Privatization in Bulgaria: State Ownership Is Dead, Long Live State Ownership!

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In recent years, privatization in Bulgaria has gradually lost momentum after large-scale investment was finalized in 2003-2004. Judged by the amount of revenue, it has reached a point of a virtual stall in 2015–2016 as privatization proceeds fell to just BGN 3–4 million (EUR 1.5-2 million)[1] annually. The view that dominates the executive power more and more is that no more assets in the Bulgarian economy can be privatized. In other words, everything that had been "privatizable" was already privatized in the transition period and privatization should be deemed finished. Ironically, one of the loudest voices of this political line is the current minister of economy, Emil Karanikolov, who managed the national privatization agency between May 2011 and May 2017 until he became minister.

> HOWEVER, PLENTY OF STATE- (SOEs) AND MUNICIPAL-OWNED ENTERPRISES (MOEs) PERFORM FUNCTIONS AND ACTIVITIES THAT THE STATE AND LOCAL AUTHORITIES SHOULD NOT ENGAGE IN AT ALL, – AT LEAST NOT IN A MARKET ECONOMY

However, plenty of state- (SOEs) and municipal-owned enterprises (MOEs) perform functions and activities that the state and local authorities should not engage in at all – at least not in a market economy. Among existing state and municipal enterprises, one can find companies for dairy production, cargo transportation, garbage collection, music and video recording, textile production, and the like. Apart from these, the state keeps its interest in other sectors (electricity, railway transport, and health care) where its dominance prevents their liberalization, distorts competition, and leads to huge subsidies from the state budget to these companies each and every year.

Public choice makes it clear why the privatization freeze has happened. State enterprises are a convenient tool for the pursuit of political goals: They are used for populism or mere profiteering by politicians. Their employees and clients are a large voter base, easily manipulated before elections. Their assets and market share, on the other hand, are a "tasty treat" for politicians, their relatives, and donors. Some of those companies also benefit from monopoly or "fast-track" access to certain public procurement orders. For instance, the Ministry of Interior has its own textile company (Intendantsko Obsluzhvane)

[1] The Bulgarian lev was pegged to the Deutsche mark in mid-1997 with the introduction of a currency board arrangement. With Germany's adoption of the euro, the anchor currency for the lev became the euro at a rate of 1.99583 leva per euro; the fixed exchange rate has not been re-valued to date.

Table 1: Fiscal Price of Banking Crises in CEE, % of GDP

Country	Budget expenditure due to banking crises, 1991–1998
Georgia	0.1
Estonia	1.9
Latvia	2.7
Lithuania	3.1
Poland	7.4
Kyrgyzstan	10.6
Hungary	12.9
Kazakhstan	18.4
Czech Republic	25.4
Macedonia	30.3
Bulgaria	41.6

