Bulgarian economic development and EU integration. How FDI and EU Structural Funds could help this process?[1]

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Abstract: *The aim of this research is to focus on Bulgaria's macroeconomic development as an EU Member State and to focus on the results, which Bulgaria has achieved during the process of economic catching-up to the other, more developed economies. Bulgaria's economic development depended and still depends on the inflow of fresh financial resources for restructuring the economy and deepening the process of integration with the other EU Member States. That is why the inflow of foreign capital in the form of direct foreign investments (FDI) has become one of the main tools for impacting and stimulating the industry and the services sectors in the country, both on a national and on a regional level. As a country suffering from a shortage of funding, Bulgaria is in need of significant investments in priority sectors of the economy. In this regard, what remains of crucial importance for the country is the utilization of financial resources under the Operational Programs (OPs) of the European Structural Funds (ESF), which emerged as almost the only source of funding for major projects of the Bulgarian economy and a means for addressing the country's lagging behind in different spheres of economic life in the years following the economic crisis. Thus, this research is aimed at showing the extent to which Bulgaria has managed to get closer to the level of economic development of the other Member States, and especially to that of the other Eastern European countries. This research aims to show how FDI and financing under the ESF have attributed to the economic development and growth of the Bulgarian economy.*

The first part of this research is dedicated to the presentation of the economic situation in Bulgaria, mainly in the period after the economic crisis, and the problems related to the economic catch-up. The second part tries to show the extent to which FDI and EU Structural and Investment Funds (ESIFs) have helped the process of economic

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development and growth in Bulgaria during the process of economic integration to the EU.

Keywords: *Macroeconomic development of Bulgaria, catch-up and cohesion of Bulgaria to the other EU countries, FDI, EU Structural Funds*

JEL Classiffication: *F15, E24, F21.*

Introduction

This research is concerned with examining Bulgaria's economic development and the opportunities for macroeconomic stabilization, especially after the economic crisis. The economic development of the country is an issue of high importance because, despite the significant differences between its economy and the economies of the other EU Member States, the country had to make significant efforts in order for its economy to catch-up to those of the other EU Member States. The catch-up was inextricably linked with the need to increase the competitiveness of the economy. Catching-up has proven to be a complex process, because after the economic crisis some countries within the EU registered higher rates of economic growth and were overcoming the imbalances caused by the crisis, while others failed to make up for the delays from both the pre-crisis and the post-crisis periods. As a new EU Member State whose economic development in the period of transition to a market economy was characterized by a number of economic, political and financial turbulences, Bulgaria made a number of efforts to overcome the imbalances, accumulated in the economy, in order to achieve cohesion with the other EU economies. In this respect, attracting FDI was one of the priority policies of Bulgaria as a country with a shortage of funding so that the process of cohesion could move forward. Another tool that significantly contributed to the financing of the economy was the ESF, which Bulgaria relied on for the modernization of the major sectors of the economy.

The main goal of this research is to reveal Bulgaria's potential for economic convergence within the EU. The extent to which FDI and ESF have managed to contribute to improving the competitiveness of the economy and the development of priority sectors in which the country has some relative advantages is examined.

With this goal in mind, the first part of the research presents the macroeconomic state of the Bulgarian economy as opposed to the economic development of the Central European countries and Romania. The characteristics of the process of economic convergence and catching-up of the Bulgarian economy are compared to those in the other new EU Member States. The second part focuses on the effects that the attracted FDI have had on the Bulgarian economy (both on a national and on a regional level) and the role of the ESF in the development of the Bulgarian economy.

The contradictory and difficult development of the Bulgarian economy and its economic convergence with the other EU economies

The macroeconomic situation in Bulgaria

The Bulgarian economy has gone through impressive changes during the economic transition from a central to a market economy. The years of the transition to a market economy were turbulent and characterized by extreme economic and political instability. The applied monetary and fiscal policies have guided the country's economic activity to the private sector, which became the central point of economic shocks and mechanisms. They had an impact on the entire economic and political system of the country.

The use of a "loose" monetary policy and weak banking supervision lay at the heart of a number of economic and financial shocks, which affected economic growth. The culmination of this inconsistent monetary and fiscal policy was the outbreak of the banking crisis of 1995-1996. Subsequently, the establishment of the Currency Board in 1997 stabilized the economic system, the payment system and the banking system.

Bulgaria's integration to the EU structures (on 1.01.2007) was a positive stimulus to the development of the economy. The economic growth was driven by private consumption, by investment activities, by the lowering of unemployment and by the increase in export. The stabilization of the Bulgarian economy happened also due to the favourable international economic environment and Bulgaria's integration to the EU structures.

In line with Currency Board arrangements, Bulgaria kept a strict financial discipline. The budget surplus was 3% of the GDP. Financial discipline allowed for tax cuts, aimed at the attraction of investments into the economy from local and foreign investors, and helped ease the burden of taxes on the population. Under the Currency Board, the lack of monetary policy was compensated by the accumulation of foreign reserves in the Bulgarian National Bank (BNB), which acted as a buffer against the occurrence of liquidity shortages or other external shocks.

The bank credits that were channelled towards the enterprises, contributed to the modernization of the industrial sector and the increase in production and job creation. Credits towards households led to the expansion of domestic consumption. The rising domestic demand pressures fuelled the inflation rate and the real appreciation of the Bulgarian currency against the euro. In the years 2005-2008, the economic boom was accompanied by an increase in foreign trade volume, during which the volume of imports exceeded that of exports. As a result, the negative trend in the balance of payments deficit deepened.

On average, the real economic growth was 5% annually in the years 2003-2008. The GDP growth, the increased consumption, the investment activities and the lower taxes influenced the appearance of a deficit in the current account balance and were associated with the loss of competitiveness of Bulgarian exports. The external deficit of the current account balance increased to double digit numbers in contrast to the GDP before the crisis. The deterioration of the current account balance exceeded the levels that could be explained by the economic catching-up to the other EU economies. The higher current account deficit was mostly financed by the inflows of FDI. After 2002, the volume of FDI entries increased in line with the rise in domestic consumption and FDI contributed to GDP growth. “High foreign capital inflows contributed to the overheating of the economy and sustained increases of fixed asset prices.” (*Macroeconomic Imbalances, Bulgaria, 2014*).

Bulgarian authorities have implemented policies, aimed at reducing budget deficits and public debt, as compared to other new EU Member States (the Czech Republic, Hungary, Latvia, Lithuania, Poland and Romania), which applied expansionary fiscal policies. In several new EU Member States the expansionary fiscal policies boosted GDP growth and led to significant structural budget deficits in 2007 *(ECB Monthly Bulletin, July 2010).*

The main concerns about the macroeconomic stability came from the growing current account balance deficit and the domestic credit increase, which risked exacerbating the internal economic imbalances. Similarly, before the crisis, the Baltic EU economies grew faster, often at unsustainable rates, which led to the widening of the positive production gap, which in turn fostered the emergence of internal and external imbalances. In fact, during the pre-crisis period Bulgaria experienced a period of very rapid accumulation of imbalances, related also to the economic reforms carried out in relation to Bulgaria’s EU integration process. The macroeconomic imbalances varied between the new EU Member States because of their very different economic cyclical positions, and their different levels of economic growth.

The economic crisis of 2008-2009, which dealt serious damage to the developed European economies, was felt in Bulgaria much later - when the orders from major trading partners ceased and the volume of FDI fell sharply. Businesses were forced to cut costs and maximum production, which led to higher unemployment and led to a reduction of domestic consumption and a reduction of domestic and foreign investments. Banks significantly tightened the conditions for granting credits to businesses and households, and the interest rates on loans increased significantly, leading to an increase in the indebtedness of businesses and households. The decline in bank lending and the reduction of investment led to a sharp drop in industrial production.

The economic situation changed significantly after the crisis. Economic growth fluctuated around 1% in the period after the crisis. Many sectors of the economy were recovering slowly due to the lack of investment, the weak demand for Bulgarian goods from major external contractors and the depressed domestic demand.

Unemployment had increased sharply, and remained two times higher than its pre-crisis level. Unemployment rose faster than the percentage of the contraction of industrial production. Mostly the under qualified and young workers were affected by the loss of these work places. In 2014 the number of employees between the ages of 15 and 64 amounted to 2.9 million people; compared to 2013, their numbers had grown by 1.3%. Employment had increased in all major sectors of the economy, with the exception of the trade and transport sectors. Although the unemployment rate began to decline in 2014, it remained high in comparison to the average unemployment rate in the EU (10.7% in 2014).

Inflation fell due to the contraction of domestic demand. The recent developments in the average annual rate of inflation have followed a downward trend, declining from 1.0% in May 2013 to a low of -2.1% in February 2014, after which it recovered to some extent, reaching -1.3% in April 2014 (*Convergence Report June 2014*). The deflation rate recently registered in Bulgaria reflected the still negative output gap, the depressed demand, the weak bank credits and the negative external price developments among other factors (See Table 1).

The weak domestic demand is still a key factor for determining the level of economic growth. In 2014 private consumption showed some signs of stabilization, thanks to the influence of factors such as the reduction of interest rates by the commercial banks and the decrease in the price of oil in 2015. The formation of gross capital has remained at the same level since 2009 (Table 1).

The current account surplus of 0.1% of the GDP recorded in 2011 shrank to a deficit of 1.1% of the GDP in 2012. This was due to the weaker exports in 2012 and the need for imports as a result of the execution of some major infrastructure projects. The trade deficit also faded and in recent years it has been hovering around 5%, due to the reduction in domestic consumption and industrial production (Table 1).

