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The Experience of Bulgaria in Attracting Foreign Direct Investment — Lessons for Emerging Economies[1]

Abstract. Foreign direct investment (FDI) has been crucial in transitioning Central and Eastern European countries from planned to market economies, facilitating technological modernisation, job creation, export performance, and regional competitiveness. However, FDI alone cannot solve economic development challenges; effective policies are essential for leveraging FDI as a catalyst for economic catch-up. This paper aims to derive economic policy lessons for emerging economies through a critical assessment of the Bulgarian experience in attracting FDI. It employs a methodological approach that combines quantitative analysis of key FDI indicators with qualitative evaluation of the policy landscape. Since the end of the 1990s, Bulgaria has secured macroeconomic and political stability as an important precondition for FDI, applying an open-door policy for foreign investors without strategic targeting. The country's accession to the European Union in 2007 further enhanced its investment appeal. Nevertheless, the passive policy of reliance on a low tax regime and low labour costs without a strategic focus has led to unbalanced regional and unfavourable sectoral distribution with foreign investors crowding into the metropolitan area and sectors like non-tradable services and low-end manufacturing. Thereby, the Bulgarian experience, where the quantity of incoming FDI overshadowed the quality, demonstrates the insufficiency of a laissez-faire FDI strategy for maximising the benefits of FDI. The study underscores the necessity for proactive state policies in emerging economies that not only attract FDI but also ensure it fosters technological transfer and stimulates the economic potential of underdeveloped regions.

Keywords: catching-up development, competitiveness, foreign direct investment, FDI policy, incentives, industrial zones, regional development

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RESEARCH ARTICLE

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Опыт Болгарии в привлечении прямых иностранных инвестиций: уроки для стран с развивающимися рынками

Аннотация. Прямые иностранные инвестиции (ПИИ) сыграли решающую роль в переходе стран Центральной и Восточной Европы от плановой к рыночной экономике, способствуя проведению технологической модернизации, созданию рабочих мест, увеличению экспортных показателей и усилению региональной конкурентоспособности. Однако сами по себе ПИИ не могут решить проблемы экономического развития; для их использования в качестве катализатора экономического роста необходима эффективная государственная политика. В статье критически оценивается опыт Болгарии в привлечении ПИИ, который может стать уроком для других стран с развивающимися рынками. Используемый методологический подход сочетает количественный анализ ключевых показателей ПИИ с качественной оценкой политической обстановки в стране. Установившаяся в конце 1990-х гг. макроэкономическая и политическая стабильность стала важным условием привлечения прямых иностранных инвестиций в Болгарию. Реализуемая политика открытых дверей для иностранных инвесторов проводилась без стратегической ориентации. Вступление Болгарии в Европейский союз в 2007 г. еще больше повысило инвестиционную привлекательность страны. Тем не менее, проведение пассивной политики, для которой характерны низкое налогообложение и низкие затраты на рабочую силу, привело к неравномерному распределению инвестиций по регионам и отраслям. Иностранные инвесторы в основном вкладывают средства в развитие столичного региона, а также в развитие таких секторов, как некоммерческие услуги и низкоуровневое производство. Опыт Болгарии, где количество поступающих инвестиций важнее их качества, демонстрирует недостаточность стратегии невмешательства для максимизации выгод от ПИИ. Проведенное исследование подчеркивает необходимость активной государственной политики в странах с развивающейся экономикой, нацеленной не только на привлечение ПИИ, но и на обеспечение передачи технологий и усиление экономического потенциала отстающих регионов.

Ключевые слова: догоняющее развитие, конкурентоспособность, прямые иностранные инвестиции, политика ПИИ, льготы, промышленные зоны, региональное развитие

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Introduction

Foreign direct investment (FDI)[1] is largely conceived as a major tool for economic catching-up, restructuring, modernisation, regional cohesion, and increased competitiveness of late-developing countries. Most of the Central and Eastern European countries (CEECs) have accordingly embarked on a FDI-led growth model after starting the systemic transformation from planned to market economies. Many authors attribute different levels of economic prosperity those countries have achieved to their varying ability to attract FDI. Besides trying to establish a favourable business climate, their governments have devised a whole set of policy tools to compete for the interest of foreign investors. This competition is likely to intensify in the coming years, given the

[1] According to the Organisation for Economic Cooperation and Development (OECD), FDI is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence (through acquiring ownership of 10 % or more of voting stock) over an enterprise resident in another economy. Source: OECD iLibrary. Retrieved from: https://www.oecd-ilibrary.org/finance-and-investment/foreign-direct-investment-fdi/indicator-group/english_9a523b18-en (Date of access: 31.08.2022).
FDI represents a capital inflow for the receiving country, increasing investment and output; it facilitates the transfer of technology; it encourages international trade by providing access to foreign markets; and it may be a significant engine for economic growth and development. Unlike other forms of private capital flows like portfolio investment or debt flows, FDI includes more lasting corporate commitments and is relatively more resilient.

disrupted global FDI flows due to the COVID-19 pandemic, trade tensions, the conflict in Ukraine, and other escalating global risks.

Despite the potential benefits for growth and development, it should be underlined that FDI is not a panacea. The disadvantages of relying on FDI become apparent especially in crisis times. Such is the case with the global financial crisis in 2008–09 when mobile foreign capital withdrew on a large scale from certain emerging host economies, and, more recently, the global health crisis that prompted a growing number of governments around the world to introduce restrictive measures on new investment to protect domestic capacities in strategic sectors such as pharmaceuticals, medical devices and equipment, and healthcare.

Furthermore, the benefits associated with FDI do not flow automatically.[1] FDI can cause a spillover when technology, know-how, skills, and advanced management and organisational practices of multinational companies are adopted by domestic enterprises, enhancing growth and innovation, boosting productivity, and ultimately raising the living standards in the host economy. However, that depends critically on the capabilities and institutions of the country receiving the investments and its policy context (Šćepanović, 2013; Crespo & Fontoura, 2007; Blomstrom & Kokko, 1997). Therefore, it is of high interest to study experiences of countries pursuing FDI-led development and to infer the factors that enhance the positive effects of foreign capital inflows on the host economy.

Bulgaria, which has proceeded more systematically with the market-oriented reforms a bit later than the other CEECs, has managed to establish itself as an increasingly attractive investment location since the turn of the new century. In 2007, the country joined the European Union (EU); in line with the theoretical underpinnings of regional economic integration, that further boosted its attractiveness to foreign investors. The inward FDI stock increased at a remarkable pace — from 3.5 % of Bulgarian gross domestic product (GDP) in 1995 to 85 % in 2007. The global financial crisis in 2008–09 and the COVID-19 pandemic had an extremely negative effect interrupting the growth of FDI inflows, but still, in recent years, they were higher compared to all the EU regional peers of Bulgaria.[2] According to Financial Times,[3] Bulgaria has emerged as one corner of South-Eastern Europe's "Silicon Valley", attracting a surge of greenfield foreign investment in information and communications technology (ICT). The FT database, fDi Markets, reported that the number of jobs creating greenfield FDI projects in the Bulgarian ICT sector increased by 300 % between 2015–2018. However, the great majority of those investments are concentrated in the capital city of Sofia.

