

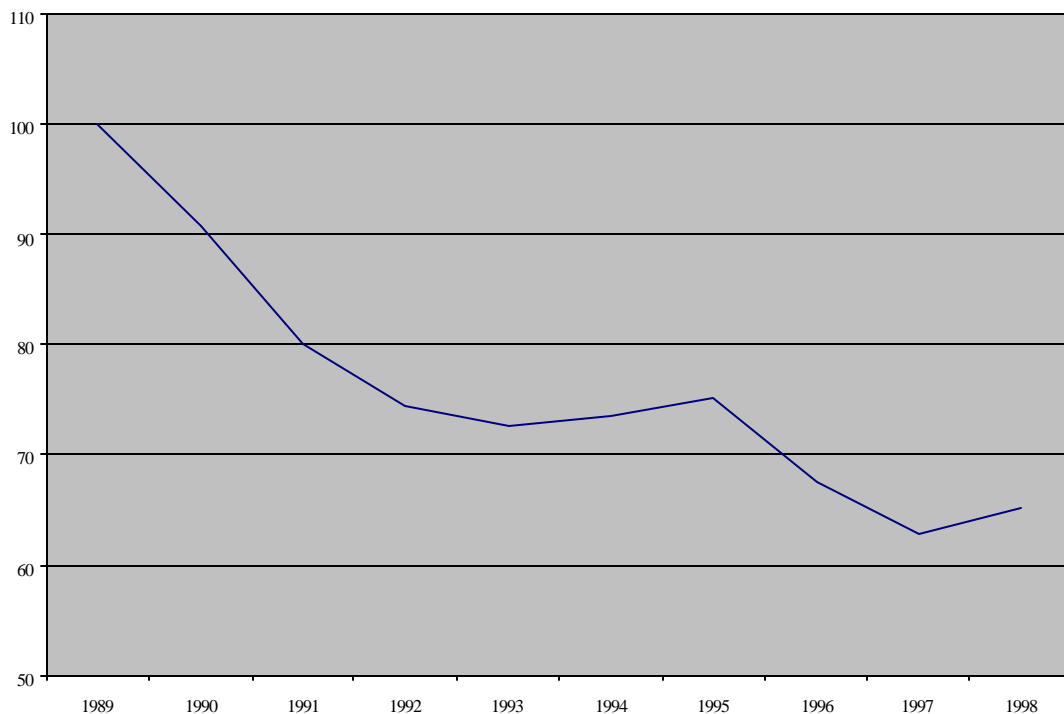
Introduction

Bulgarian economy happened to be resilient to external shock, but more so after the introduction of the currency board arrangement in 1997. It is not simply a merit of the arrangement per se but, practically speaking, it has helped to follow set of policies, which eventually offset negative developments on the international markets. It is no accident – in early and mid-1990's more crucial domestic policy deficiencies and constellations mediated external shocks. In the cases of embargoes etc. they aggravated the negative impacts. In cases of international market turbulence, they prevented the chocks. In the post 1997 period, the economic restructuring is taking off from the limbo of the previous period. At the same time, besides structural inefficiencies and the ambivalent impacts of external factors Bulgarian economy managed to reorient its markets from the ex-Eastern Block countries to the EU and the European free trade zone, and domestic economic structure is adjusting itself to this circumstances through increased FDI after 1998.

Mismanagement of reforms (1990-1997)

After 1989, only four years registered growth in real GDP. In 1994, 1995 the growth was modest but fueled by indebtedness of the state owned enterprises, quasi-fiscal subsidies and international conjecture. It reemerges in 1998 and 1999 on sounder fundamentals (stable currency, low inflation, bankrupted loss making enterprise, etc.). 2000 is likely to register growth of about 5% of GDP, thus completing a three-year test period for growth sustainability. At the same time, since 1989, real GDP has lost more than one-third of its initial volume and the recovery is slow, reaching in 2000 72% of the pre-reform level.

Real GDP Index (1989=100)



Source: NSI, IME calculations

Growth factors in 2000

Bulgaria in 2000 is registering a third year of economic growth. It is a sign of sustainability.

