Bulgaria

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On the winding road to stability

A sense of progress is evident despite slow post-crisis growth and the need to rein in public finances, writes *Neil Buckley*

Compare what is happening in Bulgaria with the state of affairs in countries around it – economic crisis in Greece, surging unemployment in parts of former Yugoslavia, political troubles in Romania – and one phrase recurs: “We are”, says the country’s president, Rosen Plevneliev, “an absolute island of stability”.

The claim, repeated by many senior Bulgarians, has substance. Though the economy shrank by 5.5 per cent in the 2009 global recession, unlike neighbouring Serbia, Romania and Greece, Bulgaria required no international bailout. It has since had 13 consecutive quarters of growth, even if this has been anaemic. With among the lowest budget deficit and government debt figures in the European Union, it is one of only three countries, alongside Finland and Denmark, that fully meet the Maastricht criteria for euro membership.

There have been no mass street demonstrations against austerity, though occasional protests on specific issues have flared. Support for premier Boyko Borisov’s government has waned since it came to power on an anti-corruption platform in 2009. But polls suggest in parliamentary elections due next June or July it may be the first in Bulgaria’s post-communist history to win re-election.

“You can’t underestimate his charisma,” says Ognian Shentov, director of the Centre for the Study of Democracy, a think-tank, of Mr Borisov, a square-jawed former police chief and karate black belt. “His approval rating is high. People trust him.”

Beneath the surface of stability, however, lurks disquiet: about the state of democracy, about how much is still to be done in the battle with graft and organised crime and the need for deep reforms to enhance growth prospects. Such complexities of today’s Bulgaria reflect an often rocky post-communist transition. After faltering early reforms, it slid into an economic and banking crisis and hyperinflation in 1996-97. The currency, the lev, lost 90 per cent of its value in the year before it was pegged in 1997 to the German mark, and later the euro, in a currency board arrangement that remains an economic anchor.

After a period of more effective reforms and privatisations, Bulgaria joined Nato in 2004 and the EU in 2007 and began to transform its business environment. Like other new EU members, it had seen in the years before the 2008 financial crisis a flood of foreign investment, which had fuelled rapid growth. But not enough went into factories and too much into non-tradable sectors such as real estate. This inflated a bubble which – as in Ireland and Spain, if with slightly less force – burst after Lehman Brothers went bankrupt.

Bulgaria remains the EU’s poorest country, with the lowest average wage. Helped by EU funding, which the country has become more adept at managing, the government has preserved some sense of progress despite slow post-crisis growth and the need to rein in public finances. It has built a metro in Sofia and started to construct motorways and upgrade railways. Under Vejdi Rashidov, a renowned sculptor brought in by Mr Borisov to be culture minister, the country, for the first time since the 1980s, has even modernised theatres and opened new museums.

“We have started delivering on Bulgarians’ dreams” for better roads and infrastructure, says Mr Borisov. “We did it in Sofia,” where he was mayor from 2005 to 2009, he adds, “and now we have done it for the rest of Bulgaria.” Yet the country has long battled perceptions in western Europe that it, like neighbouring Romania, was admitted to the EU before it had done enough to tackle corruption and organised crime. It has had to live with continued EU monitoring of progress in those areas, which Brussels says remains inadequate.

Perhaps more unsettling are accusations that the country has slipped

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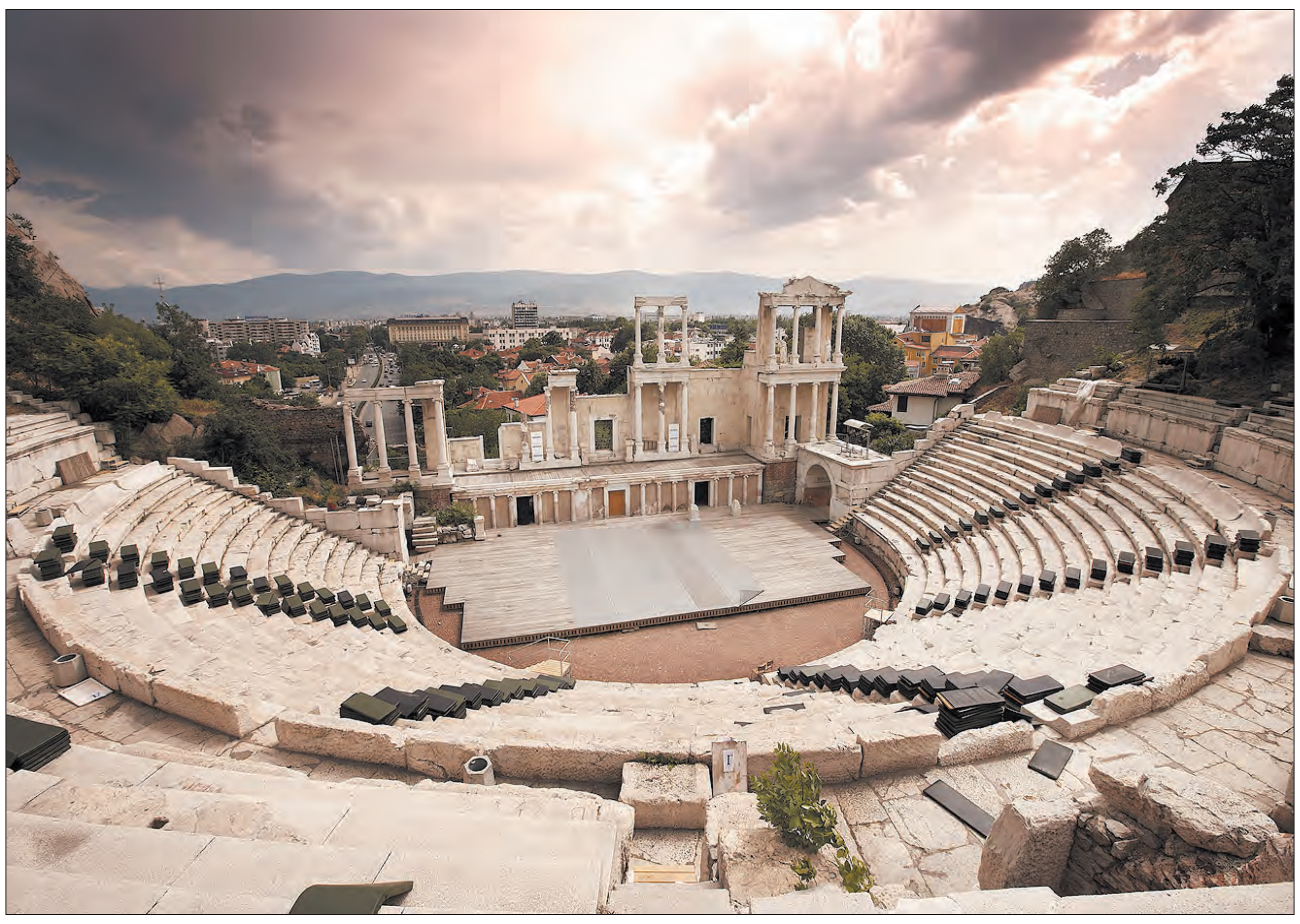


