

International Studies Program

Working Paper 03-10
May 2003

No pain, No gain:
Market Reform, Unemployment,
and Politics in Bulgaria

Neven Valev



Georgia State
University

Andrew Young
School of Policy Studies



**No pain, No Gain:
Market Reform, Unemployment,
and Politics in Bulgaria**

Working Paper 03-10

**Neven Valev
May 2003**

International Studies Program
Andrew Young School of Policy Studies
Georgia State University
Atlanta, Georgia 30303
United States of America

Phone: (404) 651-1144
Fax: (404) 651-3996
Email: ispaysps@gsu.edu
Internet: <http://isp-aysps.gsu.edu>

Copyright 2001, the Andrew Young School of Policy Studies, Georgia State University. No part of the material protected by this copyright notice may be reproduced or utilized in any form or by any means without prior written permission from the copyright owner.

International Studies Program Andrew Young School of Policy Studies

The Andrew Young School of Policy Studies was established at Georgia State University with the objective of promoting excellence in the design, implementation, and evaluation of public policy. In addition to two academic departments (economics and public administration), the Andrew Young School houses seven leading research centers and policy programs, including the International Studies Program.

The mission of the International Studies Program is to provide academic and professional training, applied research, and technical assistance in support of sound public policy and sustainable economic growth in developing and transitional economies.

The International Studies Program at the Andrew Young School of Policy Studies is recognized worldwide for its efforts in support of economic and public policy reforms through technical assistance and training around the world. This reputation has been built serving a diverse client base, including the World Bank, the U.S. Agency for International Development (USAID), the United Nations Development Programme (UNDP), finance ministries, government organizations, legislative bodies and private sector institutions.

The success of the International Studies Program reflects the breadth and depth of the in-house technical expertise that the International Studies Program can draw upon. The Andrew Young School's faculty are leading experts in economics and public policy and have authored books, published in major academic and technical journals, and have extensive experience in designing and implementing technical assistance and training programs. Andrew Young School faculty have been active in policy reform in over 40 countries around the world. Our technical assistance strategy is not to merely provide technical prescriptions for policy reform, but to engage in a collaborative effort with the host government and donor agency to identify and analyze the issues at hand, arrive at policy solutions and implement reforms.

The International Studies Program specializes in four broad policy areas:

- **Fiscal policy**, including tax reforms, public expenditure reviews, tax administration reform
- **Fiscal decentralization**, including fiscal decentralization reforms, design of intergovernmental transfer systems, urban government finance
- **Budgeting and fiscal management**, including local government budgeting, performance-based budgeting, capital budgeting, multi-year budgeting
- **Economic analysis and revenue forecasting**, including micro-simulation, time series forecasting,

For more information about our technical assistance activities and training programs, please visit our website at <http://isp-aysps.gsu.edu> or contact us by email at ispaysps@gsu.edu.

No Pain, No Gain: Market Reform, Unemployment, and Politics in Bulgaria

Neven Valev

Abstract

In 1997, a new center-right government came to power in Bulgaria with a mandate to accelerate market reforms. By the time of the next elections in 2001, 75 percent of GDP was produced in the private sector, compared to 45 percent in 1996. The government however lost the elections. This paper uses unique survey data to examine whether the high unemployment associated with market reform contributed to the election outcome. The results suggest that high unemployment does not explain the election loss. In fact, many of the unemployed believed that high unemployment was the necessary price for future prosperity.

JEL Classification: D72; E24; E61

Key words: Market reform; Transition; Voting; Eastern Europe

I would like to thank Jamie Boex, Franziska Bieri, and Bogdana Dimitrova for valuable comments and suggestions, and Valentin Zhechev from Fact AD for providing the survey data. I would also like to acknowledge the financial support of the National Science Foundation grant SEC 0234664.

Department of Economics, Andrew Young School of Policy Studies, Georgia State University, Atlanta, GA 30303-3084, telephone: 404-651-0418, e-mail: nvalev@gsu.edu

I. Introduction.

In most cases, the benefits of economic reforms in transition economies have not accrued instantaneously. Cutting public subsidies, privatization, and closing down inefficient state firms are expected to produce output and employment growth in the long-run but the initial effect is high unemployment. All transition economies experienced rapid growth in unemployment at the start of reforms, in many cases from zero to double digits within a few years. The unemployed therefore generally personify the losers of the transition process.

The literature has devoted significant attention to the political implications of this delay in benefits. Would the unemployed demand from political leaders a slowdown of reforms, more public subsidies and more protection? Would they vote against further reform? If so, reforms may need to be implemented gradually and should be sequenced so that there are clearly recognizable gains before the next step is taken (Dewatripont and Roland 1992). Alternatively, Rodrik (1995) argues that the unemployed may demand even faster reforms recognizing that the completion of reforms is the only long-term solution to unemployment. How the unemployed vote therefore has important implications for the sustainability of reforms.

