Bulgaria: The Greatest Vacillations

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In one of the most famous economics books, *Capitalism, Socialism, and Democracy*, Joseph Schumpeter (1942) predicted the inevitable collapse of capitalism. I grew up in the last two decades of socialism in Bulgaria and as students we were repeatedly told that socialism would prevail in the whole world, and that in Bulgaria it would soon enter its ultimate form, communism. Then everything would be free and nobody would have to work, unless they wanted to. A strange thing to tell children. Luckily, few believed.

In the summer of 1989 I finished high-school and took the entrance exams in international relations at the Karl Marx Institute of Economics in Sofia. In my graduating high-school class was also the grandson of the Secretary General of the Bulgarian Communist Party Todor Zhivkov. He, too, fancied a career in diplomacy. This was a problem. There were rigid quotas for entering international studies – for fear of students taking off to the West after graduation – and in that particular year there was only one slot allotted for diplomacy. As luck had it, Zhivkov Junior failed the exams and did what most offspring of totalitarian leaders had done before – went to study in Switzerland. And I entered the Karl Marx Institute.

I did not stay long at the Karl Marx Institute, and neither did its name. In December 1988 during a speech at the United Nations Council in New York, Mikhail Gorbachev had declared that the Soviet Union would no longer intervene in the international affairs of other countries from the socialist bloc. This unleashed a rapid chain of events throughout Eastern Europe. First, in Poland the government held roundtables with the Solidarnost movement leaders on having free elections. Those took place in June 1989 and the communists were solidly beaten. Then in August Hungary allowed East German tourists to cross the West German border without visas. In one month 13,000 did so. The East German government responded by disallowing travel to Hungary. East Germans swarmed to Czechoslovakia and in October 30,000 East Germans crossed the border into West Germany. By then mass demonstrations overwhelmed Berlin and the Honecker government fell. On November 9, 1989 the Berlin Wall fell too. That was the end of socialism. Joseph Schumpeter wasn't that far-sighted, after all.

In Bulgaria, Secretary General Zhivkov was retired forcibly on November 10th, 1989 by his erstwhile comrades. Petar Mladenov, former Foreign Minister and member of the Central Committee of the Communist Party, became head of state and tried to keep the communist party in power. This was effectively a coup, instigated by Moscow – Petar Mladenov was seen by Mikhail Gorbachev as the type of new communist leader capable of restructuring the regime from within. (A similar pre-emptive communist coup took place in neighboring Romania.) That didn't last long. Street protests erupted around Bulgaria. In February, 1990, Mladenov was caught on camera threatening to bring in the tanks against the protestors. He resigned, and the first democratic elections were called for June 1990. That did not give sufficient time for the opposition to organize itself politically. The communist party renamed itself socialist and comfortably won the elections. This was among the two cases in Eastern Europe, the other being Romania, where the old communists remained in power even after democratic elections. It would become the first important feature of transition in Bulgaria – the former communists would come back to power again and again – in 1994, in 2005, and in 2013. In no other Eastern European country have the successors of the communist party won so many elections. This would also characterize the nature of the transition process in Bulgaria – a spurt of reform activity would be followed by a reversal of reforms, during the time when the former communists (now socialists) would run the country.

The meandering path to reforms created a second feature of transition in Bulgaria: the former secret police, the best organized institution under socialism, took control of parts of the economy, in particular the banking sector and the exporting business. Control over the banks was important to embezzle hard currency and use it as start-up capital – what Marx called the initial accumulation of capital in Bulgaria took place almost overnight. Exporting was important for a similar reason. Under the COMECON system of international trade during socialism, Bulgaria was a major exporter of chemical and pharmaceutical products, of agricultural products, and of electrical machinery. Alongside these products, it exported synthetic drugs and weaponry to many parts of the developing world, in particular the Middle East and Africa. In the first year of transition, this profitable business was taken up by former members of the secret police, with the tacit approval of the socialist party leaders. The Yugoslav embargo in 1999 created additional opportunities for contraband, increasing the resources of Bulgarian organized crime, something not experienced in the other transition economies.