Ancient and modern: the Roman theatre in Plovdiv, which was rediscovered and restored 35 years ago
Alamy

Inside »

Policy makers carry the fight to escape from Europe’s shadows

Governance

Path to satisfying demands of Brussels is an arduous one, writes *Tony Barber*

Almost six years after Bulgaria’s entry into the EU, an occasional cloud of disappointment drifts over Sofia as Bulgarians contemplate the gap between the promised advantages of membership and the concrete gains made. The mood is reciprocated in some EU capitals, especially in western Europe, where it is common to hear the view that Bulgaria was granted admission too soon and that its progress towards EU standards of governance continues to falter.

“It was expected that things would get better and better, but I never guessed when we joined in 2007 that the country would have such a slow take-off,” says Meglena Kuneva, who negotiated Bulgaria’s EU membership and was its first commissioner in Brussels.

Next to Nato membership, a place in the EU was an essential requirement for Bulgaria after its geopolitical vulnerability was exposed by the collapse of communism in eastern Europe in 1989 and wars in neighbouring Yugoslavia. In 2007 EU membership quickly proved its worth when Bulgaria’s new European partners secured the release of five Bulgarian nurses sentenced to death in Libya on groundless charges of deliberately infecting children with HIV.

With its vital interest in Balkan stability, Bulgaria keenly supports the EU’s regional expansion to include three of its five neighbours that remain outside the bloc: Serbia, the former Yugoslav republic of Macedonia and Turkey. Yet the first two are unlikely to join the EU before the end of this decade, and Turkey may never be allowed in. Relations with Macedonia are getting frostier because of disputes over that state’s treatment of its Bulgarian minority. All this leaves Bulgaria with a sense that it is ploughing a lonely furrow in a corner of Europe that is relatively neglected and, on account of Greece’s debt crisis, rife with economic uncertainty.

Bulgaria is nevertheless aware of its EU responsibilities. In its public finances it is one of the bloc’s most disciplined member-states. Unlike the UK and Czech Republic, Bulgaria did not refuse to sign this year’s “fiscal compact” treaty, a cornerstone of future European economic governance.

After much hard work Bulgaria has also met all the technical demands imposed by the EU as a condition of joining the bloc’s border-free Schengen travel regime. Bulgaria is active in the EU’s fight against drug trafficking and illegal immigration. Yet, like Romania, Bulgaria is being kept out of Schengen because of Dutch, German and Finnish opposition. A compromise under which passport-free travel would be permitted through Bulgarian airports and sea ports is not yet within reach.

The northern European argument is that Bulgaria’s inability to stamp out corruption, crack down on organised crime and reform its judicial system justifies the nation’s continued exclusion from Schengen.

The origins of these failings lie in the political, economic and legal chaos that accompanied Bulgaria’s emergence from communism in the 1990s. Even Boyko Borisov, the centre-right premier who came to power in 2009 vowing to root out corruption, has found it hard to satisfy his EU partners that his government is making enough progress.

> ‘I never guessed when we joined [the EU] in 2007 we would have such a slow take-off’

“Few important organised crime cases have resulted in sentences, and there have been several acquittals in important cases where evidence in the public domain raised expectations of convictions,” the European Commission said in a report last July.

Out of 33 contract killings monitored by the Commission since 2006, only four court cases had started, it said. Moreover, Commission officials regularly received complaints from Bulgarian citizens and foreign investors about judicial inaction and alleged collusion with organised crime at a local level. Sergei Stanishev, leader of the socialist opposition and a former prime minister, said the EU report “lifted a curtain hiding a dark reality”.

For his part, Mr Borisov says he accepts the need for the EU to issue regular reports on Bulgaria’s performance. But in a FT interview in Sofia he adds: “If by December next year we’ve done our homework right, there’ll be no more need for such reports.”

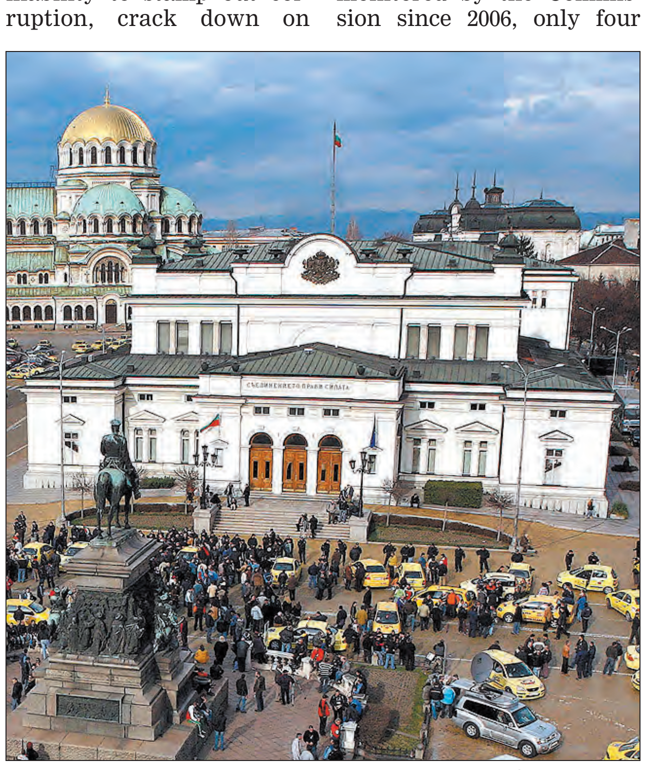
The EU authorities also express impatience with Bulgaria for its inability to make full use of the generous regional aid funds and other programmes on offer since 2007. Bulgarian officials say, however, that the absorption of EU funds is improving rapidly.

According to Professor Venelin Tsachevsky, a leading authority on EU-Bulgarian relations, Bulgaria in its first five years of membership managed to use only 30 per cent, or €3.9bn, of the total financial resources available to it through the EU. Yet, during this period, Bulgaria made a financial contribution to the EU that amounted to about €1.9bn.

As a result, the net financial benefit to Bulgaria from EU membership between 2007 and 2011 turned out to be €400m a year – useful, but not transformational.

