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Privatisation in Bulgaria. Strategies, Methods, Results and Conclusions

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The Process of Privatisation in Bulgaria - Strategies, Methods, Results and Consequences

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1. Introduction

Privatisation in Central and Eastern Europe can be defined as the transfer of property rights from the State to private owners. The transfers are carried out so as to vest the new private owners with the full property rights of use and disposal over their property, these rights being guaranteed by the legal framework established by the rule of law. In Bulgaria, one can distinguish between three main stages in the process of privatisation. Each was shaped by the conflicting resolutions of frequently changing governments and meant to serve different political goals.

The first stage (1990-1993) is characterised by the blockade of legal privatisation, as 'spontaneous privatisation' was accorded high priority. As in other former socialist countries, great emphasis was placed on the so-called commercialisation of state-owned enterprises. This did not involve the actual transfer of State property into private hands, but rather the independent transformation of state-owned enterprises into joint-stock companies, as well as the establishment of subsidiary companies.¹ The goals of introducing more efficient structures and applying modern methods of production by transferring property to a more suitable management were not achieved.

The second stage (1993-1995) is a cash privatisation, which laid the foundation for an employee/management buy-out, aided by the legal provisions granting concessions in the payment of instalments. The most important factor in the third stage of the process of privatisation in Bulgaria was the adoption of the mass privatisation model as an alternative

¹see Earle/Frydman/Rapaczynski (1993, pp. 90-107).

method of procedure. In 1996, legal regulations for mass privatisation were introduced and a privatisation fund was established. In the meantime, the process has evolved into its fourth stage, during which a strategy of privatisation has been formulated under the supervision of a monetary council, and various agreements with the IMF and the World Bank are being adhered to.

Privatisation is the decisive factor in the structural reforms of East European countries. The problem of converting State property into more effective forms of property management has been exacerbated by the additional demand of carrying out the far-reaching structural changes as swiftly as possible. The expectation that a large part of State property would be privatised within a short time in Bulgaria, has not been met for a number of reasons. When the reforms began, the private sector was too weakly developed to become a catalyst for structural changes. Until 1995 there were no laws regulating the stock exchange or securities and bonds - the capital market was practically non-existent. Moreover, the various political parties could not agree upon the various models and objectives of privatisation. The population itself had no capital. The restitution of private ownership which will not be discussed in further detail was limited to the smallest businesses, traders and workshops. Furthermore, the Privatisation Agency and State authorities employed to initiate the privatisation process lacked experience. Another problem hindering privatisation was that the laws passed lacked precision and were constantly subject to change.

2. Spontaneous Privatisation

Spontaneous privatisation refers to the transfer of State property rights into private hands, which takes place without a legal foundation. This can include the illegal acquisition of property through criminal schemes. However, it can also describe the change in status of property rights resulting from the legal vacuum during the first stage of change in Bulgaria. The independent managerial transformation of enterprises into joint-stock companies or their establishment of subsidiary companies can be mentioned in this context. Thanks to the generous support they received from state-owned banks, such companies were able to acquire State assets with great ease.²

While this extra-legal transfer in property rights was taking place, state-owned and private companies became more and more integrated with one another, which led to the excessive

² see Angelov (1996, pp. 8-13).

exploitation of the former by the latter. This arose when private individuals, often managers of state-owned enterprises, formed new companies, the sole purpose of which was sell the products of the state-owned enterprises. The state-owned enterprises were lowered in status to mere manufacturing plants and were generally burdened with large financial losses. The profits, on the other hand, were diverted entirely to the suppliers and sales companies.

3. Cash privatisation in Bulgaria

3.1. Legal Foundations

The uncontrolled growth of spontaneous privatisation in Bulgaria emphasises the need for the swift development of laws regulating the transfer of State property into private hands. The first of such laws was passed in 1992. It was the law concerning the transformation and privatisation of state-owned enterprises, which was frequently modified and changed in ensuing years. The privatisation law was complemented by further regulations, for example the law regulating the settlement of credits (1993), regulations about auctions (1992), directions of the Council of Ministers concerning the organisation and appropriation of shares and interests in preferential sales (1992), laws governing financial obligations of the State (1994) and ordinances about conditions of the acquisition of shares for the purposes of appeasing creditors (1996).

3.2. Forms of cash privatisation

In terms of privatisation, the Bulgarian experience offers a wide range of different procedures, which do not differ greatly from the procedures implemented in the other Central and East European countries.³ As far as sale of the corporation shares is concerned, negotiations with potential buyers (55% of sales) as well as public invitations to tender have been preferred as privatisation procedures (see Table 1). The sale to employees and leasing have also increased in importance, rising to 22.7% of total privatisation transactions in corporations during the years 1992-1997. Transactions involving the sale of outsourced subsidiaries and untransformed enterprises have succeeded mainly through public auctions (29% of all sales) and the sale, or leasing, to employees (46.7%).

³ see Glismann (1993) and Siegmund (1997).

Table 1: Selected Privatisation Transactions (1992–1997) in %

	Direct Sale of Shares	Auctions	Invitations to Tender	Negotiations	Sale to Employees
Corporations	0.3	1.0	21.0	55.5	22.7
Untransformed Enterprises or Outsourced Subsidiaries	–	29.0	7.6	16.7	46.7

Source: NSI (1998, p. 190).

Auctions

Open auctions begin with a previously determined minimum price, which is raised by at least 1% and not more than 10% with each bid, in accordance with the determined rate of increase. Secret auctions involve bids being handed to the auction commission in sealed envelopes, the highest bid being accepted. In the event of two or more bidders bidding the same amount, an open auction is held in order to determine the outcome.