Despite the success with attracting a high volume of FDI and less so with high quality, the process of Bulgaria's convergence with the more advanced European partners is far from being completed.[4] Thus, it seems that the country has not fully tapped the potential benefits that FDI bring to host economies and could hardly be considered a "role model" to emulate. Nevertheless, the long experience with the FDI promotion policy of Bulgaria, the positive outcomes together with the failures to accomplish desired results could offer important insights on what other small open economies can do and what should avoid doing or do better in order to turn incoming FDI into a major driver of economic development.

The purpose of this paper is to present and critically assess the experience of Bulgaria with attracting incoming FDI in the last two decades and, based on that, to draw lessons for the emerging economies of Europe and Central Asia. The findings of the study have useful practical implications for economic policy decision-making and can be taken into consideration when devising or updating national economic development strategies.

Methods and materials

In terms of methodology, the study uses the method of desk research of papers on FDI, le-

[1] Also, it should be acknowledged that FDI could involve some risks for the host economies. These will be discussed in the next section of the paper.

[2] OECD. (2022). OECD Investment Policy Review: Bulgaria. OECD Investment Policy Reviews, OECD Publishing, Paris. Retrieved from: https://doi.org/10.1787/6a0325b7-en (Date of access: 31.08.2022)

[3] Financial Times. (2019). Bulgaria attracts record tech investment. Retrieved from: https://www.ft.com/content/c533ee07-6190-47e3-97b6-78c3ed8f9545 (Date of access: 31.08.2022)

[4] According to the neoclassical theory, capital account liberalisation will result in large net capital flows to less developed countries allowing them to quickly converge to the level of advanced economies. If we use GDP per capita as a measure of economic convergence, we shall observe that Bulgaria has not achieved that goal no matter that it has fully lifted capital flow restrictions and has been a member of the EU for more than 15 years, therefore not fully utilising the alleged FDI benefits. In 2021, Bulgarian GDP per capita in PPS stood at just 57 % of the EU-27 average level. Eurostat. (2022). Retrieved from: https://ec.europa.eu/eurostat/databrowser/view/tec00114/default/table?lang=en (Date of access: 22.12.2022)

gal documents and data from publicly available sources released by the Bulgarian National Bank, the National Statistical Institute of Bulgaria, and the United Nations Conference on Trade and Development. Besides commonly used general research methods, we employ the induction method providing recommendations to other emerging economies based on the successes and failures of the Bulgarian FDI promotion policy.

Why does Bulgaria represent a useful case study for the other countries from Europe and Central Asia? There are several reasons for this. First, like most of the other emerging countries, Bulgaria is a small highly open economy, well integrated and dependent on the global economy. It faces similar problems emanating from inferior national competitiveness in comparison with advanced countries related to the net outflow of people and “brain drain”, stark regional disparities, specialisation in low value-adding activities, relatively low productivity and accordingly modest living standards. Furthermore, for an extended period, the country has pursued an open-door policy to FDI with very few restrictions to foreign investors and a horizontal promotional approach with no explicit sector targeting — a clear example of a laissez-faire FDI strategy in a pure form. Next, it is a member of the EU — the most advanced regional economic bloc — and has experienced integration effects for more than 15 years. Countries aspiring to join the EU (or the Eurasian Economic Union that was founded in 2015 and largely emulates the EU integration structures and processes) can learn from Bulgaria’s exposure to regional economic integration.

To evaluate Bulgaria’s performance in attracting FDI, we are going to use statistical data on FDI inflows and inward FDI stock, the former indicating the current situation and the latter reflecting the long-term attractiveness of the country. For international comparison purposes, the indicators will be presented also in per capita terms. Data on investing countries is also an important information about the FDI policy. It shows if there is an overdependence on few sources or if a key sending economy is missing from the list of the top investors. Finally, what matters for the effects of FDI on the host economy is the distribution of the inward FDI stock by economic sectors and by regions.

By assessing the Bulgarian experience in attracting FDI, we try to answer several questions:

— How much FDI has Bulgaria attracted in the last two decades?

— How successful was the country in comparison with other CEECs in attracting FDI?

— Which are the major investing countries in Bulgaria?

— What is the sectoral and regional distribution of the incoming FDI in Bulgaria?

— What are the major advantages of Bulgaria as a destination for FDI and what policy tools does the country use to attract incoming FDI?

Before turning to these questions, we provide a short literature review that focuses on two main strands, relevant to the objectives of the paper. First, we look at the potential benefits and costs of FDI for host economies. Second, we examine the factors that lure foreign investors to Bulgaria and impediments they face.

Effects of FDI on host economies. Incoming FDI is considered to have positive effects on the host economy; policymakers around the world have tried to encourage it (through numerous measures, including subsidisation) as a tool to promote economic growth. Various studies (De Mello, 1999; Denisia, 2010; Lin & Saggi, 2007) acknowledge the benefits of FDI that arise through:

— new capital investment,

— creation of knowledge, productivity and technology spillovers,

— development of human capital and skills,

— development of forward and backward linkages with local economic agents,

— integration into global economic networks,

— strengthening the competitive environment in the host countries.

The idea of existence of positive externalities and spillovers is at the heart of the justification for FDI attraction by host nation governments; the entire social benefits of FDI must outweigh those that are absorbed by a foreign investor and its host economy partners. Without the existence of externalities in the form of technological and learning spillovers for other activities, subsidising of foreign investors is a particularly foolish policy, according to Rodrik (2004, p. 30), as it transfers money from the taxpayers of impoverished countries to the shareholders of affluent nations with no commensurate gain.

Technology, knowledge, and innovation diffusion is not a mechanical result of foreign capital inflow. Lall (2000, p. 30) asserts that the technologies that transnational corporations (TNCs) use in every country depend on that location's capacity to absorb knowledge and supply the "immobile elements". The simplest operational know-how is given to those with poor capabilities, which increases the danger that their competitive base may languish. Additionally, while TNCs may want to encourage knowledge transfer to local suppliers, they also have a reason to stop information from reaching their rivals in the host economy. In certain instances, TNCs use imports to supplement national production of specific product lines and insulate their subsidiaries from local businesses and suppliers. This may involve importing materials and components just for final assembly. Therefore, it cannot be assumed that the sheer presence of inward FDI flows will produce enough externalities and help to speed up the pace of technological catch-up. It needs to be examined country by country (Zhelev, 2014).

