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ECONOMIC COMMITTEE

BULGARIA: ECONOMIC REFORMS

Note by the United Kingdom Delegation

PART I. SUMMARY

Since the Second World War economic activity in Bulgaria has been dominated by the push for industrialization and high rates of growth have been attained. The highly centralized planning system enabled Bulgaria, traditionally in agricultural economy, to industrialize very rapidly although investment in the consumer and agricultural sectors suffered. By the late 1950s industry had grown more complex and the economy was beginning to suffer from the strains imposed by rigid, detailed control from the centre.

2. After a period of experiments in the early 1960s, the "Theses on the New System of Planning and Management" were published in 1965. These were designed to use financial levers to a greater extent in economic management and to give the enterprise a more important rôle in the decision taking process.

3. Implementation of the reforms was slow because of inadequate preparation, inefficiency on the part of industrial management and the innate conservatism of the Government. Several important features such as the price reform were postponed. The lack of efficient managerial staff who could cope with new responsibilities and financial disciplines was to prove particularly significant.

4. In 1968 and 1969 there was a return to stricter central control, strongly influenced by evidence of financial mismanagement at a number of the trusts established under the reforms and by a deteriorating foreign exchange position necessitating Russian assistance which may have been conditional on tighter central control.

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5. The centralizing process culminated in a reform of industrial organization in January 1971. Economic power has been vested in new State Economic Corporations and the individual enterprises have been deprived of their legal independence. The emphasis is now on larger unit production size and on improving central planning techniques.

6. In the agricultural sector Agro-Industrial Complexes have been established, each integrating the work of several collective and state farms which have thus lost some independence in management and finance.

7. No real autonomy is permitted to any organization under the Ministry of Foreign Trade which approves all foreign trade dealing, though Bulgarian export corporations seem to be allowed some flexibility in adapting to foreign market requirements.

8. In the short term the economy is not likely to suffer greatly from the emphasis placed once again on administrative means of control. But many of the old problems will remain for the longer term and will deepen as the economy grows. Among the more serious are the distorted heavily subsidised price system, the lack of meaningful financial costings for investment decision taking, the relatively low productivity of labour and capital and the lag in the application of modern technology compared with the West.

## PART II. MAIN REPORT

### Introduction

1. Bulgaria, with a population of 8.6 million, is the smallest of the CMEA countries, and is also one of the least developed, having an estimated per capita GNP of United States \$1,310 in 1970 - less than that of any other CMEA country with the exception of Rumania. Traditionally an agricultural country, Bulgaria has developed her industry at a very fast pace since World War II, though from an extremely small base, and by 1970 industry was accounting for about 50 per cent of the GNP.

### The 1965 reforms

2. The highly centralized planning system, particularly through its control over capital investment, enabled Bulgaria to industrialize very rapidly and to achieve high rates of economic growth on a small and relatively simple industrial base,

although investment in the consumer and agricultural sectors suffered. By the late 1950s the difficulties in controlling micro-economic activity from the centre were becoming apparent and during the early 1960s Bulgaria probably conducted more experiments with new forms of economic management than any other East European country. The theses on the "New System of Planning and Management" were published in December 1965 and were among the more progressive reform movements announced in Eastern Europe at the time. Although the more complex aims of the Czechoslovak reforms, such as a radical restructuring of the economy, were not envisaged in Bulgaria (and would not have been particularly relevant), there was a common emphasis on the development of a more capital intensive economy. A realistic pricing system was envisaged, forcing enterprises to reduce costs, to increase productivity and achieve faster technical progress. The theses allowed for a considerable devolution of powers to the enterprise and the main changes which were intended are examined in paragraphs 3-11 below.