Bulgaria is, understandably, anxious to increase its aid levels in the EU’s next seven-year budget cycle.

But, in an article for Finland’s Turku School of Economics, Mr Tsachevsky wrote: “Bulgaria’s demand for a greater allocation from the 2014-2020 EU budget will gain support in the EU on condition that its government steps up the utilisation rate, curbs the corruption and misuse of funds and improves the effectiveness in absorbing the EU resources.”



Focal point: the Bulgarian parliament building in Sofia Getty

Bulgaria

Speculation boom gives way to opportunity with solid foundations

Inward investment

Emphasis is shifting from property and tourism to factories and overseas sales, writes *Tony Barber*

After an unsustainable boom from 2005 to 2009, foreign direct investment in Bulgaria is settling down at levels that are less abnormal for an economy of its relatively small size. More promisingly, investment is switching from real estate and construction into less frothy activities which, in the course of time, should boost the nation's competitiveness and modernise its industry.

"Of course, all investment in Bulgaria is welcome," Boyko Borisov, prime minister, says in a FT interview in his Sofia office.

"But most investments before the European financial crisis were not made in factories and plants. A lot of it was speculative investment."

Borislav Stefanov, director of the InvestBulgaria Agency, which seeks to attract inward investment, estimates that Bulgaria sucked in €40bn between 1996 and 2011, and that 70 per cent of this amount arrived between 2005 and 2009. But in these five years a great deal of foreign investment was "hot money" seeking a fast return from finance, real estate and construction.

"I think the speculative wave of investment in construction and tourism is over," says Georgi Ganev, an economist at the Sofia-based Centre for Liberal Strategies think-tank. "The structure and profile of foreign investment are now more towards what we can produce and export and what makes Bulgaria competitive."

Mr Ganev says that in 2007 alone FDI and other capital inflows soared to an extraordinary 45 per cent of GDP. But over the past three years, all that has changed. According to Bulgaria's central bank, net FDI in the first three quarters of this year amounted to €971.8m, or 2.5 per cent of GDP. This compares favourably with a figure of €711.9m for the same period of 2011. If past trends are a guide, total FDI in 2012 will be in the range of €1.7bn.

"FDI of €2bn a year would represent about 5 per cent of GDP. That would be good, but you would expect an economy at Bulgaria's stage of development to have a bit more," says Mr Ganev. To some extent this year's mild increase may reflect a growing interest in Bulgaria among businesses in need of a long-term, competitively priced European base with a well-qualified workforce.

Among foreign industrial companies that have recently established a presence in Bulgaria, or are planning to do in coming months, are automotive suppliers from Germany, Japan and South Africa and engineering products and machinery makers from India.

Russia remains a prominent investor, with the state-owned VTB bank having paid €100m last year for an 80 per cent stake in Bulgartabak, the former tobacco monopoly.

Much Russian investment is channelled through vehicles established for tax purposes in Austria, Cyprus and the Netherlands. Bulgaria's business process outsourcing industry remains buoyant, too. Hewlett-Packard, the US technology company, sets the benchmark, employing more than 3,500 people and having selected Bulgaria two years ago to be one of its six global hubs for support, engineering and IT outsourcing services.

"Bulgaria is not just offering a low-cost environment in Europe, but a new industrial policy that is positioning Bulgaria in the right clusters," says President Rosen Plevneliev, Bulgaria's head of state.

Mr Plevneliev, a tireless advocate of Bulgaria's advantages as a location for FDI, is admired in foreign business circles because he brings unaccustomed managerial expertise to the highest level of the Bulgarian state. He lived for eight years in Germany, speaks fluent English and ran projects in places as varied as Dubai, Greece and Hong Kong.

'On offer is not just a low-cost environment in Europe, but a new industrial policy'

But the responsibility of promoting Bulgaria extends throughout the government apparatus. Both Mr Stefanov of the FDI agency and Delian Dobrev, Bulgaria's economy, energy and tourism minister, have just returned from trips to China. An encouraged Mr Dobrev recounts how a promotion event in Shanghai attracted more than 300 Chinese companies.

"I made the point that labour costs are lower now in Bulgaria than in China. We are also a nation of very good mathematicians and software specialists, so we have a lot to offer the Chinese," he says.

A skilled and often multilingual workforce is without doubt one of Bulgaria's strongest points, as is a national minimum wage which, although due to go up 7 per cent next year to 310 lev (€159 per month), will remain exceptionally low by EU standards.

The low cost of electricity, and of buying and renting land and office space, is also important. Bulgaria is particularly proud that it has kept its corporate and income tax rates at a flat level of 10 per cent – among the lowest levels in the EU.

Low taxes may even explain why some smaller Greek companies have relocated their headquarters to Bulgaria since the eruption of Greece's debt crisis in 2009. "The Bulgarian flat tax is very attractive, if you are a Greek company and you realise that you have to pay tax for the first time," Mr Ganev says.

On the winding road to stability

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back in some other key areas. The fact that the popularity of Mr Borisov and his Citizens for the European Development of Bulgaria party (known by its acronym, Gerb) has held up reasonably well, say opponents, can be explained not just by charisma and new roads. It owes much to a largely pliant print media, much of it in the hands of owners loyal to the government. Neelie Kroes, European Commission vice-president, wrote to Mr Borisov in October expressing concerns about media freedom.

Meglena Kuneva, formerly Bulgaria's first EU commissioner and who has set up a political party, says the country has retreated, politically, since its EU admission. "I swear – and I was the chief negotiator for my country, so believe me – that if Bulgaria was to negotiate [EU] accession now, it would fail."

'We have started delivering on Bulgaria's dreams' for better roads and infrastructure

Georgi Kadiev, who last year was Sofia mayoral candidate for the main opposition Socialist party, agrees. Bulgaria's biggest problems during its membership negotiations, he notes, were in concluding talks on "Chapter 24" – relating to justice, freedom and security. "I don't think Bulgaria would be able to close this chapter today," he says.

Mr Borisov rebuffs such criticisms. "Bulgaria is number one in terms of freedom of speech," he says. "We have 240 media outlets, if not more. Everyone is free to say and write whatever he or she wants."

Some critics suggest Mr Borisov, by appointing loyalists and using the authority stemming from his own law enforcement background, has established a firm grip on power based on control of the police and security services.

Evgenii Dainov, an academic, writer, and civil society activist, says Bulgarian democracy had long been something of a "façade". "The façade still reflected some reality," he adds. "But today, on top of this, we have the first concerted attempt at establishing personal rule."

Symbolic of how things have developed, say critics, was last month's scandal over the nomination to Bulgaria's constitutional court of Veneta Markovska, a magistrate who then faced accusations of links to corruption, which she denied. Though nominated by parliament, she was widely seen as backed by Gerb.

