

Draft

**Report on:**

**Economic Integration and Social Security in Bulgaria during Transition**

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**Introduction**

Bulgaria entered into the second decade from the beginning of the reforms from a planned to a market economy. During these years of transformation was realised cardinal changes in the economic, social and institutional spheres. The economic development has shown controversial directions which are presented in considerable decline till 1997 and recovery process up to now. As a result the inequality and poverty have increased and put the social security system under serious challenges. The transitional period was accompanied by re-orientation of the Bulgarian economy towards European countries. After 2000 the process of European integration of Bulgaria entered into a new statement: Bulgaria has started negotiations for accession to the EU.

The present study analysed the development of the basic macroeconomic indicators; the degree of economic integration process through analysis on the liberalisation of the trade and capital flows; the changes in inequality and poverty status of the population; identification of the main factors explaining the increase of inequality and poverty; identification of the most risk groups threaten by poverty; development of the social security policy for job creation and poverty alleviation.

The report is organized as following. In the first part is analyzed the macroeconomic development during 90s. The second part concerned the issues of economic integration process. Next is examined the inequality and poverty, risk groups and factors for poverty increase. The forth part includes analysis on the policies for jobs promotion and access to minimum incomes.

## 1. Macroeconomic development during the 90s

The development of the Bulgarian economy during the period of transformation to market economy is defined by plenty of exterior and interior conditions and factors that have multiple influences. The processes in the exterior environment (globalization of the world economy, regional conflicts in the Balkans and Near East, the disintegration of the Council for economic cooperation of the former socialist countries, integration processes in Europe) had significant influence on the Bulgarian economy. Among the exterior factors, the conflicts in the region had the most negative influence (the embargo on Yugoslavia and on some countries in Asia) together with the disintegration of the trade system of the former socialist countries. The latter turned out to be of significant importance for the decline in the domestic demand because about two thirds of the Bulgarian trade was carried out with Soviet block countries. The positive aspect of the disintegration process among is the redirection of the integration process towards the countries from the European Union.

The interior conditions are decisive for the economic development in Bulgaria. The transformation to market economy includes series of actions directed towards liberalization of prices and commercial activity, privatization, creation of new institutions, etc. In this quickly changing legal and economic environment the economic development had controversial directions.

### 1.1. Dynamics of GDP and production

In general the macroeconomic development of Bulgaria during the 90s is characterized by a strong decline in industrial production and GDP (Table 1.1). For the period 1990-2001 GDP declines with about 30% and the industrial output with more than the half. This decline is particularly expressed in the beginning of the period and during 1996-1997.

**Table 1.1: GDP and Industrial output Development, Bulgaria, 1990-2001**

Indicators	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Real GDP, Annual changes, %	-9.1	-11.7	-7.3	-1.5	1.8	2.1	-10.9	-6.9	4.0	2.3	5.4	4.0
Industrial Output – annual changes, %	-16.8	-22.2	<b>-15.9</b>	<b>-10.9</b>	<b>8.5</b>	<b>5.4</b>	<b>0.1</b>	<b>-8.6</b>	<b>-12.7</b>	-12.9	10.3	-2.4
Share of private sector in the GDP		10.9	18.0	25.3	26.3	30.5	45.2	56.5	56.7	57.1	61.6	63.4
Productivity growth** - annual changes, %	-9.1	-8.4	-17.5	-5.9	1.4	2.3	-9.8	-8.9	1.8	1.8	6.7	11.2

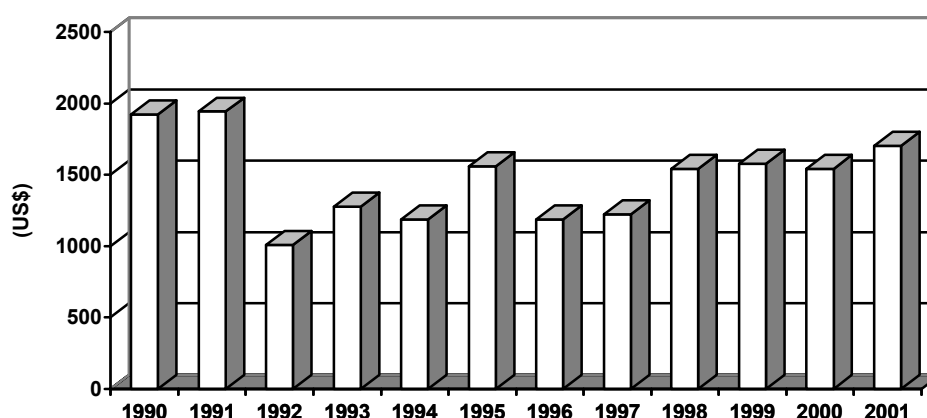
\*\* calculated as gross value added per employee.

Source: Statistical Yearbook, National Statistical Institute; Bulgarian National Bank, Annual Reports for the respective years.

In GDP dynamics two periods are distinguished. The first period includes the years from 1990 to 1997 and is marked by the failure of the applied stabilization programs. The deepening of the economic crisis in 1996-1997 led to the subsequent considerable decline in production. The GDP level in 1997 comprises 66.6% of the level before the start of the reforms (1989).

The second period (1998-2001) includes the years after the inauguration of the currency board and is characterized by the attainment of financial stability and a process of slow economic recovery. In the frames of four consecutive years GDP increases at a moderate rate. Nevertheless, the level of GDP, attained at the end of 2001, is lower with about 20% than the level at the beginning of the transition.

The Bulgarian economy has a considerably low economic potential. The size of the produced GDP per capita is below 2000 USD. Despite the poor reliability of this indicator<sup>1</sup>, it shows the dynamics of economic development in a summarized form (Fig.1.1).



**Fig. 1.1. GDP dynamics per capita (in US\$), Bulgaria, 1991-2001**

During the past period the change in this indicator is not notable for considerable dynamics. For the period 1998-2000 it is stable and in 2001 it slightly increases.

Considerably more indicative is the indicator about the level of GDP, measured per capita according to purchasing power parity. Despite the differences in the estimations of the experts<sup>2</sup>, the common conclusion is that GDP per capita in Bulgaria is about 1/5 of the average level in the EU. In comparison with the countries from the EU, Bulgaria considerably lags back with respect to this indicator (Table 1.2). Moreover, in dynamic aspect there is a discernible retardation in terms of the average European level. Considerably less is the slowdown of the other East European countries that are candidates for accession to the EU. At the same time, among the countries in the European Union there is a certain convergence in economic development. Probably the membership into the European Union creates favorable conditions for economic growth and reduction of discrepancies.

The retardation of Bulgaria and the other East European countries does not have to be considered as a trend, indicating polarization and moreover disintegration. The adaptation process of institutional and economic structures to European standards necessitates time and active use of the potential opportunities in the separate countries.

<sup>1</sup> Greatly dependant on the change in the currency exchange rate.

<sup>2</sup> They are based on the methods used.

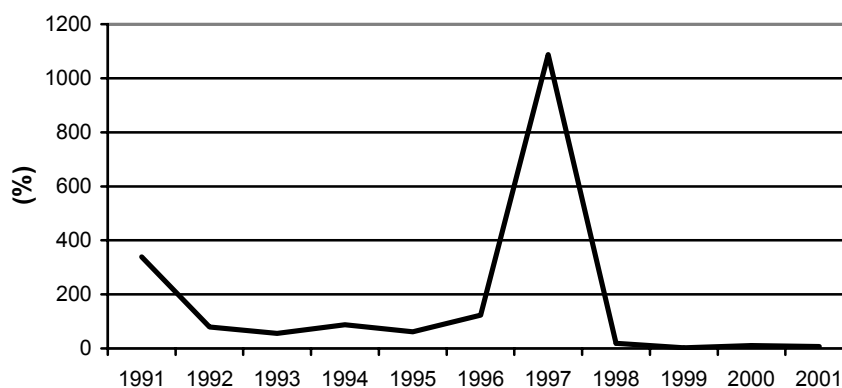
**Table 1.2. GDP and GNP per capita, based on the concept of PPP**

	GDP per capita in 1990 as % of EC-15	GNP per capita in 1997 as % to EC-15
Bulgaria	36	19
Czech	52	50
Hungary	39	34
Poland	32	32
Romania	21	21
CEE-6	34	31
Austria	104	107
Belgium	104	113
Denmark	111	114
France	103	108
Germany	116	103
Greece	62	61
Ireland	69	85
Italy	99	98
Holland	103	104
Portugal	66	69
Spain	75	76
Sweden	109	93
Great Britain	101	101
EC-15	100	100

Source: "Bulgarian Economy and the EU: Pre-accession Period", Statprint, Lmd, 2001, p. 171.

## 1.2. Inflation

The reforms in Bulgaria started with a set of liberalization measures among which removing the control on a great part of the consumer prices had the leading importance. As a result of that and of the accumulated considerable inflation potential, the inflation in 1991 sharply increased (338.5%). The subsequent stabilization measures did not manage to bring the level of inflation in tolerable range. Up to 1997 it remained too high and fluctuated within a quite broad interval (55-120% annually).



**Fig. 1.2. Inflation trend, Bulgaria, 1990-2001 (% change)**

The reasons for this situation are complex but they are based on the slow structural reform, growing deficits, floating currency exchange rate, and high inflation expectations of the economic agents.

The deepening of the economic crises in 1996-1997 reflected in reaching hyper inflation levels at the beginning of 1997. The introduction of a currency board in the middle of 1997 as an urgent stabilization measure had a positive influence on the decline of inflation. In the last three years the level of inflation dropped to 6-10%. This result was achieved through introducing a fixed currency exchange rate and limiting the pro-inflation factors. In these years the stability of the currency board is supported by a policy of reducing the budget deficit, rigid financial discipline, and close inspection of the banking system.

The attainment of a low level of inflation (at the size of one-digit number) is a serious indicator of economic stability and a prerequisite for economic growth.

### 1. 3. Employment and unemployment

The Bulgarian transition to market economy is marked by a considerable reduction in employment. For the period 1990-2001 the total number of the employed decreases with about 1.2 million. The limited demand of work force is determined by two basic factors: shrinking of the total demand on the products' market and carrying out the structural reform in the economy (shutting down ineffective enterprises and activities).

The trend of shrinking employment dominates almost all the period of the 90s (with the exception of the years 1994-1996). The dynamics of employment proceeds at different rates (Table 1.3) that shape three periods of development.

**Table 1.3. Employment and Unemployment Trends, Bulgaria, 1990-2001**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Employment - % changes	-6.2	-13.0	-8.1	-1.6	0.6	1.2	0.1	-2.6	-1.4	-2.6	-4.7	-7.1
Employment rate -(%)	64.1	53.7	52.2	49.2	52.2	53.1	51.8	51.6	50.4	49.2	49.4	48.1
Employment in private sector (1990=100)	100.0	148.9	239.7	377.4	482.8	551.4	644.3	722.0	795.2	828.5	853.5	872.3
Employment in public sector (1990=100)	100	83.1	69.9	59.9	53.8	50.5	44.8	36.6	31.9	28.2	22.8	20.5

Source: Statistical Yearbook, NSI, respective years.

In the first three years of the transition (1990-1993) the employment decreases at extremely high rates. It is due to the adaptation of the economic organizations to the level of productivity and to the beginning of the structural reforms. Because of a decrease in productivity, a great part of the enterprises were in a situation of over-employment and one of the conditions for their survival was getting rid of the extra work force. The basic branches that dismissed workers in great extend were industry, construction, and commerce.

The period of stabilization and a slight increase in employment (1994-1996) is associated with several factors: attainment of economic growth, rapid development of

the private sector (small and medium enterprises), and termination of the structural changes. The influence of these factors did not last long. The economic growth generated employment in sectors that had no perspectives for development (ore output and metal work). The private sector absorbed to a maximum extent the dismissed labour force from the government enterprises and exhausted its capacities. The termination of reforms temporarily alleviated the pressure on the labor market, but at the same time it set up the prerequisites for the deepening of the economic crisis.

The increase in the rates of the decline in employment after 1997 is due to the resumption of the structural reform. A great part of the ineffective enterprises were closed, and the privatized enterprises, aiming at the optimization of employment, laid off useless workers. In the last several years the economic growth could not create more jobs that was liquidated.

During the 90s there were considerable changes in the structure of employment with respect to the form of property and the separate economic sectors.

With the development of the private sector (in the form of privatization and creation of new enterprises), the share of employees rapidly increases (Table 1.3). It absorbs a great part of the workers coming from the government sectors as most of them go to the labour market. The share of the employed in the private sector has increased from the insignificant 5.9% in 1990 to 73.4% in 2001. In the next several years this share will continue to increase because of the forthcoming privatization of several big monopolistic enterprises (telecommunications, energetic, etc.). At the present moment the employed in the private sector dominate in agriculture (98% of the employed in the sector), trade (98%), construction (84%) and some branches of the manufacturing industry.

The structure of employment with respect to economic sectors is also marked by development. The basic tendencies are the following: 1) a decreasing employment in industry; 2) increasing the employed in the sector of services; 3) retaining the share of the employed in farming. During the last three years the share of the employed in the industry decreases from 30% to 27%. This tendency is related to the shut down of unprofitable and unvital enterprises and activities (ore output, metal work, etc.). The employment in the sector of services has a quick development due to the private sector.

The share of the employed in agriculture is comparatively big (25%) and remains relatively steady during the last 3-4 years. The reasons for this great employment are due to the fragmentation of the land (after it has been returned to the owners) and the low productivity of labor. After the shut down of the farming co-operations, the productivity sharply decreases and the opportunities for its increase are strictly limited.

The changes in employment directly reflect on the level and dynamics of unemployment. According to data about the registered unemployed persons, the percentage of the unemployed in Bulgaria during the first three years of the reform grows over 10 times (Table 1.4). Practically from zero in 1989 the unemployment increased to 16.4% from the labour force at the end of 1993. The decrease and

stabilization in the following period are marked by relatively high levels (11 – 13%). The continuation of the structural reform from 1999 raised the level of unemployment even more.

**Table 1.4. Main unemployment indicators, Bulgaria, 1990-2001**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Registered unemployed thousand	65	419	576	626	488	423	478	521	465	611	683	662
Unemployment rate*	1.5	10.7	15.2	16.4	12.8	11.1	12.5	13.7	12.2	16.0	17.9	17.3
Inflow rate	n.a.	n.a.	1.8	1.4	1.3	1.4	1.6	1.9	1.4	1.9	2.1	
Outflow rate	n.a.	n.a.	9.2	6.8	9.6	11.6	11.2	10.7	10.7	8.9	7.8	
Vacancy rate	n.a.	0.43	0.31	0.26	0.34	0.48	0.49	0.38	0.40	0.47	0.37	

Note: Registered unemployment at the end of the year.

Source: Employment agency.

The percentage of the inflow in unemployment is not great (Table 1.4). During the whole period of the 90s it does not exceed 2 % of the number of employed. The share of the unemployed persons, who have left the registers, changes in quite broad intervals. This share, however, includes both the persons who have been recently employed and the persons who dropped out for other reasons. The relative share of the unemployed who got a job changes from 19.1% in 1992 to 38.6% in 1999.<sup>3</sup> This is a positive tendency that indicates the growing opportunities of the unemployed for reintegration.

