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LATE NEOLIBERALISM AND THE GLOBAL FINANCIAL CRISIS

Prof. Dr Ec. Sc. Atanas Leonidov

In a number of lectures and papers Lord Turner wonders whether modern finance has become a "rent-seeking" industry, which is the economic term for "parasitism". By "rents" economists mean gains made possible due to the modern finances’ role of a "brake" or a "leech" and not due to real economic input.

Charles Ferguson, "Predatory Nation"

The term "neoliberalism" is used in economic literature to denote a single phenomenon. However, this leads to oversimplification of its content. We believe that there are grounds to distinguish between two periods in the development of neoliberalism: early period and late period. Two main arguments warrant such a distinction. The first has to do with changes in the economic and social policy of the bourgeois class, and the second accounts for the significant changes occurred in the structure of financial capital and the financial oligarchy in the Anglo-Saxon world (the US and the UK) in recent decades preceding the global financial and economic crisis.

Early neoliberalism appeared on the historical scene in the late 1920s. As a new phenomenon of socio-economic thought it arose as a result of the disastrous consequences of the global economic crisis of 1929-1932. This necessitated the reconstruction of the bourgeois political economy. In addition to the emergence of Keynesianism, this reconstruction was reflected in the further development of liberal views on economic life.

The early neoliberalism did not abandon the ideas of classical liberalism in terms of maintaining the internal stability of the market economy and the effectiveness of price information and price mechanisms. Alongside this, however, given the new economic realities, redefining some basic principles of classical liberalism was required. This concerned primarily the revision of the laissez-faire principle and the
"invisible hand" of the market. The postulate of the automatic functioning of competition was also revised.¹

The beginning of late neoliberalism was marked by the coming to power of the conservative government of Margaret Thatcher in Great Britain (1979) and the administration of Ronald Reagan in USA (1980).

Unlike early neoliberalism, characterized by measures for social reformism, late neoliberalism focuses on actions defined by the pursuit of class revenge and revocation of the social benefits obtained by hired laborers through methods of violence. This is a line particularly pronounced after the collapse of the communist system in the Soviet Union and in Eastern and Central Europe.²

The large-scale privatizations carried out in 1984 in the United Kingdom by the government of Margaret Thatcher were marked by the concept of "people's capitalism" where the citizens were encouraged to acquire shares. However, characteristic of the Conservative government was the use of forceful methods directed against the BBC, universities and local authorities. The main targets though were the trade unions, especially the National Union of Mineworkers led by Arthur Scargill.

Despite playing to the liberal rhetoric of people’s capitalism, the government of Margaret Thatcher went down in history with the brutal curbing of the mineworkers' strike led by Arthur Scargill. On the occasion of the 30th anniversary of this strike the Sega newspaper covered the event as follows, based on materials in foreign media: "The dramatic year-long strike by British miners left behind victims, devastated biographies and a deep rift in society".

Under the heading "Margaret Thatcher – Freedom Fighter" the April 13, 2013 issue of The Economist dedicated a special material on her role in politics. The article outlined several achievements: reduction in inflation rates which dropped) from 27% in 1975 to 2.4% in 1986; reduction in the number of working days lost due to strikes from 29 mln to 2 mln in 1986, reduction in the highest tax rate from 83% to 40%.

However, the article does not forgo mentioning some negative sides of the longest lasting government in the UK: the authoritarian style and methods within

¹ “In place of the automatic harmony of the "invisible hand", ordoliberalism puts the visible hand of the state, which exercises permanent control on the structure of competition” (Handwoerterbuch der Wirtschaftswissenschaft. 1980, S. 45.).

² To avoid misunderstandings, we consider it necessary to draw attention to the fact that in the US representatives of the reformist movements regard themselves as liberal economists. On the other hand, economists not only in the US but also in Western Europe, who have essentially conservative ideas and defend the existing social and economic status quo, claim nonetheless to be successors of the economic liberalism from the era of free competition capitalism.
Thatcher’s own party. Further on in the article it is pointed out that "Her reforms sowed the seeds of the current economic crisis. Without Thatcherism the big bang would not have happened. Financial services would not have become such a large share of the British economy and the country would not have struggled with the burden of individual debt caused by excessive borrowing and national debt incurred in order to carry out operations to prevent insolvency of the banks... Due to the crisis the pendulum is swaying dangerously far away from the principles followed by Mrs. Thatcher. In most rich countries the share of the public sector in the economy has persistently increased." (Margaret Thatcher – Freedom Fighter. 2013 p.3/3)

The policy of the Federal Reserve in the grip of market fundamentalism: the unconventional position of Nouriel Roubini

The governors of the US Federal Reserve under Chairman Alan Greenspan attached great importance to the concept fetishisizing the unrestricted ability of markets to quickly self-correct and eliminate emerging imbalances. From this neoliberal creed logically follows the conclusion on the need to minimize the role and functions of the state and its authorities, or even their complete non-intervention in economic life. In the efficient market hypothesis in particular, these untenable views are brought to absurdity, which became evident from the collapse of financial markets and the US banking system.

There is a tendency towards explaining in oversimplified terms the crisis in the global financial system as a consequence of the effect of individual factors considered in isolation from their overall system context. We are witnessing attempts to explain the crisis by the greed of individual financiers and bankers, by their indiscriminate pursuit of personal enrichment. The actual existence of such pursuit cannot be denied. But the flaw in this approach is that it does not seek to identify a connection with the inherent laws of the capitalist public system. The striving for higher profit determines the behavior of businesses, but it is naturally contingent on the bourgeois economic relations. Ignoring this fundamental factor leads to a superficial interpretation of the global financial crisis as an entirely subjective psychological phenomenon.

The collapse of the global financial system is the logical result of changes of

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3 Not surprisingly, this approach has been criticized in literature. In a 2009 report by UNCTAD on the global economic crisis, it is rightly emphasized that the reasons for this crisis are undoubtedly more complex than suggested by some simplistic explanations focused on the failure of the government. In this context, further on in the same report it is stated that "neither excessive liquidity nor global excess from savings can explain the collapse of the financial system as a result of the expansionary monetary policy in the US" (UNCTAD, 2009, p. XI).
institutional and structural nature accrued primarily in the US economy, but also in other developed capitalist countries in the course of three decades. One of these changes is the removal of institutional constraints imposed after the Great Depression of the 30s of last century aiming to counteract strong turbulence on the financial markets. Banks were not allowed to carry out unrestrictedly both commercial and financial operations, and restrictions on the movement of capital flows were implemented. But as we will see, a key factor for the crisis is the excessive expansion of the financial sector.

Last but not least, we should point out the fact that the collapse of the global financial system is a logical result of the deeply-seated American belief in the unrestricted free market with its alleged ability to automatically self-regulate and ensure stable development at national and global level.

The gradual lifting of) restrictions on the movement of capital flows which started after the 80s and the subsequent increase in the volatility of financial markets culminating in their collapse at the end of the first decade of the new century fit in with the ideology of the extreme market fundamentalism with its blind faith in the efficiency of deregulated financial markets.

The quintessence of this ideology, advocated by representatives of the Chicago School, was adopted by the governors of the US Federal Reserve.

It is precisely this untenable dogma preaching apologia and fetishizing of market forces that was elevated to the height of unshakable wisdom in American society in recent decades. Indeed, this extreme neoliberal creed has given rise to the efficient market hypothesis (hereinafter EMH). In its strong version it was uncritically used as something corresponding to the common sense in the policy of the Federal Reserve under Alan Greenspan.

Indicative is the fact that, given the numerous signs of the looming financial disaster, and despite repeated warnings, including the whistle blown by the governor E. Gramlich, no measures were taken to prevent the collapse of the banking system in USA. Alan Greenspan’s leading role in the practical implementation of late neoliberal fundamentalism in Federal Reserve policy has a special place in the book of famous American researcher Nouriel Roubini.

"The markets know best and Alan Greenspan, probably the most prominent advocate for a self-regulating financial system, argued that markets would take care of things, and warned in 1997 that when it comes to financial innovation "we must be very cautious in passing legislation or creating regulations that would unnecessarily hinder market development". And further on, "Greenspan even spoke in support of high risk loans, arguing in 2005 that lenders are now fully able to effectively assess the risk posed by individual customers" (Roubini, 2010, p. 33). In this regard, he
noted that "these remarks seem ridiculous" and continued: "In reality, financial innovations have made the question of whether lenders have shown concern for risk assessment irrelevant: lenders have rather sought to lend out funds and keep these in their accounting books; banks and other financial institutions granted loans, regardless of the creditworthiness of their users" (ibid). Then they continued to channel the loans towards Wall Street, where these were converted into more complex and esoteric securities and then sold worldwide to trusting investors unable to assess the risk of the original loans. "Securitization was the name of the game, and banks and other Wall Street companies charged heavy fees, while passing the risk onto imprudent investors" (ibid).

According to Roubini, rating agencies like Fitch, Moody's and Standard & Poor's could have prevented this from happening. But they have not done this, because they also received large fees from the securitization process. Instead of criticizing this convenient relationship, Greenspan and other proponents of financial innovation gave their blessing to it (ibid).

Greenspan is rightly blamed for two other serious wrongdoings. The first relates to the fact that instead of countering the spread of securitization, it was given the green light. This led to flooding not only the US financial sector, but also the global economy with high-risk assets.

According to Roubini, the second lapse concerns the Federal Reserve’s cheap money policy which caused a sharp drop in the interest rates of the loans to the financial system. From the beginning of 2001 to mid-2003, the interest rate of the US Central bank was reduced by 5.5%. Subsequently, interest rates were preserved for a long period at a low level. This was a factor for increasing the instability of the credit and housing boom. Despite the fact that over the period 2004-2006 long-term interest rates and fixed mortgage rates barely moved, measures to tighten fiscal policy failed to produce the desired effect.

Summarizing the effects of the many sources of money abroad Roubini notes: "Over the past decade large reserves from savings were accumulated in China, Japan and Germany, which were lent back to the US to finance budget deficits and excessive borrowing by households and corporations. In fact, China lent America the rope to hang itself with" (ibid, p. 33-34).

It is clear that the views of Greenspan did not reflect the actual operation of the markets, especially the financial ones. The roots of these views are found in the EMH fiction with the resulting inconsistent conclusions in terms of recommendations for the complete abstention of the Federal Reserve from intervention.
**Efficient market hypothesis – genesis, essence and basic forms or versions**

Given the key importance of this hypothesis and the recommendations made on its basis on the policy of the Federal Reserve, we need to analyze in greater detail its theoretical nature and substance.

In financial theory, the efficient market hypothesis is associated with the assertion that financial markets are information-efficient markets. This means that it is not possible to constantly or sustainably achieve results that exceed the average market performance. There are three forms or versions of the hypothesis: "weak", "semi-strong" and "strong." The weak EMH claims that the prices of tradable assets (e.g. shares, bonds or property) already reflect all previously available public information. The semi-strong EMH is associated with the assertion that prices reflect all publicly available information so that prices instantly change to reflect new public information. Accordingly, the strong EMH further argues that prices instantly reflect even hidden or insider information. There is some evidence for or against the weak or semi-strong EMH, while there is strong evidence against the strong EMH. The validity of the hypothesis is questioned by critics who blame the faith in rational markets for many of the impacts of the current global financial crisis (see Wikipedia, the Free Encyclopedia).

The efficient market hypothesis was first formulated by French mathematician Louis Bachelier in his Theory of Speculation (1900). In the 50s the same hypothesis gained in popularity among academics thanks to the thesis of Prof. Eugene Fama from the University of Chicago School of Business, which was published in 1965 in the Journal of Business and later achieved wide acclaim, becoming part of the neoclassical mainstream. According to Roubini "in the 70s efficient market hypothesis became conventional wisdom preached by academic preachers at the University of Chicago and elsewhere" (Roubini, 2010, p. 41). In his book he names Robert Shiller of Yale University, author of "Irrational Exuberance", as the harshest critic of this hypothesis. According to Shiller, the share prices show far greater volatility than EMH can explain.

In its original form the efficient market hypothesis advocated that the prices at which assets (stocks, securities (bonds and shares), property were bought and sold reflected accurately all available information on them. According to the above hypothesis, prices can change dramatically, but the changes would simply constitute a rational response to new information. In contrast to Bachelier's homeland (France), where his ideas were not very enthusiastically embraced by the academic community, in the US these ideas provoked much higher interest.

Referring to EMH, Roubini notes: "the effects of the Great Depression should have put an end to this kind of nonsense, but the postwar academic departments of
economics and finance have breathed new life into the old fallacy" (Roubini, 2010, p. 40-41). According to him, a lot of the credit given to this hypothesis is due to the economic department at the University of Chicago. Eugene Fama and others sympathetic to the economic policies of laissez-faire started to construct mathematical models designed to prove that markets are perfectly rational and effective. (Roubini, 2010, p. 40-41).

Along with this, it is assumed that various unknown factors may affect price developments. Admittedly, it is not possible to predict in which direction prices will change. Through this modification the hypothesis takes a more acceptable form. Yet its hard core is retained as its fundamental characteristics remain valid: markets are efficient; the prices of various assets reflect all available information; there are no conditions for excessive profits to be made by economic agents.

Two are the basic preconditions on which EMH is based: the traditional neoclassical assumption that economic agents maximize utility, as well as the assumption that they are able to form rational expectations as a basis for predicting asset prices. Realistically, however, it is the second precondition that determines the nature and essence of the hypothesis.

The supporters of said hypothesis do not claim that economic agents are always able to predict accurately the prices of financial assets. Admittedly, the agents may make errors, but the fundamental argument is that markets always predict accurately asset prices.

The disadvantages of rational expectations are criticized by Western economists. They point out both the weak and the strong sides.4

Reality shows that put into practice, EMH proved extremely negative for the US financial system. Not surprisingly, the hypothesis is strongly criticized by researchers analyzing business policy. Already after the financial crash of 1987 Robert Shiller referred to this hypothesis as "the most remarkable error in the history of economic theory" and, according to Roger Lowenstein, "he [Shiller] could have called it the most damaging error."5

Justin Fox, columnist for Time, recognizes that "true believers in the market’s efficiency suffered from a "blinkered" mindset and "tunnel vision".

4 Famous American macroeconomists Rüdiger Dornbusch and Stanley Fischer pointed out that the "equilibrium approach is the most controversial element of the concept of rational expectations and it is not consistent with the slow response of the political actions economy" (Dornbusch, Fischer, 1997, p. 677).
5 According to this author the reverse side of the Great Depression is that it could pierce the heart of the academic panacea known as the efficient market hypothesis. This theory maintains that stock markets are almost perfect, even during the dot-com frenzy, and that prices accurately reflect the available information on publicly traded securities. (Fox, 2009).
The application of the equilibrium approach both within the new classical macroeconomics and in EMH has in both cases led to disregard for the principle of discretion, i.e. the necessity of active use of the governments’ economic policy measures, evaluated as something devoid of real meaning. The result is lowering the impact of anti-crisis and countercyclical measures, and measures for stimulating economic growth. At the same time we have to take into account the fact that the EMH is related to the operation of financial markets characterized by the greatest unpredictability and instability, which can cause major disruptions affecting the entire economy.

Practice shows that this hypothesis, especially in its application in its strong version, can generate extremely negative consequences. Not surprisingly, it is the focus of criticism from researchers, analysts, politicians and businessmen.

**Alternatives to the concepts of economists who believe in the power of markets**

There are in literature two alternative views on the ability of economic agents to accurately determine the prices of financial assets. It comes to two types of approaches: the behavioral economics approach and the school of behavioral psychology. The most famous supporter of the first approach is Daniel Kahneman. He is skeptical about the assumption that investors can take over the market. Opponents of the efficient market hypothesis bring forward new arguments against its merits from the perspective of behavioral finance. Based on the presence of feedback in the operation of financial markets, these opponents point out that this increases to a much greater extent the instability of the financial system. They emphasize that this creates favorable conditions for the generation of speculative bubbles.

In this regard, N. Roubini reaches a very important conclusion: "All this attention to irrational economic behavior created a less flattering portrait of the way markets function – or not function. The studies by Schiller and others suggest that capitalism is not some kind of a self-regulating system...; rather, it is a system prone to irrational waste and unfounded pessimism. In other words, it is extremely unstable." (Roubini, 2010, p. 43).

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6 In this context, another important point is stressed: "This idea is both new and very old. Long before behaviorist economics many thinkers of the 19th century noticed that for all its remarkable ability to generate wealth, capitalism was prone to spectacular booms and downturns. While these thinkers are rarely read today, they are important because their ideas clearly show the false lines that still divide our understanding of crises and their consequences." (Roubini, 2010, p. 43). The reference is to studies by John Stuart Mill, William Stanley Jevons, John Maynard Keynes, Hyman Minsky, Irving Fisher and even Karl Marx.
Both approaches, behavioral economics and behavioral finance, are based on the concept of John Maynard Keynes, who introduced the term "casino economy" and emphasized the role of herd impulses as a factor for the instability of the financial system.

Regarding the collapse of the hedge fund, which exploded in 1998, Lowenstein concluded that "it so happens extreme events do occur in the financial markets." He rightly adds that "contrary to the rating agencies which assume that subprime mortgages would have a random behavior... many people would not have become insolvent at the same time."

In literature, as examples of the fact that in the course of 20 years great fluctuations in stock markets have occurred, are cited at least "three such statistically impossible events that took place just over the 20 years during which efficient market hypothesis has been the dominant financial doctrine. These are the stock market crash of 1987; the bond and currency market crash of 1994 and the arbitration for interest rates in 1998, when Russia stopped servicing its debt and the Long-term Capital Management hedge fund collapsed spectacularly." (Kaletsky, 2013, p. 240).

**Changes of macro-economic nature and in the financial sector**

Thanks to approaches that have a place in both behaviorist economics and finances, a number of factors against the unfounded view that financial markets are able to regulate themselves are revealed. The approaches and arguments used are, however, confined to human psychology. The analysis does not include other factors related to the profound changes occurring in two main areas: the strong increase in the share of the financial sector in developed Western economies, and the emergence of new instruments, creating high risk assets. We are talking about deep structural changes of macro-economic nature, as well as fundamental changes in the financial sector itself. Both types of changes cause a significant deterioration of the environment for the smooth functioning of financial markets and increase the possibility for great crashes and shocks.

As early as in the mid-80s James Tobin noted in his lecture that the financial sphere, which is best developed in the US, followed by Great Britain, has grown to an extent likely to create problems for the economic efficiency of both countries (Tobin, 1984). Another study raises the question whether the size of the financial sector is too large for the new conditions of global crisis. This question is answered in the affirmative, stating that this will have a negative effect on economic growth, while credit to the private sector exceeds 110 percent of GDP. It is also stressed that developed countries currently experiencing the effects of the global crisis have been standing on this threshold (Arcand, Berkes and Panizza. 2011, p. 1/5).
Martin Wolf draws attention to the fact that the public and private debt relative to the GDP in the US has reached 358% in the third quarter of 2008. This is the highest debt in US history. The previous peak of 300% was reached in 1933 during the Great Depression (Wolf, 2009, p. 1/4). According to him "something decidedly unhealthy has come to existence: instead of being a servant, finance became a master of the economy."

The reasons for the current global financial crisis cannot be properly illuminated if the role of the new information revolution and the new globalization processes are not taken into account. Thanks to these key factors in the development of the world economy far more productive financial and organizational technologies have been created, which have been widely used in most developed countries. Given the established tendency towards a hypertrophied development of the financial sector, and its increasing detachment from the real sectors of the economy, financial investments have become far more attractive than real investments as a source of profit making. As a result, production and economic growth are given lesser priority than the financial sphere.

Examining the global financial crisis in terms of the economic strategy of the current US administration, Russian economists V. S. Vasilyev and E. A. Rogovskiy analyzed a series of new patterns in the process of reproduction and movement of capital. In particular, stressing that capital gains are made possible due to the detachment from the production areas and are secured virtually, in a state of detachment from the real resources, they make an important conclusion: "the widespread financial technology ensuring capital growth in detachment from the development of the real economic sector has meant that in the last 20 years the financial sector has become the leading sector first of the US economy, and then of the world economy" (Vasilyev, Rogovskiy, 2009, p. 23).

