

Foreign Investments – Trends in Bulgarian Industry

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Summary: The dynamic rates of attraction of direct foreign investments are a key factor for overcoming the serious problems in increasing labour productivity, improvement of production quality, and enhancing the competitive power of Bulgarian industry. The last four years (2003 – 2007) were characterized with positive changes in the dynamics and trends of this process. The main emphasis is on the structure and quality of investments in key industry sectors and high-technology, export-oriented production.

Key words: investments, foreign direct investments, industry, trends in development, industry branches and sectors.

Bulgaria has been a full and duly responsible member of United Europe for one year now. **Sustainable rates of growth** in the Gross Domestic Product, financial and bank stability, keeping inflation within reasonable for both Bulgaria and Europe limits, the consolidated parameters of the macroeconomic frame, within which the Bulgarian economy is developing **are becoming more distinct**.

These positive trends in our socio-economic development, however, **cannot offset** the fact that Bulgarian economy is considerably lagging behind the European one in terms of three fundamental fields:

- Slow and insufficient rates of growth in labour productivity of Bulgarian enterprises and companies. The produced GDP per employee in Bulgaria over the past three or four years is on average 2.5 times and sometimes even up to three times lower than the level of labour productivity in the developed EU member states;
- Higher resource- and energy-intensive production and considerable exceeding of running production costs and capital expenses per unit of production;
- Inadequate innovation rates, lower quality of produced items and insufficient competitive power of Bulgarian enterprises and business organisations in comparison to European ones.

The overcoming of these difficulties, which are of considerable importance to strengthening the country's economy, is subjected to the strong influence of a set of social, economic and political factors. Under the conditions of globalization and strengthening European economic integration a special importance is given to increasing the rates and stimulating the attraction of **sufficient in volume and quality foreign investments**. The speeding up of this process is a significant resource for the dynamic technological and product restructuring of the Bulgarian industry and its enterprises, for improving the level of their competitiveness and bringing it to the level of European criteria and standards.

Making the process of attracting foreign investment resources to the Bulgarian industry more dynamic requires the adoption of **a unified approach** to the economic categories and notions, used in this area of investment

management, by the legal and regulatory system, and the practice.

Foreign investments are subject to intensive development and special attention in respective legal and regulatory Acts and documents. Some of the most important ones are: the Trade Law and its latest amendments and supplements, Foreign Investments Law from 1997, Bank Law, Investment Encouragement Act from 2004, the Law on Amendments to the Investment Encouragement Act, which was passed and then published in the State Gazette (issue 42/29.05.2007), Regulation for Application of the Investment Encouragement Act (State Gazette, issue 76/21.09.2007).

Irrespective of the different aspects in the theory and evolution of the term "foreign investments" in the economy, from practical point of view it would be most appropriate to use its characteristic, stipulated in the Law from 2007 [3]. According to this definition "**foreign investment**" is any investment or increase in investment by a foreign body or its subsidiary in the following: stocks or shares of a trading partnership; right to ownership of buildings and limited property right over real estate; right to ownership and limited property right over movables which bear the characteristic of tangible fixed assets; right to ownership of separate parts of corporations with more than 50 per cent state or municipal share under the Privatisation and Post-privatisation Control Act; securities, including bonds and Treasury bills as well as their derivatives, issued by the government, the municipalities or other Bulgarian juridical bodies, which have a maturity period not shorter than 6 months; credits, including financial leasing for a period not shorter than 12 months; intellectual property – subject to copyright and related rights, patented innovations, useful models, trade marks, marks for services and industrial design; rights under concessionary contracts and under contracts for assigning management.