The ratio between vacancies and the number of the unemployed is quite small. During the last years there is a tendency of an increase that indicates problems in matching demand and supply of labor.

The high level of employment and the small supply of jobs create relatively high values. The number of the registered unemployed per job decreases from 48 in 1994 to 28 in 1995 and again increases to 65 in 2001.

The basic characteristics of unemployment in Bulgaria can be summarized as follows:

1. The unemployment in Bulgaria is marked by a high degree of persistence. The study of unemployment in Bulgaria indicate<sup>4</sup> that this persistence is quite close to the estimates for the most of the developed European countries. The high persistence of the unemployment is basically due to the small demand for labour and the relative power of the employed.
2. The unemployment has a long-term character. More than a half of the registered unemployed is out of work for more than one year (Table 1.5). Out of them the share of the long-term unemployed women is greater than the share of men. This great share of long-term unemployed creates a considerable hazardous group that

<sup>3</sup> Beleva, I., V. Tzanov, (2001), Labour market flexibility and employment security. Bulgaria, Employment paper 2001/30, ILO, Geneva, p. 18.

<sup>4</sup> Tzanov V., P. Lukanova,(2002), The employment in Bulgaria – macroeconomic interactions and opportunities for reduction, .

needs special measures on the market of labor and social aid.

**Table 1.5. Share of long-term unemployment, Bulgaria, 1993-2001**

	Share of unemployed over 12+ month	Share of unemployed Women over 12+ month
Sept.'93	53.8	53.4
Oct.'94	60.1	61.6
Oct.'95	65.6	68.0
Nov.'96	59.9	59.7
Oct.'97	57.7	57.6
Nov.'98	54.3	53.6
Dec.'99	53.8	54.4
Dec.'00	59.5	58.7

Source: Labour Force Survey, NSI, respective years.

3. High unemployment among young people. During the whole period of the 90s the unemployment among young people is relatively high. The percentage of unemployed young people (15-24 years old) is more than two times greater than the average level. Dynamically there is a process of a decrease from 47% in 1993 to 37.6% in 1995 and reaches the lowest level in 1996 (33.4%).<sup>5</sup>
4. Great share of the unemployed with a low level of education. In the structure of the unemployed with respect to educational status a considerable part of the unemployed people with a low level of education (primary and lower) is formed. The percentage of unemployment among them fluctuates within the interval of 26-30% with a decreasing tendency. Nevertheless, their relative share in the unemployed persons remains relatively high without distinct trend.

The basic tendencies and structural changes in employment and unemployment, presented above, show that they are a source of serious social-economic problems. The main factors for poverty enlargement and deepening are a reduction in employment and high unemployment. They form the basic risk groups of the poor in Bulgaria.

#### **1.4. Incomes and consumption**

At the beginning of the reform the Bulgarian economy plunged into a deep and prolonged crisis of incomes. It is a result not only of the conducted restrictive policy, but also of an unfavorable inner and outer economic environment. Subsidizing ineffective business structures as well as the weak internal and external investment activity greatly restrict the opportunities for economic development and an increase in the incomes of population.

The characteristics of the income crisis can be summarized as follows:

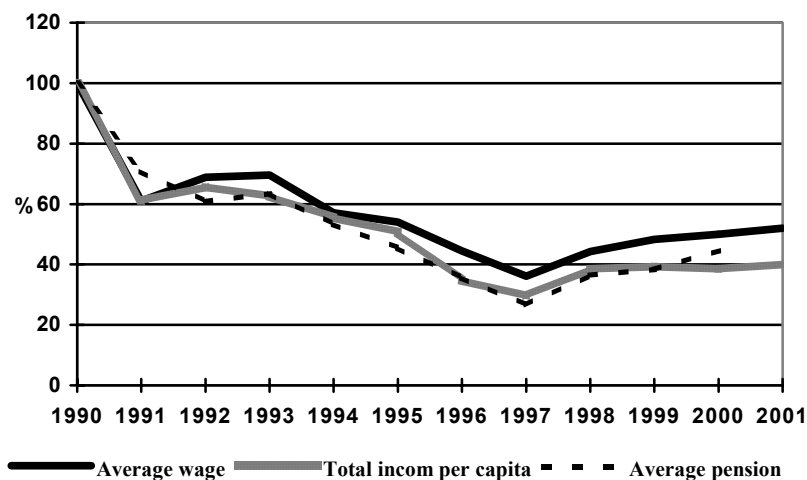
1. *Strong decrease in the real values of all incomes of population.* During the period of the 90s, the incomes of population lose a considerable part (more than the half) of their purchasing power. In comparison with 1990, the real incomes per household

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<sup>5</sup> According to data from LES, different yearbooks.



person decrease with over 60%. At the same time, the real wage decreases with about 48 %, and the average pension with 55 % (Fig. 1.3). The minimal payments (minimum wage and minimum pension) melt down even more.



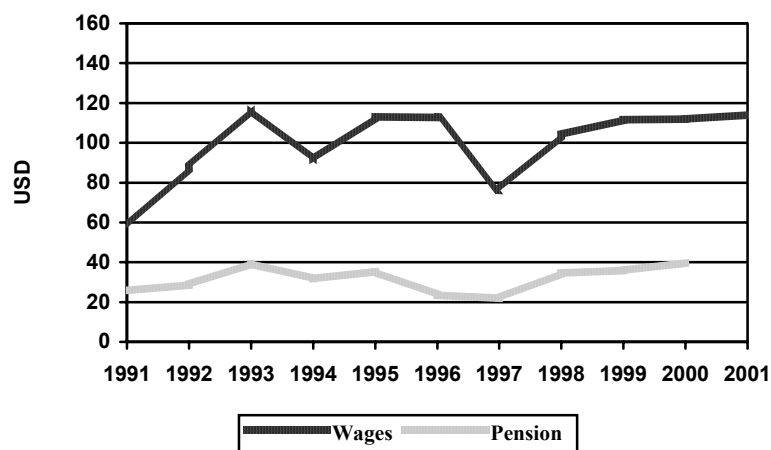
**Fig. 1.3. Real Incomes Development, Bulgaria, 1990-2001, (Index 1990=100)**

This tangible decrease in the real incomes is not steady in the course of years. It is a direct consequence of the shock prices and inadequate policy of compensations in 1991, 1994, 1996, and 1997.

Overcoming the decrease in the real incomes begins in the middle of 1997 after the implementation of the currency board and a decrease in inflation. The obtained positive growth in the real values of all incomes in 1998 and 1999 compensates the decrease to the level of 1996.

The loss of purchasing power goes along with the exceptionally low level of incomes. For the entire period of the 90s, the average wage doesn't exceed 120 USD monthly<sup>6</sup>, and the average pension – 40 USD (Fig. 1.4). This circumstance places Bulgaria in unfavorable position, concerning the negotiations about the integration into the EU. Overcoming this lagging may prove to be one of the main directions and priorities in the incomes policy.

<sup>6</sup> In current USD according to the average annual currency exchange rate.



**Fig. 1.4 Dynamics of wages and pensions in current US\$, Bulgaria, 1991-2001**

The discrepancy between the diminishing purchasing power of population and the shrinking of GDP (Table 1.6) is a peculiarity of great importance that should be underlined (Table 1.6). The real wage decreases more than two times in comparison with GDP. This exceptionally strong erosion of wages indicate that it is a consequence of the price shock and inadequate incomes policy rather than the worsening of the economic results.

**Table 1.6. GDP and Real Wages, Bulgaria, 1990-2001, (Index 1990=100)**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Real GDP	100.0	88.3	81.8	80.6	82.1	84.2	75.0	70.6	73.5	75.1	79.2	82.4
Real Wage	100.0	61.0	68.8	69.6	57.1	53.9	44.5	36.1	44.3	48.3	50.0	52.2

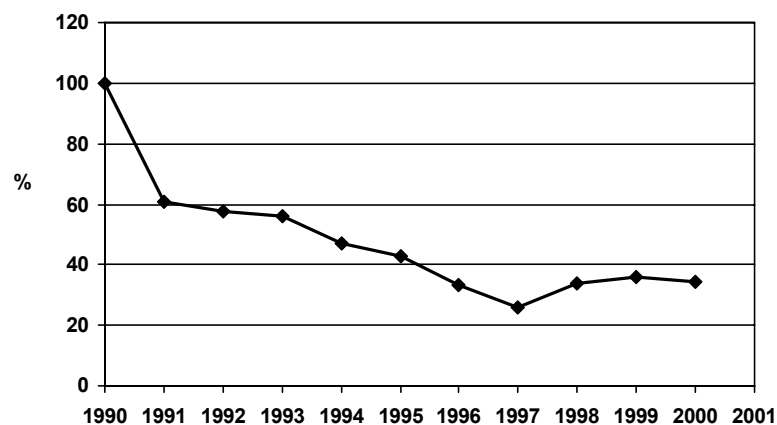
Source: Statistical Yearbook, NSI, respective years.

The most important economic effect of the incomes crisis is the tangible decrease in the living standard of population. During the 90s a model of consumption, typical for the countries with low living standard is formed. It is characterized by the following three main tendencies:

1) *Drastic decline in personal consumption.* During the entire period of transition, the real consumption of population considerably decreases (Fig. 1.5). For the period 1990-2001 consumer household's expenditures per person decrease with about 65 %. After the initial collapse in 1991, a more tangible decrease is observed in 1994, 1996, and 1997.

The achieved economic stability and the relatively high growth of real incomes in 1998 influence favorably the purchasing power of population as well as the level and structure of consumption. In that year the amount of consumer expenditures of households approached the highest growth from the beginning of the 90s. In real terms the total household's expenditure per person increased by 31.2% in comparison to 1997. The growth of consumption after the crisis of 1997 approximates the level in 1996.

2) *Naturalization of consumption.* In order to keep the level of consumption in the conditions of high inflation and low incomes the households increase the natural consumption. In the years of the deepening crisis, the share of natural consumption in the total expenditure increases with about 5-6 percentage points above the ordinary level (10-12%). This reduction of the market consumption at the expense of the natural consumption has a direct negative effect on the economic growth. The limited role of the consumer market leads to ineffectiveness of production and no incentives for investments. Under the conditions of a deep production crisis, the increase in the domestic demand has to be considered as a key element for economic prosperity. Due to the long-term tradition and the role of household plot production for the Bulgarian household nutrition, the perspectives for a considerable decrease in the natural consumption are not great.



**Fig. 1.5. Real consumer expenditure per capita, Bulgaria, 1990-2001 (Index 1990=100)**

3) *Restructuring consumer expenditures.* The decrease in the real consumption goes along with a considerable reconstruction of consumer expenditures. The direction of change leads to an increase in the share of expenditure of living necessities of population and respectively, to a decrease in the share of expenditures of durable goods, education, and leisure time. Only the expenditures of food, housing, and household energy that to a great extent cover the pressing necessities are about 64 % of the household budget in 1997 against 51 % in 1992. The positive growth of incomes and consumption in 1999 reduces this share to 59 %, but nevertheless, it remains high. The structural changes concerning the food expenditure are considerably drastic. Their relative share in the total consumer expenditure increases from 36% in 1990 to 55 % in 1997 and decreases to 44 % in 1999.

## 1.5. Foreign trade and balance of payments

The dynamics and structure of international economic relations in the 1990s were determined by inner and outer factors. The liberalization of foreign trade as a main element of the implemented reforms influenced foreign business activity in two directions. On the one hand, the import-export government monopoly was abolished, but on the other hand, the Bulgarian producers and exporters were exposed to severe market competition for which they were not prepared. The greatest advantages from the foreign trade liberalization regime went to the business importers. The business

exporters experience serious difficulties to access different markets due to the low competitive power of Bulgarian production and because of the existing non-tariff barriers.

The influence of outer conditions and factors had a dominant importance for foreign trade development. The disintegration of the trade block among the ex-socialist countries as well as the sanctions imposed over the former Yugoslavia had a strong destructive influence on the foreign trade turnover (Table 1.7). At the very beginning of the transition, the foreign trade turnover decreases more than two times. The tendency of decrease is retained till 1994, after this it is stabilized at the level of 9-11 billions US\$. Throughout the last two years a certain increase in the foreign trade turnover appeared.

**Table 1.7. Foreign trade, Bulgaria, 1990-2001 (in bln. US\$)**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Turnover	26.6	10.2	8.1	8.3	7.9	10.6	9.3	9.5	8.8	9.0	10.8	11.8
Export	13.4	5.5	3.9	3.7	3.9	5.4	4.7	5.0	4.2	4.0	4.8	5.1
Import	13.1	4.7	4.2	4.6	4.0	5.2	4.6	4.5	4.6	5.0	6.0	6.7
Balance	+0.3	+0.8	-0.3	-0.9	-0.1	+0.2	+0.1	+0.5	-0.4	-1.0	-1.2	-1.6
Current account	-2.1	-0.07	-0.3	-1.1	-0.02	-0.03	-0.02	+0.4	-0.06	-0.7	-0.7	-0.9

Source: Bulgarian National Bank.

The unfavorable external conditions and the limited export possibilities of Bulgarian economy considerably reflected on the export trend. The export trend shows a pronounced tendency of decreasing and slower recovery. During the entire period (1990-2001) the amount of export values has decreased about 2.5 times. As a result of favorable external conditions<sup>7</sup> in 2000 the export increases with about 20% in US\$. The growth is due to the increased export of products from the metallurgy, oil processing, the chemical industry, fabrics, furniture, etc.

The increase in exports continues in 2001 but slowly. In comparison with the previous year in 2001 the exports increased by 6.3%. This a result of the low economic activity on the international markets, retarded economic development in the EU countries and the crises in the neighbouring Balkan states.

In contrast to exports, the amount of imports experiences the weaker influence of the unfavourable economic conditions. Throughout the greater part of the period, imports exceed the exports, and thus a negative balance of trade (trade deficit) is created. For the entire period (1990-2001) the imports decrease about two times.

The positive trend of imports in the last two years is mainly based on the increasing oil prices on the international markets as well as the import of consumer goods. According to the BNB experts, the import has increased with about 453 million USD in nominal values. As a result of higher oil and natural gas prices this increase is partly compensated by the export of oil products, but the worsening of the trade

<sup>7</sup> The increased demand from the basic trade partners and the increased prices of black and color metals, fertilizers and other goods that form the traditional Bulgarian export.,

balance is estimated at 275.5 millions USD<sup>8</sup>. In 2001 the import continues to increase with a relative high rate – 11.7 %. The greatest contribution for this rate has the import of raw materials (17.9%), consumer goods (28.7%), and investment goods (12.8%).

The prevailing influence of trade deficit (imports exceed exports) almost during the entire period of the 1990s forms a negative balance of trade account that worsens the balance of payments in the country. The total effect of accumulated negative trade balance for the period 1990-2001 amounts to 5.5 billion USD.

The effect of foreign economic activities of the country during the 1990s becomes visible through the dynamics in the balance-of-payments (the account of the current transactions among countries). Almost during the entire period a negative balance of payments appeared that at the end of the period indicated an increasing trend.