Source: *Anatomy of Transition* by IME, citing World Bank's WP 2484

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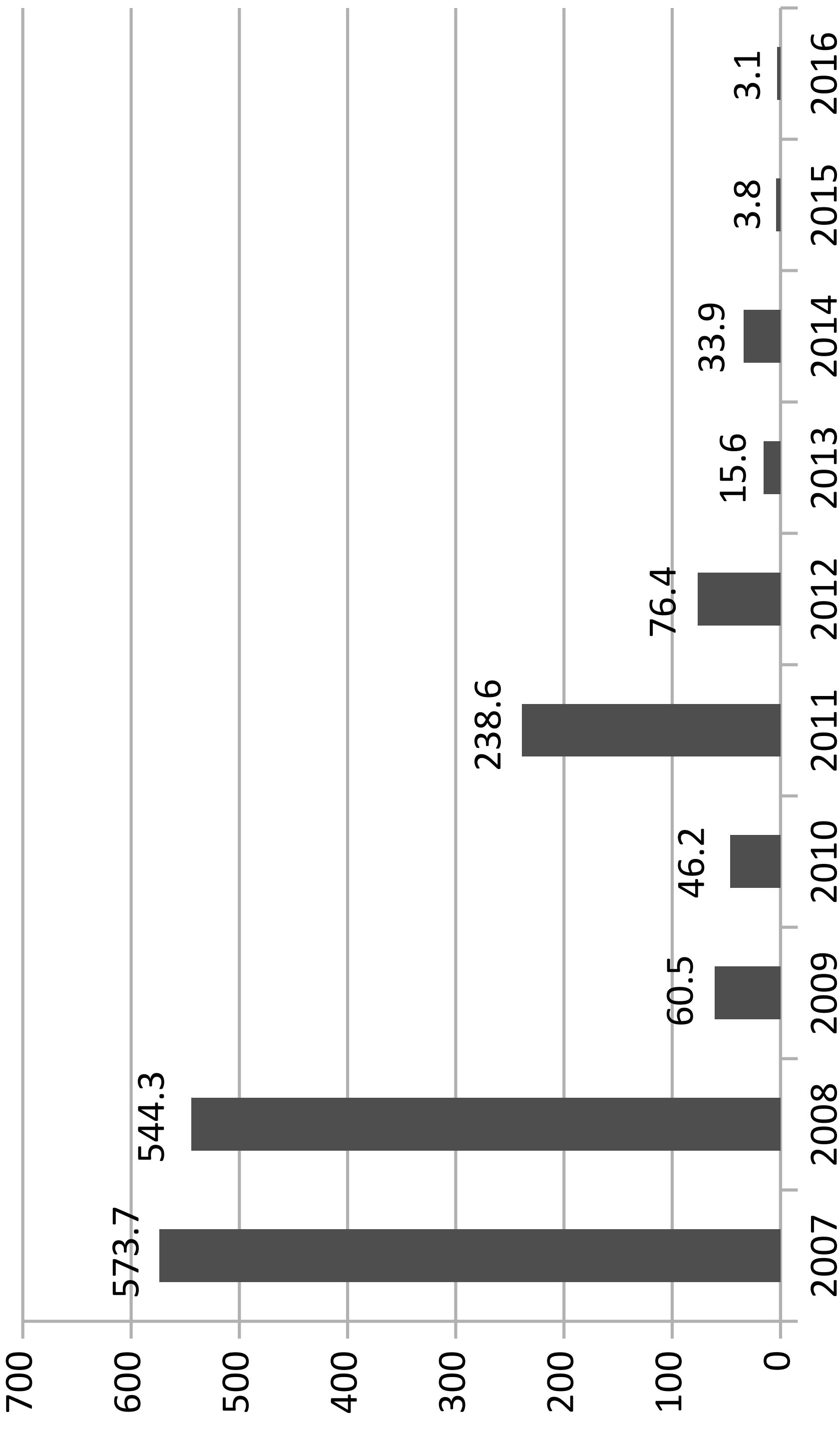
which sews police uniforms – even if the Bulgarian economy is flooded with private textile companies.

Prospects for a privatization revival are meager, considering the increasingly strong capture of Bulgarian institutions by private interests. In the meantime, Bulgarian citizens will keep paying the bills for SOEs through budget subsidies to unprofitable companies, high prices, and low-quality goods and services.

PRIVATIZATION IN BULGARIA: A BRIEF HISTORY

Similar to other CEE economies, privatization in Bulgaria did not start with the 1989–1990 transition period. The same

Figure 1: Proceeds from privatization (BGN million, net)



Source: Ministry of Finance

applied to other market reforms, too, as the dominant view among policymakers at that time was that Bulgaria should undertake gradual changes to minimize social suffering. Bulgaria formed part of the "gradualists" among former socialist countries, in contrast to "shock reformers" who embarked radical reforms in the early 1990s. With hindsight, this choice cost Bulgarians dearly in terms of standards of living, economic development, and catching up to developed economies.

By 1997, about 70% of Bulgaria's economic assets were still state-owned[2]. In 1996–1997, the Bulgarian economy was ravaged by a full-blown currency, banking, and economic crisis which led to rapid devaluation, hyperinflation, and 17 bank failures that accounted for about 1/3 of the sector (in terms of deposits). Bulgaria's banking crisis was the most expensive in the entire CEE in GDP terms [See Table 1].