A topical, in terms of methodology and practical application, **issue** is also the correct characteristic of direct and foreign indirect investments in the country's industry. The statistic documents, investment and business projects of industrial enterprises put the emphasis on direct investments. The international standards and requirements of the Organisation for Economic Cooperation and Development (OECD), Eurostat documentation and the Central European Bank, issued in 2004, are taken as basis when examining and analyzing their content in the different information sources of Bulgarian National Bank (BNB), Bulgarian Investment Agency (BIA), National Statistical Institute (NSI) and other institutions,

In accordance with them, **foreign direct investments** (FDI) are characterized as international investments, capital movement, through which the investor acquires ownership and long-term interest in an enterprise or a company in the Bulgarian economy. They include both the initial investment of finance and all further investments and capital movements. Two other essential points should be mentioned: first – foreign direct investments include only the investments at their market price that have actually been made in the company, and second – the existence of long-term interest and a significant influence on behalf of the direct investor on the management of the company, where the foreign capital has been invested.

Foreign indirect investments are those which give the investor the right to a certain part of the profit. They do not secure him long-term relationships with the enterprise or the business organisation and a significant influence over their management. Their main aim is participation in the distribution of income and the purchase of corporate securities, shares or bonds. These, however, do not give them control over the management of the company – where the investment has been made.

Essential, in respect of speeding up the inflow of direct foreign investments in the Bulgarian industry, **is the question** about the analysis of the state and **the trends in the movement of the flows of capital worldwide and nationwide.**

At the end of 2007 the World Report on Investments – 2007 was released and a considerable growth in the general flow of direct foreign investments was registered. By 31 December 2006 and the beginning of 2007 it had reached the staggering amount of \$ 1 trillion 306 billion worldwide, which is more than in 2005. If this data is compared with the level of direct investments in 1999 – \$ 470 billion, once again the dramatic jump in the processes in this field is emphasized – approximately three times the nominal growth for a period of 7 years – 2006 compared to 1999.

An upward trend in these investments has been observed both in the developed countries – growth of 45 % in 2006 compared with 2005 and amount – \$ 857 bln, and in the developing countries – growth – 21 % – \$ 379 bln. However, the countries in Southeastern Europe and the Commonwealth of Independent States (CIS) register the highest growth rate – 68 %, almost reaching the level of \$ 70 bln foreign direct investments.

These rates and trends are **particularly characteristic for Bulgaria too** as a country in Southeastern Europe. According to data from BNB, NSI, BAI and Privatization Agency (PA), the foreign direct investments in our country for the period January – November 2007, amounted to € 5050 bln, or 17.7 % of the GDP. For the same period in 2006 they amounted to € 3865 million or 15.4 % of the GDP.

Classified **by country**, the largest direct foreign investments for 2007 in our country were attracted from Great Britain – 17.1 % of the total amount of foreign investments, Austria –

8.3 % and Greece – 7.9 %. In 2006 according to data, provided by BNB the ‘ranking’ differed slightly. Great Britain again was first with \$ 862 mln US foreign direct investments, while the Netherlands came second with \$ 842 mln direct foreign investments and Austria was third with \$ 554 mln. As it can be seen from this list of the flow of FDI in Bulgaria and its industry during 2006, it is not only Greece that is not on this list as a major investor, but also countries like Germany, Italy, USA, Russia and others, which for the entire period of transition prior to Bulgaria’s accession to the EU made directly or indirectly (through other countries) substantial direct investments.

For the period 1992 – 2006 (the year before our accession to the EU) **the state of flow of foreign direct investments** in Bulgaria classified by country with over US \$ 100 million is as follows:

1. Austria	-3454.1
2. The Netherlands	-2075.3
3. Greece	-1819.5
4. UK	-1586.3
5. Germany	-1207.2
6. Italy	-960.4
7. Hungary	-865.4
8. The Czech Republic	-851.6
9. Belgium and Luxemburg	-823.1
10. Switzerland	-822.1
11. USA	-817.0
12. Cyprus	-766.6
13. Ireland	-465.4
14. Russia	-371.6
15. Spain	-338.2
16. France	-335.0
17. Turkey	-273.3
18. Denmark	-193.5
19. Israel	-117.5
20. Japan	-102.0

Source: 1992 – 1998 – Ministry of Finance; 1999 – 2006 – Bulgarian National Bank.