Invitations to Tender

If the sale of shares or parts of state-owned enterprises is to be carried out by invitations to tender, additional demands can be made of the buyer. These demands concern with the planning in the enterprise, as well as the level of intended investment. Buyers are thus bound by the company's statutes, even if they did not contribute to their development. They must fulfil the clauses of the statutes and are usually bound to leave them unchanged for a determined period of time. It must also be noted that buyers generally do not buy all parts of a particular enterprise after there has been an invitation to tender.

Negotiations

The popularity of privatisation through negotiations can be attributed to its flexibility. Unlike the other procedures, negotiations allow the potential buyer to change initial offers at any time during the negotiation period, without conflicting with principles of equal participation by all in the privatisation process. During negotiations, the commission responsible for the sale is allowed to deal flexibly in the market, because this flexibility towards changes in price, forms of payment and conditions of transfer enables the seller to achieve the most advantageous results. Thus, both the buyer and seller can benefit from this form of transfer. Negotiations, however, can be a drawn-out process, meaning that ultimately, subjective factors could become more relevant than objective market-driven criteria. This often results in the society losing faith in the privatisation process.

As a condition of the participation in negotiations, potential buyers must:

- i) submit the legally required documents;
- ii) cash deposit to the value of at least 1% of the company's fixed assets, or an appropriate bank guarantee and
- iii) submit a three-year company management plan.

The deposits are subtracted from the ultimate price of the sale in the event of successful negotiations, and are refunded should negotiations fail.

Direct Sale of Shares

The open and direct sale of shares can be employed as a method of sale only by the agency responsible for the privatisation. Other institutions intending to pursue an open sale of shares may only do so with the agency's permission. Whereas the above-mentioned methods of sale only allow for the sale of bundles of shares, the direct sale of shares can involve single shares being sold. This means that more people can obtain a share in the company. The wide distribution of ownership, however, may make leadership of the company more difficult, as well as weakening its position in the market. The nominal and sale value of the shares, the opening and closing dates for sale, the form of payment and the date of the general meeting determined must be contained in the resolution to privatise the company. From a practical point of view this is very time consuming, a process made even slower in cases where the enterprise must first be changed into a corporation. For these reasons and because of several inconsistencies in the law, this method of sale is rather unpopular in comparison with the others.

Sale to Employees

The sale or leasing of companies or parts of companies to employees or former employees and management plays a special role in the process of privatisation. If these groups own more than 50% of the company's capital, and should the company's value be placed at less than 150 million Leva, then the buyers are given the opportunity to pay the due price in several instalments over a period of ten years. Payment only begins a year after the sale transaction is completed.

3.3. Insider-Privatisation and Participation of Employees

While insider privatisation is concerned largely with the role played in the privatisation process by the directors of state-owned enterprises and the upper-level administrative staff of the former planning bureaucracy, it can also involve lower levels of staff. The question of what roles insiders ought to play in the privatisation process is a critical one, especially due to the importance of the process gaining wider acceptance. Nevertheless, it is not discussed very openly in Bulgaria. It must be mentioned that the participation of staff in the privatisation process - in the form of leases or sales of small business units and the acquisition of shares under special conditions - appears to be largely unproblematic. However, insider transactions allow the former top-ranking officials to take on leadership roles in the economy, a situation unacceptable to the general population.⁴ The important question is thus not whether insiders profit from the privatisation process, but whether they are doing so in reasonably transparent and legal ways. The question of the proportion of insider participation in the privatisation process in Bulgaria can currently be regarded as the least well-documented aspect of the process of transformation.

The participation of employees only starts with the direct sale of businesses. Bulgarian legislation envisages a preferential participation of staff and employees in all forms of privatisation. Twenty per cent of the shares of a business to be privatised can be acquired by insiders at a discount (half of the sale price) if they agree to do so within three months of the commencement of sales. The maximum amount of shares allowed to be sold to individuals is not to exceed their gross salary for the previous 24 months. Together with the level of the discount and the method of payment, this maximum is determined in advance.

In Bulgaria, employee/manager privatisation was introduced after 1993. The preferential conditions of sale in favour of this group, introduced in 1994, increased the group's interest in the participation in privatisation: in 1996, 53.7% of transactions completed by the privatisation agency were carried out with employee/manager participation.⁵ The special conditions provide an opportunity for those acquiring interests to develop private economic activities. This form of privatisation, especially with respect to small to medium size businesses, has proved to be exceptionally successful. There are, however, disadvantages to the employee/manager privatisation, including the loss of important sources of public income in times of greater financial need. Furthermore, there are doubts as to the transparency of the

⁴ see Heinrich (1993).

⁵ see Privatisation Agency News Service (1997a, p. 18).

transactions. The causes for the frequent replacement of management are largely political. In the economic sphere there are a high number of opposing opinions of individuals and groups, leading to a continuous conflicts. Managers often behave negatively in dealing with potential investors from abroad, as these are regarded to be competitors who could threaten their plans in the process of privatisation.

3.4. The Status of Creditors

Creditors in Bulgaria have a vested right to acquire shares to the value of the guaranteed credit in the businesses to be privatised. As a result of this, creditors of the company become shareholders and have the opportunity to influence the management of the company. Creditors include persons contracted to work for the company who have not been paid their salary, the State bank, as well as commercial banks and non-banks if the proportion of these institutions owned by private parties exceeds 50%. Not included are commercial banks and non-banks of which the State or public owns more than 50%, as long as they have been paid compensation for unpaid credits.

