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When Foreign Direct Investment is Good for Development: Bulgaria's accession, industrial restructuring and regional FDI

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Diana Bozhilova[#]

ABSTRACT

This article examines the dynamic between the process of Bulgaria's European Union accession and the flow of Foreign Direct Investments to the country in its industrial base. A critical differentiation between speculative and non-speculative FDI is drawn while determining that the geographic origin of investments matters. Greek FDI, in particular, emerges as a major source of strategic regional investments in Bulgaria's industry highlighting the significance of regional trade and cooperation for the long-term economic outlook not only for the host country but also for the region by enhancing the area of economic progress and development.

Keywords: Bulgaria, EU Phare Fund, FDI, regional cooperation, industrial restructuring

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1. Introduction

Following the accession of Bulgaria in 2007 with the second wave of the fifth enlargement of the European Union (EU) to the countries of Central and Eastern Europe (CEECs), it is time to take stock of the profound transformation that the states of the region have undergone since first lodging their applications for membership in the early 1990s. The change is nowhere more manifest than in the area of economic activity and development. Lingered criticism from the European Commission over the full attainment of political criteria, such as the universal application of the rule of law, the gradual adaptation to the institutions and the *acquis communautaire* of the EU and the parallel process of deeper integration, as well as the adequacy of administrative absorption capacities in Central and Eastern Europe (CEE) notwithstanding, all of the new EU-12 member states satisfactorily fulfilled the Copenhagen economic criteria for accession¹.

Yet, the accomplishment of the economic criteria has come with varying degree of success amongst the ten CEE candidate countries. For instance, the

¹ European Council in Copenhagen, 21-22 June 1993, Conclusions of the Presidency, pp. 12-ff.

Visegrád group² and the Baltic states are widely believed to have become much better adjusted to the application of the open market rules than Bulgaria and Romania. In consequence, their relative success led to better progress with development and economic prosperity since transition began³. On that count, the former are also considered more affluent than the latter. Yet, what started as a global financial crisis but grew into economic recession has hit the emerging market economies in CEE with acute harshness only some twenty years after they first embarked on the path of economic policy overhaul. Amongst them, the Baltic states (Latvia, in particular), Hungary and Poland have perished. Impressive GDP growth rates over the past few years were achieved in part through heavy borrowing from Western banks, giving them easy access to foreign currency denominated loans⁴. Now that credit lines are in halt and uncharacteristically high interest rates prevail, huge debt loads have accumulated to repay, leaving many Eastern European currencies in free fall.

The relative '*poverty*' of Bulgaria left its economy oblivious to the direct impact of the global financial crisis of 2007-2008. Although this incidence is itself not an isolated case amongst the CEECs, the causality of it is in large part founded in the particular structure of the Bulgarian economy. The negative externalities of the bulk of the defaulting market instruments associated with various kinds of mortgage-backed securities (MBS) and the over-leveraging of

² Refers to the Czech Republic, Hungary, Poland and Slovakia for the purpose of the European integration of those states in the 1990s.

³ GDP per capita in PPS, Eurostat (2009): <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsieb010> (site last accessed 12/08/2009)

⁴ Time Magazine, The Economic Crisis Hits Eastern Europe by Pelin Turgut, 25 February 2009

households and financial institutions was never a threat to a market unexposed to those instruments. However, the lack of a negative direct impact was offset by an inability at central government level to reverse the snow-balling repercussions which manifested themselves primarily through shortage of liquidity on the market as the majority foreign owned bank subsidiary system (second tier) tightened up the private sector lending criteria. This exacerbated the rise of private debt in the country⁵, already spurred on by the commodity bubble in anticipation of Bulgaria's EU accession. The shortage of liquidity on the market intensified by the sharp withdrawal of foreign direct investments (FDI) where Bulgaria had become the most FDI reliant economy in CEE by 2009. At the same time the current account deficit stands at more than 24% of GDP⁶ to be entirely financed by FDI capital flows.

How to maintain development in the state under such circumstances has turned into the most challenging stumbling block after the last financial crisis in Bulgaria in 1997 and the country's EU accession⁷. This posits two questions in respect of the analysis in the present article: (1) how effectively was Bulgaria's economic transition steered during the EU pre-accession period; and (2) how disparate was the effect of FDI in the country? The discussion ensuing from these two primary questions provides some insights as to the sorts of economic reforms, on the one hand, and the kinds of FDI concentration, on the other, that is needed. If current economic reforms and FDI concentration have a consistent

⁵ Source: Bulgarian National Bank and InvestBulgaria, 2008

⁶ Bulgarian National Bank, 2009

⁷ Bulgaria suffered a deep crisis in the banking sector in 1996-7. For more, see: Roussenova, L. (2002): The 1996-1997 Financial Crisis in Bulgaria, Policy Documentation Centre

positive impact on the national economy, this would imply that the country should continue to pursue similar policies aimed at attracting FDI in the future.

2. The case of Bulgaria

Although Bulgaria is the poorest of the EU-27 member states today, the low GDP base has allowed for robust real GDP growth rates between 2000 and 2008⁸. This coincided with the period of EU accession negotiations and EU membership. As a cumulative result of (1) projected GDP growth rates, (2) the lack of exposure to the direct impact of the defaulting market instruments, as well as (3) the EU experience that a new member's accession is often followed on by a period of strong economic growth⁹, the overall economic contraction in 2009 and 2010 for Bulgaria was first projected at lower rates than in many of the remaining EU member states¹⁰. However, as it happened, much of the slowdown was accounted for by a contraction in the construction sector¹¹. This harmed productive capital investment which is generally considered to be the main drive of economic restructuring and technology diffusion¹².

In Bulgaria, a substantial part of capital investment is accrued from FDI inflows. This is due to the fact that the Bulgarian economy is much more

⁸ Source: Eurostat, 2009 (Real GDP growth in Bulgaria in 2008 was one of the highest amongst the EU members states, behind only Romania and Slovakia)

⁹ Buch, C. and Piazzolo, D. (2001): Capital and trade flows in Europe and the impact of enlargement, *Economic Systems*, Vol. 25, Issue 3, pp. 183-214, Elsevier Science B.V.

¹⁰ Ibid.

¹¹ Anti-crisis Plan of the Confederation of Employers and Industrialists in Bulgaria, 2009

¹² FDI and Productivity Convergence in Central and Eastern Europe: An Industry Level Investigation, European Central Bank, Working Paper Series No. 992/ January 2009, p. 5

heavily reliant on FDI capital-inflows than other CEECs, which comprise 9.9% of GDP per annum and rising¹³. Comparatively, the average share of FDI in GDP in the remainder of the CEECs is 3.7% (Poland: 2.2%; Romania: 5.6%; Slovakia: 4.1%; Slovenia: 1.2%; Hungary: 3.1%; Czech Republic: 4.4%)¹⁴. The gap is significant, primarily reflecting the smaller GDP of Bulgaria than that of other CEECs. It also highlights the greater difficulty that the state will experience in adjusting to a sharp withdrawal of FDI inflows that is expected to occur under circumstances of restricted bank lending¹⁵.

The initial forecast by Eurostat was for a much more measured contraction of the Bulgarian economy over the period 2009-2010, namely in the region of -1.6 to -0.1%. This was favourable as compared to the rest of the CEECs. However, the latest projections of the International Monetary Fund (IMF) and the European Bank for Reconstruction and Development (EBRD) foresee a sharper contraction at -3 to -3.5% in 2009 and at -1% in 2010. The estimate for 2009 is consistent with expectations for much of the CEE region. However, the forecast for 2010 is weaker than for some of the CEECs, such as the Czech Republic (0.8%), Poland (1.8%), Romania (0.5%), Slovenia (1.3%) and Slovakia (1.9%), which are expected to have already come out of the recession by the end of 2009 and go into positive growth territory in 2010¹⁶. Those of the CEECs remaining in negative growth territory in 2010, such as Hungary and the Baltic

¹³ Source: Ministry of the Economy and Energy of the Republic of Bulgaria, Investment Policy Directorate, 2005. FDI in 2007 was 22.6% of GDP and in 2008, 16% of GDP according to data of the Bulgarian National Bank.