The takeover of the major exporting companies by members of the former secret police created a third feature of Bulgaria's transition: the emergence of organized crime and its pre-eminence during the whole transition period. Organized crime came within the ranks of the former secret police, and started bloody gang wars over the contraband channels for selling drugs and weapons abroad, as well as for dominance over the energy sector. For that it needed the cooperation of the police and customs officials. This cooperation was secured through either bribes or threats. It went all the way up the former communist leadership and the leadership of the secret service. In one such fight for securing a grip on lucrative Russian energy contracts, the last communist Prime Minister Andrei Lukanov was assassinated in October 1996. Lukanov was chairman of the Bulgarian-Russian gas company Topenergy, which was to construct a gas pipeline from the Bulgarian port of Burgas to Greece and Macedonia.[1] He had previously become known for creating the "red mafia" in Bulgaria, by giving several dozen people from within the ranks of the communist elite and the security services access to loans worth hundreds of millions of dollars. These loans, from state-owned banks, were never returned. In one such meeting, a witness reports, he told his comrades "I am appointing you millionaires." [2]

In 2003, Ilia Pavlov, a champion wrestler turned the richest Bulgarian businessman, was assassinated while standing trial for allegedly masterminding Lukanov's murder. Between 1996

[1] Richard Crampton. "Obituary: Andrei Lukanov," *The Independent*, October 4, 1996.
[2] Editorial Board, "Andrei Lukanov: Red Baron of Bulgaria," *The Sofia Echo,* February 11, 2011.

and 2008, about three hundred members of the Bulgarian mafia, including some political figures, were assassinated by rival factions.

Bulgaria started some reforms early: The government of Dimitar Popov, 1990 to 1991, liberalized prices of consumer goods, of real estate, and of foreign currency. The next government of Philip Dimitrov, which ran Bulgaria for a year in 1991-1992, initiated large scale restitution of property to its rightful owners. This took place both with real estate in the cities and land in the agricultural areas, and created a class of Bulgarians interested in the protection of property rights. Ivan Kostov – the future Prime Minister – served as Finance Minister. But the government lost power in a no-confidence vote and did not fulfill its ambitious agenda.

The socialist government of Zhan Videnov, which came to power in 1995, revoked some earlier reforms and ran up the budget deficit to over 10% of GDP, creating hyperinflationary pressures. These resulted in the collapse of the banking sector in 1996. A transformational change began in earnest only in 1997, with the government of Prime Minister Ivan Kostov. Kostov lost the next elections to Simeon Saxe-Koburg, who ran the country heading a centrist government. Its main success: entry into the European Union. The socialist government of Sergei Stanishev, ruling the country from 2005 to 2009, enjoyed a period of economic growth throughout Europe, which allowed it to postpone several reforms, for example in pensions and healthcare.

The next center-right government – that of Prime Minister Boyko Borisov, came to power in 2009. It had to deal with the effects of the Eurozone crisis on the Bulgarian economy, and as a result did mostly reforms in the fiscal and administrative areas. Prime Minister Borisov's party GERB won the next elections, in May 2013, but with insufficient number of seats to form the next government. Instead, the socialists came back, this time under former Finance Minister Plamen Oresharski.

Altogether, from 1989 to 2014 center-right governments were in power for 9 years, the same length as the ex-communists. With ex-communists running the country for 9 out of the 25 years from the start of transition, the ex-secret police, in the guise of organized crime, ran large parts of the economy and the banking sector, and Bulgaria was going on and off the reform path continuously. This is the fourth feature of transition in Bulgaria: the polarization of politics, where no party has succeeded in holding onto power for successive terms.[3] Moreover, center-right governments iterated with left-leaning governments, with centrist or caretaker governments in-between. This made for the greatest vacillations in economic and social policies in Eastern Europe. These vacillations continue to-date, with the current Socialist-led government re-nationalizing several previously-defunct manufacturing enterprises, with the alleged goal of re-industrialization.

