
Bulgarian Economy and the Role of the State in the Conditions of a Global Economic Crisis and the Debt Crisis in the EU

On 4 April 2012 the Chairman of the Supervisory Board of Corporate Commercial Bank AD and Member of the Council of Trustees of the University of National and World Economy Tzvetan Vassilev delivered a public lecture on the Bulgarian economy and the role of the state in the global economic crisis and the EU debt crisis. The University Student Council organized the lecture, attended by students, teachers, and bankers at the University's Great Hall.

Tzvetan Vassilev: "*The times we live in are crucial and the question ´Where do we go now?´ is a topical issue on the desks of the world political leaders. If 10 years ago someone had posed the question of the cyclic nature of the economy in capitalism, the majority of the public would probably have considered that person a madman, at least because we seemed to have decided that capitalism had overcome its main property to follow certain stages of development passing inevitably through crisis moments as well. But as a result of a series of ´successful´ manipulations of the capitalistic cycle it was just swept away.*

Capitalism should pass through a 13-year cycle of development where its main phases should follow consecutively. But this 13-year-long cycle was in actual fact replaced by one that lasted for more than 30 years. As a result, the consequences have been evident since 2008.

After the crisis in the US economy in the 90's that led to the need of seeking new sources and fields of financing, the administration of President Clinton passed consecutively three acts to stimulate investments in homes and mortgage bonds, the main one of which was the revision of the 1995 Community Reinvestment Act. As a result, in a purely centralized way, the banks' attention was turned to a priority financing of the US population for the acquisition of new homes.

At the same time the Community Reinvestment Act laid the foundation for the development of the unfortunately known today Fannie Mae and Freddie Mac. They held the main share of a huge amount of mortgages (including the so-called subprime) which led to the collapse of the US financial system in 2008.

The number of high-risk mortgages is 27 million of which only the outstanding ones are over 4 trillion U.S. dollars.

The great amount of bonds covered with bad mortgages laid the beginnings of the downfall of the US financial system, which subsequently dragged down a number of European banks as well. I will touch on the subject of the influence of the US financial system crisis on the European banks and the resulting negative effects in Europe later.

The question of the crisis depth and its duration has been thoroughly examined and reveals very interesting but, unfortunately, not so optimistic conclusions. Historically, analyses show that there are crises that lasted for 20 — 30 years. That is, in any case, concerning but gives an answer to the main question at the moment: ´How long will the crisis last? Does the crisis have a bottom? Has that bottom been seen or is it still going deeper?´

In my opinion, we not only have not seen the bottom yet but it is uncertain when we will see it, because the degree of indebtedness of citizens, on the one hand, and the state, on the other hand, is so high that at the moment the driving force that could stimulate the consumption on the relevant markets cannot be seen for us to actually witness any somewhat different stage of the crisis and capitalism development.

The slight revival in 2010 — 2011 which, to a certain extent, had also an impact on improving the indicators of the Bulgarian economy, in particular on increasing the export, has only showed that the crisis process continues and that the revival is more of a result of the huge amount of money that was infused into the economy through the interventions of the Federal Reserve (The FED) and the European Central Bank (ECB). This, by no means, was enough to change the crisis direction. In this regard, a question comes to the fore: is it possible for the capitalist economy to continue to develop by using only purely monetary methods or do we have to seek more and more persistently the role of the state? I was cited that I am a staunch Neo-Keynesian. I would rather say that the stage of the capitalistic cycle development today requires, indeed, greater involvement of the state, not only by infusing money. Evidently, infusing money into the banks does not achieve the desired effect since their portfolios are full of bad loans which must be provisioned and the banks' income is still not enough to cover these losses in the short run.

That is why the role of the state must be rather expressed mainly through its entrepreneur function characteristic of this stage of development of the cycle of the capitalist economy. One quite scandalous and controversial author, Nouriel Roubini, says in an interview that ´it's a paradox but in the conditions of a crisis the monetary model works more and more through the state.´ In my opinion, this is indicative of the artificial, to a certain extent, differentiation of the two extreme theories — for the involvement and non-involvement of the state in the economy. Today, the model of the capitalist economy is more different than the one in the 1930's when we had a crisis closest to the crisis today, both in terms of duration and outside manifestations.

For me the need of capitalist economy to find that driving factor that will rip it off the bottom is emerging more and more clearly. Unfortunately, as of today, in the traditional centers of capitalism, i.e. the developed European countries and USA, this is not very realistic.