¹⁴ Ibid.

¹⁵ FDI in 2009 is anticipated to contract to ca. 7% of GDP, compared to 16% of GDP in 2008. (Source: Ministry of the Economy of Bulgaria)

¹⁶ Eurostat, Real GDP Growth Rate, 2000-2011

states, were also directly exposed to the defaulting financial market instruments¹⁷. Thus, the incidence of two factors in particular makes Bulgaria a singularly interesting case to investigate amongst the CEECs: on the one hand, this is the lack of exposure to the defaulting market instruments but on the other, the prolonged economic slowdown. Whereas in the majority of CEECs the incidence of the latter can be explained through the presence of the former, this is not the case of Bulgaria. Therefore, alternate explanations must be sought.

This article suggests that the disparity in real growth outlook between Bulgaria and the majority of the CEECs is on account of three factors in the main: (1) an overreliance of the national economy on FDI; (2) a large volume of speculative investments in the total FDI stock that failed to generate significant absorptive capacities in the country's industrial base; and (3) a faster rate of withdrawal of FDI inflows from the country in 2009 than first anticipated. Speculative investments are considered to be short-term financial flows whose impact can threaten market liquidity¹⁸. A distinction between speculative and non-speculative capital flows is sometimes also drawn along a differential between 'non-productive' and 'productive' investments, respectively¹⁹. The majority investments in Bulgaria went to the service and property sectors instead of

¹⁷László Andor, 'Hungary's Boomerang effect', 28/10/2008, The Guardian;

'The Baltics in the Shadow of the Financial Crisis', Speech by Mr Lars Nyberg, Deputy Governor of the Sveriges Riksbank, at Intervalor and Baltic Property Trust, Stockholm, 9 September 2009

¹⁸ Deacon, B. (2000): Eastern European welfare states: the impact of the politics of globalization, *Journal of European Social Policy*, Vol. 10, No. 2, pp. 146-161

¹⁹ Salvatore, D. (2006): Currency Misalignments and Trade Asymmetries among Major Economic Areas, pp. 1-19, in Alexander, V. and Kotz, H.-H. (eds.): *Global Divergence in Trade, Money and Policy*, Edward Elgar Publishing

developing production capacity in the industrial sector. Those, in particular, have allowed for an accelerated rate of FDI (and remittances²⁰) withdrawals from the national economy than non-speculative (strategic) such would have otherwise provided for. Export development was thus weak while imports increased rapidly as a result of strong domestic demand.

Recent harmonised industry-level analysis by the European Central Bank (ECB) has shown that foreign capital, in the form of FDI inflows, plays an important role in accounting for productivity growth in the central and eastern European region²¹. A key conclusion of the study is that the impact of FDI on productivity critically depends on the host country's capacity to absorb technology²². The empirical evidence further highlights the fact that FDI and absorptive capacity are key factors for productivity convergence in CEE. This favourable impact of FDI on productivity is not, however, automatic and can be strengthened by improving the absorptive capacity of the recipient economy²³. Therefore, in order to draw conclusions about when FDI is good for development, this article first takes a critical look into the restructuring of Bulgaria's industry since transition began. The following section further highlights the extent to which the country has developed sufficient policy instruments to enhance absorption capacity as a result of its recourse to pre-accession facilities in preparation of EU membership.

²⁰ In 2003, remittances composed 49.64% of FDI (Source: Krassen Stanchev, Institute for Market Economics, Sofia)

²¹ FDI and Productivity Convergence in Central and Eastern Europe: An Industry Level Investigation, European Central Bank, Working Paper Series No. 992/ January 2009, p. 6

²² Ibid.

²³ Ibid.

3. Industrial restructuring

Since transition began in 1990 the industrial sector has progressively shrunk *vis-à-vis* the services sector as share of the national economy, a trend observed in the developed world since the 1970s²⁴. Thus, whereas in 1991 industry represented 42.8% of GVA²⁵ with services at 43%²⁶, by 2007 industry formed 32.3% of GVA while services accounted for 61.5%²⁷. Although this may seem symptomatic of a profound reorientation of economic activity, it is important to note that the declining share of industry within the national economy was in large part accounted for by a degree of freefall, resulting from the dissolution of the Soviet Union and the COMECON, the principal export destinations for Bulgarian industrial goods. In addition, inefficient and aged state-owned enterprises (SOEs) that were viable only within the context of intra-COMECON country trade specialisation pre-1989, added to the burden on industry to restructure post-1990. Notwithstanding, this was further compounded by a comparatively slow pace of privatization and the involvement of insiders who failed to incentivise the process sufficiently.

Industrial restructuring reform post-1990 has been driven in the first instance by the process of European integration. To this end, it benefited from the following pre-accession instruments, conceptualised in this article as the direct

²⁴ Industrial Metamorphosis, The Economist, 29/09/2005

²⁵ GVA represents GDP minus adjustments, which are the financial intermediation services indirectly measured, non-deductible value-added tax, excises and import duties.

²⁶ National Statistical Institute of Bulgaria, 1999

²⁷ AEE, 2005; InvestBulgaria Agency, 2009

effect of European integration: (1) PHARE, (2) the Europe Agreements, and (3) Phare (initiated at the onset of enlargement to CEE). These initiatives were expanded on after Bulgaria's EU accession in 2007 through the Post-Accession financial envelope that the new EU member states were allocated to benefit from in 2004²⁸. A review of these instruments in the subsequent sub-sections shows in greater detail the extent to which sufficient absorption capacities were created in industry as a result of recourse to the pre-accession funds. In turn, this will indicate the capacity of the restructured industrial sector to absorb long-term FDI capital flows.

The empirical findings suggest that the overall direct effect of the pre-accession instruments is rather negligible. It finances 6-7% of the cost of Bulgaria's preparation for accession²⁹. Furthermore, the impact on the fiscal position of the state is believed to be negative³⁰. The absorption capacity both at central government and at local government level (municipal) has remained highly problematic³¹. For instance financial absorption under the Programme INTERREG IIIA / PHARE CBC Greece-Bulgaria was 7.12% by the end of 2003 due to implementation, approval and recruitment delays³².

In consequence, the most prized contribution of the pre-accession facilities to the economic transformation of Bulgaria is indirect. It lies in the credibility that

²⁸ SEC (2004) 160 final, Brussels 10.2.2004

²⁹ Angelov, I. (2001): Positive and Negative Effects from the Integration of Bulgaria to the European Union, *Economic Thought*, Issue 4, pp. 24-61

³⁰ This article: Table 5, p. 16

³¹ Operational Programme Technical Assistance 2007-2013, Republic of Bulgaria, Ministry of Finance, November 2007, p. 7-ff.

³² ΑΞΙΟΛΟΓΗΣΗ Π.Κ.Π. INTERREG IIIA/PHARE CBC ΕΛΛΑΔΑ-ΒΟΥΛΓΑΡΙΑ, EEO GROUP A.E.- GLOBAL VIEW A.E.

they afforded the country as a prospective EU member state with the associated political stability and economic prosperity that the European integration process lends the accession-candidate. It is this indirect impact that has allowed the Balkan state to attract substantial FDI inflows as percentage of GDP over the past decade. By 2006, 22% of FDI stock in Bulgaria had gone to the industrial sector³³. Thus, Foreign Direct Investment has had the most singularly significant *external* advantageous impact on the development of the national economy as a major source of liquid capital flow for second-generation industrial reforms that ensued following the initial privatisation offering of SOEs.