The empirical evidence on the effect of unemployment on voting pro or against reform in transition economies presented by Fidrmuc (2000), Warner (2001), and Pacek (1994) among others is generally consistent with the notion that high unemployment leads to lower political support for reform parties in the transition economies. As Ham, Svejnar, and Terrell (1998) write, "The unemployment crisis in the CEE (Central and Eastern Europe) countries has contributed to a political backlash as disenchanted voters often ousted the first reform governments after a few years." These results lend support to the view that the sustainability of reforms requires the building of pro-reform constituency by careful sequencing of reforms and by the provision of compensatory measures. The results imply in addition that the idea of necessary short-term costs as a tradeoff for long-term prosperity is not widely accepted by voters. Instead, voters "penalize" the reform parties for the current negative economic conditions.

This paper uses unique survey data from Bulgaria to provide further tests on the effect of unemployment on political support for reforms. In 1997, a new "center-right"

government (the Union of Democratic Forces or UDF) came to power in Bulgaria with a mandate to implement market reforms. By the time of the next elections in 2001, 75 percent of GDP was produced in the private sector, compared to 45 percent in 1996. The immediate outcome of the reforms however was an increase in unemployment. While the economy started gaining some speed sustained improvements in employment were not yet achieved by the next elections in 2001. The government that implemented the reforms lost the elections.

On the surface, this election outcome looks like a backlash at the reforms spurred by the sharp increase in unemployment. The survey data analyzed here reveal however that unemployment did not contribute to the growth in political opposition in significant ways. Unemployment did have an effect but it was very small. What is more, in places with very high and persistent unemployment, the support for UDF was stronger rather than weaker. As the paper argues, the experience in Bulgaria may be attributed to the perception of permanence and irreversibility in the reforms. By the time market reforms were accelerated by UDF in 1997, it was clear that policy reversals, which were characteristic in the early years of transition in Bulgaria, would lead only to deterioration of economic conditions. Rapid privatization and enterprise liquidation along with introducing a currency board increased the credibility of the government that reforms will be permanent. The experience therefore highlights that “*ex ante* hostility to reform and *ex post* support are quite consistent with each other.” (Fernandez and Rodrik 1991)

An interesting feature of the survey used here is that it reveals whether individuals in Bulgaria believed that the high unemployment associated with market reform was necessary to achieve long-term economic gains. The results from previous research that unemployment generates political opposition to reform parties may suggest that the necessity of short-term costs is not widely accepted. The data from Bulgaria show however that, at the height of unemployment, almost half of the population believed that unemployment was the necessary short-term cost of reforms. In fact, a significant proportion of the unemployed agents believed in that. These beliefs then translated into additional votes for UDF, which suggests that there is an additional instrument which can be used to sustain political support for reform. In addition to keeping unemployment as low as possible (something achieved in the Czech Republic; see Ham, Svejnar, and

Terrell 1998), sequencing reform, and providing compensatory payments, it is important to convince the public that sacrifices are necessary.

The paper also complements earlier research which has used aggregate country or regional data (e.g. Fidrmuc, 2000 and Warner, 2001) by studying voting on the individual level. The survey data provide that opportunity. For each individual, the survey shows which party she/he voted for in 1997 (when UDF came to power) and which party she/he intended to vote for after much of the reform package had been implemented and unemployment had increased. That makes it possible to study the change in voting on the individual level and to test whether the employment status of individuals or/and their views on the reforms contributed to the rapid decline in political support for UDF. As the survey is nationally representative, it matches voting behavior very closely.

Before the paper returns to the survey, the next section discusses in brief some major economic developments in Bulgaria over the last few years. The sections following that present the data and report empirical results. Section VII concludes with final remarks.

II. Delayed market reform in Bulgaria.

Bulgaria has generally been one of the laggards in the transition process in Eastern Europe, at least until UDF accelerated reforms in 1997. According to the EBRD (1998, p. 158), between 1992 and 1997, only 20 percent of total enterprise assets were privatized. In the early years of transition, loss-making enterprises were allowed to operate on soft budget constraints which lead to continued drain on tax money, large budget deficits, and deteriorating credit portfolios of commercial banks. Governments changed almost each year. According to Aslund (2002, p. 385) the experience of Bulgaria illustrates the danger of “patently inconsistent policies and erratic policy reversals” where “vested interest have been a far greater threat to sound economic policies in transition than disorder”. Bulgaria fits well the model advanced by Hellman (1998) where reforms were kept “partial” under the influence of vested interests who managed to extract large rents in a semi-market environment.¹

¹ To lift some of the blame from policymakers, it should be acknowledged that to some extent the slow pace of reforms can be considered endogenous to Bulgaria’s initial conditions in the transition process.

The delay in reforms contributed to large budget deficits and rising public debt (Table 1). By 1996 much of the banking sector credits, in many cases extended under government directive, were non-performing. Confidence in the banking system reached very low levels and deposits started fleeing the financial system. As the exchange rate depreciated and prices spiraled out of control, political unrest grew and in early 1997 the then Socialist (BSP) government called early parliamentary elections. The elections were won by the UDF which came to office with a mandate to implement structural reforms.

According to the Bulgarian Privatization Agency, only in 1998 the government completed 654 privatization deals, which is almost as many as the number of deals completed in the prior five years from 1993 through 1997 (694). Direct and implicit subsidies to enterprises were cut (Braxi, Shatalov, and Zlaoui, 2001), the government closed down 110 out of 140 unprofitable state firms, and many banks were privatized. As a result of the reforms, the private sector share of Bulgaria's GDP increased from 45 percent in 1996 to 70 percent in 2001, which put Bulgaria in line with the private sector shares in advanced transition countries (EBRD, 2001).