However, this tendency should not be overemphasized; it should not be understood as inability to achieve significant growth rates. Even less justified is to expect an inevitable prolonged stagnation of production in developed countries and in the world economy. Hypertrophied development of the financial sector can result in an increasing gap between the opportunities for potential growth and the lack of actual growth, and the negative impact of the financial sector on sustainable development.

The excessive expansion of the financial sector of the economy has been accompanied by the emergence of a number of innovations such as hedge funds, subprime derivatives, securitization of debt, speculative pyramids, etc., all of which have been defined in American literature as financial engineering. These new instruments were a key factor in enhancing the risks and uncertainty in the financial
system, and acted as a powerful catalyst for the outbreak of the global crisis at the beginning of the new millennium.

With the expansion of its elements the financial system increased its potential to generate more negative effects in terms of greater systemic risk and uncertainty, greater instability of the financial markets and the economy as a whole.

**Late neoliberalism: progress or regress in the economic theory and practice of the West**

Unlike early neoliberalism, the ideology of late neoliberalism, whose conceptual basis is market fundamentalism, instead of providing the Federal Reserve policy with the right basis, contributed significantly to the outbreak of the global financial crisis with its grave socio-economic consequences.

The further development of economic theory during the early neoliberalism was an essential factor for the economic success achieved by West Germany after World War II: the German economic miracle based on the model of the social market economy.

The final conclusion that can be drawn from our study is that market fundamentalism, characteristic of the late neoliberalism, signifies regress rather than progress in the development of economic theory and practice of developed Western countries.

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LATE NEOLIBERALISM AND THE GLOBAL FINANCIAL CRISIS

Prof. Dr Ec. Sc. Atanas Leonidov

Abstract

The analysis is based on the introduction of the notion of "late neoliberalism" as contrasted with the practice established in the literature to unequivocally use the concept "neoliberalism". There are given arguments in favour of the differentiated approach chosen by us. The content of the ideology of late neoliberalism is connected with the changes that have taken place since the end of the 1970s in the structure of Anglo-Saxon capitalism, as well as those in the economic and social policy of the USA and Great Britain under Thatcherism and Reaganomics. There is emphasized the central place of the Efficient Market Hypothesis (EMH) and is revealed its untenability against the background of the global financial crisis.

Keywords: late neoliberalism, market fundamentalism, efficient market hypothesis (EMH), global financial crisis.
DEVELOPMENT OF CONSUMPTION AND THE INCOME OF THE POPULATION IN BULGARIA IN THE YEARS OF TRANSITION

Prof. Nikolinka Salova, Dr Ec. Sc.

Introduction

The consumption of the population is a major factor for the macro-environment in the country. Consumption ensures meeting the population’s basic needs and reproduction of the workforce, and along with investments and export, comprises the main stimuli and prerequisites for development of production and growth of the Gross Domestic Product. In addition, consumption is an important factor in the standard of living of the population. Consumption depends on the income of the population.

The purpose of the present article is to study the development of consumption and population income over the years since 1989, or, in other words, over the last 24-25 years.

A subject of this study is the changes in population consumption and income, while the object of study is Bulgaria.

Consumption and income of population can be tracked down with the help of published statistical data in the following main directions:

1. Consumption in kind by staple products per capita. When income is relatively low, the main consumption is that of food.
2. Consumer income and expenditure per-person per-household (according to statistics on household budgets) and incl. consumer spending on food.
3. Structure of the end use of gross domestic product, incl. for end consumption.
4. Major population changes – by number, age structure, employed persons, employment status and other.

1. Consumption of population in Bulgaria

Some of the most important indicators of a population's standard of living are associated with its consumption. Bulgaria also witnesses, though less markedly, the general tendency of rising standards of living and income generating quicker growth rates of consumption of non-food items and slower rates for that of food and for this reason their relative weight in the overall sales volume is falling (from 37% in 1986 to 33.8% in 2013).

In this country consumption (and sales) of foodstuffs has a fairly large share due to the relatively low income of the population and more poverty. Here market con-
Consumption has the main role, but the share of consumption of household production is not small (20% on average), with an even larger share in villages. Nutrition is vital to life and therefore a primary need to be satisfied, while all the remaining needs are satisfied later according to their order of importance. In this connection, when studying population consumption in this country, it is important to analyze consumption of food in kind, which eliminates the impact of inflation.

Data in Table 1 show the annual consumption in natural indicators of staple foods per capita in Bulgaria.

It can be seen from the data in Table 1 that at the beginning of the period of transition, there is a drop of consumption for all foodstuffs, which is later more markedly expressed and is continuing up to the present days, despite the relative improvement since the year 2000. In 2013, compared to 1987, or over a 25-year period, consumption declined for all products and in 2013 amounted to 40 to 80% of that of 1987. In other words, for over 20 years we have not been able to achieve the per-capita consumption of before the transition. The most significant drop is observed in the consumption of milk and dairy products and in 2013 this amounts to 33% of the 1987 consumption.

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<td>1. Bread and bakery products in kg.</td>
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<td>170.2</td>
<td>155.5</td>
<td>136.7</td>
<td>121.2</td>
<td>117.1</td>
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<td>107</td>
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<td>2. Meat and meat products in kg.</td>
<td>73.3</td>
<td>54.5</td>
<td>38.2</td>
<td>34.7</td>
<td>37.6</td>
<td>45.8</td>
<td>46.3</td>
<td>46.6</td>
<td>64</td>
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<tr>
<td>3. Fish and fish products in kg.</td>
<td>8.3</td>
<td>2.6</td>
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<td>5.4</td>
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<td>4. Vegetable nutritious oils in litres</td>
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<td>23.1</td>
<td>17.0</td>
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<td>14.8</td>
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</tr>
<tr>
<td>5. Milk and dairy products in kg.</td>
<td>196.0</td>
<td>136.1</td>
<td>74.0</td>
<td>63.3</td>
<td>57.9</td>
<td>65.4</td>
<td>64.5</td>
<td>64.6</td>
<td>33</td>
</tr>
<tr>
<td>6. Eggs in number.</td>
<td>263.0</td>
<td>166.0</td>
<td>141.0</td>
<td>129.0</td>
<td>136.0</td>
<td>137.0</td>
<td>137.0</td>
<td>143</td>
<td>54</td>
</tr>
<tr>
<td>7. Sugar and sweets</td>
<td>35.7</td>
<td>16.7</td>
<td>14.5</td>
<td>14.6</td>
<td>15.9</td>
<td>16.0</td>
<td>15.0</td>
<td>15.6</td>
<td>44</td>
</tr>
</tbody>
</table>

Consumption per person in this country in 2013 is even lower than the physiologically recommended amounts, where for milk, for example, the recommended norm is 116 kg, whereas the consumed amounts are 65 kg; for fish the norm is 10.8 kg but only 7 kg are consumed; 180 eggs is the recommended number and 143 are actually consumed; 84 kg vegetables recommended and 73 kg consumed; 109.2 kg of fruit recommended but 50 kg consumed, etc. Besides, physiological norms largely shape rational and healthy nutrition.

Consumption of the population in this country fell dramatically over the first decade of the transition (1990-2000).

In 1980 the average daily calorie intake per person in this country was 3,593 calories and this amount matches the volumes consumed in Western Europe and the USA (although in Bulgaria these calories are generated by a more unfavourable structure of nutrients). Over the first decade of transition the average number of calories consumed per person per day is falling to only 2,404 calories a day in the year 2000, which is insufficient for the proper development of the human body, and, what is even worse, certain population groups consumed even less than 2000 calories a day (see Table 2).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>3593</td>
<td>3554</td>
<td>2572</td>
<td>2404</td>
</tr>
<tr>
<td>1 group</td>
<td>.</td>
<td>.</td>
<td>1877</td>
<td>1847</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>X group</td>
<td>.</td>
<td>.</td>
<td>3532</td>
<td>3089</td>
</tr>
</tbody>
</table>

Table 2

Calorie content of consumed foodstuffs per person by decile groups in Bulgaria

Over the first decade of transition the income and the purchasing power of the population fell considerably. For the period 1995-2000 only, the consumer price

---

index is 3447 (see table 3) and the population real income declines by 73 % (see table 4). It can be seen that after the introduction of the currency board in 1997, the huge inflation was brought under control and since then real income has started to grow slightly.

Table 3

Average annual indices of consumer prices in Bulgaria³

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1995 = 100</td>
<td>221.6</td>
<td>2567.0</td>
<td>3046.4</td>
<td>3124.8</td>
<td>3447.1</td>
</tr>
<tr>
<td>Preceding year = 100</td>
<td>221.6</td>
<td>1158.4</td>
<td>118.7</td>
<td>102.6</td>
<td>110.3</td>
</tr>
</tbody>
</table>

Table 4

Real income indices by year over the first decade of the transition 1990 – 2000 in Bulgaria⁴

<table>
<thead>
<tr>
<th>year</th>
<th>index</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>100.0</td>
</tr>
<tr>
<td>1991</td>
<td>51.6</td>
</tr>
<tr>
<td>1992</td>
<td>52.1</td>
</tr>
<tr>
<td>1993</td>
<td>44.8</td>
</tr>
<tr>
<td>1994</td>
<td>37.9</td>
</tr>
<tr>
<td>1995</td>
<td>34.6</td>
</tr>
<tr>
<td>1996</td>
<td>23.9</td>
</tr>
<tr>
<td>1997</td>
<td>20.7</td>
</tr>
<tr>
<td>1998</td>
<td>27.8</td>
</tr>
<tr>
<td>1999</td>
<td>28.4</td>
</tr>
<tr>
<td>2000</td>
<td>27.0</td>
</tr>
</tbody>
</table>

The share of end/final consumption in GDP is growing till the year 2008, including growing individual consumption, owing largely to the negative foreign trade balance (Table 5).

Table 5

Structure in % of end-use of GDP in Bulgaria

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>1. Final/end consumption</td>
<td>70.7</td>
<td>88.5</td>
<td>87.1</td>
<td>88.2</td>
<td>83.0</td>
<td>79.4</td>
<td>79.0</td>
<td>78.1</td>
<td>79.9</td>
<td>81.3</td>
</tr>
<tr>
<td>2. Gross capital formation</td>
<td>33.1</td>
<td>8.4</td>
<td>18.3</td>
<td>28.0</td>
<td>37.5</td>
<td>29.7</td>
<td>22.9</td>
<td>21.9</td>
<td>23.8</td>
<td>21.1</td>
</tr>
<tr>
<td>a) of registered capital</td>
<td>26.1</td>
<td>13.6</td>
<td>15.7</td>
<td>24.2</td>
<td>33.6</td>
<td>28.9</td>
<td>22.8</td>
<td>21.5</td>
<td>21.4</td>
<td>20.7</td>
</tr>
<tr>
<td>b) phys. meas. of stocks</td>
<td>7.0</td>
<td>-5.2</td>
<td>2.6</td>
<td>3.8</td>
<td>3.9</td>
<td>0.5</td>
<td>0.1</td>
<td>0.4</td>
<td>2.4</td>
<td>0.4</td>
</tr>
<tr>
<td>3. Foreign trade balance (export minus import)</td>
<td>-3.8</td>
<td>3.1</td>
<td>-5.4</td>
<td>-16.2</td>
<td>-20.5</td>
<td>-8.8</td>
<td>-1.9</td>
<td>0</td>
<td>-3.7</td>
<td>-3.0</td>
</tr>
</tbody>
</table>

In the period 2009-2013 negative foreign trade balance considerably decreased, which is all very well in normal circumstances, as it reduces the accumulation of foreign trade debts, but it also greatly influenced final consumption, as well as the gross capital formation into registered capital.

It is imperative that the export grow and a positive balance be guaranteed between the export and import of goods and services. This is the foundation for higher growth rates and is to be facilitated by a faster development of domestic consumption. The share of accumulation should grow, but final consumption is too low and cannot remain like this or drop even further so that investments grow. Meanwhile, accumulation must grow in absolute and relative terms, particularly capital investments in core/registered capital. Before the introduction of the Currency Board (1997), when GDP continued to fall considerably (1989-1996), consumption fell in absolute terms to below 50% that of 1989, but its share in the GDP grew in relative terms. In this situation gross capital formation could not grow, as limited production was to provide the extremely low consumption, which, though very low in absolute terms, rose to a relative share of nearly 90% of the GDP. Consumption could not shrink any further, so as to make investments. Considerable economic growth is necessary in order to increase consumption in absolute terms, but at the same time reduce its share in the GDP, while achieving an increase in both absolute and relative terms of gross capital formation, in particular that of core/registered capital. Failure to achieve that precludes any chances of going ahead.

2. Incomes of population in Bulgaria

Consumption is closely related to income. Incomes per person per household in this country are growing slowly and are considerably lagging behind, which is also due to the fact that many household members are out of work or retired (see Table 6).

Table 6

Incomes and expenditures per person per household in Bulgaria

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Incomes in BGN.</td>
<td>1664</td>
<td>2579</td>
<td>2851</td>
<td>3347</td>
<td>3748</td>
<td>3867</td>
<td>3812</td>
<td>3937</td>
<td>4541</td>
<td>5094</td>
</tr>
<tr>
<td>2. Expenditures in BGN.</td>
<td>1450</td>
<td>2250</td>
<td>2580</td>
<td>3088</td>
<td>3521</td>
<td>3668</td>
<td>3481</td>
<td>3672</td>
<td>4293</td>
<td>4745</td>
</tr>
<tr>
<td>3. Consumer spending as % of expenditures, incl. spending on food as % of expenditures</td>
<td>84.9%</td>
<td>86.3%</td>
<td>86.1%</td>
<td>85.1%</td>
<td>85.2%</td>
<td>85.7%</td>
<td>85.7%</td>
<td>84.0%</td>
<td>83.6%</td>
<td>83.3%</td>
</tr>
<tr>
<td>4. Deposits in BGN.</td>
<td>34</td>
<td>66</td>
<td>95</td>
<td>107</td>
<td>133</td>
<td>167</td>
<td>78</td>
<td>46</td>
<td>65</td>
<td>75</td>
</tr>
<tr>
<td>5. Purchase of foreign currency in BGN.</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>6. Paid debts and lending in BGN.</td>
<td>32</td>
<td>87</td>
<td>108</td>
<td>123</td>
<td>124</td>
<td>166</td>
<td>125</td>
<td>132</td>
<td>170</td>
<td>205</td>
</tr>
</tbody>
</table>

A significant proportion of per-capita expenditures of the population in this country goes on food - from 33 to 44%, which is a sign of considerable poverty, compared to around 13% on average in the EU. Deposits of the population are growing, but only around 2-3% of annual income are saved\(^7\). The main source of income for households is the salary (50-53%), followed by pensions (nearly 30%), incomes from self-employment (7-8%), income from entrepreneurship, from the social sphere and others.

The issue that stands out in this study is that economic development in this country is slow and has to be accelerated, with faster growth of population incomes and

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\(^7\) Calculated according to table 9.
consumption. Another problem is that GDP per person in this country is growing much faster than income per person, which is also connected with the distribution of product between labour and capital, a fact that is not only worth considering, but calls for actively taking actions in order to change the situation. In other words, there is an increase in labour productivity by means of GDP per person, but the corresponding increase in per-capita income is missing.

Data from Table 7 show that over the period 2009-2013 indices for per-capita GDP in Bulgaria is 44 to 47% compared to the EU average of 27 (28), while at the same time indices for GDP final consumption per capita are lower in this country than the EU average of 27 (28) and amount to 42 to 45% and only reach 50% in 2012. Data also show that before Bulgaria was admitted to the EU, in 2005, the situation with consumption was better.

Table 7

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2005</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Indices of physical volume of GDP in real terms per capita in Bulgaria on EU-27(28)=100</td>
<td>34</td>
<td>44</td>
<td>44</td>
<td>44</td>
<td>47</td>
<td>47</td>
</tr>
<tr>
<td>2. Indices of the physical volume of GDP per-capita expenditure in Bulgaria on EU-27(28)=100</td>
<td>37,9</td>
<td>45</td>
<td>42</td>
<td>42</td>
<td>45</td>
<td>50</td>
</tr>
</tbody>
</table>

The absolute size of population savings (see table 8) as an absolute size grew from 19,689.6 m BGN in 1990 to 2,419,199 m BGN in 1998 or 123 times, and to 3580.1 m (denominated) BGN in the year 2000 and over 36 billion BGN in 2013, but in 1990 savings stand for 52 % of the annual disposable income of the population and after that fall to around 10% of it. Moreover, the vast majority of deposits are very small in size. Over the first decade of the transition deposits declined by 70% (see table 9).
Table 8

Deposits of the population in Bulgaria as of 31.XII.\textsuperscript{9}

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Total deposits of population in million BGN incl.</td>
<td>19,689</td>
<td>384,799</td>
<td>3,580.1</td>
<td>33,432</td>
<td>36,408.1</td>
</tr>
<tr>
<td>- In BGN %</td>
<td>77 %</td>
<td>37 %</td>
<td>55 %</td>
<td>55 %</td>
<td></td>
</tr>
<tr>
<td>- In foreign currency %</td>
<td>23 %</td>
<td>63 %</td>
<td>45 %</td>
<td>45 %</td>
<td></td>
</tr>
</tbody>
</table>

This is mainly due to inflation, but also to using up a large part of previous savings for personal consumption. Since the Monetary Board was introduced in 1997 the population has begun to regain its trust in the banking system and the Bulgarian lev and as a result, savings have increased again.

Table 9

Indices of total amount of population deposits in Bulgaria (calculated by consumer price index on the basis of 1995=100) over the first decade of transition\textsuperscript{10}

<table>
<thead>
<tr>
<th>Year</th>
<th>1995=100</th>
<th>Previous year=100</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>1996</td>
<td>40.4</td>
<td>40.4</td>
</tr>
<tr>
<td>1997</td>
<td>21.8</td>
<td>54.0</td>
</tr>
<tr>
<td>1998</td>
<td>23.3</td>
<td>106.8</td>
</tr>
<tr>
<td>1999</td>
<td>26.2</td>
<td>112.2</td>
</tr>
<tr>
<td>2000</td>
<td>29.0</td>
<td>110.8</td>
</tr>
</tbody>
</table>

Considerable social inequality can be observed here. The income divide between the poorest 20% of Bulgarian households and the wealthiest 20% is around 6-7 times (with recommended ratio around 3 times), and this difference is much bigger with the 10% of the poorest households and the 10% richest households respectively\textsuperscript{11}, or, in other words, income polarization is striking. Sluggish consumption, low incomes and unemployment threaten the population health, working capacity and reproduction, as well as receiving proper education.


\textsuperscript{10} Social Trends 2000, NSI, Sf., 2002, p. 44.

The main factor that ensures raising population incomes and consumption is economic growth. High rates of economic growth are necessary in order to improve consumption, raise the standard of living, ensure technological innovation and re-structuring of the economy and pay back debts.

3. How population changes in Bulgaria

Population and the changes occurring in its numbers, structure, migration and others are an important factor connected with consumption in this country (see Table 10).

Over the period 1989-2013, or over the last 25 years, the population of Bulgaria decreased by 1521.3 thousand people, or around 1.5 m as a result of emigration abroad and falling birth rate with death rates higher than birth rates. Density of population also fell from 78 people per square kilometer to 65.3 in the period of transition\(^\text{12}\). As birth rate is dropping, the relative share of the population below active working age is systematically declining – from 22.1\% in 1989 to 14.6\% in 2013 and the share of population at and above active working age is growing. Negative natural growth has been observed throughout the years of transition. Birth rate is falling from 13.1 per thousand people in 1988 to 8.1 in 2000 and 9.2 in 2013 and has been rising slightly over the last few years. Death rate is up from 12.0 per thousand people in 1988 to 14.1 in the year 2000 and 14.4 in 2013.\(^\text{13}\)Deaths outnumber births. Besides, 73\% of the population live in the cities and 27\% - in villages. Women represent 51\% of the population and men-women ratio is 1000 to 1056.