In turn, these investments are differentiated between speculative and non-speculative in order to distinguish between the short- and the long-term impact of FDI on the economy. In the break-down the article points to the significance of regional FDI that emerges from the analysis. In the case of Bulgaria, regional FDI is provided for by Greek capital inflows in the main. This incidence is both historical and logical in that regional trade can lead not only to bilateral but also to multilateral agreements *vis-à-vis* FDI³⁴. It was only due to the fundamental difference of system values during the pre-transition period that this event never occurred prior to 1990 in South-East Europe, leaving the region divided and weak for many decades. Proving the importance of regional

³³ Bulgaria Factsheet 2006: Economy Investment, Business and Industry, InvestBulgaria Agency, 2006

³⁴ This incidence is not novel within the wider European context: note the relationship between Sweden and the Baltic region; Germany/Austria and the Central European region, etc. See also: Blomström, M., Kokko, A. and Globerman, S. (1998): Regional Economic Integration and Foreign Direct Investment: The North American Experience, Working Paper Series in Economics and Finance No. 269

co-operation, FDI in Bulgaria originating from Greece was the most significant single source of FDI flows to the country in the years 1996-2003³⁵. Italy, Austria, the Netherlands and others followed on by some distance during this period³⁶. It was only by the time that Bulgaria's EU membership looked increasingly certain that the primacy of Greece as geographic origin of FDI was gradually overtaken by the larger economies of Austria and the Netherlands. Greek FDI remained the overall second strongest source of foreign investments in the country in 2004³⁷, which also coincided with a period of robust GDP growth in Bulgaria³⁸. Overall, during the period 1996-2008, FDI stock originating in Greece represented 9% of total investment inflows, making it the third largest source of FDI after the larger economies of Austria (16%) and the Netherlands (12%)³⁹.

It is, therefore, significant to point out that the logic of regional trade and investment helped Bulgaria spring out of its economic weakness in the first instance. Following the grave financial meltdown that the state suffered in 1996-1997 the confidence in the future economic outlook of Bulgaria displayed by Greek businesses aided in the reforms of the country. Thus, this article discusses in subsequent section 4.2 at greater length the structure of Greek FDI in particular, due to the fact that the regional characteristics of the investments have more often than not contributed to their strategic quality. Concurrently,

³⁵ Source: Bulgarian National Bank and InvestBulgaria, 2009

³⁶ Ibid.

³⁷ Source: www.bulgarianindustry.bg (site last accessed 17/08/2009)

³⁸ Bulgarian National Bank, 2009

³⁹ InvestBulgaria Agency, 2009

the foreign trade turn-over between the two countries has increased significantly. Greece has become Bulgaria's third-largest trading partner, whilst Bulgaria, the fourth-largest trading partner of Greece⁴⁰. This effect is often observed where export-oriented FDI capital flows go towards developing production capacity in the industrial sector of the host country as opposed to its service and property sectors⁴¹.

3.1. PHARE and the Europe Agreements

In the immediate aftermath of transition, the EC set up the PHARE programme as a financial tool to aid in the economic transition of Poland and Hungary (as the name suggested)⁴². It was expanded to the remainder of the CEECs after 1990 with Council Regulation (EEC) No 2698/90 and successive such amending the original as the main tool to channel EC financial assistance 'for economic and humanitarian aid to support the process of economic and social reform before the decision to commence formal membership negotiations with the states of the region was taken.'⁴³ As such, PHARE had two main directions of impact: (1) to strengthen institutions of transition states included in the annex of the list of states covered by the programme; and (2) to promote economic and social cohesion with those states and the region. Covering 13

⁴⁰ Bulgarian Statistical Institute

⁴¹ 'The Baltics in the Shadow of the Financial Crisis', Speech by Mr Lars Nyberg, Deputy Governor of the Sveriges Riksbank, at Intervallor and Baltic Property Trust, Stockholm, 9 September 2009, p. 2
Barry, F. And Bradley, J. (1997): FDI and Trade: The Irish Host-Country Experience, *The Economic Journal*, Vol. 107, No. 445 (Nov., 1997), pp. 1798-1811.

⁴² Council Regulation (EEC) No 3906/89

⁴³ Ibid.

partner countries by 1996, the original budget of PHARE was set at ECU 4.3 billion for the period 1990-1994⁴⁴.

The advent of the PHARE programme saw a need to formalise and institutionalise trade relations between the EU and the states of CEE. This came in the form of the Europe Agreements (EAs) or Free Trade Agreements (FTAs) which provided the legal bilateral framework for interaction between the EU and the individual CEE state. It offered the latter certain preferential trade agreements with the EU area that were key incentives to trade liberalisation and phasing out rules on the provision of state aids in the CEECs. Seen often not as traditional free trade agreements, the EAs are sometimes referred to as a stepping-stone to EU accession⁴⁵.

Investigating the impact of the EAs over their lifeline, Spies and Marques (2006) have established the following results⁴⁶. The overall effect on trade imports of the EU-15 from the CEECs was positive and growing at rates three times faster than the rates compared for the rest of the world (ROW)⁴⁷. However, an econometric analysis of the import flows shows that the FTAs with Slovenia and the Baltic countries (except for Lithuania) were less harmful to the ROW than the FTAs with Hungary, Poland, the Czech Republic, Slovakia, Romania and Bulgaria⁴⁸. This is derived as an estimate of EU imports

⁴⁴ Source: IBIS (<http://www.ibis-eu.com/index.php/phare/> site last accessed 13/08/2009)

⁴⁵ Phinnemore, D. (1999): *Association: Stepping-Stone or Alternative to EU Membership?*, Sheffield Academic Press

⁴⁶ Spies, J. and Marques, H. (2006): *Trade Effects of the Europe Agreements*, Institut für Volkswirtschaftslehre, Universität, Stuttgart, ISSN 0930-8334

⁴⁷ Ibid. p. 3

⁴⁸ Ibid. p. 5

over GDP ratios for the CEECs. The authors also find that the biggest growth of imports over GDP ratios has occurred for those countries that signed the FTAs soon after their transition (Slovakia, Hungary and the Czech Republic). Virtually no or even negative growth was reported for the Baltic countries and Slovenia, who entered into the FTAs later⁴⁹. In all, it is estimated that the EAs have generated anything in the range of 11% to 25% more trade between the EU and the CEECs as compared to a scenario where those agreements did not exist⁵⁰.

Although in terms of pure trade volumes the analysis by Spies and Marques should appear to hold, it seems that Bulgaria is a deviant case seen against the context of the hypotheses in their study. The logic that the earlier a trade agreement is signed, the more advantages are to be drawn from it by the CEECs is in the case of the Balkan state erroneous. Bulgaria had signed its EA (1993) before Hungary (1994), pointed as an example of an early comer in the Spies and Marques analysis. Nevertheless, Bulgaria continued to display worse macroeconomic performance throughout the 1990s than other CEECs. Moreover, its trade balance has remained in deficit almost uninterrupted since 1993, widening sharply especially since 2003⁵¹.

Overall, during the pre-accession period, Bulgaria's trade with the EU increased modestly. EU imports from the country have moved from ECU 1.013

⁴⁹ Ibid. p. 5

⁵⁰ See also Hanson, B.T. (2003): What happened to fortress Europe? External Trade Policy Liberalization in the European Union, *International Organization*, 52:55-85

⁵¹ Source: InvestBulgaria, 2009

million through to ECU 1.835 million in 1995 to Euro 3.062 million in 2000, maintaining the same share of EU total at 0.3% throughout the time period. EU exports progressed from ECU 1.487 million in 1993 through to ECU 2.052 million in 1995 to Euro 3.229 million in 2000. Total EU share has also been maintained throughout the period at 0.3%⁵². This indicates very marginal industrial restructuring in the state as the host country export capacity *vis-à-vis* its largest trading partner has not increased during the pre-accession period. The recorded trade volumes appear rather to be resulting from the dissolution of closed trading in the Eastern block, making the EU naturally the dominant international trade partner for the country⁵³.