If I have hope in something that could take the global economy out of today's crisis in the short run, that thing is the development, although a bit slow, of the transition countries from Asia and the countries of the so-called BRICS (Brazil, Russia, India, China, South Africa) group. All micro-indicators and comparisons of the development of the traditional centers of capitalism with the development of the BRICS countries and the emerging Asian economies at the moment show a priority of the latter. The fact that in the past 10 years (from 2000 to 2010) the gross world product share of the BRICS countries has increased from 17% to 26% and the share of the G7 countries has dropped down from 49% to 39% is sufficient evidence in this regard.

If we talk about the depth of the crisis in the global economy, we touch upon ´half of the trouble´ compared to what we see in the European system. I mentioned in the beginning that the crisis of global capitalism started from the US, from their financial system and mainly as a result of the relatively low control over it. I also emphasized on the ´promotional´ policy of the US Government stimulating indiscriminately the granting of unsecured and poorly secured loans. The paradox is that this Community Reinvestment Act lays down as a criterion for the rating of banks the amount of unsecured and poorly secured mortgage loans extended to people of low income. I see here many representatives of the banking system and they can understand what paradox I am talking about, more or less like the one we have at the moment, when we, the banks, have to explain to the financial minister why we cannot fix our interests and put them down. Such administrative impact on an economy that claims to be a market economy has such consequences eventually.

In the European system the crisis has been brought in. Only for your information, the European banks had expositions of around 4 trillion U.S. dollars in U.S. bonds, including in the subprime mortgages in question. Of this 4 trillion, over 740 billion U.S. dollars have already been written off as losses. This unfavorable fact, i.e. bringing huge losses from the investments of the European banks in the Unites States, reflects on all possibilities of the European financial system to redeem the consequences of the crisis.

Of course, when we talk about the crisis in Europe, apart from the classical reasons that have led to it, certain factors, I think, stand out that are typical and result from the characteristics of the European system itself. The European Union (EU) has shown that to a great extent it is still a mechanical group of economies that differ in the degree of their development, which, by no means, operate as a single system. The core of the systematic approach is the operation of the main parts in one direction.

One of the main formulations of the EU is that the difference in the degree of development of the Member States must be decreased as a result of the enlargement policy. Unfortunately, it has turned out that the difference in the degree of development of the Member States is very high. The highly developed countries, mainly the so-called Nordic countries or the countries of the Rhine group, have gone much further compared to the Southern states and the new members acceded after 2000.

The main reason for this is that the enlargement of the EU created conditions for an almost monopolistic domination of the big German and French companies which gained access to the markets of numerous countries for free. A great part of the Southern countries constantly have a negative trade balance, mainly as a result of their trade with Germany and the Netherlands. There is nothing wrong with that but the trade deficit in question should have been and was financed mainly with a government debt until the time when even the banks holding that debt were not in condition to assume new liabilities to keep making that balloon bigger and bigger.

Even in the case of Greece, it is indicative that supplies from Western countries lay in the core of its debt of 350 billion euros. I was looking for statistics, which to my great regret happened to be inaccessible, with regard to the percentage of EU funds in which the end beneficiaries are German companies. Do not think that I am a Germanophobe but, I think, we can certainly talk about a warp in the European system which makes it even more difficult to get out of the crisis.

The problem here is that to a great extent the European Community is closed in itself. It did not manage to create competitive advantages over third parties. It is no coincidence that over 60% of the trade of the Member States, including Germany, is within the EU. On the one hand this is normal (after all it is a matter of integration prepared on purely political basis) but on the other hand it does not allow for seeking vents and other solutions of the problem that has arisen with the debt crisis in the European countries.

I personally do not think the debt crisis has been solved. The solution of the first stage of the Greek debt crisis was a technical solution, which, however, does not give any idea how things will go from now on. The depression in which the Greek economy has fallen into would hardly enable the servicing of even the debt so decreased.

For the manifestation of the crisis in Europe we can judge from a series of indicators characterizing the scale of the crisis. A great number of the countries are over-indebted. The gross government debt to the gross domestic product (GDP) ratio of not a small part of them (for example Greece, Italy) exceeds 100%, and of the rest is between 60% and 90%. We are among the leading countries. The problem is what do we gain from that? But we will talk about that later when we start discussing the consequences of the crisis on the Bulgarian economy.