A number of studies (Javorcik, 2004; Durham, 2004; Girma, 2005; Roy & Paul, 2022) show that the nature, density, and depth of the links formed with local firms — all of which depend on the host country's absorptive capacity — largely determine positive effects of FDI for the host economy. Further research has revealed that the development of the financial system, the quality of institutions, higher levels of GDP per capita, and better education are factors that boost a country's absorptive capacity (Kang & Martinez-Vazquez, 2021).

Besides the generally beneficial effect on host economies, FDI might also entail certain risks:

— reversing it through financial transactions,

— crowding out of local companies from the market;

— engaging in anti-competitive practices;

— constraining of advantages by leverage;

— increasing imports and repatriation of profits leading to a deteriorating external position;

— lack of transfer of advanced technologies;

— increasing unemployment due to improved productivity and production automation;

— rising workers' income inequality and regional gaps;

— environmental degradation due to shift of pollution-intensive production from higher-wage countries;

— a high share of FDI in a country's total capital inflows may actually reflect weak rather than strong institutions (Loungani & Razin, 2001; Ercegovac & Beker, 2022).

According to UNCTAD (1999), the existence of information or coordination failures in the investment process and divergences between the private interests of investors and the economic interests of host countries can lead FDI to have negative effects on economic development, or it may lead to positive but static benefits.[1] Hence, there is a need for a public policy that attracts, regulates and guides FDI. Due to the deficiencies in markets and existing institutions, a laissez-faire policy that just opens the market for incoming FDI is unlikely to deliver their potential benefits.

Determinants of FDI in Bulgaria. Bitzenis (2007) interviewed 64 of Bulgaria's largest multinational companies in the period 1998–1999 employing a questionnaire survey. Its results have been statistically evaluated according to the respondents' country of origin and sector. The author found out that, in the first years of the transition period, foreign investors focused primarily on the characteristics of the market, satisfying customers' needs. The main motivations of the investors were: market size (94 %), cheap cost of unskilled labour (67 %), geographic proximity (58 %), international pressures from competition (45 %), potential for market growth (44 %), connectivity to nearby countries (42 %), and absence of local competition (40 %). The uncertain legal system was the main obstacle for investors in Bulgaria (74 %), followed by bureaucracy (58 %), corruption and organised crime (53 %), and the high investment risk (52 %) (Bitzenis, 2007).

Kalotay (2008) explored FDI in Bulgaria and Romania in the wake of their EU accession. The author stated that the two new EU members offered a well-trained and motivated labour force at very competitive wages. A skilled worker's projected annual gross wage in these two nations was USD 6000 in 2005, as opposed to more than USD 10000 in the EU-10 and about USD 39000 in the EU-15. Also, both countries offered competitive corporate taxation to investors. Despite the significant production costs and tax advantages, Romania and Bulgaria have attracted just a limited number of efficiency-seeking projects by 2007, mostly in low-tech industries such as garments and footwear. Kalotay (2008) believed that these countries could become the 'workbench' within the EU for many other industries if they manage to significantly enhance the business climate (through bolstering the judicial system and combating corruption, as a continuation of the remarkable pre-accession accomplishments).

Sakali (2013) analysed bilateral FDI inflows from a panel of countries investing in Bulgaria from 1996 to 2010. The findings show that FDI has been driven by a combination of market and efficiency factors as well as the high skills of the workforce in Bulgaria. Integration with the EU and the advancement of transition reforms both had a significant and even deciding impact on the attraction of foreign investors to the Bulgarian market. The author observes that traditional determinants such as unit labour costs appear to be los-

[1] UNCTAD. (1999). World Investment Report 1999 – Foreign direct investment and the challenge of development. UN. Retrieved from: https://unctad.org/system/files/official-document/wir1999_en.pdf (Date of access: 05.09.2022)

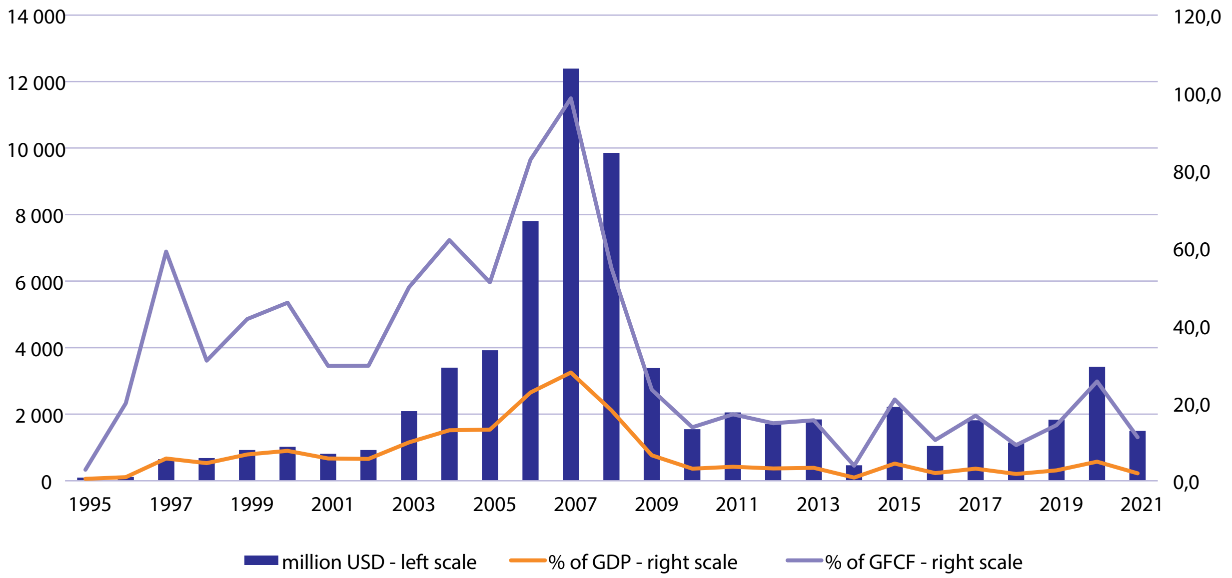


Fig. 1. *FDI inflows to Bulgaria (1995 — 2021, in million USD, % of GDP and % of Gross Fixed Capital Formation)*
Source: UNCTAD. (2022). UNCTADStat. Retrieved from: https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx (Date of access: 31.08.2022)

ing significance in favour of other, more important determinants, such as the educational attainment of the labour force and the building of efficient institutions.

The potential for exporting beyond the EU and the size of the domestic market were seen by Bitzenis and Vlachos (2013) as the primary drivers of FDI inflows into Bulgaria between 1999 and 2011. Therefore, the opportunity to relocate production from one EU member state to another with lower labour costs is not primarily related to intra-EU exports in Bulgaria, as suggested by previous studies.

