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ИНСТИТУТ ЗА ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ПРИ БЪЛГАРСКАТА АКАДЕМИЯ НА НАУКИТЕ

Година XX

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ

ECONOMIC STUDIES

Книга 2, 2011 година

Written revised versions of the presentations from a bilateral meeting held in 2010 in Sofia, organized by the Economic Research Institute at the Bulgarian Academy of Sciences (BAS) and the Institute for World Economics at the Hungarian Academy of Sciences (HAS).

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

ГОДИНА XX, 2011, 2

András Inotai[1]

THE MANAGEMENT OF THE COSTS OF CRISIS MANAGEMENT EUROZONE, EU 2020 AND THE FUTURE OF EUROPEAN INTEGRATION[2]

Although the European Union (EU) was not the main source of the global financial and economic crisis, as one of the leading economic players, it was fundamentally affected by the immediate and longer-term consequences of the crisis. Similarly, it is expected that it would play an important role in how to get out of the crisis (not yet clear, whether a passive or an active one).
Almost all areas of community-level and member-state-based economic policy were affected by the crisis. Three of them have been chosen to be addressed in this paper. First, the challenge to the Eurozone and the common currency, as an immediate impact of the crisis will be dealt with. Second, as a coordinated answer to crisis management and post-crisis coordinating (and decision-making) mechanism, the idea of European Economic Governance will be analyzed. Third, in a longer-term perspective of post-crisis sustainable growth, the EU 2020 project will be shortly described and assessed.
JEL: O57; F43; F36

1. Crisis in the Eurozone

Together with the enlargement to Central and Eastern Europe, the creation of the EMU and the introduction of the common currency was – justly – considered as the two success stories of the European integration in the last decade, particularly as compared to a large number of areas where real progress could not be identified and the deepening of the integration was practically blocked.

The crisis has drastically changed this situation. It has, however, to be added that the pre-crisis view was always distorted in favour of self-complacency, for every expert (and maybe also politician) dealing with this issue had to know how, with what kind of „dirty compromises" the EMU had been helped to life. Of course, the crisis made immediately clear the internal fault lines of the whole structure and raised a number of crucial questions about the viability of the project. In addition, some of the

[1]*András Inotai is Prof. Dr., General Director of Institute for World Economy, Hungarian Academy of Sciences.*
[2] The manuscript was closed at the end of October 2010 and reflects the actions of the EU and the respective European institutions until this date.

problems would have come to the fore without the „benign or malign support" by the crisis. Namely, the appearance of some fundamental construction failures on the surface and in everyday politics, as well as the financial and monetary management of the EMU could not have been avoided. There was a fortunate or unfortunate overlapping in time, because the long maturing internal conflicts became manifest shortly before the crisis and were heavily exacerbated by the spreading crisis phenomena.

The construction failures start with the difference between theory and practice (I would not like to say that theory is always right, see for instance the early stage of the treatment of the systemic transformation in Central and Eastern Europe by international institutions as part of „development economics".) In fact, there was a lot of discussion among EU member countries about the right sequencing between political and monetary union. Since the former was far from reality and the EU wanted to create a deeper layer of integration before the transforming countries would join the first layer of integration, political will was in favour of a monetary union without deeper political coordination (let alone supranational decision-making). Another discussion developed along the interrelation between monetary and fiscal integration. However, most member-states insisted on their independence in fiscal issues (practically to the harsh reality to keep the national parliaments, the constituent parties in the parliament and the decision-making on annual budget as a fully sovereign national issue). Thus, fiscal and monetary integration had to be separated. Some fiscal discipline was expected to be imposed on the member countries by the Maastricht criteria and the Germany-forced Stability and Growth Pact (SGP). Last but not least, and still on the level of comparing theory and practice, the deficiencies of the EMU as compared to an optimum currency area have to be mentioned. Although the EU did achieve a high level of integration, but the internal market did not become fully operational, because several barriers to the free circulation of different production factors (mainly services and labour) remained in force. Let alone that an optimum currency area can only be implemented among countries on similar level of economic development and sustained/sustainable competitiveness. This, however, would have required a very strong economic policy coordination/harmonization well beyond the frequently quoted „fiscal cooperation" (not to speak of „harmonization").

Conflicts between theoretical approach and practical implementation have been burdened by several decisions. The first was the taking of some member countries into the original (starting) group of EMU that were „astronomically away" from fulfilling the basic entry conditions (both criteria and convergence process).[3] This option has weakened the efficiency of the EMU from the first moment on and has sown the cells of future conflicts. Second, the „Bible" of the EMU was built on the Maastricht criteria and on the SGP. However, the first contained a number of important but nominal adjustment criteria without considering the more important conditions of real convergence (e.g. structural reforms, current account balance,

[3] In this way Italy and Belgium had to be part of the first group despite their huge public debt over 100 per cent of GDP, while Spain and Portugal raised several questions of competitiveness (with special regard to real convergence).

flexibility of the economy and the society, burden-sharing capability, etc.). It has been demonstrated that the fulfilment of the nominal criteria does not tell a lot about the status, quality and speed of real convergence (being the Baltic countries with their „transformation bubble" the best examples). The second, namely the SGP could have served as an important policy instrument but, in critical situations, its rules of the game have been either not observed or even obstructed (violated), sometimes just by the large member countries, such as France and Germany. Several times, excessive deficit procedures, as foreseen in the SGP, have not been initiated or were announced without any consequence on the country breaching the rules. (At the same time, all potential applicants outside the Eurozone were examined with utmost precision. Concerning several Maastricht criteria applicants were fulfilling them much more than members of the Eurozone, an issue difficult to be explained to the society of the applicant country and even less to avoid rapidly spreading populism and demagogy about „second-class membership".)

Moreover, the opting-out (exit) possibility did not become part of the basic treaty of the European Central Bank (ECB). Although, due to strong German insistence, the statute of the ECB clarifies that there is no rescue or bailing-out obligation by any member country to any other that may fail. This statement should have been complemented by a clear and unequivocal procedure of insolvence (Schweickert, 2010, p. 13.).

The crisis hit the Eurozone at the moment when a decade-long economic development of different member countries accumulated a critical mass of internal discrepancies. Before the crisis, all EMU member countries did have access to easy money, at the same conditions, because they have borrowed in euro and this currency was accepted at equal terms, whether the money was raised by Greece, Portugal or Germany. Since, however, some less developed member countries followed a (re)lax(ed) wage policy without linking wage development to productivity gain, experienced higher inflation. The spread between borrowing cheap money and registering relatively high(er) inflation disappeared, or sometimes credits in euro could be taken at zero or even negative interest rate. This situation seduced particularly the Mediterranean members to keep on borrowing, enhance the living standard and forgetting about (unpleasant) structural changes. For a decade, the international capital market did not make any difference between euro credits taken by different member countries of the EMU. The ECB was considered as a reliable ultimate player or „last resort". However, different wage developments and productivity gains increasingly expressed in diverging competitiveness and accumulating huge surpluses and deficit in trade among the EMU member countries started to signalize the conflict potential well before the outbreak of the crisis.[4]

[4] In most cases, differences in wage development in one year do not introduce dramatic changes in relative competitiveness. However, if the wage difference is maintained and accumulated for a longer period, the "performance gap" will become visible. In fact, while in the first decade of the EMU German unit labour costs grew by about 3 per cent, this indicator experienced in some EMU member countries a 20 to 30 per cent growth.

Finally, another birth failure of the EMU remains that may be exacerbated in the next years when the future of the European integration will be at stake. It is about „fiscal solidarity" or the challenge of the „transfer union". Monetary integrations involving countries on different levels of development, competitiveness, GDP per capita and (cap)ability and willingness to reforms can hardly survive without some kind of internal transfers. This system can be found in several monetary (and, of course, political) unions, such as the USA, Germany, Spain and others. One of the key challenges of and threats to the future of the European integration is this issue – evidently with widely diverging interests and emotions among the member countries.

The Greek crisis represented a qualitative turning point in the history of the EMU and, most likely, also in that of the EU as well. The open crisis was the combined result of long-term economic (and social) mismanagement in Greece and the manifestation of the construction failures of the EMU at the same time. The „attack" by the international capital markets targeted Greece as the weakest chain in the system, but the main effort was directed against the EMU in general, and its leading (anchor) country, Germany. In fact, the solidity and cohesion of the entire monetary system was tested – maybe, not for the last time. The answer suffered several months of delay and increased the initially estimated bailing-out costs of Euro 25 bn to Euro 110 bn by early May 2010 just for Greece. In addition, another umbrella has also been created to avoid similar „pitfalls" or, in the worst case, disposing of the necessary instruments to intervene into adverse processes at due time.

In cooperation between the ECB/EU and the IMF the rescue plan for Greece has become operational in May and is scheduled for a three-year period. Greece has to implement a number of deep and painful reforms in this period, and the process of implementation will be closely controlled (otherwise the next part of the credit will not be transferred). EMU member countries put together Euro 80 bn and lend money to Greece on a bilateral basis (at 5 % interest rate that brings net profit, since it is higher than the interest rate of the money at which the lending countries can borrow on the international market). Although the price Greece has to pay is rather high, but going alone, the country would not have been able to find money at these conditions (or no money at all). This is the current price of „bailing-out". The project is, however, not free from some obstacles.

In technical terms, one can easily be overcome, namely the Slovak opposition to participate in the lending operation. Although Slovakia became the most recent member of the EMU (in 2009), the newly formed Slovak Government raised two objections (they were already part of the election campaign, a clear sign of how European issues can easily be „internalized" and form arguments „against Europe", a fundamental danger in several member countries and a real challenge for the future of integration). First, it emphasized that Slovakia has a substantially lower GDP per capita figure than Greece, so it is difficult to convince the Slovak society why a poorer country has to participate in a bail-out project for a richer one. Second, not without some exaggerated complacency, Slovak politicians pointed out that while Slovakia did implement the necessary reforms before joining the EU and the EMU, Greece failed to do so for decades (the second part of the argument is correct, the

first only with partly serious reservation). In consequence, Slovakia's part of the project (about Euro 800 mn) will have to be taken over by other members willing to support Greece. At first glance, the Slovak arguments can be justified. However the „second glance" looks at and asks for „solidarity" that should not be a one-way street among EU members (first of all, in the future if we want to build a competitive and cohesive Europe).

