

CENTER FOR THE STUDY OF DEMOCRACY

BULGARIA: SUMMING UP PRIVATIZATION

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**Bulgaria: Summing Up Privatization**

Bulgarian privatization now has a three year history. The 1993-1995 period saw the first steps of privatization, the establishment and development of its institutional foundations and in 1995, the phasing-in of actual privatization.

Over 24,000 entities had been privatized by December 31, 1995. Most units (about 22,000 shops, restaurants, hotels, warehouses, small production enterprises, etc.) passed into private hands through restitution. The specific nature of the recent development of Bulgaria's private sector is determined largely by this restoration of ownership rights to small urban properties. Restitution helped create favorable conditions for the establishment of a real estate market and for the promotion of entrepreneurship, mainly in trade and services. However, there are still many unsettled restitution claims, as well as some unresolved problems concerning how some former owners may be indemnified by giving them the opportunity to participate in other forms of privatization.

A total of 1,650 municipal and 534 medium- and large-sized state enterprises have been privatized in the last three years through cash privatization. Cash privatization in Bulgaria started a bit later than that in the other Central and East European countries and such transactions have tended to take more time to prepare and conclude. Yet the process has been gathering speed with every passing year. In 1993, only 110 entities went private against cash, while in 1995 their number reached 1,504.

In compliance with the Transformation and Privatization of State-Owned and Municipal-Owned Act (passed by the National Assembly in April 1992), popularly known as the Privatization Act, a strongly decentralized approach to privatization was adopted in Bulgaria. The advantages of this approach are that it widens the scope of the denationalization process and helps it to maintain a relatively high degree of independence. Under the Privatization Act, the major organizations entrusted with privatization are, the line ministries, the Privatization Agency (which can put state enterprises of national importance up for privatization only with the approval of the Council of Ministers), the municipal councils and the Centre for Mass Privatization. However, the participation of diverse state bodies in the process makes it difficult to work out and pursue a single privatization strategy. Interaction among them has improved in the last year, though better coordination and more efficient handling of privatization are still needed.

Municipalities are the most active in the process of privatization. The privatization of municipal property has outpaced the denationalization of state enterprises. A total of 1,671 transactions for the sale of municipal units or self-contained parts thereof were made in 1995.

The privatization of municipal property directly creates "real" owners and provides the basis for the establishment of small and medium-sized businesses in bigger towns. Nearly 50% of the privatization deals have been carried out by auction. This method produces an

immediate economic effect, as auction transactions are settled in cash. Gross proceeds from the privatization of municipal property are impressive, though the average value of privatized units is under 4 million leva.

The most important result of municipal privatization is that the local authorities are relieved from the extraneous functions of property owners. By creating new jobs, municipal privatization also helps reduce unemployment from other sectors. Unlike the denationalization of state-owned enterprises, municipal privatization in Bulgaria is unfolding at a pace close to that of the Czech Republic, Poland and Hungary. Its characteristics are also similar to these cases. There are some grounds to conclude that on the whole, the privatization of municipal-owned enterprises has been more successful than that of state-owned ones.

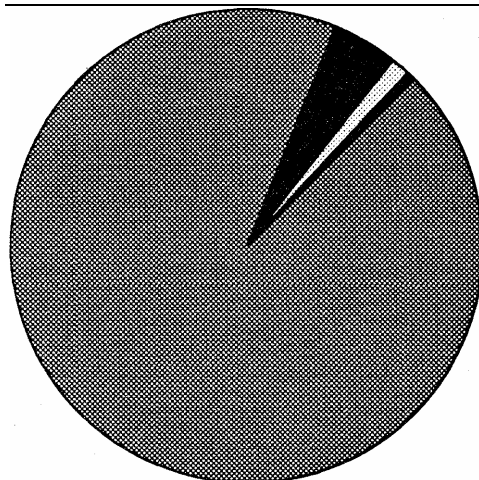
The Privatization Agency and the line ministries have sold 534 state enterprises in the last three years.

A considerable part of the privatization transactions (501) were for small enterprises with a balance sheet value of fixed assets under 70 million leva. Enterprises with fixed assets worth 70 to 200 million leva accounted for 4.3%. Keeping in mind that the value of fixed assets of state enterprises in Bulgaria averages about 100 million leva, the sales of units which are typical for the country in terms of size and economic importance are rather modest.