According to experts<sup>9</sup>, the dynamics of the balance-of-payments accounts displayed two periods: the first (1990-1996) is characterized by a negative balance of payments on the trade account, as well as the other accounts; and the second (1997-2001), with positive activities on the current account that compensate to a great extent the negative balance of payments on the trade account.

## 1.6. Public finances (Fiscal Policy)

The main characteristics of the budget policy during the 1990s is the ambition to sustain a low level of the budget deficit in order to achieve financial stabilization. Prior to the implementation of the currency board, the desired financial stability was not achieved and one of the reasons is the high budget deficit (Table 1.8). It changes in quite broad intervals (5-11% of GDP). After the implementation of the currency board, the budget deficit was reduced into the frames of 2 % of GDP.

**Table 1.8. Budget deficit (% of GDP), Bulgaria, 1992-2001**

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Budget deficit as % of GDP	-5.6	-10.9	-6.0	-5.0	-11.0	-3.9	-1.0	-1.0	-1.6	-2.0

Source: Bulgarian National Bank, Annual reports for respective years.

The achieved financial stabilization during the last years was at the expense of a decrease in the budget deficit and the restructuring in the government expenditures.

The decrease of the interest rate since 1997 has had the most favorable impact on the budget expenditures because it reduced payments for the external debt, reaching 46.4% of the budget in 1996. An increasing financial discipline and decreasing portion of interest payments during the last two years made it possible to provide more active social policy and to increase the public spending for social purposes. In 1999, 24% of the budget expenditures were targeted for social benefits, education and health services.

<sup>8</sup> The Bulgarian economy in 2000 (annual report); Agency of economic analysis and prognosis, 2001.

<sup>9</sup> “Economy of Bulgaria and the European Union – pre-accession period”, Statprint, p. 109

## 2. Development of integration processes

Bulgaria is a small European country with limited economic potential and an open economy. Till 1989 Bulgaria was integrated into the Soviet block and as a result of this ¾ of the foreign trade turnover was realized with ex-socialist country. After the collapse of the Soviet block and after the political and economical changes in Bulgaria, a period of reorientation towards integration into the European structures begins. In spite of fact that Bulgaria is not still a member of the European Union, a process of economic integration has started. This process was particularly accelerated during the last years after the start of the negotiations for joining.

The integration of Bulgarian economy can be followed by an analysis of the tendencies in the development of the main channels of integration: liberalization of trade (merchandise flows); capital flows (foreign direct investment); labor power flows; progress in privatization, etc.

### 2.1. Liberalization and integration of trade

In the 1990s Bulgarian economy marks a considerable advancement in trade liberalization. At the beginning of the transition the liberalization was based on the motives related to the establishment of market economy (price liberalization, domestic trade and currency regime, anti-monopoly foreign trade policy, policy for creating business competition, etc.). Along with the process of the European integration and the necessity of further extension of Bulgarian economy, the changes in trade regime were aimed at achieving correspondence with the recommendations for joining the EU.

According to the appraisal of the European Bank for Reconstruction and Development<sup>1</sup> the progress of Bulgaria in market liberalization is encouraging. (Table 2.1). The average appraisal of these three indicators increases from 2.67 at the beginning of the reform to 3.2 in 2000.

**Table 2.1. Indicators of market liberalization and competition policy, Bulgaria, 1991-2000**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Average	2.67	2.67	2.67	2.67	2.67	2.67	3.1	3.1	3.2	3.2
Price liberalization	3.0	3.0	3.0	3.0	2.0	2.0	3.0	3.0	3.0	3.0
Trade and currency regime	3.0	3.0	3.0	4.0	4.0	4.0	4.0	4.0	4.3	4.3
Competition policy	2.0	2.0	2.0	2.0	2.0	2.0	2.3	2.3	2.3	2.3

Source: Transition report 2000, European Bank for Reconstruction and Development, 2000, p. 148-149

The price liberalization in Bulgarian economy includes about 2/3 of goods and services. The prices of monopolist producers as well as the prices of socially important goods (electric power, thermoelectric power, rail-way transport, etc.) are placed under control. In 1995 the government expanded the circle of regulated goods (over 45%) in order to reduce the social value of transition. The desired results were

<sup>1</sup> Transition report 2000, European Bank for Reconstruction and Development, 2000, p. 148-149.

not achieved. The introduction of the currency board and the decrease in inflation was again followed by price liberalization.

The greatest success was achieved in liberalization of trade and currency regime. The evaluation of the European Bank for Reconstruction and Development increases from 2.0 to 4.3 and reaches one of the greatest values.

The liberalization of trade activity was expressed through a decrease and elimination of import tariffs, qualitative restrictions, and export subsidies, based on the mutual agreement with the European Union. This task was carried on the basis of the asymmetrical principle in order to provide more time for adaptation of the developing Bulgarian economy to the market conditions of the EU. After the EU reduced its import tariffs since the beginning of 1997, the integration of Bulgaria and the other East European countries have to end in 2002. Bulgaria as well as the other candidate countries abolished the import tariffs for about 80% of the EU products of the processing industry since the beginning of 1999. The import tariffs for scientific-consuming production were also abolished and the import preferences were given to some agricultural products.

As a result of the achieved trade liberalization the average import tariffs have declined from 9.4% in 1998 to 5.9% in 1999<sup>2</sup>. For the period till 2002 a new reduction is expected. Despite this progress Bulgaria remains among candidate countries with a relatively high index of trade restriction. For Bulgaria according to the 10-degree scale it is 6, while for the Czech Republic and the Baltic it is 1, for the EU it is 4.

Extremely slow is the progress of Bulgaria in creating of competitive business environment. Low estimates increase only at the end of the period (Table 1.2). This is related to the abolishment of monopoly in telecommunication. Despite the institutional framework, anti-monopoly activities in the economy do not mark considerable progress. The government monopoly is retained in the sphere of electric power, rail-way transport, telecommunications and other spheres of the economy.

The achieved satisfying level of liberalization of trade activity favorably reflected on the integration process of Bulgaria. The data about the geographical structure of the import and export (Table 2.2) distinctly demonstrate the degree of trade integration of the country. The data indicate tangible restructuring of foreign trade exchange among different groups of countries.

The redirection of the trade flows towards the EU countries happens extremely fast. For the period 1990-2001 the share of export towards the EU has increased more than 10 times. The share of import has increased about 5 times. At the same time the exchange turnover with CEFTA countries decreases over 7 times. These are mainly candidate countries and their orientation is to integrate into the EU, not to develop cooperation with ex-socialist countries. The trade integration with Bulgarian neighboring countries is not great. The Bulgarian export to other Balkan states decreases after 1996 - a result of the Yugo-embargo. The share of import from these countries is even smaller. As a basic trade partner till 1989, Russia, is no longer a dominant figure in the export orientation of Bulgaria. There are numerous reasons,

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<sup>2</sup> EU. Bulgaria 2000. 2000 regular Report. 8<sup>th</sup> November, 2000.

but the high import duties, imposed on Bulgarian goods have the greatest importance. Russia remains an important partner for Bulgaria in respect to import. Russia remains a basic supplier of raw materials and mainly energy resources (oil and natural gas).

**Table 2.2. Export and Import Structure by Economic Groups, Bulgaria, 1990-2001, (%)**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
	Export											
OECD	10.1	26.4	42.0	43.4	48.9	50.3	51.2	58.3	63.4	66.2	67.8	70.7
EC	5.3	16.1	29.5	28.2	36.4	37.0	39.2	43.2	50.1	52.0	51.1	54.8
Russia	-	-	17.1	15.4	14.2	10.1	9.8	8.3	5.4	4.7	2.3	2.3
C&F&O	10.2	5.4	5.5	5.3	2.4	2.4	2.3	3.2	5.2	4.3		
Balkan countries	4.0	4.4	12.2	13.1	17.4	13.2	11.4	6.2	5.3	7.8		
	Import											
OECD	15.2	33.4	44.1	45.3	47.1	45.4	42.2	47.4	55.1	57.9	53.0	58.6
EC	10.2	21.3	31.2	30.1	37.5	36.3	35.4	38.4	45.2	48.4	44.0	49.4
Russia	-	-	21.2	22.0	25.2	27.4	33.1	28.1	20.3	20.2	24.4	19.9
C&F&O	13.3	3.4	5.2	4.1	4.2	3.4	3.2	4.4	5.1	6.2		
Balkan countries	3.3	3.2	3.4	3.2	5.4	4.3	3.1	2.2	2.1	1.3		

Source: Statistical yearbook, NSI, respective years.

Considering the presented data, the conclusion is that Bulgaria has achieved progress in the trade integration into the EU. The level of 55% can be regarded as satisfactory and compatible with the levels of other countries of CEE (60%). There are possibilities for a higher degree of integration because the potential of Bulgarian economy is not exhausted.

What are the effects of the obtained level of integration on the economy and social security?

The effects have to be considered in their positive and negative aspects. The positive aspects of the trade integration into the EU can be summarized as follows:

- Bulgaria receives investment goods of high technological level. This is of great importance for the reconstruction and technological renovation of the Bulgarian economy. The share of goods with investment function (machines, appliances, and equipment, etc.) grows in the last several years from 18.1% in 1997 to 31.5% in 1999.
- The competitive import encourages Bulgarian producers to be more competitive with their production. In this way the foreign competition is a powerful accelerator for perfecting and obtaining high quality of the Bulgarian production.
- The export to the EU is a major factor of achieving economic growth and economic stabilization in Bulgaria.
- In a social aspect the greatest degree of trade integration is a prerequisite for creating stable jobs suitable for average and high skill labor force. In Bulgaria there is no specialized surveys about the influence of the foreign trade exchange on employment and unemployment. It is logical to expect that the penetration and preservation of foreign markets create favorable conditions for keeping and



increasing employment, other things being equal. Besides, the export ensures growth in incomes of the population and, therefore, the budget revenues and social insurance increase. Because of the limited domestic demand the export is a main source of wage dynamics and other sources of incomes of the population.

The negative aspects of Bulgarian integration into the EU are expressed in several aspects:

- The Bulgarian producers were not ready for foreign competition. Some of them who couldn't adapt to the new conditions were driven out of the domestic market. This situation led to serious economic difficulties for a major part of Bulgarian producers. The effect is expressed by a decrease in industrial production and closing jobs.
- The Bulgarian export has the EU protection in respect to goods for which Bulgaria is more competitive. These goods are mainly agricultural products and products of low technological level (labor and capital consuming products).
- The Bulgarian trade integration into the EU negatively influences the country's balance of payments. A sufficient trade deficit is accumulated that creates problems with its financing. The data shows that the trade deficit increases along with the trade exchange during the last several years. For the last two years (1999-2001) the trade deficit increases with 420 million USD and reaches 1.4 billion USD in 2001.

## **2.2. Liberalization of capital flows and integration**

The Bulgarian integration into the world economy and particularly into the European economic structures is related to the development of the capital market and liberalization of capital flows.

The development of the capital market in the country has three stages<sup>3</sup>: unregulated market (unregulated exchange of stocks and creation of local exchange market-places according to the Trade Law); official market (creating organized stock exchange and a process of adaptation towards the institutional structure), increase and stabilization of stock trade (new market segments and instruments appear). The main characteristics of the capital market can be summarized as follows:

- The market participants are predominantly firms from the small and average business. The big companies in the country desist from participation due to various interests.
- The amount of trade stocks is relatively small.
- The capital market has low liquidity. This is due to reasons, connected with the low level of exchange privatization and a lack of portfolio investors. A limited relative share of company stocks is offered in the stock exchange. The most liquid

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<sup>3</sup> Koparanova, M., (1997), "Development of Bulgarian Capital Market in the First Half of the 90's: Is the Incubator Period Over?", in *Emerging Capital Markets in a transitional Environment*, pp. 24-41.

are the stock shares of tourism, chemical industry, machine-construction and tobaccos industry.

- Strong mobility of prices. Some overestimation of prices of the new stock shares and a gradual decline in the next periods is observed. This is an expression of the great expectations for market activities and expected high rate of exchange privatization.
- Unsteady interest in investments from the side of the foreign investors. The relative share of foreign direct investments (FDI) on the capital market is barely 5.3 % from their total amount.

The indicated characteristics of the Bulgarian capital market show that the market is in its initial stage of development, in which the problems prevail over the positive effects. The appraisals of the international institutions about the progress in development of the capital market confirm this statement. For instance, the appraisal of the European Bank for Reconstruction and Development<sup>4</sup> is 2.0 from maximum 4+.

The unsteady development of the capital market in Bulgaria does not correlate with the progress of liberalization of capital flows. In order to attract foreign investments and stimulate the interest of foreign investors, specific measures for liberalization of the access of foreign capitals were taken. According to the present legislation, the flow of foreign investments is fully liberalized. Till 1999 there were tax preferences for foreign capitals, but later they were abolished. In this way the foreign and domestic investors were put in equal position. At the present moment the foreign investors can make free repatriation of their capital and profit. The only limitation is the constitutional prohibition of land acquisition by foreigners. This problem is partially solved by founding mutual companies, entirely possessed by foreigners, but registered according to the Bulgarian law. This measure will probably expire after joining the EU.

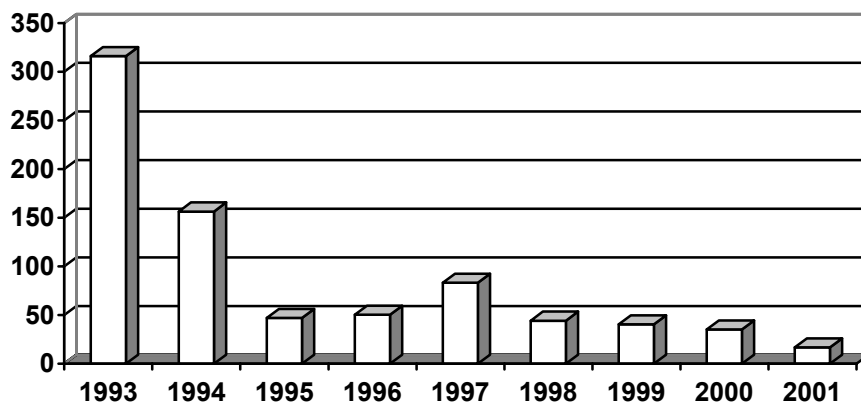
The direct effect of liberalization of capital flows is the level and dynamics of foreign direct investments (FDI) in the country. For the period 1992-2001 the total amount of FDI in Bulgaria reaches 4.5 billion USD, that in comparison with the beginning of the period has increased more then 100 times (Table 2.3).

**Table 2.3. Foreign Direct Investment, Bulgaria, 1992-2001**

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Accumulated
DFI - mln. US\$	34.3	102.4	210.9	162.6	256.4	636.2	620.0	818.8	1001.5	650.9	4494.1
Growth rate - %		216.0	105.9	-22.9	57.7	148.1	-2.5	32.1	22.3	-35.0	
Accumulated DFI (Index, 1992=100)	100.0	397.7	1011	1483	2229	4078	5880	8260	11172	13064	

Source: Bulgarian Foreign Investment Agency.

<sup>4</sup> Transition report 2000, European Bank for Reconstruction and Development, 2000, p. 178-173.