The other issue is more difficult and open-ended. What happens, if at the moment the current support scheme expires (in three years), the Greek economy will not be in a better shape than today, maybe despite all the structural changes that were required to be implemented as a precondition of continuous financing within the given period. To be sure, the fundamental problem is structural and mental, not financial, budgetary or even economic. Sustainable growth in Greece can only be based on a more competitive economic structure based on more high-tech production, a substantial increase of exports (out of agriculture), more efficient skilled-labour, cooperation with transnational companies to be located in Greece and cooperating with (competitive) local small and medium-sized firms. Can such a structure be created in a three-year period, with special attention to the serious fiscal restrictions on the one hand, and the rather unfavourable global and European economic environment of the „post-crisis" (?) period? And even if all these conditions were available, can a society with centuries long history-rooted traditions and decades of „subsidy mentality" change itself in a few years? And if this objective is to be achieved, which are the potential or very real costs of „adjustment" in economic, social but also Europe-wide security terms?

The stability fund was established together with the signing of the Greek bailing-out package (on May 09, 2010). The Euro 750 bn project consists of three elements: 440 bn is provided by the member countries of the EMU, 60 bn comes from the EU budget (guarantee offer) and 250 bn originates in the IMF. Similar to the Greek package, it is based on cooperation between the ECB/EU and the IMF (with the USA behind it). However, it differs from the Greek pattern, because the credits, if necessary, will not be provided on a bilateral basis but by the „European Financial Stability Facility" (EFSF).[5]

According to some experts, the key „mission" of the ESFS does not consist in providing credits to EMU member countries with serious financial difficulties but to create a preventive and early-warning system that, on the one hand, keeps international speculation away from potential „candidates" for bankruptcy (Spain, Portugal, Ireland but also Italy), while, on the other hand, develops and implements a system that makes countries with potential risk aware of the looming problems and can mobilize domestic policy-makers to take the necessary measures, including fundamental reforms. Some experts unequivocally state that the Fund can only fulfil

[5] The EFSF has been created according to Luxembourg law, and is headed by Klaus Regling, a German expert. Another compromise in favour of reluctant Germany was that Euro 60 bn out of the Euro 440 bn will not be paid out but will be used to achieve an AAA rating for the EFSF, an important aim in order to raise credits at the best term on the international financial market. For details see: *Frankfurter Allgemeine Zeitung,* July 14 and July 23, 2010.

its function if, in fact, it will not be claimed to be used. The underlying fear is that any intervention of the Fund could either contribute to higher inflation (if the financial support will be provided by fresh money, including that borrowed from the IMF) or buy bad (non-performing) state bonds, the costs of which have to be taken up by financially stable countries and their citizens (or, as an alternative, the loss has to be „socialized" by new printed money leading again to higher inflation).[6]

In order to avoid the unavoidable (last resort) utilization of the ESFS, first of all the rules of the game of the SGP have to be tightened. In this context, a French-German joint initiative deserves attention that was elaborated in July 2010.[7] Although differences in terminology (or probably also conceptual ones) have remained, because the Germans talk about „economic policy steering" (wirtschaftspolitische Steuerung), while the French about economic governance (gouvernement économique), there is agreement on the necessity of a „genuine European economic strategy" („wahre europaeische Wirtschaftsstrategie"). The proposals include the acceleration of the excessive deficit procedure, with clear consequences for all those who are not ready to fulfil the Maastricht criteria of budget deficit (and public debt) according to a prefixed timetable. The punishment spreads from special deposits (with interest rate) over the non-payment of EU contributions from the structural fund to the withdrawing of voting rights in the Council of Ministers of the EU (practically non-participation in the decision-making process of the integration). France accepted the strict German demand that all member countries have to incorporate into their national legislation a „debt brake" that constitutionally limits the indebtedness of the State. The new rules have been analyzed in detail in a recent publication by Deutsche Bank Research (2010). In turn, Germany supports the French initiative to extend the economic policy supervision of the member states by the EU and set up a supranational authority to safeguard the debtor's financial affairs. Importantly, this supervision would not be limited to the fiscal and budgetary policies of the respective countries but would cover also areas such as competition policy and structural reforms. In addition, the indebtedness of private households, an important element of overall indebtedness in several countries (not least in some new members that created an „early-born consumer society") will also be included into the supervision.

Harsher winds started to blow already. In the summer of 2010 all EU members had to face the starting of (or the prolongation of earlier started) excessive deficit procedures. Even those countries that previously could escape this „straitjacket" (such as Finland or Luxembourg) have been involved in the „debt brake" structure.

Still, despite the determined action of the ECB and the two key Eurozone member states, some questions remain unanswered. First, some German priorities have not been mentioned in the joint position paper, such as the limitation of the „bailing-out umbrella" to not more than three years or the creation of clear rules of insolvency procedure for over-indebted Eurozone countries. In addition, Dennis Snower, president of the Kiel Institute of World Economy raises several concerns (Snower,

[6] Willgerodt (2010), p. 24.
[7] For a detailed description see: *Frankfurter Allgemeine Zeitung,* July 22, 2010.

2010). He has serious doubts whether the recently adopted bailing-out package (ESFS) would be sufficient if Greece were followed by other member countries, particularly by Spain. Also, he argues that financial straitjacket rules could certainly force countries to nominal convergence but, at the same time, they would be deprived of fiscal instruments required for higher growth and more manoeuvring room in reforming and overcoming structural rigidities. Moreover, the availability of Eurobonds to indebted countries would be a strong incentive to get further indebted at very favourable interest rate, instead of restraining them from further indebtedness. Also the exclusion (or expulsion) of the '"sinners" is considered a double-edge approach, since the citizens of the given country could withdraw their savings from the banks (of course, in euro), before the Damocles sward started to hit. This could destroy the entire banking system with unpredictable consequences of the expected domino effect on other members. Moreover, the punishment in financial terms of irresponsible members does not seem the right approach, because it deprives countries of resources that it is anyhow already missing or would desperately need them to get out of the crisis. Finally, an international supervision over how to manage national budget, fiscal policy and public debt reduction could seriously violate the democratic system and the national sovereignty of the given country, with anti-EU and „anti-international" emotions and actions and with reminiscences of remote colonial times. This would hardly support the cohesion of European integration. Therefore, he recommends a two-stage strategy. In the first stage national fiscal rules have to be established that identify the speed (timetable) and the ways of bringing back the public debt level to the 60 per cent target. In the second stage, each government has to set up an independent „debt commission" responsible for the implementation of the procedure as established in the first stage.

2. European Economic Governance

The financial and macroeconomic crisis did not raise the idea of a common EU strategy. Just the opposite, both the banking crisis and the unfolding economic downturn were predominantly managed by national policies. It was surprising how little European-level thinking (let alone acting) characterized most member states, particularly the large ones with more manoeuvring room.[8] The Euro 200 bn package communicated by the Commission consisted of the sum of national rescue plans in the amount of Euro 170 bn, with a tiny contribution by the EU budget and – potentially – by the European Investment Bank (EIB), each of Euro 15 bn. The alarm bell started to sound when the common currernсy had to face the challenge of the global financial market. From this very moment on we can seriously talk and think about the necessity of a European Economic Governance (EEG). In the first months of 2010 the EEG idea was strictly linked to how to save the euro and what kind of procedures should be elaborated and implemented in order to save member countries that, for different reasons, became the target of international financial attacks („speculations"). As a result, the EEG appeared as a suitable (unavoidable?)

[8] The situation was very similar to that during the first oil crisis at the end of 1973, when *The Economist* published an editorial starting with the sentence: „Everybody for himself and God save the strongest". However, the level, quality and depth of the European integration in 2008-2010 cannot be compared to those at the early seventies.

institution to enforce the Maastricht criteria and tighten the SGP rules. Only in recent weeks a broader approach started to emerge concerning the potential function of the EEG by incorporating structural policies (such as competition, labour market, innovation, the idea of introducing an EU tax,[9] etc.) into the agenda of the EU-level coordination framework elaborated by the task force headed by Herman van Rompuy by the end of October and to be approved by the European Council Summet in December 2010.

Although the need for more economic coordination in the EU is widely accepted, the challenge has had an ambiguous impact on the French-German tandem. On the one hand, it demanded a renewed common effort that manifested itself in more intensive cooperation, including the elaboration of the above mentioned joint position paper. On the other hand, however, it made once again evident the different „philosophical" approach of both leading countries. While France claims for an economic governance with supranational competences (although the word „supranational" can hardly be found in the official arguments), Germany emphasizes the importance of economic coordination but without a common economic governance.[10] Germans fear the return of French „state dirigism" that could impair Europe's global competitiveness (mainly that of Germany, of course), could jeopardize the independence of the ECB (and its basic principle, the price stability) and, at the end of the day, establish a „transfer union". In addition, the birth deficiencies of the monetary union could not be eliminated by a supranational EEG. In turn, France sees another (historical) opportunity to strengthen its (co-)leadership in Europe the gravity centre of which did shift from the Atlantic to the geographic core of the continent with Germany in the centre as the consequence of „Eastern" enlargement(s) and the additional dynamism created by the new member countries (not only in economic, but, with delayed impact, also in mental terms).

It is up to the van Rompuy task force, but, more importantly, to the political and business leaders of the member countries to find the right balance between opposite priorities. First, to what extent should the EEG serve just the consolidation of the rules of the game in the Eurozone or be extended to other community-level policy areas as well. Second, how can a sustainable compromise shared by all member countries be found between more supranational decision-making urged by fundamental global challenges and the preservation of „national sovereignty" in key issues of economic policy. Third, a viable solution should be found for the (apparent) contradiction between enhancing global competitiveness of Europe and the sustainability of the critical minimum of cohesion and solidarity, in order to keep the integration alive and make it fit for facing the opportunities and threats/risks of the 21st century (where Europe stopped to be the centre of economic growth).