Table 1 - Main macroeconomic indicators for Bulgaria

Indicators*	2008	2009	2010	2011	2012	2013	2014*	2015
Real GDP growth (y-o-y) (%)	5.8	-5.5	0.7	2.0	0.5	1.1	1.4	0.8
Private Consumption (y-o-y)	3.7	-6.4	0.5	1.8	3.9	-2.3	1.4	0.8
Public consumption (y-o-y)	-1.1	-7.6	2.0	1.8	-1.0	2.8	2.1	0.2
Gross Fixed Capital Formation (GFCF) (y-o-y)	22.0	-17.4	-18.3	-4.6	2.0	-0.1	2.3	-2.3
Exports of goods and services (y-o-y)	2.5	-11.7	17.2	11.5	0.8	9.2	0.3	3.0
Imports of goods and services (y-o-y)	4.9	-21.5	4.1	8.5	4.5	4.9	1..2	2.0
Inflation (HICP) average (y-o-y) (%)	12.0	2.5	2.9	3.4	2.4	0.4	-1.6	-0.5
Unemployment rate (%)	5.6	6.8	10.3	11.3	12.3	13.0	11.7	10.9
Current account balance (% of GDP)	-23.1	-8.9	-1.48	0.1	-1.1	3.0		
Trade Balance (% of GDP)	-20.6	- 8.2	-2.48	-5.4	-2.70	-5.9	-6.9	

*Annual per cent change

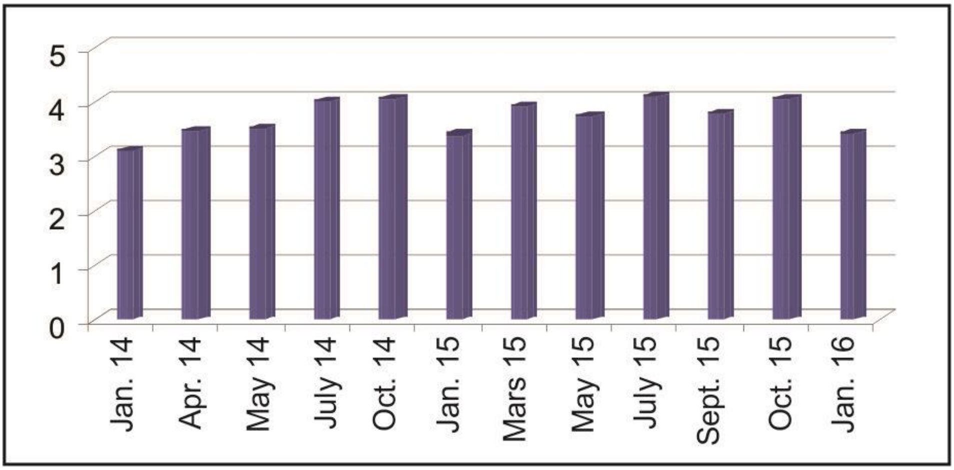
Source: NSI, BNB

The implementation of monetary policy, both in the beginning of the crisis and in response to the crisis, contributed to the differences between the new EU Member States. Bulgaria had a very limited number of possible responses to the economic crisis shocks, because it was impossible to carry out an independent monetary policy due to the Currency Board regime. In 2009 Bulgaria implemented fiscal measures by cutting expenditure and raising the collection of taxes for the purpose of containing the rise in budget deficits, and so did the Baltic EU Member States (Estonia and Lithuania).

As a consequence of the contraction in domestic demand, and given the high import content of some export-oriented productions, Bulgarian imports decreased after 2009. In Bulgaria and Romania in particular, as well as in the Baltic EU Member States, the fall in imports by far exceeded the decline in exports, thus leading to a positive contribution to the economic growth by the net exports.

Because of the high degree of openness of the Bulgarian economy, the impact of exports was important for the country's economic growth. Bulgaria, which was under the regime of the Currency Board, saw its exports decline, however, the firmly fixed exchange rate of the Bulgarian lev (BGN) towards the euro did not permit a sharp depreciation of the nominal exchange rate. Nevertheless, the cross-country differences in the impact of foreign trade could be partly attributed to differences in the exchange rate regimes. In fact, the EU Central European countries (EUCEC), where more flexible exchange rate regimes applied, did not see their nominal exchange rate fall as sharply. Perhaps as a consequence, between the 3rd quarter of 2008 and the 3rd quarter of 2009 Hungary, Poland and Romania saw a contraction in their exports that was relatively less sharp. By contrast, in the Baltic countries and Bulgaria, the fall in the volumes of exports was very sharp. "The rather sharp real depreciation may have helped countries with flexible exchange rate regimes to contain the decline in their exports" (*ECB, July 2010*).

Figure 1: Bulgarian exports, January 2014 - January 2016.
In millions of BGN



Those sectors of the Bulgarian economy that were oriented towards export overcame the effects of the crisis relatively quickly. Bulgaria took certain niche markets and restored its export earnings, especially after 2013. Exports from Bulgaria in the period between January 2014 and January 2016 on average amounted to EUR 3.7 billion. The export growth created the expectation that exports in particular would be what boost the economic growth.

Convergence or divergence of the Bulgaria economy to the EU

Bulgaria's economic growth is closely tied to the economic development of the EU. One of the main questions that arise is how Bulgaria dealt with real economic convergence .in the EU.

The Bulgarian government authorities had to also meet the requirements of Europe 2020 for smart, sustainable and intelligent growth. A series of reforms had to be made in order to increase the competitiveness of the economy, so as to promote and strengthen economic cohesion with other EU countries. In Bulgaria, similarly to the Central European countries, the increase of competitiveness in manufacturing and the implementation of reforms to strengthen state and municipal finances holds the risk of increasing the developmental differences between regions, while cohesion on the other hand means a uniformity of the economic development of the regions and an even distribution of the profits made as a result of the growth. Real convergence in the EU countries continues to be a determining factor for the economic strategy and policy of the new EU Members States, including Bulgaria, in the medium term. The main determinants of the dynamics of the convergence of prices are the rate of convergence of incomes, the increased domestic demand as % of GDP, and the exchange rate regime. In the short-term, factors such as the nominal exchange rate and its movements, the effects of changes in food prices and general global resources may temporarily divert the inflation trends, which support the convergence of prices. Some structural factors, such as trade liberalization and competition in the product markets may have similar effects. The equilibrium real exchange rate (RER) appreciation (price level convergence) was considered as a natural consequence of the economic catch-up (*De Grauwe and Schnabl, 2005*). The appreciation of the RER depends on the monetary policy and the exchange rate levels. The movement of the RER could be implemented by the nominal exchange rate and its appreciation and/or by the increase in domestic inflation.

At the same time, not all inflationary differences might be consistent with the need for ensuring the competitiveness and external stability of the economy in the medium term. In some Central European countries, unsustainable domestic demand caused higher inflation. The processes were fuelled by the overly optimistic expectations of economic agents or by the applied inadequate economic policies. Looking back at the price convergence over a longer period, the consumer price inflation in Bulgaria had been volatile, ranging from 0.4% up to 12.0% on an annual basis over the past ten years. The increase in inflation in the years 2004-2008 reflected the adjustments in administered prices, the harmonisation of the excise duties with the EU levels, as well as a series of supply-side shocks and increasing demand pressures. The sharp fall in inflation in 2009 was a result of lower commodity prices and the contraction in economic activity. In 2010 and 2011 inflation gradually picked up again, reaching up to 3.0% and 3.4% respectively, as a result of the higher commodity prices. The easing of commodity price pressures, combined with weak internal and external demand, resulted in the gradual decline in inflation in 2013 and the fall in deflation. Even though during the pre-crisis period inflation in Bulgaria was higher than the average level of inflation in the EU countries, the sharp inflation fall in Bulgaria came close to the trend inflation levels in the Eurozone during the post-crisis period. Thus, it can be argued that the Bulgarian economy has shown signs pointing towards a moderate level of economic convergence.

According to the report on the "European Catch-up Index 2016"[1], Bulgaria was at the bottom of the overall EU Member States' ranking. In terms of the category "economy" Bulgaria ranked 28th after Romania and Croatia. In terms of "quality of life" indicator, Bulgaria ranked 30th out of 35 countries under consideration. Montenegro which is an EU candidate country has more favourable position in this area. Czech Republic and Slovenia are already before Italy and Spain in quality of life, while Estonia and Poland occupy higher position in comparison to Portugal and Greece. Bulgaria occupied the 29th position by overall score among the 35 countries in the ranking, sliding down by one position in comparison to the 2011 Catch-up Index. Despite the fact that Bulgaria had been integrated in the EU structures for years, the country continued to lag behind the other EU Central European countries substantially throughout the process of catching-up. The catch-up process in Bulgaria was accelerated after the EU integration; however, the incomes continue to be far below those in the EU Central European countries.

This confirmed the tendency for an increasing divide between the West, the Central European countries and the countries in South Eastern Europe in terms of economic standard and accumulation of wealth. The Catch-up Index clearly shows the divergence between the economic and social development of the EU countries. Despite some positive signs, it will be really difficult for Bulgaria to overcome all the accumulated imbalances and to come close to the level of GDP per capita of Portugal, as is already the case in Estonia, Slovakia and Poland. Central European leaders reached the level of GDP per capita of Portugal, despite the fact that the income levels in those countries amounted to only half of the Portuguese level (Fig. 2).