The Three Waves of Reform

Bulgaria's transition process went through three reform waves. The first wave was initiated by the government of Dimitar Popov in 1990-1991. During his short term all prices – of consumer goods, of real estate, and of foreign currency – were liberalized. Reforms continued in the next

[3] Ivan Krastev, "What the Bulgarian Elections Mean for the European Union," *Foreign Affairs*, October 31, 2011.

government of Prime Minister Philip Dimitrov, with the main focus on the institution of private property. The restitution process for land and buildings nationalized under the communist regime was started. This transfer was in effect reversal of the nationalization process that took place in late 1940s and early 1950s. Agricultural collectives were also disbanded. The restitution, together with the creation of new private firms, was the primary reason for the increase in the share of the private services sector from 20% in 1991 to nearly 50% in 1994. The first system of national accounts was put in place. In 1992, Parliament adopted the first Privatization Law. This government could have achieved a lot more, but political miscalculations – reliance on support from the ethnically-based DPS party - led to its fall only a year into its term.

The most significant reforms took place during the government of Ivan Kostov, 1997 to 2001. This was Bulgaria's only government that managed to implement a significant transformation of economic activity. Having served as Finance Minister in two governments – that of Dimitar Popov in 1990-1991 and later in the reformist government of Prime Minister Philip Dimitrov, Prime Minister Ivan Kostov was well-positioned to implement a transformation. And he did: the banking sector was reorganized and a currency board arrangement instituted, large-scale privatization took place, pension reform enabled to shrink the deficit in the Social Security Fund.[4] The previous years of hyperinflation made all these reforms possible: a majority of the population supported radical changes towards macroeconomic stability. In addition, Prime Minister Kostov's government harmonized the Bulgarian tax legislation with that of the European Union; and reduced the size of the army from 110,000 to 60,000. This set the stage of a shift to a professional military, away from a conscript army.

The third wave of reforms took place during the government of Boyko Borisov, where I served as Deputy Prime Minister and the Minister of Finance. The government's term coincided with the Eurozone crisis and most reforms were directing towards fiscal discipline and curtailing tax avoidance. However, important administrative, pension and healthcare reforms were attempted, with mixed results. In sum, macroeconomic stability was regained, but the transformational change towards further economic freedom was cut short.

We started the administrative reform by cutting the number of ministries and agencies. Two ministries were subsumed by others already in November 2009. Next was the streamlining of government agencies. In 2010, we compiled a full list – 122 in all. After a month's work, 30 were slated for closure. Here the team incurred the wrath of labor unions and ex-government officials, who at the same time argued that streamlining was necessary but these were the wrong "victims." We moved ahead and within one year of the start of reforms the government payroll was reduced by 13,000 (out of 110,000 initially). Still, the number of government entities and bureaucrats remained higher than a decade earlier, which was the desired goal.

The next step was to create a common salary and promotion structure for the whole administration, starting in 2011. Prior to that, a patchwork of nearly 90 separate laws regulated the pay of public officials in different parts of the government. As a result some administrations were paid three times more than others, for comparable tasks and responsibilities. Some administrations had

[4] Kostov (1998).

double the paid annual leave than others. Some has a bonus system in place, others relied solely on fixed salaries. Putting all this in one law required utmost patience and being immune to the incessant complaining from one administration or another.

Once the new law was ready, a fight ensued in the Council of Ministers with everyone defending the importance of his own agencies. After heated discussions, we managed to prevail and the bill went to parliament. Only to be stopped there – intense lobbying was already underway. I doubt whether it would have passed, if not for a major scandal that erupted in the media several weeks after we tabled it in parliament in the fall of 2012. The media released information about paid bonuses in the Ministry of Agriculture, which for some employees were several times higher than their salaries. "This is legal," the minister had explained in his defense. The law was immediately attacked publicly for allowing such abuse. The new bill passed the following week. Sometimes luck helps the prepared reformer.