The privatisation of enterprises with high debts is not sensible. However, the introduction of a process of privatisation can be permitted even if it has been determined that the enterprise in question is unable to pay its debts, but there is an agreement with the creditors for the introduction of measures to reestablish the financial soundness of the enterprise and when the bankruptcy proceedings have been stated.

3.5. The Process of Privatisation

3.5.1. Institutions of Privatisation

The businesses to be privatised are selected by the Privatisation Agency (487), the Ministry for Industry (477), the Ministry for Trade (358), the Ministry for Territorial Development (171) and the Ministry for Agriculture (293) (see Table 2). Other institutions, including the Ministry for Culture, the Ministry for Transport and the Agency for Electricity, have also supported the privatisation process. A total of 282 were selected by these institutions. The success rate of selections from different institutions, however, varied greatly. The Ministry for Territorial Development was most successful in terms of the percentage of its selections being privatised (73.7%). The Privatisation Agency was next most successful with 41.5%. The businesses under the responsibility of the Ministry for Industry were least successful.

Table 2: Privatisation of selected and privatised businesses according to Ministry and public authority (1992–1996)

	Objects to be privatised	Privatised objects	Relative proportion of realized businesses as against those objects determined for sale (in %)
Total	2068	599	29.0
Privatisation Agency	487	202	41.5
Ministry for Industry	477	28	5.9
Ministry for Trade	358	119	33.2
Ministry for Territorial Development	171	126	73.7
Ministry for Agriculture	293	56	19.1
Other	282	68	24.1

Source: NSI (1998, p. 193).

3.5.2. The extent of cash privatisation

By the end of 1997 and since the law concerning the transformation and privatisation of state-owned and public enterprises has come into being, 7173 orders to privatise trade companies, outsourced subsidiaries or untransformed enterprises have been made in the field of cash privatisation in Bulgaria. Untransformed enterprises are state-owned enterprises which were not turned into joint-stock companies in 1991. During the above time span, the number of completed privatisation transactions was reduced significantly to 4115 (see Table 3). In the year 1997 alone, 2363 decisions to privatise were made (the number during 1996 was 1082) and 679 transactions were completed (792 during 1996). Of the units offered for sale, 80% were not enterprises or parts thereof which had been converted into corporations. The proportion of enterprises converted to corporations with respect to completed transactions was even lower, trailing at 7.3%.

Cash privatisation involves mostly small to medium size businesses, such as retail shops, cake shops and snack bars, studios, restaurants, workshops or warehouses. Undoubtedly it is easier to sell smaller business because these require lower levels of investment. While 85% of the businesses sold in the area of cash privatisation belonged to the local authorities, only 15% were in the hands of the central administration. In spite of this difference, 85% of all assets which changed hands were assets from centrally owned enterprises. Of the 371 000 employees of privatised businesses in this area, 349 000 were employed in state-owned enterprises.

Table 3: Privatised businesses - determined and completed (1992–1997)

	Total	State-owned	Communally-owned
Determinations	7173	2068	5105
Of which:			
Corporations	1497	1389	108
Untransformed Enterprises or Outsourced Subsidiaries	5676	679	4997
Completed privatisation of businesses	4115	599	3516
Of which:			
Corporations	300	245	55
Untransformed Enterprises or Outsourced Subsidiaries	3815	354	3461

Source: NSI (1998, pp. 185).

Between 1992 and 1997, state-owned and local enterprises sold in the field of cash privatisation had a total value of 375.5 billion Leva (see Table 4). The proportion of shares of corporations lay at 85%. In this process, bonds are playing an increasingly important role. After having been practically unimportant during 1996, bonds comprised 73% of all revenues of privatisation in 1997.

Table 4: Privatised enterprises – proceeds of sale and privatisation costs (1992–1997) in million Leva

	Number of Objects	Value of sold property	Proceeds of sale		Privatisation costs
			Total	of which bonds*	
Total	4115	375682	316441	253707	656
Corporations	300	318772	281069	252032	345
Untransformed Corporations or Outsourced Subsidiaries	3815	56910	35372	1675	311

*) Buyers can pay with previously acquired State bonds instead of with cash.

Source: NSI (1998, p. 186).

In the year 1997 alone, a 346.5 billion Leva turnover was made through privatisation - twelve times the turnover evidenced in all previous years put together. This is, however, not necessarily a sign of more intensive privatisation, because this rapid development is partly a result of high inflation. In order to more accurately estimate the development of privatisation, it is necessary to examine its value in real terms, such as a convertible currency. Table 5 shows the results of the privatisation transactions until the end of 1998 in terms of US dollars (in millions). The direct financial effect amounts to around US \$ 2.15 billion. This amount includes the agreed payments of around US \$ 1.65 billion, the pre-existing liabilities taken over by the buyers (around US \$ 405.6 million) and the financial obligations already

performed by the buyers (to the value of around US \$ 96 million).⁶

The acceptance or performance of pre-existing obligation by the buyers is encouraged in Bulgaria. One must not lose sight of the fact that the privatised businesses are former public enterprises which have incurred debts to the value of around 160 billion Leva as a result of the delay in the transformation process. These debts are exacerbated by bank debts of around the same value. There are additional financial liabilities toward the State budget, State social insurance, State employees and suppliers.

