandates. All three governments had a clear anchoring agenda: EU accession.

EU accession defined the institutional changes in Bulgaria after the beginning of accession negotiations in late 1999. Chapter after negotiating chapter, institutions in Bulgaria were reformed, regulations introduced or modified, and the conditions deemed necessary for membership were introduced into the Bulgarian economy. Another source of foreign conditionality in this decade were

¹⁷ From a bit above 40% to more than 60% for both exports and imports. Data from Bulgarian national bank.

¹⁸ Same source.

¹⁹ On the remarkable turnaround in the Bulgarian monetary environment with the introduction of the currency board see Hristova et.al. 2004:99-120 and Ganev and Wyzan 2005.

the international financial institutions, at whose insistence and with whose assistance reforms in important spheres such as healthcare and the pension system were introduced.

At the microeconomic level, the financial system was completely overhauled as part of the change in the monetary regime, and commercial banks were privatized to foreign investors and gradually began to channel domestic and foreign savings into the Bulgarian economy. Almost nonexistent at the end of the 20th century, banking credit experienced a boom in the first decade of the 21st, and became so robust that the Bulgarian national bank resorted to one of its few available instruments (the reserve requirement) to try to moderate it. Related to the combination of privatization, the bank financing boom, and influx of foreign direct investment (accompanied by a surge in imports of investment goods) were significant surges in the construction and manufacturing industry. An important aspect of the development of the microeconomic environment in this period was the visible improvement of the conditions favoring productive entrepreneurship. The currency board, the balanced budgets and many institutional and regulatory reforms significantly decreased the resources available for predation both from and through the state, thus rendering the returns for predatory strategies less attractive than in the previous decade.²⁰ Simultaneously, improved institutionalization of market niches, the increase in the role of privately owned enterprises, and the valuable experience related to the inflow of foreign businesses with their entrepreneurial and managerial traditions constituted a significant uplift in the outlook for productive entrepreneurship.

The facts about the second economic decade of Bulgaria after 1989 discussed up to here allow to infer a definite image of the developmental model followed during this period. It is a model based on the re-instituting of the economy as a privately-owned, capital-oriented, and market driven one and on activating the two most important factors of production – capital through vastly increased

²⁰ This is not to say that predatory entrepreneurship disappeared in Bulgaria. It just registered a relative retreat in this period.

real investment, and labor through significantly raised levels of employment. An important plank in the model was the selling point of Bulgaria as a low-cost, including low-tax, place of production, which is however integrating and well-connected to one of the most lucrative markets in the world. The crucially important for the success of this model expectations of economic agents were successfully anchored by the EU accession process. All aspects of this model converged sufficiently well to make this decade one of the most economically successful in Bulgarian history, and the most successful in terms of the speed of catching up to the rich West. Yet there are some features in this model which make it inherently unsustainable in the long run. If successful, the low-cost strategy tends to inevitably undermine itself – as a country gets richer its production environment necessarily becomes more and more high-cost. Also, the major driver of positive developments in this decade is the expectation for accession. But expectations are never a long-run constant, and, especially if they are as bright as they were in Bulgaria with respect to EU membership, have a tendency to get disappointed at some point.

Bulgaria's third post-1989 economic decade: post-accession and post-recession

The end of the accession decade of Bulgaria was framed by two accidentally simultaneous events: the start of actual EU membership in 2007 and the global Great Recession, which arrived in Bulgaria in late 2008. Since 2009 Bulgaria has been, economically, in its post-accession and post-recession decade. The Bulgarian record during this latest period, which is still going on, has been decidedly more mixed and nuanced than either of the previous two decades.²¹

The Bulgarian economy underwent a recession in 2009 the depth of which was comparable to recessions around the world during this episode. When growth returned, it was far from spectacular, yet still sufficient for the country to resume its catching up, albeit at a pace much slower than during the previous decade. In all, real income per capita in absolute terms increased by about one third

²¹ This decade in Bulgarian economic development is covered in greater detail in G. Ganev 2017.

during this latest decade, while in terms relative to the five rich Western European countries it increased by about ten percentage points. Unemployment increased by about eight percentage points and stayed at the high level until 2014, but then fell significantly and as of early 2019 has reached historically low levels. In parallel, employment fell and stayed relatively low until 2014, but then began to rise and as of 2019 is at historically high levels. Inflation has been very low throughout the decade, including a three-year period of consumer price deflation in 2013–2016.²²

The dynamic of gross fixed capital formation, so critical to the analytical viewpoint adopted in this exposition, is somewhat negative, but to an extent which indicates a slowdown rather than a decline in the process of capitalization of the Bulgarian economy.²³ Over the decade membership in the EU has proven to be of great significance for Bulgaria's capitalization due to the fact that EU transfers have enabled the financing of a large part of capital investment in various types of infrastructure by the state. At the same time private capital inflows into Bulgaria have been much slower after 2009 than during the preceding decade.