We made some positive steps in reforming university education. At the beginning of our term, we sat out three reforms: to link the government subsidy for universities to the quality of education they offered, not just the number of students; to decentralize the decisions on doctoral degrees; and to ensure that research and education were tighter linked by shifting government subsidies from the Bulgarian Academy of Science to the universities. We succeeded in two. First, parliament approved a scheme that each year ranked university departments on their relative strength. This ranking determined a share of their budget, with this share increasing every year until it reached 25%. In other words, quality would account for a quarter of the budget financing for universities.[5]

Second, we disbanded the Higher Academic Committee, which was responsible for awarding academic degrees to all university faculty. The Committee comprised predominantly of academicians and professors who were members of the former secret police, well past retirement age. As a result, focus on modern research methods was discouraged and the average age of new PhDs was 48. Under the reform each university had the right to design internal procedures for awarding academic degrees. The majority of members of the PhD committees had be external to the university. There was outcry that this would flood the academic market with new professors. And it did, in the first year, when many unsuccessful applicants to the Higher Academic Committee got degrees from their universities. But by 2013, the new system was functioning smoothly.

In 2011, after almost two years in the government, we also made some small steps towards pension reform, complementing what was done under the Kostov government in 2001. The pension system was running large deficits, nearing three billion euro a year. Yet the mandatory retirement age was 60 years for women and 63 for men, among the lowest in Europe. In early 2010, we proposed an increase in the retirement age to 65 years for both men and women. This would take place gradually, by adding 4 months each subsequent year. For men the new age would be reached in 6 years, for women – in 15 years. Also, we proposed to eliminate the provisions that allowed members of the police and the military to retire after just 15 years of service. After two months of hard work, we had convinced enough members of parliament to make this reform happen. But the

[5] Djankov (2014).

Prime Minister wavered under pressure from the labor unions, and the reform was stopped before reaching Parliament. In early 2011, the identical proposal for pension reform passed through Parliament. The deteriorating social climate in Europe and similar reforms in other European countries had convinced Prime Minister Boyko Borisov in the necessity of reform.

But our biggest success was fiscal reform. In line with reforms that had just taken place in Germany in 2009, I decided to change the Constitution and the organic budget law, the main fiscal law of the country, to include an explicit benchmark for the fiscal deficit and the national debt. In particular, we proposed a 2% deficit to GDP ceiling, and a 40% debt-to-GDP ratio. In the event that these were breached, parliament would trigger a no-confidence vote for the government. The rationale for this change was to pre-empt future populist governments from running higher deficits and increasing the debt burden.

We spent the better part of October and November 2010 convincing the leaders of political parties in parliament why this would be another important signal to foreign investors that Bulgaria would always follow a conservative fiscal policy, and thus avoid financial meltdowns. In the end, we could not master enough votes to change the Constitution – 160 votes in the 240-member parliament were needed. But there were enough votes to change the organic budget law and employ the deficit and debt ceilings. This was an important legislative victory.

The second legislative success was the ban on smoking in public places. Bulgarians rank among the heaviest smokers in the world, and the result is a high incidence of pulmonary and cancer diseases. As the healthcare policy was in my portfolio as Deputy Prime Minister, I pushed for measures to reduce smoking. The first policy – to increase the VAT on tobacco and cigarettes – failed, as our borders with Greece were porous, and soon after the imposition of the new VAT rates contraband increased. It took two years, until 2012, to tame it. The reason was that the Greek-Bulgarian border was intra-European Union, and hence formally we could not impose any customs checks. And successive Greek governments were too busy with strikes and banking meltdowns to bother curtailing the contraband cargo coming through its ports.

In 2011, we turned attention to securing sufficient parliamentary support for a smoking bank. Prime Minister Boyko Borissov, himself a smoker, supported the ban. As did the other center-right party represented in Parliament. But the tobacco lobby had strong parliamentary backing, and two dozen of the members of Parliament were themselves in the tobacco growing or cigarette selling business. This made for a big and exhausting fight in parliament. It took over a year before we could pass the legislation.