Table 5: Financial results of privatised businesses (1993–1998) in US\$ million

	1993	1994	1995	1996	1997	1998	Total
Agreed payments	44.23	144.25	113.70	184.76	571.83	587.87	1646.65
Assumed liabilities	12.70	32.96	57.56	218.30	35.04	50.08	405.63
Discharged liabilities	15.25	55.60	10.66	13.51	1.13	0.00	96.16
Monetary revenue	72.18	232.81	181.92	416.57	608.00	637.95	2149.44
Investment undertakings	58.97	201.78	151.91	170.56	891.35	390.91	1855.44
Total	131.15	434.59	333.83	587.13	1499.34	1028.87	4014.88

Source: Privatisation Agency data.

3.5.3. The Financial Procedure

An analysis of the methods of payments in privatisation transactions reveals that immediate payment is by far the preferred method (61.1% of transactions) in the case of corporations. Payment in instalments is the next most popular at 30.9% (see Table 6). The payment by outsourced subsidiaries and untransformed enterprises, however, is more frequently carried out in instalments (52.8%) than in immediate payments (46.8%). This difference can be explained by the differing types of sale which attract different categories of buyers (see Table 7). Corporations are largely bought by legal persons and employees. The latter receive preferential treatment in the payment of instalments, but the legal persons, who form a large proportion of the buyers, are revealing themselves as a group able to find the necessary capital for immediate payment more easily.

⁶ The investment promises can be added to the income derived from privatisation. Until 1998, such promises were made to the value of US \$ 1.86 billion. These promises are to be seen as a necessary part of every contract of privatisation. There is no reliable information available about the performance of investment promises.

Table 6: Privatised enterprises according to form of acquisition (1992–1996 in %)

	Immediate payment	Payment by instalments	Exchange against debts	Lease with option to buy	Other
Corporations	61.1	30.9	1.1	0.4	0.7
Untransformed Enterprises or Outsourced Subsidiaries	46.8	52.8	-	0.3	0.1

Source: NSI (1998, p. 191).

The transfer of Bulgarian property in exchange for foreign debt concessions is a special form of payment. It became possible after negotiations with the creditor banks of the London and Paris Clubs in 1992 and 1994 respectively. These negotiations resulted in the relief of US \$ 200 million from Bulgaria's foreign debt. According to the regulations concerning the conversion of foreign debt, one may not pay more than 50% of the value of the shares or parts of businesses to be sold with Brady-bonds. The buyer has the option of paying the remaining 50% in Leva or US Dollar bonds (ZUNK-bonds are issued in accordance with the law concerning the regulation of the unpaid credits) or in cash. In contrast to the Brady-bonds, which reduce Bulgaria's foreign debt, the ZUNK-bonds are aimed at reducing the State's internal debts.⁷

Securities were issued for the first time on 28 July 1994 with an eight-year respite of payment for the FLIRBs (bonds with reduced interest rates to begin with), a seven-year deferment for the PDI (with a deferment of interest payments) and with a 30-year respite for the DEBs (with discounts). The agreed upon performance of bonds is to be made compatible with the promises by Bulgaria to repay its debts within the required time. In this context the introduction of a variety of methods of payment (for example through cash payment, ZUNK-bonds or Brady-bonds) is to be recommended.

A positive aspect of privatisation through swapping transactions is the buyers' acceptance of financial obligations of the enterprise being privatised, as well as their repayment of its debts according to a repayment plan. The reduction of foreign debt automatically leads to a reduction of total State debts. The contracts promote the repayment of debts while also reducing the burdens on the budget. The Bulgarian method of converting foreign debt directly into property safeguards the effective development of property through contractual clauses which do not actually affect the price of the property, but which determine the future obligations of the buyer. The clauses that do not affect the price of the property (regulating commitments to future investment, repayment of the company's debts to the State and the

⁷ Compare details on this type of financing in the Institute for Market Economics (1997, pp. 23-26).

retention of employees) are to ensure the long-term effectiveness of the property and the achievement of social goals of privatisation.⁸

3.5.4. The Legal Status and Nationality of Buyers

A quick look at the structure of the new owners of property is quite revealing. One can see, for example, that only 0.7% of the sold companies have found a foreign investor. This statistic confirms that Bulgaria finds itself in a rather unattractive position for foreigners. Above all, the cause for this lack of interest can be attributed to the unwillingness of the State bureaucracy to hand over enterprises to foreign investors, as they fear that doing so would diminish their previous power. Moreover, constant and frequent changes in the legal foundations governing privatisation lead to hesitation, especially amongst foreign investors. Also worth mentioning are the problems with the banking system, the restrictions on swapping transactions, which automatically lead to a reduction in potential investors, and the generally unstable political and economic environment.

The largest category of participants in privatisation are Bulgarian natural and legal persons, accounting for 61.2% and 20.6% of the transactions respectively. 15.8% of sold enterprises were bought by employees and management (see Table 7). The legal status of buyers depends upon whether a corporations or an outsourced subsidiary or untransformed enterprise are being privatised. Bulgarian natural persons accounted for 8% of sold corporations, while employee collectives and Bulgarian legal persons accounted for 40.7% and 43.9% respectively.

Table 7: Legal form and nationality of purchasers, 1992-1997 in %

	Employee	Natural persons		Legal persons		
		Bulgarian	Foreign	Bulgarian private	other	Foreign
Corporations	40.7	8.0	0.7	43.9	0.7	6.0
Untransformed Enterprises or Outsourced Subsidiaries	13.9	65.3	0.2	18.7	1.8	0.1
Total	15.8	61.2	0.2	20.6	1.7	0.5

Source: NSI (1998, p. 189).