[9] For the unfolding discussion see: Alfred Boss: Brauchen wir eine EU-Steuer? *Frankfurter Allgemeine Zeitung,* August 11, 2010.
[10] See the fascinating debate on this issue in *ifo Schnelldienst* (2010).

3. EU 2020: Chances for a New Strategy for Europe

In the Chinese script, crisis is described by two signs: threat and opportunity (risk and chance). In fact, the unprecedented global crisis would need a twofold approach. China opted for seizing the chances, while the United States, as the only real global player at present, seems to apply both policies (extensive crisis management and preparing for keeping its leading role in the rapidly changing global environment of the 21st century). In turn, the EU seems to be submerged in short-term crisis management, how to avoid or minimize risks, even if the costs of management would undermine the economic, financial and social manoeuvring room to grasp some of the opportunities offered by the crisis. This approach can be verified by national crisis management, short-term bailing-out projects, the stabilization of the past (and that of vested interests linked to the past and present) and the general lack (or insufficiency) of forward-looking, let alone comprehensive, strategy. (If such strategic approach exists, one can identify it on the national thank-tank level in some countries, but not on the level of the integration.)

At first glance, the recently launched EU 2020 strategy seems to be either the exception or an attempt to break out of the „short-termism" of the socio- economic and political decision-making routine. By no surprise, in strategic thinking the business community is far ahead of the political „class" and the public administration.[11]

The European Roundtable of Industrialists, the top gremium of European business published its vision for a competitve Europe in 2025, based on a study prepared by the European Commission (The World in 2025: Rising Asia and socio-ecological transition, 2009) and the global forecast of the US National Intelligence Council (Scanning the future: American and European perspectives, ISS Policy Brief, 2008).[12] The framework of the global setting in which Europe has to find its place has been substantially influenced (and co-shaped) by the shift of economic growth and weight to the developing countries in general, and to Asia, in particular. Trade and capital flows will remain the basic driving force of growth. The USA and Europe will be facing R+D challenge from a number of emerging economies. Demographic changes will negatively influence Europe's position (due to its shrinking population in global terms and the ageing of population), while the international aid role of Europe will not be reduced at all. In addition, smooth accession to raw materials (minerals, energy and food) will be more difficult, and climate change would require a universal response and adaptation. Based on current experience and future challenges, the US (and potentially China as well) do consider Europe as a weakening power in global competition. This is mainly due to internal differences, lack of economic liberalization, insufficient reform of welfare systems and the protracted decision-making process. Although further enlargement and

[11] The same happened during the process of "Eastern" enlargement. The international, and particularly the European business involved the new member countries into their strategic plans and development projects years before the political decision on enlargement/accession was taken.

[12] European Round table of Industrialists (2010).

special relations to Eastern neighbours may generate some additional dynamism, the EU can easily be locked into an inward-looking policy with growing conflicts both with other regions of the world and in its intra-regional framework.

The EU 2020 program (called also Post-Lisbon Agenda) (see Deutsche Bank Research, 2009) calls for facing global and regional challenges (partly identified above) with an offensive EU strategy. The EU 2020 program substantially differs from its predecessors, the Lisbon Strategy of 2000 and its updated version from 2005. First, the global environment has dramatically changed in the last decade, a fact that has to be taken account of. Therefore, the competitiveness framework of the EU has been extended. It is not any more a bilateral competition between the USA and the EU but a multi-player competition including the emerging countries, first of members of the BRIC (Brazil, Russia, India, and particularly China) and of other rapidly catching-up countries (South Africa, Indonesia, Argentina, Mexico, Turkey, let alone the already competitive East Asian first- and second-generation tigers). Second, the EU 2020 program is embedded in the period and short-term priorities of crisis management. The recently announced financial stabilization plan seriously narrows the chances and sources of implementing the EU 2020 plan. At least for the first years of the decade (until 2013-2014) there will be practically no additional resources available for implementing far-reaching goals (excepting some earthquake-like change happens in the system of social redistribution of the welfare state that, of course, could generate another earthquake-like change in the political and social texture of several member countries). Realistically, in the best case, the implementation of the EU 2020 plan could find the necessary favourable conditions about the mid of the decade. It does not mean that a lot could not be done before but a comprehensive breakthrough seems to be blocked by the primacy of financial consolidation (either accepted or enforced by common rules or by external pressure/reality) in all member countries.

Of course, one can only agree with the basic goals of the EU 2020 program, essentially with the need for a new growth strategy. However, it is not clear how this goal could be achieved. First, the triangle of priorities (growth, employment and sustainable development) contains several conflictive goals. Up to 2-2.5 per cent of growth there is no positive impact on the labour market in a developed and competitiveness-driven economy, because this growth can „automatically" be produced by technological progress, improved management practice, productivity gains and international spill-over effects of competition. There is no medium-term growth forecast predicting figures even near to this level. In fact, the available labour volume can be redistributed among more people (part-time work, working at home, etc.) but it would not increase either the volume of the labour market or the aggregate purchsing power of the employees/consumers. Similarly, the effort to simultaneously achieve the growth figures and the environmental cleaning purposes (including climate change-related programs) can be agreed upon but it would inevitably reduce the growth rate (and, at least temporarily, competitiveness as well – in a rapidly changing world).[13] Third, the EU 2020 still insists on quantitative

[13] If the implementation of the dual priority occured in a static world characterized by slow and protracted changes, the benefits would be evident. However, in the current stuation the

indicators (member-country tasks or obligations). This is very similar to the Maastricht criteria of nominal convergence. In effect, the discussion remains in the framework of which amount of the GDP should be spent on R+D and which should be the share of high-school absolvents in the given age group of the population. Particularly in he new member countries, we have plenty of experience how little R+D/GDP does tell about the reality. What would really be important is the efficiency of R+D (2 per cent can bring more to the economy than 4 %). Not less importantly, the quality and the demand-orientation towards the labour-market of education are the substantial indicators not the number of (mis-educated and many times low-quality) students. Fourth, the coordination mechanism of how to achieve (or to force member countries to achieve) the EU 2020 goals remains unclear. The original Lisbon Strategy emphasized the importance of the open mechanism of coordination (OMC), expecting that the best-performing countries (and best-practice policies) could exert a positive impact on other, lagging-behind countries. For several reasons, this approach did not work, partly because none of the lagging-behind (or non-performing) member countries was punished. Some punishment may have come from the international market, but, mainly for Eurozone countries, this threat was overcompensated by having access to unlimited credits in euro at cheap interest rate, a substantial barrier to any reform effort. The new method opted for improved communication „to engage national populations, interest groups and decision-making bodies with the reform targets" (Deutsche Bank Research, 2009). It remains more than unclear to what extent such a communication will materialize and if yes, how could it address the different target groups. Without identifying and communicating a clear „mission" of the EU, such efforts do no promise any progress (sometimes just the opposite).

4. Looking at the Future: Domestic and Global Challenges Ahead

Despite some mildly encouraging signs, global and European growth did not consolidate at the moment. In the last months, positive and negative messages have been communicated by politicians, business, capital markets and experts alike. Once the USA was considered to be out of recession and pulling the global train, another time China and the emerging markets were considered to be the likely locomotives, and, most recently, German economic upswing is expected to mean the end of recession, not least in Europe. As a good example of lasting uncertainties, rapid shifts (fluctuations) can be observed in the exchange rate developments between the US dollar and the Euro. The fundaments of a sustainable growth that, at the same time would be able to successfully manage the costs of crisis management, remain weak and unpredictable, both in Europe and in the USA. In a positive case, a double-dip can be avoided that it would not automatically lead to sustainable and higher growth but, particularly and most probably in Europe, to a sluggish growth

outcome will only become manifest int he medium-term, while in the short-term loss of competitiveness (with all of its consequences) seems to be likely. It is an open question how this (temporary) gap can be managed and bridged over by the EU, including the member country politicians and societies.

with continuing signs of stagnation (or even deterioration) in selected areas of the economy and the labour market.

Certainly, an encouraging sign is the revival of international trade. Following a deep decline in 2009, international trade measured on figures submitted by the G-20 group recovered by 10 per cent that does not fully compensate the size of decline in 2009, but can be considered as a strong support to overall rebound. Beyond this favourable but short-term impact, this trend has two and more important longer-term messages. First, it seems to prove that the export-oriented development pattern of many countries, although highly vulnerable in crisis, should and **must not be** replaced by a high-cost and „adventurous" attempt to turn fundamentally to domestic markets. Second, and connected with the previous statement, the rise of protectionism on the global scale could be prevented, despite the fact that multilateral negotiations in the Doha Round were paralyzed and the pressure to protect selected domestic industries (and jobs) is unlikely to be weakened for unemployment is expected to keep on rising despite the bottoming-out of GDP decline.

A further factor of EU recovery is linked to the exchange rate of the euro against the US dollar in general, but to some other currencies (mainly that of China) in particular. In the past period, ups and downs could be observed with sizeable impact on investment decisions and trade flows of most companies. Some experts predict a weak decline of the euro aginst the dollar (from today's 1.32-1.33 to the range between 1.15 and 1.20), while others starting from the weakining and increasingly difficult financing of the US economy have much higher exchange rate forecasts (up to 1.50 USD per Euro). Evidently, this move cannot be decided either by the FED or by the ECB (or any close cooperation between both institutions that, in fact, exists). The ECB is confronted with another challenge within the Eurozone. How to shape the appropriate monetary (and interest rate) policy in a monetary union that includes countries characterized by widening gap of growth potential. Member countries with large deficits would need the lowest possible interest rate of the euro, while recovering economies would require a bit higher interest rate in order to prevent potential overheating. Of course, the current low interest rate (and still favourable exchange rate) is helping the export-based recovery.

It is an open question how the EU (and the member countries) will be able to solve the dilemma between continued stimulus and financial consolidation. In this framework, an addditional issue can be raised: whatever the decision will be (most probably it will be financial consolidation and exit strategies from the stimulus project), will the consolidation take place in a pre-agreed framework of common actions/policies or each country will individually opt for the solution it considers the best as regards its „national interest".