A very important part of the reforms was the introduction of a currency board. The currency board not only provided a nominal anchor by fixing the domestic currency to the German mark and thus lowering inflation, but it also made it impossible for the government to finance budget defects by money creation.² That was a strong impetus to put public finances in order which in turn provided an incentive to the government to reduce subsidies and liquidate or privatize firms. In essence, maintaining a credible currency board required structural reform. The large political costs associated with abandoning the currency board implied that the cost of reversal of structural reforms was also high which raised the credibility of the government's commitment to complete the

Dobrinsky (2000) argues that unlike other transition countries in Eastern Europe, Bulgaria had barely implemented any market reforms until the very end of communism. A large part of its trade was with the former Soviet Union and much of the industry operated on old technologies dependent on cheap Soviet energy. Reorientation of the economy required massive enterprise restructuring and liquidations, and therefore substantial layoffs. As the opposition spurred by the potentially negative consequences of such policies was strong, reforms were delayed.

² A currency board is a fixed exchange rate regime with the additional provision that the central bank maintains foreign exchange reserves that are sufficiently large to cover the monetary base and the currency is fully convertible. The currency board removes discretions over monetary policy. Changes in money supply are linked to the balance of payments with balance payments deficits leading to monetary contraction and balance of payments surpluses leading to monetary expansion. See Schwartz (1993) and Carlsson and Valev (2001).

reforms. Interestingly, in some cases in the framework of Dewatripont and Roland (1992), such ability to pre-commit may be associated with more gradual rather than more rapid reform, opposite to what seems to have happened in Bulgaria.

As Table 1 shows, with the introduction of the currency board inflation declined very rapidly into single digits and has remained low since 1997. Stable prices, privatization, increased competition in financial markets, and opening the economy contributed to growing investment levels and higher growth rates (Table 1). For the first time since the beginning of transition Bulgaria experienced sustained positive economic growth. Nevertheless, the effect on employment over the initial years was small and the positive growth was not sufficient to compensate for the loss of jobs. By 2000 official unemployment had increased to 17.9 percent compared to 12.5 percent in 1996 and unofficial statistics suggested an even higher rate.

Along with enterprise liquidation in 1998 UDF adopted the Unemployment Security and Employment Incentives Act. The Act reformed the unemployment benefits system reducing somewhat the generosity of benefits and strengthening incentives for reentry into the labor market. It also introduced a number of initiatives designed to facilitate job search and retraining. In general, the reform was intended to encourage the transition of workers between jobs rather than provide generous compensatory payments. This is interesting because political economy models on economic reform generally envision a need for compensatory payments as a way of reducing individual uncertainty and maintaining the political support for reforms (see Roland, 2002, for a discussion).

It should be pointed out that privatization and enterprise liquidation were not the only reasons for high unemployment. The World Bank (2001, p. 79) concludes that “the adverse labor market experience in Bulgaria has been linked not only to fast labor shedding, but also to a chronic inability to create jobs.” The inability of the private sectors to create jobs is in turn explained by an array of factors such as policy uncertainty, administrative burdens, and lack of credit. External factors also played a role. The war in Kosovo and the financial crisis in Russia in 1998 lead to a decline in exports. The international financial crises in Russia and elsewhere in the late 1990’s might also have depressed the inflow of foreign direct investment.

The political movement that defeated UDF and took office in 2001 had a very unclear economic agenda until late in the election campaign. It entered the political scene only a few months before the elections when Simeon Saxe-Coburg Gotha, the son of the last czar of Bulgaria before socialism, announced his intention to return to Bulgaria and run for office. The economic team was not formed until a few weeks before the elections. The economic plan which was rapidly put together included a mix of proposals for lower taxes and greater government spending and promised large inflows of foreign direct investment and rapid growth in incomes. The program promised substantial gains in income over a target period of 800 days. Ivan Kostov, the leader of UDF had referred to the program as "wild populism" (CNN, June 17th 2001)³.

III. Description of the survey data.

The survey used in this paper was conducted by personal interviews by a national polling organization in August 2000, more than three years after the elections in April 1997 and 10 months before the elections in June 2001. By the time of the survey, unemployment had reached the high levels discussed above. The sample size of 1000 consumers, ages 16 and over, and its demographic structure are considered representative of the population of 8 million. The analysis in the next sections excludes agents who were not yet 18 in 1997 as eighteen is the voting age in Bulgaria. The survey asked respondents which party they voted for in the 1997 elections and which party they would vote for if elections were held today. The survey also inquired about respondents' views on the reform process by asking agents whether they strongly agreed, agreed, disagreed, or strongly disagreed with the following statement:

High unemployment is the price we have to pay for future prosperity.

The survey asked about respondents' employment status and included questions on demographic characteristics – age, education, gender, income, and place of residence.