Table 10

**Population of Bulgaria – in total and by structure\(^\text{14}\)**

<table>
<thead>
<tr>
<th>Year</th>
<th>In thousands as of 31.December</th>
<th>Structure in % by age</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Below active working age</td>
</tr>
<tr>
<td>1989</td>
<td>8,767</td>
<td>22.1</td>
</tr>
<tr>
<td>1990</td>
<td>8,669</td>
<td>21.6</td>
</tr>
<tr>
<td>1995</td>
<td>8,385</td>
<td>19.1</td>
</tr>
<tr>
<td>2000</td>
<td>8,149</td>
<td>16.8</td>
</tr>
<tr>
<td>2005</td>
<td>7,718.7</td>
<td>14.8</td>
</tr>
<tr>
<td>2010</td>
<td>7,504.9</td>
<td>14.6</td>
</tr>
</tbody>
</table>

\(^\text{12}\) Ibid. (as in table 13)


Population influences the overall social and cultural development of the country. Young generations are diminishing and the tendency of population ageing continues. The average age of the population in 1960 is 32.4 years, in 1990 it is 37.5, in the year 2000 - 39.9, in 2012 - 42.8 and 43.0 in 2013.\(^\text{15}\)

Over the transition period average life expectancy in Bulgaria, an important indicator for the standard of living, initially declines but afterwards recovers and even increases (see Table 11). For the period 1989-1991 average life expectancy in the country is 71.22 years (incl. 68.02 years for men and 74.66 for women); In 1995-1997 it drops to 70.5 (67.1 for men, that is one year less, and 74.3 for women); life expectancy increases in 1997-1999 and in 2013 is already higher than it was at the beginning of the transition period.

### Table 11

**Average life expectancy in Bulgaria\(^\text{16}\)**

<table>
<thead>
<tr>
<th>Years</th>
<th>Men</th>
<th>Women</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989-1991</td>
<td>68.2</td>
<td>74.66</td>
<td>71.22</td>
</tr>
<tr>
<td>1996-1997</td>
<td>67.1</td>
<td>74.3</td>
<td>70.5</td>
</tr>
<tr>
<td>1997-1999</td>
<td>67.64</td>
<td>74.67</td>
<td>71.01</td>
</tr>
<tr>
<td>2012</td>
<td>70.6</td>
<td>77.6</td>
<td>74.1</td>
</tr>
<tr>
<td>2013</td>
<td>71.0</td>
<td>78.0</td>
<td>74.5</td>
</tr>
</tbody>
</table>

The forecast is for the population of the country to continue to decrease and age, with a growing relative share of persons above active working age.

The employment and unemployment of the population is important, as they determine income and consumption, the standard of living and, to a large degree, life satisfaction. Employment rate (the number of persons employed over the total number of persons aged 15-64) is fluctuating and over the last few years since 2008 has been falling and has been generally low (in 1996 it is 44.7 %, 39.7 % in the year 2000, in 2008 - 64 %, in 2012 - 58.8 %, and - 59.5 % in 2013 with an EU-27 average 72.5 % in 2012). Unemployment rate is also fluctuating at a generally high level (1990 - 1.6 %, 2000 - 19.5 %, 2008 - 5.6 %, 2012 - 12.3 % with an EU-27 average of 4.3 % in 2012). Economic activity rate (employed and unemployed over population aged 15-

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\(^{15}\) Ibid.

64) is 51.8 % in 1996, in 2000 it is 47.5 %, 2008 – 67.8 %, 2012 – 67.1 %.\textsuperscript{17} In other words, this rate is relatively low.

The status of employed persons is also important (see Table 12)

\textit{Table 12}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|c|c|c|}
\hline
\textbf{Employment status} & \textbf{Total in thousands} & & \textbf{Structure in \%} & \\
\hline
Total & 2735.5 & 2934.0 & 2934.9 & 100 & 100 & 100 \\
1. Employers & & & & & & \\
259.5 & 104.5 & 115.1 & 2.5 & 3.6 & 3.9 \\
2. Self-employed persons & & & & & & \\
259.5 & 210.9 & 221.6 & 9.5 & 7.2 & 7.5 \\
3. Employed persons & 2364.4 & 2594.0 & 2578.6 & 86.4 & 88.4 & 87.9 \\
4. Unpaid family member workers & 30.6 & 24.5 & 19.6 & 1.1 & 0.8 & 0.7 \\
5. Other & 13.3 & 0.1 & - & 0.5 & - & - \\
\hline
\end{tabular}
\caption{Employed persons in Bulgaria as of December 2000, 2012 and 2013 by employment status\textsuperscript{18}}
\end{table}

Data in table 12 show that over the period 2000-2013 the number of employers is growing, while the number of self-employed, as well as the number of unpaid family member workers is falling; the number of those employed in the private sector exhibits a considerable growth and their share in total employment is up from 40 % to 64 %, at the expense of a definite drop in the numbers of persons employed in the public sector (from 47 % to 25 %). All these changes have taken place against the background of a 7.3% growth of the total number of employed persons for the period, or nearly 200,000 people.

\textbf{Resources that can be used in order to increase population income and investments:}

\textbf{First} – increasing government (public) debt by borrowing more. No development is possible without funding. The European commission admits a public debt of up to 60 % of GDP, and our debt amounts to only 18 % with a EU total of 86.2 % at the end of 2012. We come second after Estonia in low government debt. There is a good possibility for this debt to increase to, say, 30% as indeed it happened in 2015, and even more.


Loans, if put to good use, could ensure compensating accelerated economic development and higher rates of GDP growth in total and per capita and thus higher income and consumption for the population and larger investments.

Second – raising the budget deficit. EU allows up to 3 % budget deficit and in Bulgaria the National Assembly may decide on up to 2 %, with the average case for the EU 3.6 %, and 1.3 % in Bulgaria. The stipulation for up to 2 % should be changed and we should stick to up to the 3% required by the EU.

Third – making better use of the mechanisms for redistribution by means of which the poor could be exempt of certain charges and the burden be borne by the rich. This also calls for a tax reform; flat tax should be replaced by a moderately progressive tax and family taxation with non-taxable minimum for both individuals and the profits of small businesses, zero taxation on reinvested profit, VAT differentiation, a balanced approach to labour and capital – currently productivity is growing at about twice the rate of income growth and other.

Fourth – better management and reforms in the Customs, the National Revenue Agency, in state administration, the legal system; no privatization of objects of social importance, government exploitation of natural resources instead of granting concessions, considerable support for science, public education and health, reducing income inequality, innovation policy based on a national economic strategy by 2030, absorption of EU funds and attracting foreign investments, providing a sustainable business environment, etc.

References

DEVELOPMENT OF CONSUMPTION AND THE INCOME OF THE POPULATION IN BULGARIA IN THE YEARS OF TRANSITION

Prof. Dr Ec. Sc. Nikolinka Salova

Abstract

There are studied the changes in consumption and income of the population and also the changes in the population in Bulgaria in the years of transition after 1989, or a period of around 25 years. There are made suggestions for policies and resources for better development in the future.

Keywords: consumption, income, population, resources.
INSURANCE DECISIONS FOR SAFE TOURISM

Assoc. Prof. Stoyan Kirov, PhD

Introduction

Safe tourism should be a priority for every tour operator. This means that such insurance protection for travelers should be chosen which guarantees the quality of the tourist service. Insurance policies must be signed when adequate covering is available, they should have suitable limits of responsibility, be easy to administer and so on. Sadly, Bulgarian tour operators rarely carry out diagnostics of travel risks and recommend their clients traditional insurance with minimal limits of responsibility. This does not allow the implementation of the most relevant protection for passengers. In this respect it is to blame local insurers who react inadequately to the dynamic tourist market and do not provide flexible conditions in their tourist insurance, including facilities in using insurance indemnities.

The subject of this article is travel risks that are a threat for tourists to travel safe in time of organized excursions abroad, the topic – insurance decisions made by tour operators in order to handle these risks. Of course, part of the decisions are made by the passengers themselves, yet, in practice due to the lack of competence and experience on behalf of passengers insurance policies are signed after consulting tour operators. The goal of this study is to give some guidelines and rules for quality insurance of risks in traveling. There are offered practical tips for protecting health risks while travelling, tour operators’ professional responsibility, compensation for stolen luggage, covering expenses for terminating excursions and others.

1. Insurable travel risks and their mapping

Passengers are exposed to plentiful risks while going on an excursion. In order to determine which of those are suitable for insurance, it is necessary to carry out identification and mapping. Depending on the sources and the degree of their manifestation, travel risks can be classified as follows: climatic risks, financial risks, organizational risks, health risks, political ones and environmental risks.¹ This classifi-

¹ This classification is a modified version of the one given by Taleski, P. and Tashkov, N. Insurance in tourism industry. XI International Conference “Service sector in terms of changing environment”, University “St. Kliment Ohridski”, Ohrid, October 2011, p. 2. The authors use a classification made up of four groups travel risks: natural, technological, biological and political.
cation has two main advantages. Its detailed analysis makes it more adaptable to the scope of tourist insurances and the way for stipulating clauses in them. Besides, identifying travel risks in this way enables making more adequate insurance decisions in correspondence with the frequency and weight of harms from accidents.

**Climatic risks** are random ones that are not a direct consequence of the tour operators’ activity and they occur irrespective of passengers’ will. The initial reason for them is natural phenomena like flooding, earthquakes, volcano eruption and others. They can prevent excursions, terminate one’s stay in a hotel or can worsen the quality of the vacation. Climatic risks rarely happen, but they lead to serious harm for passengers.

**Financial risks** are due to changes in the price of the tourist service, currency rates, tour operator’s solvency, cancelling prepaid trips, loss of money and banking cards, untimely transfers, fraudulent deals with locals and others. In general, all these risks are provoked by factors of the external environment. The power and frequency of financial risks depend on the currency and the way in which passengers make payments, tour operators’ financial abilities and so on.

Organizational risks refer to the usual activities of tour operators and the individuals engaged in implementing the tourist service. They depend directly on the quality of management and the organization of the tourist business. Suitable examples for organizational risks are low-quality service, uncomfortable transport at the time of travelling, jumbled reservations, inadequate decisions of people in charge and others. As a rule every tour operator strives for handling these risks quickly and not allowing them to occur in his activity. This explains the low frequency of such events for large, reliable and competitive companies.

**Health risks** are particularly unpleasant while travelling. When they take place it always leads to harmful results and some have lethal outcome. All passengers are exposed to the risk of getting sick, eating dangerous food and beverages, disability after an accident, catching a virus or bacteria and others. Such risks can be predicted and are suitable for insurance. The only issue is the so called *health tourism* which from the insurer’s point of view is dangerous and unacceptable. Recent sociological studies show that health risks are among travellers’ greatest fears while travelling. More than 70% of US travellers point out health risks as the basic factor which gives the background for their decision to sign an insurance policy.²

**Political risks** occur as a result of events from outside which are difficult to predict. Among those are terrorism, uprisings, strikes, taking hostages and others,

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Changes in visa regulations of a particular country are also a type of political risk. By rule these risks affect all passengers and lead to considerable irrevocable harm. Regardless of the fact that they occur rarely, it is difficult to get insurance and to do this a state guarantee is necessary.

*Environmental risks* are unpreventable and occur under the impact of external factors similar to climatic risks. The difference is that there is human interference with the former. This group includes loss of personal belongings and documents, delay of luggage, theft, pick-pocketing, unsettled infrastructure, lack of communication and others. It is rarely for these risks to do big harm to passengers and fortunately for them they occur seldom. Preventive measures play vital role in such cases.

Besides recognizing the type of travel risks they need to be defined according to their intensity and power of impact. This makes it necessary to estimate the frequency and weight of harm when such risks take place. From this point of view risks can be *mapped*. Mapping lays out emerging travel risks in a matrix. It should ensure clear, easy and understandable visualization which can clearly show the importance of risks for passengers according to the way risks take place, develop and transform. Each matrix has its unique content dependent on the specifics of the tourist destination. The reasons for this are hidden in the individual values of the frequency and weight of harms for the different destinations. Thus for ex., the frequency of the risk for having money and documents stolen is different for excursions in Turkey and the Czech Republic. On Fig. 1 there are shown six exemplary travel risks depending on their frequency and weight of harm.
Фиг. 1. 3х3 matrix of travel risks for excursions in the Czech Republic

Usually mapping risks is used in order to determine which risks are threatening for a trip and which ones need to be insured. As a rule, insurance is most suitable for events that occur seldom but cause significant (big) harms of material and non-material nature. It is recommendable that risk mapping is done periodically. Thus extra information is provided concerning the development of risks. The dynamics of the process helps to assess tour operators’ insurance programmes and offer more relevant protection to their clients.

2. Insurance transfer of travel risks

Mapping travel risks is only a preparatory stage of the insurance process. Further on tour operators have to decide for which risks and what degree of intensity they should offer insurance protection to their clients. Thus their insurance decisions should be comprehensive instead of being based on the approach of managing “risk by risk”. In this way signing a certain insurance policy won’t be an isolated act; it will rather be in compliance with all risks instead. Insurance decisions need hierarchy and subordination. This means that travel risks should be ranked according to their significance and the means from their insurance need to be invested with priority. Those must be created on the ground of travellers’ risk tolerance. In the long run, it is the trippers who determine the price range of the tourist service on which the scope of insurance protection depends.
The quality of insurance decisions depends on compliance with two principles.³ The first stipulates that the weight of harms is much more important than their frequency. This means insurance of risks that travelers cannot finance themselves. Obviously, insurance is a function of travelers’ inability to handle big losses when traveling. In this sense one should not ask the question “Is the traveler able to afford the insurance?” Instead, the question must be: “Is the traveler able to allow himself to do without insurance?” It is true that insurance makes tourist services more expensive and few people can afford comprehensive insurance against all risks. However, this can be overcome with the help of franchising contracts which allow travelers to keep small sums of money for themselves and thus have extra funds for insurance against more possible risks.

The second principle concerns well-grounded purchasing of insurance. Transferring travel risks is not a particularly cheap method for managing risk and should be used only when absolutely necessary. There is no logic in insuring baggage loss, provided that nothing valuable is in there and all belongings could be bought for a small price abroad. An immediate consequence of this principle is the recommendation to refrain from the so-called “extra insurance covering”. It is necessary to always cover all travel risks and only then one could think of broadening the insurance against adjoining risks. This is so because extra coverings divert passengers’ money and deprive them from the chance to buy insurance against big (significant for them) risks.

It is a commonly spread practice for tour operators to make their insurance decisions only on the ground of the first principle. However, situations occur when it is desirable to insure only risks in which harms do not have big weight. These are the cases concerning the use of administrative and legal services abroad, which are much more accessible and offer good quality with the assistance of insurers. The harm incurred could not be that big, but in combination with expenses for its recovery it might turn out unaffordable. Besides, in certain circumstances insuring leads to economies, even though the insurance premium exceeds the expected value of the harm. If a passenger does not have insurance, he/she should have a lot of money or a considerable amount of money should be available in his banking cards so that he is able to finance potential harms. This in turn, leads to the emergence of other risks (theft, loss and others) or extra costs for servicing the bank products (interest, fees and so on). That is why in making insurance decisions it is necessary to take into account both factors: the expenses for wiping out harms and the alternative ones for retaining the risk.

Tax treatment of insurance companies and paid indemnities also has an impact on insurance decisions. This means that tour operators have to take into consideration the tax effect from purchasing insurance on the traveller’s budget. Usually travelers in their role of individuals use tax deductions in respect to their income tax. In Bulgaria tax deductions refer only to personal “life insurance” and health insurance. All other insurance is made on the taxed traveller’s income without the right to a follow-up deduction from the premiums paid. In this sense for certain insurance products there are extra financial stimuli and they can be easier to offer to passengers.

As for the indemnities paid on risk insurance without a savings element (part of these is travel insurance), there are particular tax allowances. According to the existing Bulgarian legislation such incomes are not taxed, fully at that. This is so because they have compensatory purpose and the individuals harmed need them in full. It is important to mention here that if a certain travel risk is not insured, travellers have to finance the harm from their net income. In another case they pay the insurance premium from their net income (with the exception of insurance under article 19, item 1 from ATII (Act for taxing individuals’ income), but they will receive times more insurance indemnity which is not subject to taxation.

Undermining insurance protection of passengers on behalf of tour operators can lead to trust crisis. The issue is that insurance decisions are made mostly on the ground of frequency and weight of harms for travellers, without taking into consideration the losses with potential and indirect character for the tourist business. Thus for ex., if a tour operator does not insure his clients against a particular travel risk, this could have a negative impact on his image, because the service he provides is unprotected and he hasn’t managed the risk appropriately. In this sense one should consider not only direct harms to passengers, but also the possible decrease of revenue from worse image. In order to decrease the power of negative link between tourist business and emerging harms for passengers through insurance, one needs to have in mind the following facts:

- Media are exceptionally sensitive and they cover extensively signals given by unsatisfied travellers (especially if their life and health has been threatened), which harms tourist business.
- The negative attitudes of clients in respect to the fact that they are not pro-

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4 Article. 19, item. 1 from the Act for taxing individuals’ income. //State gazette, №95, 2006.
5 From the point of view of tour operators the issue of compensations that they owe for being guilty of certain behavior is completely another story. The sums of money, paid by them to travelers, are a way to postpone the tax owed on the profit for the following year. This is so because paid compensations are reported as expenses and they directly decrease taxed financial result.
tected enough (through insurance as well) are almost as dangerous for the tourist business as real harms from events are.

- Rumours about lack of security in a provided tourist service prevent the tourist business from development much more than the disappointment of direct participants in risky situations.

The principle notions mentioned above underline the necessity of relevant, comprehensive and hierarchically interdependent insurance decisions. It is in the interest of tour operators to understand that it is much more cost-efficient to manage risk before the harm-incurring event takes place, than handling a crisis after the travel risk occurs.

3. Product design of tourist insurances

On the market various insurances are offered; they are more or less suitable for individual and group excursions. However, five of those deserve special attention, having in mind that they manage travel risks best and are designed to serve the interests of tour operators and their clients:

1) Insurance against unforeseen travel costs;
2) Insurance “Professional responsibility”;
3) Insurance “Traveller’s accident”;
4) Travel insurance;
5) “Medical costs” insurance.

The insurance against unforeseen travel costs is designed to make up for the harms incurred by financial transactions. It is a common practice for tour operators to oblige their clients to make advance payment in order to provide for the trip and hotel accommodation. The insurance can protect this money in case that the tour operator is forced to claim insolvent. It is important to point out that the insurance does not indemnify the clients of companies which have left the tourist business voluntarily or have carried out their activity by breaking the law.

The “Professional responsibility” insurance is meant for tour operators and their agents who organize and promote cultural tourism. It compensates travelers for harms incurred by unprofessional services, misleading information, irrelevant consultation, tour operator’s insolvency and others. The environment where tour operators function is too dynamic, intense and stressful. Clients want fast, cost-effective, attrac-

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7 It is a common understanding that the insurer reimburses sums of money to travelers provided there is proven insolvency of the tour operator. Similar interpretation limits the insurance protection and does not give significant guarantee to tourists. Very often tour operators simply leave the business without legal affairs having been started concerning their insolvency. This allows insurers to refuse some indemnities.
tive and complex offers, generating them might led to mistakes and omissions. In the last couple of years one observes considerable increase of claims for mistakes and omissions. In this sense the “Professional responsibility” insurance can answer passengers’ needs and weaken the negative effects for tour operators.

The issue of the “Professional responsibility” insurance is that the indemnity is paid on the ground of an extrajudicial agreement between the two parties or in compliance with a judicial decision against the tour operator that has come into force. Yet, to prove the behavior guilty in court is a difficult, cost-consuming and emotionally exhaustive work for the claimants. Sometimes this discourages travellers and diminishes the advantages of the insurance advocacy. In some countries “Professional responsibility” is compulsory and is a condition for running tourist business.