An encouraging sign, rarely observed in the past, may be the growing public support across Europe for a financial consolidation strategy in Europe based on cutting spending.[14] According to the latest opinion poll conducted by the Financial Times

[14] *The Financial Times,* July 12, 2010 and *Frankfurter Allgemeine Zeitung,* August 07, 2010.

and Harris, the majority of citizens in the five largest countries of the EU oppose any rise in the national budget deficit. Fiscal consolidation (even conservatism) seems to be on the agenda not only in political and economic decision-making circles but in a growing section of the societies as well. This may create more elbow-room for the spending cuts (and partly also structural reforms) of governments, if they are able to come up with convincing arguments why cuts, including in the social welfare net, are unavoidable. In addition, suggestions where deficits could be cut do not undermine longer-term factors of competitiveness. Sectors with the lowest level of cuts include healthcare and education, while much higher cuts have been proposed in defence and in aid to developing countries. In sum, most European citizens start to understand that stable or increasing social benefits cannot be enjoyed without additional economic growth. Not less importantly, particularly new member countries should learn that the EU (and its net-contributing countries) will not be ready to keep on financing higher social standards and economic welfare than those in conformity with their respective economic performance.

In this context, two key issues are presented for further discussion. First: if the redistributing role of the State is likely to decline would it automatically mean the general withdrawal of the State from the management of socio-economic processes or should also States be reshaped and strengthened in order to face the new challenges of the changing global environment? Second: how should less developed new member countries be treated in order to suport their gradual cathing-up process and maintain European stability, cohesion and solidarity at an acceptable level? Here, the negotiations on the next EU budget (from 2014 to 2020) to be started in 2011 may provide relevant information.

Unfortunately, the crisis made the EU more inward-looking, just at a crucial period when, at least in principle, its global role could have been enhanced. At least two relevant reasons can be found to explain the increasingly inward-orienting attitude. On the one hand, the global crisis pointed to several deficiencies of the „European construction" (mainly regarding the Eurozone, institutions and the slowness and ambiguity of the Community-level decision-making process). As a consequence, the EU had to give more attention to intra-EU issues and work on the better functioning of internal mechanisms (particularly that of the EMU). On the other hand, the crisis –both with its risks and chances – found the European integration unprepared to develop and submit for international discussion its own global strategy for the 21st century. Although EU member states are still overrepresented in most international institutions, including the G-20, their impact remained from very low to ignorable. At the same time, the Commission was not able and entitled to speak on behalf of the member countries, because each of them (at least the largest ones) wanted to keep their „national independence" and act according to their „sovereign status" in a world globalizing at a dramatic speed and creating a new quality of international relations.

While focusing on the financial sector's sustainability, drawing up the EU 2020 project and, as a result of the finally ratified Lisbon Agenda, working on future responsibilities within the EU bureaucracy, little attention and energy were paid to the necessity of elaborating a global strategy for the EU (Solbes-Youngs, 2010),

with particular regard to the unfolding G-20 cooperation in general, and the very special G-2 contacts between the USA and China, in particular. As a result, and despite the continuous emphasis on „multilateralism", the EU is threatened to be (self-)excluded from the emerging basic fora that are expected to shape the future of the international system (Inotai, 2010). The underlying reason is by far not only the lack of intra-EU coordination and a common position in various areas of the international arena but, more importantly, the still surviving „supremacy" and self-complacency feeling and attitude of selected (mainly ex-colonial) EU member states. As a consequence, we do not know about any EU-level project or proposal concerning the long-term role of the IMF or the EU's **active** role in and **genuine contribution** to the post-crisis new world order. Although the traditional „teachers' role" to some emerging countries (mainly China) started to change as a result of recognizing rapidly changing geopolitical and economic realities, old reflexes are hard to die (such as „hidden protectionism" widely practised during the crisis not in form of trade barriers but in the context of state subsidies, stronger rules to control immigration, increasing nationalism, etc.).

If the EU wanted to become a real global player, both by keeping its current economic influence and enhance its political weight in the new world order, it has to give clear answers to four key questions, both for intra-EU communication as well as for global purposes.

First: it has to define what is '"European identity" (exempted from colonial and semi-colonial reminiscences and prejudices that still dominate the behaviour of politicians and the attitude of large part of the public opinion).

Second: a widespread and in-depth opinion poll should be started about the (so-called) „European values". Do they exist, and if yes, which are these values (in a positive, progressive sense, and not by telling that „we are different").

Third, and most importantly: the EU that, from the beginning of its foundation was understood not only as an economic but also as a political community (finalité politique), has to identify and communicate its expectations, priorities and potential role in the international system of the 21st century. For this purpose, reference made to historical documents does not suffice (even more, it does not matter at all any more). What the EU urgently needs is a strategy paper on its **„mission"** for the longer period ahead of us. There is no doubt that such a **„mission paper"** could be filled with highly interesting and challenging contents (from soft power over environment and migration up to international aid, regional development and global solidarity).

Fourth: this strategy should be implemented by a strong leadership that could represent the EU as a really global player and not a „soft and uncertain amalgam" (mixture) of mutually rivalring national interests.

The global financial, macroeconomic and social crisis had a serious impact on the European integration. Probably the most serious one following the breakup of the post-war „order" in Europe 20 years ago. It is broadly recognized that the European

integration always needs internal and (mostly) external shocks for its further development (deepening). In this context, one could not have imagined a stronger external shock than the impact of the current crisis on the future development of the EU. In effect, short-term and immediate challenges seem to have been managed appropriately, although by far not always on the level of integration. However, some challenges that may substantially influence the future of the „European construction" remain unanswered. But let be optimistic… However, the biggest challenge is global: how can the EU remain a global economic and become an more influential political power in the network of rapidly changing international power relations. It is probably the most urgent and, for its survival a not less important, literally „vital" task of the EU to tackle this issue. All other EU policies, from internal market through EMU to enlargement have to be „subordinated" to this challenge.

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
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EU DECISION-MAKING AFTER THE EASTERN ENLARGEMENT: INTERESTS AND INFLUENCE OF THE NEW MEMBER STATES

This article is a shortened version of a summary that was published in July 2010 as part of an extensive research report carried out by the Institute for World Economic at the order of the Foundation for European Progressive Studies.[2] *In this paper four categories of influencing EU affairs by a Member State were introduced, namely agenda-setters (innovative behaviour), decision-shapers (creative influence), decision-takers (passive approach) and decision-blockers (or veto players) reflecting a kind of rigidity in the name of defending national interests. This behaviour was tested on selected policy areas with a view to identifying the new Member States' impact on European integration so far.*
JEL: F15; O11

Interests, Positions and Influence in Major Political Issues

Enlargement

As regards enlargement and the Eastern dimension of European Neighbourhood Policy, it can be stated that all the ten examined countries are in favour of taking new members on board. Potential Turkish and Icelandic membership (although very different in nature, of course) are generally supported, without being in the centre of attention and discussion however. Here the only exception is Poland voicing some reservations vis-à-vis Turkish full membership. On the contrary, due to the geographic proximity, the new Member States (NMS) are mainly interested in the accession of the Western Balkan countries and, later on, of some of the Eastern European states as well. The general approach in the NMS is that any European country should be entitled to join, once it meets all the necessary criteria. The Union should keep its doors open and should always evaluate each candidate country

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[2] Vida, Krisztina (ed.): The impact of the 10 new Member States on EU decision-making. The experience of the first years. FEPS-IWE Report, 123 p. (Summary by Krisztina Vida: 108-121 pp.) http://www.feps-europe.eu/fileadmin/downloads/framingeurope/1008_FEPS_IWE_NewEUMS.pdf See also all references there, in the individual chapters.

according to its own merits (regatta approach). It is important to highlight that even though the NMS do have fears that the poorer newcomers might "channel away" some cohesion and agricultural subsidies from them, their interest in a more stable and secure neighbourhood seems to be just as important as their immediate financial interests.

Within this general approach to enlargement, there are of course many different nuances according to individual countries. The Baltic States seem to have no specific preferences for new members, but show a clear interest in reinforced cooperation within the Eastern Partnership. Due to historic reasons, and also due to their energy dependence, the top priority for them is a normal relationship with Russia for which their membership in the EU is the best vehicle. As regards the Visegrad countries the picture is quite diverse. Poland is the most supportive, as it would like to see in the EU one day all the countries which are presently between the EU and Russia: Ukraine, Belarus and Moldova, but also the republics in the Caucasus. From this group, Ukraine is the most important country for Poland because of geographical proximity, strong historical and economic ties. Given this background it is easily understandable that Warsaw took the lead in stepping up the Eastern dimension of ENP and proposing a tighter framework for cooperation between the EU and its Eastern neighbours, namely the Eastern Partnership. In this topic Poland became a real agenda-setter country, although not alone. It successfully chose an old Member State as its coalition partner (Sweden) and was also enjoying the support of the other NMS in this regard.

As to the Czech Republic and Slovakia, both pursue a pro-enlargement policy, without naming any special country preference. Hungary, on the other hand, has very special interests, as it would like to see all its neighbours in the EU, thereby reuniting all Hungarians living in these states. Hungarian interests go even further as Budapest attaches great importance to the stability and prosperity of the whole Western Balkan region being so close to its borders. This is why Hungary wholeheartedly supports the present and future candidacy of all the countries concerned. This approach is shared by Slovenia too, nevertheless, Ljubljana became almost a veto player in the course of EU-Croatian accession negotiations when it felt its vital national interests (namely the definition of its state borders) were at stake.

Romania is again in a special position from the point of view of enlargement. It has strong, although not uncontroversial ties with neighbouring Moldova (where the language spoken is Romanian too). Bucharest already granted Romanian citizenship to hundreds of thousands of Moldavians and is highly interested in the country's stabilisation and full membership in the EU. Because of this situation Romania pursues a pro-enlargement policy in the wider sense too. Finally, Bulgaria is also favouring enlargement in general, although has reservations vis-à-vis Turkey as well as Macedonia (but is not likely to hamper any accession to the EU).