³ Available at www.cnn.com. Along those lines, in reference to the potentially negative effects on public debt of proposed increases in social spending and a proposed increase in public employment, a leading newspaper in Bulgaria published an article titled: "Budget 2003 – A Fight Against Unemployment or a Time Bomb." (Kapital, June 11, 2002)

In the survey, 28.95 percent of the individuals in the labor force (the unemployed plus the employed) reported that they were unemployed. The unemployment rate reported in the survey is higher than the official and reflects the view that official unemployment does not capture the magnitude of the problem.⁴

To determine how closely the survey responses match the actual election outcomes, election results were obtained from a database compiled by the Department of Government at the University of Essex with the help of The International Foundation for Electoral Systems and the Association of Central and East European Election Officials. The database provides detailed historic information on voting in transition economies.

Before discussing the distribution of votes, it should be pointed out that voter turnout (the percent of eligible voters who did vote) reported by the survey is somewhat different from the actual turnout. In the survey, 78 percent of respondents reported that they cast a vote in 1997. In the actual elections, that number was 55 percent. Apparently, either the survey over-sampled voters or many agents claimed that they voted without having done so. The survey predicted a 56 percent turnout in the 2001 elections, while the actual turnout was higher, 67 percent. This is easier to explain, since the party that won the elections was not yet formed in August 2000. As elections approached, more agents decided to vote for them rather than not vote.

With this in mind, consider Table 2 which shows the actual and survey distributions of votes. The actual percent of votes for UDF in 1997 (49.15 percent) was very close to that reported in the survey (51.94 percent). The survey overestimates somewhat the percent of votes for the socialist party BSP which was in office until 1997: 31.73 percent in the survey as opposed to 22.40 percent in the actual elections. The remaining numbers on the 1997 election from the survey and the actual election are close to each other. In the 2001 election, the percent of votes for UDF, BSP, and MRF⁵ predicted by the survey are also close to the actual outcomes. The big addition in 2001 was Coalition Simeon. In general, the survey does a reasonably good job matching the

⁴ Blanchard (1997) discusses the mismatch between official and actual unemployment in transition economies. His preferred measure is the unemployment rate compiled from surveys as the one studied here.

⁵ The Movement for Rights and Freedom (MRF) is generally associated with the large Turkish ethnic minority in Bulgaria. The other two smaller parties that received votes above the 4 percent threshold to enter Parliament were the Bulgarian Business Bloc and Evrolevica. Neither of these parties is distinctly pro or anti-reform.

actual results. Most importantly, it reflects the withdrawal of political support for UDF between the two elections which is the focus of this paper.

Using the survey data, we can determine whether the withdrawal of political support from UDF was influenced by the employment status of an individual and his or her views on the reform. In essence, the research question is whether the likelihood of voting for UDF in 2001 is lower for an unemployed individual compared to an employed individual or for someone who does not believe that unemployment was necessary. Before we examine the effect on voting, however, the next section discusses the views on reform. Did Bulgarians believe in the tradeoff between short-term costs and long-term gains?

IV. Views on the necessity of the cost of market reform.

Table 3 shows the distributions of answers regarding the statement on economic reform. The data reveal that 38.86 percent of the population believed (more or less strongly) that high unemployment was the price for future prosperity. The percent is smaller compared to the percent who disagreed with the claim (48.02 percent). The remaining 13.13 percent did not provide an answer. It is difficult to judge whether 38.86 percent is a large number because similar data are not available from other countries. Nevertheless, it is interesting that a large part of the population still saw a purpose for the high unemployment despite the very high unemployment. Table 3 also reports the beliefs regarding that statement separately for the unemployed and the employed respondents. Notice that the beliefs among the unemployed are not very different from the beliefs in the population at large. Thirty five percent (34.60) of the unemployed believed that current unemployment was the price for future prosperity. In fact, it is remarkable that 16.22 percent *strongly* believed that claim.

These results suggest that the growth in political opposition to reform produced by personal experiences at the micro level (unemployment) may be ameliorated to some extent by an understanding of how that personal experience fits in the macro-level dynamics of the economy. In that sense, from a policy perspective, to sustain reform it is important how effectively the government communicates that a period of high unemployment is unavoidable as much as how successful it is in trying to minimize the

level of unemployment. The data from Bulgaria show that the message of short-term costs for the purpose of long-term gains is likely to get through to the public even when personal experiences at the individual level are negative.

To explore whether the views regarding the statement differ in systematic ways across various segments of the population, Table 4 reports the estimates of a probit equation where the likelihood that an agent agrees or strongly agrees with the necessity of high unemployment is explained by their employment status and several demographic characteristics: education, age, gender, income, and place of residency. Views on the cost of reforms may differ across agents because of better information or because of different personal experiences.

Agents with more education were more likely to state that unemployment was a necessary short-term cost. This result may reflect a better understanding by the more educated about the tradeoffs between the short-term and the long-term involved in the process of market reform. The result may also be explained by the generally easier market experience of more educated agents during transition. The World Bank (2001) reports that the unemployment rate for individuals with higher education has been around 5 percent throughout the 1990's which is more than two times lower than the unemployment rate for the population at large. These agents have found it easier to retool and transition between sectors of the economy.