It is easily noticeable that for the period under consideration Austria, the Netherlands and Greece, and Great Britain in fourth place, are the first four countries on the list. Germany is again not one of them – fifth place, Italy – sixth, USA – eleventh, Russia – fourteenth and so on.

All that quite reasonably raises the question of the conditions under which the inflow of foreign direct investments is registered by countries and years. The adopted methods and methodology require that the origin of investments should be specified by the country where the central office of the company or the investing firm is located. It is quite common for them to invest capital through subsidiaries, located in other countries. It will be quite sufficient if we point out that the investments in the 'Billa' chain of stores are considered Austrian while the owner is a German company, those in 'Viva-tel' are also considered Austrian FDI but, in fact, they are British and North American. We observe a similar situation in terms of investment in Neftohim and Lukoil – Bulgaria, which are registered as Dutch since the investments have been made through Lukoil-Bulgaria, situated in Amsterdam, but we know who the ownership of the company belongs to. All these circumstances and facts account for the state and the tendencies in 'the classification', given in the table above.

The analysis carried out over the past three or four years and the findings once again confirm **the trend to increased interest of foreign investors** in the Bulgarian industry, seeing it as an attractive place for direct foreign investments. These positions should be strengthened, developed and upheld more vigorously. Special attention should be paid to the following new phenomena and trends in the socio-economic and industrial development of our country:

- High investment rating worldwide – 7th position in terms of FDI-GDP ratio (for 2007 – 17.7 % of the GDP);

- Bulgaria's membership in the EU and NATO results in greater confidence and higher interest among foreign investors;
- The liberal legislation and control of direct foreign investments, and attractive sectors for investment – energy, transport, telecommunications, agriculture etc.;
- Attractive tax and fiscal policy – one of the lowest rates of income tax in the EU – 10 %, during 2008 – 10 % tax on the income of physical persons (the so called 'flat rate') and others;
- Attractive natural, geographic, climatic and transport conditions in our country both for the investors from the EU and those from the USA, the Middle East, Asia and others.

These circumstances are essential advantages for our country and its investment policy for encouraging foreign direct investments in the Bulgarian industry, which is the major branch determining the structure of the national economy [6].

An important factor for the improvement of its results is the analysis of **the state and the development of the trends in the foreign direct investments** in this essential economic sector (see Table 1).

Certain findings, conclusions and generalizations can be based on the data in Table 1.

First. The industry branch of the Bulgarian economy and its sectors are characterized by **priority rates** of attracting and realizing direct foreign investments. For the period 1998 – 2006 they quickly reached around US \$ 7.7 mln, which is more than 45 % of the total quality of investments, attracted to the country.

Along with that we should bear in mind that the Bulgarian industry, except for Energy, is still not of interest to strategic investors. What prevails are investment projects, related to industrial economic microinitiatives, with small and

medium entrepreneurs in the service sector and others. Foreign investment flows are unequally distributed in the separate sub-sectors. The investment potential in the different industrial

Table 1. Inflow of direct foreign investments in Bulgaria by sectors and years, US\$ millions