**Fig. 2.1. Changes of Accumulated Foreign Direct Investment, Bulgaria, 1991-2000**

The most significant flow of FDI was realized in the second half of the 1990s. It is connected with the improvement of the investment climate in the country and realization of bigger contracts in the privatization process. The annual amounts of FDI after 1997 increase, but the trends for the total foreign investments flow decrease (Fig. 2.1).

In comparison with other Central and East European countries the foreign investments flow in Bulgaria is modest (Table 2.4). It is comparable to this of the Baltic states (Lithuania, Latvia and Estonia), Slovenia and Slovakia and comprises only 3% of the total flow of FDI in CEE countries. Bulgaria is ranked at the last but one place in respect to FDI per capita (284 USD).

**Table 2.4. Foreign Direct Investment in CEE, 1989-1999**

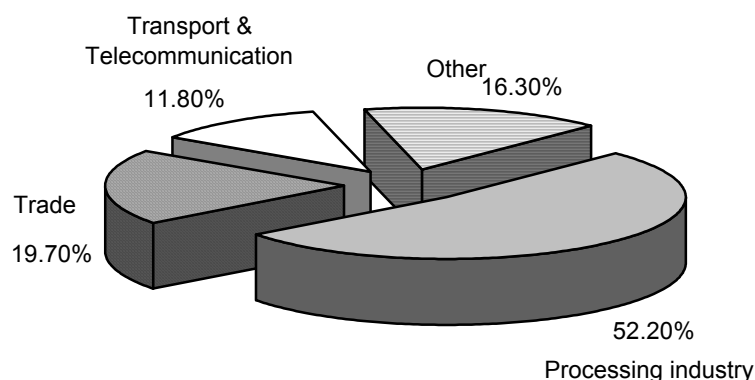
	Accumulated FDI Bln. US\$	Accumulated FDI per capita US\$
Bulgaria	2.3	284
Czech Republic	14.9	1447
Estonia	1.6	1115
Hungary	17.8	1764
Lithuania	2.1	866
Latvia	2.0	545
Poland	20.0	518
Romania	5.6	252
Slovak Republic	2.1	391
Slovenia	1.4	701
Total	74.1	636

Source: EBRD, Transition Report 2000. Employment, Skills and Transition, London, November 2000, p. 74.

Two indicators can demonstrate the influence of FDI on the economic growth of the country: the ratio between FDI and GDP and the ratio to total investments for basic capital. For Bulgaria the first ratio comprises about 16% of GDP in 1999 while in other countries it is sufficiently greater - in Hungary – 40%, Poland – 18%, the Czech Republic – 32%. According to the second indicator (the share of FDI in the total investments) Bulgaria is ahead of the other CEE countries. In Bulgaria this share is about 40%, while in Hungary it is about 16%, in the Czech Republic it is 19% and in Poland – 17%. The high percentage is not only due to the great amount of FDI but rather to the low domestic accumulation. Therefore, the foreign investments are sufficiently important for the economic development of the country.

The prevailing part of the foreign investment flow is directed to the real sector. The share of the accumulated investments in the real sector comprises 59.4% of the total investments till 2000. The branch structure of the foreign investments indicates preferences towards the industrial sector (Fig. 2.2). More than the half of the investments (52.2%) is directed to the processing industry. In the sphere of services, the greatest is the concentration in trade (19.7%), and transport and telecommunications (11.6%).

Since there is no data about more specific branch, production, and product direction of FDI, it is hard to make informed conclusions about their efficiency. In general the foreign investments are directed to low technological and labor-consuming productions (textile industry, sewing, shoe-manufacturing and other industries). The benefits of combining cheap and highly qualified labour are the advantages of the investors.



**Fig. 2.2. Branch structure of FDI, Bulgaria, 2000**

The economic and social effect of FDI to a great extent depends on their functional structure. According to data from the Bulgarian Foreign Investment Agency 41.1% are directed towards privatization, 53.6% to other investments (including green field investment) and 5.3% to the capital market<sup>5</sup>. The greater share of the investments in new construction confirms the assumption for the positive role of the FDI in the

<sup>5</sup> Bulgarian Foreign Investment Agency, Investment statistics, Web side.

creation of new jobs and decreasing unemployment. Besides, the new construction presupposes the use of new technological decisions and the renovation of the product list.

At the same time, the great share of privatization investments decreases the effect of the increase in employment by the green field investment because in the process of reconstruction and optimization of the personnel in the privatized companies labour force is released.

The EU countries are the main source of FDI for Bulgaria. Their share in the real sector reaches more than 53% at the end of 2000. Among the basic investors are Germany (14.2%), Great Britain (11.8%), Holland (7.1%), Austria (7.2%), and Italy (4.3%)<sup>6</sup>. Among the countries not belonging to the EU, the greatest flow comes from the USA (13.4%), Cyprus (9.2%) and the Republics of Korea (2.1%). This structure of the capital flow in Bulgaria can lead to the following two summarizing conclusions: first, there is a stronger integration process with the EU countries and second, the origin of the capitals in some sense ensures the highest qualities of the investments.

The appraisal that can be made about the degree of integration of Bulgarian economy, in respect to the capital flows is that some progress in this sphere is achieved. In comparison to the candidate countries from Central Europe (The Czech Republic, Poland and Hungary) Bulgaria considerably falls behind. But in comparison with the countries from the EU periphery (The Baltic states, Slovenia, Slovakia, and Romania) the Bulgarian position is similar. In general Bulgaria is near the average level of integration.

The economic and social effects of Bulgarian integration into the capital flows can be hardly quantified and demonstrated on the basis of the present statistical information. Nevertheless, several spheres of positive and negative influence can be indicated:

- FDI are an important source for financing the Bulgarian economy due to the low domestic accumulation. The limited own potential for accumulation probably will be preserved in the next 5-10 years, therefore the foreign investments will compensate the lack of resources.
- Foreign financing is a factor for solving the problems of structural and technological changes in the economy. In the conditions of great external indebtedness, FDI are a preferable source of “know-how”, modernization and technological renovation of production and product list.
- FDI make favorable conditions for the development of export direction of Bulgarian economy, open the access to the world markets, help to involve Bulgaria into global and transnational business structures.
- The social effect of FDI is expressed in several aspects: increasing employment in respect to new construction; high payments and social insurance in companies

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<sup>6</sup> Statistical Reference Book, NSI, 2002, p. 100.

with foreign participation; affirmation of European and world standards in industrial relations and management of the firms.

- Some disloyal investors may easily transfer the profit to countries with lower business taxation. Taking into account that a part of the capital comes from offshore firms (for example firms registered in Cyprus) this risk is rather real and Bulgaria will sustain great losses.
- Liberalization of the capital account for short-term investments leads to greater vulnerability caused by the conjuncture or more global crisis.
- FDI exert strong influence on the territorial differentiation. In principal foreign investments are orientated towards regions with developed infrastructure and qualified labor. That aggravates social discrepancies between the different regions in the country. The developed become more developed, but the poor become more impoverished.

### 2.3. Privatization and process of integration

Because of the small attraction of the capital market in Bulgaria, one of the main forms of attracting foreign investors is the privatization of government companies. This model of integration prevails in all newly founded market economies in CEE. Its effectiveness and social influence can be estimated from now on.

In Bulgaria the privatization process started with a certain delay in comparison with the other CEE countries. The total amount of government assets that are subject to privatization comprises about 66% of the total government assets. Till 2000 the assets of the infrastructure companies (electric power, transport, water and canalization and thermoelectric power energy) were not included in this amount. They comprise about 30% of all government assets.

Till 1995 the privatization process proceeded very slowly. During this period only 47% of the assets were privatized or 2.6% of the total government assets (Table 2.5).

**Table 2.5. Share of privatized state assets, Bulgaria, 1993-2001**

	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
Share of government assets, subject to privatization	0.56	2.47	1.62	6.19	27.81	6.80	25.79	6.70	1.46	79.4
Share of total government assets	0.37	1.63	1.07	4.09	18.36	4.49	17.03			52.7

Source: Privatization Agency, Report 2002.

Only after 1997 the privatization and the selling of big companies were accelerated. In 1997 three auctions of the mass privatization were organized, where 80% of the offered stock shares were sold. The greatest success in privatization was achieved in 1999, when 1224 privatization deals were made.

As a result of this acceleration at the end of 2001 about 80% of the government assets, subject to privatization, were privatized. This comprises more than a half of the

government assets. Some monopolistic companies from the infrastructure branches (electric power, telecommunication, rail-way transport) remain for privatization.

A confirmation of the achieved high level of privatization is the appraisal of the European Bank for Reconstruction and Development. For 2000 it is 3.7 of the maximum of 4+<sup>7</sup>. The economic effect of privatization can be assessed by the relative share of the private sector in gross value added (GVA) and by the share of the employed in the private sector. In 2001 the share of the private sector in GVA reaches 71.7% against 10.9% in 1991. At the same time the share of the employed increases from 10.1% in 1991 to 70.1% in 2002.

The function of the foreign direct investments in the privatization process in Bulgaria can be estimated as modest. For the whole period since the beginning of privatization the total amount of foreign investments in privatization deals amounts to 1.4 billion USD. This level can be regarded as relatively low and not compatible with the high degree of liberalization of the capital flows in Bulgaria. The reasons are various, but they are based on the relatively low share of total FDI in the country as well as the small attractiveness of the privatized companies.

The total amount of FDI in privatization deals (with accumulation) increases about 65 times in comparison with 1993 and reaches 32% of the total flow of foreign capitals (Table 2.6).

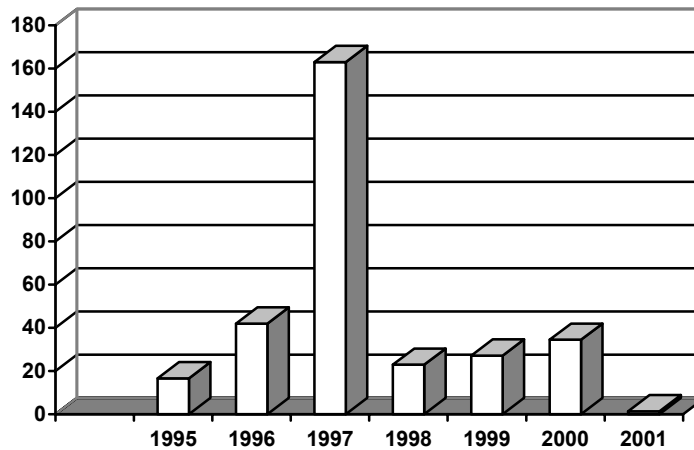
**Table 2.6. Foreign Direct Investment flow in privatization, Bulgaria, 1993-2001**

	1993	1994	1995	1996	1997	1998	1999	2000	2001	Total
FDI flow in Privatization- mln. US\$	22.0	134.2	26.0	76.4	421.4	155.8	226.7	366.0	19.0	1447.5
Share of total FDI - %	21.5	63.6	16.0	29.8	66.2	25.1	27.7	36.5	2.9	32.2
Growth of Accumulated FDI in privatization - (Index, 1991=100)	100.0	710.0	828.2	1175	3091	3799	4830	6493	6580	

Source: Bulgarian Foreign Investment Agency.

The dynamics of revenues from the privatization deals with foreign investors depends on the privatization companies offered. Till 1997 there is a great leap in the flow of FDI for privatization and after 1997 a smooth increase by moderate rates (Fig. 2.3). During the next several years, we expect a new process of acceleration of foreign capital flows in privatization due to the imminent privatization of important for the Bulgarian economy key infrastructure companies (holdings “Bulgarian telecommunication company” and “Bulgartabak”; companies in electric power and rail-way transport).

<sup>7</sup> Transition report 2000, European Bank for Reconstruction and Development, 2000, p. 148-149.



**Fig. 2.3. Rates of growth of FDI flow in privatization (accumulated), Bulgaria, 1995-2001**

The given levels and dynamics of FDI in privatization indicate that the process of integration in Bulgaria by means of privatization of government assets is not enough active. Foreign investors prefer green field investment, additional investment in companies with foreign participation and joint ventures.

The economic and social effect of privatization of Bulgarian firms by foreign investors can hardly be assessed due to a lack of sufficient information. Irregular surveys indicate certain benefits to the employed in these firms. The advantages are mainly expressed by higher labor payments, more favorable work conditions, and adequate level of social insurance<sup>8</sup>. The decrease in employment is one of the basic disadvantages observed in all privatized companies from social point of view. This is a consequence of the reconstruction of firms and optimization of their personnel. This is a desirable and rational process, concerning the effectiveness of the companies, but under the conditions of high unemployment and limited financial resource it complicates the social policy of the government.

### **3. Inequality and poverty**

A direct consequence of the crisis in incomes is the social polarization of population and expansion of poverty. In the 90s in the Bulgarian society a bipolar model of social stratification is formed. The majority of the population gets low incomes. A small number of persons get average incomes and a very limited part of the population – high incomes.

The main reasons for this situation are the culpable redistribution of national wealth and incomes. The powerful processes of redistribution, mainly as a result of the shadow economy, form a small stratum of population that possesses a great share of incomes. In the second place, the bank system as a source of enrichment should be considered. Borrowed but not serviced credits are mainly used for the consumption

<sup>8</sup> The common practice in Bulgarian private companies is to provide social insurance at the level of the minimal labour salary or some approximating salary.



and accumulation of property. The differentiation of population with respect to labor salaries, pensions and incomes from entrepreneurship (small private business) can be regarded as the third important factor, but this factor differentiates the population mainly below and a little above the average level of incomes.

### 3.1. Income inequality

The quantitative dimensions and trends in the development of income inequality in society can be followed with the help of some widely used integral and partial measurements (Table 3.1).

**Table 3.1. Measurements of income inequality of households, Bulgaria, 1990-2001**

Indicators	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Gini Coefficient	0.23	0.24	0.31	0.33	0.35	36.0	0.34	0.34	0.32	0.31	0.31	0.32
Income ratio between lowest and highest 10% of household persons	-	-	7.7	8.6	10.7	11.9	10.4	10.2	9.3	8.9	9.2	9.3
Relative share of income of groups of persons in the total income:												
- lowest 20%			8.3	7.9	7.2	6.8	7.3	7.2	7.5	7.6	7.4	7.4
- highest 20%			40.0	40.6	44.6	43.2	42.1	42.6	40.9	39.8	39.8	40.0

Source: Household Budgets in the Republic of Bulgaria, NSI, 1994, 1996, 1999, 2001.

Inequality of households, measured by Gini coefficient, has an increasing tendency till 1995, after that slowly decreases and reaches 0.32 in 2001. The coefficient increases to 57 % during the first half of the 90s, while the decrease is in the range of 4-5 percentage points.