Older agents were less likely to share the view that unemployment is a necessary cost of reforms. Although older individuals have had a lower unemployment rate compared to the population at large (e.g., 10.1 percent for people ages 50-64 compared to 31.4 percent for agents ages 15-24 in 1999, World Bank 2001), for many employment was tied to state firms. As many of those were restructured, privatized or liquidated during the rapid reforms after 1997, older agents may have experienced increased employment uncertainty. In addition, older agents have spent a larger portion of their lives under socialism when unemployment was close to zero.

V. Employment status, beliefs about market reforms, and support for UDF.

Table 5 reports a cross-tabulation of votes in the 1997 parliamentary elections reported in the survey and the expected distribution of votes in the 2001 election.

Respondents are placed in three categories: those that voted for UDF, those who voted for another party and those who did not vote. The cross-tabulation shows a large withdrawal of votes from UDF. Only 41.8 percent of agents who voted for UDF in 1997 intended to vote for them again. There was a shift in votes towards other parties (17.9 percent) as well as a decision on the part of many agents who voted for UDF in 1997 not to vote at all (40.3 percent). Very few agents (six in total) who had not voted for UDF in 1997 now intended to do so. Within three years, the political support for UDF had diminished substantially. This section explores whether the decline in political support can be explained by the rise in unemployment.

We begin by looking at some summary statistics. Table 6 reports the percent of respondents who intended to vote for UDF. The sample is split according to the employment status of respondents as well as their views on the two statements discussed above. The purpose of these divisions in the sample is to show whether unemployed individuals and those that disagreed with the two statements were less likely to vote for UDF. Consider the first column of results which reports the distribution of votes using the whole sample of agents. Among the unemployed, 11.96 percent intended to vote for UDF compared to 18.70 percent in the group of employed individuals. The difference of 6.74 percentage points is statistically significant. Only 12.42 percent of the respondents who did not believe that high unemployment was the price of future prosperity intended to vote for UDF compared with 22.18 percent for the rest. The difference of 9.76 percentage points is statistically significant.

The second column of results shows the same distribution of votes but only in the group of individuals who voted for UDF in 1997. Here, the percentages reflect the probability that agents who voted for UDF in 1997 would vote again for UDF in 2001. Unemployed individuals and those that did not believe that unemployment was a necessary cost of reforms were less likely to repeat their vote for UDF. There is a 20.60 percentage point difference in the likelihood of voting again for UDF between employed and unemployed individuals.

Next, we explore whether these relationships hold in a multivariate context by estimating a probit equation where the dependent variable is equal to 1 if a respondent intended to vote for UDF and 0 otherwise. The independent variables are as follows. The

model includes a dummy variable equal to 1 if a respondent is unemployed, zero otherwise and a dummy variable that equals 1 if she disagreed or strongly disagreed with the statement on economic reform. The model controls for voting in 1997. It includes a dummy variable that equals 1 if an individual voted for UDF in 1997, zero otherwise. Also included are agents' level of education, gender, age, income, and place of residency (rural or urban). The results are reported in Table 7.

Table 7 reports the marginal effects so that the coefficients can be interpreted as a direct influence on the probability of voting for UDF evaluated at the mean of the respective independent variable. In the case of dummy variables used as independent variables, the reported coefficient estimate equals the probability of voting for UDF if that dummy variable is one minus the probability of voting for UDF if it is zero. For example, the coefficient 0.389 on voting for UDF in 1997 means that, controlling for the other effects, the probability of voting for UDF in 2001 was 38.9 percentage points higher for an agent who voted for UDF in 1997 compared to an agent who did not vote for UDF in 1997.

The first two columns in Table 7 report estimates using the whole sample. Similarly to the results in Table 6, unemployed individuals and those that did not consider unemployment to be a necessary cost of reforms were less likely to vote for UDF. This result holds after controlling for their voting in 1997 and for demographics. The size of the coefficients however is very small. The likelihood that an unemployed person votes for UDF is only 3.3 percentage points lower compared to the rest of the population (model 1). Similarly, the likelihood that an agent, who believes in the necessity of unemployment, votes for UDF is only 6.3 percentage points higher compared to other agents.

Columns 3 and 4 report estimates using only for the sample of agents who voted for UDF in 1997. Here, the likelihood that an unemployed individual votes again for UDF is 18.2 percentage points lower compared to an employed individual. Although the coefficient on unemployment is larger compared to the results in the first two columns, the effect is still small. The effect of unemployment can be interpreted as follows. Out of five individuals who voted for UDF in 1997 and are now unemployed, about four would still vote for UDF and one would not. In terms of a number of votes, that translated into

15 unemployed individuals in the survey who had voted for UDF in 1997 and were not voting for them in 2001. That is only 4 percent of the electorate of UDF in 1997, a relatively small fraction of the percent of votes they lost.