3.2. Accession negotiations: Phare

Pursuant to Council Regulation (EC) No 1266/1999, Article 4.2 amending Council Regulation (EEC) No 3906/89, establishing the PHARE programme, the latter financial instrument was restructured in 1999 in order to ‘focus on the main priorities for the adoption of the *acquis communautaire*, i.e. building up the administrative and institutional capacities of the applicant States and investment, except for the type of investments financed in accordance with Regulations (EC) No 1267/1999 and (EC) No 1268/1999.’⁵⁴ The purpose of PHARE was thus expanded in order to suit the demands of the accession

⁵² Source: FiFo Ost Database

⁵³ Tsamboulas, D. (1999): The Future of Trans-European Corridor Developments in Eastern Europe, International Conference Paper on European Transport Policy and Research: What Future?, Vienna 17-18 May, 1999, pp. 14-ff.

⁵⁴ Council Regulation (EC) No 1266/1999

process. However, the approach that centred on funding for specific projects remained unaltered.

The volumes of Phare projects subscribed to Bulgaria in the area of Industrial Policy in the period 1999-2005 is on average three projects per annum, which is few. This is accounted for by the fact that the average length of each project is between 24 and 36 months, including the stages of contracting, tendering, subscribing, and disbursement (payment appropriations) of funds. This is far too long considering the constraints imposed on the state by the sheer speed of the process of European integration. Where the time-frame of accession is four to six years (six in the case of Bulgaria), seeing initial project outputs only after two to three years into the negotiations addresses inadequately the intensity of the restructuring process required.

The attention of Phare focused overwhelmingly on three major industrial policies: (1) competition policy, (2) privatization and (3) the restructuring of state monopolies⁵⁵. It targeted three lines of funding in the main, namely (1) the Bulgarian Post-Privatization Fund (BPPF), (2) *acquis* harmonization in competition policy, and (3) the energy sector. Only a small fraction of Phare assistance was devoted to technological progress, research and innovations in the state. The two projects that were run did so only as pilot schemes. The size of pre-accession aid is shown in subsequent tables 1 respectively spread over large, medium and small projects. The evidence shows that the overall volume

⁵⁵ Reference: Commission Regular Reports on Bulgaria's progress towards accession, 1999-2004

of the pre-accession facility is low as compared to the total cost of the country's preparation for accession⁵⁶.

Table 1: Pre-accession project aid

Year	Title	Sector	Public policy investment	Institution-building investment
Large Projects				
2004	BG/016-711.11.04	SME/Competition	MEUR 21.3	MEUR 1.6
2005	BG017-586.04.01	Industrial zones	MEUR 13.5	MEUR 1.0
Medium Projects				
1998	BG980502	BPPF ⁵⁷	MEUR 3.5	0
2000	BG0004.01	Competition/QMS	MEUR 4.8	MEUR 0.2
2001	BG0102.01/02	SME/Technology	MEUR 4.4	MEUR 0.3
2005	BG/017-586.01.01	Energy/Acquis	MEUR 3.075	MEUR 0.9
Small Projects				
2000	BG0003.01	Telecoms acquis	MEUR 0.7	MEUR 1.75
2000	BG00.03.03	Procurement acquis	MEUR 0.3	MEUR 1.0
2000	BG0003.04	Energy acquis	MEUR 0.1	MEUR 1.0
2003	BG004-937.02.03	Clusters	MEUR 0.1	MEUR 0.5
2004	BG/016-711.02.01	Competition acquis	0	MEUR 0.9
2005	BG/017-353.02.03	Industrial policy acquis	MEUR 1.818	MEUR 0.963

Average annual financial assistance from Phare to Bulgaria is estimated at ca. MEUR 178 over the period 2000-2004⁵⁸, of which roughly 13% was devoted to industrial restructuring from 2000 to 2004, which in fact is 8% of total when spread over the entire period of pre-accession negotiations, 1999-2005. This is less than 0.14% of national GDP *per annum*. Pre-accession aid towards the development of export capacity in the industrial sector can be, therefore,

⁵⁶ Angelov (2001)

⁵⁷ Bulgarian Post-Privatization Fund

⁵⁸ Source: Commission estimations, Commission Regular Reports on Bulgaria's progress towards accession 2004, p. 7

considered negligible. It addressed inadequately the need to develop absorption capacity in the state in order to halt and reverse the dramatically widening trade deficit during the accession period. Of the projects listed the average absorption rate of funds stood at 46.5% of allocated financing. This led to the fact that to finance industrial restructuring, the state had to use the OPP method ('out of pocket' cost method) to implement earmarked reforms. Applying cost-benefit analysis, Table 2 shows an estimation of the direct effect on the net balance of payments for Bulgaria and on the fiscal position of the state (Table 3) at the close of accession negotiations.

Table 2: Net Balance of Payments effect for Bulgaria, % GDP

Share of GDP	Current prices, % GDP (MEUR)
Promotion of strategic behaviour (steelworks only)	2.9% (410.405)
Pre-accession aid (all sectors)	0.05% (7.217)
Sustaining technologies (steelworks only)	0
Systems of Innovation (all sectors)	0
Clusters (all sectors)	0
Net impact	+ 2.95% (417.72)

Source: Bozhilova (2008).

Table 3: Net Fiscal effect for Bulgaria, % GDP

Share of GDP	Current prices, % GDP (MEUR)
Co-financing of EU programmes	0.13% (18.760)
Expenditures relating to acquis harmonization	1.75% of 5.56 billion or 0.69% (equivalent to 97.3 million p.a.)
State aid (all sectors):	0.52% (73.33)
Disruptive technologies (steelworks only)	1.79% (250.8)
Net fiscal effect	- 3.14% (440.19)

Source: Bozhilova (2008).

The evidence in Tables 2 and 3 points to a number of interesting conclusions. First, it shows that an increase in the net balance of payments to compensate

the deterioration of the state's actual fiscal position has not occurred during the pre-accession period. Second, the EU has pursued a policy of curbing state aid in accession states (Table 3), not only in order to ensure equal competitiveness for industries across the single European market, but also in order to relieve the deterioration of the state's fiscal position arising from reform pressures in preparation of EU membership⁵⁹. The overall effect of accession shows a stabilization of the industrial sector to the extent that it is brought in line with EU standards and norms (*acquis*). The state is thus considered to have completed the Copenhagen economic criteria of enlargement.

In actual fact, this effect is aided in by two main factors. First, by the state addressing the Commission benchmarks for accession through the OPP cost method. Second, more successful second-generation reforms in the industrial sector in Bulgaria occurred in large part aided in by FDI capital inflows, which represent the indirect effect of the European integration of the state with annual share of the national economy rising to ca. 10% of GDP in 2005 through to ca. 16% of GDP in 2008, the highest in CEE.

⁵⁹ A scenario where during critical periods of rising unemployment and falling domestic demand, indiscriminate recourse to state aid can lead to a necessary deterioration of the state's fiscal position is described by the European Commission in 'Communication from the Commission — Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis', (2009/C 16/01)

4. Foreign Direct Investment

4.1. FDI and Economic Development

FDI is described as having a positive effect on the economic transition of states in the area of technology transfer for capacity development in the industrial sector⁶⁰. The impact of FDI on the host economy can be recognised in any one of three ways: (1) by stimulating development in the country through GDP growth, export capacity growth and capital stock growth; (2) by improving the technical and know-how transfer in the host country; (3) by developing the infrastructure that is consistent with environmental standards⁶¹. There are countries within CEE, which attracted FDI already in the first decade of transition, whilst others achieved this only in the second decade. Different assessments of the impact of ‘early’ and ‘late’ FDI on productive assets exist.