Decision Taking

3. The principal change envisaged by the theses was the concept of "independent accountability" at enterprise level. Central planning would remain the basis for guiding overall economic activity but the central planning machinery would concentrate to a greater extent on the five-year plan as compared to the annual or quarterly plans and enterprises would participate more fully in the planning process. Two targets were to be imposed on enterprises, namely output of essential goods and foreign exchange receipts from exports. Ceilings were to be imposed on capital investment expenditure, imports of basic raw materials and foreign currency for imports. In achieving the targets and keeping below the ceilings, enterprises were to be influenced by more general indications on for example, levels of income, taxes and prices. Within these constraints, profit would be the main success indicator. Enterprises would for the first time be able to decide the size of their labour force, carry out their own investments and enter into contracts with each other.

4. The central authorities would guide enterprise activity through the fiscal system, the banking system and, in the last resort, administrative sanctions. There would also be a Central State Organ for Material and Technical Supply which would distribute raw and other materials, semi-fabricates, and consumer goods for which quotas were included in the central plans. This body would also supervise contracts agreed between enterprises.

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5. The director of the enterprise would continue to be appointed by the Ministry but would have greater freedom over decision taking. In order to bring employees of the enterprise more into the decision taking process it was decided to set up Production Committees, composed of representatives of management, technical and economic advisers, workers' representatives and trade unions' representatives. Although these bodies would be able to veto certain decisions of the enterprise director their main function was intended to be advisory.

#### Organization

6. It was recommended that State Economic Amalgamations (SEAs) should be set up to co-ordinate various aspects of enterprise activity such as research and development, marketing (particularly export) and raw material supplies. The SEAs would be vertically and horizontally organized trusts, monopolistic in nature, each controlling all production of its speciality. With the increased powers given to enterprises and the creation of the SEAs, the central Ministries would lose most of their detailed planning functions.

#### Profit, Taxation and Enterprise Funds

7. Under the new system the first charge on enterprise profits would be payments to the State Budget. These would consist of a profit tax, a turnover tax and a new tax on productive fixed and circulating capital intended to encourage more rational use of capital reserves. After these payments and a contribution to finance the SEA, the enterprise would use its retained profits to form the following funds:

- (a) Expansion and technical improvement fund (this fund would also include a proportion of depreciation allowances).
- (b) New products fund.
- (c) Technical progress fund.
- (d) Social and Cultural outlays fund (including bonus payments).
- (e) Wage Reserve fund.

#### Investment

8. The old system of free investment grants from the State Budget had been wasteful of resources. In future, although the State would continue to determine and finance all major

projects, enterprises would have to finance their own investments (mainly modernization and capital repairs) out of the Expansion and Technical Improvement fund or by using bank credits. With this greater reliance on enterprise self investment the banking system would assume a more important rôle in assessing the profitability of enterprise investment projects and a new system of interest rates would be worked out.

Prices

9. In the early 1950s industrial prices had generally been fixed at low levels to encourage rapid industrial growth. This had distorted price relationships between industry and other sectors of the economy, particularly agriculture. In addition a system of prices which remained rigidly fixed even in face of cost changes had resulted in increasing distortion of relative prices in industry and a heavy dependence on price subsidies. In 1965 it was proposed that prices of products should be related to their cost of production, taking into account world market price levels, quality differences and market demand for the product. Also an element of price flexibility should be introduced through a three-tier price system (similar to that proposed in Czechoslovakia) consisting of fixed prices, prices fluctuating between set limits and free prices. It is probable that the last category was intended to apply only to a limited range of non-essential consumer goods.

Wages

10. In the past heavy reliance had been placed on the use of piece rates even in highly capital intensive enterprises. This, combined with unrealistic norms, had resulted in an undue emphasis on quantity at the expense of quality, thus leading to a high level of reject products and unsaleable production. The "1965 Theses" recommended that although the State should continue to determine relative wages between branches of industry, the enterprise would set its own wage norms and wage quotas within centrally imposed limits. There should also be a switch over to hourly rates wherever possible with bonus payments being paid out of the Social and Cultural outlays fund.

11. The basic wage would be paid for out of enterprise costs. The wage reserve fund (see paragraph 7) was to be built up in case the enterprise in any bad year did not obtain enough income to pay its basic wages. Bonuses to enterprise employees could only be awarded from retained profits after the various funds outlined in paragraph 7 had received their financial allocations.