In order to provide safe travelling, it is recommendable for tourist operators to sign “Accident” insurance for their clients. In this case insurance is made for someone else’s expense because the tour operator pays the insurance service, whereas the travellers use it. The common occasions covered by the insurance are death and less long-term working efficiency and temporary lack of it that have occurred during the trip. The size of the indemnity depends on the degree of lost working efficiency. There might be cases in which the insurance is offered with extra covering, including temporary lack of working efficiency and other risks. It is recommendable for the insurance sum of money in the “Accident” insurance to be adapted according to the personal needs of every client, which means that one has to study beforehand the insurances of the travellers that have been signed on another occasion.

The Travel insurance is a product which concerns individuals who take part in individual or group trips. Usually the insurance is bought together with the tourist package and is offered through the intermediacy of the tour operator. The most common coverings in the travel insurance are:

- “Cancellation of trip”. The cover compensates travellers in case they give up the organized excursion for good reasons. The compensation has the size of the sanction that tour operators charge when a trip is cancelled.
- “Preliminary termination of the trip”. Each excursion can be terminated preliminary because of sudden illness, professional appointment and others. In this case the tourists lose all the money paid, even this for the unused part of the excursion. The cover makes up for exactly this unused means.

8 In Bulgaria this insurance is named “Tour operator’s responsibility”. It is stipulated in the Regulation about the conditions and order for signing a contract for compulsory insurance “Tour operator’s insurance”, approved with SCM №306 from 21.12.2013//State gazette, №2, 2014.
• “Baggage loss and having personal belongings stolen”. This clause covers the loss of luggage and other personal belongings while travelling which have been declared beforehand. The coverage could be enlarged with the loss of and the money stolen, but this always makes the insurance considerably more expensive.

The “Medical costs” insurance covers the money paid for diagnosing and covering sickness during the trip. The health and dentistry risks are among the most troublesome for passengers, having in mind that they concern pain, discomfort due to a stay in hospital and at the same time they cost a lot of money. Sometimes the insurance covers the expenses for medical help on the site of an accident and, if necessary, for transferring the patient to a hospital with the necessary equipment and specialists. Besides, the insurance can scope bringing back the injured passenger or his remains to the country of origin.

For many countries where there is no uniform system for insurance relations, the “Medical costs” insurance is compulsory. In these cases it is a prerequisite for the stay in the country. Such is the case with organized excursions to Cuba, for example.

4. Problematic aspects of insuring travel risks

Tourist insurances have a lot of advantages, but signing such at random often leads to duplicate covers. Since some types of insurance cover the same risks, signing such at simultaneously harms travellers. In similar cases reinsurance is done which, by law, is invalid and is transformed in full insurance – a process in which money is lost. In order to avoid such situations, one has to study beforehand all insurances signed by the passengers. Thus they will be offered only unique and absolutely necessary coverings. The duplicates emerging most often which need preliminary information are as follows. Sometimes a personal “Life insurance” covers the risk of “death” not only at the time of travelling in the country but abroad as well. When such insurance exists to sign “Medical costs” insurance is pointless. Of course, there are differences and they are mainly in respect to the expenses for medical evacuation to the nearest hospital or sending back the harmed passenger to his/her own country.

Usually using one’s personal vehicle during an excursion concerns the fact of signing “KASKO” insurance. In the clauses of some insurance contracts there is provisional indemnity also for the damaged baggage inside the vehicle. This hides the danger of duplicate covering “Loss of luggage and having personal belongings sto-

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9 Dental treatment is seldom included in covering the “Medical costs” insurance. Yet, even if it is among the insurance risks, usually it is quite limited in value. The main reasons for this concern travellers’ reluctance to use prophylactic dental help abroad, the possibility to catch hepatitis B, language barriers and the lack of personal record about intervention in the past.
len”. One has to be careful for the scope and definitions of insuring risk in separate insurance contracts.

More personal health insurance contracts cover expenses made for medical services at the time of travelling which makes them being handled again unnecessary. Duplicating health risks is done often, when passengers have a European health-insurance card. However, the card does not replace fully the “Medical costs” insurance”, because it does not cover personal health services\(^\text{10}\) and the expenses in sending the sick person back to his/her own country. Besides, some airlines refuse to have on board the injured or sick passenger with special needs having EHIC but no medical insurance.

Credit cards used for payment abroad are offered with standard insurances which often could duplicate what is covered in tourist insurance. They can provide protection against certain illnesses, delaying or missing a flight, damages to hired vehicles and others. The insurances tied to credit cards are comfortable but they hide a lot of dangers. What is characteristic for them is that they have limited coverage with minimum insurance sums of money.\(^\text{11}\) Apart from that they start functioning only under the condition that travel services are purchased with a particular credit card.

Another aspect which creates problems for passengers are the exceptions in insurance concerning existing circumstances; when they exist insurers do not take any responsibility. Thus for example, certain illnesses diagnosed in the past hide the danger for being activated again. When this occurs immediately before and during a trip, it could lead to refusal to pay insurance indemnity. What is interesting, passengers rarely inform their insuring company about their own health condition or hide significant facts about it. A study of “Sainsbury’s Travel Insurance” carried out in 2009 found out that nearly 1.3 mil English people with health problems travel abroad without considering it important to inform about these circumstances in the documents that are part of their insurance contracts.\(^\text{12}\) This could simply make the clauses in the contract invalid because of existing exceptions in it. Of course, some insurance companies have a more liberal procedure concerning their clients, by negotiating with them “quarantine periods of time”. If, for example, the symptoms of an illness are sharpened within a long period of time after the last treatment and this coincides with the insurance period, the insurance company still pays out the due indemnity.

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\(^\text{10}\) The European health-insurance card (EHIC) does not guarantee free medical service, not for all illnesses, at that. The card provides its holders the same prices and conditions for treatment used by residents of the respective country. Since the health-insurance systems are various, services that are free in Bulgaria might require payment abroad and vice versa.


Often the exceptions in insurance contracts contain also the circumstances connected with practicing action sports. This means that injuries from parachute jumping, diving, car races, horse races and others would not put into action the indemnity clauses in tourist insurance contracts. What also needs attention is the exception concerning “pregnancy”. Thus for example, if this risk is not part of the insurance covering, the company won’t be able to be given back the sum paid in advance to a woman who has become pregnant after booking the excursion and makes her mind to cancel the trip. All this suggests a very careful study of the “Exception” section in the insurance contract, so that passengers won’t feel disappointed.

A common mistake in signing travel-insurance contracts is the incorrect choice of the period they will function, including the initial and final moment of the insurance protection. The time of functioning should be selected in such a way that it covers the whole excursion. Very often insurance agents offer standard terms concerning their insurance such as three, seven, ten days which does not always coincide with the duration of the trip. This makes passengers make compromise by leaving uncovered several days at the start or respectively at the end of the excursion. Similar practice is unacceptable for the insured individuals. It is recommendable for the insurance policies signed with the clause “Cancelling a trip” to come into action enough time before departure. Thus the insured individuals will have the right to indemnifying the risks that emerge in the last minute, including such that could occur on the way to the airport, passenger terminal, pier and so on.

It is interesting to point out the characteristic features of the “Medical costs” insurance which concerns a trip abroad covering medical evacuation. Some insurance companies make it comfortable for passengers by covering the costs for urgent transportation with specialized technical equipment to a particular hospital. What is significant in such cases is whether the insurance covers only the expenses for taking the sick person to the nearest medical institution and also his/her evacuation to his/her own country. It turns out that the majority of US and European travellers prefer to have quality medical treatment in their own country under the supervision of their GPs than being left under the care of other specialists with unfamiliar standards of service. Similar attitudes have their logical explanation by having in mind that mortality rate after surgery intervention in the countries from Latin America is 50% higher than that in Western Europe and nearly 40% higher compared to that in Eastern-

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14 The prevalent part of US citizens travelling abroad (92%) want to have immediate access to quality medical treatment in their own country and insurance cover that allows them to be transported to a hospital in USA. (The Chubb Insurance Company. March 1, 2005).
European countries. The percentage increases more when the comparison is made with the quality of surgery services in USA.\textsuperscript{15}

A useful coverage in the “Medical costs” insurance is sending back the remains of a passenger who has died at the time of a trip. The alternative to end a trip with death is unacceptable for insuring agents and they often ignore it. The expenses for sending a dead body back home, however, are extensive (sometimes more than £25 000), because they require special conditions for transportation, issuing many documents, cremation and others. Insuring the costs for doing this for sure helps the dead man’s relatives which one should not undermine.

Irrespective of the fact that the risks for having one’s luggage lost, delayed, damaged or stolen are among the most common, to insure them happens rarely. Almost always they are for the expense of the carrier or the hotelier. Very often the airline itself indemnifies passengers with baggage problems if they are to be blamed. One has to approach insuring the risk concerning luggage with reason because covering it is rather limited. Thus for example, more insurers do not pay indemnity for lost, stolen or damaged baggage which contains computer equipment, cameras, watches, jewellery and other valuables. In addition, they also take into consideration the degree of the baggage worn-out by reimbursing only the damage for unused property.

The truth is that the risk of delaying a luggage leads to a number of inconveniences for the passengers and this costs money. They have to buy clothes, cosmetics and other items until their luggage is delivered. This risk can be insured but the harm weighs little and the risk is more suitable for retention. Besides, the standardized covering in this insurance is usually for small sums of money (for ex. up to USD 100) and in order to come into action the baggage delay should be more than 24 hours.

Most insurance companies sign contracts with foreign assistance firms. These are specialized business entities with call centres in many countries worldwide which help passengers when problems which occur overseas. These companies can be used for legal issues, translation, assistance for free medicines with prescription, credit card replacement and other urgent needs. The assistance clause in the insurance contracts, however, can be misleading. One has to be careful whether the assistance firm helps passengers only with information or has also financial commitment with them (for example, to pay certain services for them). Yet, the financial duty needs to be negotiated explicitly in the insurance contract and usually concerns extra payment. The travelers need also to take into consideration the fact that usually call-center

employees only redirect the signals to the specialized information offices in the country where the accident has taken place. They are rarely located in the respective country and are not ready to give directions to the insured individuals about the most suitable hospital, car-service, motor-vehicle service, lawyer and other quality services.¹⁶

**Conclusion**

Most Bulgarian tour operators do not make thorough diagnostics of travel risks and do not care enough for the insurance record of their clients. The main reasons for this are the expensive process of processing data, undermining the insurance protection, misleading information about insurance projects and many others.

Making insurance decisions on behalf of tour operators involve mapping travel risks, choosing an insurance product, defining the insurance covering and mediation in signing insurance policies. All these stages should be done in conditions of giving complete information, hierarchy of goals, subordination of interests and decision argumentation. Only in this way will the travelers receive adequate and timely insurance protection.

The most common issues in tourist insurance concern duplicate coverings, lack of informing about significant risk circumstances, unsuitable deadline of action, lack of negotiating the medical evacuation and sending back to one’s home country, assistance clauses in contracts and others. A big part of these issues is actually not subject to solution without the help of tour operators. In order to provide safe travelling, they need professional consultation and mediation.

**INSURANCE DECISIONS FOR SAFE TOURISM**

Assoc. Prof. Dr Stoyan Kirov

**Abstract**

Safe tourism must be a priority for each tour operator. This means choosing such insurance protection of travellers that would guarantee the quality of the tourist service. Insurance policies must be concluded at adequate coverage, they must have appropriate liability limits, must be easy to administer, etc. Regrettably, tour operators in Bulgaria rarely perform diagnostics of travel risks and recommend conventional insurance policies at minimum liability limits to their customers. This prevents the achievement of the most adequate insurance protection for travellers. Part of the blame in this respect goes also to local insurers, which sluggishly react to the dynamic tourist market and do not provide flexible terms in their travel

insurance, including facilities for the absorption of insurance payments. In this context this article is an attempt at providing some guidelines and rules for the quality management of travel risks. The study offers practical advice for insuring health risks during travel, the professional liability of tour operators, compensating for the theft of luggage and valuables, the coverage of the cost of curtailed excursions, etc.

**Keywords:** travel risks, tourist insurance, insurance decisions, safe tourism.
THE INFORMAL SECTOR’S IMPACT ON THE BUDGET REVENUES

Assistant Prof. Vanya Encheva

Introduction

Within the system of effective wealth distribution an efficient, sustainability-oriented economic structure should be based on private property, giving wealth disposal rights to private entrepreneurs and households. Private property creates the necessary incentive to acquire income through labour and is the basis for innovative entrepreneurship. Only an economy based on private property could ensure sustainable employment. This is the way to demonstrate personal liability and personal initiative, which are indispensable prerequisites for the efficient use of capital, education, innovation, growth and prosperity. Private property is a characteristic of the public policy of competition whereby many small- and medium-sized entrepreneurs are liable for their activities through their personal property. Ownership implies social obligations, while its use must serve the common good. This ensures moderate and sustainable entrepreneurial action and prevents one-sided pursuit of short-term profits.

Sustainability itself can be ensured through the appropriate fiscal and financial policy of the state. The lack of such a policy in turn is a prerequisite for the existence of an informal sector, a phenomenon that has been observed in Bulgaria for over 20 years and which is a major factor for the country’s insufficient competitiveness.

Therefore the purpose of this paper is to analyze the informal economy and its impact on the revenue side of the budget. To achieve this objective we have set ourselves the following tasks:

- defining the informal sector;
- tracing the dependency between the size of the informal sector and the budget revenues;
- analyzing the possibilities and measures for eliminating the informal sector problem.

The following methods have been used towards the achievement of the above tasks: graphic method, table method, comparison method and regression analysis.

1. The informal sector in Bulgaria as tax evasion

There are different ways to define the informal sector. One of the most popular definition is the following: “market production of goods and services, whether legal
or illegal, which is included in the official statistics for calculating the GNP“ (Ministry of Finance, 2011, page 2). It can also be described as „the part of lawful business activities that remain unaccounted for by authorities“. (Schneider, 2009, page 2).

The terms “informal economy” and “grey sector” were first used in academic literature and political circles in the 1970s. Hart (1973) classified the informal activities into “legitimate” and “illegitimate” activities. Legitimate activities are those that contribute to economic growth, though on a smaller scale (e.g. domestic manufacturing, personal services, etc.), while illegitimate or informal activities are those which, though not necessarily criminal in their nature, have a dubious value for the national development (e.g. begging, pickpocketing, etc.).

According to Kumanova and Manolov (1996) „grey economy“ or „shadow economy“ are only two definitions applied to a real social and economic phenomenon, whose dimensions can be observed under different forms and in a different degree in every country’s economy.

There is a shared opinion (Mantarova, 1999), (Doynov, 2002) that the informal sector in Bulgaria started to gain speed at the beginning of the transition period and the collapse of the planned economy. The above-mentioned authors also claim that the said phenomenon is not a product of the transition period; its roots should rather be traced in the socialist period, in the so-called „second economy“ that used to satisfy the need for goods and services that the official economy was not in a position to supply to a sufficient degree.

Four basic factors can be identified (Schneider, 2009, page 4), that influence the size and scope of the informal sector and push people into informal employment in any country:

- **savings**: by working outside the formal economy, participants avoid taxes and social contributions into the budget, thus bypassing the tax and labor regulations. There is a strong cause-effect relationship between the tax rate of the country and the size of its shadow economy. This relationship is particularly strong during times of crises;

- **the lack of a "guilty conscience"**: the informal economy is often considered normal by the society. This attitude is prevalent in countries where the quality of public institutions and national wealth is low or trust in the state is shaken;

- **lower risk of disclosure**: participation in the informal sector is illegal, but the lower the chance of disclosure and the smaller the penalties, the more people believe that the risk is worth it. Therefore, it takes a firm legal stand and better law enforcement to reduce the share of the informal sector;

- **easy participation**: cash payments facilitate entry into the shadow economy, because they can not be traced. Such payments are the main driving force of the informal sector.
If we try to produce a generalized definition of the term "informal sector", we can describe it as a set of legitimate business activities, wholly or partly not reported by the national statistics, whereby the people employed in those activities knowingly conceal a part of or the entire amount of their income therefrom. Since the sector is not fully covered by national statistics, it actually "works in the shadows." Therefore, there is no way to fully and explicitly measure the quantity or value of its operations. Only assumptions and estimates can be made (subject to various restrictions) on its size based on the traces left in the formal economy.

A series of studies within the project "Reducing and preventing the informal sector" have outlined several trends concerning the scope of the informal sector in Bulgaria in the period 2010 – 2013. In 2010, the scope of the informal sector in the national economy was 42.2 %, while in October 2012 its share decreased by 5.4% to 36.8%. A survey conducted from September to October 2013 demonstrated that according to employers the scope of the informal economy was 33.6 %. This means that compared to 2012 the informal sector shrank by 3.2%, while compared to 2010, the decrease was 8.6%. 2014 data show that the level of informal practices continued to decline, with the average estimate of the share of the informal economy in 2014 being 32.3% (Industrial Capital Association, 2014, pp. 29-31). It can be assumed that the measures undertaken by the Government have led to some progress in the fight against the informal sector, which, however, is still operating.

The main factors that stimulate the informal sector include mass unemployment, the economic crisis, poverty, taxes that increase labor costs and the strong competition, which affects company performance.

The sectors that have traditionally had the largest share in the grey spectrum of the economy are infrastructure construction, health, tourism and milk processing. However, if we have to mention different business sectors in the country, these must include trade and various service sectors; informal practices are most common in the case of services whose end consumer is an individual, since in this case it is possible not to give the customer a receipt or another type of document. The main reasons for this phenomenon are the low standard of living of the population and the lost trust between the state and its citizens. It is exactly the shattered trust that has led to skepticism and susceptibility to grey practices. This phenomenon is manifest even among employers in business, the consequence being low tax collection and susceptibility to corruption.

2. Study of the dependence between the informal sector and budget revenues

This paper attempts to present the informal sector through the indirect method “electricity consumption”, introduced in the 1960s (Kaufmann and Kaliberda, 1996). When using this approach it is assumed that the electricity consumption is actually the best
single indicator of the general economic activity (including both the official and informal sector). Following that logic, the rate of change of the electricity consumption is a good enough indicator for the rate of change in the general economic activities. Therefore, the difference between the rates of electricity consumption change and of the change in the national economy is indicative of the informal sector dynamics. This method calculates the GDP growth, the electricity consumption increase and the country’s GDP elasticity. To this end the GDP and the final energy consumption (FEC) for the last 14 years are compared. It is assumed that the electricity consumption is an indicator of the growth of the registered and non-registered GDP. This method is conditional, since it does not account for potential changes in consumption determined by technological advances.

**Table 1**

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP¹ (mln BGN)</th>
<th>GDP change rate (%)%</th>
<th>Final energy consumption (thousand tons of oil equivalent)</th>
<th>Rate of Final energy consumption change (%)³</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>50 268</td>
<td>-</td>
<td>8 574</td>
<td>-</td>
</tr>
<tr>
<td>2002</td>
<td>52 521</td>
<td>4,48</td>
<td>8 601</td>
<td>0,31</td>
</tr>
<tr>
<td>2003</td>
<td>55 334</td>
<td>5,36</td>
<td>9 247</td>
<td>7,51</td>
</tr>
<tr>
<td>2004</td>
<td>58 964</td>
<td>6,56</td>
<td>9 150</td>
<td>-1,05</td>
</tr>
<tr>
<td>2005</td>
<td>62 475</td>
<td>5,95</td>
<td>9 512</td>
<td>3,96</td>
</tr>
<tr>
<td>2006</td>
<td>66 518</td>
<td>6,47</td>
<td>9 880</td>
<td>3,87</td>
</tr>
<tr>
<td>2007</td>
<td>71 112</td>
<td>6,91</td>
<td>9 748</td>
<td>-1,34</td>
</tr>
<tr>
<td>2008</td>
<td>75 205</td>
<td>5,76</td>
<td>9 552</td>
<td>-2,01</td>
</tr>
<tr>
<td>2009</td>
<td>71 436</td>
<td>-5,01</td>
<td>8 493</td>
<td>-11,09</td>
</tr>
<tr>
<td>2010</td>
<td>71 904</td>
<td>0,66</td>
<td>8 720</td>
<td>2,67</td>
</tr>
<tr>
<td>2011</td>
<td>73 690</td>
<td>2,48</td>
<td>9 050</td>
<td>3,78</td>
</tr>
<tr>
<td>2012</td>
<td>74 475</td>
<td>1,07</td>
<td>9 044</td>
<td>-0,07</td>
</tr>
<tr>
<td>2013</td>
<td>75 745</td>
<td>1,71</td>
<td>8 598</td>
<td>-4,93</td>
</tr>
</tbody>
</table>

*Source: [www.nsi.bg](http://www.nsi.bg)*

The situation that results from the data in the table is demonstrated in Figure 1. The graph shows that in the period 2002 – 2004 the GDP increased by almost equal annual rates. However, the FEC jumped from 0,31% in 2002 to 7,51% in 2003. In 2004 there was a decrease in FEC (to -1,05%), the GDP grew by 6,56% compared to

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¹ GDP as per comparable 2010 prices.
² Calculations done by the author.
³ Calculations done by the author.
the previous year. If we assume that the GDP accounts for the created products, a logical question would be how the production that is growing at a steady annual rate would “absorb” so much energy? The answer could be the unreported economic activity that resulted in the increased energy consumption.