Foreign investors are more likely to be involved in the acquisition of corporations. The acquisition of untransformed companies and part companies, on the other hand, is dominated by Bulgarian natural persons (65.8%). These great differences reflect the different forms of

⁸ See Privatisation Agency News Service (1995, p.15).

privatisation and the various sizes of the businesses being privatised. Outsourced and untransformed enterprises can usually be placed in the category of small business. These can more easily be afforded by private individuals.

4. Mass Privatisation in Bulgaria

As a result of the delayed start of privatisation in Bulgaria (effectively it only began in 1993), the lack of interest by investors in the highly debt-ridden enterprises and the unsatisfactory results of privatisation in 1994, a search for alternatives was necessary. In 1996 the Bulgarian legislature developed the concept of mass privatisation, the goals of this being the acceleration of privatisation, the establishment of a capital market, the expansion of possibilities for investors and the improvement of the enterprises' management. It is expected that the cooperative ownership envisaged by mass privatisation will, especially in the initial stages, promote the entrepreneurial dynamic, while ensuring its stability in the long term.⁹ Mass privatisation also pursues social goals, as it gives all citizens over 18 years of age the opportunity to become shareholders, enabling them to participate in the acquisition of parts of State property. Mass privatisation, however, is lower in priority than cash privatisation. In the event that an enterprise intended for mass privatisation finds an investor, it will be struck from the list of enterprises for mass privatisation.

4.1. Legal Foundations

The legislation governing mass privatisation is based largely on the laws governing the privatisation of state-owned enterprises. A number of further regulations specially aimed at mass privatisation have, however, been passed. The most important of these include the resolution of the Council of Ministers to establish a Centre for Mass Privatisation, the 1995 regulations for the development and distribution of voucher booklets for mass privatisation, the concessions law of 1995, the law governing the securities market and investment companies of 1995, the law governing the financial rehabilitation of state-owned enterprises of 1996, the 1996 law governing the privatisation fund and the regulations concerning investment vouchers passed in the same year.

⁹ See Pasev (1996, pp.78–87).

4.2. Participation of Citizens in Mass Privatisation

All citizens over 18 years of age are participants in mass privatisation. The participants each received privatisation vouchers to the value of 25,000 Leva during the first wave of privatisation. In order to obtain these, they were obliged to pay a registration fee of 500 Leva. Pensioners received concession rates of 100 Leva. The second wave of privatisation provided each participant with vouchers to the value of 250,000 Leva. Registration fees were raised to 5000 Leva (or 1000 for pensioners).

The laws governing mass privatisation guarantee employees and management the right to obtain a 10% share of the enterprise free of charge. The total value of shares obtained by individuals in this way may, however, not exceed the value of the individual employee's gross income over the past 24 months. In accordance with the most recent laws governing privatisation (passed on 10 April 1998), all employees are entitled to receive free shares, if they have been working in the enterprise for a minimum of two years prior to the announcement that the enterprise is to be privatised. Pensioners who worked in the enterprise for at least three of the ten years prior to privatisation, and managers who were involved in the enterprise for at least one year, may also receive free shares.

4.3. Privatisation Funds

The most important task in the process of mass privatisation concerns the privatisation funds. They bridge the gap between the enterprises and the citizens. They are to act as intermediaries by conveying information to citizens and recommending the most worthwhile investment strategies available. Competition amongst the funds is to ensure their efficiency. However, citizens are also permitted to invest in the enterprises personally or through an authorised representative.

If they participate through privatisation funds, Bulgarian citizens owning vouchers become shareholders in the funds themselves. In effect, they therefore not only possess shares in the privatised enterprises, but also in the privatisation funds which have themselves acquired shares in the enterprises. The shares bought by the funds are determined only by their managers. Shareholders in the funds have various rights to information and control against the managers of the funds, but not against the managers of the enterprises themselves. As long as they own the necessary proportion of shares, the privatisation funds are entitled to influence the policies of the enterprise. The shareholders of the funds have only a rather restricted influence over the funds. Those who hold only few shares in the funds have next to no

influence over their investment strategy.

The Bulgarian legislature regulates the investment strategy of the funds quite strictly. In order to avoid monopolies, individual funds may not acquire more than 34% of the shares of any one enterprise. This requirement forces funds to expand their investment portfolios widely into a variety of companies. This is not only aimed at minimising monopolies, but also seeks to provide investment guarantees through diversification of ownership. The diversification of the portfolios protects small investors from losses should one or more of the enterprises not succeed in their entry into the competitive market economy. The privatisation funds, which are established exclusively as share companies and are licensed by the Commission for Securities and Fund Markets, are obliged to demonstrate capital to the value of at least 70 million Leva. At least 10 million Leva are to be invested in assets or in State securities; the rest (at least 70%) is to be held in investment coupons. Legal persons with predominantly State property (over 50% of capital) may not establish funds or acquire their shares. This restriction does not apply to banks and insurance companies. A bank may not, however, be the founder or shareholder of a fund while at the same time managing its finances.

Also foreign persons or companies can establish privatisation funds. As a condition of doing so, they must be recognised as financial institutions in their home country and they must prove a minimum of five years of business activity in that country. Alternatively, a reference from a first class bank would be sufficient to allow such investment. Thirteen of the 81 privatisation funds in Bulgaria, including the third largest Dutch-Bulgarian fund established by the ING-Bank, have been established by foreigners.