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Implementation of the reforms

12. In general terms the theses were endorsed at a Plenum in April 1966 but there were already signs of retreat from their more radical decentralizing features. It had been intended that the reforms would be introduced by the end of 1967 and about 70 per cent of industry was in fact placed under the new system. But many aspects of the reform had not been implemented at this date:

- (a) There was still a great reliance on piece rates at enterprises and on the whole, the new wage norms had not been introduced.
- (b) Although the Bulgarian National Bank and the State Investment Bank had been amalgamated to simplify the process of granting credits, only 10 per cent of investment was being financed through the banking system.
- (c) The crucial price reform had not been carried out and the new factory and retail prices were still not ready.

13. It was decided to introduce the new system throughout the economy on 1st January, 1969. However, the retreat from the full implementation of the decentralization proposed in the 1965 Theses became a definite trend towards recentralization from the middle of 1968. The initial turning point came with the July Plenum of the Central Committee of the Party. At the Plenum Premier Zhivkov reassessed the prominent rôle of the centre in directing the economy. As a result a new Committee for Economic Co-ordination responsible to the Council of Ministers was set up to co-ordinate the activities of the Ministries, SEAs and enterprises. Furthermore, although SEAs and enterprises would be able to make suggestions regarding the central plan, these suggestions would not in future form the basis of the plan which would be determined centrally.

14. To improve the distribution of materials and semi-manufactures the Central State Organ for Material and Technical Supplies was to be elevated into a Ministry for Supplies and State Reserves and the enterprise independent contract system was to be restricted to consumer goods. In order to increase the efficiency of the banking system, certain departments of the National Bank were reorganized as a separate Agriculture and Trade Bank and an Industrial Bank which, from 1st April, 1969, were to serve the investment credit requirements of these sectors. Despite their nominal independence however, the two new banks remained subordinate to the National Bank.

15. A decree on planning passed in November 1968 confirmed the recentralization process and the number of mandatory indicators and other constraints on enterprises increased. An ordinance on prices introduced in November 1968 made it clear that the new factory prices were still not in operation and were now expected to be introduced during 1969. According to the ordinance the prices of the same goods would be uniform for all producers and consumers and the right of enterprises to fix prices by contract would be restricted to a range of consumer goods not marketed through the State retail trade network.

Developments in 1969

16. Certain domestic developments hastened the recentralization process. During 1968-1969 there were instances of the SEAs violating plan, state and financial regulations; contracts were concluded which proved uneconomic and corruption and mismanagement led to a number of scandals such as the one involving the Texim Importing and Exporting Agency and another involving the Merchant Fleet Super Trust which had been given considerable economic powers. The failures of some of the SEAs contributed to Bulgaria's serious foreign exchange situation in 1968-1969, and her debt service ratio rose to crisis proportions. It seems likely that the USSR made a convertible currency loan at the end of 1968 and this may have been conditional on the Bulgarian's re-establishing strong central control over the SEAs and enterprises. (There were a number of Russian investigating teams in Sofia at the time.)

17. Thus in September 1969 a meeting of the Central Committee dealing mainly with "State and Labour discipline" decided to extend the limitation to enterprise independence and particularly to improve financial discipline through extensive checks and auditing (early in 1970 a Central Financial Office responsible to the Ministry of Finance was set up). The Production Committees established in 1966 were also, during 1969, transformed into Economic Committees elected by a general assembly of employees but with reduced worker representation and with fewer responsibilities.

