



**Cost Benefit Analysis of the Draft Legislation on
Private Bailiffs and Private Execution
(Summary)**

By Krassen Stanchev and Martin Dimitrov

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General Conclusions

1. As of end 2004, the **costs of the existing system of state executive judges incurred by lack of efficiency amount to BGN 850 million. It is a gross sum, calculated at a relatively high, by today standards, assumption of a success rate of receivables collection of 50%: the overall amount of unresolved cases is BGN 1.7 billion.** This sum has been accumulated over last five years, and is reported by the system itself, in other words – we do not know how many claimants choose to avoid the It is likely that the number of these cases is not trivial. At a conservative assessment and supposedly 50% success rate, the cost for the economy as a whole 3.5 billion, ie. a half of the uncollected receivables in 2003, as reported by financial statements of the corporate sector (sole proprietors are not included).
2. Budget expense of the incumbent enforcement system might be calculated as administrative cost at the end of 2004 and as benefits (opportunity cost) that were omitted from as tax revenues from enforcement activities that could have taken place provided the enforcement costs were lower (but did not take place). **The annual state budget costs to retain the state execution amount at BGN 13.6 million. The opportunity costs (omitted over years) are at least BGN 170 million.**
3. In Bulgaria, **the execution process is two and half times more expensive than in countries with private execution, countries like Netherlands and Estonia. The comparison with Belgium is even more discouraging: Bulgaria is three times more expensive.** To a great extend, this is due to **the duration of the process – it is ten times longer than in Holland and three times longer than in Estonia. This is an indication that the incentives for the system are basically not function.**
4. **The transition to a system of private bailiff co-existing with state executive judges amount to BGN 15.3 million for a period of three years (i.e. for the period prescribed by the draft bill). Of them BGN 3.17 million are the initial costs for the first year. These costs could and should**

be met by the 2005 budget of the court system and they are **negligible compared to provisional (fiscal) benefits of the new system.**

5. These benefits are estimated as incumbent system's costs saved. (These costs were outlined above in the paragraph 2.) **The private execution potential, from the moment it is up and running, is BGN 460 million that would emerge from resolving pending writs of execution (BGN 1.7 billion) and preventing (resolving more cases that it is currently possible) new delays.** (These are the benefits if we assume that the efficiency of the new system is similar to that of Estonia). **In a medium (over one year) and long (three year and beyond) term, the expected benefits significant since there is great probability that the cost of collecting receivables would be reduced.** Under the system of private executions, the protection claims that are currently outside the system will emerge and will be closed and new business would take place. Thus, the benefits (savings) of the economy as a whole (the BGN 7 billion claims remaining outside the system of execution) would equal the reduction of the economic costs of execution of about BGN 1.9 billion (if, again, the system functions at the Estibnian level of efficiency).

General economic and quantifiable estimates of the new system efficiency

For the period of 2001 – mid-2004, the total number of new delayed claims is 15,000. If we reduce the number of case by the number of those already resolved the number of the pending cases would be 375,693 (as of mid-2004). The above-mentioned BGN 1.7 billion is the aggregated sum of these cases. The monetarized value of the newly accumulated (registered) pending cases is around BGN 714 million. We underline: these are only the registered cases. These cases amount to 2% of 2003 GDP. Any sustainable system that reduces the number of these cases is an economic (prosperity) growth gain.

If the incumbent system is retained, in five year the new registered pending cases would be around BGN 1 billion, in other word the 2003 monetarized value would be doubled. This means that as percent of GDP it would be between 2.5 and 3% (of the forecasted GDP for 2005). **The growth of the postponed receivables is relatively similar to the growth of registered cases. This means that the incumbent system does not perfect itself; that there is no internal drive for perfection. In other words, the inefficiency, the systemic imperfections, which amount to 0.6% of 2001 – mid-2004 GDP, will reappear in the next three years, i.e. there will be similar or greater loss of income for the economy as a whole.**

As a inefficiency in narrow sense it equals the unrealized interest of the claimants (creditors) that the incumbent system itself reports as BGN 1.7 billion. In five year this sum would be BGN 2.7 billion.