In a more recent paper, covering a wider period (1995–2018), the stock of foreign direct investment was employed as a dependent variable, and indicators of international trade, economic trends and components of the signalling indicator provided by economic freedom indices were used as independent variables. In the instance of Bulgaria, it was established that rising exports, imports, trade balance, and balance of payments all contributed to expanding FDI stocks. Additionally, an increase in the stock of FDI inputs into the Bulgarian economy results from a higher score for the economic freedom components, which are defined by a business environment as free as feasible, a low tax rate, and a decreased degree of corruption. (Popescu & Brostescu, 2022)

Based on dynamic panel methodology covering the 2009–2016 period for the 10 New Member States of the EU and the 5 Western Balkan countries, Haliti and Merovci (2020) investigated the relationship between investment environment and FDI flows. They found out that GDP per capita, corporate income tax, corruption prevention, political stability and improvement in Distance to frontier score within the WB Doing Business ranking indicate a positive and considerable impact on FDI attractiveness for European emerging economies. Drawing on their research, the authors advise these nations to ensure political stability, fight corruption, and enhance the business environment in order to draw in more FDI.

Results

Dynamics and structure of incoming FDI in Bulgaria.

Sakali (2013) distinguishes 4 major periods with regard to the FDI patterns in Bulgaria:

— first period (1991–1996) — extreme economic and political instability with very low FDI;

— second period (1997–2004) — macroeconomic stabilisation and advancement of privatisation and market reforms;

— third period (2005–2007) — European accession, characterised by record investors' interest;

— fourth period (2008-onwards) — the negative effect of the global financial crisis and the establishment of a "new normal" of subdued investment flows.

Bulgaria had very little foreign capital before economic liberalisation in 1991, as its centrally planned and managed system of the economy created bureaucratic obstacles that hindered foreign investment. There were only thirty-one foreign investors prior to the reform, that is, thirty times fewer than in Hungary (Koparanova, 1998, p. 6).

Table 1

Inward FDI stock to selected emerging economies from Europe and Central Asia (1990-2020, USD per capita)

	1990	1995	2000	2005	2007	2008	2010	2015	2019	2020
Albania	..	68	79	331	888	955	1 104	1 500	2 910	3 483
Bulgaria	13	53	338	1 804	5 007	5 856	6 057	6 038	7 532	8 595
Croatia	_	107	629	3 110	9 659	6 502	7 443	5 756	7 123	7 811
Czechia	_	710	2 103	5 914	10 853	10 856	12 196	11 001	16 029	17 627
Hungary	55	1 092	2 238	6 059	9 524	8 815	9 168	8 821	9 629	10 454
Kazakhstan	_	183	675	1 663	2 840	3 722	5 085	7 588	8 181	8 063
Moldova	_	22	107	297	521	608	704	700	1158	1188
N. Macedonia	_	44	265	1 013	1 814	1 999	2 101	2 304	3 076	3 507
Poland	2.9	204	868	2 250	4 286	3 869	4 894	4 890	6 201	6 572
Romania	0.0	36	314	1 185	2 929	3 109	3 356	3 533	5 123	5 589
Russia	_	38	203	1 243	3 408	1 486	3 236	1 812	3 381	3 061
Serbia	_	_	_	_	_	2 333	2 773	3 674	5 504	6 520
Ukraine	_	18	79	367	821	1 018	1 155	975	1 168	1 119
Uzbekistan	_	5	28	49	80	105	90	231	291	307

Source: UNCTAD. (2022). UNCTADStat. Retrieved from: https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx (Date of access: 31.08.2022)

According to Koparanova (1998), the establishment of a much more welcoming environment for foreigners wishing to invest in Bulgaria was made possible by the sudden changes in the political and economic situation at the beginning of the 1990s as well as the introduction of laws and institutions promoting foreign investment in the country. Before this potential could be realised, though, other prerequisites had to be satisfied.

The transition period from a planned to a market economy was characterised by political and economic instability. There was no national political agreement between 1990 and 1997 over the essential macroeconomic and microeconomic policy priorities. As a result, the transition to a market economy was uneven, and structural changes were considerably postponed. Accordingly, there was little foreign investors' interest in the country.

Since the introduction of a Currency Board in 1997 and the subsequent assurance of macroeconomic, financial and political stability, FDI has begun to flow significantly into Bulgaria. In the year it joined the EU, FDI inflows accounted for 28 % of GDP, signalling the country's gradual transformation into a highly preferred location for international capital (Fig. 1). While in 1997 the incoming FDI flows amounted to USD 647 million, in 2007 they reached a peak of USD 12.4 billion. This accounted for 98.5 % of the gross fixed capital formation in the country that year, demonstrating the critical role of FDI in the transition process in funding investments and increasing national productive capacity. Undoubtedly, the EU integration process played an important role in the increase as a stimulus for institutional reforms. It comes as no surprise that in the year of EU accession Bulgaria attracted the most FDI. With USD 1635 per capita, Bulgaria became a leader among the emerging economies in Europe and Central Asia in FDI inflows in 2007.[1]

However, the leading position of the country was not maintained for too long. With the global financial and economic crisis of 2008–2009 and the ensuing credit crunch, many foreign investors withdrew from the country. Thus, in 2010, the incoming FDI flows to Bulgaria were USD 209 per capita — almost 8 times lower than 3 years earlier. After 2009, Bulgaria has not been able to attract an annual inflow exceeding USD 2.3 billion (or over USD 350 per capita). Since then, FDI has funded just around 15 % of the overall investments in the country on average per year.

In order to see how Bulgaria performed in comparison with other countries from the region, we shall look at the cumulative value of FDI inflows per capita. In 2020, Bulgaria has accumulated USD 8595 of the inward FDI stock per capita which is over two times lower than the top performer Czechia (Table 1). The only other country from the region that has attracted more FDI per capita is Hungary (USD 10454). Bulgaria has outperformed not only non-EU countries like Albania, Serbia, North Macedonia, Russia, Ukraine, Kazakhstan and Moldova, but also new EU member states like Croatia, Romania, and Poland. However, it should be underlined that what matters for economic development is not

[1] Unless otherwise mentioned, all data is taken from UNCTAD.