Those who believed in the necessity of unemployment had a 17.7 percentage points higher likelihood of repeating their vote for UDF which is also higher compared to the coefficients in the first two columns. How does that effect translate into votes? Among the individuals who voted for UDF in 1997 (385 altogether), 187 believed or strongly believed that unemployment was a necessary cost of reforms. That, combined with the 0.177 coefficient estimate, implies that UDF received 33 votes (187×0.177) more compared to a case where no one in the population believed that unemployment was necessary. The interesting result is that these votes were more compared to the votes lost because of unemployment (15 votes). In essence, what UDF lost in terms of votes because of individuals' personal experience with unemployment was more than offset by convincing part of the population that unemployment was necessary.⁶

The results show two additional interesting effects. Individuals with more education were more likely to vote for UDF. As pointed out earlier, these agents had less dramatic experience in terms of unemployment during the reforms. Not only was unemployment among the university graduates lowest throughout the transition but it also declined between 1998 and 1999, the years of most intense reforms. These agents were therefore willing to support current policies. Table 7 also shows that female agents were less likely to support UDF. That may also be related to their market experiences during transition. According to the World Bank (2001, p. 80) one of the features of the rapid decline in employment rates in Bulgaria has been the massive "dis-employment of women."

VI. A differential effect of unemployment on voting.

The results reported in the previous section suggest that, although the size of the effect is not large, unemployment in Bulgaria contributed to the growth in political opposition. The evidence therefore does not lend support to the idea advanced by Rodrik

⁶ This conclusion assumes that some agents had decided to discontinue their support for UDF because of painful reform outcomes even though they may not be unemployed themselves. With a high rate of unemployment, many agents are indirectly affected through the experience of relatives.

(1995) that the unemployed perceive the completion of market reforms as the only long-term solution to their problem and would therefore vote for more rather than less reform. That however may not be the complete story. The experience with unemployment has not been the same across social groups and regions in the country. Unemployment for example has been much higher in rural areas compared to cities. In many of those localities, a single larger employer had been liquidated during the transition process and the percent long-term unemployed is higher compared to cities where unemployment has been lower. For the country overall the long-term unemployed, i.e. agents who are unemployed for at least 12 months, are approximately 50 percent of the unemployed which is higher than in many other transition economies (see Boeri and Terrell 2002). Is it possible that, as Rodrik (1995) suggests, unemployment would increase rather than decrease the support for reform in localities where the labor market has been stagnant? For these workers, after years of failed incomplete reforms, the solution may be associated with growth in private sector employment as opposed to continued state intervention.

Another interesting variable is age. Unemployment among older workers has been lower compared to younger workers as many of them have maintained employment in state firms that still operated or were privatized rather than liquidated. With the liquidation of more state firms the age distribution of unemployment has changed somewhat but in general younger individuals have experienced more unemployment even though they may be better suited (through more recent education) to find employment in the newly expanding sectors of the economy such as services. The high unemployment among young individuals reflects the inability of the private sector to create jobs. For those individuals, as for the unemployed in more rural areas, the solution may be more rather than less market reform. To explore those ideas, we interact the dummy variable for unemployment with place of residency and age and include the interaction terms in the probit equation which explains voting in 2001. The equations are estimated only with the sample of voters who voted for UDF in 1997 to examine directly the reasons for loss of support for UDF. These estimations produced stronger results compared to equations using the full sample.

The first column of results reported in Table 8 show that while the coefficient on unemployment is negative and significant as in Table 7, the interaction variable of unemployment and rural residence is positive and statistically significant. In addition, the size of the coefficient on the interaction variable is greater than the coefficient on unemployment and the difference is statistically significant. These results suggest that unemployment in rural areas actually contributed to stronger support for UDF while in urban areas it contributed to political opposition. The interaction variable with age did not produce statistically significant results.

VII. Final remarks.

This paper examines the loss of political support for a “reformist” party in the 2001 elections in Bulgaria. At those elections, the party that had come to power four years ago and implemented market reforms was defeated. The paper uses data from a national consumer survey to examine whether the election defeat can be explained by the increase in unemployment produced by the reforms. The data show that despite the very high level of unemployment, many agents (including the unemployed) believed that high unemployment was a necessary short-term cost of the reforms. High unemployment was not sufficient to explain the loss of political support for the party implementing the reforms.

Although the election campaign of the new government in 2001 featured a variety of tax and spending initiatives that may be considered populist, they generally continued the same path of reform. The advancing negotiations for European Union membership and the strong presence of the International Monetary Fund in Bulgaria contributed to softening most of those initiatives. In that sense, the Bulgarian experience fits well with observations from other transition economies where reformist parties have been voted out of office but the reforms themselves were not reversed (Hellman 1998). While that can be attributed to some external pressure to continue reforms, the evidence presented here shows that the internal resistance to reform was not strong. The unemployed who are generally considered the losers of market reforms did not become political opponents of the reformist party. In that sense, the election loss of the reformist party cannot be interpreted as a vote against reform.

A potential reason for that outcome is the high degree of irreversibility in reforms produced by their rapid implementation and the introduction of the currency board. While it may make sense for state workers to oppose proposed liquidation of inefficient state firms while the firms still operate, it does not make much sense to oppose further reform once inefficient firms have been closed for good. At that point, the solution requires further reform rather than stalling reforms. In that sense, the results highlight the difference between opposition to the initiation of reforms (ex-ante opposition) and the opposition to sustaining the reform (ex-post opposition). The results suggest that opposition from the short-term losers may not be too strong once reforms have been initiated in a credible way.