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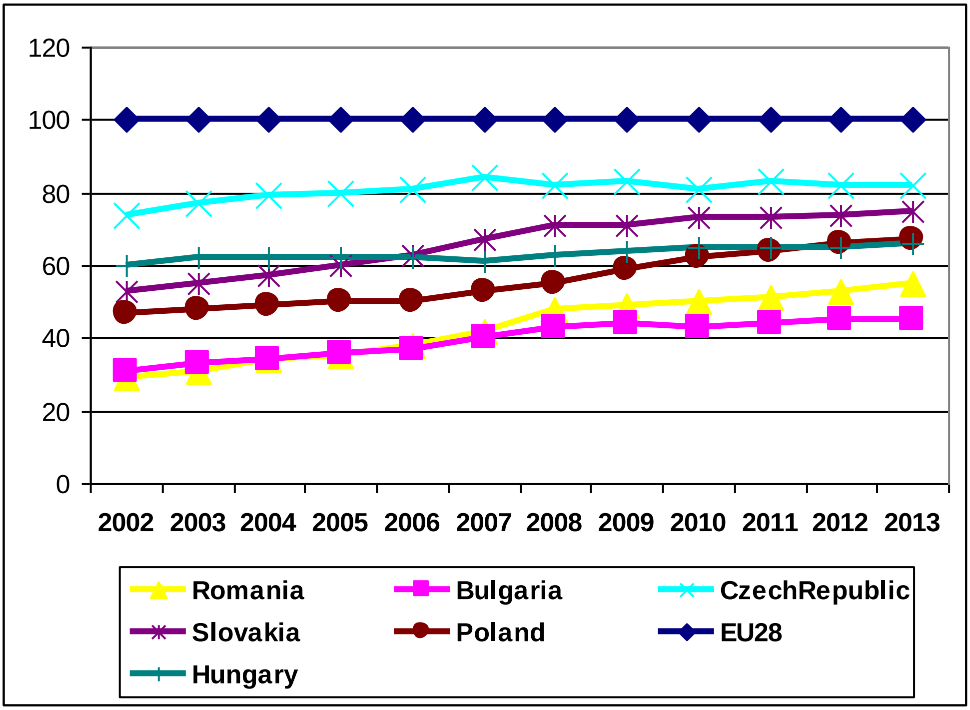
[1] The Catch-Up Index measures the performance of 35 countries, comprised of the 28 EU Member States and 7 candidate countries, including Turkey and Iceland and measures them across four categories: Economy, Quality of Life, Democracy and Governance.

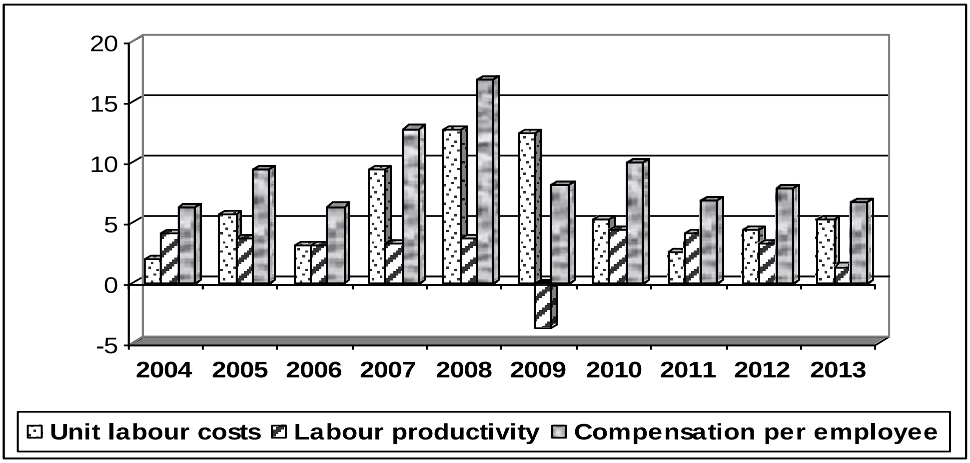
Figure 2: GDP per capita in PPS, EU-28 = 100



Source: Eurostat Statistics

The catch-up and convergence process cannot be considered as an automatic result of the integration of Bulgaria in the EU. Despite Bulgaria's efforts to struggle against the low level of economic development and to catch-up, the transformation of the Bulgarian economy towards becoming a competitive economy will take time and this process will depend on a number of economic and political factors. Bulgaria needs to enhance the standard of living, to modernize the level of production, the training of the workforce and their professional realization, to insure the financing of the economy and to invest in R&D innovation industries.

Fig. 3: Unit Labour Costs (ULC), Labour productivity, whole economy, Compensation per employee, whole economy of Bulgaria, annual percentage change



Source: ECB. Convergence Report June 2014, p.110. National Statistical Institute

Unit Labour Costs (ULC) can be considered as an indicator that describes competitiveness. It is known that labour costs should not increase faster than labour productivity on a permanent basis. Unit labour costs increased significantly after 2007, and then started to decrease. The growth of labour cost and ULC has slowed down in 2012-2013. In comparison to other EU Central European countries, the increase of wages in Bulgaria appeared high, even when they were adjusted towards the productivity growth. The slowdown was especially evident in the tradable sector of the Bulgarian economy. Nevertheless, wage growth remained somewhat higher than productivity, most notably in the services sector. “This higher growth could be harmful for cost competitiveness going forward, particularly as wage pressure in the non tradable sector can be transmitted to the tradable sector and increase overall price levels or squeeze profit margins.” (*Macroeconomic Imbalances – Bulgaria 2014, p. 17*)

Although the wages increased, their starting position was relatively very low. Bulgarian external competitiveness might be helped by having the still-lowest wage level in the EU in 2013. The average hourly labour costs in the EU-28 (excluding agriculture and public administration) were estimated to be €23.7 and €28.4 in the euro area (EA17). However, this average masked the significant differences between the EU Member States, with the lowest hourly labour costs being recorded in Bulgaria (€3.7) and in Romania (€4.6).

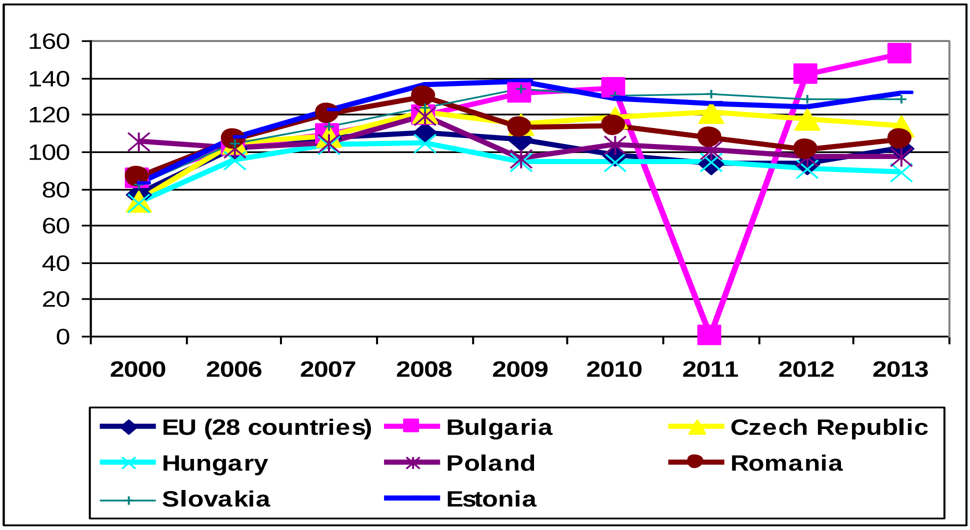
In purchasing power standards, the wages in Bulgaria amount to 37% of the EU average, making them on par with Romania. (*EC data*)

At first sight, the lower hourly labour costs in Bulgaria and Romania seemed to be at a strong competitive position in relation to other higher-wage EU countries. The level of productivity in Bulgaria is the lowest in the EU, with a nominal GDP per capita at 20% of the EU average, or 45% of the EU average when adjusted for purchasing power standards.

Competitiveness does not yet seem to be strongly affected by the ULC increases. Wage growth in the years 2009-2011 is not in line with the labour market equilibrium, as manifested by the rise in unemployment. In the future, wage levels will most likely converge towards the EU average and so will productivity levels.

The export performance did not seem to be harmed by the competitive factors, because Bulgaria maintained its market shares with the exception of the years during the economic crisis (2009). Nevertheless, while wage cost competitiveness deteriorated rapidly, other indicators of external competitiveness appeared more favourable. Notably, a solid rise in global market shares suggests that the rising ULC were compensated by non-cost factors like quality improvements and temporary factors like favourable export price trends in world markets. Non-cost factors have been shown to reconcile the gains in market shares and the losses in cost competitiveness. The ULC-deflated real effective exchange rate (REER) of Bulgaria appreciated.

Figure 4. Real effective exchange rate - 37 trading partners of Bulgaria, Romania, Estonia and CEEC. (2005=100)



Source: Eurostat

The REER (*according OECD measures*) are often used as measures of international prices and cost competitiveness. They are an indicator, which captures broad macroeconomic developments in the exchange rate and prices or costs, and provide a comprehensive assessment of the international pressures on domestic firms over the medium term in terms of costs (prices). The trend of improvement of the REER, deflated by harmonised index of consumer prices (HICP), has been continuing since the beginning of 2009. Positive developments were observed as compared to both the rest of the EU-27 and the Central European EU countries. The rate of the REER in 2010 indicates 0% compared to the rest of the EU-27 and 3.3% real depreciation compared to the CEE countries (*BG Competitiveness Review, 2011, p. 9*). The evolution of the REER shows some improvement in competitiveness and suggests that this development would contribute to the process of economic convergence. In this respect, improving competitiveness remains one of the main objectives of the Bulgarian economy and is seen as a way to improve growth. Therefore, the role of FDI and the ESF, as mechanisms that would enhance investment in the economy and ameliorate economic growth, should also be taken under consideration.