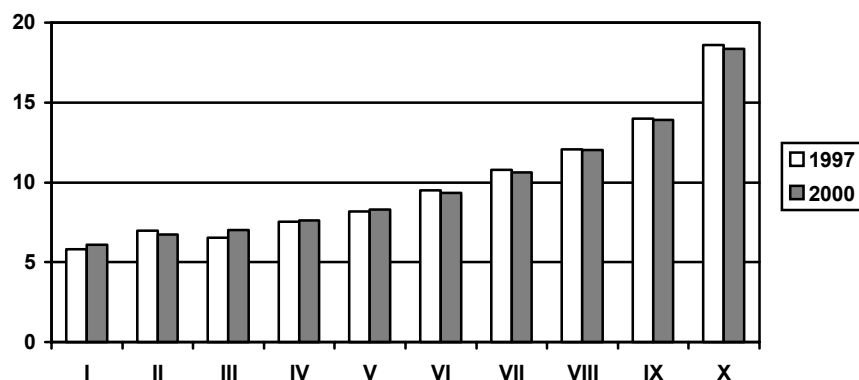
The disaggregated indicators of differentiation confirm the tendency stated above. Polarization in terms of incomes between the richest and poorest households is significant. The income ratio of households in the extreme groups (10 % with the lowest and highest incomes) increases from 7.7 times in 1992 to 11.9 times in 1995 and then decreases to 9.3 times in 2001. During the last two years of the period, the poorest households receive about a ninth of the incomes of the richest.

The share of the incomes of the poorest 20 % of the population in the total income is below 10 %. Their share decreases to 6.8 % in 1995 and slowly increases to 7.4 % in 2001. The tendency about the richest 20 % of population is the opposite. Their share increases to 44.6 % in 1994 and then decreases. According to this indicators Bulgaria exceeds the differentiation in such countries as Japan, Sweden, and Belgium<sup>1</sup>.

The differentiation in consumption is considerably lower. The comparisons between

<sup>1</sup> For these countries this ratio is between 4.3 –4.6. Cited from HBS in the Republic of Bulgaria, NSI, 1996.

1997 and 2000 indicate that there are no substantial discrepancies between the levels of consumption among the separate decile groups (Fig. 3.1). The consumption decreases to some extent in the upper groups, whereas slowly increases in the low groups. Independent of this, the consumption of the poor comprises one third of the consumption of the richest.



**Fig. 3.1. Share of the total consumption per person by decile groups, Bulgaria, 1997, 2000**

The main conclusions about the level and dynamics of income inequality in the 90s are as follows:

First, after the liberalization of the economic activity, inequality in Bulgaria increases rapidly. It reaches the highest level in 1995, than slowly decreases, but remains higher in comparison with the time from the beginning of the reform.

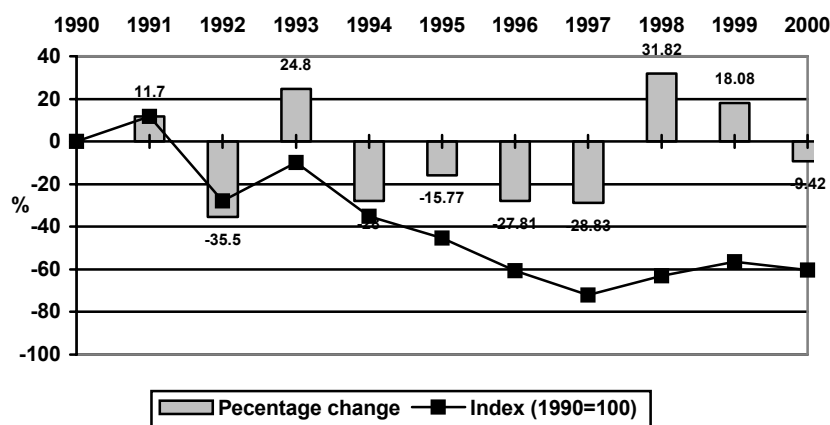
Second, the process of differentiation is accompanied by a *transfer of incomes from the group of population with low incomes to the group with high incomes*. In this case there is the indicative fact of decreasing of relative share of income in the lowest incomes groups and increasing the share of highest income groups.

### 3.2 Poverty in Bulgaria

In Bulgaria there is no officially determined poverty line, but there exists a number of empirical examinations<sup>2</sup> that give the idea about the development of this process in the years of transition. Because of the use of various definitions and methods for measuring poverty in the separate surveys, there are different results, but they manifest practically the same trends of changes. By the results of this works, as well as by the dynamics of the Guaranteed Minimum Income (GMI), that serves as a base for conducting the government policy of social assistance, it may be concluded about the level, dynamics, depth and profiles of poverty.

<sup>2</sup> The most profound are the investigations: "Poverty in transition: Assistance in the formulation and implementation of anti-poverty policies and strategies", ILO and UNDP, 1998 and World Bank's investigations, held in 1995, 1997, and 2001.

The Guaranteed Minimum Income is implemented for the needs of the social assistance in 1992. It is determined by the government according to the level of inflation and the financial possibilities of the budget. The guaranteed minimum income can hardly be accepted for an appropriate poverty line because it doesn't reflect the minimal needs of the people. The share of population that gets incomes below this limit is too small (3-4%). In 2001 the level of GMI is 37.40 BGL (17 USD) and only about 4.3 % of population get incomes below this level. As the GMI to a great extent depends on the possibilities of the budget, during the entire period of the 90s it indexed by a lower percentage than the inflation index. At a result of this, GMI loses about 40 % of the level in 1990 in real terms (Fig.3.2).



**Fig. 3.2. Dynamics of Guaranteed Minimum Income, Bulgaria, 1990-2001**

The development of poverty in Bulgaria during the 1990s marks a steady tendency of an increase till 1997, and after this decreases. Numerous investigations confirm this trend. However, the questions of the particular level of poverty and the relative share of the poor population are disputable, as different surveys give various results.

According to investigation of poverty<sup>3</sup>, held in 1997 with the assistance of ILO and UNDP, the poverty in Bulgaria increases in the first half of the 1990s. Various widely used methods are probated by this investigation to define poverty. Poverty is investigated with the help of the methodological instruments of the absolute, relative and subjective approaches. The obtained results about the poverty line and the relative share of the poor population differ from one another (Table 3.2).

Using the absolute<sup>4</sup> definition of poverty leads to high levels of poverty. According to this definition, the share of poor households exceeds 40 % and there is a distinct manifested tendency of an increase. This increase in poverty for the period 1992-1996 is estimated at about 10-15 percentage points.

A great share of poor population is observed also by using the subjective poverty line. According to this method, the share of poor households in 1996 is about 59 % and the

<sup>3</sup> "Poverty in transition: Strengthening the national policies and strategies for poverty reduction in Bulgaria", ILO, UNDP, 1998.

<sup>4</sup> The investigation involves the method of the consumer baskets, the Orshansky method and the method of the relative share of food.

extent of impoverishment (index of Foster) is 25.9 %.

The considerable differences in poverty level are obtained by using the relative approach and more precisely the method of using 50 % from median income. According to this method the share of poor households changes in the range of 7-15 %, but the tendency of an increase is distinctly presented.

**Table 3.2 Poverty trend, Bulgaria, 1992-1995**

Definitions	1992	1993	1994	1995	1996
Absolute poverty line					
Consumer basket	n.a.	n.a.	n.a.	n.a.	52.9
Orshansky	42.1	43.8	45.7	44.5	51.9
Food share	40.3	38.4	44.9	44.1	59.5
Relative poverty line					
Half of the median income	7.9	9.1	11.4	15.0	12.2
Subjective poverty line					
Leyden poverty line	n.a.	n.a.	n.a.	n.a.	58.8

Source: "Poverty in transition: Strengthening the national policies and strategies for poverty reduction in Bulgaria", ILO, UNDP, 1998, p. 14, 15, 18.

The expansion of poverty in 1992-1996 is related to the process of its profoundness. The share of poor households increases and the gap of poverty threshold also grows. The depth of poverty, measured by coefficient of Forester, Green, and Torbek, virtually is multiplied twice (from 12.9 % in 1992 to 21.1 % in 1996).

The development of poverty during the second half of the 1990s shows a decreasing tendency after the crisis in 1997. Independently of the differences in estimations, almost all investigations of poverty present this trend.

According to the investigations of the World Bank<sup>5</sup>, held in 1995, 1997 and 2001, the poverty in the country drastically increased in 1997 and considerably decreased in 2001 (Table 3.3).

**Table 3.3. Poverty trends, Bulgaria, 1995-2001**

Poverty measure	1995		1997		2001	
	High	Low	High	Low	High	Low
Rate	5.5	2.9	36.0	20.2	11.7	6.0
Gap	1.7	0.9	11.4	5.9	3.6	1.9
Depth	0.8	0.4	5.3	2.7	1.7	0.8

Source: Carletto, G., T. Fujii, An Update on Poverty in Bulgaria: a Background paper for the Bulgaria Poverty Assessment, Paper presented at the seminar in Sofia, March, 2002, Sofia, p. 7.

The estimations of the two lines of poverty are respectively: high – 61.50 BGL (28 USD) and low – 46.10 BGL (21 USD).

<sup>5</sup> Investigations are compatible in respect to the methodology, as well as in respect to the statistical sample. The relative approach is used for the measurement of poverty, by which the poverty line is defined in two levels: low – as 50 % from median income and high – 2/3 from the median income.

The percentage of the poor increases in 1997 more than 6 times and decreases by 11.7 % in 2001. Despite this decrease it remains two times higher than the level in 1995. Similar tendency is observed in respect to poverty gap and poverty depth. In 2001 the poor are less poor in comparison to the crisis year of 1997.

This trend of poverty shift in Bulgaria is proved by other investigations as well. By using the modified method of Orshansky<sup>6</sup>, the investigation held in 2000 by UNDP observed an increase in poverty till 1997 and a decrease after the year of crisis. According to it, the share of poor households increases from 10.3 % in 1995 to 44.1 % in 1997 and decreases to 18.1 % in 2000.

The stated tendency is proved also by using other methods of poverty estimation. Investigations of poverty by subjective poverty line in Dec. 1991, Dec. 1996, Apr. 1997 and May 2000 show that the households define high comparative poverty threshold (in respect to other methods), that reflects on the bigger relative share of the poor<sup>7</sup>.

The presented data about the level and dynamics of poverty in the country show that in 1990s Bulgaria faces increasing poverty. The deep economic crisis leads to a considerable decline in the living standard of Bulgarians. The economic growth and stabilization after 1997 had a positive influence on the decline in poverty, but nevertheless it remains at a considerably high level.

### ***3.3. Identification of Risk Groups***

Investigations of poverty in Bulgaria reveal the main risk groups in the population that have the greatest probability to get into poverty. Formally the identification is determined as the ratio between the number of households with incomes below the poverty line and the total number of households in the given group. In respect to risk group identification and the main conclusion for the size of the risk, there are no differences in the various investigations. But there are differences concerning the particular measurement of poverty.

On the basis of poverty profiles, presented in the investigation of poverty in 1999<sup>8</sup>, as well as the investigation of the World Bank<sup>9</sup> in 2001, the following main risk groups may be identified:

- Unemployed and economically inactive population;
- Households of many members and many children;
- Persons with low level of education;
- Population in the small settlement (rural population);

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<sup>6</sup> “Bulgaria’s Anti-Poverty Action Plan 2000-2005: Strategic Framework”, UNDP, 2001.

<sup>7</sup> Tzanov, V., “Estimation of the Subjective Poverty line Using Data from the Household Budget Survey”, Paper presented on the Seminar “Using data from the Household Budget Survey in Investigating the socio-economic processes in Bulgaria”, 19-21 June, Slivek, 2001.

<sup>8</sup> Estimations are made for the project: “Vocational Education and Training Against Social Exclusion, Bulgaria, 1999.

<sup>9</sup> Carletto, G., T. Fujii, “An Update on Poverty in Bulgaria: a Background paper for the Bulgaria Poverty Assessment”, Paper presented at the seminar in Sofia, March 2002, Sofia.

- Ethnic minorities (Gypsies and Turks).

1. *Unemployed and economically inactive population.* The analyses of distribution of poverty by socio-economic status of the household confirmed the conclusion that the unemployed persons and their families are the most risky group for social exclusion and poverty in 1999.

The lower poverty line<sup>10</sup> forms a socio-economic structure of the poor, in which are distinguished two groups (Table 3.4). The first one has no regular incomes and the seconds have regular sources of incomes, below the level of poverty line (e.g. low salaries and social insurance benefits). The first group comprises households of long term unemployed with expired period of benefits, who prevail among the very poor. The share of the poor population with low regular incomes is divided almost equally between the economically inactive people and the employed. The group of the economically inactive population comprises mainly the households of pensioners with social pensions. Below the lower poverty line fall also households of employed people, whose salary is close to the minimum wage. Their high share (almost one fourth of the poor) indicates that the minimum wage does not prevent the employed and their families from poverty.

**Table 3.4. Relative share of the poor households by their socio-economic status (%)**

Poverty line	Total	Entrepreneurs	Employed	Unemployed	Economically non-active
Lower	3.4	3.1	2.0	21.1	1.6
Upper	49.5	40.8	35.2	76.4	55.9
Lower	100	3.9	21.6	51.0	23.5
Upper	100	3.6	25.7	12.7	58.1

Source: "Vocational Education and Training Against Social Exclusion, Bulgaria, 1999.

The upper poverty line leads to significant changes in the socio-economic structure of the poor households. The share of working poor people is equal to those below the lower poverty line, however the share of economically inactive population is increasing. This means that almost all pensioners should fall below this poverty line. At upper poverty line the unemployed has relatively low share among poor because of their weak prevails in the society.

The households of unemployed are also characterized with a significant risk for becoming poor. The probability of the households from this group to become poor increases from 21% at the lower line to 76% at the upper line (Table 3.4). The group of the permanently unemployed is characterized with a particularly high risk. The increased duration of the unemployment reduces the chances to find job due to the loss of qualification. This risk subgroup needs special measures, related not only to the provision of social benefits, but also to provision in educational and training system.

<sup>10</sup> Determined at the level of GMI in 1999.

The situation is the same also in 2001. According to the investigation of World Bank<sup>11</sup> the unemployed are 38.2 % of poor, as long as the economically inactive persons – 42.5 %.

2. *Households of many members and many children.* The large families (3 or more children) form the second risky group at both poverty lines. This is particularly valid for households with children and elderly people.

The structure of poor households by number of children below 18 years confirms the hypothesis that poverty increases with increasing number of children in the household (Table 3.5). The share of households with 3 and more children below the lower poverty line (GMI) is 16.7%, or 10 times higher compared to their share in the population as a whole. The higher poverty line changes the structure towards significant increase of the poor households without children. Their share reaches 61.3%, while the share of those with one and two children decreases to 18% and the share of those with many children – to 2.6%. The reason is that the pensioners' households prevail in the category without children.

**Table 3.5. Distribution of poor households by number of children (%)**

Poverty lines	Total	1 child	2 children	3 and more children	No children
Lower	100	31.4	27.5	16.7	24.5
Upper	100	20.4	15.7	2.6	61.3

Source: "Vocational Education and Training Against Social Exclusion, Bulgaria, 1999.

The poverty profile by size of household takes into account the number of individuals, who earn income. The percentage of the poor households at both poverty lines increases with the increasing size. The share of the poor one-member households, living below the lower line is very small due to the fact that these are mainly households of old age persons receiving pensions above the Guarantee Minimum Income. Households with more than four members cover over 80% of the very poor. Part of them are large families with more than 3 children and another part includes co-habitation of three generations (couple with children and their grand-parents), which is typical for low-income groups.