Why did UDF lose the elections then? Ivan Kostov, the leader of UDF explained the 2001 election defeat in the following way: “We have taken a lot of unpopular decisions and also made mistakes.” (CNN, June 17th 2001). The “mistakes” to which Mr. Kostov refers to are most likely his government’s inefficiency in fighting corruption and high crime. Many of the privatization deals were not transparent and in many cases the media argued that privatization deals were not done in the public’s interest. It is also possible that voters had higher expectations in 1997 of what can be accomplished in terms of growth and employment in a few years. Krassen Stanchev, director of the Institute for Market Economics in Bulgaria pointed out that if “the often dour Mr. Kostov has a weakness, it is his failure to communicate his successes to Bulgarians.”⁷ On that last point, however, the survey data show that many agents in Bulgaria were receptive to the message of short-term sacrifices for long-term benefits advanced by UDF.

As pointed out earlier, the new government promised substantial improvements in living standard within a target of 800 days. Judging from the economic performance halfway to that target, that may have been too optimistic. A follow-up survey in June 2002, one year after the 2001 elections, revealed that only 9.65 percent of Bulgarians intended to vote for the new government if elections were held on that day, down from 42.74 percent in the actual elections in 2001. Just like with UDF, the government had lost support very rapidly. Does that mean that Bulgarians oppose market reform? Probably

⁷ The New York Times, June 17, 2001.

not. More likely, they feel that reforms should be done better and that six years is too long for what was supposed to be a short-term period of high transition costs.

References

- Aslund, Anders (2002). *Building Capitalism*. Cambridge University Press.
- Blanchard, Oliver (1997). *The Economics of Post-Communist Transition. Clarendon Lectures in Economics*. Clarendon Press. Oxford.
- Braxi, Hana, Sergei Shatalov, and Leila Zlaoui (2001). Managing Fiscal Risk in Bulgaria." The World Bank, *mimeo*.
- Carlson, John and Neven Valev (2001). "Credibility of a New Monetary Regime: The Currency Board in Bulgaria." *Journal of Monetary Economics*, 47, 581-594.
- Dewatripont, M. and Gerard Roland (1992). "The Virtues of Gradualism and Legitimacy in the Transition to a Market Economy." *The Economic Journal*, 102(441), 291-300.
- Dobrinsky, Rumen (2000). "The Transition Crisis in Bulgaria." *Cambridge Journal of Economics*, 24, 581-602.
- European Bank for Reconstruction and Development (EBRD), *Transition Report*, various years.
- Fernandez, Raquel and Dani Rodrik (1991). "Resistance to Reform: Status Quo in the Presence of Individual-Specific Uncertainty." *American Economic Review*, 81(5), 1146-1155.
- Fidrmuc, Jan (2000). "Political Support for Reforms: Economics of Voting in Transition Countries." *European Economic Review*, 44, 1491-1513.
- Ham, John C., Jan Svejnar, and Katherine Terrell (1998). "Unemployment and the Social Safety Net during Transition to a Market Economy: Evidence from the Czech and Slovak Republics." *American Economic Review*, 88(5), 1117-1142.
- Hellman, Joel (1998). "The Politics of Partial Reform," *World Politics*, 50(2), 203-234.
- Pacek, Alexander (1994). "Macroeconomic Conditions and Electoral Politics in East Central Europe." *American Journal of Political Science*, 38(3), 723-744.
- Rodrik, Dani (1995). "The Dynamics of Political Support for Reform in Economies in Transition." *Journal of the Japanese and International Economies*, 9, 403-425.

Roland, Gerard (2002). "The Political Economy of Transition," *Journal of Economic Perspectives*, 16(1), 29-51.

Schwartz, Anna J. (1993). "Currency Boards; Their Past, Present and Possible Future Role," *Carnegie-Rochester Conference Series on Public Policy* 39, December, 147-187

Warner, Andrew (2001). "Is Economic Reform Popular at the Polls?" *Journal of Comparative Economics*, 29, 448-465.

World Bank (2001). Bulgaria: The Dual Challenge of Transition and Accession." A World Bank Country Study, February.

Table 1: Macroeconomic developments, Bulgaria 1992 – 2001.

Year	CPI inflation (percentage change in the CPI)	Budget balance (percent of GDP, - deficit)	Gross fixed capital formation (percent of GDP)	Real GDP growth (percentage change)	Unemployment rate
1992	79.2	-2.9		-7.3	15.3
1993	63.9	-8.7		-1.5	16.4
1994	121.9	-3.9	9.3	1.8	12.8
1995	32.9	-5.7	14.6	2.1	11.1
1996	310.8	-10.4	8.9	-10.1	12.5
1997	578.6	-2.1	12.2	-7.0	13.7
1998	1.0	0.9	11.6	3.5	12.2
1999	6.2	-0.9	15.9	2.4	16.0
2000	11.4	-1.1	16.3	5.8	17.9
2001	10.4	-1.5	19.9	4.6	17.3

Sources: European Bank for Reconstruction and Development, *Transition Report*, various years; Bulgarian National Bank, *Annual Report*, various years.

Table 2: Matching survey responses to actual voting outcomes in 1997 and 2001.
Percent of votes for various political parties.