Source: The author.

Fig. 1. Rate of change of the GDP and the FEC in Bulgaria for the period 2002 – 2013

In 2005 the GDP dropped by 5.95% compared to the previous year, while the FEC increased by 3.96%. Thereafter, however, the growth of electricity consumption slowed down (to 3.87%), while the GDP increased by 6.47% compared to 2005. The lack of correlation between the delayed energy consumption and the GDP shows that there is a user unreported through the GDP which slows down their consumption. This can be seen even more clearly in 2007, when the reduced consumption of electricity did not affect the growth of GDP. During that period, the growth in energy consumption from declining turned even to negative (-1.34%). This is again evidence of smaller use of energy resources and other things being equal, it should have resulted in a drop of output, and hence of GDP. However, gross domestic product even marked record growth of nearly 7% in 2007. The situation can be explained as follows: the legal economy impacting the GDP expanded. The energy that it consumed, respectively, was also on the increase. The FEC reduction was due to the shrinkage of the informal business that abandoned energy facilities. This assumption is confirmed by the informal sector reduction in 2007 - 2008 (See Table 2), which will be discussed later. The 2009 crisis triggered simultaneously a shrinking in the informal sector, a decline in the formal economy, a record reduction in end-use energy consumption (-11.09%) and in GDP (-5.01%). In 2010 the economy gradually recovered, electricity consumption started to increase, and in 2011 the annual growth rate had almost returned to the 2006 levels. The annual growth rate of GDP, however, remained far lower than in 2006, which again gives indications of unreported
economic activity. In 2012, there was a simultaneous decline in FEC and in GDP, while in 2013 the opposite trends in their rates of change were recovered (FEC -4.95, GDP 1.71% compared to the previous year).

It is an established observation that the tax revenue income management policies strongly impact the informal sector practices and vice versa: the changes in the latter sector are reflected in the amount of tax revenue. In order to prove and model this relationship, data concerning the size of the informal sector has been used for the purposes of this analysis (Schneider, 2015), as well as the dynamics of some revenue items from the revenue part of the statements on the state budget implementation. Table 2 below shows data on the GDP size, the total revenue, the tax revenue (TR) and the informal sector size (IS) in the last 11 years.

### Table 2

**Dynamics of the informal sector and the interrelated revenue items for the period 2003 – 2013**

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP (mln BGN)</th>
<th>Tax revenue (mln BGN)</th>
<th>TR as % of GDP</th>
<th>TR as coefficient of GDP</th>
<th>Chain indexes of TR</th>
<th>Total revenue (mln BGN)</th>
<th>Total revenue as % of GDP</th>
<th>Total revenue as coefficient of GDP</th>
<th>Chain indexes of total revenue</th>
<th>IS as % of GDP</th>
<th>IS as coefficient of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>50 268</td>
<td>11 114</td>
<td>22</td>
<td>0.2211</td>
<td>14 070</td>
<td>28</td>
<td>0.2799</td>
<td>35.9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>52 521</td>
<td>12 779</td>
<td>24</td>
<td>0.2433</td>
<td>15 855</td>
<td>30</td>
<td>0.3019</td>
<td>1.079</td>
<td>35.3</td>
<td>0.983</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>55 334</td>
<td>14 484</td>
<td>26</td>
<td>0.2618</td>
<td>18 012</td>
<td>33</td>
<td>0.3255</td>
<td>1.078</td>
<td>34.4</td>
<td>0.975</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>58 964</td>
<td>16 326</td>
<td>28</td>
<td>0.2769</td>
<td>20 034</td>
<td>34</td>
<td>0.3398</td>
<td>1.044</td>
<td>34</td>
<td>0.988</td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>62 475</td>
<td>19 324</td>
<td>31</td>
<td>0.3093</td>
<td>24 063</td>
<td>39</td>
<td>0.3852</td>
<td>1.134</td>
<td>32.7</td>
<td>0.962</td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>66 518</td>
<td>22 167</td>
<td>33</td>
<td>0.3332</td>
<td>27 313</td>
<td>41</td>
<td>0.4106</td>
<td>1.066</td>
<td>32.1</td>
<td>0.982</td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>71 112</td>
<td>20 172</td>
<td>28</td>
<td>0.2837</td>
<td>25 041</td>
<td>35</td>
<td>0.3521</td>
<td>0.858</td>
<td>32.5</td>
<td>1.012</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>75 205</td>
<td>19 014</td>
<td>25</td>
<td>0.2528</td>
<td>23 933</td>
<td>32</td>
<td>0.3182</td>
<td>0.904</td>
<td>32.6</td>
<td>1.003</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>71 436</td>
<td>20 594</td>
<td>29</td>
<td>0.2883</td>
<td>25 378</td>
<td>36</td>
<td>0.3553</td>
<td>1.116</td>
<td>32.3</td>
<td>0.991</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>71 904</td>
<td>21 529</td>
<td>30</td>
<td>0.2994</td>
<td>27 469</td>
<td>38</td>
<td>0.3820</td>
<td>1.075</td>
<td>31.9</td>
<td>0.988</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>73 690</td>
<td>22 370</td>
<td>30</td>
<td>0.3036</td>
<td>28 977</td>
<td>39</td>
<td>0.3932</td>
<td>1.029</td>
<td>31.2</td>
<td>0.978</td>
<td></td>
</tr>
</tbody>
</table>

*Source:* *The calculations have been done by the author on the basis of data from the NSI and the Reports on the statements on the implementation of the state budget of the Republic of Bulgaria in the period 2003 – 2013.*

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4. Data from the Schneider research has been used, where the size of the informal sector has been assessed on the basis of the MIMIC model.

5. GNP according to comparable 2010 prices.
The graphs on figure 2 are based on the data in the table. Although the information covers a short period of time, it can be clearly seen from the graphs that there is a dependency which requires further research.

Source: The author.

Figure 2. Growth rates (coefficients) of the informal sector parallel to the tax revenues and the total budget revenues for the period 2004 – 2013

A single factor regression analysis is applied using Excel, whereby the relationship between the dynamics of tax revenues and the size of the informal sector is examined first, and subsequently the dynamics between the informal sector and the general budget revenues is monitored. Some additional calculations have been made for the purposes of the analysis (see Table 2). Since the order is too short, the model does not claim complete accuracy and precision, given the nature of the gray economy phenomenon and the fact that the results concerning the size of the informal
sector are based on a different study\(^6\) (Schneider, 2015). Two hypotheses are considered: zero hypothesis, whereby the variation in the tax revenue is not caused by the dynamics of the informal sector and the regression model is not adequate; and alternative hypothesis, according to which the variation in tax revenues is caused by the dynamics of the informal sector and the model is adequate at a level of significance \(\alpha = 0.05\). Data from this model is shown in Figure 3.

Source: The author.

Fig. 3. Results from the single-factor regression analysis

It follows from the obtained results that there is a considerable dependency between the researched parameters (R Square = 0.596991786). The model is adequate (Significance F = 0.008791543 < \(\alpha = 0.05\)), that is the zero hypothesis is rejected and the alternative hypothesis is adopted, according to which the variation in the tax revenues is caused by the dynamics of the informal sector and the studied parameter is significant (P – value = 0.00322464 < \(\alpha = 0.05\)). There is a reverse dependency (X-Variable = - 5.136301636) between the informal sector and the tax revenues. This means that if the informal sector growth rate increases by 1%, the tax revenue growth rate will decrease by 51%. Results show that 77% (Multiple R = 0.772652435) of the change in tax revenue results from the dynamics of the informal sector, while the remaining 23% are caused by other factors, which are not accounted for in this study.

Figure 4 shows the results of the single-factor regression analysis of the growth rates of the informal sector and the total budget revenues. Here again two hypotheses are considered: zero hypothesis, whereby the variation in the total income is not

\(^6\) Data from the Schneider research has been used, whereby the size of the informal sector is evaluated on the basis of the MIMIC model.
caused by the dynamics of the informal sector and the regression model is not adequate, and alternative hypothesis, according to which the variation in tax revenues is caused by the dynamics of the informal sector and the model is adequate at a significance level of $\alpha = 0,05$. This analysis is dictated by the relationship observed in Fig. 2.

**Source:** The author.

**Fig. 4. Results of the single-factor regression analysis**

It can be concluded as a result of this research that there is a considerable dependency between the researched parameters ( $R$ Square $= 0,698758813$). The model is adequate ($Significance\ F = 0,002588477 < \alpha = 0,05$), that is the zero hypothesis is rejected and the alternative hypothesis is adopted, according to which the variation in the total revenue results from the dynamics of the informal sector and the researched parameter is significant ($P – value = 0,000846736 < \alpha = 0,05$). A reverse dependency has been observed ($X$ Variable $= - 5,21980775$) between the informal sector and the total revenue. This means that provided the informal sector growth rate increases by 1%, the total income growth rate will decrease by 52%. Results show that about 84% (Multiple $R = 0,835917946$) of the variation of total income results from the informal sector dynamics, while the remaining 16% result from other factors that are not accounted for in this study.

A question that arises logically is whether we could expect the business to be legalized to a greater extent with the stabilization of the economy. This could as well happen, however, it does not mean that the informal sector would immediately disappear with the end of the economic downturn (Democracy Research Center, 2011). The informal sector would rather continue to exist, although on a smaller scale. It would take purposeful actions aimed at the specific shadow practices and this would
be the best approach (e.g. decreasing the number of procedures, the unnecessarily long deadlines for their implementation, the registration costs and the imposition of requirements that do not follow any market logic; alleviating the social security burden, the non-transparent procedures for permits and licenses renewal, especially in the field of construction and public work, etc.).

Another goal-oriented approach is raising the citizens’ awareness of the damages they suffer. This is exactly how the big change in society can be unleashed: when people start believing that the grey practices that they believed for many years were “the necessary evil you cannot do without” can actually be reduced and their reduction would benefit the whole society and every one of us (Association of the Industrial Capital in Bulgaria, page 15).

The government’s degree of involvement is also very important. Schneider has expressed the strongest views in this respect, stating that if a government aims to decrease the size of the informal sector, it should first and foremost analyse the complex relationship between the official economy and the shadow economy and, what is more important, evaluate the impact of its own policy on the existence of grey practices (Schneider, 2005).

**Conclusion**

The proper understanding of the dynamics of the informal sector is of great importance for the improvement of the public and private sector management. Its negative effects are many-sided and therefore it is important that they are identified and restricted. The large scale of the grey economy in Bulgaria undermines the economic development of the country and requires serious political attention.

The tax system’s potential for achieving economic growth remains not fully utilized. The changes in the said system should be considered very carefully and they should have public support. Raising taxes motivates both the employee and the employer to operate in the shadow economy by avoiding taxes and social security payments.

Tax fraud and tax evasion concern the society as a whole. There hardly exists a country that is not ‘suffering’ from the informal sector, which impacts the size of its tax revenue. There are a number of preventive practices in this respect that could influence positively the state budget revenues. On the one hand, it is necessary to seek greater responsibility from businesses, in combination with considerable sanctions for infringers. This is the way to make tax payers feel satisfied and not taken advantage of. On the other hand, businesses and individuals should be facilitated in their willingness to pay their dues. In order to achieve this, it is necessary to ensure cooperation and coordination in the administration, to fight corruption and to build greater trust in the state.
Obviously, the informal economy is a complex socio-economic phenomenon permeating all economic sectors and areas. It can only be reduced through sensible, well thought out, coherent and sustainable, long-term actions engaging the good will and the conscious efforts of the whole Bulgarian society.

What is needed is an atmosphere of partnership between the public and private sectors. By implementing and complying with clear rules and alleviating the burdensome administrative procedures, our country will become a more attractive place for foreign investors. There will also be fewer incentives for tax evasion by individuals and companies. This is the only way to create an environment in which everyone is responsible and fulfills their obligations, which will improve tax collection and will increase revenues in the state budget.

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THE INFORMAL SECTOR’S IMPACT ON THE BUDGET REVENUES

Assist. Prof. Vanya Encheva

Abstract

The shadow economy reduces budget revenues, which - against the background of the crisis deficit - additionally harms the fiscal equilibrium. In addition - also against the background of the crisis - the shadow economy increases the costs of the honest business entities, forcing them to compensate for the actions of the dishonest ones. On that basis it is necessary to conduct regular analysis of its effect - both on the public sector, and on business. In view of the limited volume of the present article, the latter will focus on the analysis of the shadow economy phenomenon and the effect on the revenue portion of the budget.

Keywords: shadow economy, state budget, budget revenue, GDP.
MARKETING EFFECTS RELATED TO SOCIALLY RESPONSIBLE BRANDING

Doctoral student Maria Georgieva

Introduction

Nowadays many business and social organizations are increasingly trying to adopt policies for social responsibility towards a sustainable future\(^1\). The 21\(^{\text{st}}\) century has been witnessing a new stage in the marketing theory and practice defined by Philip Kotler as Marketing 3.0 in the context of which more and more emphasis is placed upon values. What is now seen as a major factor determining consumer choice and desire for purchase is not the product’s rational qualities and the emotional and psychological aspects of the brand or brand image but rather the message that is projected in the consumer’s mind. In answer to this growing trend, the significance of socially responsible branding (SRB) is also taking off. In addition, more and more brands are being positioned as clean, green and socially responsible (Clegg, 2007). Owing to a shift in the paradigm of traditional marketing, these brands are indicative of the aspirations of present day society for social, economic and environmental justice and in the words of some experts such brands can be further defined as the brands of the future (Nieto, 2009). This accounts for the increased interest in these brands and their marketing effects.

Increased scientific research in this area shows that socially responsible branding (SRB) has a considerable influence upon customer loyalty. The latter stands out as an important strategic factor determining the success of business organizations. Prioritization of loyalty in the context of modern marketing is driven by the process of re-conceptualization of marketing activities, which modifies transactions into relationships if favoured by marketing conditions. (Sheth & Parvatiyar, 1995).

The purpose of the present paper is to offer a systematic view on the multifaceted nature of SRB and its marketing effects by outlining three main directions of SRB and its influence on customer loyalty i.e. direct/indirect impact on brand value; level of customer satisfaction and its impact upon corporate reputation and image of the company/brand.

\(^1\) Sustainable development creates opportunities for satisfying the demand of today’s generation without encroaching the demand of future generations (World Commission on Environment and Development).
The concept of socially responsible branding (SRB)

Specialized marketing literature fails to offer a coherent definition of the term socially responsible branding (SRB) (Vallaster & Lindgreen & Maon, 2012). Some authors (Stanimirov, Zhechev, 2013, p.182) define it as a type of branding; others argue that certain ethical brands have emerged in the process of SRB which ‘increase social welfare rather than affect it in a negative way.’ (Fan, 2005).

The phraseological and semantic analysis of the term shows that SRB can be seen as a process of brand building and management adhering to the principles of corporate social responsibility (CSR); it is a form of integrating brands with the concept of CSR. In other words, in the context of SRB, brand creation and maintenance serves social needs for economic, social and environmental sustainability. To this aim, brands are aligned with some of the six types of corporate social initiatives, identified by Kotler and Lee: 1) cause promotions; 2) cause-related marketing; 3) corporate social marketing; 4) corporate philanthropy; 5) voluntary activities of society; 6) socially responsible business practices (Kotler, Lee, 2011).

Brands created and managed with the assumption of social responsibility integrate the concept of sustainability in their vision and strive to successfully implement it. Consequently, not only do they identify the product and its characteristics but they become communicators of an organization’s values and act as ambassadors of socially-significant causes which business organizations stand by alongside their corporate interests. These brands can be described as socially responsible i.e. brands of a new generation which Kotler named social cause brands (Kotler, Kartajaya and Setiawan, 2010, p.34).

Socially responsible brands are at the heart of a new marketing direction - that of brand citizenship (Thompson, 2013). The latter can be discussed as part of corporate citizenship (Vesselinova, 2005) as a form of commitment to social norms and values, nature, state, society and social issues in the process of brand creation and management.

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2 CSR concept and its effects have been studied by a number of specialists working in the area of marketing and management. However, the link between CSR and branding is still seen as an insufficiently examined topic which to some extent explains why a scientific definition of SRB is still unavailable.

3 The authors argue that one of the branding types is the so-called cause branding which links the brand with a social cause and/or CSR.

4 People aspire to responsible brands which take into account consumers needs and make the world a better place to live in. These are the so-called ‘socially engaged brands’.

5 Corporate citizenship represents a system of values, aimed at harmonizing business and social interests and preservation of eco-systems. This implies that the company takes an active part not only in the market but in the social area too.
The latest shift in the paradigm of traditional marketing demonstrates that brand citizenship has largely increased in popularity. This trend has been marked by the emergence of a new consumer segment being identified as sophisticated \(^6\) by the modern marketing theory and practice.

Sophisticated consumers cut a new category of clients\(^7\); they are not only seeking functional and emotional satisfaction from the purchase of a product or service but also contentment of the human spirit. (Kotler, Kartajaya and Setiawan, 2010). Sophisticated customers are buying brands which match their personality, beliefs and values; brands they identify with and the purchase of which is seen as a form of self-expression (Xiaoli & Kwangjun, 2007; Palazzo & Basu, 2007).\(^8\)

In this vein, brand citizenship is an effective method in meeting the expectations of the sophisticated customers segment and more importantly, winning their trust and loyalty on a long-term basis. Indeed, building and maintaining customer loyalty is associated with the most prominent marketing effects in terms of socially responsible branding (SRB).

**SRB and associated marketing effects**

Marketing effects associated with SRB are illustrated in fig. 1\(^9\):

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\(^6\) In western literature this consumer segment is called ‘sophisticated’. The absence of a direct and accurate translation of the borrowing ‘sophisticated’ in Bulgarian gives us reasons to use a synonymous expression. In this context ‘sophisticated’ clients are identified as ‘refined’.

\(^7\) Putting the sign ‘equal’ between ‘user’ and ‘client’ in the text is done solely for the purpose of avoiding repetition.

\(^8\) This trend is identical to the situation of ‘product symbolism’ in which customers perceive the purchase and use of certain products and services as a form of self-expression.

\(^9\) The above figure is created by the author. It is designed on the basis of extensive research and selection of specialized sources providing a theoretical and empirical basis for the relationships being illustrated in the figure.
Fig. 1. Marketing effects associated with SRB

Relatedness is of key importance in tracking the interrelations and interactions between individual elements of the diagram and linkage between SRB and brand value. Studies in the area of marketing prove that applying CSR to SRB enhances brand value directly or indirectly, having a beneficial effect upon formation of brand associations, projecting a positive brand image and brand identity.

High brand value is of great importance for the successful market performance of business organizations; it has a series of positive effects, one of the most important being related to building and sustaining customer loyalty.

Apart from its impact on brand value, SRB has a direct influence on the following constructs: customer satisfaction and corporate reputation. The latter is of great significance for the performance of the organization and brand perception in particular. Customer loyalty is driven by good brand performance and level of customer satisfaction.