The crisis in Europe, apart from being intensified by problems of systematic nature, is also connected with certain political decisions in the EU which, by no means, work in favor of solving its consequences. At the moment there is an active debate as to what form of cooperation must be applied in the EU, which will help not only overcome the crisis but also gradually establish Europe and the EU as one of the centers of capitalism.

I personally have great doubts of the possibility to introduce the principle of federalism to Europe now, not because it is not right, but because I doubt now is the right moment, especially after the

great disappointment and the serious centrifugal forces that have taken possession of a part of the European countries. Therefore, I reckon it is rather likely to have certain processes that will lead to changes in the EU structure as a whole, than creating any confederation principle nowadays.

In my opinion the problematic countries, especially those of the so-called PIIGS (Portugal, Italy, Ireland, Greece, and Spain) group, are more likely to leave the European Monetary Union (EMU) than to manage to cope, regardless of the appeals made to them. I do not believe that the big disproportions and enormous debts accumulated by them could be solved in any other way but by getting out of the EMU and the processes which we already observed in Bulgaria in 1996 — 1997. The significant domestic and foreign debt must be resolved in some form and one of the most frequently applied one is the hyperinflation. At the same time the Greek foreign creditors should seek any ways to keep their interests. That would be possible in only one way — full priority to the servicing of the foreign debts of the country at the expense of which: hyperinflation, zeroing the budget deficits, zeroing the intercompany debts, zeroing the domestic debts — something which I reckon is the more likely scenario for Greece, and not only for Greece. It seems that the help for Portugal has turned out to be not effective enough, too. The situation with Spain is also the same.

Within the EU, several programs were created which, for me, are more like 'emergency' programs. A lot of money was infused into them (like with the Federal Reserve), but their effect, as of today, is not too big. Approximately 100 billion euros have already been put into the covered bond purchase program. Under the bank refinancing and financial system protection program of a total of 3.5 trillion euros, already 1 trillion euros have been infused into the European banks, but the effect is not enough. As of today the banks in the developed European countries continue to be poorly active, which proves the thesis that the amount of money infused into the economy in the conditions of a crisis of such type is no way the factor that acts in a purely pro-inflation manner. Furthermore, the greater part of the money the European Central Bank infuses into the banks through the tenders they participate in is, in actual fact, used back to purchase certain bonds issued by either the governments of the relevant countries or by the European Central Bank.

The result is a closed circle which only purpose, to a certain extent, is to subsidize the financial results of the banks to cover the huge amount of losses and bad loans which are anyway still in their portfolios. Evidence of that poor activity is the constant warnings we receive from clients that they have been refused funding from their European banks. At the moment even the ship owners from Germany and the Netherlands seek funding from us, from Bulgarian banks, for their new development projects, which means there is a denial of funding. Here is the place to say that this policy of the European Central Bank and the European political leaders is palliative. It does not lead to solving the particular deep problems related to the crisis. Maybe this is just to buy time while looking for a more drastic solution.

Time will tell but, in any case, Europe has really come to a crucial time to choose which direction to go. We, as part of Europe, unfortunately suffer together with it, no matter we are the country which has most recently passed through the circle of hell and hyperinflation. Perhaps that saves us to a certain extent at the moment and helps us be among the leading countries in the EUin terms of the main indicators. Our budget deficit is among the lowest ones (2.1% in 2011). We even report that we

have overfulfilled our budget plan. In terms of government debt we are also among the first three countries with a debt-to-GDP ratio of less than 20% (in comparison, even Germany is with a debt-to-GDP ratio of over 80%). The big problem is that all this does not help us in any way to put into use our financial advantages over the other countries for the simple reason that just that cannot solve our problems.

Bulgaria was affected by the crisis in 2009 with a delay of about 6 months, which on the one hand allowed us, to a certain degree, to decrease part of our expositions in properties, but on the other hand hit one of the most important sectors of our economy — exports. In 2009 we observed a decrease of 23% in export. The positive fact is that imports also fell down, as a result of which in 2011 we even observed an excess on the current account, as far as it can be called a positive fact at all. The big problem both for Bulgaria and the other poorly developed countries in the EU (mainly the Southern countries) is that we maintain in the conditions of growth a negative balance on the current account which, in any case, exhausts our economy and finances and at the same time has no serious alternative.