In terms of foreign trade, the most recent decade has been similar to the previous one, exhibiting a significant increase in total turnover and shifts of the structure of exports towards industrial products and investment goods. A telling difference from the previous decade in this

²² While deflation is generally not considered a symptom of a healthy economy, the particular episode in Bulgaria indicates that the downward movement of consumer prices was not due to internal problems, since the deflationary episode coincided with a tripling of the economy's growth rate.

²³ In real terms, capital formation according to the latest available data is at 75% of its peak levels in 2008. Yet even at these lower levels, and maintaining a ratio of about 20% of GDP, it is sufficient to not only replace depreciated capital goods, but to expand the economy's productive capacity, even though at a slower pace than in the previous decade.

respect is the fact that exports have been growing significantly faster than imports, with most of the increase due to rising exports to the other countries in the European Union.

The economic policies of the government also continued to be generally sound over the most recent decade, with consistent implementation of the currency board regime and a relatively stable fiscal stance. There were, however, two episodes during which the budgetary discipline was compromised – during the recession and in the wake of the KTB failure (see below), the government allowed sharp increases in the budget deficit, accompanied in the second episode by an increase in public debt. However, in both cases balance was restored relatively quickly. But while the macroeconomic policy mix has remained sound and stable, the reform efforts of the government have dwindled. After the pre-accession decade of intense, numerous, and momentous reforms in most spheres of economic life in Bulgaria, the most recent decade has seen no reforms which can be qualified as such. As will be postulated later, the lack of reforms in some areas, especially the judiciary and the governance of state-owned enterprises, is becoming an important factor in determining the future direction of the Bulgarian economy.

While in terms of processes and policies at the macroeconomic level there has been no significant change over the most recent decade compared to the previous one, besides some general slowdown, the changes at the microeconomic level have been more significant. At least three directions of such changes can be mentioned (G. Ganev 2017:45-6). One is integration of Bulgarian businesses in the complex international value-added chains. Such incorporation of Bulgarian production in the global economy can be observed at many levels – from mining (e.g. non-ferrous metals), through light (apparel) or heavy (electrical machinery) industry, to services (tourism, software, call centers). Another microeconomic development is competition, and especially the exhibited capacity of Bulgarian businesses to engage in and withstand it. Beside individual cases, widespread concerns during the pre-accession period that once Bulgaria actually becomes a member of the EU its producers will be severely threatened by the strong competitive pressure coming from

their more established, more experienced, and more productive counterparts from the common European market proved ungrounded. On the contrary, the developments in the size, geographical, and goods structure of the Bulgarian trade balance mentioned above indicate an increase in the competitiveness of Bulgarian producers, who thus seem to have benefited rather than suffered from the enhanced competition within the EU. A third microeconomic development over the most recent decade has been the deepening of the introduction of demonstrably successful business practices and models – industrial zones, air travel, logistics, tourism (especially accommodation), or mass retail are a few examples.

Such practices and models also bring the affirmation of a business ethic rather favoring productive and value-adding entrepreneurial strategies over the well-established in Bulgaria predatory ones, and it would seem that this change would tip the balance between predatory and productive entrepreneurship in Bulgaria even more in favor of the latter than it was during the accession decade. However, the reality seems to have been more complex. While developments favoring productive entrepreneurship have continued, changes favoring predation have also happened. Besides all their other effects, continued rising real incomes of people, monetary stability, and budget discipline have with the years significantly increased the total wealth base on which non-productive entrepreneurs can prey, increasing once again the expected returns to such business strategies. The most common mode of predation has changed considerably compared to the 1990s. While the first decade after 1989 was characterized by preying *on* the state in its quality as the single dominant wealth-holder in the country, the third decade after 1989 sees preying *through* the state by using it to secure rents. Thus, predatory entrepreneurship in Bulgaria has taken the more traditional form of rent-seeking through state-capture. The state is used to create privileged access of well-connected predatory entrepreneurs (known as “oligarchs”) to economic opportunities by limiting the access of their competitors. This is happening in spheres such as public procurement, regulation of specific business and market niches, and, last but not least, disbursement of EU funds.