But there are liabilities beyond those registered. Although it is obvious that not all of the delayed inter-firm payments and other liabilities are subject to execution, their minimum 2003 volume (BGN 5.3 billion) constitutes the thinkable limits of the potential of a system that works efficiently. After five year this potential inefficiency (or potential new system's efficiency) would be BGN 10-11 billion.

The economic analysis of the deficiencies of the current system of execution (based only on state executive judges) leaves no doubt that it does not serves the

mission it was deemed and designed to serve. This conclusion omits a number of obvious but difficult to monetarized costs without a special field survey – the cost of claimant to avoid imperfections, delays and foregone opportunities, and time tax (the time spent in personal and firms’ attempts to use the incumbent system).

Non-quantifiable impacts

1. Without special field research, some impacts could be described only in qualitative terms. From an economist perspective the following overall impacts are quite probable: The demand for the “service” of private execution is substantial. Good executive judges are tempted to work on private assignments where their service would be judged by quality and efficiency. However, given the low standard set by the incumbent system, the pressure for the perfection even of good judges must fairly negligible. State system in motivating work outside the government (state judges) domain. The price, as indicated by our respondents, for such work is three times more attractive than the remuneration.
2. A relatively high share (one fourth to one third) of unemployed in Bulgaria were former workers in loss-making state own enterprises. Most of them were liquidated in 1999 and early 2000. The overall system of execution still suffers from those claims that remain unresolved and, although the monetary value of these claims is relatively small (between BGN 70 and 80 million), it still complicates employment related disputes. 50,000 out of 370,000 unemployed today suffer from unresolved claims from before 1999. The reform would prevent the future similar situations and will stimulate bailiffs focusing on the claims as well.
3. Mixed incentives and inefficiency of the incumbent system is most visible in the so-called “social cases”, in claims on family disputes and for employee receivables from liquidated, formerly government owned enterprises. Obviously, other factors like the inefficiency of social welfare and employment agencies contribute to the deepening the problems in this area. **At the end, however, pending “social” receivables grow two and a half time faster than the rest of registered delayed cases of execution.**

Although the GNI level per capita in Bulgaria is on average three times lower than OECD countries, it maintains a more expensive and inefficient execution system. **Collection of receivables in Bulgaria is more than two times more expensive than the execution in OECD countries that fall in the category of high income ones.**

State budget expenditure

The estimation of these effects is required for the justification of the new draft legislation and must be done to comply with the law on normative act.

1. A judge (not necessarily an executive judge) costs the taxpayers in 2004 BGN 4,500 a month.¹ The aggregated costs of all incumbent executive judges in 2004 are BGN 13.553 million.² The reporting system does not give any

¹ This is the amount of 2004 state budget expense for one judge, below we discussed what this sum means for other aspect of the reform.

² We do not take into account the fact that some judges in some locations have other functions.

information about the revenues of the incumbent system from fees for the provisional services. The BGN 13.5 million are gross expenses of the state budget. The actual costs could be even higher. At a collection rate of 50%, the hidden social (for the economy as a whole), as already mentioned, are BGN 850 million.³ More importantly, these social losses are debtors' benefits.

Under the proposed system the one time expense (if the salaries of the Executive chamber after the first year are covered by own sources) are BGN 3.17 million and for three years of co-existence of private and state bailiffs are BGN 15.273 million.

Qualitative benefits and features of the new system form an economist's perspective

1. The list of these benefits is the following: Incentive for effective execution;
 - Change (partial, only for private bailiffs) in the financing mechanisms, debtor pays
 - Emergence of professional dignity and reputation as factor to overcome the ambiguity of the incumbent system;
 - Specialization and competition
 - Unified rules that reduce costs
 - Overall efficiency enhancement and reduction of risk
 - Additional structural benefits (inclusion of more cases into the system);
 - Positive fiscal effects
 - Accountability, transparency and opportunities to perfect the system.

2. Using the analogies of Estonia and Netherlands, we receive two scenarios: under the first (Estonian practice), the pending cases would be collectable with an efficiency that is BGN 459 million, and under the second scenario (Dutch practice) – the social costs of execution are more efficient with BGN 493 billion.