The proponents of the former have based their arguments around early observations of FDI flows to CEE⁶². They have noted that those were very much focused on the Czech Republic and Hungary and much less so - on the remainder of the CEECs. Against this background and given the already noted negligible direct effect of capital flows from the pre-accession financial facilities as compared to the demands of transition, their observation stands. However, they make further mention of determinants on FDI that contribute to a disparate concentration of investments across countries and regions. Scholars

⁶⁰ Campos, N. and Konishita, Y. (2002): Foreign Direct Investment as Technology Transferred: Some Panel Evidence from the Transition Economies, William Davidson Institute Working Paper Number 438

⁶¹ Grigorova, V. (2007): FDI in Industry in Bulgaria, BAS, Sofia, p. 29

⁶² Lankes, H-P. and Venables, A.J. (1996): Foreign Direct Investment in Economic Transition: the changing patterns of investments, *Economics of Transition*, Vol. 4 (2), pp. 331-347

have noted the role of geography, the size of GDP and inflation, all of which have influenced the choice of destination for investors⁶³. Bulgaria falls in Europe's geographic periphery, has low GDP and in the early years of the transition, had considerable inflation that was not reversed until as late as 1998 (Table 4). The EBRD transition report of 1995 notes that Bulgaria ranks only ahead of Romania in terms of how advanced its transition is with 2.56 out of maximum 4 points (which many foreign investors incidentally correlate with risk assessment), and this index is likewise reflected in its attractiveness to investors.

Table 4: Main economic indicators of Bulgaria, 2000-2005

Indicators	2000	2001	2002	2003	2004	2005
GDP growth, %	5.4	4.1	4.9	4.5	5.6	5.5
Industrial output growth, %	4.6	2.2	4.6	15.0	18.1	16.4
Inflation, %	10.3	7.4	5.8	2.3	4.1	6.5
Exports (bn EUR)	5.3	5.7	6.1	6.7	8.0	9.5
Imports (bn EUR)	7.1	8.1	8.4	9.6	11.6	14.7

Source: Grigorova, V. (2007): FDI in Industry in Bulgaria, BAS, Sofia, p. 64.

A study by Iammarino and Pitelis on Greek FDI in Bulgaria and Romania explains the incidence of its concentration in the two Balkan states as flows from a peripheral EU economy to less favoured regions (LFRs)⁶⁴. The evidence focuses on the effect of investments both for the host/home country analysis, as well as the effect for the EU integration of LFRs and conversely the impact of

⁶³ Ibid., p. 334

⁶⁴ Iammarino, S and Pitelis, C. (1999): Foreign Direct Investment and Less Favoured Regions: Greek FDI in Bulgaria and Romania, ERSA Conference Paper Aug. 1999

those on the state of the Union. A unifying feature that the authors identify between Greece, Bulgaria and Romania is the fact that they all benefit the category of EU LFRs.

Yet, this explanation alone appears deficient. Total volumes of Greek FDI to the growth markets in South-East Europe indicate that it is a far more sophisticated economy than Bulgaria and Romania⁶⁵. Thus, Greek companies could have chosen as investment destination any of the other CEE growth markets. Moreover, Greek FDI flows to Turkey and the Western Balkans are also significant over the same period, yet those countries were not yet EU accession candidates. Adding to the Iammarino and Pitelis centre-periphery explanation, this paper proposes the formation of stronger intra-regional ties within traditional regional trade blocks⁶⁶.

The idea of regional trade blocks is not an idea instead of multilateralism but rather post-1990, an idea in addition to multilateralism, so that we have both multilateral trade agreements (GATT) but also preferential trade agreements (EU). Within regions of preferential trade agreements we also observe the gradual formation of regional centres or 'neighbourhoods' based on the effectiveness and utility of bilateral trade relations. In effect, we observe a three-tier trade system made of (1) multilateral agreements, (2) regional trading

⁶⁵ Stoian, C. and Filippaios, F. (2008): Foreign Direct Investment in Central, Eastern and South Eastern Europe: an 'eclectic' approach to Greek investments, *International Journal of Entrepreneurship and Innovation Management*, Vol. 8, No. 5, pp. 542-564, p. 553

⁶⁶ Reardon, J., Kling, N., McCorkle, J.E. and Miller, C. (2002): The formation of regional trade blocks: A theoretical perspective using game theory, *American Business Review*, Vol. 20, No. 1, pp. 91-99

blocks and (3) regional trading neighbourhoods⁶⁷. The stronger dynamic of trade between Greece and Bulgaria, as well as between Greece and other of the states in SEE, such as Romania, Turkey and the Western Balkans, as opposed to the CEE region is better explained from this perspective than from the strict perspective of a centre-periphery hypothesis alone. In turn, it should seem logical that for non-EU members that are also transitional economies, such as Bulgaria in 1990, regional FDI from neighbouring states should be more significant in the first instances. At a second stage FDI from the wider regional trading block and from multilateral partners is attracted. This explains why in the case of Bulgaria the largest volume of FDI in the pre-accession period has come from Greek investors (1996-2003)⁶⁸. This was followed on by a substantial additional investment from the EU more generally as accession negotiations progressed significantly (2003-2008) and was complimented by FDI from ROW as the certainty of accession increased (2004-2008). All along, the immediate regional FDI effect has not lost its significance, continuing to aid in the industrial restructuring and general economic development of the host country⁶⁹.

4.2. Greek FDI in Bulgaria

A number of benefits accrue to the host state from FDI. A firm embodies labour, capital, technology, and accumulated management expertise and marketing skills, and when it invests abroad, it transfers many of these

⁶⁷ Also supported by the Inter-Balkan Cooperation, the BSECO and the Tripartite Initiative.

⁶⁸ Cr.-ref. section 1, p. 6-ff., this article

⁶⁹ Monastiriotes, V. (2008): Quo Vadis Southeast Europe? EU Accession, Regional Cooperation and the need for a Balkan Development Strategy, GreeSE Paper Series, No. 10

components to its affiliate. Another benefit is set in the ability of an enterprise to channel its various outputs in the host country through its affiliate network, impacting positively on the host country's trade balance albeit this effect is differentiated according to the type of FDI⁷⁰. In this way, the goods produced in the host country are distributed to markets elsewhere.

In addition to such obvious advantages FDI has a 'dynamic' component. This arises from the international rivalry of firms:

The entry of a foreign investor into a market can pose a competitive challenge to local firms or to existing investors. For firms producing goods and services which cannot be traded internationally owing to their intangibility or prohibitive transport costs, FDI is the only mechanism for international competition.⁷¹

This is an assessment particularly true of economies in transition that have not yet been partly or fully integrated into a regional trade block. Then, FDI from a neighbouring state, that is however already fully integrated and operates a more sophisticated economy, can provide such much needed transfers and channels of affiliate networks to help in the restructuring and thereby, the integration of the host country by creating absorptive capacities.