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### Distribution of privatization deals by the value of fixed assets

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A- up to 70 million leva  
93.8%  
S from 70 mill. to 200 mill.  
leva 4.3%  
B-from 200 mill. to 500 mill.  
leva 1.5%  
C-over 500 million leva 0.4%

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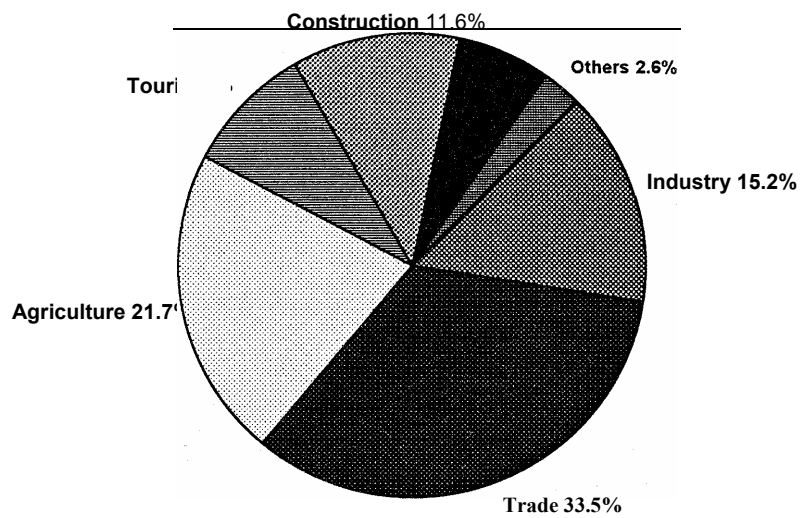
The privatization process in Bulgaria is characterized by a considerable measure of inertness in terms of industry distribution and methods applied. The 1995 privatization programme, approved by the National Assembly in May with clearly pledged political support, set much more ambitious tasks than before. For the first time it clearly defined targets to be met throughout the year, listing priorities by industry and business line, delineating the privatization techniques, the payment instruments and the organizational measures to be implemented by the institutions responsible for the preparation and conclusion of privatization transactions. However, despite these innovations, last year's actual results show that in terms of quantity and organization, the tendencies of the previous years remained unchanged.

As far as industries are concerned, investors appear to be interested mainly in trade - 179 privatization deals have been concluded in the last four years. The other major fields of interest are agriculture and food processing - 116 privatization deals; industry - 81 deals; construction - 62 deals; tourism - 48 deals.

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### Distribution of privatization deals by industries

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The denationalization of tourism and industry is unfolding at a slow pace. One reason for this is that government officials at the respective ministries are unwilling to part with their positions as de facto owners of tourist and industrial enterprises.

It takes too much time - from six months to one year - to prepare and conclude a privatization deal. Longest is the period from the appraisal of assets to the conclusion of the transaction. The reasons for this include, the lack of a pre-privatization period in which preparations for the sale of an enterprise could be made with the participation of its management, the slow process of collecting the necessary information and making a legal analysis, unascertained ownership of the land and buildings of privatizing enterprises and the quagmire of restitution claims.

These are the circumstances which drive the unsatisfactory ratio between the number of privatization decisions adopted and the number of contracts actually finalized. The Privatization Agency and the line ministries have adopted 1,543 decisions for denationalization, while the number of transactions actually concluded comes to only 534. The privatization process is often terminated either because during the procedure the financial and economic state of the enterprise has worsened, or because of investors' flagging interest.

The number of privatization techniques utilized in Bulgaria is limited, and they are largely bureaucratic and time-consuming. There is a continuing tendency to sell large enterprises by negotiated placement with potential buyers, while smaller entities and self-contained units in trade and services are sold by auction. The first method, that of negotiated placement, is perhaps the most "non-market" form of privatization. This method is applied in the industrialized countries only as an exception. It is inevitably largely bureaucratized. Problematically, the Bulgarian Privatization Act does not define the term "potential buyer". This leads to discretion in the selection of potential buyers and creates conditions for challenging the concluded privatization contracts. Significantly, all the large transactions which the Privatization Agency concluded by this method were later challenged and caused public scandal.