All in all, the NMS have high stakes in the EU's enlargement policy and they are trying to actively engage themselves in it by playing a decision-shaper role. Moreover, as mentioned, in one case a new Member State became agenda-setter,

while at the same time, in another case another new Member State nearly became a decision-blocker.

European Security and Defence Policy

In the field of security and defence policy, it can be stated that all the ten examined NMS show a stronger preference for NATO than for the Union's ESDP. This is explicable with their post-war past: in the bipolar world they belonged to the Warsaw Pact, the enemy of NATO. Upon the systemic changes the Warsaw Pact ceased to exist and in a kind of vacuum situation NATO remained the single security "pole" in the world. Ever since, NATO meant for the Central and Eastern European region the most important potential security anchor while they looked at the EU as the most important anchor for democracy and prosperity. This approach did not change much through the past two decades. This does not mean, however, that the NMS would not be prepared to support all initiatives under ESDP and they actually do participate in many EU missions in this framework. It must be emphasised, however, that most of the NMS have only limited military capabilities (and financial background) to contribute to such operations, and so far they seem to be more engaged in NATO missions than in EU missions. Thus it can be stated that the ten countries examined are rather decision-takers under ESDP. None of them is agenda-setter here, but surely none of them would veto or opt out from any decision neither.

Minority Rights

For a long time the rights of ethnic and national minorities were not included into the EU acquis. This came up on the Union's agenda thanks to a new Member State, namely Hungary. Being an agenda-setter in this topic, Hungary managed to persuade all the other Member States to include into the Constitutional/Lisbon Treaty a reference to minority rights. In a further step, the initiative of a European Roma Strategy was also voiced by Hungarian MEPs in the European Parliament and this topic will be high on the agenda of the upcoming Hungarian Council Presidency – in cooperation with the Commissioner responsible for Employment, Social Affairs and Inclusion, who happens to be Hungarian too. This issue means very different challenges for each new (as well as old) Member State. Nevertheless, Hungary is convinced that minority rights should gain importance at the EU level and preferably – despite the significant differences in political approaches to it – some European norms and standards should be elaborated and adopted in this policy field too.

Institutional Issues: Negotiations on and Ratification of the Lisbon Treaty

The new Member States have been associated with the EU Treaty reform from the outset, as they were invited to participate in the European Convention and later on also in the Intergovernmental Conference on the Constitutional Treaty. In these negotiations, as well as in the negotiations on the Reform Treaty, the position of the NMS became clear. The general policy direction of the NMS in these reform debates

has been to increase the efficiency, transparency and democratic legitimacy of the EU. All the NMS are interested in a stronger Union which is competitive, prosperous and safe inside, and which can make its voice heard in the international arena. Beyond this general approach, however, there were of course some differences in the national positions of the NMS regarding the main items of institutional reform.

As far the size of the Commission is concerned, the NMS would have preferred to maintain the principle of one Commissioner per Member State. This is especially important for the small and medium-sized members who cannot counterbalance the lack of their presence in the Commission by their presence in the Council. Nevertheless, none of the newcomers wanted to veto the rationalisation of the Commission's size in the medium term.

Regarding the modification of the voting system in the Council, namely shifting from weighted votes to double majority voting, only Poland had serious objections. Poland is satisfied with the "generous" weight granted to it by the Nice Treaty (together with Spain) and therefore did not like the idea of losing some of this weight in the new system. Thus Poland was prepared even to block this decision, but in the end it entered a compromise whereby introduction of the new system could be postponed to 2017 the latest (with a transition period between 2014 and 2017). All other NMS were contented with the new regime, because, even if it alters their weight, this voting method is more transparent and also facilitates further enlargements. Moreover, the Poles also succeeded in maintaining the Ioannina compromise in the new Treaty (enabling the Council to postpone a decision even if the blocking minority is not reached) which was then accepted by every Member State. In these issues therefore, Poland has been a strong decision-shaper country.

The increased role of the European Parliament (via the ordinary legislative procedure) was absolutely welcome by all newcomers as they advocate greater democratic control of EU level decisions. They also agreed on maximising the size of the EP with a cap of 750+1.

The most controversial question for these countries was the creation of the permanent President of the EU. They initially feared that such a position would be occupied by a politician from a big Member State who would dominate decision-making in the European Council. They also regretted to lose the possibility of holding a six months Presidency at the highest level of the Union. Nevertheless, none of them wanted to veto this idea neither and, when it became clear that the President would rather carry out strong chairman-type and representative functions, they all adopted this proposal. The idea of an EU "foreign minister" and the setting up of a European External Action Service was also accepted in its present form.

Finally, as to the Charter of Fundamental Rights, the NMS supported its becoming legally binging – with the exception of Poland who opted out. The special case of the Czech Republic must also be mentioned as Prague, before completing ratification, asked for a guarantee that the Charter would not have a retrospective effect.

In the process of Treaty reform the NMS played mainly a decision-shaper role as they actively participated in the deliberations from the outset. They did not refrain from raising objections but were also ready to make compromises and in the end of the day they overwhelmingly supported the new documents. A major conviction shared by all the NMS is that the model of a multi-speed Europe should be avoided as this might produce different classes of membership. Both the Constitutional Treaty and the Lisbon Treaty reassured the NMS in this respect as none of them points to such a development of the European Union.

As regards the ratification process of both the Constitutional Treaty and the Lisbon Treaty, it must also be underlined that none of them was stopped because of a new Member State. The majority of the NMS were actually among the first to ratify both texts (none of them organised a referendum on them). On the other hand, when it came to the ratification of the Lisbon Treaty, two new Member States, Poland and the Czech Republic were the last ones to complete the ratification process. Namely, after the first, negative Irish referendum on the Lisbon Treaty both countries' Presidents suspended ratification. It was only after the second, this time affirmative, Irish referendum that Poland ratified the text, while the Czech Republic still asked for further preconditions to do so. In the end this issue was solved and the Treaty could enter into force on the 1 December 2009.

Interests, Positions and Influence in Some Key Policy Areas

Common Agricultural Policy

All new Member States are interested in maintaining the present form of the Common Agricultural Policy of which they are beneficiaries. The crucial element of change should, however, be the total elimination of any differences in direct payments between old and new Member States as soon as possible.

At the same time, the NMS are aware that the CAP is in need of reform. Thus, in general they support the Health Check process but there are some specific aspects advocated by most of them. They actually stress that the direct payments (to which they are only gradually getting entitled) should be maintained as the farmers have to comply with several criteria requiring costly investments (cross-compliance). Also, with the help of these payments, the substantial income gap between Eastern and Western European farmers should gradually be closed in order to have equal opportunities for competition on the Internal Market. At the same time, the NMS are also interested in the second pillar of the CAP, namely support for rural development. According to the majority view even if – against their interests – direct payments are to be cut back, this pillar should not be decreased, on the contrary. Export subsidies should remain in place too, given the strong competition on international markets.

Due to the specific nature of the agricultural sector, the NMS are all in favour of keeping its management and financing at a supranational level and none of them would ever support re-nationalisation of the CAP. This is equally the case of such

countries as Poland, Romania, Hungary (or even Bulgaria and Slovakia) with strong agricultural potential, or for example the Czech Republic and Estonia where this sector is not of key importance. The latter country seems to have the most liberal approach to CAP reform, accepting the lowering of the amount of payments but only in parallel with increasing the efficiency of agricultural farms and phasing in to more viable and competitive market regulations, enabling the EU agriculture to align with the general world economic developments. The least hostile to re-nationalisation ideas could be Slovenia who can imagine a kind of partial re-nationalisation of the CAP if really necessary.

Some new Member States would also like the CAP to assist member countries hit by excessive meteorological events such as floods or droughts.

All in all, the NMS are heavily interested in the Common Agricultural Policy and would like to see only moderate reforms which, however, should go in the direction of improving their position on both the European and the world markets. They are making efforts to become decision-shapers in the changes of this policy area by mostly allying with each other as well as with the strongest pro-CAP old Member States such as France, Ireland or Greece. Nonetheless, it still remains to be seen whether they can make a real impact on the future of the Common Agricultural Policy.

Budget

Regarding the future of the EU budget, the position of the new Member States is strikingly similar vis-à-vis both the revenue and the expenditure side. There are of course some nuances and different emphasises but the general approach is very much the same.

As to the revenue side of the budget, the NMS agree to keep the ceiling at 1.23% of EU GNI (many of them would prefer to spend the whole sum totally each year). The principle of multi-annual perspective is also supported as it provides for long-term planning. The NMS would like to see a simplification on the income side by keeping the own resources system coupled with the GNI based revenue (even if it has to be raised), but they would prefer to see the VAT based payments abolished. At the same time, the NMS would not like the Union to introduce an EU tax neither. Furthermore, they all agree also that there should be no special treatment of any Member State (i.e. any kind of rebate should be eliminated).

On the expenditure side all new members – regardless of their levels of development – highlight the importance of the financial solidarity principle which is leading in the longer run to more cohesion and consequently stronger competitiveness of the Union. Their top priority within the expenditures from the budget is therefore the current 1b line, namely, "Cohesion for Growth and Employment". Within this policy field some new Member States (e.g. Poland, Romania) would like to see more decentralisation and simplification of the procedures linked to application for funding as well as to the implementation of the projects. Beyond the absolute

priority of cohesion support and the maintenance in some form of agricultural subsidies, the NMS would like the EU to spend more on external border control, on energy policy, or on innovation.

Given the net recipient position of all NMS, however, it is not very likely that they could become agenda-setters in formulating the future rules and structure of the EU budget. Nevertheless, they can become decision-shapers in many aspects, especially if they ally with a range of old Member States too.

Internal Market

The mostly small and medium-sized NMS all pursue liberal-minded market policies due to their openness and strong interdependence with especially the European markets. The EU takes up the majority of NMS exports, the main investors in these countries come from other (mainly old) EU members, and many of them are important exporters of workforce to Western Europe (especially Poland, Lithuania, Romania and Bulgaria).