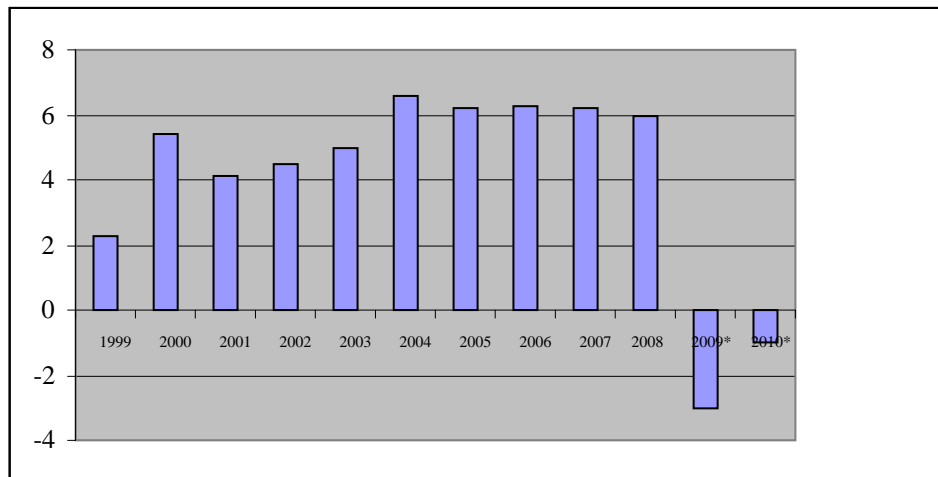
If we compare the results in Figure 1 and 2, we can see that there is a clear correlation between GDP growth and FDI flows. GDP growth is accompanied by surges in FDI and conversely, GDP contraction is accompanied by a

⁷⁰ Foreign Direct Investment and Economic Development: Lessons from Six Emerging Economies, OECD, 1998, p. 53-ff.

⁷¹ Ibid.

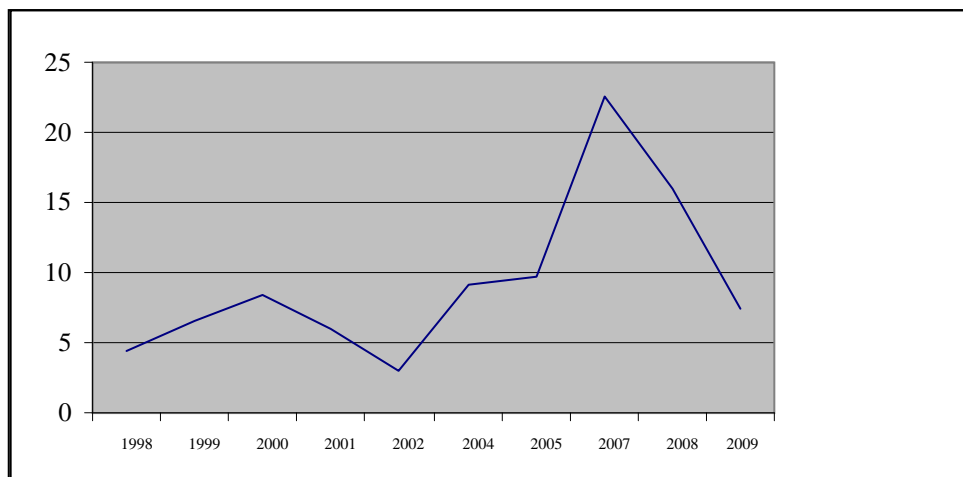
withdrawal of FDI. There are more many factors that contribute to both events but since this study only looks at the structure of GDP as related to FDI, the analysis is constrained within those parameters.

Figure 1: Real GDP growth in Bulgaria, 1999-2010, %



Source: Eurostat, 2009; IMF, 2009.

Figure 2: Share of FDI in % of GDP, 1998-2009



Source: Bulgarian National Bank, National Statistical Institute, Ministry of the Economy, Greek National Statistical Service.

Table 5: Distribution of FDI by sectors of the economy, 1992-1997⁷²

Sector of the economy	Number of deals	FDI, % of total GDP
Industry	499	47.84
Construction	97	1.25
Transport	157	6.71
Telecommunications	19	18.6
Trade	45	7.36
Tourism	45	7.36
Finance	146	12.75

Table 6: FDI flows in Bulgaria, 1998-2008, by industry, EUR million

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Total	605.1	866.0	1103.3	903.4	980.0	1850.5	2735.9	3152.1	6158.4	8487.9	6163.0
Agriculture	7.8	2.2	0.0	0.8	1.9	2.4	5.6	9.5	27.8	75.2	51.5
Construction	2.9	21.5	29.2	19.6	36.5	5.0	81.7	171.6	501.0	797.4	465.0
Education	-0.1	-0.3	1.7	4.9	4.7	2.6	0.0	-0.6	0.1	0.8	0.4
Electricity, gas and water supply	2.0	-4.9	-15.6	3.1	73.3	7.7	670.8	308.5	352.4	332.5	176.2
Financial intermediation	168.7	103.0	17.7	137.6	135.7	432.5	236.1	667.3	799.4	2112.5	1485.9
Fishing	0.0	0.0	0.0	0.0	0.0	0.0	2.7	0.1	0.0	0.2	0.1
Health and social work	-0.1	-0.3	0.1	-0.1	0.4	-0.1	0.4	1.2	0.8	4.6	1.1
Hotels and restaurants	18.4	22.2	10.7	18.8	8.6	24.8	26.3	52.4	103.2	163.7	53.0
Manufacturing	220.9	460.6	551.9	293.8	89.3	523.3	435.7	868.2	1064.7	906.2	810.0
Mining	0.0	-0.3	6.4	5.4	11.3	18.7	17.5	36.3	21.4	5.3	7.6
Other services	0.6	-0.7	17.2	5.7	32.0	22.3	7.5	19.5	65.3	89.9	30.9
Real estate and activities	38.0	42.6	146.0	13.4	67.2	169.1	215.6	533.8	1778.0	2505.1	1900.3
Transport and Communication	16.8	17.5	20.1	243.3	230.9	153.7	426.5	-108.7	447.7	89.3	214.1
Wholesale and retail trade	127.5	142.2	283.9	130.6	261.9	439.9	496.5	576.9	964.5	1237.4	796.9
Non-classified	1.8	60.8	34.0	26.6	26.4	48.6	113.0	16.2	32.2	167.7	169.0

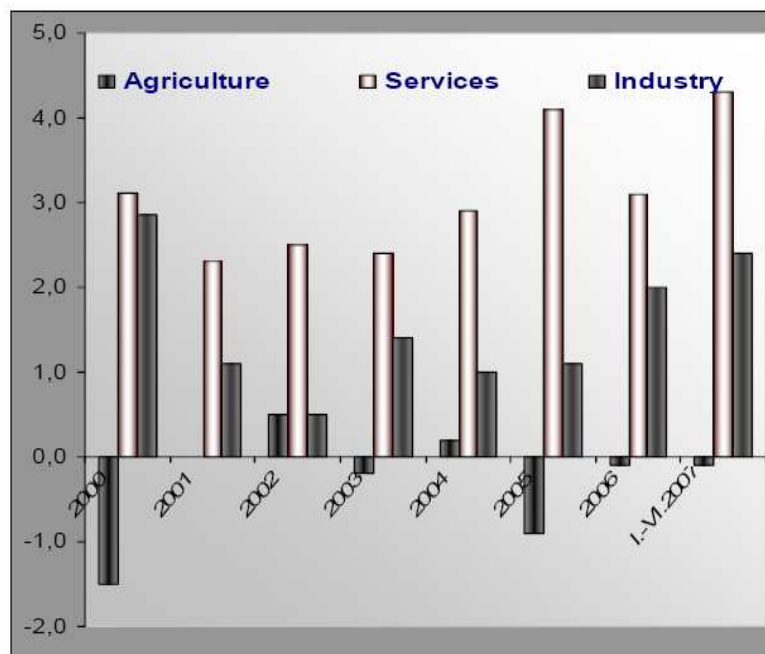
Source: Bulgarian National Bank, 2009. Note: * Preliminary Data.