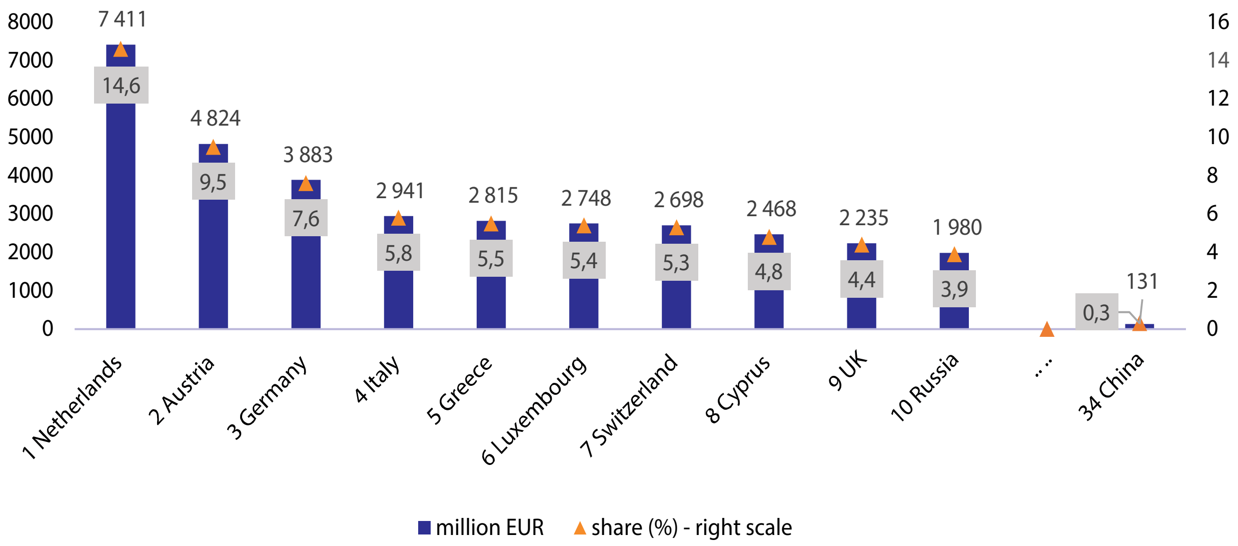


Fig. 2. *FDI stock in Bulgaria by investing country (2021, rank, million EUR and %)*
Source: Bulgarian National Bank. (2022). BNB Statistics section. Retrieved from: https://www.bnb.bg/Statistics/index.htm (Date of access: 05.09.2022)

just the volume of FDI attracted into the economy but rather the quality of these investments. To infer the latter, we will look at the sectoral distribution of the inward FDI stock, but before that it is informative to check the countries that are the biggest investors in Bulgaria.

Countries of origin structure of inward FDI in Bulgaria.

The biggest investor in Bulgaria by far is the EU. Among the top ten sources of FDI to Bulgaria, only 3 are non-EU members: Switzerland, the United Kingdom that left the EU in 2021, and the Russian Federation. In the first position with a share of almost 15 % of the accumulated FDI in the country is the Netherlands (Fig. 2). Due to favourable tax regulations, various companies from non-EU countries have set up their European headquarters in the Netherlands and perform their outward investments from there. That means that some FDI that originate from third countries (e.g. Russia, the USA) is recorded by the statistics as having Dutch origin.

The second largest investor in Bulgaria is Austria with a share of 9.5 % of the inward FDI stock. The biggest European economy Germany is in the third position with a share of 7.6 %. Next come Italy (5.8 %) and neighbouring Greece (5.5 %). Despite the traditionally friendly Sino-Bulgarian relations,[1] China, which is the world's second-biggest economy, is not a significant investor in Bulgaria. In 2021, China ranked in the 34th position among the top sources of FDI in Bulgaria accounting for a mere 0.3 % of the FDI stock. It seems that Bulgaria has not utilised its participation in the Belt and Road Initiative to attract Chinese FDI thus far, and that is a clear signal for the policymakers that there is a need for correction of the FDI promotion policy. A large chunk of FDI in Bulgaria comes from the EU partners, and it would be wise for the country to diversify its sources of investment and attract FDI from other big players in the global economy like China.

Sectoral and regional structure of inward FDI in Bulgaria.

As different branches have differing potential for achieving technological advancement and productivity growth, the FDI sectoral distribution is more significant than the total quantity of FDI attracted. According to relevant studies, the economies who have made the biggest strides in improving their trade competitiveness and technological modernisation are those that have a relatively higher proportion of manufacturing in their inward FDI stock than services (Sohinger, 2004).

The sectoral distribution of FDI in Bulgaria seems to be quite unfavourable. According to the data, the non-tradable sectors of real estate (22.2 %), financial intermediation (17.9 %), wholesale and retail trade (13.9 %), and construction (1.6 %) account for the majority (almost 55 %) of the inward FDI stock (Table 2). To a great extent, some of these investments (especially those in the top-performing sector — real estate activities) were speculative in nature and did not advance acquisition of new technologies and know-how, export competitiveness, and long-term eco-

[1] Bulgaria is the first country in the world after the USSR (that no longer exists) that has recognised the P.R.C in 1949.

Table 2

Bulgaria's inward FDI stock breakdown by economic activity (% of total, 2000-2021 selected years)

2000		2007		2014		2021	
Manufacturing	42.2	Real estate activities	20.8	Real estate activities	21.6	Real estate activities	22.2
Financial intermediation	18.3	Manufacturing	18.6	Manufacturing	17.3	Manufacturing	19.3
Wholesale and retail trade	14.9	Financial intermediation	16.9	Financial intermediation	17.1	Financial and insurance activities	17.9
Transport, storage and communication	7.4	Transport, storage and communication	15.4	Wholesale and retail trade	14.3	Wholesale and retail trade	13.9
Real estate, renting and business activities	7.1	Wholesale and retail trade	13.8	Construction	8.2	Professional, scientific and technical activities	8.1
Construction	2.7	Construction	7.3	Electricity, gas and water supply	7.8	Electricity, gas, steam supply	6.1
Electricity, gas and water supply	2.3	Electricity, gas and water supply	3.8	Transport, storage and communication	6.3	Information and communication	3.8
Other	5.1	Other	3.4	Other	7.4	Other	8.7

Note: in 2015 there was a change in the classification of economic activities used
Source: Bulgarian National Bank. (2022). BNB Statistics section. Retrieved from: https://www.bnb.bg/Statistics/index.htm (Date of access: 05.09.2022)

nomic development. After the global financial and economic crisis began in 2008, investors quickly left the country because of their heavy reliance on easy access to finance, and as a result, FDI inflow has drastically diminished (Fig. 1). Manufacturing, the sector where technological advancement is most heavily concentrated, has managed to attract less than fifth (EUR 9.8 billion) of Bulgaria's inward FDI stock. We can conclude that Bulgaria failed to draw a sizable amount of strategic investments in high value-added and technology-intensive businesses despite its EU membership and the established macroeconomic stability over the past two decades. This did not allow the country to counter the massive deindustrialisation that started during the transformation from a planned to a market economy after the liberalisation of its foreign economic ties.[1] Moreover, the FDI inflows have supported the premature switch to a services-based economy.

Furthermore, the regional distribution of the inward FDI stock shows that instead of mitigating regional inequalities FDI exacerbates the problem with territorial cohesion. Figure 3 reveals the unhealthy for the national economy concentration of FDI. The Southwestern region has attracted 60.7 % of inward FDI in the country. On top of that, just the capital city of the country, responsible for the outstanding performance of the whole Southwestern region, has accumulated almost EUR 14 billion or 52 % of all FDI. That is, Sofia is more attractive to foreign investors than all the other 27 regions (at NUTS-3 level) taken together. The contrast with the worst-performing region is staggering. By 2020, Montana has received just EUR 36 million of FDI — 385 times less than the city of Sofia. Obviously, the national policy needs to be adjusted to address these huge regional disparities in FDI distribution.