3. If we assume, as a benchmark, that the full potential of the system is the level of all postponed inter-firm payments of BGN 7 billion⁴, it is possible to calculate the potential of the new system: it is 1.89 billion under the “Estonia” scenario and BGN 2.03 billion under the Dutch efficiency.

4. As a share of GDP this means savings of 5 and 5.3% of GDP for the next three years. This means significantly better cost-efficiency in doing business in Bulgaria and improved growth potential.

Exemplification of the above conclusions

Contract enforcement

	Number of procedure*	Time (days) **	Costs (as % of the debt)***	Net costs – time and
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³ These are funds that the society fails to collect, but it has paid taxes and fees for state execution are collected before hand. This is not just a moral but also a systemic judicial (in terms of the rule of law) issue. A special survey could quantify these impacts.

⁴ This is a conservative assumption, we think that the ceiling of those payment would the next three years is BGN 10-11 billion.

				money as % of the debt
Bulgaria	34	440	14	50
Estonia	25	150	10.6	23
Holland	22	48	17	21
Belgium,	27	112	6.2	15.2
France	21	75	11.7	17.7
OECD, high income	19	229	10.7	29.5

Source: Doing Business Survey, World Bank, own calculations. It is important to note that private bailiff's reform goes hand in hand with amendments to the Civil Procedure Code

*The indicator reflects the number of court procedures. ** It measures the time in calendar days from the time of the claim submission till the day of collecting the receivables. Индикаторът мери времето за разрешаване на спор в календарни дни, броено от момента на подаване на иска до събиране на вземането.

*** Measure official costs of the procedure, including court and lawyers fees.

A comparison of the incumbent system with different reform models

	Overall costs (as % of the debt)	Pending receivables BGN 1.7 billion (billion)	Improvement rate (% 2004 GDP)	Full potential – BGN 7 billion (postponed payments)	Improvement rate (%2004 GDP)
Incumbent system	50	0.85	2.2%	3.5	9.2%
Scenario I (Estonia)	23	0.391	1%	1.61	4.2%
Scenario II (Holland)	21	0.357	0.9%	1.47	3.9%
Savings for the economy (Scenario I relative to the incumbent system)		0.459	1.2%	1.89	5%
Savings for the economy (Scenario II relative to the incumbent system)		0.493	1.3%	2.03	5.3%

Source: Ministry of Justice, BIA, World Bank, own calculations.

Overall monetarized costs of the incumbent system

Year	Executive judges reports	% of GDP*	As costs of the economy	% of GDP**
2004	BGN 850 million	2.2 %	BGN 3.5 billion	9.2%
2009	BGN 1.350 billion	2.4 %	BGN 5 - 5,5 billion	9.9 %

Source: Ministry of Justice, BIA, own calculations.

*Government forecast, **Own forecast

Assessment of fiscal impacts

	Pending cases - BGN 1.7 billion (billion)	Full potential – BGN 7 billion	General assessment (-, 0, +)	Budget revenue, at current taxation (BGN million)
Incumbent system)	0.85	3.5	0 to -	n.a.
Scenario I (Estonia)	0.391.	1.61	+	From 156.4 to 644
Scenario II (Holland)	0.357	1.,47	+	From 143.6 to 588
Savings for the economy (Scenario I relative to the incumbent system)	0.459	1.89	+	From 183.6 to 756
Savings for the economy (Scenario II relative to the incumbent system)	0.493	2.03	+	From 197 to 812

Wages of state executive judges in the transition period

Number of judges	First year (BGN)	Second year (BGN))	Third year (BGN)
120	6 480 000		
60		3 240 000	
60			3 240 000

- We assume that the salaries remain unchanged.
- Discount rate is 10%- the average credit/deposit rate in Bulgaria

The net present value of the costs for the transition period is BGN 12.1 million

One time transition costs

Expense	Amount
Office space	538,000
Salaries and Equipment (Executives Chamber)	286,000
Office rent	2,350,000
Total	3,174,000

If we add here the salaries for the remaining state executive judges (under the above assumption) the three-year costs are BGN 15.274 million.

Conclusion

The analysis above allows concluding that the benefits of the reform based on private bailiffs significantly exceed the costs. This means that the reform is very likely to reduce the overall transaction costs in the economy and serve as a condition for better investment climate and improved economic growth and prosperity.