The crisis was put an end to in mid-1997 when a caretaker government approved a stabilization program, underpinned

Table 2: Sectors in which SOEs operate

Sectors	2016
Telecoms	1
Mining and quarrying	3
Real estate	6
Finance	7
Manufacturing	16
Electricity and gas	17
Transport	17
Other utilities (e.g. water and sewerage)	31
Other activities (e.g. health care, engineering, R&D, sports, culture)	177
Total	275

Source: Ministry of Finance, IME's estimates

Table 3: List of Bulgarian companies banned for privatization (categorized by their administrative designation)

Ministry	Number of SOEs that it manages
Ministry of Exterior	1
Ministry of Finance	2
Ministry of Interior	2
Ministry of Energy	2
Ministry of Youth and Sports	3
Ministry of Education and Science	4
Ministry of Culture	5
Ministry of Defense	7
Ministry of Agriculture and Food	14
Ministry of Transport	15
Ministry of Economy	16
Ministry of Regional Development and Public Works	39
Ministry of Health Care	70
TOTAL	**180**

Source: Law on Privatization and Post-Privatization Control

[2] See, for instance, IMF's "25 Years of Transition. Post-Communist Europe and the IMF", Regional Economic Issues, Special Report, Oct. 2014.

with financial support from the International Monetary Fund (IMF). The cornerstone of the stabilization plan was a currency board arrangement that swiftly restored currency stability and subdued inflation.

Another important part of the recovery plan was the acceleration of the privatization process. The period of 1997–1999 marked the privatization of a number of large-scale enterprises, such as the Bulgarian flag carrier (Bulgaria Air), the Neftochim oil refinery, the Kremikovtsi smelter, and several cement plants, among others. The privatization of state-owned banks also gained momentum in the 1997–1999 period. The privatization of seven state banks started in the summer of 1997 with the sale of United Bulgarian Bank to a consortium of EBRD, US Oppenheimer & Co., and the Bulgarian Bulbank. Between 1998 and 2003, all remaining state-owned banks on the list for privatization (Postbank, Biochim Bank, Hebrosbank, Bulbank, Expressbank, and DSK Bank) were sold, with the former state savings bank, DSK Bank, being the last to change hands. With its sale, the process of bank privatization was declared officially closed.

STATUS QUO

Currently, the state still holds about 11% of the Bulgarian economy in terms of the state's share in the capital of enterprises registered in the country, according to the 2015 data from the National Statistical Institute. Most of this, 10.71%, stands for the state's share in companies which are majority-owned by the state; the remaining 0.27% share is the state's interest in private companies. The latter was largely a result of the practice to retain a so-called "golden share" (with voting rights) in privatized companies to keep a final say on future large-scale changes in the company.

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WHY SHOULD THE STATE PRODUCE DAIRY PRODUCTS, RECORD AUDIO AND VIDEO, TEACH FOREIGN LANGUAGES, PUBLISH BOOKS, OFFER PRIVATE SECURITY, OR SELL INSURANCE IF THERE ARE PLENTY OF PRIVATE COMPANIES THAT DO IT?

A glance at the dynamics of privatization proceeds to the state budget clearly shows the privatization slow-down in recent years. This process was more or less brought to a halt in 2015 and 2016 when proceeds fell to an all-time low of BGN 3.1 million (EUR 1.6 million). As a result, the state's share in the capital of local companies has remained roughly unchanged at 11% in the 2013-2015 period [See Figure 1].

The view that hardly anything remains for privatization is debatable. The most recent data of the Ministry of Finance (MF) shows that the state has majority ownership in 275 companies. Even if law requires financial and narrative reports of those companies to be published on the site of the MF each quarter, some of them are missing or uploaded with big delays. That, together with the fact that there is no unified format for the information, makes any attempt at summarizing this data doomed to failure or gross imprecision.

The situation with municipal-owned enterprises is even more opaque. Hardly anyone can say (with any certainty) how many of them operate in the economy. No regular (or even irregular) financial data exists for those companies. MOEs are diverse in their activities – waste collection, engineering, real estate management, waste recycling, maintenance of green areas, radio and TV broadcasts, sports facility maintenance, baby food production, and others. Private companies exist in those sectors in large numbers.

As regards state-owned companies, the MF list shows that almost 1/3 of them are hospitals and medical care units, and about 1/10 are local water and sewerage companies. In addition, there are several energy companies (mostly for generation and transmission), seaports, riverports, and airports, regional forest management companies, scientific and research institutes, and a number of industrial/economic zones [See Table 2].