Government policy to attract FDI in Bulgaria.

Bulgaria welcomed foreign investments since the start of the transition to a market economy. All the governments treated them as a major tool of economic transformation. The 1991 Constitution ensured free economic initiative and respect for international law. In the same year the Bulgarian Parliament adopted the first law related to FDI — Law on the Business Activity of Foreign Persons and on the Protection of Foreign Investments (LBAFPPFI), that enshrined some basic investment protection principles put forward in all the subsequent revisions and amendments. In 1992, LBAFPPFI was replaced by the Encouragement and Protection of Foreign Investment Act. The 1992 Act contained some of the most liberal foreign investment provisions in CEECs, permitting foreign

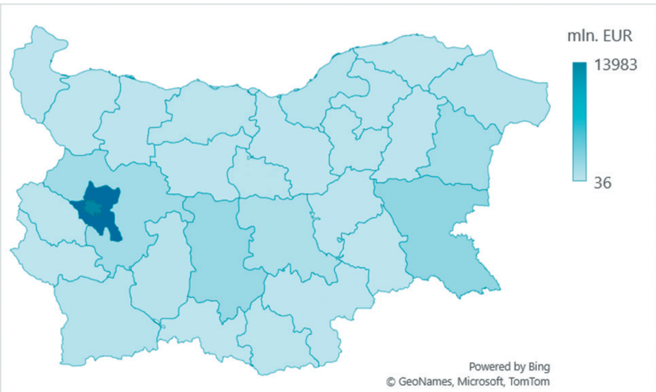
[1] The manufacturing share in value added in Bulgaria dropped from 23.9 % in 1990 to 13.8 % in 2000, 13.3 % in 2010 and accounted for 14.8 % in 2020. UNSD. (2022). Retrieved from: https://unstats.un.org/UNSDWebsite/ (Date of access: 22.12.2022)

Table 3

Incentives under the Bulgarian Investment Promotion Act

Threshold Incentives	Priority Class	Class A	Class B
	€ 50M and 50 – 150 jobs	€ 1M – 5 M or 25 – 150 jobs	€ 0.5 M – 2.5 M or 10 – 100 jobs
Short cut on administrative terms	✓	✓	✓
No tender – no competition for acquisition of state/ municipal land	✓	✓	✓
Financing vocational training	✓	✓	✓
Social security cash back	✓	✓	✓
Individual services	✓	✓	
Financing technical infrastructure	✓	✓	
Public-private partnerships	✓		
No tax on changing land status	✓		
Buying public land on favourable prices	✓		
Grants for R&D	✓		

Source: Invest Bulgaria Agency. (2022). Retrieved from: https://newwebsite.investbulgaria-virtualoffice.com/wp-content/uploads/2022/08/InvestBG-Brochure-1.pdf (Date of access: 15.09.2022)



	mln. EUR	%
Northwestern (Vidin, Vratsa, Montana, Lovech, Pleven)	679	2,5
Northcentral (V. Tarnovo, Gabrovo, Razgrad, Ruse, Silistra)	1 137	4,2
Northeastern (Varna, Dobrich, Targovishte, Shumen)	2 249	8,4
Southeastern (Burgas, Sliven, Yambol, St. Zagora)	3 582	13,3
Soutwestern (Blagoevgrad, Kyustendil, Pernik, Sofia province, Sofia city)	16 325	60,7
Southcentral (Kardzhali, Pazardzhik, Plovdiv, Smolyan, Haskovo)	2 914	10,8

Fig. 3. *Regional distribution of the inward FDI stock in Bulgaria, mln. EUR, end of 2020*
Source: National Statistical Institute of Republic of Bulgaria. (2022). NSI website. Retrieved from: https://nsi.bg/en (Date of access: 05.09.2022)

investors to own up to 100 % of the equity in a corporation. Bulgaria gave equitable treatment for local and foreign investors and did not require a special permit to conduct large-scale foreign investment projects, in contrast to countries like Ukraine, Kazakhstan, and Belarus.[1]

In October 1997, a further liberalisation of the investment regime was instituted with the Law on Foreign Investments which provided national treatment to foreign nationals and secured protection against expropriation. However, the law did not provide any kind of specific incentives for FDI.[2]

The law related to FDI changed its name again in 2004 to the Investment Promotion Act (IPA), signifying that it does not differentiate between foreign and domestic investors. Being amended a couple of times after its introduction, the IPA governs the conditions and methods for promoting investment in the nation, as well as the actions of governmental bodies engaged in fostering and safeguarding investment.

In 1995, Bulgaria established the Bulgarian Foreign Investment Agency, later renamed Invest Bulgaria Agency (IBA) to attract investments into the domestic economy by acting as a one-stop shop for investors. IBA is part of the Ministry of Economy and assists the Minister of Economy in carrying out the government policy in the field of investment promotion. Its primary objective is to

[1] Petranov, S. (2003). Foreign Direct Investments to Bulgaria. Agency for Economic Analysis & Forecasting, Sofia.
[2] UNCTAD. (2002). WID Country Profile: Bulgaria. UN.

help potential and existing investors to discover investment opportunities in the domestic business environment. The services of IBA are free of charge and include: provision of information on Bulgaria (macroeconomic situation, data on operational costs, availability of skilled labour and level of education by regions in the country, incentives, administrative procedures and permits, etc.), personalised administrative servicing, legal advice, liaison with central and local governments, branch chambers and non-governmental organisations (NGOs).

A major part of the activity of IBA is related to overcoming the weaknesses of the business environment of the country thereby improving the investment climate. Additionally, it performs investment marketing by presenting and advertising abroad investment opportunities in the country and trying to create a favourable international image of the country. However, Milanov (2014) identified various deficiencies in the activity of IBA: insufficient capacity of the staff, insufficient budget, insufficient number of the staff that does not allow it to provide real "one-stop shop" service, poor coordination with other government structures and incidental support at the local level, among others. As a possible solution to part of the problems, the author suggests a unification of IBA with the Bulgarian Small and Medium Enterprises Promotion Agency (BSMEPA), which is another governmental body under the Minister of Economy, entitled to support the internationalisation of the Bulgarian small and medium-sized businesses. This way a higher efficiency of public expenditures will be achieved by reducing the number of management administration and releasing funds for achieving higher administrative capacity, while at the same time pursuing synergy by combining efforts in the interconnected fields of international trade and investment.