Reform Reversals

During the transition period, Bulgaria saw frequent reversals of major reforms. Not just delays in reform implementation, or changing the nature of the reform, but actually going back on previously enacted reforms. As suggested earlier, this vacillation came from the continued presence of former secret service police and communist-time leaders in political life. Fourteen governments ruled Bulgaria during this period, none repeating a term in office. Some areas with major needs for reform, for example healthcare, have seen over 30 ministers in the post-communist period: a ministerial change every 10 months. But the main reason for reform reversals was the enduring power of interests groups from within the former communist elite, with business interests hat depended on government contracts or cozy relationship with government bureaucrats.

One example was in changing the powers that the customs and tax administrations had in terms of being able to obtain evidence on fraud or illicit deals. In a country with high share of informal economy, these are much-needed. Such powers were given to the revenue administrations in 1992, with the first post-communist Tax Code. They were taken away in 1996, during the socialist government of Zhan Videnov. They were re-instituted in 2001, in the final year of the Kostov government, and repealed again in 2006, under another socialist government. In 2012, I re-instituted the power of the Customs Office to obtain evidence, enduring a brutal fight with the Ministry of the Interior. We also prepared the legislative changes to re-institute this service in the Tax office, and Parliament adopted it in October 2013. The main opponents: current and former Interior Ministers, whose power over contraband channels and VAT-syphoning schemes would be greatly diminished.

The biggest issue with such vacillations is human capacity in the administration. Obtaining and evaluating evidence requires special skills, which take years to master. With each successive change in policy, the people have to be trained, then re-assigned to other jobs or simply let go, then trained again. And given the history of these services in the administration, few people who worry about long-term career prospects bother to apply.

Another example is nuclear energy policy. Bulgaria has had a nuclear power station since 1974. Since then, there have been constant debates about constructing a second nuclear power station near the town of Belene. The initial work started in 1987. First the Dimitrov and then the Kostov governments stopped work on this project. In 2002, the Simeon Saxe-Coburg government re-started the project. Under pressure from the European Union the project was stopped again, only to start in 2008 under the socialist government. The next government – that of Prime Minister Borissov – terminated the project in 2012. Two years later, in 2014, the new socialist government has again opened the public debate on restarting Belene. In-between, the costs of building and rebuilding have risen to over 3 billion euro.

Another recent example of vacillations in policy is in the area of pension reform. Bulgaria has the world's second fastest-ageing population, behind Latvia. This is the result of many young people leaving for better study and job opportunities, and also low fertility rates. This is why in 2011 Parliament voted to increase the mandatory retirement age to 65, and to eliminate gradually early retirement for the police and the army. The next government repealed these changes from January 2014, as a result opening an even larger deficit in the Social Security Fund.

But the biggest, and most surprising, vacillation throughout the 25 years of transition was the policy towards ownership of productive assets. The ex-communists delayed privatization until 1996, by which time asset-stripping had taken epic proportions. Whole industries collapsed as a result. Asset-stripping due to delayed privatization was a large reason behind the fall in industrial production – second only to the loss of COMECON markets. The government of Ivan Kostov was forced to dispose of much government property in fire sales, with the predictable result of increasing corruption in the privatization process. Alexander Bozhkov, Deputy Prime Minister and Industry Minister of Bulgaria from 1997 to 1999 during the Kostov government, took the brunt of this criticism for his alleged commissions on privatization deals.

Still, in the first two years of the Kostov government the share of privatized assets as a share of the total went up to 70%. The main remaining state-owned assets were in the energy, construction and transport sectors. Further privatization took place during the Simeon Saxe-Coburg government, most notably the sale of the national telecom monopoly and of energy distribution companies. A failed attempt was made to privatize the monopolist cigarette-maker Bulgartabac. The government of Boyko Borisov succeeded in that sale 6 years later, in 2011, as well as in selling to strategic investors several construction companies, as well as the residual shares of the three energy distribution companies. In 2013, however, the new Socialist-led government stopped privatization of the remaining state assets, and in three cases (a chemical company, a weapons producer, and an energy company) bought stakes in private companies, effectively re-nationalizing them. This was explained by the need for re-industrialization.