**The distribution of 1995 privatization deals by methods and techniques is as follows:**

- by negotiated placement with potential buyers - 269 deals (87%);
- by competitive bidding - 27 deals (about 9%);
- by auction - 13 deals (about 4%).

Investors under the Transformation and Privatization of Municipal-Owned and State-Owned Enterprises Act still do not have the opportunity to acquire shares or interest in commercial entities in the way most common to market economies- through participation in the public offering of corporate securities. Bulgaria as of yet lacks an adequate institutional stock exchange. The existing structures, which call themselves "exchanges," operate on amateurish principles and are unable to handle securities issued under the Privatization Act. The legal framework of privatization and investment was supplemented and enhanced in the first half of 1995. From now on, the development of the Bulgarian stock exchanges will depend on the political will of the Government and the financial institutions. Efficient work by the Securities and Stock Exchanges Commission will be of particular importance in this respect. In principle, the investment process should be largely stimulated by the pressure for normal trade in securities of privatizing industries.

The new owners of privatized enterprises are mainly Bulgarian legal entities. The active participation of the Bulgarian private sector in cash privatization proves that a large amount of private capital has been accumulated and that the mistrust and unwillingness of private businessmen to take part in privatization, typical for the earlier years of economic reform, has been overcome.

In contrast with the beginning years of privatization, foreign interest in the process seems to have flagged. In 1995 only four privatization deals were concluded with foreign investors, accounting for merely 1.3% of the total number of privatization transactions concluded with foreigners. Foreign participation in privatization has definite advantages (technological innovation, modern management and new markets), but unfortunately instead of recording an increase, the number of sales of enterprises to foreign investors is on the decline.

Bulgarian privatization is fully open to foreign investors and by law they are treated on an equal footing with local buyers. Several large transactions were concluded with foreign companies in the first years of the process. From May 1993 to December 1995 the Privatization Agency alone made about 14 big privatization deals with foreign investors. The proceeds exceeded 330 million US dollars (including payment, commitments for future investments and debts taken over or paid off). (See *Table* for an outline of some of these deals)

## Some sales contracted by the Privatization Agency with foreign partners

Enterprises	Transaction date	Line of business	Shares sold (%)	Proceeds (in million US\$)	Debts taken over	Future investment agreed	Buyer
Tsarevichni Produkti Inc	12.05.93	food processing	81	USD 20		USD 20	Amilum, Belgium
Republika Ltd.	15.11.93	food processing	80	USD 2		USD 10	Crafts Jacobs Suchard Ltd., USA
Hidroprobivna Tehnika Ltd.	10.02.94	mechanical engineering	97	USD 0.35	BGL 6.37	USD 0.35	Bakers A/S, Denmark
Gasobeton Ltd.	11.02.94	construction	100		BGL 5.361	DM5.6	Itong Ltd., Germany
SZI Ltd.	13.06.94	food processing	70	USD 2.1	USD 4.274	USD 7	Nestle S.A., Switzerland
SOMAT Inc.	02.04.94	transport	55	USD 55		USD 48	Willy Betz Group, Germany
Eskos Dograma Ltd.	16.09.94	wood processing	80	DM0.7	BGL 96	DM4	Gibu Ltd., Italy
Zagorka Inc.	28.10.94	the brewing industry	80	USD 21.7		USD 41.4	Brewinvest S.A., Greece
Vamo-Razshirenje - self-contained part of VAMOInc.	03.11.94	the automobile industry	100	USD 1.4		GBP3.5	Rover Bulgaria Ltd., Britain
Hotel Vitosha Inc.	14.12.94	tourism	80	DM65			Ivan Zografski, Germany
Kamenitsa Inc.	25.01.95	the brewing industry	70	USD 4.88		DM31.87	Interbrew, Belgium
Bourgasko Pivo Ltd.	27.04.95	the brewing industry	67	USD 5.2	BGL 33.9	USD 19.7	Interbrew, Belgium
Storko Inc.	02.11.95	food processing	80	USD 0.1	BGL 880	USD 6.5	Luxcraft Trading Ltd., Britain
Pirinska MouraInc.	03.11.95	wood processing	67	BGL 185		BGL 350	EurotechLtd., USA-Bulgaria