These conditions explain well why all the new Member States advocate full liberalisation of the four freedoms thereby completing the Internal Market. A clear evidence of this attitude was the NMS approach to the Services Directive. They all wanted to see full liberalisation of providing services on the Internal Market (with the country of origin principle, as emphasised in a position paper by the Czech Republic, Poland, Hungary as well as Spain, the Netherlands and Great Britain). In the end, the NMS were rather disappointed by the final outcome of negotiations.

The NMS support the better regulation efforts of the Commission, as well as any decision and financial support that would promote the situation of the small and medium-sized businesses in the EU. Another position shared by most new Member States is about opposing to tax harmonisation on the Internal Market. Many new Member States introduced flat tax rates and are trying to reinforce their competitiveness also via their tax systems. For this reason they would not be in favour of further harmonisation fearing that it would be detrimental to their actual competitive positions. Keeping fiscal harmonisation in the Lisbon Treaty under unanimity in the Council satisfied all NMS.

EU2020 Strategy

The NMS welcomed the European Union's new competitiveness strategy, succeeding the expiring Lisbon Strategy. While the ten countries had different points to make during the consultation period, most of them criticised the Commission proposal for not including explicitly the objective of economic, social and territorial cohesion into the main objectives. They also emphasised the need for more transparent and efficient governance of the Strategy, by stipulating fewer targets with clear peer review mechanisms. Furthermore, the majority of the ten countries

expressed their wish to see a direct link between the goals of the EU2020 Strategy and the new budget stretching from 2014 to 2020.

Energy/Climate

All new Member States welcomed the new legal basis for energy cooperation at the EU level in the Lisbon Treaty, as most of them are struggling with serious import dependence (mainly from Russia). One of the key issues in the NMS is ensuring security of energy supplies (the gloomiest example of the temporary lack of it was already experienced in Bulgaria). All these countries are therefore interested in close energy policy cooperation within the EU, in interconnections of energy networks especially with old Member States, and in new, alternative import routes such as the Nabucco pipeline project. The NMS are favouring nuclear energy too, some of them ally especially with France in this respect (maintaining that nuclear energy belongs to clean energy sources, enabling to increase self-sufficiency). As regards the ambitious objectives of the Union concerning fighting climate change – namely its "20-20-20 strategy" – the NMS agree with that and support the Commission in international negotiations. However, some countries (e.g. Poland) draw attention to their carbon-based industry which would suffer from a fast reduction of CO2 emissions.

Area of Freedom, Security and Justice

In this policy field the immediate interest of the new Member States has been to get successfully integrated into the Schengen zone. This was done by the eight countries which joined in 2004, by 2007, while Romania and Bulgaria have to prepare for full Schengen membership by 2011. With the exception of the Czech Republic (and after the Croatian accession Slovenia) the NMS are situated at the external borders of the Union, some of them having very long land borders. Complying with the Schengen requirements involves huge costs this is why the NMS are emphasising the necessity of EU financial solidarity here.

Although situated at the external borders of the Union, the new Member States are not destinations of immigrants or refugees therefore they are typically decision-takers in this policy field. As regards police cooperation, however, some new Member States (e.g. Poland and Hungary) have reservations vis-à-vis the depth of EU competences, although they are never decision-blockers in this policy area.

Conclusions

The main conclusion of this article is that influencing EU decisions by mostly small and medium-sized, new and poorer Member States is not easy. Exercising an impact on EU developments has been a real challenge for these countries, which seem to be decision-takers in the majority of the cases. In some rare cases they became agenda-setters (e.g. Hungary with minority rights or Poland with Eastern Partnership) while

in some other rare cases again they acted temporarily as decision-blockers (e.g. Slovenia during Croatian accession negotiations or the Czech Republic with the Lisbon Treaty), although even in these cases a compromise could be found in the end of the day.

The NMS are also increasingly learning how to become creative decision-shapers. They are expressing their interests, with a view to shape the outcome of negotiations, when they fear losing some rights and benefits (CAP, Cohesion Policy) or when they feel overburdened by EU requirements (border control, agricultural cross-compliance, bureaucratic rules linked to Cohesion Policy, or fast cut of green house gases when the domestic industry is dependent on fossil energy sources).

All in all, it can be stated that the NMS are basically interested in a strong European Union which continues with both deepening and enlargement. The NMS are in general satisfied with the present policies of the EU, they prefer to have a moderate modification of the CAP, the maintenance of cohesion objectives and instruments, a tighter cooperation in energy policy (with special regard to security of supplies), a full liberalisation of all four freedoms on the Internal Market, solidarity as regards external border control, simplification of the rules of the budget on the revenue side and some streamlining on the expenditure side (without altering the present ceiling). The NMS are all committed to their transatlantic ties but they also support a strong ESDP, without any duplication with NATO activities, however. All NMS are champions of further enlargement to the East due to their geographic position, economic, historic and even human ties, as well as due to their interest in a stable and prosperous immediate neighbourhood. This is why they also supported the Eastern Partnership as a means to strengthen the relations with the countries concerned.

As regards institutional issues, the NMS are in general in favour of the so-called Community method, they want to see a strong Commission, a powerful Parliament and efficient decision-making in the Council. They tried to stick to the old Presidency system, but came to terms with having a permanent President of the European Council too.

Based on these interests and attitudes, the NMS already made important contributions to different debates at the EU level and managed to make their voice heard. They did it sometimes alone but they were more successful when they could take part in coalitions. In this respect, the NMS do not form a voting block at all, even if in some cases many of them can be found in the same group. On the other hand, they are natural allies in such cases as the policy on CAP direct payments or liberalisation of buying of agricultural land, because they are subject to the same rules and same risks since accession. But the NMS usually ally with both old and new members according to their actual needs and preferences. In this sense they behave as any “normal” Member State.

Being a full member of the European Union meant so far for the new Member States a chance to influence European integration in such decisive debates as those on Treaty modification and institutional reform, the budget review, as well as the

Union's new energy and climate strategy, the upcoming competitiveness strategy or the new goals concerning the area of freedom, security and justice. The NMS did their best to grasp these opportunities to shape EU decisions instead of just remaining passive decision-takers. However, more time is needed (especially for the latest comer Romania and Bulgaria) to make a stronger impact on EU developments by strengthening their creative influence and at the same time by preserving their readiness for compromises.

ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

ГОДИНА XX, 2011, 2

Tamás Novák[1]

IMPACTS OF THE GLOBAL CRISIS: SPECIAL FOCUS ON CENTRAL EUROPE AND HUNGARY

The Central and Eastern European countries outside the Euro area were hit particularly hard by the global credit crunch; their previously fast growth was replaced by a recession, putting their catch-up as part of the integration process into a completely different context. The crisis has made it clear for some of the Central and Eastern European newcomers that growth cannot be maintained based on generous inflows of capital. The abundant international liquidity that marked the years before the crisis vanished, FDI in the region plunged dramatically, and the drying-up of the government bond market imposed extremely tough limits on the external funding of budgetary overspending. The crisis hit Hungary especially hard as this country was already at a low growth path after the 2006 stabilisation package.
JEL: O18; O57

Losing ground for quite some time, this international financial and economic crisis proved to be a major challenge both for the European Union as a whole and its Member States in the global reshuffling of power that was triggered by processes of globalisation. Enlarged from 15 to 27 members in the last two rounds, the integration organisation is already being severely tested without the global crisis thanks to its ageing society, its disappointing innovation performance, poor competition, heavy indebtedness and its clumsy decision-making procedures.

With the accession of the new Member States, the EU has expanded its geographical borders, increased its population and boosted its production and market potential, thus making an attempt to slow down and stop its marginalisation in the world economy and the international political arena. The horizontal enlargement, however, led to greater development differences within the Community. Compared with any previous enlargement, the EU is faced with far more complex tasks of helping its Members catch up, deepening integration and strengthening cohesion, as they require a root-and-branch reform of the EU's institutional background, operational, decision-making and interest-asserting mechanisms.

EU institutions failed to give instant crisis management responses to the crisis that deepened quickly from September 2008 on, and so pushed by their own national

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interests, Member States started to save their banking systems, strategic sectors and jobs on their own. Later on, in an attempt to handle and weather the consequences of the crisis in the long run, the European Commission elaborated its European Economic Recovery Programme, the key elements of which cover all these sensitive areas. The crisis showed how weak and unprepared the European Union was as regards crisis management, both in terms of its institutions and Community resources. This increasingly raises the notion that the EU's development has come to a turning point. The EU urgently has to prove whether it is able to offer efficient Community responses to the crisis on the basis of the cohesion built up so far, and in the meantime, to keep pushing ahead consistently with completing the launched reforms and give fresh impetus to the Lisbon modernisation programme launched in 2000 that focuses on growth and employment. The other scenario runs the risk of Member State interests overriding those of the Community, risking or wiping out results achieved so far in the single market, the common currency, the regulation of competition and in Community policies. These potential outcomes are clearly not independent from the readiness and commitment of the individual Members States to Community solutions.

Although the crisis affected the entire European Union, one can still clearly distinguish two different groups of countries in terms of the objectives and instruments of crisis management. One group contains the economies of the EMU, while Member States either opting out of the EMU or those still waiting in line belong to the other, the latter predominantly being new Member States. The United Kingdom, Sweden and Denmark are formally outside the EMU, but being developed market economies their status within the EU is determined by completely different aspects to those affecting Central and Eastern European countries which converted to market economies once the Soviet influence on their economies receded.

Economic Development in Central Europe since EU Accession

International economic relations of countries in Central Europe underwent radical change between 2004 and 2007 on account of the two enlargement waves of the European Union, creating new conditions for economic development and convergence. EU accession lent new momentum to the economic growth and therefore convergence of all the new Member States – with the exception of Hungary, where the initially higher rate of growth had slowed substantially by 2007, while living standards measured in terms of per capita GDP have merely stagnated since joining the EU in contrast to the dynamic growth recorded in the other nine countries. On the whole the region developed at a pace rarely seen in economic history, which accelerated the pace of convergence, though it will be practically impossible to repeat this in the near future. The economies in the region have to formulate a radically different economic strategy under the new domestic and international conditions. During this period of rapid expansion, however, the sustainability of growth registered by the various countries differed, and therefore the crisis found the EU Member States in Eastern Europe in very different situations.