The complex combination of logically sound and empirically validated relationships and interactions gives us grounds to conclude that by exerting influence in three main directions, i.e. brand value, corporate reputation and degree of customer satisfaction, SRB has a bearing on customer loyalty which is one of the most significant marketing effects of SRB application.
Directions of SRB influence on the degree of customer loyalty

The impact of SRB on customer loyalty can be discussed in the following three directions:

**First direction: through direct or indirect influence on brand value:**

- Many scientific studies prove that using SRB has a direct effect on brand value and adds more value to it. (Lai & Chiu & Yang & Pai, 2010; Melo & Galan, 2011).

- SRB creates strong, favourable and unique brand associations which in turn have a positive impact on brand image (Raman & Lim & Nair, 2012; Keller, 1993). An appealing brand image, formed as a result of SRB leads to increased brand value (Hsu, 2012; Berry, 2000).

- It is worth noting that associations too have an immediate effect upon creation of brand value (Crimmins, 1992). Folkenberg believes that building favourable brand associations and inspiring positive feelings among target groups of consumers increases brand value (Folkenberg, 1996). Associations can help increase brand value in the following aspects: Firstly, they create the basis for product differentiation (i.e. association driven differentiation is necessary to build competitive advantage but at the same time it may act as a deterrent to switch customer loyalty to other brands). Secondly, associations are behind purchase motivation (it is often the case when certain product attributes or consumer benefits determine the purchasing decision). Thirdly, associations help clients to recall, process, interpret and memorize important information about a particular brand. Last but not least, associations create positive brand perceptions (this helps refute arguments against brand purchase and guarantees maintaining positive feelings during consumption of product/services) (Stanimirov, Zhechev, 2013, p.120-121; Brestnichka, 2004, p. 111-113).

- SRB has a direct impact upon brand identity and helps augment its attractiveness (Lundmark & Elsalhy, 2009). The more attractive the brand, the fatter the chances to create a better brand image which in turn leads to a higher brand value.

Arguably, the joint manifestation of the herein discussed constructs and their interrelatedness contributes to a higher brand value. High brand value is targeted and valued by companies for the various positive effects it exerts:

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10 The terms ‘market value’, ‘added brand value’, ‘brand value’ are identical and interchangeable. However, the ‘brand capital’ differs in meaning – this is the net value of future cash flows, generated by companies brands, a kind of excess of value, which non-branded goods have for customers.
- There is a positive relation between brand value and brand market share (Agarwal & Rao, 1996). Higher brand value results in a larger market share which translates into a larger market share for the company maintaining the brand.

- There is a positive relationship between brand value and consumer perceptions on brand quality (Dodds & Monroe & Greal, 1991). Based on the provisions of index models for measuring consumer satisfaction (Swedish, American and European) we can conclude that perceived quality is a construct which has a direct influence upon the level of consumer satisfaction and an indirect effect upon customer loyalty. On principle, higher quality perception results in higher customer satisfaction and loyalty.

- There is a positive relationship between brand value and customer evaluation of brand extensions (Aaker & Keller, 1990).

- There is a positive relationship between brand value and price insensitivity of consumers (Erdem & Swait & Louviere, 2002).

- There is a positive relationship between brand value and brand endurance under crisis (Dawar & Pilluta, 2000). This predefines a comparatively more stable market position of the companies owning the brands.

- There is a positive relationship between brand value on the one hand and consumer preferences and desire to purchase the brand, on the other (Cobb-Walgren & Ruble & Donthu, 1995). Kotler and Lee, citing the results of a survey on CSR conducted on 25 000 respondents in 23 countries argue that 17% of them avoid buying brands and company products which they consider not socially responsible (Kotler, Lee, 2011, p.14).

- There is a positive relationship between brand value and degree of customer loyalty (Stanimirov, Zhechev, 2013, p.36). When customers have a high perception of brand value, the chance for a repeat purchase increases (Kotler, Armstrong, 2008). It is economically justified and reasonable to argue the opposite: the more loyal customers a brand has, the higher its value.

**Second direction: influencing the level of consumer satisfaction**

Specialized marketing literature provides evidence of different approaches used by socially responsible branding (SRB) to influence customer satisfaction (Luo & Bhattacharya, 2006). According to one of the most common approaches, SRB helps create high levels of customer identification with the company 11 (Raman & Lim &

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11 *Customer identification with a company* is defined as the degree to which consumers perceive company values and goals as their own; and to what extent they are willing to identify themselves with the business organization and its goals/operations.
Nair, 2012), which allows to meet customer needs and desires more fully, and increases customer satisfaction in return (Bhattacharya & Sen, 2003), including customer perception of the brand value (Keller, 1993).

In other words, the segment of ‘sophisticated’ customers will exhibit more satisfied customers, the more socially responsible the company becomes in its actions from the point of view of its brand building and management. In this case, customers tend to identify with the company and the brands it offers on the market, as by meeting their expectations SRB provides customers with the opportunity for self-expression (Hsu, 2012).

The resultant high level of consumer satisfaction exerts a favourable influence on the level of consumer loyalty. An argument in support of this claim is the fact that customer satisfaction is seen as a ‘key factor in building customer loyalty’. (Georgieva, Tonkova and Stanimirov, 2008, p. 173). Kotler argues that ‘one key to customer retention is customer satisfaction’ (Kotler, 2000, p.10). The likelihood of a customer repurchasing a company product/brand is largely determined by the level of their satisfaction arising from their first experience with that particular product or brand. Mladenova further argues that a satisfied consumer will continue buying company products and share his or her positive experience with other consumers; being less distracted by competitive offers and focusing on new products launched by the company on the market (Mladenova, 2000, p.173).

The opposite argument also holds true – the higher the level of customer loyalty, the greater the customer satisfaction. Nonetheless, identification with a delighted and loyal customer is not always reasonable. Zhelev points to situations when some unsatisfied company clients continue being loyal to it, either because they have no other alternative offers or because other suppliers can offer nothing better. The opposite situation is also true i.e. when highly satisfied clients of a given company switch their loyalty to other suppliers expecting better offers and more purchase benefits (Zhelev, 2000, p. 84).

Customer satisfaction is not only linked with consumer loyalty but has a direct positive influence on corporate reputation (Bontis & Booker & Serenko, 2007), (Jones, 2005) which plays a crucial role in company/brand promotion.

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12 The more satisfied customers are with the range of a company’s product and services, the better the perceptions of a particular business organization.

13 Jones focuses on the opposite direction of the impact ‘corporate reputation’ → customer satisfaction → brand value”. The author notes that satisfaction generates brand value only if the expectations of all stakeholders are met. Jones argues that all stakeholders have expectations for good corporate reputation. Good corporate reputation results in satisfied customers which in turn adds value to the brand.
**Third direction: influencing company reputation and company/brand promotion:**

Applying corporate social responsibility (CSR) to branding can be viewed as a form of strategic investment which aims to build and sustain corporate reputation (McWilliams & Siegel & Wright, 2006). Scientific research in the area of marketing confirms the positive influence which CSR has on corporate reputation (Garberg & Fombrun, 2006).

Building a favourable corporate reputation is one of the key factors in creating an organization’s competitive edge and sustained superior financial performance (Sanchez & Sotorrio, 2007) towards a more effective brand performance on the market. If the company has an established reputation, it holds a promise and becomes a guarantee for the quality of the company’s products and services; it also becomes a magnet for better educated and more qualified workers as it requires more confident and self-assured employees (Roberts & Dowling, 2002). Barnett emphasizes the positive influence which corporate reputation has upon company/brand financial performance. (Barnett, 2008). In terms of costs, good reputation builds trust between the organization and its stakeholders which in turn reduces the share of transactional costs and risk involved in financial and market operations. From the point of view of earnings, good corporate reputation creates a favourable investment climate and opportunities for price reductions and discounts to attract new clients and keep loyal customers.

As a result of the positive influence of SRB on corporate reputation, different companies/brands are better positioned on the market which can be partly due to the availability of loyal customers.

**Conclusion**

Although relatively new in the marketing theory and practice, socially responsible branding (SRB) is taking off in popularity and areas of application. This can be attributed to the positive marketing effects of SRB in general and to its positive influence upon the level of customer loyalty in particular.

Having in mind the fact that customer loyalty is manifested through repurchases and inclination for personal recommendations and supplier feedback, we can point out that by influencing customer loyalty in the three outlined directions, SRB is able to directly or indirectly influence company financial outcomes and its successful market performance.

It is worth mentioning that the herein discussed marketing effects associated with the use of SRB have a potential character. The adopted systematization of SRB marketing effects can be used as the basis for analysis of the real/actual dimensions of said marketing effects upon a specific industry sector.
References


MARKETING EFFECTS RELATED TO SOCIALLY RESPONSIBLE BRANDING

Doctoral student Maria Georgieva

Abstract

"Socially responsible branding" (SRB) is a category that is new for modern marketing, which is gaining ever greater popularity. Among the main reasons for that there can be mentioned the considerable number of positive marketing effects, which the application of SRB carries. Maintaining high levels of consumer loyalty is one of these effects. By exerting influence in three main areas - on the value of the brand, on the corporate reputation and the level of consumer satisfaction, SRB also influences the loyalty of consumers, and the latter is in turn a factor of strategic importance for the successful market realization of each company.

Keywords: corporate social responsibility (CSR); branding; socially responsible branding (SRB); loyalty; brand value.
OPPORTUNITIES FOR IMPLEMENTING THE INFLATION-INDEXED DEBT IN THE PRACTICE OF THE REPUBLIC OF BULGARIA

Vladimir Chernaliev, PhD student

The market for inflation indexed government securities has been growing rapidly for the last decades. The main catalyst for this is the greater creditors’ security and their guaranteed safety of depreciating the investor’s capital caused by inflation processes. From the sovereign’s point-of-view the inflation indexed government debt is able to help the rise and retention of investor’s trust and at the same time provide protection against excessive growth of the debt burden.

The purpose of the present research is to define the potential for issuing of inflation indexed government debt, as well as the related benefits and risks for the sovereign. In this respect the research makes a review of best practices in issuing the inflation indexed government securities. The research logic requires assessing the benefits and risks for the Bulgarian state and its creditors in the conditions of issuing this type of debt.

The concept „inflation indexed government debt“ can be defined as: government securities, the payments on which are linked to a precisely defined price index – the most common being the consumer price index (CPI)1. The interaction between the government securities yield and the national inflation provides the creditors and the sovereign with protection from unexpected changes in the interest rates, as a consequence of the price levels dynamics (W. Krämer, 2013).

It should be pointed out here that the risks and benefits generated by issuing inflation indexed instruments are not limited exclusively by the correctness and expectations of estimates related to the national currency (inflation, deflation, devaluation). Another essential point is the ability of the national economy to generate budget surpluses (A. Missale, and E. Bacchicocchi, 2005). As a continuation of the hypothesis, one can postulate that the fund accumulation in the treasury will help reimbursement of debt instruments, if the inflation indexation is commensurate with the sovereign macroeconomic peculiarities. Hence, the engagement of additional variables which will help the assessment of the issuers’ ability to pay off their debts in a future period is entirely logical and recommendable.

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1 Each country chooses the indicator to which its government debt is indexed. In the USA the government securities are linked to the Consumer prices index, in Great Britain – the Retail prices index, in France – the Consumer price index, from which all tobacco products are excluded.
The economy potential to generate capital to repay government liabilities cannot be expressed explicitly by rise or fall of industrial production or be related solely to the employment dynamics. In order to further clarify the analysis it is more appropriate to use the real growth rate of the country’s GDP because the industrial production and employment are not the only factors which define the amount of budget proceeds. In support of this statement it can be pointed out that production in the services sector can also be a factor which accumulates means. Following this logic the basic parameters of inflation indexed government debt can be drawn out:

- Government securities yield (nominal interest rate);
- National inflation;
- GDP growth rate.

The advantages of inflation indexed government securities for the economic agents are related to the basic characteristics which this type of debt possesses:

- Protecting the investment capital from depreciation;
- Maintaining price stability;
- Cost cutting in servicing the debt.

The indexed government debt guarantees return on investment capital and the nominal interest rate is added to the accumulated inflation for the debt settlement period. This means that the state is liable to pay the negotiated interest on the borrowed funds and add the inflation rate irrespective of its amount. Hence, the investor’s capital is not devalued and receives its negotiated profitability. The researchers of these issues (M. Kumar, W. Jaejoon, 2010; S.Wijnbergen, and A. France, 2012; G. Rossini, and P. Zanghieri, 2009) widely accept the assumption that by aligning the debt with the national inflation minimizes the government incentives to devalue its currency. This hypothesis is valid because at debt indexing, an inflation induced process will increase the sum total of payments on the government debt. Further to this logic, J. García, and A. van Rixtel (2007) pointed out that issuing inflation linked government securities serves as an instrument for stimulation of price stability. Empirically, such a perspective is welcome by the institutional investors such as pension funds, because they can provide the amount of cover of their long-term liabilities which are sensitive to inflation.

The inflation indexed securities are an essential instrument of the sovereign debt management. They may serve as a tool for restoring and retaining the investors’ trust which is particularly important in defining the future debt expenditure. If there is a lack of trust and/or the creditors expect inflation on the national market, this may cause the requirement for greater risk premium for the government securities or higher than expected interest rate on the primary market. At the inflation indexed debt, the risk for significant growth of the risk premium is minimized. Therefore, the indexed securities may reduce the expected expenditures at debt servicing.
The elaborated above benefits for the creditors and the sovereign from issuing and buying the government debt linked to inflation allow the summary of the most important advantages for the economic agents:

1. **Investors**: the return of investors’ capital is guaranteed whereas its depreciation is minimal. The latter is valid for every economic situation different from sovereign default.

2. **State**: by the help of inflation indexed government securities the government incentives for reducing the debt burden are limited by resorting to inflation, and on that basis the investors’ interest is retained and enhanced. The creditors’ trust in the issuer reduces the debt servicing expenditure which is due to the lower nominal interest rate of indexed government securities.

The government debt which is linked to the national inflation possesses essential advantages, as it was stated above, but it also implies risks for the issuing body and its creditors. The most important risks for the economic agents consist in:

- Opportunities for deflation;
- Interest rate fluctuations;
- A small growth rate of GDP;

*The deflation processes* in the sovereign economy reduce the expected return on invested capital. The prospects for similar processes could provoke the future holders of such financial instruments to request higher interest on the sovereign securities (*reverse conversion*).

*The interest rates fluctuations* being the result of the implemented by the state fiscal and monetary policy could cause extremely high costs for the sovereign. The implementation of restrictive fiscal policy is undoubtedly related to increasing the interest rates. Hence, if the state is trying to accumulate enough funds for its debt repayment by taxation, this may lead to increased interest rates and reduced inflation. Following the above logic, it should be noted that the investors would require compensation for their capital depreciation which might force the state to default on its debt engagements.

The potential risk for the sovereign and its creditors is also related to implementing a *lower than expected real growth rate of GDP*, which will lead to fewer than planned accumulated funds. In such economic situation the sovereign can resort to default and the investors may not obtain the estimated yield on their capital.

The main disadvantages of the inflation indexed government debt for the creditors and the sovereign are:

1. **Investors**: From the positions of the economic practice the creditors are impossible to be protected from government default. Hence, the precision of estimates of the basic macroeconomic variables on which the funds accumula-
tion and the issuers ability to make a future payment of interest and principal on inflation indexed debt depend is the main risk for the investors.

2. **State**: The achievement of lower than expected growth rate of GDP is the main risk for the sovereign. The interest payments and/or the debt reimbursement may be exorbitant for the state budget if the sufficient capital was not accumulated. The issuing of inflation indexed securities requires an accurate assessment of market risks, the investors’ expectations and the macroeconomic environment. These factors to a great extent determine the future debt expenditures.

There are many cases in the economic history which illustrate the benefits and risks caused by the inflation indexed debt. If the share of these securities is not aligned with the economic peculiarities of the issuing country, the sovereign default is almost unavoidable. One of the most conspicuous examples for a risky and badly planned inflation indexation of government debt was performed during the Mexican crisis from 1994-1995 (D. Lederman and et al, 2005) In this period part of the government securities, denominated in USD are indexed to the national inflation, whereas the Mexican currency is unexpectedly devalued.

The countries which use inflation indexed securities can be integrated into three main groups (J. García, and A. van Rixtel, 2007):

- States which by inflation indexation try to get command of their national inflation: Chile in 1956, Brazil in 1964, Columbia in 1967 and Argentina in 1973.
- States which by issuing inflation indexed debt try to increase investors’ trust in them and declare the state’s attempt to reduce the expected national inflation: Great Britain in 1981, Australia in 1985, Sweden in 1994, and New Zealand in 1995.
- States, using the inflation indexation of government securities as a protection from the instances of long-term inflation, which would influence the welfare of population (in most cases the problem is analysed in the context of the pension scheme): Canada in 1991, the USA in 1997 and France in 1998.
The practices of managing the inflation – linked sovereign securities in countries such as USA, Great Britain, France and Germany (Figure 1) which are the issuers of the largest share of indexed government securities are particularly interesting. These states exemplify the model for overcoming disadvantages and tapping into the maximum potential of inflation-linked government debt. A key moment in achieving this result is the precise assessment and estimate for the macroeconomic situation, investors trust and market expectations.

The logic behind the present analysis requires the outline of some of the main benefits and risks for the Republic of Bulgaria and its creditors ensuing from the use of inflation indexed securities.
In economic practice it was found out that the inflation indexed securities are most often long-term with maturity up to 10 years (Figure 2).

To render the analysis of the possible issue of indexed securities by the Republic of Bulgaria more precise, in the specificity of its economic situation it is appropriate to use some of the statistics approaches. Accordingly, A. Missale and E. Bacchiocchi develop “signaling” indicators which can be used by economic agents in transactions with inflation indexed securities.

The main indicator for assessing the benefits and risks which are posed in the particular macroeconomic environment is the covariance between the real growth of GDP and inflation measured by CPI. In other words, what is assessed is the interconnection between the economic capacity to generate budget surpluses and expenses (the inflation), respectively the profitability, on inflation indexed government debt. Weighing up the advantages and disadvantages for the creditors and the sovereign is the result of covariance between the two macroeconomic variables:

2 In literature several factors defining the successful issuing of indexed government securities which are a compilation of variables are studied. Examples for such variables are: the index-factor, nominal coupon, repurchase price, accumulated interest for the period, settlement price, etc. The covariance between the GDP real growth and inflation measured by HICP is one of the few indicators discussed in literature which evaluates the ability of national economy to accumulate funds for the indexed debt interest payments settlement.
From the point of view of theory and practice, the covariance can be a positive number, a negative one or a zero, and the impact of benefits and risks is evaluated in respect of the size of the covariance.

At positive values of the covariance between real growth of GDP and inflation measured by CPI, it is assumed that smaller interest payments would be made on the inflation indexed government debt. Therefore, indexation plays a protective role against the manifestations of unexpected inflation in the national economy, which under equal conditions protects the issuer from significant increase of debt burden. In this respect, „the high real economic growth reduces externally the sovereign debt burden“ (Minasian, G., 2007). It should be pointed out that at positive covariance the economy would be in position to generate budget surpluses which would facilitate the interest and principal payments of the debt.

The negative values of the covariance are interpreted as superiority of the risks of issuing such a debt over the advantages which the economic agents would take. A result below zero would mean that the economy is not in a position to generate surpluses. Therefore, the increase of debt burden caused by inflation processes may force the sovereign to default on debt engagements. At similar values of covariance the issuing and purchase of inflation indexed government securities is unjustified.

A. Missale and E. Bacchciocchi (2005) examine the possibility for benefits manifestation for the economic agents at covariance zero value. According to the authors it is entirely possible that the inflation indexation should provide a protection against unexpected inflation at Covar (R. GDP, PCI inflation) = 0. In support of this statement, it has to be pointed out, that the indexation against CPI, could protect from excessive growth of the ratio Debt/GDP at realization of lower than expected GDP growth.