Possibly the largest-scale and best-known case of this state-capture based predatory project during this decade was the case of KTB.²⁴ Emerging as a small bank in the beginning of the century, it expanded to become the fourth largest bank in the country, connected with a broad array of businesses, with a media empire, and with political parties. For various reasons, eventually the project fell apart and the bank collapsed, causing the largest bank failure in Bulgarian history, exposing a capital deficiency to the tune of 5% of GDP, and causing serious pressure to the rest of the Bulgarian banking system in the second half of 2014. A necessary condition for the unfolding of this and other predatory projects is the complicity, if not the outright assistance, of the state. There must be high-level politicians whose political and economic calculus comes out in favor of allowing, or actively sponsoring, such projects.

This means that the issue of the success of predatory projects in Bulgaria over the most recent decades is related to the question of why Bulgaria's ruling politicians face the incentives they face. Two important aspects of their incentives are the sanctioning of their decisions and actions in the context of foreign conditionality (can they be punished by the EU?) and in the context of domestic law enforcement (can they be punished by the Bulgarian judicial system?). The answer to both questions at present is a conditional "no". While the EU does have the instruments to sanction and condition when macroeconomic policies are out of line and may threaten economic stability in the Union as a whole, its ability to punish political behavior causing mostly domestic problems in the member state is, up to now, limited. At the same time, the problems of the Bulgarian judicial system, especially in dealing with cases of high corruption and abuse of power, can be aptly demonstrated by the fact that in Bulgaria there have been no high corruption, conflict of interest, or abuse of power indictments or convictions. This problem is reaching a point where the major deficiency of the

²⁴ A highly detailed exposition of the unfolding of this case can be found in Markova 2017. The intricate way in which the whole system of state bodies designed to prevent precisely such cases of predation was compromised is analyzed in Transparency International Bulgaria 2017.

Bulgarian judicial system – the lack of accountability of the Prosecutor General – is mentioned explicitly in a report analyzing Bulgaria’s macroeconomic imbalances.²⁵ Ultimately, the state of the Bulgarian judiciary points to yet another “without”, which characterizes the environment in which Bulgaria’s development has had to happen: without a rule of law.

Having outlined the incentives facing Bulgarian politicians and favoring the effectiveness of predatory strategies in Bulgaria, it must be noted that there is pressure for change both internally and externally, in both cases coming from the EU. Domestically, the push towards changes in the Bulgarian judiciary towards greater efficiency and checks on the actions of the executive has come since 2007 from the cooperation and verification mechanism of the EU, which was imposed on Bulgaria and Romania as a condition for membership.²⁶ At the EU level, a process has started towards introducing a regulation conditioning EU funds on the presence of rule of law in the member country.²⁷ It remains to be seen whether and to what extent changes in the Bulgarian judicial system towards an increased capacity of the system to hinder the effectiveness of predatory entrepreneurs will happen.

The observations covering the third post-1989 decade for Bulgaria allow for a short summary of its development model for the decade. In a sense it seems a hybrid one. The leading engines of the previous decade – low cost and activation of factors of production – continue to be important elements in the mix. It seems, though, that these engines are weakening and cannot be sustained for

²⁵ European Commission 2019: 8.

²⁶ See https://ec.europa.eu/info/policies/justice-and-fundamental-rights/effective-justice/rule-law/assistance-bulgaria-and-romania-under-cvm/cooperation-and-verification-mechanism-bulgaria-and-romania_en

²⁷ See for example http://www.europarl.europa.eu/doceo/document/TA-8-2019-0349_EN.html and the links therein.

the future. For many observers the old growth model of the beginning of the 21st century is exhausted and needs to be replaced.²⁸

However, other engines also seem to have been emerging during the last decade, following a more intensive mode of development. These include integration in the global economy, utilization of more qualified labor, and adoption of technologies closer to the global technological edge. This means less reliance on low cost, and more strategic orientation towards active participation in higher value-added complex global production chains. Such a model of development does indeed hold the promise that Bulgaria may break out of the endless cycles of catching up to a point and then falling behind, and may converge towards the rich West in a more sustained manner. However, the question remains whether the conditions necessary for such a development are, or at least will be, in place.

The 2019 outlook for Bulgaria's economy: pessimism vs. optimism

As is often the case, the analysis of the Bulgarian economy up to this point does not enable a definite answer about the prospects for the future. Everything said so far may support both a pessimistic and an optimistic outlook for the coming decades. The analysis does enable, however, a clear and simple definition of pessimism and optimism in this case, as well as an informed argumentation of both the case for pessimism and the case for optimism.