Notably, an annex to the Bulgarian privatization law (in effect since 2004) contains a list of companies that are banned for privatization [See Table 3]. The list[3] has undergone changes since its conception, but officially, it contains companies presumed to be "of strategic interest" to the state, or which are part of Bulgaria's security and defense system [See Table 3].

The list of companies banned for privatization currently contains 180 companies majority-owned by the state. This, compared to a total of 275 state companies, means that some 2/3 of all state companies are not earmarked for privatization. The list contains 76 hospitals and health care units, 31 water and sewerage companies, five airports and five sea/river ports, arms producers, railway and energy companies, forest management companies, research centers, irrigation companies, holiday resort, canteen, foreign language teaching center, publishing house, textile company, real estate company, a dairy producer, perfume laboratory, events hall, sports bases and halls, a tech park, audio&video maker, music recorder, film maker, and a private security company (the latter also trades in weapons and acts as an insurance broker).

Even if one can think of arguments in support of the state's strategic interest in some of the above-mentioned companies, there is hardly any rationale why the state should keep its shareholding in others. For instance, why should the state produce dairy products, record audio and video, teach foreign languages, publish books, offer private security, or sell insur-

[3] See Annex 1 of Law on Privatization and Post-Privatization Control, http://lex.bg/laws/ldoc/2135439873

ance if there are plenty of private companies that do it? The presence of the state distorts competition and the state companies keep a chunk of the market exclusively for themselves. Also, the implicit guarantee from the state makes them function under softer budget constraints, which in turn allows them to offer below-market prices.

The situation with arms producers is even more serious. Information on the export of arms producers is not public, which periodically fuels scandals about illegal export of weapons to conflict-ridden countries, authoritarian regimes, and ISIL. One expects that arms production and trade is a lucrative business that no government wishes to let go.

Apart from the list of companies banned from privatization, there are also 95 SOEs, for which privatization is not a threat even if they are not formally a part of this list[4]. That category includes mines, construction and engineering companies, foreign trade companies, a bank, an IT company, and a lottery, among others. As is the case with other SOEs, many private companies operate in those sectors, against which the SOEs often gain an unfair advantage in public procurement. That does not include the related risks of corruption, misuse, and waste of public funds that those enterprises are exposed to.

HOW SOEs SERVICE THE GOVERNMENT: BEST PRACTICES IN A NUTSHELL

SOEs have traditionally been used by politicians to service their private or wider partisan interests. The many uses of SOEs, based on Bulgaria's experience, can be summarized as follows:

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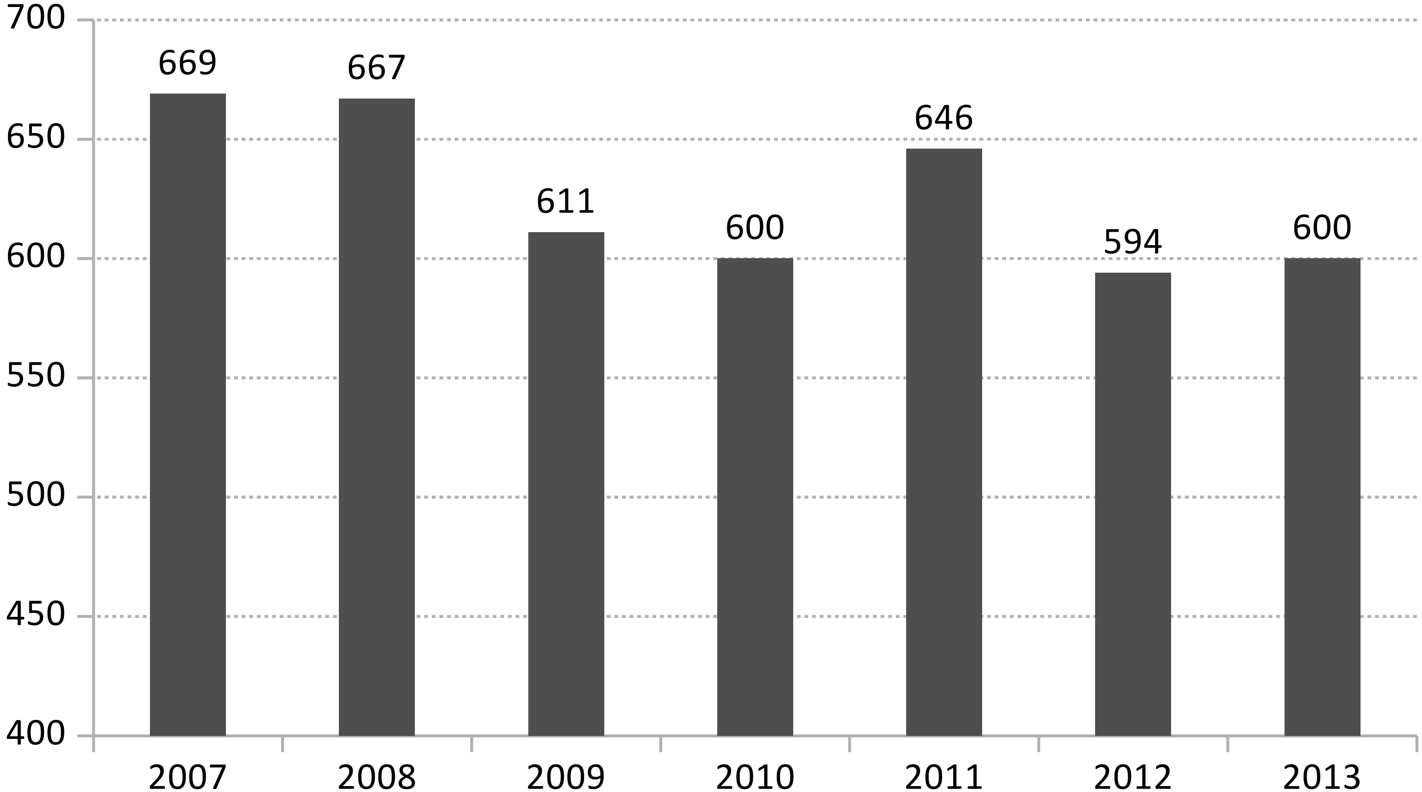
NO PUBLIC STATISTICS ON THE DIVIDENDS PAID BY THE SCC EXIST, SO ONE CAN ONLY GUESS HOW MUCH PROCEEDS HAVE BYPASSED THE SILVER FUND

[4] See: Annex 1 of Law on Privatization and Post-Privatization Control, http://lex.bg/laws/ldoc/2135439873 (in Bulgarian).

Figure 2: Current subsidies and capital transfers from the state budget to SOEs (BGN million)



Source: IME's calculations, based on responses to request for public information

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FINANCIALLY UNSUSTAINABLE COMPANIES ARE KEPT AFLOAT FOR YEARS DESPITE HUGE LOSSES AND MOUNTING DEBT

1) Political appointments to SOE management bodies

This is usually used for influence trading and payback of favors. Sitting on the board of an SOE pays well in monetary terms. Moreover, appointments can serve as a stepping stone for future interactions between the appointer and the appointee with the aim of mutual profiteering. SOE board appointments are made in a non-transparent and non-competitive way, and board mandates usually follow government mandates.

2) Use of SOEs and their assets for private business interests (i.e. draining of SOEs)

A recent example was the appointment of a board member to the board of dairy producer LB Bulgaricum, who was said to have close ties to a local crony businessman, Delyan Peevski, with an interest in the dairy market[5]. Thus, the state-owned company could service the interest of Peevski, who reportedly used its production facilities and technologies to produce dairy products under his own brands.

3) Use of SOEs for populism and boosting party ratings

A good illustration of this “practice” was energy price regulation in 2013–2014. With the help of an energy sector regulator (independent in name only), end-prices for individual consumers were sharply reduced in three consecutive actions. Thus, the National Electricity Company was used as a “buffer” for underpricing electricity bills for households, a populist motivation. As a result, the NEC experienced losses and rising debt.

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THE PASSENGER RAILWAY COMPANY (BDZ–PASSENGER TRANSPORT) AND THE POST COMPANY (BULGARIAN POSTS) HAVE BEEN TRADITIONALLY KEPT AFLOAT WITH REGULAR BUDGET SUBSIDIES

[5] See: http://www.capital.bg/biznes/kompanii/2015/04/03/2505954_zakvaskata_na_peevski/ or http://www.capital.bg/politika_i_ikonomika/bulgaria/2016/11/23/2869859_lukarski_udarno_smenia_direktorski_bordove/? (both in Bulgarian).