The logical continuation of the present research is to apply the approach of A. Missale and E. Bacchciocchi for the Bulgarian economy. The period covered is eight years long. The choice of such a time frame is preconditioned by:

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1. A. Missale and E. Bacchciocchi carry out a number of empirical studies for countries such as Belgium, Denmark, France, Germany, Ireland, Italy, Japan, Spain, Sweden, Great Britain, and the USA. The findings of the study let the authors define the limits of covariance between the real GDP and the inflation, measured by CPI. From statistical point-of-view Covar (R. GDP, PCI inflation) adopts the limits [-1;1], by which the correlation between variables is indicated. The beneficial covariance limits are (-0.3;0.3), which can be interpreted as a weak connection between economic growth and inflation. In other words, the economic growth will not be a consequence of inflation processes in the national economy.

2. This statement is true for issuing inflation indexed debt in currencies which are different from the national one. It should be pointed out, that a change in the exchange rate caused by depreciation of sovereign paying unit will increase the debt burden.
1. For the purpose of the research two symmetrical time frames are used which facilitates the data analysis.
2. Calculations and analysis for the period 2011-2014 are made which can be called “the basis” or “prerequisite” in the present research.
3. Calculations and analysis for the period 2015-2018 are made which are based on the official estimates for the macroeconomic indicators for our country.

**Table 1**

Real growth of GDP and inflation measured by HICP in the Republic of Bulgaria

<table>
<thead>
<tr>
<th>Year</th>
<th>Real growth of GDP %</th>
<th>Inflation measured by HICP %</th>
<th>Covar (R.GDP, PCI)</th>
<th>Var(PCI)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>2.00</td>
<td>4.20</td>
<td>0.000004125</td>
<td>0.0006276</td>
</tr>
<tr>
<td>2012</td>
<td>0.50</td>
<td>2.40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>1.10</td>
<td>0.40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>1.70</td>
<td>-1.60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2015*</td>
<td>1.40</td>
<td>-0.60</td>
<td>0.0000307</td>
<td>0.0001569</td>
</tr>
<tr>
<td>2016*</td>
<td>1.70</td>
<td>1.80</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017*</td>
<td>2.30</td>
<td>1.90</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2018*</td>
<td>2.10</td>
<td>2.00</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** IF, own calculations

**Note:** *Macroeconomic estimate*[^5]

The available data and estimates (Table 1) for the macroeconomic indicators of our country can be summarized as follows:

1. During the period 2011-2014 the real GDP growth does not show a clear trend. What is particularly striking is the fact that the time frame is characterized with decreasing inflation, whereas in 2014 a deflation is registered. The covariance between real GDP growth and inflation has a positive digit and shows a slight relation between the variables.
2. During the period 2015-2018 a real GDP growth and a rising inflation is expected. It should be pointed out that in that time frame the covariance between the real growth of GDP and inflation has a positive digit and indicates a slight relation between the variables.

On the basis of the conclusions drawn some essential benefits and risks can be highlighted for the economic agents from the issue of inflation indexed government debt:

[^5]: For further details see. [http://www.minfin.bg/bg/page/866](http://www.minfin.bg/bg/page/866)
1. The time frame 2011-2014 is looked at in the present research as a period which is preceding the potential issue of indexed securities by the Bulgarian government. What is characteristic for this period is that it influences the activities of the sovereign and its creditors in a future period. The value of covariance and the variables related to it can be interpreted in the following way:

- On creditor’s behalf: insecurity concerning the return of capital. A lack of a strong tendency of GDP growth dynamics which question the ability of the national economy to accumulate the needed funds for interest payments on the government debt. Contrary to this logic, the positive covariance between the real GDP growth and inflation will be indicative for the creditors, in a future period, when they assess the risk for their investments. In other words, requests for higher nominal interest on the indexed debt will be unjustified.

- On the sovereign’s behalf: it can be pointed out that the GDP growth will be sufficient to offset the national inflation. There exists the threat that sufficient funds may not be accumulated for interest payments on the indexed debt which would be caused by lack of specific dynamics in GDP real growth. Following that logic the sovereign has to look for additional resources for reimbursing its debt. Therefore there is a risk for the correlation Debt/GDP to increase.

Therefore, it is concluded that the investor’s capital may not obtain the contractual profitability which will be due to the issuer’s difficulties to accumulate funds for it. It should be pointed out that the possibility for sovereign default cannot be excluded, but, having in mind the low value of covariance for that period, it will only be partial. Notwithstanding the above mentioned, the covered period (2011-2014) is characterized with a positive covariance between GDP growth and inflation. In this context, a value above zero (within the limits (0; 0.3) will have a beneficial impact on the decisions of the economic agents during the next time frame. Having in mind the above mentioned, it would appear logical to expect that the investor’s interest to the indexed government securities issued by the Bulgarian state would rise. The latter suggests lower nominal interest on these debt instruments, and, respectively, lower costs related to servicing the debt.

2. The time frame 2015-2018 is looked at in the contingencies of macroeconomic forecasts for the Bulgarian economy. The available data allows the following essential benefits and risks to be pointed out:

- On creditor’s behalf: the expected dynamics of GDP growth combined with rising inflation in the period will not result in unforeseen increase of interest payments, due to investor’s requests for capital guarantee. This conclusion is supported by the positive covariance between GDP growth and the inflation during the period.
- On sovereign’s behalf: the positive covariance justifies the government to issue inflation indexed government debt in the next four-year period. The recommendation is based on the hypothesis that the GDP growth and inflation in the period will be moving in limits close to the expected ones. In that case, the sovereign will not have difficulties in funds accumulation for settling the interest payments on the government indexed debt.

It is therefore concluded that the period 2015-2018 is appropriate for issuing inflation indexed government debt from the Republic of Bulgaria. This conclusion is based on the made analysis for the previous (2011-2014) and future (2015-2018) time frames. The tests made show that at achievement of only one percent of real GDP growth in each year (from a four-year forecast period) and inflation fluctuating around the expected one, the covariance equals zero. Therefore, if the achieved GDP growth is below the expected, the economy will possess the necessary potential to accumulate funds for the interest payments on indexed debt. At the same time, the indexation at that time frame will limit the inflation impact on the ratio Debt/GDP, i.e. a potential depreciation of the national currency will not pose an additional debt burden on the sovereign.

The research findings lead to the conclusion that during the time frame 2015-2018 the Bulgarian government can issue inflation indexed government debt, without leading to processes which facilitate the increase of ratio Debt/GDP as a result of inflation processes.

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OPPORTUNITIES FOR IMPLEMENTING THE INFLATION-INDEXED DEBT IN THE PRACTICE OF THE REPUBLIC OF BULGARIA

Doctoral student Vladimir Chernaliev

Abstract

The interest in the inflation indexed national debt has risen in the past few decades. This is due to a number of advantages which this type of debt instrument possesses as compared to conventional securities. The advantages and the risks accompanying the indexation of GSs for the economic agents are significant and depend on the accuracy of macroeconomic forecasts. The aim of this study is to determine the possibilities for using inflation indexed national debt in the practice of Republic of Bulgaria.

Keywords: national debt, indexation, GDP, inflation, covariance.
INSTITUTIONAL INFLUENCE ON THE LIQUIDITY OF THE BULGARIAN STOCK MARKET

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Introduction

Stock market liquidity is a resultant indicator of multiple factors which, broadly speaking, affect the security of investors. Security is in turn a multi-layer category and includes the protection of the rights of ownership, the predictability and attractiveness of the investment, the monetary and fiscal environment, the stability of the macroeconomic indicators. These conditions are secured by the institutional national macroframework, whereas their level is the result of the achieved efficiency of its work. A specific aspect of investment uncertainty is the protection of the rights of ownership. It is achieved through the administration of justice and supervisory institutions on the one hand, and upon a broader interpretation - also through the market infrastructure. Outside of the strict legal terminology the importance of the rights of ownership, as far as the investment behaviour of the entities is concerned, is manifested in the protection from expropriation due to opportunist behaviour or adverse selection, provided to them by the institutions. The latter ensure the protection of shareholders through the content of the legal standards, the regulations of the supervisory institutions and the rules of the market infrastructure (nominal protection) and through the extent to which the rules are applied to all (actual protection). In that sense, the institutional efficiency in the protection of the rights of ownership is manifested in the establishment of the rules and their application.

The study of institutional efficiency is topical due to the influence that the institutions have on the investment process as a whole and on the liquidity of the stock market in particular. Their day-to-day activities form the level of trust with the shareholders and the latter in turn react by rerouting funds towards or out of the national stock market.

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1 The term institutional efficiency is used in order to present the degree to which institutional measures and policies succeed in improving the investment environment in a broad context and the liquidity of the stock market in a narrow context. This is the success with which institutions create and set the rules, as well as the extent to which their actions are beneficial to market liquidity.
The object of the present study are the institutions involved in the formation and enforcement of the rules on the Bulgarian stock market and of the infrastructure needed for the investment process. The subject of the study is the work of these institutions, the degree to which they achieve the goals assigned to them to ensure investment security. The aim of the study is to determine the institutional weaknesses, which - according to market participants - predetermine the low market liquidity. The tasks of the study are to reveal the specific evaluations on the various aspects of the institutional effect, and the different effect on the liquidity of the stock market, respectively.

Because of the direct connection between stock market liquidity in Bulgaria, which is extremely low\(^2\), and the efficiency with which the institutions manage the investment process, there will be examined the following Hypothesis: The efficiency of the institutions ensuring the protection of investors on the Bulgarian stock market is low.

1. Efficiency of the institutions in protecting the rights of investors

The institutions of the legal and the regulatory system must guarantee the shareholders equality in the investment process, specifically, access to objective information about the assets, equal opportunities for the realization of profits and equal rights in the management of companies and the distribution of profits. In addition, the institutions of the market infrastructure must guarantee security and equality of the trading process, of the settlement and the preservation of the assets. High institutional efficiency guarantees the protection of shareholders, whereas low efficiency creates conditions for inequality and therefore risk of expropriation. It is precisely the protection of investors that is a factor for high market liquidity, which turns its provision into an important prerequisite for the functioning of the national stock market.

In the literature studying the quality of the investment environment in the national economy, the term "expropriation" is used with the meaning causing loss to the investors, taking away their opportunity to get the same profit from their investment as the majority shareholders, or the people governing the company. Opportunist behaviour is a term describing the actions of the majority shareholders or the people governing the company, with which they make deals with related parties to the detriment of minority shareholders, do not exercise due care in managing the company or take advantage of inside information (insider trading). The disadvantageous choice is due to information

\(^2\) The various liquidity indices of the Bulgarian stock market are 5 to 50 times lower than the average ones for the EU.
asymmetry - when the company - the object of investment - does not reveal important information about its activity and its prospects, shareholders cannot appreciate the real quality of the asset. As a result, they possess overvalued shares or do not possess the assets that will bring profits.

The level of investment uncertainty in the narrow aspect of the protection from expropriation depends on the rules in the investment process and the extent to which they are observed, respectively, is the result of institutional efficiency. The importance of institutions for the economic behaviour of economic agents in general, and for their investment behaviour in particular, is due to two of their major functions (Sedlarski, 2008). The first is connected with the rules of behaviour and the extent to which the agents follow them, and their efficiency in that sense directly determines the confidence, transparency and security of investors. The second function is connected with the transaction cost of the subjects in commercial contracts, in particular with the investments, which also directly affect the level of liquidity. The institutional matrix defines the set of the social and economic (including investment) opportunities for the members of society (North, 2005), whereas according to Knack and Keefer (1995) it is precisely the former that determines the quantity and the quality of investments. North's definition is shorter (1990) - the rules of the game in a society affect the economic results.

The quality of the legal system (rules of law and effective administration of justice) shapes the economic results due to the support which the legal system renders to market-based economic activities (Armour, Deakin, Sarkar, Siems, Singh, 2008), an important part of which is the stock market. Market liquidity is a direct consequence of the market foundation of the national financial system, since it reflects the investment traditions and the sources of external capital accepted by the investment community, in this case equity capital. La Porta, Lopez de Silanes, Shleifer and Vishny (1997) prove that external equity financing is determined by the differences in the legal standards and their application. The share of the capitalization of the stock market, held by minority shareholders and the number of initial public offerings correlates positively with the extent to which the law is respected, with the quality of the application of the law and the legal protection of minority shareholders. The opportunist behaviour of managers and controlling shareholders at the expense of investors is more limited when the legal protection of investors is substantial and the application of the laws is timely and cost-effective. The factor "rules of law and law enforcement" ultimately leads to a certain or uncertain investment environment, it either creates, or does not create, confidence in the market, hence it generally determines the market liquidity as a readiness to invest or neglect the equity market on the part of investors and issuers, foreign or national. Its action is fundamental and
multidimensional. The resultant indicator is the level of trust in the stock market, and is a major determinant of liquidity and uncertainty. A decline in confidence instigates a "freeze" of the markets.

A primary function of institutions is, broadly speaking, to reduce transaction costs (Williamson, 1985) (a consequence of combining the indeterminateness and complexity of the environment with the limited rationality of individuals), and on the stock market this is achieved through the standards of transparency and non-admission of opportunist behaviour. These goals of regulations are pursued through monitoring the supervision authorities by means of the processes of licensing and permits regimes, whereas in the case of ascertained breaches - through public regulatory prosecution. According to Prentice (2006) the regulating institutions on the stock market aim to achieve efficiency of the markets that is higher than the efficiency without government intervention. There has been adopted the view that the alternatives (private contracts, self-regulation, competition between the regulators, restrictions due to reputation, private prosecution) are obviously insufficient due to the extremely high "profit" from opportunist behaviour.

The rules connected with the trade in shares are generally set in the laws on securities, public companies and the markets for financial instruments, as well as in the secondary legislative base, whereas the detailed requirements are set out in the exchange market rules for listing and trade, as well as in the rules of procedure of the depositary institution. The institutions which enforce the rules are the courts of law, the authorities for supervision of trade in securities, stock exchanges and depositaries, respectively. In Bulgaria these institutions are respectively the court of law, the Financial Supervision Commission, the Bulgarian Stock Exchange and the Central Depository, therefore their significance in the investment process is huge (they shape out and enforce the rules). Since Bulgaria belongs to the continental tradition of civil law, the legal standards are drafted by a legislative body, namely the National Assembly.

2. Assessment of the institutions involved in the process

This study is based on a survey, the results of which demonstrate the way in which participants in the investment process perceive the quality of the system ensuring the observance of the rules, respectively the protection of shareholders in public companies. The survey has been conducted among 19 active participants on the capital market in Bulgaria and includes the opinions of securities brokers (6), executive directors of public

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3 The participants in the survey are representatives of 4 investment intermediaries (out of a total of 57), 4 management companies (out of a total of 30) and 7 public companies (of 444 registered issues). The lawyers serving market agents have the most complete notion of the weight of the regulations and law enforcement which determines their place in the survey.
companies (4), executive directors of management companies (2), executive directors of
investment intermediaries (1), investment consultants (3), one director for investor rela-
tions and two directly involved lawyers. Besides being professionals, the majority of the
participants in the survey are also individual investors on the Bulgarian stock market, and
some of them are also representatives of institutional investors.

The questions in the survey (Table 1) have to do with the judicial system and the
Financial Supervision Commission as organs which enforce the observance of the
rules from the normative acts and with the Bulgarian Stock Exchange - Sofia AD and
Central Depository AD as institutions engaged in securing an important part of the
investment infrastructure and equal listing, trading, transfer and preservation of own-
ership of the assets.

The evaluation of justice and the Financial Supervision Commission is unsatis-
factory - 84% of those surveyed are able to identify cases in which the rules have not
been applied according to them. To the questions whether they have been the object
of an inequitable attitude, the percentage of positive answers is exceptionally high
(68%) with regard to the Financial Supervision Commission, and lower - regarding
the juridical system, but an important clarification here is the percentage of cases that
have attained to judicial interpretation. To the additional question of whether their
cases have been examined in the court of law, 9 of those surveyed respond negatively.
The balance is that barely three out of 10 accept the court rulings on investment or
regulatory disputes submitted to court as fair. The high percentages of affirmative
answers to the first three questions place the two most important institutions guaran-
teeing the confidence of the Bulgarian stock market in a position where the confi-
dence in them is not at the needed level.

The evaluation of the efficiency of the institutions ensuring the observance of
the rules is manifested also with the imposition of standards in the work of the joint-
stock companies that are raising capital. Responses to questions 4 and 5 reveal dis-
trust that investors will be protected. Over 68% mention cases in which minority
shareholders are not protected by means of the principal instrument for this - the
auction bid, and nearly 95% believe that in public companies illegal deals between
related parties are made. Low confidence in these two instruments for protection (the
auction bid and the approval of the deals with related parties) determines the low
confidence of the investment community that the rules will be observed and, accord-
ingly, the shareholders will not fall victim to expropriation.

What is important for the real observance of the rules is to disallow abuse of in-
side information. The percentage of those who have registered such deals (question 6)
looks promising - only about one third of those surveyed, one of the participants even
mentions a case in which there was a person penalized for such behaviour.
In addition to the confidence that they will not be at a loss, investors also need guarantees that they will have timely access to the information of importance for the companies. The level up to which issuers provide the investment community with the price-sensitive information and the moments in which this is done, form the level of transparency and it is an important determinant of market liquidity. Responses to questions 24 and 25 give a rather low rating on the two most important functions of the institutions involved in the observance of rules. Only one person of those surveyed is convinced that price-sensitive information is accessible to the investors. Barely one fourth of the participants in the survey actually believe the information disclosed in the prospectuses. The highest is the percentage of the participants who are convinced to a rather low degree that they have access to the important information on the assets. The percentage of those convinced to a medium degree is around one third for both questions.

Table 1

<table>
<thead>
<tr>
<th>Questions</th>
<th>yes %</th>
<th>no %</th>
<th>undecided %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1  Can you point out cases in which jurisdictional organs or FSC have not applied the law in a way that you think they ought to have?</td>
<td>84.21%</td>
<td>15.79%</td>
<td>0.00%</td>
</tr>
<tr>
<td>2  Have you been the object of inequitable treatment on the part of the judicature in your investment activity?</td>
<td>36.84%</td>
<td>63.16%</td>
<td>0.00%</td>
</tr>
<tr>
<td>3  Have you been the object of inequitable treatment on the part of the FSC in your investment activity?</td>
<td>68.42%</td>
<td>31.58%</td>
<td>0.00%</td>
</tr>
<tr>
<td>4  Can you point out cases in which there has not been made a due auction bid or it has been made at a significantly understated price?</td>
<td>68.42%</td>
<td>31.58%</td>
<td>0.00%</td>
</tr>
<tr>
<td>5  Are unannounced or unlawful deals with related parties made in public companies?</td>
<td>94.74%</td>
<td>5.26%</td>
<td>0.00%</td>
</tr>
<tr>
<td>6  Have you witnessed an abuse of inside information and high profits from insider deals?</td>
<td>36.84%</td>
<td>63.16%</td>
<td>0.00%</td>
</tr>
<tr>
<td>7  Can you point out cases in which the abuse of inside information has been penalized?</td>
<td>5.26%</td>
<td>94.74%</td>
<td>0.00%</td>
</tr>
<tr>
<td></td>
<td>Question</td>
<td>Yes (%)</td>
<td>No (%)</td>
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<td>---------</td>
</tr>
<tr>
<td>8</td>
<td>Are you confident that you will not be dispossessed in a company with concentrated ownership?</td>
<td>10.53%</td>
<td>68.42%</td>
</tr>
<tr>
<td>9</td>
<td>Can you name a company in which the majority shareholder actually holds under 50%?</td>
<td>36.84%</td>
<td>63.16%</td>
</tr>
<tr>
<td>10</td>
<td>Could you give up the control in a public company in order to attract external capital?</td>
<td>68.42%</td>
<td>26.32%</td>
</tr>
<tr>
<td>11</td>
<td>Would you say that the number of investment intermediaries is decreasing due to the high requirements and costs?</td>
<td>84.21%</td>
<td>10.53%</td>
</tr>
<tr>
<td>12</td>
<td>Would you say that the issuers are not listed because of the high requirements and costs?</td>
<td>68.42%</td>
<td>21.05%</td>
</tr>
<tr>
<td>13</td>
<td>Do you think that BSE Sofia AD and CD AD have built sufficient market infrastructure?</td>
<td>36.84%</td>
<td>42.11%</td>
</tr>
<tr>
<td>14</td>
<td>Would you say that the actions of BNB with respect to CCB AD of the last 6 months attract investors on the Bulgarian stock market?</td>
<td>0.00%</td>
<td>89.47%</td>
</tr>
<tr>
<td>15</td>
<td>Do you think that the rules of the Bulgarian regulated market for listing and trade are applied equally for all?</td>
<td>31.58%</td>
<td>52.63%</td>
</tr>
<tr>
<td>16</td>
<td>Do you think that the commercial exchange system does not allow rigging the prices of exchange deals?</td>
<td>36.84%</td>
<td>36.84%</td>
</tr>
<tr>
<td>17</td>
<td>Do you think that the presence of market makers would boost market liquidity?</td>
<td>52.63%</td>
<td>10.53%</td>
</tr>
<tr>
<td>18</td>
<td>Is it possible for market makers to work effectively on a market with high concentration of ownership?</td>
<td>31.58%</td>
<td>47.37%</td>
</tr>
<tr>
<td>19</td>
<td>Do you think that revealing the intermediaries - parties in the deals is important for the transparency?</td>
<td>68.42%</td>
<td>21.05%</td>
</tr>
<tr>
<td>20</td>
<td>Do you think that the existing framework and infrastructure of repo transactions is adequate?</td>
<td>36.84%</td>
<td>31.58%</td>
</tr>
<tr>
<td>21</td>
<td>Do you think that the existing framework and infrastructure of short sales is adequate?</td>
<td>15.79%</td>
<td>57.89%</td>
</tr>
<tr>
<td>22</td>
<td>Have you been involved in short sales, including on account of a third party during the last 2 months on the Bulgarian stock market?</td>
<td>0.00%</td>
<td>100.00%</td>
</tr>
</tbody>
</table>
Are you aware of a case in which an investment intermediary in Bulgaria was an underwriter on their own account of an issue of securities?