The definition of pessimism in the analytical framework presented here is the expectation that in the foreseeable future Bulgaria will not be able to overcome its century-and-a-half-old cyclical inability to converge to the rich West in terms of standard of living. The definition of optimism is that, on the contrary, Bulgaria is ready to break through its historical ceiling of convergence and to achieve

²⁸ The prime example of this thinking is Deputy Prime Minister Donchev's widely read and discussed blog post about the necessity of economic transformation (Donchev 2019).

within the following few decades an historically unprecedented level of catching up in its standard of living. What remains is to outline the arguments for pessimism and for optimism which the details of the analysis presented so far provide.

The outlook for Bulgaria as of 2019: the case for pessimism

The crucial ingredient for getting close to the world's highest achievable standard of living is (broadly understood) capital accumulation. Bulgaria is nowhere near meeting the necessary conditions for such a process. It has too many "withouts". It is still without sufficiently high levels of domestic saving. It is currently without any notable success in attracting foreign savings as a source of capital formation. It is without major institutions of capitalism such as an efficient capital market, reliable contract enforcement, or a predictable bankruptcy framework. In the most recent decade it has been without capacity to make important structural reforms. It is without a rule of law. But it does have a vibrant predatory entrepreneurial environment, a ruling elite which cannot be punished, and an ensuing establishment of state capture and high corruption. All this means that, inevitably, Bulgaria will lag behind the rich West, even though most likely it will be able to not allow itself to fall too far behind. All the conditions needed to ensure that Bulgaria's cycles of not-quite-convergence will continue are in place and functioning.

The outlook for Bulgaria as of 2019: the case for optimism

What Bulgaria has experienced since the beginning of the 21st century is unprecedented and renders all its previous experiences less relevant. It has experienced the most sustained catching up in a century and a half. It is going through an unprecedented two-decade regime of sound money and fiscal discipline. The degree of presence of Western capital and degree of integration in the global economy, especially one of its richest regions, as the EU is, is also unprecedented. The country is subjected to much more intricately institutionalized foreign conditionality than in any previous historical period, and the prospects are that this disciplining and development-aiding conditionality

will deepen. The last two decades have seen a definite strengthening of productive entrepreneurship. Both public and private debt levels are low and clearly manageable. The economy has demonstrated clear and convincing signs of sustained resilience related to overcoming both the Great Recession and KTB failure. Reforms aimed at overcoming important deficiencies such as those related to the rule of law and human capital will eventually happen due to domestic and external pressures. All this means that conditions in the Bulgarian economy are qualitatively different from any previous moment in its history. There is a slow, but positive and self-feeding catching up dynamic which will inevitably lead to unprecedented levels of convergence of the standard of living in Bulgaria in the next few decades.

Conclusion

For a century and a half Bulgaria has neither really converged, nor really fallen behind the rich Western countries in terms of standard of living. Its inability to effectively converge has exhibited a certain cyclicity with episodes of catching up and episodes of falling behind. The most recent three decades following the systemic changes in 1989 have not been an exception.

These three decades have seen an initial period of serious decline, followed by two distinct periods of catching up – one defined by Bulgaria's efforts to accede to the EU, and one defined by its experience as an EU member state while also dealing with the consequences of the global Great Recession. These three decades exhibit relatively distinct models of economic development. The first model was completely state dominated with loose fiscal and monetary policies, lack of market institutionalization, and very favorable conditions for predatory entrepreneurship. The second model was dominated by the EU accession effort and involved privatization, market institutionalization, a regime of sound money, and disciplined fiscal policies. The model relied on low costs of production and low taxes and provided a relatively improved environment for productive entrepreneurship. The third model, which is still unfolding, involves some of the extensive features of the previous one (low-cost competitiveness and activation of non-employed factors of production), but also exhibits

features of intensification of development towards higher-cost, higher value-added activities with integration in global production chains.

The analysis is not decisive on the question of whether it may be expected that Bulgaria will manage to break the cycle of relatively unsuccessful convergence attempts and close the gap to the richest Western countries more substantially, or whether the conditions ensuring that its efforts to catch up will continue to remind us of Sisyphus are still very much in place. Both the pessimistic and the optimistic expectations can at this point be supported by a serious set of arguments and which scenario will come to pass cannot at present be known.

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