> THE BIGGEST "BLACK HOLES" FOR BUDGET TRANSFERS ARE THE THREE RAILWAY COMPANIES: NATIONAL COMPANY RAILWAY INFRASTRUCTURE, THE INFRASTRUCTURE OPERATOR; BDZ–RAILWAY TRANSPORT, THE PASSENGER TRANSPORT COMPANY; AND BDZ HOLDING, THE RAILWAY HOLDING COMPANY

Two other companies traditionally exploited on populist grounds are the state passenger railway company, BDZ–Passenger Transport, and Bulgarian Posts. The problem with this use of SOEs is their direct and indirect cost on the state budget, realized as subsidies and capital transfers from the annual budget. The former are used to boost the revenue side of the company and reduce its losses, while the latter are used to cover losses or repay debts.

In addition, state guarantees on the loans to such companies are another common practice, which in turn result in higher state-guaranteed debts and are a source of contingent liabilities for the state. Notably, it has already happened in the past that BDZ–Passenger Transport was not able to service its state-guaranteed debts and the state guarantee was triggered. The risk of that contingency for the budget is quite real.

4) Use of SOEs to channel privatization proceeds to the budget revenue side with the help of "creative accounting"

This appears to be an original tool invented recently by the Bulgarian Ministry of Finance. The purpose of this "creative accounting" was to side-step the law on the establishment of a so-called "silver fund".

According to this law, all privatization proceeds should be directed to this fund, so that it can support the pay-as-you-go pension system sometime in the future. Yet, in 2009, the then-government bypassed the silver fund law by establishing a new state-owned holding company, the State Consolidation Company. The purpose of its establishment was to find a legal way to channel privatization proceeds to the budget revenue side, rather than classify them below the budget bottom line as budget deficit financing. In the latter case, those proceeds should be transferred to the silver fund.

After SCC was established, state stakes at SOEs earmarked for privatization have contributed to the capital of SCC. As a result, as soon as such companies are privatized, the proceeds from their sale are classified as revenue of SCC. Then, after year-end, 80% of the profit of SCC (in fact, privatization proceeds) is being paid as dividend to the state budget. That is classified as non-tax revenue to the budget and boosts the revenue side, serving as a hidden fiscal expansion tool. No public statistics on the dividends paid by the SCC exist, so one can only guess how much proceeds have bypassed the silver fund. As a result, the government has found one more budget revenue source, while the resulting budget deficit is financed out of the fiscal reserve or by issuing new state debts.

NEW SOEs KEEP EMERGING

Given all the opportunities for the government to exploit an SOE, it is no surprise that the emergence of new SOEs has been a trend. It has been done either by establishing a new SOE or renationalizing formerly privatized companies.

In 2016, for instance, the formerly privatized Avionams (a military aircraft maintenance and repair works plant) was acquired by the State Consolidation Company. The deal became possible after Avionams was declared insolvent and its assets put up for sale. The renationalization was justified by the government due to the importance of the company for Bulgaria's military aircraft.

As regards the establishment of new state-owned companies, there have been several cases. In 2008, the then-government established Bulgarian Energy Holding, a holding company for all its shareholdings in the energy sector. The company aimed to attract financing for ailing state energy companies in local and foreign markets. In other words, it is a tool for cross subsidies in the state energy sector. As its balance sheet combines profitable and unprofitable/heavily indebted companies, it can attract loans and place bonds on much better terms than some of its subsidiaries. The financing can then be lent to daughter companies that have no access to market financing.

This has already happened twice as BEH placed two bond issues between 2013 and 2016 for a total value of EUR 1,050 million, and then re-lent the money raised through two loans to the heavily indebted state-owned National Electricity Company. Thus, energy-sector SOEs in dire financial states – that have no access to capital markets – continue to receive funding through the BEH bypass. As a result, financially unsustainable companies are kept afloat for years despite huge losses and mounting debt. After BEH, the government established the previously mentioned SCC in 2009. A couple of years ago, the state-owned Sofia Tech Park, meant to become a hi-tech R&D hub, has also started operations. EU funds entirely financed the Tech Park, but so far, it remains almost entirely vacant.