According to the estimates every third household from this group falls below the lower poverty line, and below the upper poverty line - 81%. The average cash income per capita from the household with 3 and more children is 54-60% from the average for the country. The large households with many members are also in the similar situation. This is due not exactly to the lack of income sources, but to the low absolute level of the incomes, which are distributed among a greater number of household members. These two risk groups are characterised with expenses, exceeding the

<sup>11</sup> Carletto, G., T. Fujii, "An Update on Poverty in Bulgaria: a Background paper for the Bulgaria Poverty Assessment", Paper presented at the seminar in Sofia, March 2002, Sofia, p. 26.

current incomes. This “living on the verge” life style (thanks to the cash, accumulated in previous periods, or loans in different forms) in fact makes impossible the exit from the group of extremely poor people. It can certainly be stated that this part of the society, although it is not large, possesses a continuously formed poverty sub-culture.

*3. Persons with low level of education (without education and primary education).* The third risk subgroup is formed by persons with low education (primary or lower degree). This subgroup includes both employed and unemployed persons.

The structure of the poor households by professional status presents relatively low share of low-qualified workers at both poverty lines (respectively 5.9 and 6.0%). In opposite the share of the poor qualified workers is higher (respectively 13.7 and 17.1%). This is due to the fact that many low-qualified categories workers receive higher wages than qualified. For example, the average wage in some branches and activities, in which prevails the low-qualified workforce (coal mining, metallurgy, etc.) exceeds several times those of the employed in the education and science. This profile indicates discrepancies at the labor market and violation of the principle that higher qualification brings higher wages.

The impact of education on poverty and social exclusion is visible into two aspects: opportunity to find a job and wage level. Low education leads to frequent change of the job, uncertainty and high risk for moving to the unemployment category. However, this risk decreases in regard to the wage, because many low-qualified workers receive wages, which are higher than the average for the country.

The spreading of poverty among the low-educated population covers mainly groups with primary or lower education (Table 3.6). Its relative share in the poor exceeds 65% at the lowest poverty line. The share of poor people with secondary education is also relatively high. The increase of the poverty line does not change significantly the profile. The share of poor with primary and secondary education remains high, and that of the persons with secondary education increases with about 10 percentage points.

**Table 3.6. Distribution of the poor by education of household’s head (%)**

Poverty lines	Total	No education	Primary education	Secondary education	University education
Lower	100	25.5	40.2	28.4	5.9
Upper	100	14.0	38.5	38.7	8.8

Source: “Vocational Education and Training Against Social Exclusion, Bulgaria, 1999.

The possibility of the low educated subgroup to become poor increases significantly with the increase of the poverty line (from 8.2% to 64.5%). This considerable degree of risk is determined by many factors, among which is the large share of unemployed with low education whose reintegration at the labor market is difficult.

*4. Population in the small settlements.* The residence and the size of the settlement as factors for the impoverishment of the population form the fourth risk subgroup. There is significant local disparity in poverty distribution, despite the small territory of the country. This fact is explained with high level of concentration of risk groups affected



by poverty risk (cultural groups, settlements with deteriorated demographic structure, regions with persistent unemployment, etc.). Two main trends determine the poverty profiles in the cities and the villages: first, increasing share of old-age people, due to the negative population growth rate; second, there increases the disproportion between the urban and the rural population by age and sex. During the last ten years, the population in working age in the villages decreased with 16.8%.

The survey in 1999 proved that the impoverishment differs for the cities and the villages. At the lower poverty line, the share of the poor households in the cities exceeds those in the villages with 11 percentage points. At the upper poverty line this difference increases twice. The risk for the rural households is greater although the urban population prevails in the structure of the poor people. The probability for impoverishment of the rural population at the lower poverty line is almost twice higher than that of the urban population (respectively 4.6% for the rural and 2.8% for the urban population). At the upper line this difference decreases significantly.

The size of settlement has important impact on the risk of poverty status and social exclusion (Table 3.7). The percentage of the poor people is higher in the small towns and villages. This is typical for both poverty lines, but is particularly shown at the lower. The share of the poor households is the lowest in Sofia and in the bigger villages, and is the highest in the cities with population below and over 5000 people. Despite these exemptions, poverty is more distributed among the urban population, as the difference increases significantly with the increase of the poverty line. The households with low incomes are concentrated mostly in the cities with population below and above 5000 people.

**Table 3.7. Structure of the poor households by size of settlement (%)**

Poverty lines	Total	Capital city	Cities over 5,000 people	Cities below 5,000 people	Villages over 2,000 people	Villages 1,000-2,000 people	Villages below 1,000 people
Lower	100	4.9	24.5	26.5	5.9	20.6	17.6
Upper	100	12.0	31.3	23.0	9.2	12.4	12.1

Source: "Vocational Education and Training Against Social Exclusion, Bulgaria, 1999.

The possibility for impoverishment of the population in the small villages (below 2000 people) is almost three times higher than that in the larger ones (over 2000 people). The higher risk is related to the ageing of the population and the lower activity rate in these regions.

This relation is observed at both poverty lines. The Guaranteed Minimum Income defines four groups of settlements with almost equal shares. These are the poor households in the small and medium size towns and the smaller villages. Perhaps, these groups also include the settlements, which are most strongly affected by the reforms: high unemployment, local economy with only one branch, ageing and depopulation in the mountain and semi-mountain regions. The increase of the poverty line changes the quantitative indicators, but the groups of settlements in which the poverty is concentrated remain unchanged. Besides this, the share of the poor households in the small settlements decreases almost twice. The reasons are perhaps

due to the availability of household plot in the villages. This gives great opportunities for reduction of the poverty as a result of additional cash incomes from the sale of agricultural products and in-kind consumption.

**5. Ethnic minorities.** Investigations of ethnic poverty<sup>12</sup> show the high level of poverty among the ethnic minorities, especially among Gypsies, nevertheless of their small relative share in population. According to the data of last census (2001) the relative share of ethnic Turks is 9.5% and Gypsies - 4.6%. The Gypsies are dispersed all over the country. In some towns (e.g. Sliven, Lom, Maglij) the Gypsies constitute up to one third of the population. Bulgarian Turks and Muslims (Pomaks) live as compact groups in some regions, particularly rural areas of Haskovo, Russe, Varna, Burgas and Rodopy mountain.

The poverty measurements by ethnic groups are shown in Table 3.8. The discrepancies in the poverty among the separated ethnic groups are considerable. The share of the poor Turks is four times greater than the share of Bulgarians, and the share of the poor Gypsies – more than ten times. Although the share of the Gypsies in the sample is small (8.8 %), they form about 46.5 % of the poor population.

**Table 3.8. Poverty measures by ethnic groups, Bulgaria, 2001**

	Poverty rate	Poverty gap	Poverty depth
Bulgarian	5.6	1.1	0.4
Bulgarian Turks	20.9	5.3	2.2
Gypsies	61.8	25.9	13.6
Other	7.6	1.2	0.2
Total	11.7	3.6	1.7

Source: Carletto, G., T. Fujii, An Update on Poverty in Bulgaria: A Background paper for the Bulgaria Poverty Assessment, Paper presented at the seminar in Sofia, March, 2002, Sofia, p. 49.

The ethnic minorities are poorer than the others. In the group of the poor, Gypsies get less income. They have a poverty gap 25 times greater from Bulgarians and about 5 times greater from Turks. Approximately 63 % of the total index of poverty gap is due to the poor of Gypsy origin. The depth of poverty among Gypsies is the biggest. It forms about 2/3 of index of poverty depth.

The ethnic minorities and more particular Gypsies live in extreme poverty that creates a serious problem in anti-poverty fight. The main point is not the aspiration to increase the incomes of this kind of population, but to provoke deep changes in the style and type of living that considerably differ from those of the Bulgarian population.

### **3.4. The reasons for developing of inequality and poverty in Bulgaria**

The development of inequality and poverty during the years of the transition is a result of multiple political, economic, social, cultural, and other reasons with a

<sup>12</sup> The most profound investigations about ethnic poverty are the World Bank investigations (1997, 2001) and “Poverty and ethnicity”, survey of the International Center for the Minorities, 1999.

complex characteristic. Here, we try to identify the main reasons that led to poverty expansion and inequality in Bulgarian society in the 1990s.

### **A. Political reasons**

The transition to market economy is based on the idea of “shock therapy”, according to which in a relatively short period of time the needed market structures would be created and the economy would work on the market principals. The social value of this transition is high. The main prerequisite for this approach is to conduct rapid reforms. In this way, the positive effects of the economic growth will compensate the high social value after the end of the reforms.

The realities in Bulgaria didn't prove these expectations. The accepted approach of “shock therapy” was not followed by a rapid transformation of the economic system. The retardation of the reforms and particularly the reconstruction of the economy are the main reasons for aggravating the social-economic condition of population. Under the pressure of various political powers and actuated by private economic intentions, the reforms in Bulgaria considerably retarded in the middle of the 1990s. The process of privatization with low shifting didn't bring any success. A great number of the privatized firms didn't act in rational way. They were used mainly for “finance draining”, and not for creative economic activities. As a result of this, the employees didn't receive regularly their payments, and they were dismissed as a result of closing activities. As a final effect, the delay of the reforms led to the payment of high social value for long time, as well as to the impoverishment of population.

The second political reason founds expression in the unsatisfying transformation of the rural sector. The initial idea was to return the property to the real owners in a short time. At the beginning of the reform virtually all rural farms were destroyed. In their place there was a vacuum, which led to a decrease in rural production, high unemployment and natural impoverishment of rural population. The effect of the reform had another negative meaning - dividing the land into small fractions, some difficulties in machinery treatment, some irrational management, etc.

The third political reason is the insufficient social protection by the government for diminishing the social value of the transition. It founds expression in decreasing social expenditures in order to achieve some financial and economic stabilization of the country. The social assistance expenditure as a percentage of GDP were under 1% and marked a tendency to decrease. However, it is necessary to mark that in the last several years there is a positive effect of social protection on reducing the poverty.

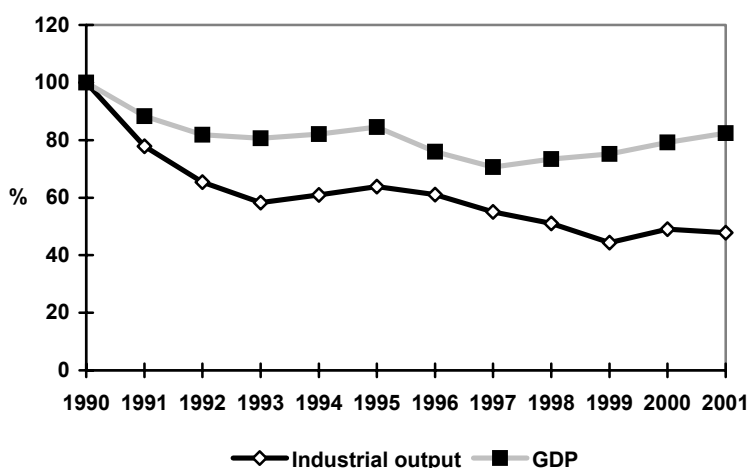
The fourth political reason is the insufficient goodwill of governments to pose the question openly, concerning poverty and strategies for poverty reduction. Many investigations of poverty were conducted and as a result many programs were developed, but by some reasons, no adequate decisions on government level were accepted.

### **B. Economic reasons**

The economic reasons for poverty expansion in the 1990s should be interpreted in the

context of the economic development of the country. Till 1997 the Bulgarian economy were in deep economic crisis and financial destabilization. It exerted a negative influence on the living standard of Bulgarians and led to a considerable increase in poverty. The particular economic reasons can be summarised as follows:

**1. Strong decline in production.** One of the main reasons for a poverty increase during the transition period is the strong decline in production and GDP (Fig. 3.3). As a result of the stated reasons, GDP declines with about 40% in 1997 in comparison with the level in 1990, and for the entire period – about 20 %. The industrial production declines at even greater extent. Till 1999 it declines with more than 48 %, and marks some recovery only in 2000. The influence on the living standard is obvious. There are narrow correlation dependency and “cause-effect” relationship between the economic development and poverty. The poverty expansion is strongly expressed in the period of deepening economic crisis (till 1997). Almost two times decline in production led to an increase in unemployment and a decrease in incomes and consumption of population. For the same period, incomes and consumption decline by more than 70 % in real terms. This considerable decline of the living standard of population is also due to the conducted restrictive policy in incomes.



**Fig. 3.3. Industrial output and GDP development, Bulgaria, 1990-2001, (Index 1990=100)**

**2. Restrictive incomes policy.** The model of transition to market economy, implemented in the country during the 1990s, defines incomes as one of the important factors for stabilization. It imposed the implementation of regulative measures in respect to the dynamics of all incomes in the public sector.

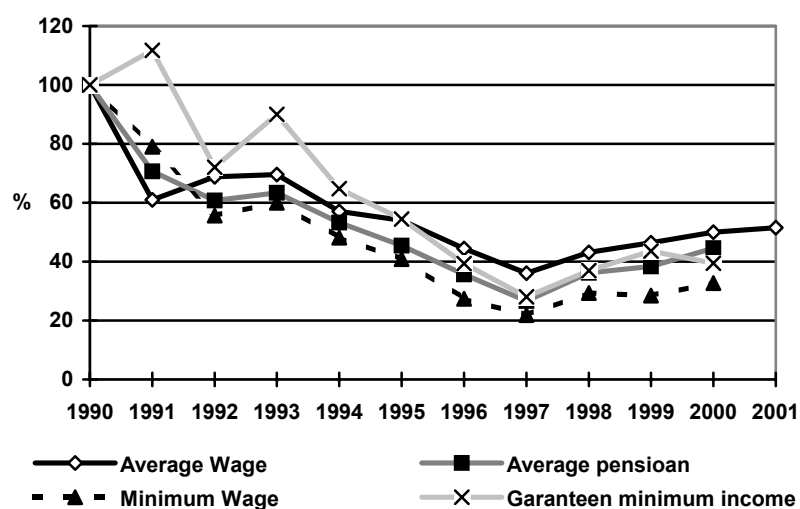
The incomes policy throughout the last decade was distinguished for predominant regulative functions and strongly displayed restrictive character. Various administrative and economic measures and instruments<sup>13</sup> were used for this goal. The goal was achieved at the expense of a strong decrease in the real incomes.

<sup>13</sup> Tzanov, V., (2001), “The Wage Policy during the 90’s: Conditions, Effects, and Long-term Perspective”, Economic Thought, 2001, pp. 3-20.

The restrictions over the growth of all kinds of incomes in public sector found expression as follows:

a) Strong decrease in the purchasing power of wages and minimum payments (Fig. 3.4). The average wage decreases with about 50 % from the level of 1990 in real terms, and average pension - with 53 %. The purchasing power of GMI, as well the social pension decreases even more – respectively with 60 % and 76 %.

b) Slow-down of minimal payments from the level of wages. Using the minimum wage as an instrument for incomes' regulation in the budget sphere led to its irregular indexing according to inflation. This has a negative social effect. The minimum wage considerably delays from the inflation and average wage, and in result it doesn't perform any economic and social function.