Biggest Shortcoming

The biggest mistake in Bulgaria's transition process is not adopting a lustration law for the members of the former secret police in the first years after socialism. Several such attempts have been made, including during the Borissov government in 2012, to no avail. The goal of lustration is to ban the collaborators of the former communist regime's secret service, the State Security, to hold leading posts in the state and municipal administration, in political parties, in state-owned companies, including banks, energy companies, and hospitals, in the foreign service and in the judiciary. Given the common borders with NATO allies Greece and Turkey, the Bulgarian secret service was quite large, by some accounts numbering almost 300,000 people. About half were never made public. In 2002, former Interior Minister Atanas Semerdzhiev was found guilty of razing 144,235 files from the state security archives.

All other Eastern European countries implemented lustration laws.[6] The 1991 Czechoslovak lustration law, adopted during the term of Prime Minister Vaclav Klaus, was the earliest example of this legislative initiative. It combined both vetting and exclusion from certain public offices for secret-service members. All those who served as officers and agents of the Communist security services or as party officials from district level upwards (except in 1968) were automatically excluded from around 9,000 posts in government and public administration, the military, the security services, the state media, state-owned enterprises, senior academic posts and the judiciary. The lustration law was applied subsequently in the Czech Republic following the break-up of the Czechoslovak state in 1993, extended for a further five years in 1995 and then indefinitely in 2000. More than 400,000 people have been screened, and about 3% had collaborated with the former

[6] Vladimira Dvořáková and Anđelko Milardović (2007).

secret police.[7] In Slovakia, the law was kept on the books but not enforced until 1998, when three-times Prime Minister Vladimir Meciar fell from power.[8]

Other Eastern European countries also did this in the first years from the start of transition. Poland passed its first lustration law in 1992, and revised it two years later after a constitutional challenge. The third time the issue came up amid allegations that the ex-Communist premier, Józef Oleksy, had been a Soviet and Russian spy. In response, Poland adopted a new lustration law in June 1997, which covered all elected state officials from the president downwards, including parliamentary candidates, together with all ministers and senior state functionaries above the rank of deputy provincial governor; judges and prosecutors; and leading figures in the public electronic and print media. The law's scope was stretched to include all legal professionals, bringing the total number of officials subject to lustration to over 35,000.

In Hungary, a lustration law was adopted in 1994, after three years of wrangling in parliament. The lustration law affected parliamentarians; government ministers, state secretaries and deputy secretaries, ministry department heads, ambassadors and other senior civilian and military officials; the heads, deputy heads and editors of the state television, radio and news agency and editors of daily and weekly papers with print runs of more than 30,000; all judges and prosecutors; mayors and county assembly presidents; the heads of department of state universities and colleges; and the heads of state-owned companies.

Romania adopted its first lustration law in 2006, but after a constitutional challenge in 2010 it came into effect after Parliament voted it again in 2012.[9]

The absence of lustration law in Bulgaria resulted in the capture of some of the new political elite, as well as large sectors of the economy by the former secret service. That, in turn, contorted the progress towards both democracy and a market economy. The former secret police took key positions in banking, and actively participated in the initial privatization rounds. The result was a collapse of the banking sector in 1996, and a corrupted privatization process that turned the population against market reforms. Another pernicious result was the creation of organized crime around drug and weapons trafficking, from within the ranks of the former secret police.

Political life was sullied too. It did not help that the most prominent political figures in Bulgaria's transition were all uncovered to be members of the former secret police. Examples include Georgi Parvanov, the leader of the Socialist Party from 1996 to 2002, and President of Bulgaria from 2002 to 2011; Ahmed Dogan, chairman of the Movement for Rights and Freedoms (DPS) party, from 1990 to 2013; his successor Lyutvi Mestan, leader of the DPS party since 2013.