Developments in 1971

18. The conclusive stage of the recentralization was reached in 1971. On 1st January, 1971 a reform of industrial organization was introduced by which economic power was concentrated at a reduced number of corporations; the number of SEAs, now renamed Stage Economic Corporations (SECs) being reduced from 124 to 65. In contrast to the old SEAs these Corporations receive their plan tasks directly from the Council of Ministers thus by-passing the

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Ministries; in addition they have complete responsibility for all the activities of their subordinate enterprises which have been deprived of the legal and economic independence remaining from the 1965 Theses - the idea being to leave them free to concentrate on production. The SECs, which cover either an industrial branch or sub-branch are designed to encourage a more rapid introduction of new technology and therefore incorporate research institutes headed by a deputy director of the SEC. The SEC is also responsible for export activity either through its own Foreign Trade Section, a specialized Foreign Trade Corporation or the Foreign Trade Section of another SEC. In the event of the SECs' plan not being fulfilled the managerial staff of both the Corporation and the enterprises can be deprived of their bonuses and have their basic salary reduced by up to 20 per cent. For overfulfilment, incentives of up to 50 per cent of their annual salaries are provided.

19. The banking system was affected by the policy of concentration and the Industrial Bank and the Agriculture and Trade Bank (see paragraph 14) were reincorporated into the Bulgarian National Bank in early 1971.

20. In the prices sector, a revision of factory prices were actually introduced with effect from 1st January, 1971. On average a 10 per cent reduction in prices was claimed but no indication was given that the new price levels would be any less rigid than the old. Some retail prices, particularly those of agricultural goods and basic services such as electricity had been increased in 1968 but no further changes were made as a result of the changes of factory price levels. The December 1970 disturbances in Poland which were partly prompted by a series of retail price increases no doubt encouraged the Bulgarians to maintain retail prices at their existing levels. No more was heard of free or "limited" prices and the idea of a three-tier price system seems to have been abandoned.

#### Agriculture

21. Collectivization of agriculture had been accomplished in Bulgaria by 1957 and the main trend since that date has been to secure the benefits of larger-scale production; the private plot activities of the peasants have been subject to the vacillations of policy familiar in the Communist countries. The 1965 reforms attempted a number of experiments at the more profitable collectives on similar lines to those conducted in industry - reduction in the number of obligatory procurement targets, emphasis on financial accounting, a contract system instead of administrative orders for deliveries to the State, and a relaxation of the restrictions on private plots in order to improve personal incentives.



22. As a result of the recentralizing policy evident at the July 1968 Plenum (see paragraph 13), a number of experimental Agro-Industrial Complexes were set up in 1969. These involved the horizontal integration of several collectives and State farms within a branch of agriculture and were designed to reduce costs by increasing specialization and benefiting from the economies of large-scale production. The Complexes were to include eventually some industrial trade and purchasing enterprises. A Central Committee Plenum in April 1970 confirmed that Agro-Industrial Complexes were to be the new form of organization in agriculture and by the end of 1971 about 140 out of a planned 155 had been established. The collectives retain their legal independence within the Complex (in some contrast to the industrial enterprise within the SEC) but have nevertheless lost some independence in management and finance to the Complexes, which have also taken over some of the responsibilities previously experienced by the Ministry of Agriculture.

Foreign trade

23. In conjunction with domestic reform policy, the Bulgarians believed the way to modernization pointed in the direction of vastly increased imports of machinery and equipment from the West. However in the late 1960s, this policy was blunted and redirected, partly as a result of the Czechoslovak experience, but more importantly because of the difficulty of producing exports acceptable to the West and the consequent unsustainable increased level of Western indebtedness. In 1968, the USSR was compelled to render the Bulgarians financial assistance and the reversal of the decentralization process in 1968-1969 may well have been the price which the Russians exacted for their help. (See paragraph 16.)

24. In general the Bulgarian economic reforms have had little effect on foreign trade and its functioning. Under the 1965 Theses, the Ministry of Foreign Trade retained responsibility for the overall fulfilment of the Foreign Trade Plan in respect of goods, foreign currency and transport. The Ministry was to supervise, control and ensure the accurate and punctual implementation of trade agreements, issue permits for import and export deals and control the prices of all goods and services.