The Bulgarian legislature attempts to protect the interests of small investors through various regulations. Excessive acquisitions of power by individuals are to be avoided. For this reason, the legislature prohibits an individual's acquisition of more than 10% of a fund's shares, whether this is done directly or through a partner. In order to ensure that the funds carry out their intended activity, they are limited to using their investment vouchers in the context of mass privatisation.

With restrictions, the privatisation funds are permitted to invest in both State and other securities dealt with on the securities market. Investment in State securities is not to exceed 25%, while investment in other securities is not to exceed 10% of the fund's total capital. Funds are not permitted to invest in the securities of members of their own administrative or supervisory organs, nor may they acquire securities in their dealing bank or its affiliated persons. These restrictions ought to ensure that insider transactions do not become a burden to

small investors or the privatised enterprises themselves. The funds are not entitled to take out loans, distribute bonds, carry out the broker's activities or participate without limited liability in personal companies and corporations.

4.4. Selection of Enterprises

Mass privatisation in Bulgaria is handled by the Centre for Mass Privatisation, which is responsible only for completing the necessary administrative and organisational tasks. The enterprises remain within the control of the appropriate ministries until their shares are sold and they have been taken over by the new owners. Thus, Bulgaria has not established an authority comparable to the *Treuhandanstalt* in Germany or the Hungarian National Agency for Capital Gain to take over the administration of State property and control the enterprises. Unlike in Poland, state-run privatisation funds have not found majority support in Bulgaria.

The selection of enterprises to be proposed by the Council of Ministers and subsequently passed through the National Assembly for approval. The Regional Ministry, the Centre for Mass Privatisation, the Privatisation Agency and the branch ministries are responsible for finalising the list.

The selected enterprises must meet certain criteria before entering the privatisation process. Thus, they must have the legal structure of share companies and be considered to have future prospects. In order to avoid conflicts between the new owners and creditors, the companies must not be subject to debts in the form of mortgages, or court orders for confiscation of property. In cases where the companies are heavily in debt, a complex financial analysis and measures to reestablish their financial soundness must precede their privatisation.

The list of enterprises considered during the first wave of mass privatisation comprised 1050 companies. The businesses were selected by the Ministry for Industry (659 businesses), the Ministry for Agriculture and the Food Industry (176), the Ministry for Transport (74) and the Ministry for Territorial Development and Construction (69). The remaining 72 enterprises were selected by the Ministry for Trade and the Ministry of Culture, as well as the Ministry for Tourism and Energy. The total net value of the capital of the privatised enterprises amounted to around 210 billion Leva. The enterprises are not, however, always completely privatised. A capital value of only 90 billion Leva is to be sold to the privatisation fund (see Table 8).¹⁰ 812 enterprises offered at least 60% of their capital for sale. These consisted mainly of small to medium-sized businesses, of which the State maintained a small proportion

¹⁰ See Centre for Mass Privatisation (1997).

of assets in order to satisfy the remaining creditor demands for restitution. In eight cases, 50-60% of share capital is to be privatised. Included in this group are medium to large-sized firms, of which the State considers it necessary to maintain strategic participation for a certain period of time. In 230 enterprises, a maximum of half of their capital is to be transferred into private hands. These consist largely of strategically important businesses, an example being businesses significant for State security. The State is seeking new investors for these enterprises, but wishes to maintain their strategic management.

Table 8: Proportion of those enterprises designated for mass privatisation and their share capital

Share of capital made available for mass privatisation	Number of enterprises	Total enterprise capital (in thousand Leva)	Capital made available for mass privatisation (in thousand Leva)
Up to 50 %	230	127 802 109	22 141 005
Between 50-60%	8	845 494	483 695
Over 60 %	812	81 575 645	56 758 437
Total	1050	210 233 248	90 383 137

Source: Centre for Mass Privatisation (1997, p. 30).

As a general rule, the lower the capital of an enterprise, the higher the proportion of shares which can be privatised. Indeed, enterprises with a capital of 50-100 million Leva are usually wholly privatised, with 20% of shares being reserved for sale to management and employees.

The average value of share capital of the enterprises on the list of mass privatisation lies at around 189 million Leva. This is not, however, an indication of the actual worth of the companies. In contrast to the procedure adopted during cash privatisation, no market assessments are carried out before mass privatisation. While this saves time and money, it reduces the transparency of transactions. In order to ensure that prices set are at least realistic to some degree, a process of gradual price fixing was introduced in Bulgaria. The ministerial council determines the minimum price for shares of each company. These shares are then auctioned off in several rounds. Before each round, the prices are adjusted in response to the demand. Should the price be set too low in the first round, no sale will ensue, and a new price is set, followed by a new auction. It is only at the end of the auctions that the price of shares can be determined.

4.5. The Results of the First Wave of Mass Privatisation

The first wave of mass privatisation, which mainly involved companies with positive balance sheets and low levels of debt, as well as a favourable outlook for the future, can be regarded optimistically. After 18 months, there are already 747 enterprises which have privatised at least 50% of their property. There are 611 businesses which have sold all of the shares

intended for sale. At least 67% of the shares intended for sale have been sold in 666 enterprises. In 81 businesses, the proportion of assets which has been privatised through investment coupons lies between 50% and 67%. There are 293 companies which have less than 50% of privatised capital.