FDI and EU Structural funds in the Bulgarian economy. Do they contribute to economic growth and convergence?

Foreign direct investment remains a key source for the funding of future economic development.

FDI was one of the main driving forces behind the financing of the economy and the growth in the country. The domestic savings were insufficient for an expansion in the investment activity of companies. FDI were particularly useful for Bulgaria because the underdeveloped capital market did not allow for the possibility of attracting savings nor did it allow for the possibility of attracting local smaller scale investors that would increase the amount of investments. The inflow of FDI in Bulgaria was beneficial for the economy as a whole and in particular for industries such as manufacturing, in which FDI contributed to the increase of productivity and the improvement of the conditions for export. FDI used to be a source of funding for Member States in which domestic savings were limited, such as Bulgaria. FDI are considered to have an important impact on the economy, on the catching-up process, and on the increase of competitiveness of the economy. For the emerging economies, FDI has significant advantages over equity and debt capital inflows. The role of FDI in domestic business encourages the transfer of advanced technologies to the host country, and it fosters human capital development by providing employee training. It also strengthens corporate institutions by exposing host countries to the developed economies' best business practices and corporate governance. This was thoroughly explained in the economic literature on the topic in the works of Dunning J.A. Caves R.E. et al.

The improvement of competitiveness and unit labour costs changes are among the drivers, paving the way for FDI entry in an emerging economy. The relatively low labour costs are one of the prerogatives for the attraction of vertical FDI and this motivates the transnational firms in their choice of foreign destination. The openness of a small economy and the increase of export share in GDP positively influence the net inflows of FDI. The main factors which the transnational firms have to take into account when choosing one destination over another are the cost of the production, the possibility to expand towards other neighbouring destinations and the internal economic and political stability.

From a macroeconomic perspective, FDI are considered to be more stable than other types of capital inflows. Equity and short-term debt in particular tended to be highly unstable and with speculative tendencies, especially during the economic crisis. The relative stability and long-term nature FDI make it the preferred source of foreign capital for many emerging economies, including Bulgaria.

The integration of Bulgaria to the EU structures decreased the investment risk and thus boosted FDI inflows in Bulgaria. In the years 1996-2008, FDI in Bulgaria amounted to EUR 33.71 billion. Before the crisis, Bulgaria's net inflows of FDI were high and were still increasing. The FDI stocks were larger compared to those in other new Member States. Most of the Bulgarian inward stocks of FDI were accumulated in the years 2005-2007.

An important share of FDI went into real estate property purchases. The last strong inflow in real estate was in 2009, when the sector attracted over 20% of the total FDI. The rapid growth of FDI stocks resulted in an overheating of the economy, as the prices of fixed assets in the above mentioned sectors increased. The FDI inflows in those sectors gained world market shares in the tourism services.

Reinvested earnings appeared in the statistics. They demonstrated the real investment process and the absorption potential of the Bulgarian economy. The build-up of Greenfield investments led to the creation of new facilities in some sectors of the economy.

A limited part of FDI stocks have been invested in the industrial sector. Some investments have been made in the automation industries, in the production of electrical systems for the automobile industry and in electronics. There was also a slow increase in FDI in the steel industry and in textile production. The transfer of business processes by foreign companies (outsourcing) in Bulgaria changed the structure of the industrial production and services sectors. FDI entered the field of marketing services through the process of assembling computers and software, through information and communication technologies (ICT), machine-building, electrical engineering and electronics.

Medium scale foreign companies entered the ICT sector. Bulgaria became an attractive destination for foreign companies, which benefited from low costs and a qualified work force (12 large-scale Bulgarian software firms and 200 small firms in the ICT sector were operating their business in Bulgarian).

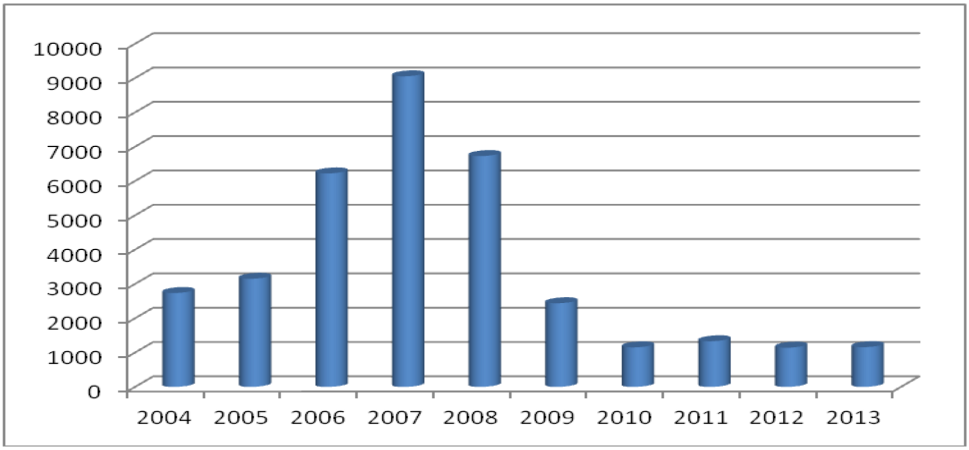
Most FDI before the crisis were concentrated in the non-manufacturing sectors of the economy (especially in the real estate and construction sectors), which in turn led to an unhealthy growth in the field. In comparison, other countries such as the CEE economies (the Czech Republic, Slovakia, Poland and, to a lesser extent, Hungary) attracted FDI, which were concentrated in the export-oriented part of manufacturing. In this way, the manufacturing capacity of these countries was reconstructed and expanded.

The development of outsourcing was quite positive, despite the fact that the uncertainties remained when it came to the stability of these kinds of investments. It is well-known, that this type of investment is flexible and is dependent on the strategic plans of the foreign firms. The foreign firm could decide to move the business to other destinations in search of efficient low costs markets.

Bulgaria was on the radar of global value chains, operating in the field of the automotive industries, when the French group "Montupet" opened a production chain for spare parts for the automobile industry. FDI has been distributed unevenly throughout the economy. Foreign investments in industries, requiring higher added value production have been scarce.

The economic crisis severely hit the FDI volumes entering Bulgaria. FDI started to slow down after 2007. FDI had decreased by 72% in 2007 –2008. In 2010 the annual amount of FDI was 1/8 of the amount of FDI in 2007 (Fig. 5).

Figure 5. FDI inflows by years 2004-2013. In million of EUR



Source: BNB

In connection with the above data, the drop in FDI inflows to Bulgaria was sudden and deep and was mainly due to the combined impact of several factors. Firstly, mostly small foreign companies (with some exceptions) came to Bulgaria and they limited their activities, because of the lack of liquidity and credit lines from their banks. Secondly, the change in attitude towards new commercial and investment transactions by international companies stopped because of the economic crisis and the foreign investors began to redefine their strategic plans. Thirdly, foreign investments decreased due to the uncertainty over funding opportunities and the economic recession, despite the measures taken by the Bulgarian government in order to overcome the difficulties in connection to payments for the small and medium enterprises (SME).

Reduced FDI, combined with the increase in interest rates by the BNB, led to the decrease of the credit lines for firms and to a slowdown of domestic demand. The contraction of the credit lines and the drop in foreign investments led to a slowdown in the economic growth and to the deterioration of the catch-up process, which had already started.

The drop in FDI that followed due to the impact of the economic crisis was accompanied by a contraction in imports and exports, indicating the reduced investment activity in the main sectors of the Bulgarian industries. Up until two years ago, it was considered that the drop in FDI inflows would have a sharp adverse effect of the ability to finance the current account of balance of payments and it was a prerequisite for the violation of the macroeconomic equilibrium The current account deficit of the balance of payments contracted sharply because of the decrease in Bulgaria’s exports and the imports.

The reduction of FDI during the medium term led to serious problems for the Bulgarian economy; the export-oriented sectors and the labour market in particular, where the unemployment increased, were negatively affected. The inflow of fresh capital in the country created difficulties in an economy where the resources to generate internal investment financing were scarce.

After years of slumps, FDI in Bulgaria started to increase in 2013 when they amounted to EUR 1275.1 million, going up from EUR 1141.7 million in 2012 (BNB). In 2014 (January-July) foreign investments amounted to EUR 1070.8 million or 2% of the GDP (BNB). The main part of the FDI came in the form of “other capital” and amounted to EUR 623.5 million. Intercompany loans, provided by foreign companies to their subsidiaries in Bulgaria were classified into this category. The equity capital since the beginning of 2014 amounted to EUR 107.9 million compared to EUR 560.4 million for the same period in 2013.

In the short term, foreign investments in Bulgaria were mostly export-oriented and were concentrated in high-tech manufacturing and services, such as automotive production, ICT and electronics, medical and electrical equipment, as well as outsourcing. In 2013 the investment certificates issued by IBA increased by ½ in comparison with 2012. The number of these certificates was 15, which corresponded to the creation of 1000 new job positions. The largest foreign investors in ICT and business process outsourcing (BPO) in Bulgaria in 2013 came from the USA and Great Britain. There was a redirection from IT support and call centres to the development of more diverse services with more highly qualified workers and more added value products. FDI remained important for the modernization of the Bulgarian economy, but in the post-crisis period their impact and structure was changing. There was some trend of change in the role of FDI as a source of know-how, new technologies and new management practices.