A key instrument that Bulgaria has been using throughout the last two decades to attract FDI is taxation. The corporate tax was reduced several times to reach 10 % in 2007 introduced as a flat rate. Since then, Bulgaria has been applying one of the lowest taxation rates within the EU, where the average corporate income tax is more than two times higher (21.3 %).[1] Another advantage that the Bulgarian authorities have been long using to portray the investment attractiveness of the country is the low production costs due to the lowest labour costs within the EU, and relatively low prices of rents, water, and energy. That combined with the strategic geographical location of Bulgaria on the crossroad between Europe and Asia (5 Trans-European corridors pass through Bulgaria which is also a Black Sea littoral country) was expected to attract a huge inflow of productive investment.

However, relying on low taxation and low labour costs as a tool to attract investments has significant downsides. Such national advantages are easy to be provided by many countries, and as Porter (1990) claims, they erode fast and are temporary and unsustainable.[2] Low taxation means low tax revenues (unless “the quantity effect” starts dominating) and limited ability of the state to provide public goods, while low labour costs are associated with low remuneration levels, which under conditions of participation in a common market with free movement of resources leads to outflow of labour. After the transformation to a market economy, Bulgaria has lost around 2 million out of its mid-1980s population of 8.9 million, to a large extent due to the exodus of people to Western countries with higher living standards. Accordingly, one of the major impediments that investors face in most of the Bulgarian regions is labour and skills shortages.

With the global financial and economic crisis, it was realised that low and flat corporate and income taxes and low costs, however, combined with low productivity and inefficient bureaucracy, are not able to attract high volume and high-quality investment. Therefore, Bulgaria has introduced additional stimuli in its investment legislation and even a new state company.

In 2009, the National Company Industrial Zones (NCIZ) was established with a sole shareholder the Ministry of Economy. Its main goal is to create favourable investment conditions and promote investments in sectors with high value added by designing, developing and managing industrial zones and technological parks, providing complex services to investors. Industrial zones help overcoming weaknesses of the business environment by providing well-maintained infrastructure (water, gas, electricity, telecommunications, road and railroad access, etc.), creating a pool of workforce, and eliminating the need to obtain certain permits. Industrial zones have proven to be an important instrument in attracting FDI in the manufacturing industry of CEECs but were introduced too late in Bulgaria, when the major European TNCs have already offshored their production. Currently

[1] Tax Foundation. (2022). https://taxfoundation.org/corporate-tax-rates-europe-2022/

[2] In October 2021, 137 countries agreed to a 15 % global minimum corporate tax rate, to be enacted in 2023 after their parliaments approve it. That will discourage TNCs to dodge taxes by profit shifting to countries with low rates and will reduce “race to the bottom” among countries to attract FDI.

NCIZ manages 7 operational industrial parks, the most successful one being “Bozhurishte” located near Sofia, and 5 other parks which are at various stages of development.

In 2013, additional incentives regarding the reduction of labour costs came into force. A new provision in the Investment Promotion Act included financial aid for partial reimbursement of the mandatory employers’ payments to the state social and health insurance for newly hired employees during the implementation of the investment project. To take advantage of this and other incentives in the IPA, investors should apply to IBA to get issued a class A, class B or priority project certificate. Table 3 summarises the requirements that investors should meet to get issued a relevant certificate and accordingly the various incentives they can avail of.

Prior to 2010, there were no prioritised sectors, all investments were eligible for support. Afterwards, some very broad targeting started to be used. The supported economic activities under IPA are: from the industrial sector — all manufacturing industries; from the tertiary sector — high-tech activities in the field of ICT, research and development (R&D), education, healthcare, warehousing and logistics. High-tech activities are given preference in the form of lowered financial requirements. Creating new jobs is one of the requirements for receiving a certificate from the investor.

As the legislation tries to promote balanced territorial development of the country, when a project is established in a region with high unemployment, it can take advantage of doubling the period of reimbursement of social security payments. Additionally, any taxable person in Bulgaria is permitted to keep up to 100 % of the corporation tax in relation to the taxable profit produced from industrial activities in municipalities with an unemployment rate above 25 % greater than the national average.

However, as we have seen above, these measures were not effective and quite insufficient to deal with the large and growing economic disparities between Bulgarian regions. Furthermore, the FDI promotion policy did not meet its primary goal which was “to enhance the competitiveness of the Bulgarian economy by increasing investment in research, innovation and technological development in production and services with high added value complying with principles of sustainable development” (IPA, art. 1, par. 2).

Milanov (2014) identified the following problems with the Bulgarian FDI promotion policy:

— irrelevance of the support measures regarding the priority industries — the same measures are applied for all the target industries. While no tender for the acquisition of state/municipal land and financing the technical infrastructure could be very helpful to investors in new manufacturing facilities, they have very little to offer to investors in ICT, R&D, education and healthcare;

— lack of flexibility of the offered incentives – IBA does not have the authority to negotiate tailor-made incentives to the specific needs of big strategic investors, it has to strictly abide by the detailed regulations in the IPA;

— lack of transparency and predictability in the financial measures — the budget for the financial incentives is very limited and investors cannot be sure if, when and in what amount they will receive the funds which is determined only after the final receipt of the application documents and depending on the available financial means;

— inadequacy and unattractiveness of some of the incentives — the high threshold for priority project certificate (EUR 50 million that could be reduced to EUR 15 million based on certain exemptions) does not allow many firms to take advantage of this measure (to date, only 10 investments have been certified as priority projects). Various requirements and limitations make it unattractive for small companies to benefit from the financing of vocational training. Given that the Guidelines on Regional State Aid (RAG) in the EU, adopted in 2021, allow for maximum aid intensity of between 50 and 60 % of the value of the investment project (all Bulgarian regions besides the Southwestern one have per capita below 75 % of the EU-27 and qualify for such regional aid), the incentives that Bulgaria offers are quite modest. Among the New Member States of the EU, only Bulgaria does not offer cash grants to entice investors (Jirasavetakul & Rahman, 2018).

Overall, the Bulgarian policy towards FDI does not have clear priorities and could be described as passive. As a result, there is a suboptimal allocation of the state’s financial and administrative resources. That fact is recognised by the Bulgarian authorities, which have initiated a change in the investment promotion legislation. One of the major proposals for amendment is related to the reduction of promotion measures to non-financial incentives for certified projects in economic activities with low added value, such as professional activities of central offices, warehousing and storage of goods, human health care, while the support for investments in hotels and similar places of accommodation will be fully suspended. That would allow the financial incentive measures to be applied in a targeted fashion to projects in the manufacturing industry and high-tech services with a contribution to regional economic activity and employment.[1]

Discussion

The lessons which could be derived from the Bulgarian experience regarding the FDI policy for other emerging economies could be summarised as follows:

— A condition sine-qua-non for attracting FDI is the establishment of stable political and macroeconomic environment. Regardless of the initiatives taken to open the nation to foreign investors, Bulgaria received very little attention from the investment community between 1990 and 1996. This period was characterised by political volatility, expressed in frequent government changes, and high macroeconomic imbalances exemplified by rising trade and public deficits, high inflation, accelerated depreciation of the national currency, etc. Mistrust of the country was swiftly overcome after political and macroeconomic stability was ensured.