Demand-side structure of GDP (1991, 1999 and 2000)

	1991	1999	2000
Private consumption	55.9	82.3	
Government consumption	17.2	8.4	
Investments	22.6	19.0	
Net exports	4.3	-7.7	

Source: NSI

The table above compares the demand driving Bulgarian GDP since the start of the reforms in March 1991. Preliminary data for 2000 demonstrate a restoration of the role of exports as a factor of GDP. The significant fact is that it is the first development of the sort for ten years. The big question mark, however, is whether it marks a beginning of a trend or simply due to conjecture factors.

To answer this question, one should look at different domestic factors that are likely to support greater trade and growth potential. For different factors I allocate different terms of contemporaneity. As factors I select:

- Average growth of GDP for certain periods, although there was a growth in 1998 of 3.5%, I categorize this year to the previous period in order to “discount” a provisional impact of the economic inertia, and not to take into account the factor of the low starting point (the contraction of 1996 real GDP was 10.9%, in 1997 – 6.9%);
- Average export growth for the same periods;
- Average growth of savings to GDP, this time the contemporary period includes 1998, and it is compared to the years between 1995-1997 in order to avoid the sharpest decline in saving at the beginning of reforms;
- Foreign direct investment and gross domestic investment (taken for the period of 1994-1997 in order to skip the disinvestments in first reform years).

Comparisons of selected growth factors for selected periods

Indicators	[Period] / percent	[Period] / percent
Average GDP growth	1990-1998 / - 3.9	1999-2000* / 3.3
Average export growth	1990-1998 / 6.7	1999-2000 / 9.7
Average savings to GDP	1995-1997 / 13.16	1998-2000 / 13.13
Gross domestic investment	1994-1997 / 11.6	1998-2000 / 18.03
Foreign direct investment	1990-1998 / 3.3	1999-2000 / 4.4

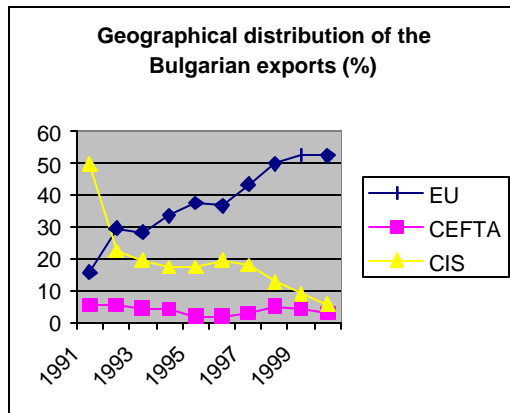
Source: IMF, NSI, own calculations

(*) – 2000 forecast.

Growth trend seems to be reversed. Investment is steadily higher in the last three years than in the previous period. Foreign investment is higher than in years before 1998 but still unused factor. Institutional background was also providing for greater government discretion, which allow eventually to mismanage the exchange rate and restored price controls and protectionism in 1995. In addition, by the end of 2000 90% of Bulgarian

banks are private and 70% of them – foreign. No domestic political party is advocating major changes in the monetary or trade policies. External policy framework of EU accession is an additional institutional constraint to domestic temptation for radical policy reversals.

In addition, Bulgarian trade was converted from East to West under circumstances less favorable in 1998 – 2000 period, than they could be at early years of transition.



Source: NSI [Data on years before creation of CEFTA are for the member-countries.]

Compared to Slovenia, which in 1991 had close to 60% of its trade with EU and EFTA, Bulgaria had to re-orient its trade from the same trade volume to then at the eve of dissolution CMEA, seeking other markets. Bulgaria's starting point of reforms was significantly worse than that of other emerging economies. Also, Bulgaria lost markets in Iraq, Libya, and Iran. Sanctions against Iraq and Libya blocked USD 2 billion of their debts to Bulgaria.¹

What exist is possible

It is possible to compare the demographics of Bulgaria with its global share in FDI's. Such a measurement has been proposed as a part of general bench-marking on Bulgaria's economy by J.A. Austin Associates (JAA). JAA compares Bulgaria's FDI for a selected year with its share in the global population. In 1998, the first year of a relative break through after the crisis of 1996-1997, Bulgaria attracted USD 401 million FDI's, which put her on 61st place out of 162 countries on which information was available for the World Development Indicators of the World Bank. Between EU accession countries behind Bulgaria in that year we only three countries: Latvia, Slovenia and Cyprus.