N	Sector	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total by sectors
1	Production and distribution of electric power, gas, water and sewage	1.8	4.6	19.7	2.4	66.9	8.1	925.5	355.0	247.1	1631.0
2	Production of oil and chemical products, rubber and plastic	41.0	165.2	72.1	-9.5	6.5	169.7	-3.1	473.8	293.6	1209.3
3	Telecommunication	23.2	14.1	14.9	236.8	205.0	127.3	401.6	182.1	-159.8	1045.2
4	Construction	2.4	19.8	47.9	17.4	33.1	5.1	55.0	184.3	523.1	888.1
5	Metallurgy and manufacture of metal products	13.2	72.2	17.1	81.0	-18.9	66.6	54.1	71.5	502.8	859.5
6	Production of items from non-metal mineral resources (cement, glass etc.)	150.6	71.8	7.4	27.7	0.7	76.8	97.5	131.6	71.2	635.4
7	Food industry	31.5	32.7	11.7	37.4	20.1	87.6	67.6	97.4	13.7	399.6
8	Production of textile and apparel	4.4	25.1	27.3	57.7	9.3	84.3	45.7	30.4	20.0	304.1
9	Machine-building	21.3	18.0	64.7	13.2	37.6	1.1	13.8	11.1	50.9	231.7
10	Production of items from wood, paper and cardboard	37.3	24.9	38.1	2.9	17.0	69.9	-0.6	18.0	20.6	228.1
11	Electrical engineering, electronics, production of office equipment, computers and communication machinery	11.5	5.9	28.6	28.2	17.9	29.5	-0.7	49.8	7.6	178.3
12	Mining industry	0.0	2.7	0.0	4.9	10.4	21.7	19.1	-10.4	2.0	50.4
13	Production of leather and leather items	0.7	0.0	21.2	0.1	0.5	-0.2	-2.5	1.7	0.5	22.1
14	Production of automobiles and other vehicles	-0.9	1.7	0.0	5.1	2.2	2.1	-0.5	0.1	2.8	12.6
Total		338.0	458.7	370.7	505.3	408.3	749.6	1672.4	1596.4	1595.9	7695.4

Source: Bulgarian National Bank

Note: The data was revised in March 2007.

sectors and the business organisations in these sectors differ a lot. Regardless of the developed strategies and the operational programmes it can be claimed that they are still not sufficiently related to the dynamics of the FDI in the respective sector or sub-sector.

Second. The highest relative share in the total volume of foreign direct investments in the Bulgarian industry belongs to the 'Production and distribution of energy, gas, water and sewage' sector – 21 %. For the same period, in terms of absolute amount, US \$ 1,631 billion is invested in this sector.

This priority position is quite logical, considering the fact that this sector provides energy for the sustainable and dynamic development of other industrial branches and the economy as a whole. What is more, after signing the agreements and contracts with Russia for the construction of the second nuclear power station near Belene, 'South Stream' and 'Burgas-Alexandropolis' pipelines, Bulgaria has become an energy centre and provider of energy for the Balkan countries.

The realization of these large-scale energy projects is related to huge investment resources – more than \$ 6 billion. American investments are still made in the 'Maritza-East-1' region amounting to \$ 1.4 bln, building new capacity, reconstruction and modernization of the existing electric power stations in this region. This raises significantly the rating of the Bulgarian power engineering and the industry as a whole.

Third. The production of oil and chemical products is a structure-defining sector and because of that approximately 16 % of the FDI was invested in the industry during 1998 – 2006, which is \$ 1.209 bln. The greater part of that money is invested in 'Lukoil-Neftohim Burgas' for technological renovation and new technical equipment, for more efficient and competitive production. In the meantime, according to

data, provided by BIA, the construction of a new oil processing plant in Bulgaria is under way. Its production capacity will be 1.5 mln tonnes annually and will be built in Southeastern Bulgaria, near Silistra. This investment project will attract substantial FDI amounting to more than US \$ 150 mln from the 'Petromaxenergy' group with British and Austrian participation.

The opportunities for and the trends in attracting FDI are further related to the construction of new capacity for biofuel as well as blending lines for oil and supplements. The biofuel sector is especially attractive because it is still in its formation stage in Bulgaria. To fulfill its main strategic goals the EU adopted Directive 2003/30/EU on encouraging the use of biofuel and other renewable energy resources in transportation – 2 % of the fuel used in the transportation sector in 2005, and the growth of this share to 5.75 % in 2010. Up to now the share of biofuel in Bulgaria is less than 1 %. That is why the investments in the production of biofuels is supported and stimulated by the government. It is expected that renewable and alternative energy sources and biofuels be exempt from excise duties, which will make their price competitive with other fuels. This additionally increases foreign investors' interest in these investment projects.