⁷² Jordanova, Z. T. (1999): FDI in Bulgaria: The basis for the formation of strategic alliances of the type 'East-West' in the process of preparation of joining the EU, *Economics and Organization*, Vol. 1, No. 7, pp. 57-62, p. 58

If we look at industry within the structure of GDP, then Table 5 shows that during the pre-accession period the bulk of FDI flows targeted the industrial sector, followed on by telecommunications and finance, whilst the construction sector attracted far less attention from investors.

After the start of EU accession negotiations in 1999, manufacturing continued to receive strong attention but this was now on par with finance, whereas the construction sector was picking up quickly. Investments in real estate, above all others, took a clear precedence during the same period. When the evidence for the accession period in Table 6 is taken into consideration together with the evidence of FDI investments in Table 5 for the pre-accession period, industry emerges as one of the most dynamic sectors post-2000 (Figure 3; Table 4).

Figure 3: Growth by sector, %, 2000-2007.



Source: Ministry of Finance of Bulgaria.

Table 7 shows the investment sector break-down for the period 1998-2005. The evidence shows that during the period 1998-2005, investments in industry have increased three-fold. A significant part of the increase is accounted for by the manufacturing and construction sector.

Table 7: Structure of investments in Bulgaria, 1998-2005, million BGN⁷³

Sector/Year	1998	1999	2000	2001	2002	2003	2004	2005
Industry	1530.2	1929.9	2322.7	2599.5	2949.3	3638.9	4059.9	4255.0
Mining	109.6	120.1	115.6	103.2	115.1	119.7	157.2	287.9
Manufacturing	919.0	876.7	1290.6	1549.3	1921.0	2004.1	2086.4	2186.9
Electricity, gas and water supply	260.0	615.3	573.4	527.7	503.3	1024.3	1053.7	918.6
Construction	241.6	317.8	343.1	419.3	409.9	490.8	762.6	861.6
Agriculture	107.0	103.1	110.8	146.3	204.8	267.5	376.3	309.1
Services	1751.0	2061.7	2976.0	3948.5	4066.4	4596.7	5513.4	5831.3
Total	3388.2	4094.7	5409.4	6694.3	7220.5	8503.1	9949.6	10395.4

Source: National Statistical Institute of Bulgaria / Grigorova, V. (2007): FDI in Industry in Bulgaria, Sofia, BAS, p. 78.

The greater the number of long-term non-speculative investments, the stronger the foundations of productive assets in the national economy. In turn, this strengthens the ability of the state to generate absorptive capacities. A measure of this is often the rate of labour productivity growth as correlation of value added in the national economy per annum and the rate of employment⁷⁴. Table 8 shows that during the period 1998-2005, labour productivity growth in Bulgaria was modest while remaining the lowest amongst the CEECs.

⁷³ 1 Euro=1.95583 BGN (fixed)

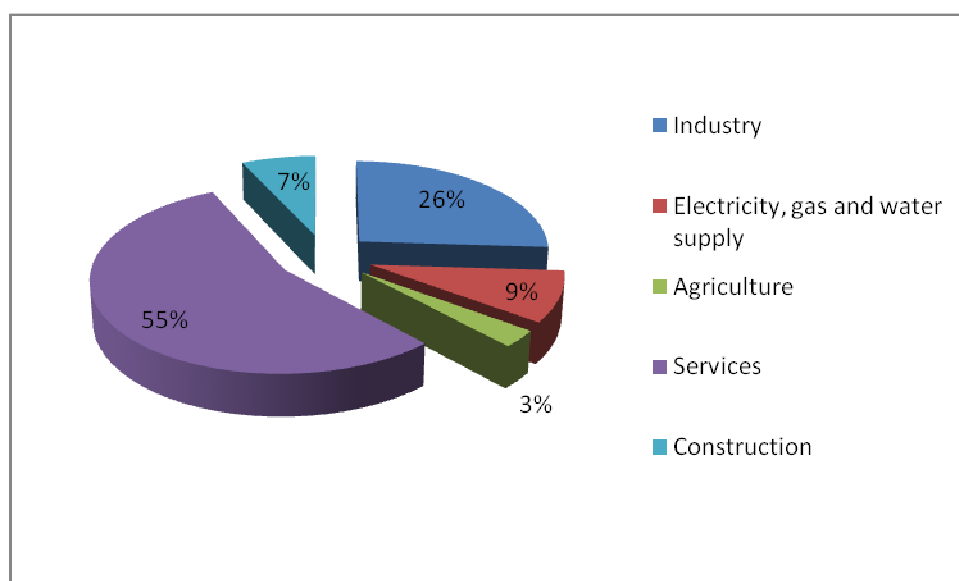
⁷⁴ FDI and Productivity Convergence in Central and Eastern Europe: An Industry Level Investigation, European Central Bank, Working Paper Series No. 992/ January 2009, p. 6

Table 8: Labour productivity, CEE region, by country, 1998-2005 (EU-25=100)

Year / Country	1998	1999	2000	2001	2002	2003	2004	2005
Bulgaria	28.5	29.5	31.3	32.5	32.5	31.9	31.9	32.7
Poland	46.2	49.1	51.3	50.3	51.5	59.6	62.0	61.9
Romania	28.0	28.8	27.9	29.8	32.0	34.0	36.3	37.1
Slovakia	50.2	51.8	54.5	55.9	58.9	58.9	60.3	61.9
Slovenia	68.2	70.1	69.7	71.2	70.9	72.4	75.1	76.6
Hungary	59.6	59.4	60.5	64.1	66.6	66.8	68.1	70.1
Czech Republic	56.0	58.5	58.5	59.6	59.9	62.0	64.3	68.6

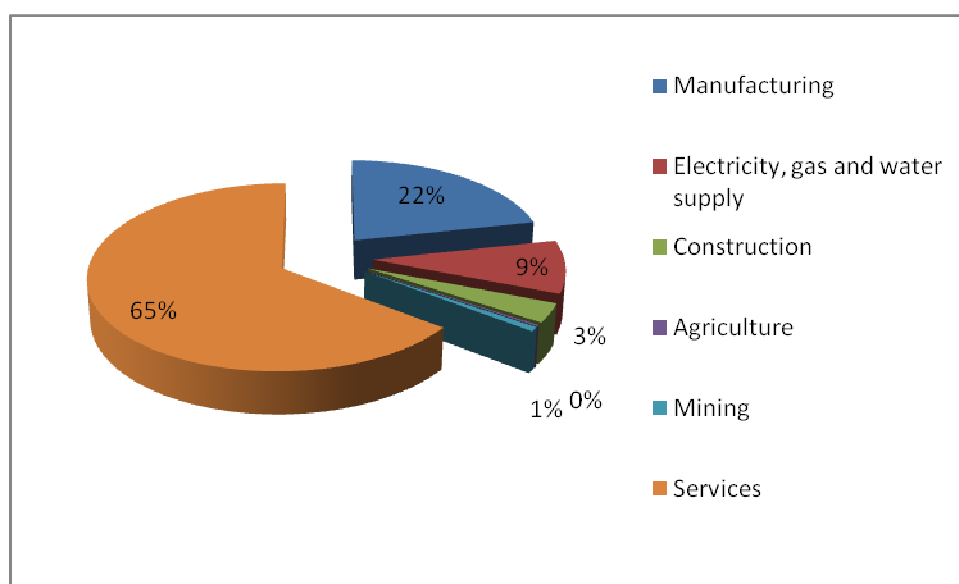
Source: Eurostat, 2007.

The evidence suggests that neither the size of the pre-accession financial facilities for Bulgaria, nor the FDI concentration by sector created sufficient absorption capacities in the national economy. Figure 4 and 5 further show that the majority investments and FDI inflows are concentrated in the non-industrial sector, creating circumstances for more many short-term speculative investments than industrial sector investments would have otherwise provided for.