¹ It happened simultaneously with the default on foreign debt payment in March 1990, announced unilaterally by then communist cabinet. It also happened at the eve of the first democratic general elections of the post-communist history of the country, held in June 1990. Then elected new set of government had still to establish itself and simultaneously, in a condensed time-period, with the reorientation of trade to deal with debt rescheduling, launching reforms and constitution making. The immediate victim of this agenda was not the constitution making, political reforms or the international relations but the consistency of economic reforms.

Bulgaria's share in global FDI flows ²

Country	FDI in US\$ Millions	Population Millions	Share of World Population	Share of Global FDI	FDI per capita	FDI/ Population Ratio	Percentile Rank
Singapore	\$10,326	3.164	0.05%	0.78%	3264.20	14.43	95
Ireland	\$4,038	3.705	0.06%	0.30%	1089.88	4.82	88
Spain	\$32,539	39.371	0.67%	2.45%	826.47	3.65	83
Czech Republic	\$2,609	10.295	0.18%	0.20%	253.42	1.12	75
Hungary	\$2,414	10.114	0.17%	0.18%	238.72	1.06	73
Romania	\$2,040	22.503	0.38%	0.15%	90.65	0.40	53
Macedonia, FYR	\$118	2.010	0.03%	0.01%	58.52	0.26	42
Bulgaria	\$401	8.257	0.14%	0.03%	48.61	0.21	37

Source: World Development Indicators, JAA calculations

JAA assumption is that FDI/population ratio might be considered “fair” if it is at least close to 1. Obviously this is a conventional assumption, but it helps comparisons. While Bulgaria's FDI share is six times smaller the share of the world population, Hungary and Czech republic, although with similar sized of population look considerably different. The development is the following. In 1998, FDI's as percent of GDP constituted 3.3%. A year later it almost doubled to 6.1%. In the years after 1998 the inflow of FDI is on average 30% higher per annum. Accumulated stock of foreign direct investment in 2000 would be at least 21% of the GDP. It would be twice less than the share of FDI's to the GDP of Hungary but roughly the same percentage as in Poland.

FDI's per country of origin give more information on provisional trade developments. Presumably, the trade would be sustained or even improved if trade partners interweave respective economic entities and cooperate.

In 1999 EU capital had 60% of the FDI's in Bulgaria, in 2000 this share will be already 63-64%. (In terms of per capita the figure would almost double the amount of 1998.) Similar but higher shares of EU investment have Central European countries.³ On the SEE scene similar is the performance of Croatia and Romania.⁴ An interesting development is that of the Italian investment. Italia use to be a prime trade partner for the last ten years, but in terms of direct investment she has been at bottom of the list with only USD 35 million. In 2000, the fourth biggest Italian bank, with a major presence at the emerging European markets, Unicredito Italiano, bought the biggest Bulgarian bank. Thus Italy's Bulgarian position as a second trade partner converted itself into a third investor. The structural impact of such development cannot be underestimated: it has finalized the privatization of the Bulgarian banking sector, diversifying the foreign presence in accordance with the major trade and investment partners.⁵ As of the end of

² Martin Webber, Kevin Murphy, Bulgaria's Competitiveness Beyond 2000, J.A. Austin Associates, Washington DC, Sofia, 2000, p. 14. WDI figure for 1998 Bulgaria FDI is different from that officially accepted by Bulgaria's Foreign Investment Agency; WDI does not takes into account reinvested earnings and credits, if we add to them the figure would be USD 620 million.

³ Gabor Huya, FDI in SEE: Implementing Best Policy Practices, WIIW, 2000, p. 5.

⁴ Ibid., p. 5-6.

⁵ The EU ownership of the Bulgarian banking system is about 70%, with other investors like Societe Generale, National Bank of Greece, AIG, Raiffaisen Bank, ING, etc. Structurally significant Italian investment is taking place on a smaller scale as well, e.g. a leading Italian woolen textile producer bought earlier this years one of the biggest Bulgarian factories (with 30% of the assets in the sector and 25% market share), inducing domestic rivalry and thus changing the future of the entire sub-sector in the

2000, Germany, Belgium and Italy would amount to over 40% of the investment in Bulgaria.