25. Certain State Economic Amalgamations (see paragraph 6) were given the right to conduct their own foreign trade activities; the economic advantage of this measure was that the user of a product became more likely to influence the producer. The independence of the Amalgamations was increased, in theory, when they were given the right to dispose of surplus fixed assets, raw materials and other stock valuables.

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26. The effect of the policy reversal signalled by the July 1968 Plenum made itself felt in the form of legislative measures which were enacted in November 1968 and June 1969, to restrict direct dealings between Bulgarian economic trusts and foreign enterprises which had apparently been permitted experimentally under the provisions of the 1965 Theses. This reshuffling of the chain of command placed increased reliance on the "branch" principle and on the Economic Amalgamations which were to serve as intermediate bodies between the Ministry of Foreign Trade and the enterprises under its jurisdiction. These measures were followed by more stringent action in November 1969 - after Premier Zhivkov's disclosure of "gross violations of financial discipline" by the Merchant Fleet Super Trust and other enterprises, notably Texim, in their import/export departments. (See paragraph 16.) The new foreign trade law enacted shortly thereafter made it clear that no real autonomy would henceforth be permitted to any organization under the Ministry of Foreign Trade. Thus all foreign trade deals require the permission of the Ministry of Foreign Trade. According to other regulations, almost all the foreign trade agencies at the various State economic enterprises ceased to exist, effective from January 1971, and were replaced by 65 enlarged foreign trade corporations under the control of the appropriate Ministry as self-supporting legal entities. These corporations were to take over the business side of the enterprises, to hold funds and to conduct foreign trade negotiations, the success of which was to be measured in the corporations' returns. Because the Amalgamations are industry wide there is some scope for competition abroad and Bulgarian export corporations seem to be allowed some flexibility in adapting to foreign market requirements.

27. In July 1970 a customs duty reform came into effect. This provided for a multi-tier tariff depending on whether it applied to members of CMEA, to developing countries, to countries which grant Bulgaria most favoured nation status or to others. The measures allow Bulgarian Authorities to impose reciprocal punitive customs measures on those countries discriminating against Bulgaria. The effect of the new duty is likely to raise certain domestic prices.

28. All foreign banking activities are conducted by the Bulgarian Foreign Trade Bank, which is semi-independent but attached to the Bulgarian National Bank. Currency realized from export and other foreign trade activities are bought by this Bank, according to the ordinance for purchase and sales of currency - the Bank then sells currency necessary for imports within the framework of specified limits of the Ministry of Foreign Trade. The Bank has recently created a foreign currency fund to give short-term credit in foreign currency.

Conclusions

29. The 1965 reforms in Bulgaria aimed to use financial levers to a greater extent in economic management, decentralizing but raising the unit size of production in industry and agriculture. They foundered on the failure to introduce a new prices system - vital in the introduction of more radical economic reforms in Eastern Europe - on an inability of management to cope with new responsibilities and to exercise proper financial judgments, and finally by having to seek Russian financial assistance which may have been conditional on the exercise of stronger central control.

30. The emphasis is now on larger unit production size, on improving central planning techniques and on automation and the use of computers. The revelation of managerial incompetence in 1968-1969 seems to have stimulated the Government towards management training and a management centre has operated in recent years under United Nations auspices. The restrictions placed on enterprise management, however, must leave limited scope for the exercise of modern managerial techniques.

31. In the short term the economy is not likely to suffer greatly from the emphasis placed once again on administrative means of control, and the concentration of economic responsibility in a reduced number of corporations makes economic sense as few Bulgarian enterprises can be considered large even by East European standards. But many of the old problems remain for the longer term and will deepen as the economy grows. Among the more serious are the difficulties of working out accurate financial costings for investment decision making under a rigid price system, the problems of increasing the productivity of labour and capital in a highly centralized economy with limited incentives; the imbalance of investment between capital goods industries and the consumer and agricultural sectors; the lag in the application of modern technology compared with the West and the limitations on the import of Western technology given the close trading relationship with other CMEA States and the limited competitiveness of Bulgarian industrial products on Western markets.

NATO,  
1110 Brussels.