<table>
<thead>
<tr>
<th></th>
<th>Percentage Distribution</th>
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<tbody>
<tr>
<td></td>
<td>high %</td>
</tr>
<tr>
<td>23</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

To what degree do you believe the information in financial statements and prospectuses?

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<tr>
<th></th>
<th>Percentage Distribution</th>
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</thead>
<tbody>
<tr>
<td>24</td>
<td>26.32%</td>
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</table>

To what degree are you confident that issuers reveal price sensitive information?

<table>
<thead>
<tr>
<th></th>
<th>Percentage Distribution</th>
</tr>
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<tbody>
<tr>
<td>25</td>
<td>5.26%</td>
</tr>
</tbody>
</table>

Concentration of ownership is an important characteristic of the Bulgarian stock market. It is believed that this phenomenon reveals failure of the legal system to guarantee the protection of the property of investors, which is why minority shareholders avoid family businesses, whereas the majority ones prefer to get financed in a manner that excludes the public issue of shares (La Porta, Lopez-de-Silanes, Shleifer, Vishny, 1997). Most public companies in Bulgaria are run by their majority shareholder or by a related party, whereas over 60% of those surveyed are unable to name a company, in which the ownership is actually fragmented. The main issue of the concentration of shareholder ownership is the belief that minority shareholders will not be harmed. Unfortunately those who do not expect to fall victim to such opportunist behaviour represent a mere 10% of those surveyed (question 8). For the majority of the participants in the survey the concentration of ownership is a threat and they do not demonstrate sufficient confidence when investing in such companies. What is interesting in this case is the response to the question whether the participants in the survey would part with their control in the company in order to attract external capital. Over 68% respond affirmatively, which means that it is possible for Bulgarian majority shareholders to reconsider their strategy if market conditions change. The participants in the survey believe that market makers would raise liquidity in the positions in which the ownership is not fragmented, but do not estimate highly the possibilities for them to do this on a market with concentrated ownership.

The regulatory process requires both the enforcement of the necessary requirements and rules, and a competent estimation regarding the adequacy of the standards and the costs of regulated entities. Excessive supervision is also a regulatory failure, and on the emerging markets such a trend leads to an increase in transaction costs (reaching prohibitively high levels, preventing the conclusion of transactions) (Sedlarski, 2008) and the respective lowering of liquidity, as well as to the important defect of the bilateral restriction of access (North, Wallis, Weingast, 2006), in which
issuers prefer non-public financing, whereas investors avoid listed assets due to the high costs. The questions concerning the high requirements and costs as a cause for the decrease in the number of investment intermediaries (question 11) and the delisting and non-listing of issuers (question 12) reveal the accord on the part of the surveyed that such a trend is also observed on the Bulgarian stock market. The greater part of the participants in the survey think that the high requirements and costs are a problem for both issuers (over 68%), and investment intermediaries (over 84%). The practice substantiates the phenomenon, since for the period 2008 – 2014 the number of listed issues has fallen by over 20%, whereas that of investment intermediaries - by over one third.

The regulated securities market as an institution, by way of its reputation is a factor concerning market liquidity - market liquidity is one of its important characteristics and defines it qualitatively. The reputation of the market is formed on the basis of its institutional qualities - the rules and their application, the efficiency of the trading process, the efficiency of the process of disclosing information. The reputation of the stock market largely reflects also the reputation of the financial institutions trading there and the reputation of the companies - issuers, whose papers are listed on it. The standards of the stock exchange (the stock exchange rules on listing, disclosure of information and the trading rules) and the willingness to enforce those (with respect to traders, investors and issuers) turn regulated markets into an important institutional factor. The trading process on the stock market must result in a fair price and disallow its manipulation. The evaluation of the surveyed as regards the rules on the Bulgarian stock market reveal distrust (question 15) - half of them think that the rules do not apply equally to all. Discrimination in the investment process is an important channel for the rise in uncertainty and the respective decrease in the confidence that the rights of ownership are protected. More encouraging results are shown by the even number of those convicted that the rules of trade disallow manipulation of the prices of transactions, and those that are not convinced in this. As far as the next question is concerned - regarding the importance of the disclosure of information for parties in the exchange transactions - the equilibrium is upset once again and the majority of the surveyed believe that this information is important and must be available.

Market opportunities for fast purchases and sales reduce systemic risk, whereas the possibility only for purchases leads to bubbles and to a respective asymmetrical development of the market (Endo, Rheep, 2006), deviation from the base value, followed by a collapse and slow recovery. On the developed markets these investment opportunities are provided through the systems of repo transactions and short sales. The evaluation of the participants in the survey on the possibilities for that kind of
trade in Bulgaria reveals the serious issues of the asymmetric investment process on the national stock market. While the assessment of the available infrastructure securing the margin purchases is balanced (question 20), the assessment regarding the possibilities for short sales is predominantly negative (question 21). Most definite is the response to question 22 - none of the participants in the survey has done any short selling in Bulgaria. The lack of opportunities for a symmetrical investment process is a serious threat to the rights of ownership, since it puts the investors in Bulgarian securities at a disadvantage with respect to those investing in foreign assets. On the other hand the asymmetric market poses additional risks to the investors, which is also an element of discrimination.

The second unanimous response is that to question 23 - none of the participants can name an occasion in which an investment intermediary has taken an issue of securities at their expense. A similar definiteness is revealed by the fact that investment banking is a completely undeveloped territory, and the issuers in Bulgaria do not have at their disposal the main tool for attracting capital.

Institutional efficiency is an important factor for the investment process, since it shows the degree to which the rules are followed and investors are protected. Attracting the latter is a function of the success with which institutions form and enforce standards, because in this way they determine uncertainty. Institutional inefficiency causes a reflux of investment since ownership is not protected. In this respect question 14 leaves beyond any doubt the connection between the extent to which supervisory institutions (in this case BNB) apply the rules and the attractiveness of the national stock market to foreign and national capital. When institutions do not perform quality oversight, do not react to the problems in the investment environment and do not act decisively, the national stock market is not attractive. When actions are contestable and decisions are not objective, uncertainty increases and that leads to a reduction in the capital intended for the stock market.

**Conclusion**

The main conclusion which we arrived at upon reviewing the results of the survey is that investors are not satisfied with the work of the institutions on the Bulgarian stock market. They do not express the explicit impression that rules are followed, that there is no discrimination, that the necessary infrastructure is accessible. On the other hand, the technologies for supervision are considered cost ineffective, which increases transaction costs. The Central Depository and the Stock Exchange are still unsuccessful in offering adequate infrastructure, which lowers confidence in the market and makes it asymmetric, therefore susceptible to bending, crashes and slow recovery.
Disapproval is the main result of the survey. The non-application of the standards to all on the part of the judicature and the supervisory authority violates the protection of the rights of ownership, because they cause discrimination, on account of which individuals with opportunist behaviour expropriate with impunity. The low level of confidence in the system ensuring transparency creates conditions for abuse. The missing market infrastructure creates expectations for overvalued assets and the respective drying up of liquidity during periods of high risk.

The results of the survey prove the hypothesis, namely, the efficiency of the institutions involved in the development and the enforcement of the rules ensuring the protection of the rights of ownership is low. The perception of the investment environment as risky due to the inadequate protection and opportunities for investors leads to low market liquidity and low prices of the assets, hence low market efficiency.

In order to overcome the weaknesses there must be an increase in the efficiency of the institutions involved in the provision of equal treatment to the agents, of the necessary market infrastructure and of cost-effective technologies for supervision. The activities in that sense must include:

- Simplification of the rules in the investment process – the compulsory standards securing the rights of ownership of investors include adequate access to timely information on the assets and protection from opportunist behaviour (deals with related parties, insider and manipulated trading). Unnecessary complication of the rules leads to difficulties in their understanding and application, and this refers not only to local investors and issuers, but also to the regulator and the justice system. In addition, public control over the observance of the plainly set out rules will be more effective. A significant consequence of the streamlined process will be the lowering of transaction costs;

- Immediate privatization of the stock exchange and the depository institution - this will achieve two important goals - integration with a more developed market and a modern clearing system, allowing for complex margin trading;

- Activities directed towards the regulatory authorities, aimed at increasing their competence.

Bibliography


**INSTITUTIONAL INFLUENCE ON THE LIQUIDITY OF THE BULGARIAN STOCK MARKET**

**Doctoral student Krasimira Naydenova**

**Abstract**

The liquidity on the stock market is directly dependent on the degree to which investors feel protected. The expropriation, non-transparency and low confidence are consequences of the absence of rules or their non-application. The study of the efficiency with which the institutions on the stock market in Bulgaria that are involved in the observance of the rules impose them, shows distrust in the system. The investors' evaluation of the institutions of the market infrastructure is low. Such perception of the institutional efficiency of the stock market determines its low market liquidity.

**Keywords:** stock market, market liquidity, institutional efficiency, proprietary rights.
AN ORIGINAL VIEWPOINT ON MODERN MARKET ECONOMY

Prof. Rossitsa Rangelova, PhD
Institute for economic research, BAS

A book was published recently in which the author suggests his unique viewpoint on the necessity for creating a balanced and effectively functioning mechanism for managing market economy contemporary conditions. The major goal of the book is to contribute for reconsidering the changes that occurred in the development of modern capitalist society and the ensuing changes in the way and mechanism market economy functions in today’s conditions.

Georgi Mateev gives arguments for his understanding that nowadays market economy and capitalist social relations exist in countries of various social, political and economic past and contemporary level of material and cultural development. Basically, these are three groups of countries: a) developed economies, b) the so called emerging market economies after the collapse of the former socialist system of countries with centrally planned economies and c) former colonial territories. According to the author of the book the observed period of development of market economies does not render greater variety, it is rather overcoming this variety instead, based on using the experience and achievements of the countries that applied and improved the capitalist civilization model longer and more successfully. G. Mateev accepts as a subject of his research the market economy in the developed capitalist countries where the model “has already revealed most clearly both its strengths and weaknesses”.

In the present stage of its development society cannot give up the automatism of market regulators which serve as a powerful drive of social and economic progress. However, it is too often that they bring in disproportions in economy which cause the occurrence of more or less devastating crisis. After every economic depression or crisis there turn up new regulatory mechanisms; in general, they impose compromising decisions pragmatically in respect to additionally corrected state regulations. Yet, introducing too many regulators for limiting to one or another degree the action of market automatism leads to delaying social progress. According to the author this

1 Матеев, Г. Съвременна пазарна икономика. Publishing house „Изток-Запад”, 2015, p.540. ISBN 978-619-152-597-3. Georgi Mateev is a PhD in economics, Associate Professor (VAK) and Professor of honors in the College of tourism in Blagoevgrad.

2 In this short article the author’s basic ideas and viewpoints are presented. Even his terminology is used to a considerable degree. The purpose is to make those popular in view of turning them into a base and/or pretext for starting a discussion on the really relevant issues of modern market economy.
makes it necessary to synchronize very carefully the action of two types of regulators – natural market mechanisms and state ones.

For a long time theoreticians and politicians argue about which approach is more correct and theoretically more consistent – the pure automatism of market regulation (the liberal model) or the regulatory mechanism of mixed type with borrowed state regulations.\(^3\) It is surprising that the representatives of both opposing politicized economic doctrines refuse stubbornly to recognize objective realities and still argue fervently and assert their own viewpoints. This happens even after the governments and the central financial organs of USA and the remaining capitalist countries applied urgent regulatory measures for handling the 2008-2009 crises through localizing its negative consequences, and these measures brought in a positive result as a whole. The plentiful opinions and assessments shared show that analysts again position themselves at the two poles of a strongly politicized argument “for” and “against” state regulation, without considering the circumstance that an economic reality imposes its own objective rules and unquestionable logic.

Georgi Mateev studies the objective realities and thus draws conclusions and evaluates plausible future changes in regulatory mechanisms, through which certain negative processes in the development of capitalist society and market economy could be overcome. His book is thematically and structurally divided into three parts, each of them comprising several chapters. Each part leads to a logical and consistent development of the author’s viewpoint in respect to characteristics of modern market economy and the role of regulatory mechanisms in these conditions.

The first part is titled “Social and economic realities”. In it the author promotes the idea that natural market regulators of economic processes and phenomena in modern society act in combination and close assistance with an ever increasing number of additional socially-determined regulatory mechanisms. As especially significant characteristics of the modern civilizational model there are viewed the following: the scope and contemporary features of commodity production; changes in the social strata of society; the processes of concentration and centralization of production and capital; the development and perfection of democracy and the turbulent development of globalization processes, called “a super summarizing manifestation of national variety” by the author (p. 182). What makes an impression in this part of the book is the very detailed analysis of the plentiful set of issues viewed in their mutual interdependence. In respect to this analysis it is necessary to point out the author’s compe-

\(^3\) Among world known scholars who comment this issue are Joseph Stiglitz, Paul Krugman, Anatole Kaletsky, Ayn Rand and others. It looks like the author prefers in his discussion Alvin Toffler and Paul Krugman.
tence and efficiency. Among the large number of issues we could mention, for example: the elaboration of Schumpeter’s concept about the positive deconstruction of competition in modern conditions (pp. 29-31), the modern view on the capabilities of the input-output analysis (p. 35), the necessity for updating the legislation framework for regulating relations in market economy (p. 141) and many other. In this broad range of issues the author also covers the synchrony between market economy and democracy which “cannot be broken without causing serious harm to the development of society as a whole in respect to all directions” (p. 160).

From studying these facts in association with the analysis and consideration of changes in the character and mechanisms of the way modern capitalist production functions, the following conclusions are drawn. *Firstly*, separate productions are free to change technology in even smaller degree, as well as the standards and range of their output without taking into consideration how the changes in a particular production will affect the whole chain of production processes with which it is functionally and economically linked. Besides, one or another new product or service could settle on the market only if managing to replace other already existing and traditionally used goods and services or if publicly there have been created conditions for expanding upmarket consumer demand in such a way that the market to be able to take in the implementation of a certain new product or service.

*The second conclusion* refers to modifying the basis on which competitive relations work on today’s market. The familiar direct commodity competition is transformed more and more frequently into a competition between technological and production chains, in which a lot of individual but interconnected producers take part. In this case there comes the necessity for establishing competitive relations in which it is possible to make the so-called creative destruction (according to Joseph Schumpeter’s concept). So, this means that in modern conditions competition should not lead to destroying the producer who lost the battle, but to restructuring the uncompetitive manufacturing activity instead, which should result into increasing its competitiveness without destroying the part of the available organizational, technical, technological and tangible resources that are still suitable for usage.

*The third conclusion* drawn is that in modern conditions it is impossible to take out any production of the general manufacturing construction of economy without harming the balance and harmony of the whole structure. And vice versa, in order for a production to suit in an already created and functioning productive structure, it is necessary to rearrange and balance from a scratch the whole structure (for ex. replacement of small neighborhood restaurants with the outlets of fast-food chains).

*The forth conclusion* is that a new product launch on the market does not lead to replacing another product – except for the cases when the necessity for a product to
exist is naturally dying out since it is out of use due to objective changes in consumer demand.

From the analysis in this part of the book one reaches the conclusion that in modern conditions the capitalist market type of economy has no alternative. And after it is proved that the modern market economy and the modern capitalist society differ significantly from their initial model, there arise the question about the essence and functional characteristics of the changes incurred. Exactly this set of issues is the focus of the second part of the book, called “Market economic mechanism”. In it the author studies the modern aspects of the issues on: supply and demand, competition as a result of implementing innovation policy, some untraditional features and assessments of the interdependence between value and prices of goods, market structure from the viewpoint of the three market segments that are clearly differentiated in modern conditions – labour market; financial market and market of goods and services for production; personal and public consumption. Special focus is put on analyzing the functional scheme of the market economic mechanism. Among the variety of studied issues those about modern competitive relations (p. 239), the monopolistic status of market and the level of democracy are reviewed with originality (pp. 272-273), etc.

The logical continuation of analysis and assessments made in the first two parts of the book is the third one - ”Market automatism and social regulation” where the focus is put mainly on the issue of regulatory mechanisms of modern market economy. Georgi Mateev defends the thesis that in modern conditions it is not only possible but rather imperative to exercise external regulatory impact on market economy. This is something new. Actually, until recently too, irrespective of the officially proclaimed understanding about inadmissible state interference in market economy, it is existent, in fact. This is done when the economy (or certain segments of it) starts functioning in a way that creates disproportions and tension in the overall social and economic life of society.

The author accepts an original approach by using cybernetics and in particular Norbert Viner’s principles of managing extra complicated systems of plausibility that allow to define two comparatively separate but functionally linked management mechanisms. The first is only natural for every complex plausibility system and a strictly specific inner regulatory mechanism which, by principle, guarantees the functional homeostasis of the system. Together with it, there is a chance for each system of this type to be regulated also by exercising the necessary external impact over points accessible for contact and defined as system “entries”. One relies on the rule that in a certain purposeful modelling of the behavior of a system there can be achieved a smaller degree of deviation in this behavior in respect to a particular ex-
ternal impact (p. 401). Viewed in this aspect, the issue of regulating modern market economy lies in the following: clear definition of the possible and by principle accessible “entries” for exercising external regulatory impact on the economy and strict distinction between external and internal (natural) regulatory mechanisms.

As a result of the author’s analyses on contemporary issues of how modern economy functions he finds out that it is possible (and would be efficient) for external and internal regulatory mechanisms to be used and act synchronically and non-antagonistically. This could happen provided that outside mechanisms for impact do not ignore and do not replace natural market regulators, while only changing the exit conditions and prerequisites in which they “work”. In other words, external regulation aims at creating and modelling a current economic environment in whose circumstances natural regulators won’t generate unwanted (crisis) conditions of economy.

The author’s idea is that it is “necessary to define and use purposefully in an ongoing regime such a set of external regulators and mechanisms for impact over economy that are able to keep its functional homeostasis, while not allowing the emergence of crisis circumstances unwanted for society”.

In general, the book represents a large-scale, multi-layered and complex study of the character and development of modern market economy and, in particular, the regulatory impact on market economy. Therefore, it is only worth assessing the fact that the book scopes a very large range of interdependent economic and social issues that are subject to the topic and are elaborated clearly. With his book Georgi Mateev claims his intention to take competent part in the current heated discussion on issues of how modern market economy functions.
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