The European Commission, without naming her, made its concerns apparent by threatening to publish an emergency report under the "co-operation and verification mechanism" that monitors Bulgaria's reforms. President Plevneliev, a Gerb member, ultimately blocked Ms Markovska's swearing-in.

Opposition parties warn of potential attempts to manipulate next year's parliamentary elections. They claim that regional elections last year were the dirtiest for some years. Many observers, including Mr Dainov, suggest Bulgaria's relatively well-developed civil society will ensure the poll is fair.

Whoever wins next year's elections faces big challenges in ensuring Bulgaria can benefit fully from any broader European upswing, and deliver the growth still needed to narrow the gap with wealthier EU members. As even Mr Plevneliev acknowledges, Bulgaria needs deep reforms of its creaking healthcare and education systems.

Real progress on the rule of law will be necessary, too, not just to satisfy the EU and ordinary Bulgarians, but to help foreign investment rebound to healthier levels. Many say the government deserves credit for avoiding a damaging economic or fiscal "bust", keeping the deficit under control and making progress on infrastructure.

The government's problem, says Parvan Simeonov, analyst at pollster Gallup, was not too much power but "not using this power for major reforms". There had been too much governing "day by day, sometimes even hour by hour".

Autos emerge as driving force

Manufacturing Motor industry grabs opportunity to show its skills, say *Kerin Hope* and *Theodor Troev*

From small beginnings Bulgaria's automotive industry suppliers have emerged as an example of skilled manufacturing making a comeback as growth in real estate, tourism and other services has ground to a halt.

About 50 companies, from subsidiaries of Tier 1 – top-of-chain auto suppliers – to small scale local manufacturers employ more than 9,000 people around the country. The sector racked up about €1bn of sales in 2011, accounting for about 4 per cent of total exports. Customers include Mercedes-Benz, BMW, Ford, Audi, Citroen, Peugeot and Renault.

"There's one cluster in Plovdiv and another in Sofia but as a sector it isn't much noticed because it's entirely export-oriented," says Pavel Ezekiev of Neveq Capital Partners, an investment manager for two Sofia-based funds investing in eastern Europe.

Automotive suppliers were attracted by the lowest wage costs in the EU, a 10 per cent flat tax rate and a stable lev pegged to the euro under a currency board arrangement.

They can find plenty of young electronics engineers for hire and, increasingly, seasoned experts who are returning as jobs become scarcer in the US and northern Europe.

"Salaries are lower than in the UK and US, it's true, but purchasing power is twice as much and there are more opportunities," says Mr Ezekiev.

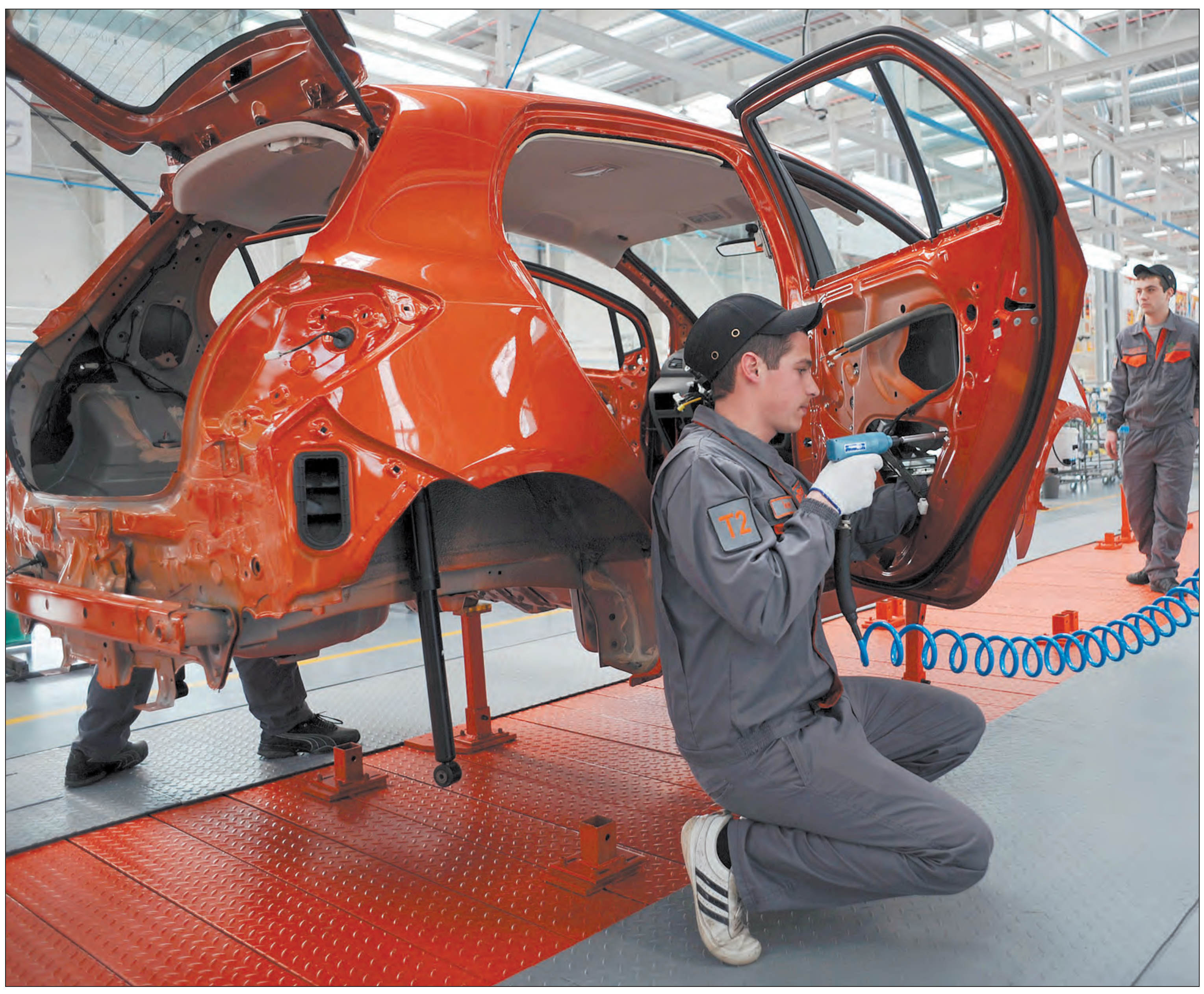
German companies have led the way. Festo, an automation specialist, started manufacturing in Bulgaria almost 20 years ago. Hydraulic pumps maker ixetic and Witte Automotive, which produces car locking systems, both export to most of Europe's carmakers. BHTC (Behr-Hella Thermocontrol) is planning to open a new factory with 600 employees near Plovdiv, the country's second-biggest city, producing automotive climate control systems.