FDI by source and year (USD for 1992-2001)**

Year	Privatization	Portfolio	Greenfield	Total per year
1992			34	34
1993	22	n.a.	80	80
1994	134.2	n.a.	76	200.2
1995	26	n.a.	136	162
1996	76.4	n.a.	180	256.4
1997	421.4	29.7	185	636.1
1998	155.8	64.2	400	620
1999	305.7	53.1	447	805.7
2000*	480	20	500	1,000
2001**	400	25	450	875
Total period	2,021.5	192	2,488	4,701.5

Source: Foreign Investment Agency (FIA), IME

[*- FIA forecast, ** - IMEforecast.]

Earlier foreign investors, like Belgium based Solvey and Union Miniere, have bought respectively major chemical plant producing soda and a copper smelter. They build up their advantages on the originally subsidized in mid-1990 markets, restructured the enterprise and provided a bridge to a sustained exports without relying on quasi-fiscal transfers. Similar developments take place in the textile and knitwear industry.

Some additional comparisons and conclusions

In 1999, FDI increased in Croatia and Bulgaria but declined in some other countries, e.g. in Macedonia and Romania. Per capita inflow for Bulgaria is approximately 2.5 times less advantageous than for Croatia but as a percent of GDP the volumes are roughly comparable. But it is also important that the combined FDI inflow for Southeast Europe in 1999 is 62% of the FDI to Czech Republic FDI for the same year.

Cumulative inflow per capita since 1989 is comparatively very low, more than seven times less than in Hungary or six times less than in Czech Republic.

Indicators of foreign direct investment in SEE economies (1998-1999 in million USD)

Country	FDI										Cumulative	
	Inflow		FDI abroad		Net		Inflow per capita		% of GDP		USD	Per capita
	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999	1999	1999
Albania	45	41	-	-	45	41	14	13	1.5	1.1	424	138
BiH	100	60	-	-	100	60	27	16	2.4	1.3	160	42
Bulgaria	537	739	-	-5	537	734	64	89	4.4	6.1	2,228	269
Croatia	873	1,332	-83	-43	781	1290	195	298	4.0	6.6	3,552	793

textiles.

Romania	2031	961	9	-12	2,040	949	90	43	4.9	2.8	5,441	243
Macedonia	118	40	-	-	118	40	59	20	3.4	1.1	217	108

Source: UN/ECE secretariat

EU has promptly become Bulgaria's most important trade partner with relative share of Bulgarian trade of 74% for the period between 1993 and 1999. At the same time the price for the trade reorientation was the low value added and losses in previously complex factors of production due again to the lack of FDI to compensate for these development. The second trade partner for Bulgaria is SEE (including Turkey and Greece) with average share of 31% of Bulgarian trade over this seven years period. On both EU and SEE Bulgaria had already repeatedly registered more exports than imports, and they constitute a natural venue of the domestic market enlargement. This seems to be a major advantage for attracting FDI.

Regarding Bulgaria peculiar history of FDI suggests that for the government there is limited space to maneuver relying predominantly of domestic savings and investment. Even in best years since 1998 FDI remain 3-4 lower than domestic investment.

Privatization in pipeline includes limited number of high valued big companies in telecommunications, transport and power infrastructure, natural gas and tobacco monopolies. Some of these companies, e.g. in telecommunications, are overstuffed with outdated equipment, and would be difficult to restructure. Investment in power generation and distribution has the advantage of a large and provisionally greater SEE market. Related to privatization circumstances for foreign investment are opportunities for re-privatization. It stems from otherwise unfortunate fact that in 1998 and 1999 large amount (74 and 39% of respective annual "sales") of formerly government owned companies were distributed to insiders, government appointees: many of them have already opted for resale.

The second natural FDI channel, the capital market, remains underdeveloped. The situation is not likely to be improved in 2001.

Since 1997, green-field FDI significantly outnumber investment through privatization and portfolio mechanisms. For the time being opportunities have been and are expected to remain significant in the following areas:

- Equity investment in competitive private companies; they are like everywhere and easy to recognize: they avoiding poor domestic demand, have strong forward integration, do not rely on government preference, apply strict internal quality control, innovate and perfect their product and services and work with education institutions;
- Private provision of former government services in pensions and healthcare;
- High-tech green-field in manufacturing, software industries, electronics, biotechnology and genetics, and ether-oils;
- Electricity production and distribution, energy efficiency projects and services.