Of the 1050 enterprises intended for privatisation, 10 dropped out following the third round of auctions. The 174 enterprises with 100-200 million Leva worth of assets form the largest category of the 1040 enterprises remaining, with 50.5% of them having already been privatised. The enterprises with a comparatively low level of capital (between 1-10 million Leva) were privatised most quickly (80.6%). Of the group with the next highest level of capital (10-20 million Leva), consisting of 112 businesses, 74.2% have been privatised. The rate of privatisation lies at 72.3% (65.2%) amongst the 107 (88) enterprises with a capital of 20-30 million Leva (30-40 million Leva).

In total, around 69 million shares have been acquired through mass privatisation, 60 million being acquired by the privatisation funds and 9 million acquired by private buyers. Three million Bulgarians, of which 2.1 million invested in the privatisation funds, participated in the first three rounds of auctions. Half a million citizens acquired 9 million preferential shares. Table 9 shows the results of the first three rounds of auctions.

In a situation similar to that in the Czech Republic,¹¹ where privatisation funds have acquired over 40% of capital, the 81 established privatisation funds in Bulgaria own 84% of the privatisation vouchers. Their total capital, consisting of cash, State securities and investment vouchers, amounts to 64.5 billion Leva.¹² According to initial estimates of Bulgarian experts, privatisation funds, State and individual shareholders respectively control 69%, 27% and 4% of the available capital. The structure of ownership following mass privatisation suggests that the existence of property concentrated in privatisation funds will establish itself as the main model of cooperative administration in Bulgaria.¹³

The United Bulgarian Privatisation Fund (Dowerije) Ltd is the wealthiest of the funds (6.5 billion Leva of capital). There are only seven privatisation funds with control over less than 100 million Leva. Most funds (38) have acquired capital of 100-300 million Leva, while four funds administrate 3 billion Leva each. It can be expected that especially those funds involved in over 100 enterprises will confront difficulties when they exercise their property rights. The

¹¹ See Buch (1997).

¹² According to data from the Commission for Securities and Funds Exchange (1997).

¹³ See Georgiev/Keremedchiev (1998).

smaller funds, on the other hand, will encounter problems in the establishment of an ideal investment budget. They are subject to the danger of being taken over by the bigger privatisation funds.

Table 9: Results of Mass Privatisation after Three Rounds

	Round 1	Round 2	Round 3	Total
Shares offered (million)	78.3	54.3	28.2	84.4
Shares sold (million)	32.4	24.2	12.5	69.1
Shares acquired by individual participants (million)	4.3	2.4	2.4	9
Credit resources issued (billion credit notes)	6.2	1.7	1.2	9.1
Average price for individual participant's share	1442	708	500	1011
Shares acquired by funds (million)	28	21.8	10.1	60
Credit resources issued (billion credit notes)	44.9	12.9	4.5	62.4
Average price for a funds' share*	1604	550	446	1040

**) Average price of the sale to funds and the direct sale to citizens.*

Source: Privatisation Agency News Service (1997b, p. 2).

The investment strategies of the funds are largely connected with their available capital. Four of the medium-sized funds (100-500 million Leva) are focussing on a maximum of five enterprises each. Twenty-five funds own shares in 11-20 enterprises. The Dowerije boasts the largest involvement, with participation in 174 enterprises. The Bulgarian-Dutch fund runs second with 111 enterprises.

In order to contain the funds' influence over the policies of an enterprise, Bulgarian legislation has limited each funds' share of an enterprise's capital to a maximum of 34%. However, where the remaining capital is distributed amongst a wide range of owners, this percentage can suffice to fully control the enterprise. The 34% limitation ceases to apply once the open market sale of shares begins and the privatisation funds have been transformed into holding companies.¹⁴ Sixty-seven of the 81 funds hold a total of 396 maximum quotas of 34%. The Dowerije, for example, owns 34% shares in 43 businesses. The Bulgarian-Dutch fund does so in 24 enterprises.

The privatisation funds have shown a particular interest in small enterprises, as maximum quotas can be obtained in exchange for a relatively low investment. Interest is significantly lower in large businesses. The funds obviously lack not only the necessary experience in

¹⁴ In reality, shares are already exchanged notwithstanding the legislative provisions. It must therefore be assumed that several PFs have secured more than one-third of their shareholding to privatised enterprises. See Danev (1997, p. 3).

leading and managing larger enterprises, but also the required financial resources to invest in these enterprises. Thus, only 3.7%, instead of the intended 35%, of Kremikowtzi Inc., a group of metallurgical companies, was able to be privatised by 1997. The oil company Neftochim Inc. is an analogous case, barely 3.2% of the intended 25% having been privatised.¹⁵

4.6. The results of the Second Wave of Mass Privatisation

The second wave of mass privatisation began on 25 January 1999 and is to be completed by the end of December 2001. The citizens of Bulgaria have each received vouchers of 250,000 Leva, which they can invest in their capacity as employees or managers of the enterprises being privatised, or as independent participants at the auctions. They may also call upon professional brokers who have been registered by the Centre for Mass Privatisation.

Thirty-one enterprises, totalling 196 891 thousand Leva in value, are intended for privatisation during the second wave of mass privatisation. At this stage, it is impossible to estimate or predict the possible success of this wave, which encountered problems right at its beginning. It was to be carried out in parallel to the reform of the Bulgarian pension scheme. The pension funds, which had been allocated the role of main investors, were unable to establish themselves until 1999 as a result of the delay in the reform of pension schemes. Thus, the second wave of privatisation began without strategic investors.