THE PRICE OF SOEs FOR TAXPAYERS

The direct price of SOEs for taxpayers comes in the form of current subsidies and capital transfers from the state budget, annually allocated to SOEs. Occasional repayment of state-guaranteed debts of SOEs when debtor companies fail to pay on time adds to the direct costs for the budget.

As mentioned above, current subsidies are channeled to the revenue side of the SOE, typically in order to compensate the company for its legally imposed social role (e.g. regular postal services in far-off villages or access to railway transport for residents of hard-to-reach settlements and socially disadvantaged groups). The social dimension is embodied in below-market prices of goods and services. The state budget then covers the difference between the discounted price and the market price, taking into account the actual cost for the company to deliver the service to socially vulnerable customers.

The passenger railway company (BDZ–Passenger Transport) and the post company (Bulgarian Posts) have been traditionally kept afloat with regular budget subsidies. Their subsidies remain unchanged (or rise in some years, even if fewer customers use their services) while inefficiency is blatant. For instance, only some 30% of the revenues of BDZ–Passenger Transport are generated from fares; the other 70% comes as a state subsidy.

Capital transfers, in turn, are used to capitalize unprofitable and heavily indebted companies. If the company is chronically unsustainable, this means a long-term "subscription" to state transfers.

The total volume of current subsidies and capital transfers to the state budget, annually, is substantial. Though no unified database for these payments exists, in 2015, IME sent requests for public information to all ministries, asking for information on the annual subsidies and transfers to SOEs under their control. The information obtained from some of the ministries (not all bothered to respond) shows that, for the period between 2007 and 2013, the state budget allocated a total of BGN 4.4 billion (EUR 2.25 billion) to SOEs through subsidies and capital transfers. That sum represents 2.4% of all general government expenditure for the period (BGN 185 billion; EUR 94.6 billion). In comparative terms, that is equal to 25% of all budget expenditure on education for the period and a rough annual burden of BGN 624 million (EUR 319 million) on the state budget [See Figure 2].

Capital transfers account for about 1/3 of the annual state support spent on SOEs. That instead of this that 2/3 of the regular transfer from the state budget to SOEs goes to finance current expenses. Hence, it affects the annual revenue and expenditure of the company, but not its long-term financial health.

Among all, the biggest "black holes" for budget transfers are the three railway companies: National Company Railway Infrastructure, the infrastructure operator; BDZ–Railway Transport, the passenger transport company; and BDZ Holding, the railway holding company. Those SOEs received almost 2/3 of all subsidies and capital transfers from the budget to SOEs over the period.

Recent data on those companies show that the situation has changed little since 2013. Annual budget transfers to the three railway SOEs already approach BGN 500 million (app. EUR 250 million), with the passenger transport company receiving about half of these funds. Those transfers are equal to about 0.5% of GDP and 2%-2.5% of the state budget. The state allocation for the railway companies is more or less equal to the entire funding for the judiciary and exceeds the state subsidy to higher education establishments.

Another illustration of the inefficiency of the state railways is the growing amount of state transfers per transported passenger. The number of passengers has been on a stable downward trend – from 50 million people in 2000 to 24.5 million people in 2014. Thus, the total state support to the company rose from BGN 6 (app. EUR 3.1) per passenger in 2010 to BGN 8.2 (EUR 4.2) in 2014 – more than 30%.

CONCLUSIONS

More than 230 state-owned enterprises exist in Bulgaria. No one knows the exact (or even rough) number of municipal-owned enterprises, but some estimates find about 800. After a political drive for privatization in the late 20th century, the process has gradually slowed in the last decade, reaching a freezing point in 2015–2016. A key reason for the suspension of privatization was better-than-expected budget performance in those years and hefty surpluses toward year-end, which rendered the need of privatization proceeds to finance budget deficits obsolete.

Bulgarian governments have traditionally used SOEs for populism or for private and partisan interests, which, combined with the lack of deficit financing needs, explains why privatization is no longer viewed as a policy option, while new SOEs keep emerging.

In the meantime, SOEs continue to put a heavy weight on the budget as annual budget transfers and contingent liabilities. The drain of public funds, inefficient management, and unsatisfactory services all add up to the price that taxpayers pay for the luxury of having SOEs. ●

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