Johnson Controls' electronics research and development centre in Sofia has become one of the US group's largest, with more than 600 employees working on technologies for driver information and car interior electronics.

Roman Vasilev, director of the centre, expects a steady flow of new auto-related investment following the arrival of Great Wall Motors, China's largest private carmaker, which has chosen Bulgaria as a test market for exporting to the rest of the EU.

"This is a good place for producing not only cars but specialist vehicles that are labour intensive – buses, trucks and fire engines," Mr Vasilev says. "There's a well-qualified workforce and wages are competitive."

Litex Motors, a joint venture between GWM and Litex Commerce, a Bulgarian diversified holding group, has started making the Voleex C10, a low-budget hatchback, at a plant near Lovech in northern Bulgaria. It plans to produce the Steed 5, a double-cab pickup, and the Hover 5, one of China's most popular SUVs from next year. Several companies from outside the EU have also selected Bulgaria from which to penetrate central and west European markets.



Market test: Great Wall's plant in Bahovitsa
AFP/Getty

ALC of South Africa has a plant near Sofia making leather seats and interiors for BMW, Mercedes and Nissan. Two Turkish companies, Ayfa Otomotiv and Mars Otomotiv, will produce headlights and other lighting accessories. Escorts, an Indian engineering company, is considering building a factory to make vehicle components and assemble tractors.

Until GWM's arrival Bulgaria had failed to attract any carmakers seeking to cut costs by manufacturing in eastern Europe. Renault's move into Romania and Fiat's into Serbia served to underline the country's sense of being excluded from mainstream manufacturing, according to Lubomir Stanislavov, vice-president of Automotive Cluster Bulgaria.

'This is a place to produce not only cars but labour intensive specialist vehicles'

"It was especially galling because Renault originally produced in Bulgaria, then moved their plant to Romania," says Mr Stanislavov.

Montupet of France produces engine parts for export to Renault's Dacia plants in Romania and other European carmakers at a 30,000-square metre factory in Ruse, close to a bridge linking the two countries across the Danube river.

It helped that the Ruse municipality came up with a greenfield site as an investment incentive, while Bulgaria's euro peg offered currency stability compared with volatile conditions in Romania, says Michael Brison, managing director of Montupet's Bulgarian subsidiary. "We spent a year and a half training about 100 people, now we have 800,"says Mr Brison. "We are starting our first production here for Ford with the new ecotec engine."

Bulgaria has set up a cluster to promote the output and use of electric vehicles. Its members' first move was to form a joint stock company to develop a locally designed charging station for hybrid and electric cars using prepaid cards, now being tested in Sofia.

Ivaylo Tomchev, cluster project manager, says Bulgaria has sufficient knowhow to produce an electric vehicle: "We were one of the world's largest producers of electric forklift trucks, so we have the professional competence to get into this market."

Premier stays popular amid public scepticism

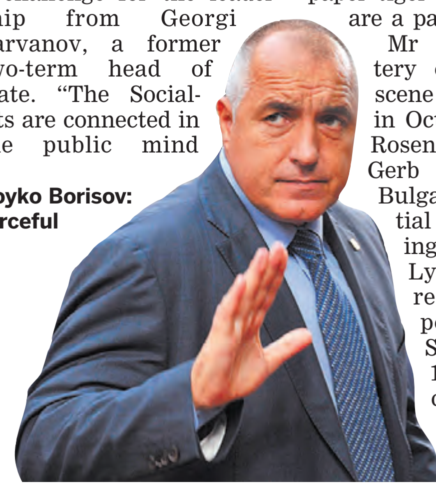
Politics

The scene is clouded by the public's mistrust of authority, writes *Tony Barber*

With six months to go before Bulgaria's next parliamentary elections, the ruling centre-right Citizens for the European Development of Bulgaria (Gerb) appears in a commanding position over the Socialist opposition and newer, more marginal parties. But opinion surveys reveal widespread public disillusionment with all political parties, and the re-election of Gerb would not banish doubts about the stability of Bulgarian politics. "It's typical of many countries these days not to trust political parties, but in Bulgaria it extends to a wide range of state institutions, including the judiciary," says Daniel Smilov, a political scientist at the Centre for Liberal Strategies, a Sofia-based think-tank. "This is a worrying sign."

Gerb, led by Boyko Borisov, the prime minister who is a former bodyguard and police chief, swept to victory in the 2009 elections with almost 40 per cent of the vote, taking 117 seats in the 240-member legislature. The Bulgarian Socialist party, which had ruled since 2005, was thereby consigned to the margins. If Gerb repeats its success, it will mark the first time in Bulgaria's post-communist history that a government has won re-election. To judge from the latest polls, support for Gerb lies somewhere between 20-30 per cent, a big decline from 2009. But Mr Borisov's popularity is higher than that of his party, indicating that his forceful character and adept cultivation of media image hold the key to Gerb's re-election prospects.

Mr Borisov draws strength from Bulgaria's success in having battled its way through Europe's economic recession and debt crisis without experiencing the turbulence that has struck neighbours such as Greece and Serbia. Mr Borisov has also benefited from a spell of infighting in the Socialist party in which Sergei Stanishev, a former premier, eventually beat off a challenge for the leadership from Georgi Parvanov, a former two-term head of state. "The Socialists are connected in the public mind with an era of corruption when they were in government," says a Bulgarian political consultant. "The Socialists are not even a paper tiger any more. They are a paper bunny."



Boyko Borisov: forceful

Mr Borisov's mastery of the political scene was underlined in October 2011 when Rosen Plevneliev, a Gerb candidate, won Bulgaria's presidential election, replacing Mr Parvanov. Lying second in recent opinion polls are the Socialists, with 16.1 to 17.5 per cent. Trailing them, with less than 10 per cent, are two smaller parties – Bulgaria for Citizens, led by Meglena Kuneva, a former member of the European Commission, and the Movement for Rights and Freedoms, a party that is supported mainly by Bulgaria's ethnic Turks and has formed part of previous coalition governments.

All polls have indicated declining support for the ultra-nationalist Ataka party, which faces a struggle to cross the threshold of 4 per cent of the vote required to win seats in the legislature. In this respect Bulgaria seems to be avoiding the experience of Greece, where the far-right Golden Dawn party won 7 per cent of the vote and 18 seats in last June's election.