Figure 4: Structure of investments in Bulgaria, 1998-2005, by sector, %

The increase in investments is in large part accounted for by an increase in FDI flows, as shown in Table 6. Approximately two-thirds of total FDI inflows were in the *services sector* of the national economy (Figure 5). It is more lucrative with higher returns and a faster rate of return on investment. The remaining one-third of FDI inflows have occurred primarily in the industrial sector, mainly in the *manufacturing* and *construction sector*. This distinction draws on an anticipated effect of investments for the host economy at large. Speculative investments are related to short-term capital flows. In certain cases, they have even the potential to be harmful to the economy, such as under circumstances of a global financial crisis with restricted bank lending. Non-speculative investments relate to long-term investment commitments that usually bear some strategic characteristics, such as in the manufacturing industry, construction, and some finance.

Figure 5: Structure of FDI flows in Bulgaria, 1998-2005, by sector, %



Source: Grigorova, V. (2007): FDI in Industry in Bulgaria, Sofia, BAS, p. 100.

Within the discussion of long-term non-speculative investments in the Bulgarian economy, the role of Greek FDI is important. Greece was the main country of FDI origin in 1996-2003. It is overall the third-largest foreign direct investor in Bulgaria over the period 1996-2008 with a 9.3%⁷⁵ of total FDI stock share (Table 9) while in some sectors, such as banking, this is rising to over 23% of FDI stock⁷⁶.

Table 9: Greek FDI flows in Bulgaria, EUR million, 1998-2008

Year	MEUR	Increase y/y, MEUR
1998	22.7	-
1999	2.3	-20.4
2000	105.8	103.5
2001	262.3	156.5
2002	240.1	-22.2
2003	198.9	-41.2
2004	179.6	-19.3
2005	324.2	145
2006	533.7	209.5
2007	801.1	267.4
2008	392.3	408.8
Total	3063.0	

Amongst the long-term Greek FDI are investments in steelworks and other non-ferrous metals by Sidenor SA/Viohalco SA for Stomana Industries SA and Steelmet AD, respectively (7.32% of total Greek FDI). OTE/Globul and Intracom Holdings are strategic investors in the telecommunications market with a share of some 48% of total FDI stock (43.27% of total Greek FDI stock).

⁷⁵ United Bulgarian Bank, National Bank of Greece Group (2007)

⁷⁶ Invest in Greece Agency

Other large non-speculative investments in light and heavy industry include Delta Dairy, Chipita, Coca-Cola HBC Bulgaria, Best Foods (food and beverages, 7% of total Greek FDI stock), Thrace paper mill (other processing, 7% of total Greek FDI stock), the Public Corporation of Greece (coal and mining), Titan SA (cement). A spread of FDI stock by sectors is shown in Figure 6.

Figure 6: Structure of Greek FDI stock in Bulgaria, by sector, %

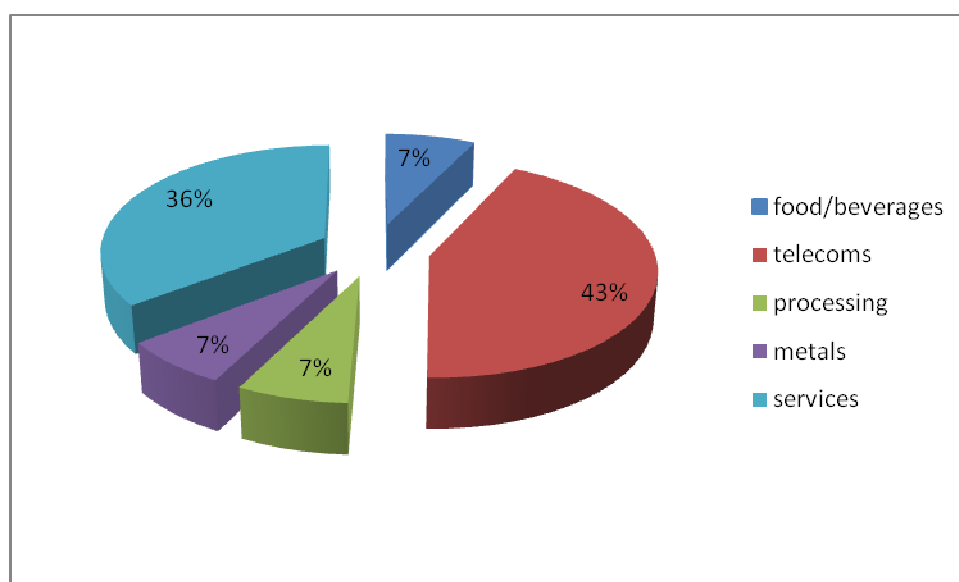


Figure 6 shows that almost two-thirds of total FDI stock is for long-term non-speculative, non-service sector investments, creating significant export capacities in the host country. Data from the bilateral trade turn-over further supports this claim. Greece has become Bulgaria's third-largest trading partner, whilst Bulgaria, the fourth-largest trading partner of Greece⁷⁷. In 2006,

⁷⁷ Bulgarian Statistical Institute

6.9% of total Greek exports went to Bulgaria (up from 6.3% in 2004). Imports from Bulgaria represented 1.6% of total Greek imports. Conversely, imports from Greece represented 4.9% of total imports (down from 5.7% in 2004) while exports to Greece represented 8.9% of total exports. These indices have continued to rise through to 2008. A possible external explanation for this (in addition to domestic policy-making devised to attract FDI) is the creation of export capacity through FDI in the host country's industrial sector. Over the period 1998-2008, of total EUR 3063 million of Greek FDI stock to Bulgaria, it is estimated that ca. 66% were made in industry (including telecommunications, or 25% excluding telecommunications)⁷⁸. This is equivalent to some EUR 2083 million in total or EUR 766 million (excluding telecoms) in net FDI flows to the host country for long-term capital investments.

5. Conclusion

This article discusses the dynamic between European integration and foreign direct investment in the industrial sector of Bulgaria, and the extent to which they have aided in the economic transition of the country. It took in turn into consideration the impact of financial instruments driven by the EU pre-accession and integration process, namely PHARE, the Europe Agreements and

⁷⁸ United Bulgarian Bank, National Bank of Greece Group

Phare, as well as the influence of what is considered an indirect impact of the EU accession process, FDI to the host country.

The analysis establishes a general relationship between European integration and FDI whereby the latter can be seen as incentivised by the progress of the former in the candidate state. The analysis also points out to exceptions to this pattern. Greek FDI appears to have followed both a European integration logic but also, critically, a logic of regional trade and cooperation as soon as growth opportunities arose in the transition market of its neighbouring state.

The direct effect of accession negotiations up to the state's accession has been weak, in some instances even negative. The indirect effect of the accession process, seen in the total volumes of FDI stock to the host country, has been more substantial. However, spread across sectors of the economy, it is clear that FDI to the industrial sector has received much less attention than the services sector, chief amongst which the real estate market and financial intermediation. In turn, FDI has impacted the creation of absorptive capacity for technology in the host economy modestly as evidenced by the comparative labour productivity growth index.

Notwithstanding the slow pace of economic progress in Bulgaria, Greek FDI has proven a significant source of investments in industry (both light and heavy). Nearly two-thirds of Greek FDI stock comprises long-term, non-speculative investments. This is markedly different from the general FDI stock pattern in Bulgaria where over 64% of investments have targeted the services

sector. In turn, regional trade between Bulgaria and Greece has recorded historical heights, even if there is still much potential to be spoken of. Importantly, the host country's export trade volumes vis-à-vis the investments geographic origin has grown in direct correlation. This had practical implications for the European integration of Bulgaria, too. With the advent of the EU accession of Bulgaria (and Romania) in 2007, the region of South-East Europe has generated renewed interest amongst foreign investors as a potential growth market with low political risk and significant economic stabilisation, indicating a generally positive impact of the process of European integration and FDI inflows on transition countries.

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