**Fig. 3.4. Dynamics of Real Wage, Real Pension, Real GMI, and Real Social Pension, Bulgaria, 1990-2001 (Index 1990=100)**

The same delay can be observed in all other minimal social payments (social pension and GMI). This reflects on increasing of incomes inequality among the population with low and average incomes. The lowest ratios between those indicators are marked in the crisis year 1997 (Table 3.9). The occurred improvements during the last two years are a positive sign for the aspiration of improving the social conditions of this category of population, but they are not sufficient for solving problems. The level of GMI and social pension doesn't exceed 20 % of average wage. In the conditions of very low wages, the person living on those means lead a miserable existence.

**Table 3.9. Ratio between some minimal payments and average wage, 1990-2000 (%)**

Ratio	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Min. wage./ Avrg. wage	35.9	38.3	35.7	32.6	27.4	23.9	24.6	31.8	33.6	
Min Pension/ Avrg. wage	22.0	23.5	23.0	20.6	16.8	15.6	17.4	17.8	18.7	
GMI/ Avrg. wage	19.4	23.9	21.0	18.7	16.4	13.6	14.9	18.6	16.6	

Source: Calculated on the base on data by MLSP.

3. *High unemployment.* Some negative characteristics of unemployment in the country and particularly its long-term character exert considerable influence on aggravating inequality and poverty. Long term unemployment, which covers a considerable part of unemployed, is the key factor for incomes' fragmentation in society and social exclusion. It was manifested by discrepancy in incomes and access to jobs.

The great part of long-term unemployed persons don't get any compensation against unemployment and become a contingent of social assistance. Their living standard is formed by irregular money incomes from relieves, incomes from informal sector and household plot. The last one has a natural character and serves predominantly for nutrition. Besides, due to loss of qualification (in spite of their participation in active politics of labor market), the unemployed have limited chances for integration in employment in comparison to other groups of active labor force.

The characteristics of the groups of long-term unemployed to a great extent explain the role of unemployment for creating the profile of the poor in Bulgaria.

The greater spread of unemployment in the rural regions can be explained with the higher relative share of the long-term unemployed in the villages. According to data of the statistical observation of labor force in March 2001, the share of long-term unemployed in rural settlement exceeds 65%. It forms steady communities with a very high level of unemployment. In December 2000 there are 15 municipalities of this sort, as in 5 of them the level of unemployment is over 50 %<sup>14</sup>.

The second unfavorable characteristic of the long-term unemployed is the low level of education. Long-term unemployed with primary and lower education constitute more than a half of this sort of unemployed. During the entire period there is a high relative share of this group (about 55-60 %), without distinct trend of development. The lack of education is a serious obstacle for reintegration and getting work, particularly in conditions of economic reconstruction.

The allocation of long-term unemployed by ages creates possibilities for getting out of the poverty trap. The old-aged unemployed or pre-retired persons are the most vulnerable, with weak possibilities for reintegration. About 60 % of the unemployed in this age group are long-term unemployed and have difficulties to participate in labor activities. The relative share of the unemployed young people for more than one year is high. With them there is no educational problem. In principle, they are highly educated young persons, who experience difficulties in finding job due to employers' demands for some period of practice and working experience.

The analysis of the structure of the long-term unemployed according to various characteristics (education, age, dissemination) shows that some "hard" structures of unemployed with substantiate potential are formed in the last years in the country<sup>15</sup>. This is the reason to think that the issue of unemployment and its influence on poverty and incomes inequality cannot be resolved only by increasing incomes. The problem

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<sup>14</sup> Tsanov, V., P. Lukanova, (2002), Unemployment in Bulgaria: Macroeconomic relationships and possibilities for reduction", Kolbis, p. 33

<sup>15</sup> Tsanov, V., P. Lukanova, (2002), Unemployment in Bulgaria: Macroeconomic relationships and possibilities for reduction", Kolbis, p. 35.

is complex and multi-aspect.

### **C. Socio-cultural factors**

Various social and cultural factors exert influence on the dynamics of social stratification and the increase in poverty in Bulgaria. They form the behavior, manners, and living style that are important for the explanation of poverty phenomena. The influence of the socio-cultural factors explains predominantly the ethnic profile of poverty in the country. The discrepancies are due to the ethnic model of living.

The socio-cultural discrepancies have an expression in the following aspects:

1. *Education level.* There is no essential discrepancy between Bulgarian and ethnic Turks in the ambition for higher educational level. The educational level is a priority in the value system of Bulgarian Turks that gives an expression by a popular participation of Turks in the educational system. The majority of Turkish population possesses secondary and higher education.

There is a substantial discrepancy between the Gypsies and Bulgarian in the education level. More than 80 % of Gypsies don't succeed in getting secondary education, whereas for others this percentage is 35 %<sup>9</sup>. The level of Gypsies with no education is 10 times higher than the others, the percentage of Gypsies with higher education is below 1 %. As a matter of fact, the education is not a priority in the value system of Gypsies.

2. *Demographic structure of households.* Gypsies live in multiple households, where children prevail. The average size of one household of Gypsies is 4.5 persons, but the other Bulgarian household - 2.8 persons. Besides, the households of Gypsies are younger, as the average age of household head is 42.6 years, whereas the average age of the head of the other households is 55.1 years.

3. *Dwelling place.* Essential discrepancies between Gypsy households and other households are observed in respect to dwelling place. Gypsies live in density as in a room of their house live on average 4-5 persons. They possess some scarce furniture. Virtually every household heat by firewood and coals, one third of them uses electricity for cooking. Every fourth household has no access to lavatory with current water and one third of them use public bath. The access to the telephone is limited as well. One of tenth household possesses home telephone.

The considerable discrepancies exposed above, concerning the socio-cultural surroundings between Gypsies and other households, are the reason of high poverty among them. On the other hand, they are also a consequence of the great poverty. In this case the boundary between the reason and the result are blurred and interrelated.

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<sup>9</sup> Carletto, G., T. Fujii, "An Update on Poverty in Bulgaria ...", Cit. op., p. 16.

#### **4. Policies for jobs promotion and access to minimum incomes**

One of the basic priority of the social policy in the area of the social security is the jobs promotion and access to the guaranteed minimum income. The latter is provided by elaboration and implementation of different active labour market programs particularly aimed to the most risk groups. Also the social security system guarantees the access to the minimum income of the people with no or low incomes.

During the years of transition the social protection system in Bulgaria developed mainly in two directions: extension of the coverage of the risk groups and improvement the targeting of the social aids. The unemployment protection scheme has gradually evolved and got close to the social security systems, with the adoption of the *Unemployment Protection and Employment Promotion Act* in 1997. Also this Law creates favourable legal environment for implementation of active labour market programs, which are considered the most important policy priority. The variety of activities in the social assistance system is based on the *Social Assistance Act*, adopted in 1998, which regulates the assistance of families and persons with low income. The universal benefits are provided in the *Birth Encouragement Decree* from 1968 and *the Law for Protection, Rehabilitation and Integration of Disabled People* from 1995.

##### **4.1. Jobs promotion programs**

The active labour market policy is direct to employment encouragement, assistance of the risk groups at the labour market (young unemployed, orphans, disabled persons or long-term unemployed and unemployed with low qualification), entrepreneurship stimulation. The basic priorities include:

- improvement the possibilities for employment;
- development of entrepreneurship;
- encouragement of the adaptation in the business;
- strengthening the policy for equal possibilities.

The *improvement of the possibilities for employment* includes variety measures and programs for public work job openings for young unemployed, orphans, disabled persons or long-term unemployed on partly subsidised wages; lump sum grants for self-employment, subsidising the municipalities and non-profit organisations for creation of temporary jobs, interest-free employment loans in specific labour intensive productions, subsidies for training and retraining, establishment of job clubs, etc.

The basic programs for job creation could be summarised as following:

- *Programs for temporary employment.* These programs were elaborated with local administration and provide jobs on the second labour market (primary for public work). The length of the program is 5 month and employed registered unemployed who are mostly from disadvantaged groups. Programs for temporary employment ensure the greatest part of the jobs from the active labour market programs - 60-70 thousands per year. In 2001 their number was significantly reduced to 32 thousands. To ensure the jobs during the hole year there are winter temporary programs. These programs employed persons who are assisted by the local social



assistance offices, long-term unemployed, etc. Winter programs provided temporary jobs for 14-15 thousands unemployed.

- *Societies for Employment Program* are implemented at approximately twenty municipalities for refurbishing the local infrastructure by arranging local partners and local administration. Till 2001 it was financed through *Professional Qualification and Unemployment Fund (PQUF)*, offering jobs for 24 months and providing minimum wage and compulsory social insurance contributions for employed. Employers may pay higher wages. The program rational is to initiate the employment in the region Rodopi. Later it was extended over other regions. Individuals are employed on the basis of contract. The program included 4455 individuals in 1999 and in 2001 - 7767.
- *Program "Beautiful Bulgaria"*. This program functioning from several years and was financed by UNDP, EU and municipalities. The aims of the program are opening temporary and permanent jobs, qualification of the unemployed, as well as to make Bulgarian towns more beautiful.
- *Program "From Social Care to Employment"* is implemented in collaboration with the USA, targeting at beneficiaries of social assistance. In 1998, 4000 individuals were included, providing them vocational training first and then employment according to the individual work plan— an individual approach. In 1999, 5600 participants were included in this program among which 33.3% of them were social assistance claimants, 55.9% of unemployed without any social assistance, young unemployed - 7.2%. The number of the participants and their structure have no changed in 2001. They stayed near 5500 unemployed of them 47.3% were social assistance claimants and 43.1% of unemployed without any social assistance.

The *development of the entrepreneurship* includes programs to facilitates starting of the business and development the possibilities for opening new jobs. The main programs include:

- *establishment of the business centres*. These centres organised business services and realised communications between local administration and private sector. In this way they assist for establishment of sustainable local economic development in the regions. In 1999 there were established three centres in West region of Bulgaria (Mesta, Vidin and Blagoevgrad);
- *Program "Starts your business"*. In 1999 the Ministry of Labour and Social Policy and National Employment Agency elaborated and implemented six regional programs. The aim of the programs is to assist for successful start in the business of unemployed people through training in the sphere of enterprising. There were organised 36 qualification courses with 51 unemployed persons. Over 45% of the participants has started owned business;
- *Regional and branch programs for employment*. These programs have local importance for stimulating the employment. The programs ensure creation of new jobs in some regions with mono-structural economy and flexible forms of employment. In 1999 has started 3 micro project in district Russe and one branch project for stimulation of employment in district Shumen. The aims of the projects were to preserve the employment by implementation of the part time work, retraining of the unemployed and redundant workers, and new job creation. However, these programs include little number participants.

The priority of *encouragement of the adaptation in the business* covers the activities for study labour market necessities and linkage them with the possibilities and directions for qualification and retraining to achieve quicker adaptation toward economic reality. The programs include:

- *retraining of employed people*. The significant part of the retraining employed persons (over 80%) were coming from the restructuring enterprises. Similar to the other programs the number of participants is very limited. Only 770 employed were finished these courses. The reasons are limited financial resources, the lack of economic stability and perspectives for the enterprises;
- *program "Quick Start"*. This program ensure the unemployed persons professional qualification and employment in the new established and restructuring firms in accordance to the employers' necessities. The number of participants is limited and varies among 300-400 unemployed.

The analyses of the presented above programs for access to the jobs show the following new moments<sup>10</sup>:

- more attention was paid to the regional development of the programs. The regional aspect reveals in their formation, organisation, implementation, and financing. The positive effects could be express in better targeting to the most risk social groups in the regions; improvement of distribution policy of limited financial resources; strengthening the linkage between interests and actions of non-government organisations, social partners and local administration; receiving the adequate information about the current situation of problems and regional needs.
- enlargement the programs with branches specialisation and its bounding with economic restructuring. These programs contribute to quicker adaptation and qualification changes of workers from restructuring branches (mining and steel industry, army, etc.);
- conducted the monitoring of the labour market programs. The results and recommendations could help for improvement the economic efficiency of the programs and the social effects;
- the hole design of the labour market policy corresponds to the European and world standards. The structure of the national labour market policy in 2000-2001 was elaborated under the requirements of EU, European employment strategy, and the other recommendations of the international organisations.

Despite the positive effects coming from the improvement of the content and the structure of the labour market programs their coverage over risk groups remained unsatisfactory. Only 8% of the unemployed participated in active programs in 1999, while 64% of the registered unemployed do not benefit both passive and active programs. In the next years the number of persons covered by the basic employment programs decline. This means that the capacity of the programs was not applied or realised completely. The positive changes proved that there is possibility to their continuation, rationalisation or replace by better ones.

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<sup>10</sup> See Tzanov, V. and P. Lukanova, "Unemployment in Bulgaria ...", cit. op., p. 124.

The active labour market policy is criticised for a number of reasons: low efficiency and effectiveness of the implemented initiatives; high financial costs, which limit the scope of covered unemployed; slow response to the real specific demands of the labour market; domination of a reactive approach, etc.<sup>11</sup>

The selective approach to the risk groups on the labor market underlies the new law, but it is implemented mainly by means of temporary employment, which encourage the employers to appoint long-term unemployed people, young people, disabled people, orphans for a short period of time, i.e. they do not invest in job places. The legal basis provides an opportunity to implement investment programs for promotion of employment in the state priority fields, such as stimulation of the development of certain regions or branches, construction of sites of particular importance, recovering of the environment, etc. The development of detailed regional and branch programs for development, is one of the main challenges in regard to the adaptation of the labor market policy to the needs of disadvantaged groups. These programs have to include investment plans, training and retraining programs and administrative mechanism for their implementation.

#### **4.2. Access to minimum incomes**

The social security system in the area of incomes ensures to every person (family) with low or no incomes access to the minimum income. The income security in Bulgaria is realised by three basic systems: 1) *system for unemployment protection* (ensure incomes of unemployed persons); 2) *social assistance system* (ensure incomes of all people under guaranteed minimum income); 3) *pension system* (guarantee social pension). All these systems have different economic end social functions, assist different risk groups, and provided different levels of incomes.

1) *The unemployment protection system* is based on the provisions of the Unemployment Protection and Employment Promotion Act. Unemployment benefits are provided from Professional Qualification and Unemployment Fund (PQUF), financed as an extra-budgetary fund by pay-roll taxes of employers and employed. From 2002 unemployment benefits were paid by the new Fund "Unemployment".

At the beginning of the transition period, the main goal was to identify the unemployed, to register them and to organise the system for benefit payments. The next stage from the development of the passive labour market policy was connected with making the unemployment criteria more precise in order to encourage the unemployed to have a more active behaviour for labour integration. The amounts of the paid compensations were also reduced.

The eligibility for unemployment benefits is based on minimum 9 months' length of insurance. To those are added also the following conditions: the loss of the job should not be a fault of the applicant, the applicant should not have declined a job offer or a training course, he/she should have checked in periodically or upon request, with the labour office, etc.