	1997 elections		2001 elections	
	Actual election results	Survey results	Actual election results	Survey results
Union of Democratic Forces (UDF)	49.15	51.94	18.18	19.25
Socialist Party (BSP)	22.40	31.73	17.5	20.75
Evrolevica	5.57	3.08	-	-
Bulgarian Business Bloc	5.27	1.20	-	-
Movement for Rights and Freedom	9.44	7.10	7.45	4.17
Coalition Simeon	-	-	42.74	-

Notes: UDF was in office from 1997 to 2001. Included are only political parties that received votes in excess of the 4 percent threshold needed to enter Parliament. Coalition Simeon did not exist in 1997 and at the time of the survey.

Table 3: Is high unemployment a necessary cost of market reform?
Survey results from Bulgaria, August 2000.

	<i>Statement:</i> <i>High unemployment is the price we have to pay for future prosperity.</i>		
	All respondents	Unemployed	Employed
Strongly agree	17.71	16.22	17.98
Agree	21.15	18.38	21.86
Disagree	23.33	20.54	23.93
Strongly disagree	24.69	24.32	24.84
Uncertain	13.13	20.54	11.38

Notes: All numbers are in percent of total.

Table 4: Beliefs about the cost of market reforms in Bulgaria.
Survey results, August 2000. Probit analysis.

	Dependent variable: 1 if an individual agreed or strongly agreed with the following Statement: <i>High unemployment is the price we have to pay for future prosperity.</i>
Unemployed	-0.036 (0.046)
Education	0.156*** (0.039)
Female	-0.042 (0.032)
Age	-0.002* (0.001)
Income	0.027 (0.017)
Rural	0.014 (0.035)
Pseudo R²	946
Number of observations	0.029

Notes: standard errors in parentheses. ***(**, *) significant at the 1, (5, 10) percent level.

Table 5: Cross tabulation of votes in 1997 and expected voting in 2001.
Survey results from Bulgaria, August 2000

In 1997, individuals who:	Individuals who planned to:			
	Vote for UDF	Not vote	Vote for another party	Totals
Voted for UDF	161 (41.8)	155 (40.3)	69 (17.9)	385 (100)
Did not vote	3 (1.4)	185 (86.9)	25 (11.7)	213 (100)
Voted for another party	3 (0.8)	93 (25.6)	266 (73.4)	362 (100)
Totals	167 (17.4)	433 (45.1)	360 (37.5)	960 (100)

Notes: Numbers in parentheses are percentages.

Table 6: Employment status, beliefs about market reform, and voting behavior.
Survey results from Bulgaria, August 2000.

	Percent of individuals who intended to vote for UDF	
	Overall survey sample	Sample of individuals who voted for UDF in 1997
Employed	18.70	45.93
Unemployed	11.96	25.33
Difference	6.74**	20.60***
Agree with Statement on reform	22.18	46.73
Disagree with Statement on reform	12.42	35.06
Difference	9.76***	11.67**

Notes: ***(**) significant at the 1(5) percent level.

Statement: High unemployment is the price we have to pay for future prosperity.

Table 7: Employment status, beliefs about market reform, and voting behavior. Survey results from Bulgaria, August 2000. Probit analysis.

	Dependent variable: <i>1 if an individual intended to vote for UDF, 0 otherwise.</i>			
	Overall survey sample		Sample of individuals who voted for UDF in 1997	
	(1)	(2)	(3)	(4)
Voted for UDF in 1997	0.389*** (0.026)	0.379*** (0.027)		
Unemployed	-0.033* (0.019)	-0.024 (0.019)	-0.182*** (0.059)	-0.136* (0.071)
Agree with Statement on reform	0.063*** (0.019)	0.054*** (0.018)	0.177*** (0.050)	0.155** (0.052)
Education		0.045** (0.017)		0.189** (0.069)
Female		-0.031* (0.016)		-0.097* (0.052)
Age		0.001 (0.001)		0.003 (0.002)
Income		0.005 (0.007)		0.028 (0.026)
Rural		0.007 (0.017)		0.020 (0.058)
Pseudo R²	0.356	0.366	0.044	0.06
Observations	952	940	382	380

Notes: standard errors in parentheses. ***(**, *) significant at the 1, (5, 10) percent level.

Statement: High unemployment is the price we have to pay for future prosperity.

Table 8: Employment status and voting behavior. Differentiating between individuals in rural and urban areas and in terms of age.
Survey results from Bulgaria, August 2000. Probit analysis.

	Dependent variable:	
	<i>1 if an individual intended to vote for UDF, 0 otherwise.</i>	
Unemployed	-0.340*** (0.071)	-0.407** (0.143)
Unemployed * Rural	0.521*** (0.087)	
Unemployed * Age		0.009 (0.006)
Agree with Statement on reform	0.167*** (0.052)	0.153 (0.052)
Education	0.182** (0.070)	0.177** (0.070)
Female	-0.098* (0.053)	-0.092* (0.053)
Age	0.003 (0.002)	0.002 (0.002)
Income	0.023 (0.026)	0.024 (0.026)
Rural	-0.095 (0.063)	0.016 (0.058)
Pseudo R²	380	380
Number of observations	0.101	0.074

Notes: standard errors in parentheses. ***(**,*) significant at the 1, (5, 10) percent level.
Statement: High unemployment is the price we have to pay for future prosperity.