Fourth. Special attention is being paid by foreign investors to the telecommunication and information technology sectors. According to data, provided by the Bulgarian Association of Information Technologies (BAIT) the market in this sector in 2007 exceeded € 2.2 bln. The dynamics in the information and communication technology is of great importance to the technological and product innovations in the other branches and sectors of industry. That is why 13.58 % of the inflow of foreign capital in the Bulgarian industry, which equals \$ 1.045 bln FDI, is invested in them.

The telecommunication and information technology sector is one of the priorities in the development of the structure-determining sectors of the industry and the economy as a whole. The prevailing share in the total volume of FDI in the telecommunication sector belongs to 'Mobiltel Holding'-Austria, 'Intracom'-Greece, 'Global Holding'-the Netherlands, 'Cable and Wireless'-United Kingdom, 'Rila Solutions'-USA. Speeding up the development of the telecommunication and information technology by using the created economic, social and legal prerequisites is a key factor for the higher productivity and competitive power of the Bulgarian industry, for the successful development of the Bulgarian economy as part of the processes of European integration.

Fifth. Metallurgy and the manufacture of metal products are characterized with the **highest rate of growth** of foreign direct investments. In 2005 these amounted to \$ 71.5 mln, however, in 2006 they increased by more than seven times and reached \$ 502.8 bln. For the entire period 1998 – 2006 the amount of FDI in this sector reached \$ 860 bln.

These facts bear testimony to the increasing interest on behalf of foreign investors in the metallurgy sector. The economic stagnation has been overcome and the need for metals, steel, tin, V-shapes iron, reinforcement iron and others has been growing. The relative share of export to the total volume of revenue from sold production has also increased. A positive factor in this area have been the efforts of entrepreneurs-investors in this sector to redirect their production to new market niches, which is the result of increasing needs and interest. The import quotas imposed by USA and EU are the objective restrictive measure.

Along with these positive trends we observe certain problems related to the implementation of non-waste technology and production, the

limitation of harmful emissions and gases, imposed by the European Committee and the Kyoto Protocol, which will inevitably affect the relationships between the foreign investors and the state institutions. What is required is a tougher stance of the government in this area in order to fulfill the contractual clauses concerning the privatization of these sites. For example, more than 140 million BGN will be needed during 2008 in order to solve the above mentioned ecological problem only in Kremikovtzi-AD. Most probably in this case there will be a change of owners and attracting new strategic investors, who would be able to fulfill the contractual obligations.

Sixth. The data in the table once again emphasize the essential **problems and challenges** which **foreign capital** entering the **'Machine building' sector** encounters. In 2006 only \$ 50.9 million foreign investments were attracted, which is 10 times less than those in the metallurgy sector for the same year. That is why Bulgarian machine building comes ninth by FDI amounting to \$ 231.7 million for the analyzed nine-year period.

This situation affects negatively the achievement of goals, set by the national Innovation Strategy from 2004. There are not any significant results, achieved in the sphere of innovations, nor are there incentives for research and development, and implementation activity in the machine building enterprises and companies.

Fund availability per person in this sector, expressed as ratio of FDI per one employee, is many times lower than the average for the EU. It is approximately 77 % of the level of the funds available in the processing industry in Bulgaria. These factors influence unfavourably the labour productivity, the cost price and the competitive power of production not only in the machine-building sector but also in other industrial branches and the national economy [5].

The problems discussed strengthen the necessity for stronger dynamism in attracting foreign investments in the Bulgarian machine-building sector. The attracted investors: 'Cerazit', Luxembourg – production of tools, 'Liebherr', Germany – refrigerators and freezers, 'Montupe', France – automobile spare parts, are insufficient for overcoming the significant lagging behind of our machine-building from the European and world standards.