— FDI policy should be selective, i. e., to steer investments to the target structural industries of the economy, in line with the goals of structural policy. Priority should be given to export-oriented investment projects bringing high added value, establishing links with local SMEs and having greater potential for creating positive externalities of technological diffusion. The use of fiscal and financial incentives for new investment and reinvestment of profits should be systematic and transparent, allowing full predictability for the investors. The main purpose is to support the transfer of resources from stagnant and ultimately futile sectors to dynamic sectors with the potential to stimulate economic growth. Unlike currently more advanced CEECs (such as Czechia, Slovakia, Hungary, Poland), Bulgaria did not follow such a policy approach, and the inward FDI did not support structural transformation as it did in those countries.

— FDI policy has to be proactive under the conditions of intensified competition from other recipient countries. Low taxes are an incentive to attract foreign investment but are not sufficient. Analysis of the Ministry of Economy of Bulgaria shows that 70–80 % of the companies that form their decision to invest in any country, while taking into account lower taxes, are also looking for financial incentives. Calculations show that if a company investing in Bulgaria is exempted for 2 years from paying security contributions for 2000 people with EUR 500 salary per person, the government is going to spend EUR 1 million, but the budget is getting more than EUR 2.5 million from taxes on income and consumption.

— Financial incentives are just a part of a strategy for attracting FDI; no matter how generous they are, they cannot compensate for certain business climate deficiencies. It is very important that policy efforts are aimed at overcoming the weaknesses of the environment: elimination of unnecessary regulations, improvement of the administrative services, speeding up the resolution of legal disputes, improving legal protection of property, etc., which will ultimately reduce the transaction costs of business (including local). To address the problem of outdated infrastructure, accelerated development of industrial zones near all the bigger regional centres with a large pool of human resources is needed. Promoting industrial zones where FDI is linked to local small and medium-sized enterprises can have a major impact on industrial competitiveness and employment in emerging economies.

The case of Trakia Economic Zone (TEZ) near the second biggest Bulgarian city Plovdiv provides a useful example in this regard. After its inception back in 1996, TEZ has attracted more than 200 companies, over EUR 3 billion of investment and created over 50000 new jobs, positioning itself as the largest and most sustainable industrial area in Southeast Europe.[2] It represents a successful public-private partnership model that has managed to efficiently coordinate collaborative interaction between various stakeholders, including local and national government, industrial associations and business communities, and educational institutions.

— Modernising the whole public administration within a country is a demanding task. However, raising the administrative capabilities of the Investment Promotion body (IPB) could be less complicated. To be able to pursue the state investment policy, IPB needs enough highly professional, well-motivated, skilled staff with a good knowledge of the world markets. It should act as a real one-stop shop for investors, taking advantage of the new digital platforms and technologies. Moreover, the IPA should have a higher authority to be able to coordinate issues across various policy domains and to negotiate with potential investors on

[1] Council of Ministers of the Republic of Bulgaria. (2022). Draft Resolution of the Council of Ministers on Amendments and Supplements to the Regulations for Implementation of the Investment Promotion Act. Retrieved from: https://www.strategy.bg/PublicConsultations/View.aspx?lang=bg-BG&Id=6958 (Date of access: 05.09.2022) (In Bulg.)

[2] Trakia Economic Zone. (2022). https://tez.bg/bg/about-us/

concrete stimuli important for the investment project. The IPA should not only assist investors in the investment process and provide an after-care service, but it should also target and try to captivate prospective strategic investors. Besides significant economic authority, that requires strategic marketing skills to promote state branding.

CzechInvest, the business and investment development agency of Czechia, founded in 1992, could serve as an excellent organisational and functional model for investment promotion agencies in emerging economies. Unlike IBA, CzechInvest maintains international (in 7 cities — San Francisco, New York, Toronto, London, Düsseldorf, Seoul and Tokyo) and regional offices (in 13 provinces). It employs efficient information systems and account management systems; negotiates with international investors on behalf of the Czech government; plays a critical function in assisting businesses and promoting investments in a concerted way, aiming to help transform the national economy into an innovation-driven one.

— Besides overcoming information asymmetries regarding the potential development of the local economy through targeted promotional campaigns in business forums and specialised press, the FDI policy should be directed to the coordination of the local assets to meet the specific needs of the desired strategic investors. A crucial role in this direction is played by the state's policy in the field of vocational training and professional and higher education which should be holistically applied and coordinated with the FDI policy. Special attention should be given to higher engineering education. Efforts should be focused on certain priority areas, for which modern facilities and equipment, advanced programmes and training methods, and increased scholarships for the enrolled students have to be provided. This will create a pool of skilled engineers, which will significantly enhance investors' interest in the country in modern knowledge-intensive industries and overcome the issue of skill shortages.

— The local business should not be discriminated against as compared to foreign investors. In fact, one of the main objectives of the FDI policy should be to create conditions for the establishment of clusters with intense and persistent horizontal and vertical production linkages between foreign subsidiaries of TNCs and local enterprises. Foreign investors should not be isolated from the recipient economy. Moreover, it is important to actively seek out and target foreign investors who can fill a gap in the regional value chains and fit into the local environment. The FDI policy needs to be specifically tailored to the unique traits of the national regions, taking into account both their competitive strengths and weaknesses. At the same time, FDI promotion measures should be an inherent part and major tools of the regional economic development plans. The lack of such interconnectedness between FDI policy and regional development policies in Bulgaria has produced high concentration of the foreign investors' activities in the country and low utilisation of the possible FDI benefits.

Conclusion

Since the introduction of a Currency Board and the establishment of macroeconomic, financial and political stability in 1997, FDI has begun to flow heavily into Bulgaria. They reached a peak in 2007, which was not sustained after the Great Recession in 2008–2009. The structural distribution has shown that a large part of the investments did not go to sectors that can boost technological capability and modernise the economy. The outright laissez-faire approach to the FDI promotion strategy did not produce the desired results. Simply opening to FDI and applying low taxes is not sufficient to overcome the existing market and institutional shortfalls in the environment of a post-socialist economy. What is required is an active state policy that simultaneously upgrades the local resources and targets high-quality investments, which generate technological and learning ripple effects for other activities and stimulate the economic potential of underdeveloped regions. Otherwise, FDI is attracted to activities with existing comparative advantages and does not improve the economic structure; it tends to concentrate in metropolitan areas and exacerbates regional disparities. It is therefore essential for governments to realise that FDI should not be an aim in itself but an important tool subordinated to more profound economic goals than capital accumulation and job creation that lead to the attainment of long-term competitiveness and greater welfare with more equitable territorial distribution.

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