In terms of per capita GDP, the Baltic States and Slovakia have made the greatest progress since 1998. Over this 11-year period, the three large new Member States of Hungary, the Czech Republic and Poland have trodden similar paths, converging 8-10 percentage points on the EU-15 average. Between 1998 and 2008 the regional ranking of countries underwent significant change: while Estonia, Lithuania and Slovakia managed to improve their relative positions, Hungary and Poland steadily worsened.

If we just examine the indicators for 2003, i.e. the year prior to accession, the trends perceived are largely similar, with the difference that Hungary's development deviated at a tangent from the other countries in the region and between 2003 and 2008 did not manage to converge on the EU-27 average at all. This catch-up process is reminiscent of Greece, where practically no convergence was achieved for almost fifteen years after accession.

Taking into account the growth processes predicted for the next 2-3 years we can expect further substantial restructuring between countries. The Baltic countries will lose a considerable part of the convergence they achieved over the last decade, while the Czech Republic and Poland will manage relatively swift convergence, just ahead of Slovakia. Any form of catch-up will continue to elude Hungary and Poland may well leapfrog Hungary in the regional rankings.

Per capita GDP of the "new Member States" Per capita GDP, PPP, EU-27=100; Change 1998-2008 percentage point; Change 2003-2008 percentage point; Change in order between NMS (1998-2008)

Per capita GDP of the "new Member States"						
	Per capita GDP, PPP, EU-27=100;			Change 1998-2008 percent. point	Change 2003-2008 percent. point	Change in order between NMS (1998-2008)
	1998	2003	2008			
Slovenia	77.7	83.4	90.7	+ 13.0	+7.3	1 → 1
Czech Republic	70.5	73.4	80.1	+ 9.6	+6.7	2 → 2
Slovakia	52.1	55.5	71.9	+ 19.8	+16.4	4 → 3
Estonia	42.5	54.5	68.2	+ 25.7	+13.7	6 → 4
Hungary	54.6	62.8	62.8	+ 8.2	0.0	3 → 5
Lithuania	40.4	49.1	61.1	+ 20.7	+12.0	7 → 6
Poland	47.8	48.9	57.6	+9.8	+8.7	5 → 7
Latvia	35.6	43.3	55.8	+ 20.2	+12.5	8 → 8
EU-15	115.4	113.7	110.8			
Source: Eurostat and own calculation						

The regional economies contracted to varying degrees in 2009, but overall we saw plummeting economic performance; as a result, per capita GDP figures have changed to almost unprecedented extents, which in turn trigger significant shifts in the relative development levels of the individual countries.

The crisis is unleashing its power the most in the Baltic countries which previously recorded the most dynamic growth rates; all three of the economies were suffering from a severe and far deeper recession than all of the other new Member States. At

the beginning of the 1990s and after suffering economic downturns reaching almost 50% of GDP the Baltic countries announced stabilisation programmes which centred around stable exchange rates; this is why they pegged their exchange rates to a key currency or to a basket of currencies. The macroeconomic imbalances were substantial even by Eastern European standards. These equilibrium problems primarily arose in the current account and resulted in double-digit deficits relative to GDP for years, but the benign conditions for the international flow of funds and the low cost of capital meant that this was not an issue; today, however, the situation is rather different. The significant external deficit is partly caused by the economic convergence process, but its size has raised questions about sustainability for years. As the crisis deepened and the flow of funds dried up the current account balance started to improve rapidly, which cast the external equilibrium in a better light as well, even though economic output had fallen by about one fifth.

With monetary policy being useless it is theoretically fiscal policy that can mitigate the economic impacts, but the economic decline was such that to compensate for the falling revenues governments have been forced to cut back massively on budgetary spending (up to 10-20% of GDP). The crucial issue is what to do with the pegged exchange rates? Pressure to devalue the regional currencies had grown, but abandoning the peg implies huge risks. While it is clear that such a step would be justifiable in many respects given the difficult economic circumstances, it would tip many businesses and households into bankruptcy. Loans "defaulting" en masse would accelerate the deterioration in banking portfolios, while the reduced solvency of households and companies could trigger an even greater economic setback that would bring down the Scandinavian banks in the region with it, thereby creating a catastrophic situation for the economies of these northern countries. Euro introduction became a viable option in the case of Estonia which became the next candidate for Euro adoption. The other two Baltic States however still have a long way to go.

From a certain perspective the economic development in the countries of South-Eastern Europe, including Romania and Bulgaria, followed the model of the Baltic States. Bulgaria has a similar exchange-rate regime and both countries have witnessed the emergence of significant current account deficits in the years just before the crisis erupted, which paved the way for the rapid growth. In addition to inexpensive international funding, the money repatriated by Bulgarians and Romanians working abroad played a significant role in financing this deficit, which was an important factor from the perspective of domestic consumption. This is why the economic downturn has been exacerbated by the fact that not only has the flow of international loans dried up, those who have lost their jobs in Western Europe are now not able to send as much money home either, which again impacts adversely on domestic demand. What is more, the return of these workers only serves to increase the level of unemployment.

Surprisingly for many, the Euro area members of Slovenia and Slovakia were heading towards an increasingly severe downturn in growth in comparison to what was previously expected. Slovakia's opportunities for growth were very much limited in the current situation by the country's vulnerability linked to its one-sided

economic structure. The automobile industry is very sensitive to cyclical trends, and the crisis has hit this sector extremely hard, even in spite of the measures taken by governments in many countries to stimulate demand. In the long run it may even be questionable just how much an economic structure based on the car industry will be capable of reaching previous levels of growth. However, the picking up of international demand in 2010 resulted in a positive change in GDP growth prospects. In Slovenia which focuses strongly on exports, the dramatic decline in external demand accelerated the economic downturn. Since the country is very open in terms of foreign trade and its growth essentially depends on exports, the general plunge in demand has very much limited the growth opportunities of such a small open economy.

In comparison to the region of Central and Eastern Europe, the Czech Republic and Poland have relatively stable fundamentals and the crisis hit them as they enjoyed a period of benign economic conditions. In Poland, managing the crisis does not take on the form of bank bailout packages or international loans linked to economic conditions but in continuing the structural reforms that had already been launched. However, this only partly explains the endurance of the country vis-à-vis the crisis, what is even more important is that it has a very large domestic economy by Central European standards and relatively speaking is less open, which means changes in international demand do not affect it as much; additionally, domestic demand together with the domestic market are able to mitigate the pace of the economic slowdown. Nonetheless, the fact that the IMF provided Poland with a flexible credit facility in spring 2009 to overcome any unexpected financial difficulties just demonstrates the unpredictable and increasingly severe consequences of the crisis. It is important to note that this credit facility can be used at any time and is not tied to any conditions, i.e. it is only there as a safety net.

The Czech Republic does enjoy its relatively stable macroeconomic conditions, but here, external demand is much more important than for Poland which is why the Czech economy is set for much more challenging times over the coming period than the Poles; however, given the features of the economy it is now likened more to the healthier Poland than to other economies in the region.

Hungary does not really "stand out" from the other economies in Central Europe in terms of expected growth. Yet because of the country's vulnerability and the level of its debt it is more often than not grouped with the Baltic countries. For this reason there were no reserves which could provide more options for the budget, as is the case in more stable countries (such as the Czech Republic and Poland), nor are there any tools available to stabilise the situation, such as the Euro in Slovakia and Slovenia, while the domestic market is too small to stabilise demand on its own. What should not be forgotten is that thanks to the stabilisation measures taken, demand had narrowed significantly and the economy had slowed down in Hungary even before the crisis erupted.

GDP Growth and Forecasts for the New Member States

	2004	2005	2006	2007	2008	2009	2010*
Bulgaria	6.7	6.4	6.5	6.4	6.2	–4.9	–0.1
Czech Republic	4.5	6.3	6.8	6.1	2.5	–4.1	2.4
Estonia	7.2	9.4	10.6	6.9	–5.1	–13.9	2.4
Latvia	8.7	10.6	12.2	10	–4.2	–18.0	–0.4
Lithuania	7.4	7.8	7.8	9.8	2.9	–14.7	0.4
Hungary	4.5	3.2	3.6	0.8	0.8	–6.7	1.1
Poland	5.3	3.6	6.2	6.8	5.1	1.7	3.5
Romania	8.5	4.2	7.9	6.3	7.3	–7.1	–1.9
Slovenia	4.3	4.5	5.9	6.9	3.7	–8.1	1.1
Slovakia	5.1	6.7	8.5	10.5	5.8	–4.8	4.1

Source: Eurostat /* Eurostat forecast.

The course of the crisis largely depended and still depends on the flow of funding. It is very difficult to judge just how the banking systems in Central European countries will remain stable while it becomes more difficult to source funding on the international markets on account of the decline in global savings and the rise in the external financing requirements of the world's largest economies.

We cannot rule out this scenario exerting its greatest impact in the Central European region. It is already difficult and sometimes even impossible to source funds on the international market, but this may get worse given that the growing problems for international companies means the future of subsidiaries is increasingly uncertain. Since developed countries do all in their power to preserve domestic jobs whilst companies concerned are coming under increasing pressure to slash costs, it seems logical to narrow the activities of subsidiaries operating in Central Europe in the next phase of the international crisis. On the other hand however, the lower cost of production in this region makes it very competitive against the production in more developed countries where the wage level is also higher. So the picture on production and investment prospects in international comparison is not black and white.

From the perspective of growth and convergence based on both internal (investments, consumption) and external (capital flows, trade) factors it is evident that the new Member States which have coped better with the crisis so far are those which have produced high but not overheated growth since accession coupled with an appropriate level of external and internal financial stability, a low budget deficit and a healthy public debt indicator. In the case of Poland an additional factor prevented larger downturn. In other countries in the wider Central European region the credit based consumption and investment was much widespread than in Poland where the financial deepening was slower. In other states where credits were the most important factors for increasing demand the sudden stop of in the financial market resulted in a demand shock, or in other words the over consumption had to be adjusted to the available income. This shock was much bigger in other countries than in Poland.