Pipeline tie-in reinforces fears of reliance on Russian supply

Energy Politicians counter that moves are under way to diversify sources and move from dependence on Moscow, writes *Neil Buckley*

Natural gas: projects in the Black Sea and onshore might, if they find the quantities expected, be enough to meet all of Bulgaria's needs by 2018-19 Petroceltic

Bulgaria spent four decades under Soviet domination. Now, even as a EU member, it is still struggling to reduce reliance on Russia in one key area: energy. It still gets the bulk of its natural gas from Russia. Bulgaria's biggest oil refinery at Burgas is owned, after a 1999 privatisation, by Russia's Lukoil. And its sole nuclear power station, Kozloduy, is Soviet-built.

Sofia last month took a step that appeared to strengthen its energy ties with Russia, by agreeing to build part of the Gazprom-led South Stream pipeline, which will run across the Black Sea and through the Balkans to central Europe, across its territory.

Yet the government insists Bulgaria is starting both to diversify its supply sources and distance itself from Moscow. Boyko Borisov, prime minister, notes that his government cancelled two other Russian-backed "grand slam" energy projects that it inherited. "Give me the name of any prime minister in the world who has cancelled two projects out of three with Moscow," he quips.

First was the Burgas-Alexandroupolis oil pipeline that would have carried Russian and Caspian oil from the Black Sea to the Greek Aegean coast. This was shelved on environmental grounds. More controversial was the cancellation in March of the partially-completed, multi-billion dollar nuclear power station at Belene, in the north of the country. Begun in the Soviet era but stopped in the 1990s because of lack of funds and environmental concerns, Belene was revived before Bulgaria joined the EU, when it had to shut down two out of six reactors at Kozloduy for safety reasons.

A proposal from Russia's Atomstroiexport – a subsidiary of the state-owned nuclear monopoly Rosatom – together with Germany's Siemens and France's Areva was accepted for a reconfigured Belene project in 2006. A construction contract was signed in 2008. But the government pulled the plug this year after costs spiralled and Germany's RWE withdrew as a strategic investor. There has been speculation, too, over pressure from the US not to allow a Russian state monopoly to get a foothold in the EU nuclear market.

Atomstroiexport struck back in September with a legal claim for €1bn compensation for work carried out. Delian Dobrev, Bulgaria's energy minister, told the FT that the claim was "absurd" and insisted Bulgaria would win the case. Some advisers to the Belene project suggest Atomstroiexport's legal case, with one reactor largely completed, is sound.

Bulgaria is attempting to part ways with Russia in natural gas. Several projects in the Black Sea and onshore might, if they find the quantities expected, be enough to meet all of Bulgaria's needs by 2018-19.

Biggest is the deepwater Khan Asparuh block, close to a substantial gas find in Romanian waters. In July, the government chose France's Total, with Austria's OMV and Spain's Repsol, to carry out exploration work. Mr Dobrev says 2D seismic surveys suggest the field could contain 100bn cubic metres (bcm) of gas – enough to meet Bulgaria's needs for 30 years.

UK-based Melrose Resources is producing gas at Black Sea fields supplying about 10 per cent of Bulgaria's annual needs. Sofia is opening tenders for exploration in two more promising offshore blocks. It has granted a concession to Direct Petroleum of the US to exploit an onshore find in north-east Bulgaria.

"We have put in a lot of efforts to diversify our sources and the best possible diversification is not gas from somewhere else but local gas," says Mr Dobrev. Reflecting those efforts, the minister says Bulgaria, in a new 10-year gas supply contract signed with Gazprom last month and starting in January, secured the option to reduce its purchases to zero after six years. It also won a 20 per cent price cut. Such flexibility from Gazprom might seem surprising, especially given Bulgaria's withdrawal from the oil pipeline and Belene projects. So was it linked to the agreement on South Stream, also signed last month?

"These two things are not connected, though they indeed coincided in time," insists Mr Dobrev. "We negotiated hard for a very long period" on the gas supply contract, he adds.

Mr Borisov says South Stream will benefit Bulgaria, and Europe more broadly. Bulgaria will not put any state money into the section across its territory, to be constructed on a project finance basis, and will provide no state guarantee.

The project, he adds, will create construction jobs in Bulgaria and provide valuable transit fees from gas transportation.

Sceptics voice concern that Bulgaria has been dragged into what is essentially a Moscow-devised political project and that South Stream will not be viable, given flagging gas demand in Europe and the shale gas boom in North America.

"Belene was a prime example of how to mismanage a project," says Ruslan Stefanov, director of the economy programme at the Centre for the Study of Democracy think-tank in Sofia. "But I see no guarantees that this new South Stream isn't going to follow in the steps of Belene."

Ship weathers tempest yet now needs to sail on

Economy

Challenges remain in spite of worst of crisis having passed, writes *Neil Buckley*

Some western European countries – and many longer-standing members of the EU – would be happy to boast the macroeconomic figures that Bulgaria does.

After contracting 5.5 per cent in 2009, the economy has shown some growth every year since, and is forecast to do so again next year. The budget deficit is a mere 1.5 per cent of GDP this year; government debt is below 20 per cent.

But economists still question how well-placed Bulgaria is to recover once the broader European economy starts to pick up. "What I'm concerned about is the dynamics [that lie] below the statistical snapshot, and the dynamics are not good," says Lubomir Christoff, an economist and member of the Bank Stakeholder Group at the European Banking Authority.

"What we have is a legacy of a very shortlived boom. Before 2008, Bulgaria was no different in terms of economy from the Baltic states, Ireland, or Spain."

The main driver of the boom, adds Mr Christoff, was housing, where prices tripled over five years. The result was some striking macroeconomic imbalances; the current account deficit soared to 24 per cent.

The reasons Bulgaria suffered less of a bust when the housing bubble burst was that its boom started later and was shorter than those in the worst-hit countries. The government also accumulated some financial cushions, running budget surpluses from 2003 to 2008.

Even after the crisis, the budget deficit peaked at only 3.9 per cent in 2010, and has since come down.

Ivan Iskrov, governor of the central bank says: "Bulgaria is among the EU's strongest supporters of fiscal consolidation and budgetary discipline."

But Mr Christoff warns that Bulgaria's previous socialist government raised spending too much during the boom, treating a temporary revenue windfall – thanks to unsustainably strong growth – as if it was permanent. The government of prime minister Boyko Borisov compounded the problem by not cutting spending sufficiently after the crisis.

While Bulgaria retained its 10 per cent flat income tax rate – the EU's lowest – it imposed a 2 per cent tax on insurance premiums, and will introduce a savings tax next year. It has also raised so-called "social security thresholds" – in effect, sectoral minimum wages used to calculate employers' social security contributions to prevent them under-declaring wages.