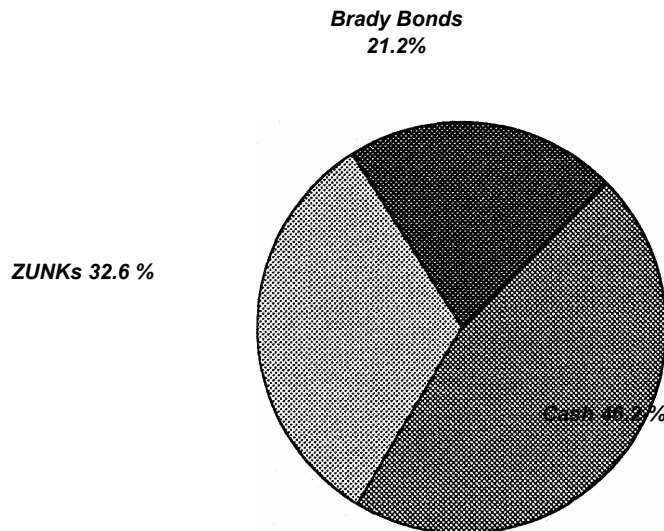
Despite political instability and the adverse macroeconomic climate, foreign investors are still showing interest in certain enterprises. The problem is that units earmarked for privatization are in short supply. Experts are seriously discussing the possibility of selling some large enterprises of national importance (for instance the chemical company Sodi in Devnya) and considerable blocks of shares in the Bulgarian Telecommunication Company and other companies to foreign investors in 1996. The executive has not reached a consensus on the issue and it would be unrealistic to expect that such contracts could be made in a little more than half a year.

One of the major shortcomings of the Bulgarian market model of privatization - limited participation of employees and management in the preparation of and actual sale of enterprises - is being gradually removed. Compared with previous years, in 1995 the number of employee and management buy-outs increased. Twenty five enterprises were privatized in this way, creating better incentives for managerial efficiency and enhancing employees' motivation to work.

Another specific feature of the Bulgarian privatization model is the possibility of using different

payment instruments and combinations thereof. The instruments include long-term government bonds issued under the Act to Settle Non-Performing Loans Contracted by December 31, 1990 and Brady bonds. The introduction of these payment options in 1994 led to an increased interest in privatization deals, which has been increasing ever since. Debt-for-equity swaps contribute to the resolution of Bulgaria's serious internal and external debt problems. Privatization deal payments contracted in 1995 (including settled debts) total 8,180,771,000 leva. Their distribution by payment instruments is as follows:

### Payment instruments used for privatization deals in 1995



*ZUNKs (government bonds issued under the Act to Settle Non-Performing Loans Contracted by December 31, 1990)*  
*Brady bonds (issued under Bulgaria's foreign debt)*

On the other hand, the debt-for-equity option has led to a decrease in cash proceeds. This is what has led some to question the expediency of contracting privatization transactions, regardless of the amount of cash proceeds the yield. The lack of a clear consensus on the desired ends of denationalization, or at least about their need to be in harmony, is one of the most serious stumbling blocks to Bulgarian privatization. There is a pronounced

tendency to seek larger amounts of proceeds and then use the funds to rehabilitate the banking system or finance social projects.

Bulgarian privatization has another prominent feature - a sweeping process of informal, covert privatization of real-economy state-owned assets and the income they produce. This runs in parallel to the official denationalization. Evaluations of the clandestine process vary, but the phenomenon is a public secret that the state institutions are well aware of. What makes one wonder is why they do not take any action to neutralize the channels and eliminate the mechanisms of this form of privatization. It is significant that certain persons are trying to benefit from the situation and oppose official privatization by all possible means. Under these circumstances, it is imperative to change the form of ownership.

The application of the cash privatization model in Bulgaria discussed hitherto has produced results that are far from the acceleration of privatization that was projected and desired by the Government. The results seem quite modest compared to the achievements of Central and Eastern Europe in general. There are a lot of signs showing that the privatization methods employed so far have been worn out. This made it necessary to develop non-market forms of privatization within the framework of a general privatization strategy, i.e. to devise and apply a Bulgarian mass privatization scheme.