Moreover, not only do we have a traditional deficit in the trade with the European partners but we are also net importers of energy carriers and raw materials, which further hampers this anyway sad situation. By the way, 2008 — 2009 was probably the most crucial year for the currency board. At that time the biggest negative balance accrued, therefore I often say that our fiscal surplus of that period is more like a 'feast in the time of plague'. The long positions of foreign banks against the lev alone were of the order of over 1 billion euros which almost led to a risk for the currency board.

In this regard, the drastic decrease in direct foreign investments in Bulgaria of over 7 times in the last financial year compared to the 2007/2008 peak is a negative factor. On the other hand, the greater part of foreign investments in the period until 2008 was in actual fact, financed by parent banks to their subsidiaries in Bulgaria (around 8 billion euros). The effect of those investments is very contradictory. A great portion of them were used to finance back their export and import in Bulgaria, unfortunately not of investment but consumer goods, and for construction, which by no means led to new investment needs. The moment the crisis reached their parent banks in 2008 — 2009, they started to withdraw their investments from Bulgaria. In the meantime they had already managed to give out loans for 20 — 25 years but withdrew them in two months. As a result it turned out that this was probably the hottest money but hardly the most needed for Bulgaria.

The Baltic countries had the same fate in 2008. Estonia, which now is deemed a leader, has, in actual fact, passed through the purgatory. Something like that happened in Latvia as well, and in Lithuania, mainly through the Scandinavian banks. Therefore, when we talk about foreign direct investments we must take into account their quality. I do not think Bulgaria has a serious need of fundings such as bicycle purchases or suchlike, which are deemed investment goods in our statistics.

For sure, things are such as we have them after all. And of course, foreign banks follow the interests of their business. It is all our fault that we sold our banking system so outrageously and

turned it into an unfenced yard with almost no bank left in Bulgaria protecting the national capital. Thank God, there are a few still hanging on and at the moment all the hope is on them to support what has a potential. The other reason why Bulgaria is in the situation it is at this point (apart from being the country that has most recently gone through a crisis among all the comparable European countries) is the Bulgarian people and their unique patience. The low budget deficit and the low amount of expenses are related to the extremely low wage level in Bulgaria.

In my opinion, the biggest challenge to the leaders of the developed countries from now one will be whether they will be able to explain to their population that the way they have lived until now can hardly be preserved. I personally have doubts in this regard, because it is obvious that there is no one to finance a life on credit and over one's means anymore. When we talked about Greece and its foreign debt I missed to mention that about 40% of this foreign debt is military supplies. I don't know if you realize the profit rate from these military supplies made mainly by a few French and German concerns. In my opinion it is above 300%, i.e. someone has earned a lot of money. The intermediaries on the Greek side at the moment live in the so-called ´district of arms brokers´ in Athens, in enormous very tall buildings. These are only the commissions. In Bulgaria we, too, have a similar practice with some Cougars and helicopters with considerable commissions, but I cannot imagine what the commissions and profits of the concerns that have exported them must have been out of 150 billion euros.

That is why from the very beginning people started to talk about a European protection mechanism, about funds and so on and so forth, I expressed an opinion that it was better to add to such a fund the profits of the companies that had made the supplies and had benefited from that, rather than have the banks suffer losses. I do not share the idea that the German and French banks now must lose because they have financed the supplies of their companies. The gains of those banks from Greek bonds were not more than 2 — 3%, let´s say they were even 5%, whereas the EURIBOR was around 4% in 2008. In any case, the main part of the profits went somewhere else and I cannot understand why the banks have to suffer because of this. But anyway, let's not think about the problems in Europe but to return to our own.

I believe that at the moment our country is faced with the extremely complicated question of the balance between the restrictive financial policy and the pro-stimulation practices which we, clearly, do not have as of today. The restrictive financial policy which this government has been strictly following for two and a half years now has not let to anything else but to pat us on the shoulder for being among the leading countries. It even went so far as that to the Prime Minister's request for some commiseration of the European Union with regard to the state funding quotas under the structural programs, we were told straight that if we had such a good budget we could afford participating with the same percent of funding.

I would not dare give advice on where, to what extent, and how, but in any case I believe that the last 2 — 2.5 years were lost to have a more stimulating policy for the economy, which has eventually led to a drastic reduction in consumption in the country. Provided that we take into account the moment of inertia in the economy in my opinion this tendency will continue and it will hardly be overcome, especially now when investors at the global financial markets are not particularly hungry

for new investments in such countries as Bulgaria.