In the years 2010-2013, the accumulated FDI amounted to EUR 4.9 billion. The largest amounts of FDI stocks were invested in manufacturing (34%), in the electricity, gas and water supply sector (32.09%), and in mining and quarrying (11%). Financial intermediation's share of the total FDI stocks was 7%. The rest was split between the trade, transport, construction and agricultural sectors. After the drop in FDI during the crisis and in the post-crisis period, those economic sectors, which had not attracted significant FDI in the past, including education, social care and health care, continued to lag behind and were in the most need of financing and modernization (Table 2).

Table 2 - FDI by sectors of the economy, 2010-2013. In million EUR

	2010	2011	2012	2013
Total FDI	1,151,2	1,330,2	1,141,7	1,275,1
Health and social work	-10,6	-3,6	9,2	0,8
Financial intermediation	202,8	257,2	-158,1	42,7
Other community, social and personal activities	-45,9	140,8	0,5	69,1
Manufacturing	541,8	283,5	529,8	302,5
Hotels and restaurants	51,7	141,2	65,5	3,2
Real estate, renting, business activities	-16	-251,8	-443,3	-80,7
Education	0,7	0,9	0,7	0
Transport, storage, communication	57,9	203,1	-363,6	436,5
Electricity, gas, water supply	324,6	450,7	737,1	59,6
Fishing	0,1	5,6	2,2	0,4
Construction	110,2	-90,5	254,8	46,9
Not allocated	88,7	8,9	6,5	171
Agriculture, hunting, forestry	0	13,5	5,8	-8,3
Wholesale, retail trade, repairing	-190,5	38,1	262,,8	105
Mining and quarrying	35,7	150,4	231,7	105

Source: BNB

Before the crisis, a significant share of FDI went into construction, real estate and tourism, which led to the "inflation" of the speculative bubble of real estate prices. As a consequence of the crisis, house prices fell by about 40% and about 1/3 of the workers in the construction sector lost their jobs. This further increased the need for FDI in the post-crisis period. A positive trend in the post-crisis period was the increase in foreign investment in the "industrial production" sector, which made foreign investment capital more balanced and more favorably distributed within the economy. Energy was one of the sectors which attracted 21% of the FDI. However, problems with the pricing of energy raised a number of questions about the profitability of this production (Table 2).

FDI in the real economics sector were beneficial for enhancing the competitiveness of the economy and for the modernization of production. Investments in manufacturing contributed to the amelioration of the competitiveness of this sector and increased the country's export performance, which had been the only driver of growth after the crisis. Export was undoubtedly an essential factor for the recovery of the Bulgarian economy. In the second quarter of 2014, in real terms, the export of goods and services was already above its peak from six years ago. However, the export of raw materials reached 40% of the total export of goods and in 2014 it remained almost unchanged from its levels at the beginning of 2000. The big share of raw materials in the export structure is a problem because there are no conditions for the creation of new jobs. It might be a sign of the lagging behind of the economy.

The Bulgarian regions[1] in line with the volume of the GDP are amongst the least developed in the EU-28. The GDP on PPS per capita is nearly 50% of the EU average. The GDP per capita is a little bit higher in Romania. Respectively, the GDP per capita on PPS in the different regions of Bulgaria are also lagging behind the EU average. In some Bulgarian regions - North West Region (NWR), North Central Region (NCR) and South Central Region (SCR) - the GDP per capita is at about 30% of the EU average (NSI). The GDP per capita in the NWR is the lowest, making this region the most underdeveloped amongst the EU regions.

The North Eastern Region (NER) and the South West Region (SWR) have a relatively better standard of living and have more opportunities for production and more services facilities. The SWR, which reaches nearly 70% of the EU average, continues to be the leading region in Bulgaria.

As it was shown, labour productivity in Bulgaria is at the level of 41.5% of the EU average. In terms of this indicator, the country is lagging behind Romania, reaching 47.4% of the average level in 2010. The difference between the Bulgaria and the Czech Republic is even greater (71.8% of the EU average in 2010), and that between Bulgaria

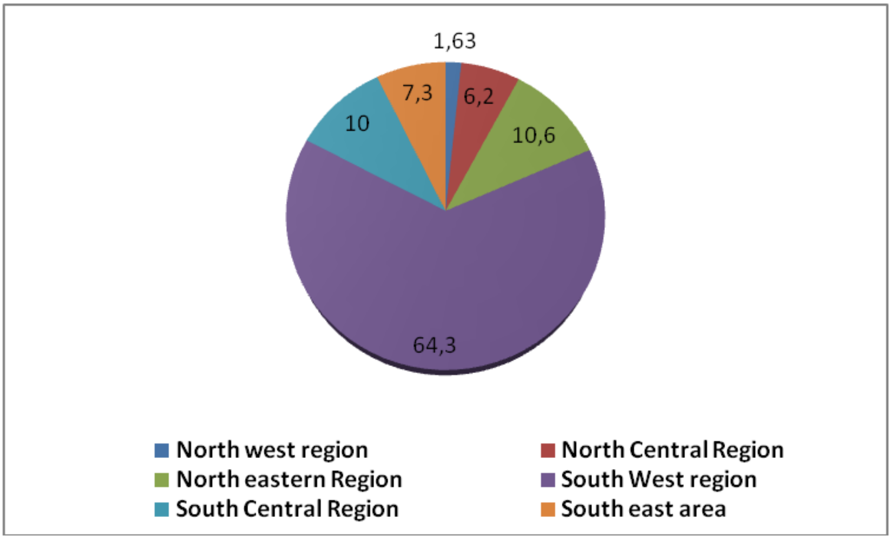
[1] Bulgaria is divided into 6 districts (NUTS2), 28 administrative areas (NUTS3) and 264 municipalities (LOM1).

and Denmark exceeds the average level of EU countries in terms of this indicator and is even greater (109.1% in 2010). The gross value added (GVA) of Bulgarian regions are among the least developed in the EU. The disparity between the regions in Bulgaria can be seen in the GVA, which varies from 0.46%, produced in the frame of NWR to 2.73% produced in the SWR. The low value added produced at the regional level demonstrates the differences in the size and performance of the industrial structure and services of the created GVA.

The main socio-economic problems, which are evident at the macroeconomic level are concentrated at the regional level. The development of regions has to overcome demographic, educational and medical problems, as well as the need for modernization of the basic infrastructure, the amelioration of competitiveness and the widening of the positions on the international markets for goods and services. A major problem of the economic development of the regions is the quality of human resources. The detailed analysis reveals there are people who have been unemployed for a long period of time, there are young people, and there are discouraged workers.

The basic characteristics of regional development predetermine the FDI entry at the regional level. The differences in the attraction of FDI are easily seen. In the years 2000-2006 the most important part of FDI was channelled towards the SWR, compared to the poorest regions, where FDI have been meaningful (Fig.6).

Figure 6: Average FDI stocks 2000-2006 by statistical regions



Source: National statistical data; own calculations

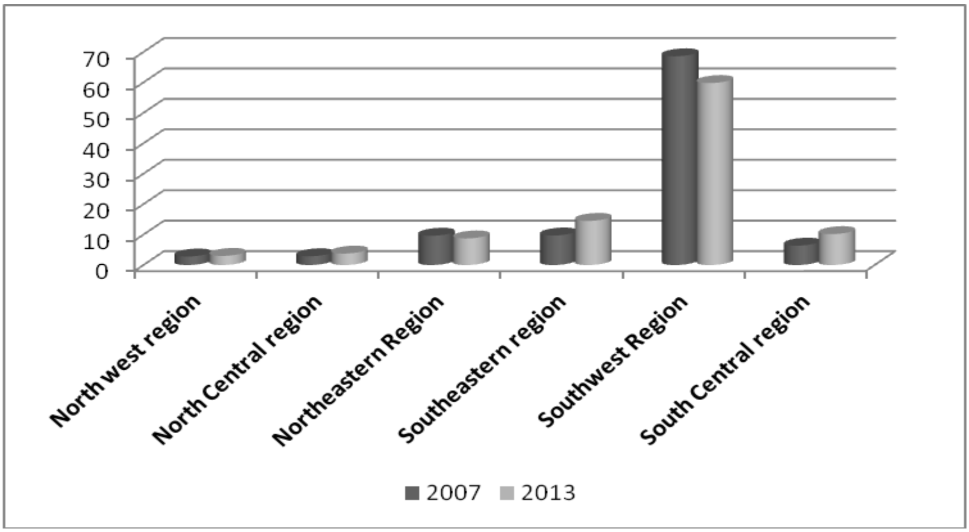
The same trend was observed during the crisis and in the post-crisis period, when FDI played an important role for the SWR. In the recent years, FDI entry was increasing in the SER and in the SCR of Bulgaria. FDI in the NWR and NCR continue to lag behind the other regions (Table 3).