The influence of the secret police did not end with business and politics. It permeates every aspect of society. When my government passed a lustration law in the Bulgarian foreign service in 2011, it turned out that over half of our ambassadors were members of the former state security, and nearly all ambassadors representing Bulgaria in European Union countries. Similarly, the opening

[7] Williams, Szczerbiak, and Fowler (2003).
[8] Ellis (1997).
[9] Dix and Rebegea (2010).

of the state security files of the Bulgarian Orthodox Church in 2012 revealed that over 90% of the clergy were former members of the secret police. Media ownership was also predominantly in the hands of former state security members, as revealed when opening their files in 2013.

The chance to pass a lustration law in Bulgaria was highest in 2006, as this was put as a condition for entry into the European Union the following year. But Bulgaria was run by a socialist-led government, which resisted the change and it didn't happen. The current ruling coalition (socialist, DPS, Ataka party) has several former state security members in their leadership, for example the leader of DPS Lyutvi Mestan, and the deputy leader of Ataka Stanislav Stanilov. These parties have consistently voted against lustration.

The continuous presence of former communist leaders and former state security members in the political life of Bulgaria ensured that consensus on the main transformational changes – both economic and social – could not be achieved. This burden fell on a few governments or individual ministers, who were quickly rejected by the prevailing political class.

Biggest Success

The biggest success of the transition period is the evolution to strict monetary and fiscal discipline, albeit after a period of hyperinflation and a banking crises that left a third of the banking sector bankrupt in 1996. The result was the establishment of the currency board, in July 1997, that deprived the Bulgarian National Bank from monetary policy, and tying the Bulgarian lev to first the Deutsche mark and later the Euro. The loss of sovereign monetary policy acted to discipline governments in their fiscal policy as well. Since 1997, no government has run a deficit higher than 4.4% (2009), and on average Bulgaria has been a surplus country for the past 15 years.

This is a remarkable achievement, considering Bulgaria's troubled history. In March 1990, the Bulgarian government declared unilaterally a moratorium on debt repayment, thus effectively cutting the economy from world capital markets. The negotiations and debt rescheduling took more than three years and even by the end of 1998 Bulgaria had not gained full access to foreign capital markets.[10]

Under the currency board only reserve requirements are retained as an instrument for monetary control. Up to this point reserve requirements have not been used to affect money supply and it is tacitly accepted that this instrument will be used rarely and only after consultation with the IMF. One specific change in the new law is that the previous ceiling of 15% is now abolished. Currently, the minimum required reserves ratio is at 11%, but it can be increased without any pre-specified limit.

Over the first decade of transition, the banking sector in Bulgaria experienced dramatic shifts. With the start of the transition period, there were seven sectoral banks in charge of financing different branches in the economy. In addition to these seven sectoral banks, there were also two special banks-- the State Savings Bank, which was holding the deposits of the population, and the Foreign

[10] Mihov (1999).

Trade Bank, which was responsible for international operations. Apart from these nine banks, fifty-nine new commercial banks were created from the branches of the Bulgarian National Bank.

The currency board was established with the assistance of the International Monetary Fund, and fashioned after the Argentine model. Similar currency board arrangements were set up in Estonia and Latvia. Both countries have recently entered the Eurozone. Bulgaria has on three occasions considered such entry too, but so far has not formally applied. The latest such consideration was in early 2013.

Even outside the Eurozone, Bulgaria has managed to maintain fiscal discipline, and in 2012 boasted the second-smallest debt-to-GDP burden and the fourth-smallest budget deficit of any European Union member. In 2013, looser fiscal policies were implemented, but still within the 2% deficit limit promulgated in the organic budget law. The stability of the currency board has acted as an anchor for the fiscal policies of all subsequent governments. Since its establishment in 1997, five consecutive governments have maintained fiscal discipline, regardless of their political orientation.