What I see as a defect of the Bulgarian policy is that in the years of transition we could not create an overall orderly concept of how to increase the competitiveness in our economy to promote export-oriented productions. For twenty years so many governments have changed and none of them has developed a more orderly program. In Serbia, for example, some percent of privatization revenues is allotted to a fund for the promotion of certain strategic productions or sectors.

We did our privatization purely in the Stakhanov method. We sold to get rid of. The state reported when it had gotten rid of something, but at what cost — that I do not want to comment on. One of the implications is that in Bulgaria there is hardly any deal without foreign capital invested in it that has not been to the detriment of the national interest. Starting from the banks, who should we talk about — Lukoil, or BTK, or the electricity distribution companies? We are known for being ready at all costs to give priority to foreign capital only not to be accused of having made a deal with Bulgarian capital. Because any deal with Bulgarian capital is always with a hint of corruption, whereas a deal with foreign capital is at any rate deemed a square deal. How square it is I can tell you by giving you an example with the deal with the so-called locomotives for the Bulgarian State Railways (BDZ). I do not know why at the moment we have to justify ourselves to Germany and wonder how to give the money back to Kreditanstalt für Wiederaufbau (KFW) when it has turned out that KFW itself, in order to sell the locomotives to Siemens, has funded the whole deal, including the commission fee. What a paradox. At the same time, in 2005 BDZ was as bankrupt as it is now. There is no difference in its financial position.

With such practices we cannot build a competitive economy that will give us the relevant advantages. We see what is happening even in the energy sector which, perhaps, is the only competitive sector in Bulgaria for its reasonable approach of building and the wonderful and well-developed distribution system (which gives us exceptional advantages). We could not fully develop even this. On the contrary, for these 20 years we have managed to waste it. The system now needs serous investments.

I personally think that the deals with Maritza-East 1 Thermal Power Plant and Maritza-East 3 Thermal Power Plant are a national betrayal. The Prime Minister has recently said that this is a diversification. I cannot agree with that argument. What diversification is he talking about when the energy is produced with the same lignite coals used to produce the electricity at the Maritza-East 2 Thermal Power Plant? But the state-owned Thermal Power Plant sells the electricity at a price three times lower than the price of the other two TPPs. For the Maritza-East 3 Thermal Power Plant the deal was made with Entergy, a U.S. energy company which half a year later went bankrupt in the USA. If we keep on looking for examples of how we have lost 20 years of development of our economy I can give you many more. The truth is that there is not any strategy or program for competitiveness development, particularly export competitiveness. With our scarce and small domestic market, both in terms of population and total solvent demand and consumption, we do not have any other chance. We cannot survive unless we look for an additional income through the foreign trade channels.

Unfortunately, as of today we can hardly name a sector in which we have serious competitive advantages, except for the energy sector. Surely, there is much to be done, and perhaps I will be criticized for my positions but I believe that for us to manage to overcome that enormous challenge we must first think how to protect our national interest.

A particular example in this regard is our practice in the utilization of the EU funds. One of the main reasons I was an optimist for Bulgaria before 2008 was the possibilities that the EU funds were to give us to redeem and bridge over the crisis in its hardest period by creating additional investment opportunities. In 2012 the utilized funds under the operational programs were 1.6 billion euros out of the 8 billion euros planned. But then it should be also taken into account how much cash contributions Bulgaria has made to the European budget. Here comes the big reserve and the big problem. I am saying ´reserve´ because we still have time and a chance to make better calculations in the following financial period and work better. The big problem is that we have not managed to find a mechanism how to utilize the funds better and use our abilities. I do not support the thesis that the only disadvantage of Bulgaria in this regard is the corruption and because of it we do not have access to these funds. There is enough evidence that in fact EU officials act mechanically and mainly the problems in Brussels regarding the projects from Bulgaria come from our country.

This is enough for an EU official to say: there is a problem so we stop and start inspecting. Every stop and inspection makes everything so long drawn out in time that at the end the project is either not happening at all or the utilization period expires. The result is indicative: 20% paid and nearly 70% agreed funds (and practice shows that a great portion of the agreed funding is subsequently not utilized for a variety of reasons) — the chances of the Bulgarian economy to redeem at least partially the consequences of the crisis are decreasing.

I am sure that many other things can be said and that a part of what I have said has caused quite mixed feelings. I am ready to answer your questions.

Thank you!"