Table 3 - FDI in non-financial enterprises for the period 31.12.2007-31.12.2013, in % of the total annual FDI stock

Statistical regions	2007	2008	2009	2010	2011	2012	2013
Total	100	100	100	100	100	100	100
North West Region	2,8	2,52	2,43	2,3	2,5	2,6	3,0
North Central Region	2,9	4,2	3,7	3,7	3,7	3,8	3,8
North Eastern Region	9,6	10,7	10,2	9,5	9,3	9,2	8,7
South Eastern Region	9,7	8,5	9,1	12,3	13,6	13,1	14,5
South West Region	68,6	67,0	67,9	64,6	62,0	62,0	59,8
South Central Region	6,4	7,0	6,7	7,5	8,8	9,3	10,2

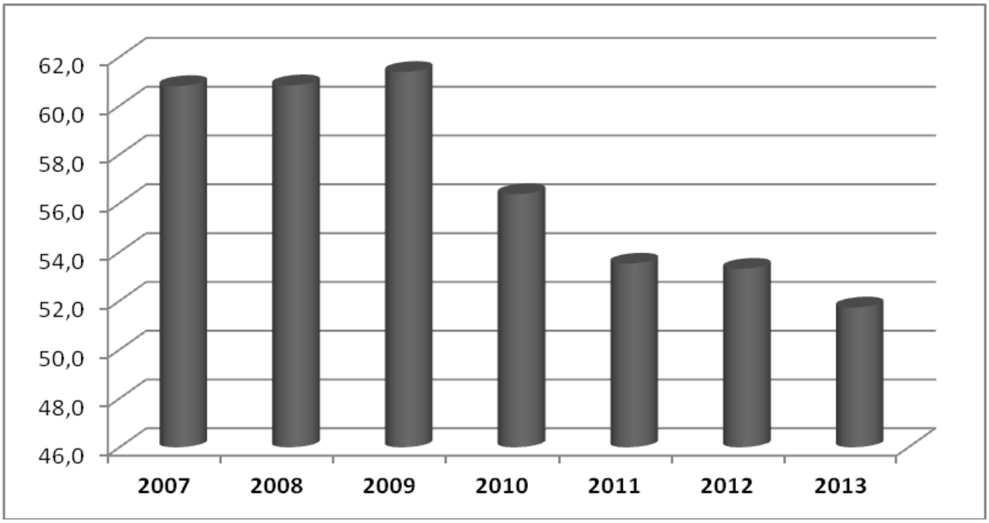
Source: National statistical data; own calculations

Figure 7: FDI inflows by regions in millions of EUR in 2007 and 2013



More than the half of the FDI stocks in the non-financial sector were concentrated in the big cities (Varna, Burgas, Plovdiv) and the leader in this field is Sofia (the country's capital). The big cities in Bulgaria attracted 80% of the total stock of FDI. The accumulation of FDI in big cities is explained by the fact that there are concentrated institutions, business organizations and a qualified labour force. The lowest FDI were recorded in Silistra, Montana, Kustendil and Vidin, where they amounted to 0.1%, 0.1%, 0.2% and 0.3% respectively. Among the most important reasons for the weak and almost inexistent interest of the foreign investors have been the structural imbalances in the regional economy, such as the long term unemployment, the inflexible labour market, the impoverishment of the population due to the destruction of enterprises, either because of closure and bankruptcy or as a result of privatization. Many of the privatized enterprises were destroyed, which had a strong negative impact on social and economic relations at the regional level. The NWR was hit particularly hard. The job losses created tremendous economic and social problems, which cannot be overcome with the penetration of some limited volumes of FDI. The problems of the regions must be resolved on the basis of targeted domestic investment and by the creation and the facilitating of the development of small and medium-sized enterprises that provide goods and services, starting from the natural and structural characteristics of the region. The differences between the urban agglomerations and the rural zones are increasing.

Figure 8: Annual inflows of FDI in Sofia (the capital of the country) in the years 2007-2013, in % of the total FDI stocks



Source: National statistical institute; own calculations

Another weakness of the Bulgarian economy with an impact on the regional level was the high indebtedness in the real estate and construction sectors, which will continue to burden the pace of economic recovery in the short- and mid-term plan. There is a significant improvement in demand in the agricultural sector, the export-oriented part of some sectors, the business services and the industry. However, they are more willing to rely on inter-company indebtedness rather than increasing their exposures to banks. The post-crisis economic environment is characterized by a greater complexity and a more limited supply of capital.

The speed of absorption of FDI in the economy is very important for economic growth. The absorption capacity of the economy is an indicator of the capability of the domestic industry to launch new products, to improve the production of certain goods, to increase the quality and to adopt more advanced technologies. By quickly absorbing the increased domestic and foreign investments, the countries benefit from the economic growth in the short run.

The penetration of ICT companies and the increase of FDI in manufacturing in the medium term will have a positive impact on export-oriented sectors.

FDI have a macroeconomic effect, because of their contribution to covering the deficit of the current account of the balance of payments, which is too high, standing at 21,6 % of the GDP in 2008. This is mainly pursuant to the deficit in the balance of payments, as a result of the imported energy sources.

Meanwhile, the deficit in the current account of the balance of payments has been reduced due to the decreased volume of imports and exports as a consequence of less economic activity on the part of Bulgaria's main trade partners (and especially Germany and Italy) due to the economic crisis.

The FDI, accumulated in Bulgaria and the FDI structure reveal a growth in the activity of the foreign companies in Bulgaria in relation to the economic development and the diversity of the economic life. In some sectors of the economy in Bulgaria there are strategic investors. Most foreign companies in Bulgaria are small and medium enterprises (SME), incorporated on the grounds of purchasing share capital or .Greenfield investments. The main aim of the comparatively smaller companies is to find domestic funding and FDI, thereby creating new opportunities for production and exports.

Relatively smaller companies with foreign capital from Greece, Turkey, Germany, etc. have come to Bulgaria. There is a high concentration of foreign capital in the light industry and services, due to the quick return on investments.

A characteristic feature of foreign SME is that they are concentrated in the sphere of trade and services, because they do not require considerable investments.

In general, the foreign investors have managed to meet their objectives on the Bulgarian market and to implement their localization strategy, maximizing the profits on the basis of low labour costs. The reduced investment risk and the legal framework of the foreign investments influence the reorientation of the foreign companies in Bulgaria from market searching to looking for export-orientated companies.

The favourable development of the foreign companies localized on the Bulgarian market does not always mean that their presence has a positive effect on the economic development of the country.

The data on the remuneration of the staff in the foreign company do not reflect the real market level and the costs per labour unit. The foreign investors benefit from their localization on the Bulgarian market because they are using the lowest remuneration rate in Europe. They have also adopted the vicious practice of saving money by not paying the social and insurance contribution to the state and, in most cases, pay salaries “under the counter”. The salary levels in the industrial sector were lowered, while the salaries of the management staff became higher. After the removal of the quotas for the textile industries, the small companies with foreign capital, working mainly on a customer-made trade basis and being of no importance to the economic development, were expected to withdraw from Bulgaria.

Although their activity helps reduce unemployment in the border areas in Bulgaria, the labour conditions and the remuneration remain too low. The establishment of such firms does not entail economic development.

Therefore, attracting strategic investors and investments in modern technologies remains of vital importance for the country. The economic development and the attracting of quality FDI are based on Bulgaria’s new competitive advantages, because the low labour costs are not a sufficient advantage and do not meet the economic and social goals of Bulgaria as an EU Member State, aimed at improving the economy, the income level and the standard of living.

The entrepreneurship in Bulgaria is twice as low as the average level in the EU. In general, the companies in Bulgaria intend to stay on the market and they have fewer opportunities to invest in innovations. The relative share of the innovative enterprises makes up approximately one quarter of the innovations in EU. It is the reason why inflows of FDI remain to be the main source of technological innovations.

Despite the fact that most foreign companies localized in Bulgaria state that they would invest in new equipment, in practice their activity is reduced to the import of machines and equipment, not suggesting any economic activity to be carried out. The fact that most of the Bulgarian industries with foreign capital have a low level of technologies and the share of the hi-tech products remains comparatively low is indicative.

Because FDI are concentrated in the big cities, with an available labour force, in smaller towns and villages FDI cannot contribute to overcoming unemployment and to keeping the inhabitants in their places of birth, which undoubtedly affects and increases the intention for emigration of the young generation.

The prospective development of FDI in Bulgaria will continue to be dependent on economic and political factors. There is a new wave of slowdown in the contraction of investment activity in the South Eastern part of Europe, and the reasons for this are various. Firstly, the economic indicators of the developed European countries show signs of improvement and secondly, the recovery in the Western part of Europe is on its way, even with the influence of the effects of the sovereign debt crisis. This boosts the entry of FDI, especially in Germany.

The situation in Bulgaria is entirely different. Foreign investors in Bulgaria continue to be cautious and to estimate the investment risk. Among the main factors are the war on the territory of Ukraine and the sanctions imposed by the EU on Russia. The embargo on the import of foods from the EU and other countries that have introduced sanctions against Russia reduces the economic growth of both Russia and the producing countries. This inevitably leads to a delay or postponement in the investment plans of Russian companies and individuals in Bulgaria. .The war against terrorism and ISIS also lead to the restricting of foreign companies and global value chains in order to increase investments in Bulgaria.

EU Funds in Bulgaria

The EU structural Funds were of crucial importance like an important financial instrument for economic development at the macroeconomic and at the regional level. The principles of cohesion and solidarity are written into the Treaty of Lisbon and constitute two of the most important pillars for the integration of the EU countries and Bulgaria. The Treaty reaffirms these principles and stipulates under article 174 that "in order to promote its overall harmonious development, the Union shall develop and pursue its actions leading to the strengthening of its economic, social and territorial cohesion". In particular, the Treaty stresses that "the Union shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions" (*European Structural Investment Funds, 2014-2020*).

The EU's structural policies aim to reduce the disparities between regions and to create conditions for better employment of the population, for cohesion, economic development, social inclusion and equal opportunities for people. The EU Cohesion Policy and in particular the ESIF should support the implementation of the investment programs for economic recovery and the creation of jobs for highly-qualified people. The

European Cohesion Policy is built on the basis of the partnership principle, which implies the full involvement of the social partners in the management of the ESF through a real consultation.