The second biggest success is the adoption of the flat tax, at 10%, in 2008. It replaced the previous system, which combined several different tax rates - between 20 and 24%, depending on income. Bulgaria's 10% flat rate makes it the country with the lowest personal and corporate tax rate in the European Union. Until 2013, Cyprus also maintained a 10% corporate income tax, but the bankruptcy of its banking system that year necessitated a rise in all taxes.

The introduction of the flat tax was first proposed by the government of Simeon Saxe-Coburg, and supported by his coalition partner DPS in 2003. However, it did not gather enough support to pass Parliament. Four years later, a socialist-led government implemented the measure, again with the support of the DPS party. That made the debate in Bulgaria different from similar debates in Estonia and Slovakia, where center-right parties were proposing flat tax reforms. The main reason why the flat tax has been a success in Bulgaria was the reduction of the share of the informal economy, which followed the reform.

During the Eurozone crisis, the flat tax was attacked numerous times, most prominently by President Georgi Parvanov. In 2012, and again in 2013, the Socialist Party announced plans to scrap it, but this intention never resulted in concrete proposals in Parliament. Just like the currency board arrangement, the flat tax is considered a success across most of the political spectrum.

A Perspective on Transition Today

According to a 2010 survey by the EBRD, only a third of Bulgarians are satisfied with their life.[11] This is 10 percentage points less than the average for the former socialist countries. Only 32% support both democracy and the market economy. Much of this prevailing negative attitude probably has to do with the vacillations in the transition process. These have left several important reforms incomplete. More importantly, politicians loathe undertaking reforms, for fear of

[11] EBRD (2010).

alienating the median voter. The result is a current trend towards populism, deepened by the economic difficulties during the Eurozone crisis.

Several reforms are still pending. The main such reform is in healthcare. Recent surveys suggest that only 8% of the population is content with the state of Bulgarian healthcare. Numerous changes to the system have been tried, including three during my time as Deputy Prime Minister. The results were discouraging. Healthcare costs rise every year, the perception of quality seems to deteriorate. Scores of doctors and nurses leave for Western Europe each year, leaving Bulgarian hospitals undermanned. At the same time, the number of hospitals per head is highest in the European Union, with 442 hospitals operating in 2013. However, attempts to close inefficient hospitals face popular uproar. Politicians avoid the topic, and most recently some previously closed inefficient hospitals were reopened by the socialist-led government.

The situation is similar in university education, where Bulgaria again has the largest number of universities per head, 53 in the country. Yet, their product is of such quality that a fifth of each recent graduating high-school class goes to study abroad. Another fifth does so later on, after they have started university. A significant share of rectors are members of the former state security, making it difficult to advance modern curricula and research methods.

Privatization is a bad word, with only 7% of respondents to the 2010 EBRD survey saying that the privatized assets should stay in the hands of their owners. This perception prevents politicians from moving ahead with the much needed privatization of the remaining energy and transport assets. This is where communist-era companies continue to operate, piling up losses that the state budget covers every now and then.

Entry into the European Union in 2007 was thought to serve as a stimulus for democratic and economic reforms. So far these expectations remain only partially met. The most significant positive changes – in the monetary and fiscal policies – came after a devastating macroeconomic and banking crisis. The hope is that Bulgaria does not wait for a similar crisis to undertake changes in its remaining unreformed sectors. Two factors can serve as a motivation for reforms. First, increased pressure from the European Union. So far, such pressure has focused on reforming the judiciary sector. And second, the demographic trends may force incoming governments to reform their social policies, or face macroeconomic instability.

In the wake of some questionable appointments by the government of Prime Minister Plamen Oresharski in the summer of 2013, a vibrant social movement has sprung up, demanding change in the political infrastructure of Bulgaria. This movement has already achieved some success, for example more transparency in political appointments and a revision in the rules on parliamentary elections. This momentum can carry into other possibilities for reform.

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