After the first attempt to carry out non-market denationalization in 1994, which proved abortive despite the favorable political climate at the time, Parliament and the Government became preoccupied with mass privatization throughout 1995.

The Czech model, considered to be the most successful in terms of pace and scope, was used as the basis for the Bulgarian privatization scheme. However, the Bulgarian legislation passed hitherto is much different from the Czech privatization laws in some very important ways - the legal framework of privatization funds, the way of obtaining shares in privatizing enterprises, the rating offenders, etc. The most essential similarity between the two models is the administrative approach to the process.

For the time being, only a tentative evaluation can be made of the preparation for and the first steps of privatization. The general impression is that it got off the ground without a clearly formulated concept and adequate preparation.

The major problems ensue from the delay in the adoption of the relevant legislation and its fragmentary nature. There is no official document setting out a comprehensive framework of mass privatization supported by economic analysis, nor for the evaluation of the further prospects of basic industries, branches and strategic enterprises. The regulation of all organizational matters is left to subordinate legislation enacted by the executive. Perhaps the idea is that in this way the Government is left more room for action, flexibility and efficiency, but in actuality this has hardly turned out to be an advantage. Adjusting the model after the process has already started is rather risky and probably impossible.

The organizational drawbacks and the changes in the original schedule made it impossible to conduct an adequate campaign for the promotion of the mass privatization programme. For this reason, potential buyers do not see mass privatization as a process unfolding in accordance with clear rules and so remain skeptical and have trouble mustering up the motivation to take part in it.

Data released by the Centre for Mass Privatization show that two weeks before the deadline for registration, a little over 10% of all eligible Bulgarians have claimed their voucher books. At the end of March 1996 the Centre for the Study of Democracy conducted a national representative poll, the results of which indicate that about 35% of Bulgarians over 18 years of age intend to register for participation in voucher privatization. These are potential rather than actual



participants in the forthcoming privatization because almost one-third of them lack a good understanding of what to do with their investment vouchers when the process enters upon its next phases.

The survey data also revealed interesting motives for taking part in mass privatization. They are not surprising, keeping in mind the overall economic situation in Bulgaria and the experience in other Central and East European countries. **Over** 60% of Bulgarians of eligible age expect additional income from the shares they may acquire; 17% will take part in the process just because they want to be like everybody else. Only 12% want to switch from a passive role in the country's economic life to an active one by exercising their right to participate in the management of privatizing enterprises.

The most serious failure in the preparation for mass privatization is that the process started before the privatization funds could take part in it. There was a great delay in the passage of the Bulgarian Privatization Funds Act, which is better than the respective Czech law in many respects, particularly in the protection it provides for small investors. The main reason for the lack of participation on the part of funds is the belated establishment of the Securities and Stock Exchanges Commission. The Commission just did not have time to carry out the tasks assigned to it by the law. If the deadlines set in the mass privatization programme are not revised, the privatization funds will probably participate rather modestly in the process compared to their counterparts in the Czech Republic.

The information on the mass privatization list about the state of enterprise finances and their prospects for future development is insufficient. Their legal analysis is not completed and some of them are yet to be transformed from single-member limited-liability companies into single-member commercial partnerships.

Despite failures in the preparation process and fears about political influence in it, mass privatization, which was greenlighted at the beginning of 1996, can successfully attain certain useful economic ends. It offers a chance for the rapid replacement of the State as owner or at least for a considerable reduction of its property. There is no doubt that the new owners will have a lot of problems with the management of enterprises in the post-privatization period. Yet, mass privatization will eliminate the State monopoly over property and each enterprise will find an owner best-suited to its particular needs; though, this will not happen immediately after completing the process.