Hence, the ESF are instruments of the EU's Cohesion Policy that aim to counterbalance the regional disparities by specifically investing in regions and countries that lag behind in economic development and performance. In order to respond to the requirements of the EU Cohesion Policy, two types of regional financing have been introduced. The SF Convergence objective (CON) covers the regions that have a GDP per capita below 75% of the EU average and aims to accelerate the economic development in these regions. The Regional Competitiveness and Employment objective (RCE) is comprised of all other regions above this threshold and seeks to reinforce the competitiveness, employment and attractiveness of these regions (*http://ec.europa.eu/regional_policy/).*

Five main Funds function in order to promote the economic development across EU-28 for the accomplishment of the main goals of Europe 2020 and the total funding from the ESIF for the period 2014-2020 amounts to an average of EUR 416.5 billion. The amount designated toward the Cohesion Policy amounts to a total of EUR 325 billion, which includes The European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund. Funding under the European Agricultural Fund for Rural Development (EAFRD) is part of the Common Agricultural Policy (CAP) Pillar II - Rural Development Policy, which amounts to EUR 85 billion. The European Maritime and Fisheries Fund (EMFF) is part of Common Fisheries Policy for which EUR 6.5 billion are provided. The above mentioned funds form the ESIF, which are commonly regulated under the Common Provisions Regulation rule. The financial assistance from the ESIF for CEE could become a stimulus, similar to the Marshall plan for Western Europe after World War II. The total budget for the Cohesion Policy 2014-2020 which is implemented by the ESIF was fixed in December 2013. „The amount for 2014-2020 is 1.3 % higher than in 2007-2013. However, when adjusted for changes in the price level, the amount would be 8.5 % lower."(*Jedlicka J., Rzentarzewska K., March 2014*).

The ESIF of the EC constitute the foundation on which to construct a strategy for economic growth in the EU and decide in which directions the investments will be directed. The ESIF form the basis of public investment in the EU. In the period 2014-2016, they contributed to public investment by an average of 14%, while in other EU countries their share reached 70% (*European Commission, 14/12/2015*). The European Development Fund is used by the beneficiaries for investments, oriented towards the reduction of economic and social imbalances between the different regions. The investments allocated towards the build-up of funds for the implementation of infrastructure projects and for the provision of basic services, as part of the development of European industries, such as transport, energy, education and others. The aim of the

EU Social Fund is to promote employment, labour mobility and to combat poverty and indebtedness. The Cohesion Fund is used to support the European transport networks and the economic development of regions and countries with a GINI coefficient of less than 90% of the EU average. Bulgaria is one of the countries eligible under this fund together with Romania and the other new Member States.

It is planed that by 2023 major amounts of investment will be allocated under these funds, wherein the main priority will be the investment of resources for the modernization and development of the real sector, in connection with the main appeal of the European Commission for promoting the role of industrial production as one of the key factors in achieving sustainable growth.

The main direction in which the EU funds are being channeled is for investments on the micro economic level – in structurally significant enterprises, whereby the aim is to achieve the following objectives: improving competitiveness, developing the production of goods with high added value, expanding foreign trade niches and creating new work places. The construction of a European industrial base that meets the requirements of the modern digital industry requires investment in human capital and especially in young people - in their education and training.

Investments in infrastructure contribute to improving the living standards of the population and increasing the competitiveness of business economics. This is particularly important for Bulgaria but also for other relatively economically backward EU Member States who make significant efforts in their economic catching-up with more developed EU countries.

In order to better implement the goals that could be implemented by the use of the EU SFI, the EU defined 274 regions, based on population. Three categories of regions were identified: a) less developed regions (GDP per capita less than 75% of the EU-28 average); b) transition regions (GDP per capita between 75% and 90% of the EU-28 average); c) more developed regions (GDP per capita greater that the EU-28 average). The Bulgarian regions are classified in the first group, because even the South West Region is below the EU average GDP per capita. The funding for each region depends on its classification, with more financing being made available for the less favoured and less developed regions. Taking into account the fact that in absolute figures the largest amount of funding has been allocated to Convergence regions, SF can be regarded as a major financial input for narrowing the economic and social gap between advanced and less developed regions. While the SF is part of the EU budget, the spending of this funding is based on the system of shared responsibility between regions, national governments and the EC.

The funds are channelled through Operational Programmes (OP) that cover the policy priorities selected by the respective countries and/or regions. Depending on the country's specific administrative structure and the degree of centralisation of regional policy-making, the OP can be formulated at the level of NUTS 1 regions, NUTS 2 regions, or at country level.

For the period 2014-2020, the EC simplified the process and enhanced the supervision over the distribution of funds in a way that complements the aims and goals of the EU. In order to achieve this change in policies, a Common Strategic Framework that reflects the political goals of Europe 2020 was introduced for the achievement of smart, sustainable and inclusive economic growth. The OPs consist of priority axes which correspond to the thematic goals that have been written in the agreement between the partners. Each priority axis corresponds to one or more investment priorities.

In the years 2000-2006, the SF investment in research and innovation reached EUR 17.9 billion or 10% of the total SF budget. The committed SF funding 15 under RTDI priorities in the EU-27 for the period 2007-2013 amounted to EUR 42.6 billion, constituting 16.3% of all available funds. It is important to point out that the Convergence regions increased their share of research and innovation in SF budgets by 12% on average (compared to about 8% for RCE regions between both periods) (*Regional Innovation Scoreboard 2014, Enterprise and Industry, EC, p. 24*).

The launch of the OPs was difficult in Bulgaria, because of the lack of experience and the need to qualify well-formed and adequate administrative and legal capacities. Projects began to be implemented in Bulgaria in early 2009.

Bulgaria has consumed only 19% of the allocated sums in the years 2007-2013. The absorption of EU Structural and Cohesion Funds in Romania increased in 2013 and reached a 33.7% utilization of funds by the end of December 2013. The low level of absorption of European funds highlights the difficulties Bulgaria was faced with, because the application of EU regulations needed time to be implemented, as the administrative and judicial officials were not quite reliable to supervise the process of funding. In 2011 and 2012, the use of funds in Bulgaria had increased because it was necessary to demonstrate a more convincing behaviour during the negotiation of the new EU fund allocations for the 2014-2020 period. By 31.12.2015, the funds agreed upon with the EC under the SF totaled an average of 107%; the real amounts paid were 95.30% and the rate of implementation of the agreed projects was 85.24%. The OP "Transport" met 79.71% of the pre-set goals. The results were evident in the updating of the outdated transport network in the major cities of the country. About 85% of the projects under the OP "Environment" were met. Around 78% of the projects under the OP "Regional Development" were met. A very high percentage of projects have been realized under the OP "Competitiveness", the OP "Human Resources" and the OP "Administrative Capacity", wherein the completion rate under those OPs is near 100% and the agreed payments from the EC were received at the end of 2015. Around 85% of the projects filed SF were completed and the utilization of resources under the OP "Development of Regions" and the OP "Agriculture" was also high (Table 4).

Table 4 - Implementation of Bulgarian Operational Programs, as of 31.12.2015, in Euro

Operational Program	Program budget			Contracted		Real Payments		Received payments from EC (EU part)	
	Total	EU Funding	National co-funding	Total	%*	Total	% *	From EC	%*
OP Transport (billion EUR)	2 003	1.624	0.380	2.017	99.83	1.687	84.22	1.295	79.71
OP Environment (billion EUR)	1.801	1.395	0.322	2.081	121.23	1.792	104.37	1.185	84.93
OP Regional Development (billion EUR)	1.601	1.361	0.240	1.689	105.49	1.570	98.02	1.059	77.78
OP Competitiveness (billion EUR)	1.162	0.988	0.174	1.175	101.08	1.114	95.85	0.925	93.62
OP Technical Assistance (billion EUR)	0.057	0.046	0.006	0.059	107.06	0.055	99.79	0.043	92.78
OP Human Resources (billion EUR)	1.214	1.032	0.182	1.274	104.98	1.167	96.12	0.980	95.00
OP Administrative capacity (billion EUR)	0.181	0.147	0.026	0.187	107.41	0.170	97.49	0.134	90.90
Total SCF (billion EUR)	7.927	6.95	1.331	8.466	106.80	7.554	95.30	5.621	85.24
Rural development (billion EUR)	3.103	2.552	0.602	3.253	104.85	2.386	75.31	1.859	72.83
OP Fisheries (billion EUR)	0.064	0.063	0.021	0.94	112.18	0.053	54.88	0.040	55.88
Total Agri-cultural funds (billion EUR)	3.186	2.564	0.623	3.347	105.04	2.439	74.71	1.899	72.37
Total (billion EUR)	11.113	9.159	1.984	11.812	106.29	10.704	96.32	7.925	86.53

** % of implementation*

Source: EU Structural Funds. http://www.eufunds.bg/en/page/31

The initial experience of the implementation of the Structural and Cohesion Funds in Bulgaria reveal a number of difficulties, related to the need for improvement in coordination and administrative capacities. The Government was late with the preparation of the strategic documents, which were supposed to regulate the presentation of good projects. Thus, the application for funding was postponed. The lack of well-trained specialist, familiar with the EU funds regulations, was also a default of the pre-accession period. There was a certain degree of decentralization and the coordination about EU integration topics in Bulgaria weakened to some extent. Everything has already been said about the irregularities in the tendering and about certain bad practices that come from the lack of control from the governing authorities (some of them have also lost the approval of the European Commission). In recent years, however, with the presence of certain periods of time, during which funding under the SF was suspended mainly for political reasons, the volume of contracted funds and received payments from the EC increased.