It is necessary to create efficient conditions and prerequisites for enhancing the interest of strategic investors in order to establish and develop the so called 'clusters'. They will facilitate the concentration of identical, interrelated or complementary to one another companies and enterprises. They have business relations, and have established contacts by using the same infrastructure, labour markets or services. This type of business organizations have been set up in the town of Sevlievo around 'Vidima-Ideal' and 'leal-Standard'. Such activities would facilitate the transformation of machine-building into a high technology sector of the Bulgarian economy with stable positions on the world market.

Seventh. Food-processing industry is one of the branches which has undergone significant **positive transformations** in the field of foreign investments and production restructuring since 1998. According to many scientists and experts it should become the 'foundation' of the modern Bulgarian industry. Leaders in terms of sales revenue in this branch are the brewery and tobacco industries. The total amount of direct foreign investments in the sector for the period 1998 – 2002 is considerable – \$ 400 million, for a period of only three years (2003 – 2005) the foreign capital invested in enterprises and firms in this sub-sector are more than \$ 252 million (see Table 1).

The attractiveness of these two sectors to foreign entrepreneurs is due to good traditions,

the comparatively well preserved equipment and the high qualification of the employees. A significant role in the above quoted results is played by foreign companies-investors – 'Nestle', 'Kraft Jacobs Suchard', 'Interbrew', 'Haineken', 'Chipita', Royal Foods' and others. During this year, only 'Nestle'-Sofia made an investment in new technology amounting to 25 million BGN. This investment policy affects favourably the significant export growth over the past two-three years. 'Nestle-Bulgaria' had already become a major exporter of chocolate products to Canada, Great Britain, Germany, the Netherlands, Italy etc. [4].

All big enterprises in the brewery industry are owned by foreign investors. This is the sector with the strongest competition between the economic entities in the country. Of significant importance in the food production industry are such well-established firms like 'Danone' – France, 'Kraft-Jacobs' – Switzerland, 'Delta' – Greece, 'Chipita International' – Greece, 'Provimi' – the Netherlands, 'Softbul Investment' – Cyprus, 'TKM Fruit and Juice' – Greece. Their activity introduces further variety in the range of foodstuff. The quality of their products meets the European standards for packaging, advertising and prices as well as the other elements of the marketing mix.

Eighth. Electrotechnical industry and electronics are also among the sectors of the Bulgarian industry which have future. They **influence directly the technological development and restructuring** of the other industrial sectors and sub-sectors.

Currently there are more than 340 enterprises, but only 18 of them, however, belong to the category of 'big enterprises', while 95 % belong to the small and medium business. The rate of attracting foreign investments does not quite correspond to the role and the importance attached to this highly technological sector of the Bulgarian industry – US \$ 178 million for a

period of 9 years (1998 – 2006 included), which is on the average less than \$ 20 million annually. A considerable growth was observed only in 2005 – approximately \$ 50 million.

As it has been pointed out in the sector strategy, the discussed negative trends affect the technological and technical level in the enterprises – considerably lower labour productivity, production quality and competitive power of the sector. That is why, starting this year, significant measures should be taken for radical changes in the investment policy directed towards faster technological and product innovations, speeding up the technological transfer towards small and medium enterprises, development of R&D departments, regional technological centres and business organisations, cluster structures etc.

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The analysis of the state and the outlined trends in the industry as a whole result in the **generalization** that the Bulgarian industry is restoring its leading positions in the field of attracting and encouraging foreign direct investments in its structure-determining sectors. The forecasts of analysts and experts, regardless of the emerging opinions, show that this trend should continue to develop and strengthen.

However, essential problems persist, referring to the structure and quality of the direct foreign investments, greater initiative and encouragement of investors in the area of high technology,

export orientation, ecological and non-waste production and products, faster construction of industrial zones etc. The overcoming of these problems and the ones related to the faster construction of infrastructure, the efficiency of the administrative system will undoubtedly affect positively the process of attracting foreign investments to the Bulgarian industry and increase its efficiency and competitive power.

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