Georgi Ganev, an economist at the Centre for Liberal Strategies, says the rise in thresholds is one reason behind a fall in employment from a peak of 3.4m to about 2.9m. That reflects, in part, a big rise in productivity. "The problem is that this productivity gain isn't translating into job creation. Companies don't want to hire," he says.

"They translate the gain into producing the same, or a little bit more, with fewer people." Unemployment remains below many EU countries, at 12.7 per cent this year on Eurostat figures. But joblessness is high in certain regions, and among young people. Mr Ganev and others warn that the social security thresholds and other labour market inflexibilities could see companies reluctant to take on workers even if the economy picks up.

Simeon Djankov, finance minister, says the government's focus on new roads and rail will help it compete with other central and eastern European countries for investment. "Infrastructure is among the relatively fast ways to create employment," he says.

Critics say deeper structural reforms are needed to improve the efficiency of the public sector and Bulgaria's growth potential – including education, healthcare and social security – and strengthen the independence of the judiciary, to help investor confidence.

One issue where domestic assessments differ from outside views, is on the country's vulnerability to the crisis in Greece. Economists say Bulgaria has suffered from a fall in trade with its neighbour, partly compensated for by increased business with another, booming, neighbour – Turkey.

They add that, even though 22 per cent of Bulgarian banking assets are accounted for by Greek banks, risk is limited because all but one of these banks operate in Bulgaria as subsidiaries, not mere branches. Subsidiaries are subject to strict local regulation requiring them to be well-capitalised and somewhat ringfenced from parent group problems.

The capital adequacy ratio of Bulgaria's banking sector, according to central bank figures, is a healthy 16.5 per cent; tier one capital is 15.1 per cent. Non-performing loans are a manageable 11.6 per cent.

Mr Ganev says the only real danger from Bulgaria's proximity to Greece is a "perceptual" one. "Because we are seen as vulnerable to Greece, we are vulnerable to Greece," he says.

Bulgaria

Winemakers set their sights on restoring a potent legacy

Viticulture Boutique producers lead industry revival in what was once world's second-largest exporter of bottled wine, writes *Theodor Troev*

Doing it their way: Konstantin Stoev and Natalia Gadjeva's Dragomir wines are internationally acclaimed
Theodor Troev

It has taken the best part of two decades for Bulgarian agriculture to overcome the negative consequences of the chaotic dissolution of Soviet-era co-operatives, food processing plants and wineries.

The life story of Natalia Gadjeva and Konstantin Stoev – founders of the Dragomir Winery Estate – is a tale of the emergence of a generation of quality focused producers that is gradually changing Bulgaria's wine scene, and restoring other areas of Bulgaria's rich farming legacy.

Ms Gadjeva and Mr Stoev, both oenologists, worked for various wineries that had either existed under the Communist regime, or had been set up during Bulgaria's transition to a market economy.

They remember Bulgaria's fame as the world's second-largest exporter of bottled wine after France, back in the 1980s when most of Bulgaria's wine was enjoyed by Russian and Polish comrades. They also recall a time when their country was the fourth top importer into the UK.

However, they witnessed the devastating outcome of poorly managed restitution of agricultural land in the 1990s, when tiny plots were returned to by this time urban owners with no interest in vineyards.

It took some new wine producers years to negotiate with thousands of small owners in order to purchase plots that would make sense.

In some cases this led to planting vineyards on land just because the new would-be winemakers could get hold of it, instead of carefully matching grape varieties to appropriate soil.

Ms Gadjeva and Mr Stoev took a different approach, once they decided to stop working as oenologists for other wineries and to join forces – as partners in life and in business.

Rather than planting vineyards for their own wine business, they selected existing vineyards of proper quality and made a deal with the owners that gave them control of the whole viticulture process and the right to select just that part of the grapes they found suitable for their wines.

As a result, some of their top quality wines, mostly blends, are known to connoisseurs not just in Bulgaria, but also as prize winning products at prestigious exhibitions such as Vinalies Internationales in Paris.

Dragomir Winery Estate is based in Plovdiv, Bulgaria's second-largest city. Its name comes from the nearby village of Dragomir where Ms Gadjeva and Mr Stoev are planning to start developing a new boutique estate – a project that would be partially financed by EU-approved programmes.

EU funding has been utilised successfully by other boutique winemakers, such as Ivan Todoroff's estate in Brestovitsa, near Plovdiv.

"There is a trend for setting up new small wineries that become the driving force for the variety and identity of the Bulgarian wines, " says Emil Koralov, organiser of DiVino. Taste, an event in Sofia, offering wine tasting sessions and a variety of workshops.

Wineries participating in last month's DiVino exhibition represented more than 90 per cent of the country's upper quality winemakers.

"Bulgaria needs both: smaller wineries that can lead in quality and uniqueness; and bigger – that can target the mass markets," Mr Koralov says.

Data from Bulgaria's agriculture ministry show the country produced 108m litres of wine last year, up by 4.9 per cent. Wine exports rose 1.9 per cent to 58.5m litres.

Russia remains the biggest foreign buyer, followed by other traditional markets such as Poland, Romania, the Czech Republic and the UK.

Bulgarian winemakers have started targeting Asia. According to Plamen Mollov, chairman of the Bulgarian vine and wine chamber, a small breakthrough in the Asian markets has been made. One of the bigger wine producers, Domaine Boyar, whose Cabernet can be found in some Tesco stores, has already shipped wine to Singapore and has revealed plans to focus on China, Japan, and Korea as well.

On the domestic market, where consumers have a penchant for wine, with its lower alcoholic strength than some other drinks, competition is coming from Chile, Argentina, Australia and South Africa. However, the economic crisis is strengthening the position of the local winemakers as consumers move away from costly imports.

As the catering sector expands and disposable incomes gradually rise, local demand for higher-quality and more expensive wine is expected to pick up.

"Bulgaria must learn to be proud of its own wines, because, ifi t can't, why should the rest of the world take any interest given there is so much global competition," says Caroline Gilby, a wine writer specialising in eastern Europe. "Exports alone are no longer enough.

"It's exciting to see the rise of boutique wineries, and their focus on quality and individuality is key to this, helping to develop a wine culture and also challenging the big producers to do better."

Publishing Ciela Norma develops as springboard for a new wave of novelists

As a young lawyer, Ivan Todorov set up a specialist publishing business, producing textbooks and software detailing the thousands ofl egal and judicial reforms Bulgaria had to adopt to establish democracy and a market economy.

"We operated almost in real time, printing up new laws as soon as they were approved . . . By the time Bulgaria joined the EU [in 2007] we had merged with a privatised electronics company and our database of European legislation was more complete than that of some founding member-states," Mr Todorov says.