The investments from the EU funds were targeted, in accordance with the policy of the EU, towards the development of the public sector, the creation of a qualified workforce, as well as towards management and administration. Investments in the public sector were targeted at large projects related to the construction and maintenance of the infrastructure of the country, the modernization of transport, the construction of water purification plants and other water-related projects, projects related to increasing the energy efficiency of the housing fund, as well as other projects related to improvements in the country's social policy.

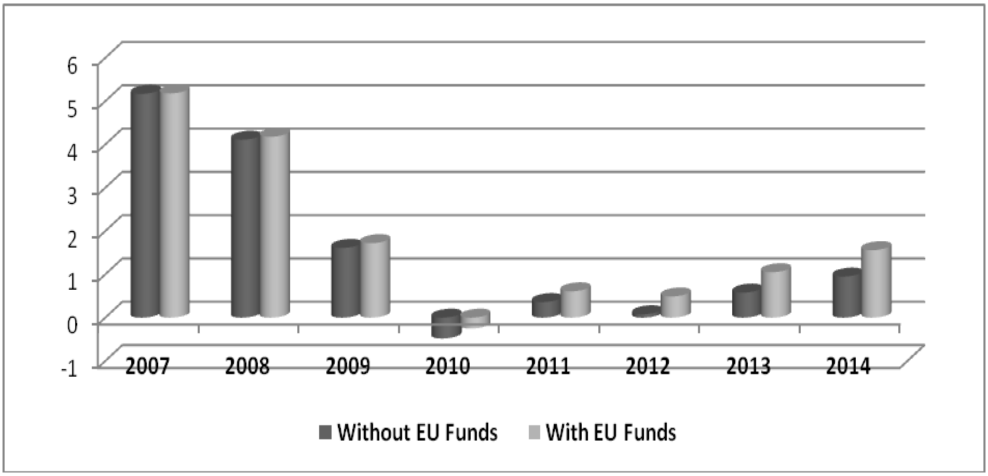
The investments in human capital in the years 2007-2015 were also significant. The major investments went towards schools and universities. The return on investment in education is usually felt in the long term and it is important that these investments have a lasting and stable nature, so that they may have a positive impact on the quality of human capital and thus may contribute to economic growth. The contribution of these investments for potential growth in 2015 stems from the utilization of modern methods of education using new information technologies by organizing post-qualification training courses for graduate students, by the retraining of workers and the unemployed, etc. Significant investments were made under the OP "Administrative Capacity" and the OP "Technical Assistance" towards improving the quality of the services provided by institutions. As of October 2015, a report came out on the reforms in the field of science and innovation in cooperation with the EC. Bulgaria was the first country in the EU to implement such a program. The main recommendation at the heart of the program was to accelerate investment in science and innovation in our country. Increased investments in scientific research will have a positive impact on the Bulgarian economy and growth, as well as on attracting FDI. To this end, our country must make full use of

EU funds and establish a link between scientific research and business needs. Thus far, the elasticity of GDP to R & D was not particularly high. In the years 2007-2014, nearly EUR 150 million were invested under the OP "Development of the Competitiveness of the Bulgarian Economy" (OPDCBE). This contributed to a growth of 0.1% (2014). So far, funding under this OP was focused on the innovation of the information technology park, as well as on organizing cultural events and on developments in tourism. However, the objectives of this program were quite different and were directed towards the innovative technologies and procedures of introducing automatic lines and improving the management structure. The EC recommended that Bulgaria spends 1.5% of the GDP on the advancement of Science. According to the estimations of the Annual Report of the ERI of the BAS, the contribution of the EU funds to potential growth exceeded 0.4% since 2012, and even exceeded 0.6% in 2014. The figure shows that after 2011 the contribution of the EU funds to potential growth is low, but noticeable.

Bulgaria finished the first programming period of funding from the ESF, as funding for the 2014-2020 period has not yet begun. However, it is worth noting that funding under ESF is oriented mainly towards the new CE Member States. For example, fin the years 2014 – 2020, the ESIF allocated to CEE 6[1], amounted to EUR 167 billion. Over half of the total EU funds will be invested in CEE-6. In comparison with the 2007-2013 periods, the funds are 11% higher. Since 2012, the Czech Republic and Slovakia (CEE-6) succeeded in their economies coming close to the economic performance of some of the old Member States like Greece and Portugal. If the potential of the EU funds id fully utilised, Poland and Hungary will have the potential to surpass the struggling economies of the southern periphery of the Eurozone by 2020. Romania, Bulgaria and Croatia have the longest path ahead of them on their way towards economic convergence. If they overcome all the obstacles in utilizing money from the EU funds in the 2007-2015 period (this is especially the case for Romania and Bulgaria), by 2020 they have achieved the same level of economic performance as the current leaders among the CEE-6.

[1] CEE6 – the Czech Republic, Slovakia, Hungary, Romania, Croatia and Poland.

Figure 9: Estimation of the potential economic growth with and without financing from the EU Funds



Source: Economic Development and Policies in Bulgaria: Evaluations and Prospects. Focus: Economic Development Policies in Operational Programmes and Common Agricultural Policy for the period 2007-2013, (2015) Annual Report of Economic Research Institute at Bulgarian Academy of Sciences (ERI, BAS), p.50.

Poland will receive EUR 77.6 billion from the EU funds between 2014 and 2020, which is the largest amount among all the EU Member States. Moreover, Poland is one of the few countries that will receive an increased amount of financial means compared to the allocation of funds for the European Cohesion Policy in the 2007-2013 period. Romania and Bulgaria, being the least developed members of the EU, were allocated a lower total amount of EU funds than they should have been. To balance this out, the two countries will also receive financial assistance from other European programs, such as the Common Agriculture Policy.

In the best case scenario, the effective utilisation of this amount of money will raise the economic and social potential of Bulgaria to a completely higher level, and the differences between it and the most developed CEE countries in the EU will slowly diminish.

A satisfactory absorption level of EU funds in Bulgaria should lead to faster convergence and to improvement of the economic stagnation. If the European funds are effectively used for investments that spur the economic growth, the pace of development should accelerate.

According to the estimations made, during the 2014-2020 budgeting period the EU funds should contribute to an economic growth of between 0.3% and 0.8% on average, depending on the amount of allocated funds and the current stage of development of the country.

As one can expect, the EU funds should have a greater impact on the less developed countries (such as Bulgaria and Romania) and a smaller influence on more developed countries (such as the Czech Republic). If the countries are successful in the utilization of EU funds, the differences in the stage of development of the different countries will steadily diminish and the distinction between the developed and emerging economies of the EU will slowly disappear.

In light of the deepening of the collaboration and strengthening of the economic relations between Bulgaria and Romania, the EU cross-border co-operation program was launched in 2007. The program is expected to have a significant impact on the economic development, the environment and the mobility in the cross-border region. The eligible area is characterised by marginality and isolation from the economic and decision-making centres. Borders limit economic, social and cultural exchanges and affect the joint, efficient and effective management of the territory.

Conclusion

The effects of the economic crisis can still be felt in Bulgaria's economic development and the period of recovery for the economic growth moves along slowly due to a number of internal and external factors. While in the pre-crisis period economic growth was due to domestic consumption and the increased volumes of FDI entering the country, after the crisis the reduced volume of FDI, the challenges facing the improvement of the competitiveness of the economy, the reforming and strengthening of industrial production and the banking systems required sustainable financing of the economy. Overcoming the imbalances in the economy was crucial for the economic catch-up to the relatively more developed economies in CE. Even though during the post-crisis period Bulgaria had achieved moderate convergence in terms of its target level in relation to the average EU level, on a number of indicators the country was different and even separated in its economic development. It is worth mentioning that the GDP per capita of Bulgaria accounts for 40% of the average for the EU-28, unemployment in the country remains high and the domestic and foreign investments in the real sector are insufficient for boosting growth. Investments remain a major factor for moving forward in the process of catching-up and convergence.

Despite the slow recovery from the crisis, Bulgaria retained its commercial niches on the international markets and managed to achieve positive economic growth. In the short term, the country must restructure its industrial sector and attract investment towards the export-oriented production of goods with high added value.

In this respect, the attraction of FDI, whose volume remained relatively limited in the post-crisis period, is of particular importance. Fortunately, the previous desire of foreign investors to gravitate mostly towards the tourism and real estate sectors had ended and more and more FDI went towards the industry and the information and telecommunications sectors. Bulgaria holds one of the leading positions as the preferred destination for "outsourcing" services. This allows us to assume that, given that the EU economy is doing well, Bulgaria has the potential to develop a working business economy in the medium term. Investments in infrastructure, in the retraining of workers, in reforming industry, science and education (thanks to funds from the ESIF as well) will be the bedrock of Bulgaria’s economic integration of and the achievement of sustainable and smart growth. This will be a difficult task in the context of increasingly intense economic and political tensions in Europe, which will have a direct impact on Bulgarian economic development. Other factors worth mentioning are the sanctions against Russia, the war in Ukraine and the Middle East countries, the waves of migrants and refugees emigrating towards Western Europe, etc.

However, if Bulgaria achieves a higher level of absorption of EU funds, it will be possible to reduce the economic gap with the EU CE Member States in the medium term. The economic catch-up and the development will depend largely on the implementation of policies supporting economic growth and macroeconomic stability in the context of EU objectives.

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