5. Conclusion

Prior to the commencement of the process of privatisation, nearly all Bulgarian enterprises were in State hands. Compared to the other post-socialist countries, the economic and structural reform in Bulgaria has progressed far slower. As a result of this, particularly in the first phase, largely uncontrolled transfers of property, initiated by insiders (consisting mostly of the top-ranking officials), have resulted in questionable concentrations of power within the economy. The true shift of control away from the State only began once cash privatisation and mass privatisation were introduced. Incidentally, this process, as far as the privatisation funds are concerned, has strongly resembled the model followed in the Czech Republic.

Transfer of property rights in Bulgaria has revealed itself as a painstakingly slow restructuring process with an indefinite conclusion. Considerable proportions in the new share companies have been acquired by government and managers. In contrast to Poland, where traditionally

¹⁵ NSI (1997, p. 7).

strong trade unions initiated the reforms, the participation of employees has not played a significant role in Bulgaria. Thus, the enterprises' management and the privatisation funds were the most active investors. It is substantially the quality of management which will determine the stability of the weakened Bulgarian enterprises. The behaviour of managers constitutes a particular risk to privatisation. Should their power or employment be threatened by the takeover, their performance may suffer due to their lack of interest during the time (usually 8-12 months) before the privatisation has been finalised, meaning that the enterprise's financial situation could deteriorate even further. Although increase in a company's debt is prohibited during the privatisation process, a dramatic deterioration of its financial situation as a result of a manager's irresponsible actions or inactivity cannot be ruled out. The lack of incentives for the old management is a particular instance of a principal/agent relationship.¹⁶ There is thus a need for strict supervision over management, as if company control is not yet functioning adequately in Bulgaria. Should management, on the other hand, be performing the optimal entrepreneurial leadership, the question remains of who will take on the supervisory role. In the long term, during the course of the restructuring, an improvement of supervision by investors is to be expected. Furthermore, the privatisation funds will no doubt act to bring about a more market-oriented behaviour within the enterprises. It is, however, still too early to determine whether the funds will enforce their status as main investors and thus be able ensure the control of effective entrepreneurial leadership in the interests of the new owners.

The behaviour of the funds' executive committees can often also be seen as imposing a risk. Managers could act in their own interest with the property they control, as opposed to the interests of the funds' shareholders. Thus, there is also a principal/agent problem in this field. This necessitates the introduction of additional incentives and sanctions in terms of managerial behaviour, especially while the stock market is not yet fully functioning. Connecting the manager's remuneration to the value of the assets at the fund's disposal would provide just one incentive for the effective administration of the investment portfolio.

Moreover, it is highly likely that more than a year will pass between the establishment of the funds and the first meeting of shareholders - a time during which the shareholders receive next to no information about the behaviour of their managers. Even after the completion of mass privatisation, when funds will be controlling their proportion of the enterprises, counter-productive acts by managers against the interests of the shareholders cannot be ruled out. In order to avoid this, shareholders should maintain strict control, particularly by demanding

¹⁶ See here Petersen/Müller (1999, pp. 69).

information about bought and sold shares, as well as completed transactions. There are further conflicts of interest when, in cases of overlapping ownership,¹⁷ management gives priority to the interests of the bank without having regard to the interests of the shareholders.

In spite of a positive beginning, the Bulgarian model of mass privatisation has not resulted in a pervasive market-oriented economy. Bulgaria still lacks an efficient privatised system of banks, which represent the heart of every efficient market-economy. Mass privatisation commenced largely within a system of state-controlled banks after many private banks had gone bankrupt, a fact which greatly increased the citizens' mistrust in a new system. Currently, the activities of the Bulgarian financial sector are limited to the administration of the savings, rather than its acting as an independent institutional investor. The management of non-cash transactions and, even more so, the capital and stock markets, are still in their very early stages of development.

Of all financial institutions, banks are the only ones which provide financial resources while at the same time exercising control over the enterprises. The active participation by banks in the process of privatisation in Bulgaria is hindered strongly by the system of crediting which has been inherited from the past. Bulgarian banks have neither the practical experience, nor are they competent in monitoring and controlling indebted enterprises. The combination of direct bank control over state-owned enterprises (the banks, of course, being their primary creditors) and indirect control over subsidiary investment companies would bring the Bulgarian model of administration closer to that found in most modern economies.

Bulgaria currently lacks adequate supervisory mechanisms, as well as mechanisms of cooperative leadership of enterprises. The forecasted transformation of enterprises by the privatisation funds can not be confirmed as having been successful. The six-month ban on the sale of privatisation fund shares and the practical impossibility of selling the registered shares with restricted transfer which were handed to employees free of charge, has promoted the establishment of a speculative market in vouchers. The lack of dynamic has dire consequences for mass privatisation, the delay in further mass privatisation having already become a reality. Furthermore, there is a profound lack of clarity concerning the sale of the companies' share packages.

The more mass privatisation relies on market forces rather than the bureaucratic intervention of the State, the greater its success will be. Although the role of the State is important, it ought

¹⁷ For example, where a bank has shares in the privatisation funds and the same fund owns shares in an enterprise, which is in turn indebted to the same bank.

to limit its activities to the determination of regulations and the preparation of enterprises for privatisation - it ought to change the relevant structures, establish a legal framework for privatisation and reform the bank system. It is, however, clear that only a stable State can provide favourable conditions for a dynamic market-oriented development, the most important foundation for this being effective competition. If the money and capital markets were to be subjected to increased competition, this would lead to improved control of the privatisation funds, while at the same time serving the interests of the shareholders. In spite of the observed weaknesses, it must be remembered that there is no alternative to the process of privatisation and that important partial successes have already been achieved.

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