Mass privatization, the legal framework of which is not built on market principles but on administrative ones, may be expected to have a complicated and controversial impact on the process of privatization as a whole. On the one hand, state property amounting to almost 90,000 million leva, which represents about 20% of the country's economic potential, will be nominally denationalized. Achieving this end within a short term (in a year and a half or so) will be a significant result in itself. However, it will be artificial and formal to some extent. In fact genuine privatization will start after the shares acquired through mass privatization are resold. There are reasons to suppose that initially shares will change hands at ridiculously low prices because a lot of people will be eager to cash-in their investment vouchers. The investors who really have liquid assets will abstain from taking part in market privatization for some time, awaiting their chance to acquire the assets of former state enterprises at the cheap prices offered by their mass-privatization "owners."

The future of the Bulgarian economic reform will largely depend on the success of privatization. However, it should be remembered that it is only a prerequisite for the promotion of a market economy based on private ownership and competition. Unfortunately, this primary objective of economic reforms in the former socialist countries is not always understood correctly or pursued consistently. There are signs that privatization in Bulgaria is seen as an end in itself; it seems as if it is carried out only to report an increasing number of privatization deals or just to complete some

respective stage of the mass privatization programme.

The change of the form of ownership is a necessary but not sufficient condition for the normal development of privatized enterprises and newly established private businesses. Bulgaria needs a more decisive structural reform and guarantees that the new institutions of a market economy will strictly apply the basic economic laws and work efficiently.

It is natural to want to focus all efforts throughout 1996 on the progression of mass privatization. However, in reality this process has become inseparable from cash privatization. The achievement of positive results requires the pursuit of a consistent privatization strategy with medium-term targets and priorities. It is of particular importance that the state bodies responsible for privatization harmonize their interests and coordinate their activities in order to promote and popularize the opportunities and beneficial economic effects offered by privatization. This will make the process more transparent, will provide investors and the public with adequate information and will strengthen confidence in privatization. 1996 and the next one or two years are crucial for the success of privatization and the Bulgarian economic reform. A failure now would mean starting it all over again.

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N.B. All data in this paper are cited from the reports of the Privatization Agency

## **THE CENTER FOR THE STUDY OF DEMOCRACY**

*"To Foster Civil Society in Bulgaria by Bridging the Gap between Scholars and Policy Makers"*

The Center for the Study of Democracy (CSD) was founded in late 1989 as an independent, non-profit, public policy research organization committed to fostering the stabilization of a democratic social and economic system in Bulgaria by encouraging an open dialogue between scholars and policy makers. CSD is not affiliated with any political party or structure and operates on the basis of the universal principles and values of democracy.

CSD's main objectives are:

- to encourage economic reform in Bulgaria by conducting independent research in the field of privatization and private sector development, providing training to Bulgarian experts, and building an adequate institutional framework for reform;
- to assist the legal reform in Bulgaria by introducing advanced foreign expertise, drafting laws and training members of the Bulgarian legal community;
- to provide independent analyses of public attitudes towards social, economic, and political aspects of the transition;
- to encourage the development of a viable non-governmental sector that would guarantee the success of democratic reforms in Bulgaria;
- to assist the process of Bulgaria's integration into the European Union by providing expert analyses and recommendations, and encouraging the debate on integration issues.

### **CSD's ECONOMIC PROGRAM**

The Economic Program of the Center combines the efforts of a team of researchers and assistants with professional background in economics and a significant number of outside contributors. Its main objective is to encourage and assist economic reform and private sector development in Bulgaria. The Economic Program fulfills this aim by conducting independent research, dissemination, education and promotion on the most vital aspects of economic reform, legal and institutional development in Bulgaria.

The Economic Program has successfully conducted research and advocacy projects on privatization, foreign investment, private sector development and foreign debt conversion. Through interactive networking with representatives of the government, academia and media the Program has established an excellent reputation of an objective and independent contributor to public debate on key issues of economic transition.

The Economic Program at CSD was the pioneer in research and promotion activities in the field of foreign debt management and conversion. As a result of the project "Debt Conversion: Guidelines for Bulgaria" a detailed program for the implementation of debt-for-equity swaps in the context of privatization was developed and presented to the relevant governing circles. Because of its vital importance for the pace and success of economic reform, privatization has always occupied a conspicuous place in the Program's research and advocacy activities. The Economic Program has conducted four privatization projects, the latest directed at assisting the government agencies in striking the correct balance between the two forms of privatization currently under way in the country - mass and market-based.