Ciela Norma has become a vertically integrated software provider and book publisher, playing an important role in developing electronic government projects for Bulgaria, including portals for the country's company register and verdicts handed down by local courts. Turnover reached €8m last year.

The profitable software business helps support a flourishing book publishing operation, offering more than 300 titles a year, from new Bulgarian fiction to translations of Booker and Pulitzer prize-winning authors, political biographies and cookery books.

At Ciela's cavernous store beneath the Sofia University metro station, part of a 33-outlet chain, neat rows of legal, economics and business books overlook stands piled high with best-sellers and the latest children's books.

"It's encouraging that Bulgarians are reading books again for entertainment as well as vocational learning," says Veselin Todorov, who took over as Ciela's chief executive when his brother's law practice expanded following EU accession.

"There was a long period after the state-owned bookstores collapsed when there were hardly any outlets and few books being published here," he says. "Now we have a new generation of authors, including Bulgarians abroad writing in English, German or French, and readers who are seriously interested in Europe and the US."

Ciela translates Bulgarian writers' work in other languages for the local audience and has launched an e-book series aimed at the 1m-strong diaspora.

Ciela added Ludmila Filipova, the country's best-selling novelist, to its stable of authors after she checked out its store in a Sofia shopping mall, when trying to a find a publisher for her first book, *Anatomy of Illusions*, set during Bulgaria's turbulent transition in the 1990s.

"I picked out a few novels I liked and saw they were all published by Ciela, so I sent them my manuscript . . . It's still in print after six years and six more books," says Ms Filipova.

She used extracts from a diary kept by her grandfather, prime minister in the 1980s under Todor Zhivkov, Bulgaria's long-serving communist leader, to frame a love story between Anna, a girl from a privileged "nomenklatura" family and Boris, an ambitious university student.

In the post-Communist upheaval, their circumstances are reversed. Boris becomes a powerful but doomed oligarch, while Anna struggles to rebuild her life, eventually becoming a successful journalist.

"There's a strong documentary element in all my books," Ms Filipova says. "But when *Anatomy of Illusions* was made into a television series I gave it a happy ending . . . and I did the same for the next impression of the book."

"I didn't feel I was being unfair to the characters . . . perhaps the climate has changed."

Kerin Hope

EU funding pushes expansion of road, rail and port upgrades

Infrastructure

Today's efficiency contrasts sharply with past practice, writes *Kerin Hope*

Bulgaria struggled after joining the EU to win funding to upgrade poorly maintained highways and a crumbling rail network, even though it stood to receive some €2bn of aid for infrastructure projects in 2007-13 as the union's poorest member-state.

Its ambition of becoming a transit hub, with international truck traffic moving smoothly between central Europe and the Middle East, a high-speed rail link with Turkey and cargoes returning to refurbished Danube river ports, seemed a distant dream.

EU cash is now flowing in, with 90 per cent of contracts signed and 30 per cent ofi nfrastructure aid disbursed, according to Lilyana Pavlova, minister of regional development and public works.

"We're doing quite well . . . We worked hard to prove we had transparent public procurement procedures – none of our projects has been suspended [by the European Commission]," says Ms Pavlova, a 34-year-old technocrat who started managing EU aid projects while taking a degree in public administration at Varna Free University.

Bulgaria's new efficient image contrasts sharply with past practice. The country faced censure by the commission over corruption and mismanagement of pre-accession EU programmes, with one €7.5m fraud case still unresolved after the Sofia appeal court last month overturned the convictions of seven defendants.

Lazar Lazarov, chairman of the road infrastructure agency, which manages €1bn of EU funds, says tighter control of tender procedures, close supervision of construction work and withholding of payment to contractors until defects are corrected, has brought results.

"Our inspectors take a keen interest in the thickness of tarmac being laid," says Mr Lazarov.

The 380km Trakia motorway linking Sofia, the capital, with the Turkish border, which serves 6,000 trucks daily, will be the first upgrade to be completed. The final 50km section is due to be completed late next year.

Bulgaria is seeking €1.6bn from the 2014-20 cohesion programme to advance three more motorway projects, though it may have to settle for around €1bn-1.2bn because of UK and other northern member states' objections to increasing the EU budget.

That would fall well short of the €4.2bn needed to complete the motorway network, "but we have to be realistic," says Ms Pavlova.

Bulgaria's motorways will remain a patchwork until ring roads, tunnels and viaducts are completed. It would cost almost €1bn at current prices to build a 13km tunnel on the Struma motorway linking Sofia with the Greek border and the port of Thessaloniki, required under EU environmental rules to protect wildlife in the spectacular Kresna gorge.

North-south truck traffic is projected to increase with the opening in 2013 of the second Danube bridge linking Vidin in Bulgaria with Calafat in Romania. The 200km road link with Sofia is being upgraded to a four-lane highway with bypasses around the cities of Montana and Vratsa. "Northwest Bulgaria is Europe's poorest region at present but we believe Vidin can become a cross-border logistics hub," says Richard Roe, a UK investor managing two land banks with 2.5m square metres of property around Vidin.

> 'We worked hard to prove we had transparent public procurement procedures'

Dimitar Savov, head of policy at the transport ministry, says there are no plans to accelerate motorway construction through public private partnerships: "It's more cost-effective to use EU grants and European Investment Bank loans for roads and railways, and sell operating concessions for existing airports and ports."

Bids will be invited next year for a concession to operate Sofia airport, used by 3m passengers annually. The Black Sea ports of Varna and Burgas, would follow, together with half a dozen ports along the Danube, Mr Savov says.

Some €640m of EU aid is being used to upgrade the rail network to carry trains at speeds of 100-120km per hour on lines to Greece and Turkey, though it will be almost two decades before the system can match western European counterparts.

Metropolitan, a Sofia municipality company building a €650m extension of the capital's subway system, has proved the fastest Bulgarian provider ofi nfrastructure. With 61km of subway completed or under construction, "Sofia is rapidly catching up with the European city average," says Stoyan Bratoev, Metropolitan's executive director.

EU funding covers 55 per cent of the subway expansion compared with 80 per cent for rail and road projects. The EIB is providing a €105m loan, with the rest coming from the state and municipal budgets.

Subway excavation work in the city centre has exposed sections of ancient Serdica, a wealthy Roman trading city, with mosaics, an early church and fortification walls all on view after a redesign of the central station. Construction costs at about €38m a kilometre are the lowest in Europe except for Spain, Mr Bratoev says: "The faster you build a metro, the more you can hold down costs."

The second subway line, opened three years ago, is being extended 5km to Sofia airport. A third line is planned to serve new business and residential districts south of the capital.

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