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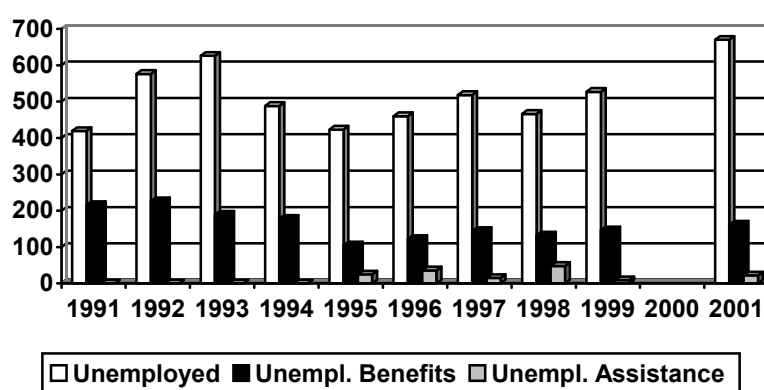
<sup>11</sup> See Yordan Hristoskov in Social Consequences of the Implementation of a Currency Board in Bulgaria, chapter III, Center for the Study of Democracy, 1999

The amount of benefits is earning-related. With a replacement ratio of 60 per cent, the benefit is limited and varies from 80 to 150% of the minimum monthly wage. The period of entitlement varies from 4 to 12 month depending on the accumulated length of services of the unemployed person.

Considering the chronic problem of long-term unemployment in 1995 a new scheme was implemented – Long-term Unemployment Assistance, paid by PQUF. Long-term unemployed registered within the labour offices are entitled. Waiting period is envisaged equal to 6 months after expiring of unemployment insurance. The maximum period of payment of unemployment assistance is three months. It amounts 60% of the minimum wage or approximately equal to the Guaranteed Minimum Income. The income of recipients of unemployment benefits and unemployment assistance usually is above poverty threshold and they are not entitled to monthly benefits.

The coverage of the schemes, which target recipients of unemployment benefits and unemployment assistance, is shown in Fig. 4.1. There is a clear downward tendency in the proportion between the beneficence of unemployment benefits and the total number of unemployed. This share changed from 47% in 1991 to 25% in 1995 and reached the same percentage in 2001.

This trend is a result of the more restrictive passive labour market policy regarding to the access criteria and the payment period for unemployment benefits. The question is what is the impact of such restrictive social policy on the job searching. There have not been made evaluations on the impact of unemployment benefits to the intensity of job searching process. An investigation of the matching function for Bulgaria<sup>12</sup> suggests that there is low efficiency of the job searching. This result could be explain by the weak impact of the unemployment benefits to the matching process. Also this means there is no important connection between restrictive unemployment benefits policy and intensity of job searching.



Source: Ministry of Labour and Social Policy

**Fig. 4.1. Unemployed and Recipients of Benefits by Type of Schemes, Bulgaria, 1991-2001, (in thousands)**

<sup>12</sup> See Tzanov, V. , P. Lukanova, 2002, “Unemployment in Bulgaria ...”, cit. op., p. 88.

2) *The social assistance system* in Bulgaria is based on three approaches: *income based approach*; *benefits to risk groups* (uninsured parents, disabled people, mothers of many children, etc.); *target benefits for meeting specific needs* (heating, electricity, drinking water).

***The income based approach*** is introduced as a major instrument of the poverty alleviation policy. The monthly welfare benefits are granted to people who live below the Guaranteed Minimum Income, which is defined by the government and adjusted to the family size and composition through a system of coefficients. Larger families are entitled to higher income line.

Generally the eligibility to welfare benefits depends on the all income sources of the family (income from salaries, retirement benefits, unemployment benefits, child allowances, etc.), property of applicant and his possibilities for acquiring income from labour or property. Their total income should be below the respective differentiated minimum. The rules relating to property include the size of the house and money savings. The size of the monthly benefit is calculated as a difference between Guaranteed Income and all personal incomes.

Bulgaria has a very detailed level of eligibility rules. So, the risk of targeting people, who are not really poor, is relatively lower. These criteria have the role of restrictive predicaments in determining eligibility to social welfare assistance. Persons and families, who are in possession of assets above the established levels are not eligible, though their income could be below the differentiated minimum level. The purpose of these restrictions is to secure adequate targeting of the people who are in real need and to avoid the direction of the limited resources to recipients who have alternative sources of income.

The welfare assistance eligibility criteria also contain a number of requirements like active job seeking and non involvement in the shadow economy. The unemployed, who are economically active, have to be registered with the labour office as active job seekers and should not have declined a job offer from the labour office or municipality.

The low income line of the differentiated minimum income and the tight eligibility criteria reduce the level of clients mostly to chronically unemployed and marginalized strata of the population. After 1992 the base minimum income has been maintained considerably under the level of the minimum wage, the unemployment benefits and even the social pension.

*Benefits to people at risk* are a form of social assistance that allows universal benefits, which eligibility criteria include affiliation to a specific group at risk (parents with children, single mothers and mothers with many children, disabled persons) irrespective of their employment and insurance status. Their purpose is to meet urgent needs, such as necessity for treatment abroad or shortage of funds for specific needs. The amount is determined subjectively and it is also possible for individual' income

to be used as a secondary criterion. Sometimes they are used as informal compensation as an alternative to low income benefits.

The benefits to uninsured parent under the *Birth Encouragement Act* are the main universal income support scheme. They include the full range of family benefits, envisaged for insured parents and paid from the Social Insurance Fund: lump sums for child delivery, maternity leave (starting 45 days prior to the delivery till the completion of 2 years of age of the child) and child allowance till the completion of 16 years of age (or 18 years of age, if the child is still studying).

For child allowances to be provided from the social assistance system both parents should be unemployed and registered as active job seekers. This criterion does not have selective function -- it is rather a precaution to abuse, since families where one of the parents is employed, self-employed or a pensioner, are entitled to child allowances from the Social Insurance Fund.

Entitlement to lump sums for child delivery and maternity and parental leave to uninsured parents does not depend on the employment status. The formal requirement for the mother to have worked for at least one day over the past six months prior to the delivery has a symbolic role. In practice do not limit the eligibility of women who is voluntary non-employed. A large part of uninsured beneficiaries comes from Turkish and the Gypsy minorities, where the model of a non-working wife is quite traditional.

This benefits for uninsured parents have an anti-poverty impact. However, on the other hand, the sociological studies reveal that about 20 per cent of all parents without social insurance coverage do not come from low income groups.<sup>13</sup> This percentage relates to cases where the limited resources have been addressed to families, who are not among the most needy. At the same time, the families, who are really poor, are unable to meet minimum needs in the early period of child care on income that is equivalent to the minimum wage.

*Targeted energy grants* were introduced in 1995 as a result of the liberalization of the prices of energy and fuel. These grants are also disbursed following means-test criteria. The income line, determining eligibility for energy grants, is higher than the differentiated minimum income line. It is calculated by adding the heating season (1 November - 30 April) energy rates to the base minimum income. The eligibility criteria for families with children and for disabled persons were relieved after the introduction of higher coefficients in the calculation of the differentiated minimum income. For this reason the number of the beneficiaries is bigger than the recipients of monthly welfare assistance. Below this line are a large number of families with unemployed members, receiving unemployment benefits, as well as low paid working people and pensioners with low pensions.

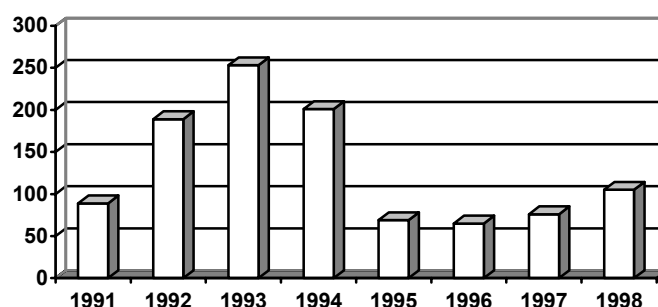
The amount of the monthly welfare benefits and that of the energy grants is calculated as a difference between the differentiated minimum income and the other income of the household. The lower the income, the higher the level of assistance. If the family

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<sup>13</sup> Center for the Study of Democracy. "At- Risk Groups and Social Problems in the Bulgarian Society", 1995

has no other sources of income, the level of assistance is the highest possible. Families, who are eligible, but have income that is closely below the poverty line are entitled to lower levels of assistance. This differentiation creates certain administrative difficulties, but gives a chance to avoid “poverty trap” and to exit step-by-step from the social safety net, while reducing the contradiction between the eligible and the other low income groups, which remain above the Guaranteed Minimum Income.

The data on the number of recipients show that the small contingents of chronically poor people and families, who do not meet the eligibility criteria for monthly welfare benefits, are not fully covered by the social welfare system. After 1993 the number of the recipients of monthly welfare benefits has declined, regardless of the exacerbation of poverty and the growing need of social assistance. The take-up coefficient is low, particularly those of the Monthly Benefits.



**Fig. 4.2. Beneficiaries of social assistance, Bulgaria, 1991-1998, (in thousands)**

The limited coverage of poverty alleviation programs is a result of many different problems.

First, the Guaranteed Minimum Income has a very low level. It is about 40% lower than the minimum wage. To a certain extent, this is a justifiable difference from the point of view of the incentives for labour market re-integration. In the recent years, however, this difference has gone beyond reasonable limits. The actual purchasing power of the minimum salary declined much below the minimum amount needed to purchase basic foodstuffs. The attempt to keep the gap between the base minimum income and income from work has led to extremely low levels of the income line, entitling to social assistance. The people who are eligible cannot live on the social assistance only. The re-integration in the labour market is not a realistic alternative for most of them, since their educational and skill standards are very low. Therefore, the low level of the Guaranteed Minimum Income encourages the migration of the poor people to the shadow economy, rather than their return to the labour market.

The second problem stems from the fact that eligibility for social benefits, particularly the ownership criteria, are interpreted in a subjective way. Very often social workers do not allow benefits following formal means test criteria in cases where property can not be a source of income, for example possession of a big house in depopulated settlement. This practice due to the limited resources for social assistance in some

municipalities.

Third, the universal measures of income protection, which expend a huge amount of the social welfare resources, is apparently inadequate in respect to the most vulnerable groups of the population. Aimed at protecting the living standards of the population as a whole, they fail to provide an adequate compensation of the specific problems of these groups. That is why, the new trends for social policy are oriented to ***more active integration of disadvantaged groups through targeted social services and programs.***

3) *The pension system* ensures access to the minimum income of disable people over 16 years and elderly persons over 70 years. The annual income per member of the elderly persons' family should be lower than one half of the total sum of the minimum wage during the previous 12 months.

Social pensions are also received by persons<sup>14</sup> who are unemployed because of the liquidation of the enterprise they were working in and have remained jobless for more than three months after the end of unemployment benefits. Their income should also fulfil the requirements mentioned above. The Council of Ministers can also provide social pensions in specific cases, listed in the Pension Law.

The social pension cannot be bequeathed or received together with other kinds of pensions. The Council of Ministers defines the amount of the social pension and the pensions are paid by the National Insurance Institute, which is reimbursed by the state budget.

The size of the social pension is determined little above the Guaranteed Minimum Income. In this way the recipients of social pensions have not access to the monthly benefits and can not duplicate the social payments.

The social pensions take a little share of the Pension Fund. In the last several years their share has increased (from 1.8% in 1998 to 2.7% in 2001). This is due to the increasing number of recipients. But similar to the other minimal payments they were mostly stroked by the erosion. To the end of the 2000 the real social pension lost over 80% from its value in 1990, while the average pension lost 72%. This put pensioners with social pension in unequal position to other pensioners.

The basic question, concerning the efficiency and adequacy of social policy is about the role of social assistance system in the poverty alleviation. The previous analysis pointed to the decrease of poverty in the years after 1997. What is the role of Social Assistance in this process?

An exploration of the targeting efficiency and adequacy of social benefits in alleviating poverty in Bulgaria was made by the World Bank study<sup>15</sup> on poverty in Bulgaria in 2001. According to the results, the impact of social assistance on poverty

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<sup>14</sup> Men should be over 57 years old and women over 52. They should fulfill the years of service requirements for the third category of labour.

<sup>15</sup> See Carletto, G., T. Fujii, "An Update on Poverty in Bulgaria: a Background paper for the Bulgaria poverty Assessment", Paper presented at the seminar in Sofia, March, 2002, Sofia.



alleviation is considerable. Poverty rates in the group receiving social benefits drop from 20.6 to 14.9%, which is about 28%<sup>16</sup>. This means that overall poverty rate decrease by 3.2 percentage points (from 14.9 to 11.7%) in order of social transfers.

The private transfers also have positive impact on poverty reduction. According to the results of the study the private transfers have the biggest impact on the poorest groups which suggests for well functioning and targeting social assistance system.

## **5. Summery**

The analysis of the economic integration process and the development of the social security system in Bulgaria during the years of transition gives an opportunity to draw the following conclusions.

Bulgarian economy experienced a deep economic and social crisis at the beginning of the reforms. This crisis is marked by a considerable reduction in employment and significant growth of unemployment, high inflation, strong erosion of real incomes, low degree of economy integration, etc. All these unfavorable characteristics of the economic development show that they are basic sources of serious social problems and expansion of poverty in Bulgaria. The started from 1998 economic growth has a positive effect on poverty reduction. This means that the economic development in some extends was translated into social benefits.

During 90s Bulgarian economy marks a considerable advancement in trade and capital liberalization. The achieved satisfying level of liberalization of trade activity favourably reflected on the integration process of Bulgaria. The positive effects predominate over negative. Bulgaria receives investment goods of high technological level, the export is a major factor of achieving economic growth and economic stabilization, trade integration is a prerequisite for creating stable jobs suitable for average and high skill labour force, etc. FDI are an important source for financing the Bulgarian economy due to the low domestic accumulation. Foreign financing is a factor for solving the problems of structural and technological changes in the economy. The negative aspects of Bulgarian integration are import of foreign competition, negatively influences on the country's balance of payments.

A direct consequence of the economic crisis was the worsening of the living standard of the population and expansion of poverty. The development of inequality and poverty in Bulgaria during the 1990s marks a steady tendency of an increase till 1997, and after this decreases. Numerous investigations confirm this trend. However, the questions of the particular level of poverty and the relative share of the poor population are disputable, as different surveys give various results. Among the reasons for poverty expansion the basic importance has economic reasons (downward economic development, high unemployment, low incomes, etc.). The influence of the social and cultural factors explains predominantly the ethnic profile of poverty in the country.

In the case of Bulgaria it was easy to identify the main risk group. Investigations of poverty reveal the main risk groups in the population that have the greatest probability

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<sup>16</sup> Above Cit. op., p. 25.

to get into poverty. These are unemployed and economically inactive population; households of many members and many children; persons with low level of education; population in the small settlement (rural population); ethnic minorities (Gypsies and Turks).

The analyses of the social policies for jobs promotion and access to minimum incomes show that in Bulgaria was established a social security system that impact positively on the labour market and poverty alleviation. The active labour market programs are targeting to the most vulnerable groups of unemployed despite their limited coverage. The structure and the content of the job promotion programs correspond to those in the EU countries. The main factor for poverty reduction in the last years is the economic recovery started from 1998. This means that the economic growth in Bulgaria brings to some social benefits. The design and the functioning of the social assistance system also have important meaning for poverty reduction. It was found that in the last years the targeting of most risk groups has been improved.