The economies in the Central European region are supposed to formulate a different economic strategy under the new domestic and international conditions. This strategy seems to be different from the previous one in two aspects. The first is that achieving fiscal balance becomes a number one priority, and second that the growth should much more be based on savings rather than easy credits. These changes are affecting the region's countries differently, because of the not uniform initial position, but the mainstream of the "new" economic policy points toward these directions.

The expectation for post accession period was that the need to comply with the Maastricht criteria pushes the Central European countries to decrease the economic disparities between their countries and the former EU Member States. The indirect harmonisations of economic policies were supposed to be a tool to support convergences between their economies. In the longer run it is certainly true that outside pressures help indirectly certain convergence of economic policies between the Visegrad countries independently from economic policy coordination. This coordination has been almost non-existent during the past two decades and only under serious (economic) security policy threats could alter the situation. This is exactly the case currently; however the developments in the region hint that the tools chosen by the regions' countries are different and the dividing line is again between Hungary and the others.

Except for the Slovak and Slovene economies, the countries were unable to meet the prerequisites for introducing the single currency even before the crisis. The consequences of the crisis, however, have pushed the fulfilment of the requirements even further away, especially if the current Maastricht criteria remain in force. Their relevance was questioned by many even before the crisis, as aspiring countries are expected to comply with conditions that the EMU countries themselves fail to fully abide by. What is more, commitments made in the convergence programmes – restrictions relating to a sustainable balance, financial regulation, oversight, interest rates and exchange rates in particular – have, in the short run, narrowed the crisis management alternatives for the countries waiting to join EMU.

The crisis highlighted the benefits of exchange rate stability guaranteed by the single currency for the countries in the region. The majority of these economies are extremely open in terms of foreign trade, while export ratios relative to GDP are high and most of their foreign trade is with EU markets. Some countries (Hungary and Poland) are experiencing massive corporate and household indebtedness in foreign currencies, which only adds to their vulnerability. Due to their export sensitivity and their dependence on external funding, the global recession made their position even worse; and from September 2008 investors hastily withdrew their capital from the region. All of these factors combined with speculation attacks against certain currencies and listed companies led to dramatic falls in exchange rates and great volatility. Had it not been for the financial assistance of the IMF, the World Bank and the European Union, Hungary and Latvia would have been unable to avoid a financial collapse, maintain the funding of their budgets or stabilise their currencies.

Despite the global crisis seriously threatening the financial stability and currencies of the Central

and Eastern European countries waiting to introduce the Euro, neither the European Union, nor the EMU or the ECB showed any willingness to grant them protection under the common monetary policy. It was the IMF which proposed that the countries in the region afflicted by the crisis should get rid of their national currencies and introduce the Euro instead, without formally joining the Euro area. This would have been quasi membership, but without membership of the ECB Board. In addition, the IMF and the EBRD tried to persuade the EU and the Central and Eastern European countries to work out a regional crisis management strategy and set up a regional financial rescue fund, which encountered widespread resistance from both sides and so the issue was dropped from the agenda. Joining the Euro area was opposed not only by the ECB but also by the EMU countries, as they did not wish to water the Maastricht convergence criteria down.

As suggested by analyses, the crisis has pushed the aspiring countries even further away from fulfilling the formal convergence criteria. Addressed to the new EU Commission, the Bruegel Report underlines in terms of the enlargement of the Euro area that the Maastricht criteria set forth in the early 1990s are contradictory and the crisis has finally rendered them unfit for purpose. Therefore a new procedure, clear requirements and economically reasonable benchmarks (performance evaluation) need to be set to replace today's mostly irrelevant conditions. This should be offered to the countries wishing to join the club, but we should also acknowledge Member States wishing to delay the introduction of the Euro. In the years preceding the crisis the reference value of the budget deficit set at 3% of GDP was exceeded most by Hungary and Poland. As a result of the strict budget consolidation launched in Hungary to redress the balance and pave the way for sustainable growth, the deficit was successfully curtailed. Due to the high Hungarian indebtedness, fiscal policy has very few opportunities left to provide massive budgetary funding for crisis management measures. In Hungary the visible government aim at the moment is to stabilise the public finances with revenue increases which is based on additional sectoral taxes, the channelling private savings in the pension system into the budget and at the same time cutting income taxes both for households and the corporate sector. In short run the Hungarian budget position due to these steps will be in order but the longer term consequences are not seen at the moment. The sustainability of the public finances and also the transfer system (pensions, social transfers etc.) will be questionable after 2012-2013.

Revenue side stabilisations were rarely successful in the past 15-20 years in Europe. The mainstream stabilisation efforts in Europe and that are followed in other Visegrad countries as well is much more based on the spending side. This difference explains that the future budget position and debt risk in Hungary and in the other three Visegrad countries is judged differently by the international actors at the moment. This is clearly reflected in the recent Moody's downgrading of Hungary' sovereign debt putting it into Baa3 category while Czech and Slovak ratings are A1 and Polish is A2.

What can be an interesting feature for each of the Visegrad countries are the changing international strategies of global firms. Many firms are forced to search for further cost cutting in order to regain their competitiveness in face of an economic environment where demand is several sectors is expected to stabilise at a lower level than before the crisis broke out. In such circumstances firms are eagerly looking for cost saving measures that in large firms may result in rethinking their global presence that leads to closing high cost production facilities and move them partly to lower cost countries. As big multinationals in some cases are deterred to close facilities in their home countries (because of government warnings i.e. in some major Western European countries) they may chose to downsize their production in other high wage countries. Visegrad countries are low cost locations and the capacities in some sectors (car industry for example) are technologically modern, very competitive so they can expect some additional investment as part of global cost optimization strategies of multinationals. It is by no means an accident that in Hungary we witnessed several additional investments from big car makers in recent months while future prospects of economic growth and fiscal stability are still not very bright. And this phenomenon is very promising as this show that Central European countries as locations are attractive in international cooperation that can be an additional element in maintaining export oriented growth in Hungary, Slovakia and partly in the Czech Republic. Poland stands out a bit from the region as the size of its domestic market makes possible to rely more on the domestic demand instead of external one that is the major growth component in the other three countries from the region.

The Hungarian Economy and the Global Economic Environment

If we analyse the effects of global economic processes on Hungary, here and now, we cannot emphasise strongly enough that in spite of the many apparently favourable trends the global economic crisis is not yet over, because global economic processes are far from having created a (relative) balance.

1. All around the world, there are still huge superfluous productive capacities, which were accumulated during the past few decades by big companies themselves, and today they are partly maintained artificially by government bailout packages. Bigger real economic failures could still be round the corner. The structural change, ‘the creative destruction’ is not yet finished.

2. There will be strong demand constraints to an economic upswing for some time. The momentum of international trade is unusually dynamic for crisis times, but unemployment, the decreasing earnings of the population, the restraint of welfare spending, the deferral of government investments and the lag of business investments and housing construction is pulling demand back.

3. The solvency of retail and corporate debtors is weak, and in some cases the insolvency ratio is even growing.

4. This situation burdens bank portfolios and financial institutions may incur losses. The high funding needs of state budgets in developed countries mean that money market supply and risk-taking are still scarce. Lending continues to be very prudent, and companies, especially those in less developed countries, will find it harder and more expensive to obtain working capital.

5. Given the relative financial consolidation, many financial institutions have launched 'repackaged' derivatives with uncertain backing (e.g. the cash-for clunker loans in the USA).

6. The possibilities for financing and sustaining further countercyclical economic policies, governmental bailout packages and near-to-zero interest rates are narrowing. The risk of budget imbalances and insolvency is not just an issue for Greece.

7. The abrupt increase in government debts reinforces the possibility that they could eliminate them by inflating them, boosting general inflation.

8. The only moderate decline in the international trade and payment deficit of the USA remains a factor of tension in the global economy, as well as the general prevalence of international balance deficits, although these usually disappear during large crises. The same conclusions were drawn by the aforementioned Nouriel Roubini. He mentioned bubbles without foundations too, which could burst in 2010 or 2011, and feared that 'monetising large deficits' would cause inflation. Under such circumstances, a weak financial or macroeconomic figure could trigger major fluctuations. We agree with Roubini that the current crisis process is rather long – to use Mihály Simai's witty words, it will be the shape of a bathtub – and a new, deep wave could appear within it, forming a W-shaped crisis curve. And even if massive bailout packages, severe public debt and strong inflation could still help developed countries avoid the newer and deeper crisis wave for now, and if bigger bubble bursts can still be avoided, the presence of the unnecessary bubble capitals and their low return – in our opinion – will shorten the next economic cycle (relative growth and prosperity will be shortened to 3-5 years), and structural tensions will set a moderate tone for economic growth, at least in developed countries.

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
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Plamen D. Tchipev[1]

FIGHTING THE ECONOMIC CRISIS: COULD BULGARIA BE A NEOLIBERAL SUCCESS STORY?[2]

In April 2010 Bulgarian government announced an economic and socail plan targeted on counteracting the swift economic downfall and hopefully, on helping the economic recovery. The way the plan was launched and the character of some of the measures created a lot of comments, rejection and controversy among the economic agents in the country. That inspired the main idea of that paper - to look more carefully into the plan. First section outlines roughly the global response to the financial crisis. Section 2 observes the government anti-crisis plan in some detail; the third features plan's specifics summarizing it as a fire plan, comprised of a bunch of neo-liberal measures targeted on shrinking belts and relying on the self-sufficient ability of private business to overcome the recession. Section 4 tries to answer the question – why the plan is as it is - and pays attention to the objective determinants of the plan, to the "ideologemes" which frame the economic thinking of policy makers and points out the first results and the first cracks of that plan. Finaly, the paper concludes that, a radical shift away from the neoliberal economic policy seems more and more as an unavoidable decision.
JEL: B52, E32; E61; E65; E66

The Global financial crisis shook Bulgaria severely. The GDP fell from +6.19 in 2008 to -5.5% in 2009 causing a dramatic effect over the whole economic activity. The worse result went to the FDI, which were the engine for the preceding growth. They fell from above 9 billion Euros in 2008 to 1.6 billion for the 2010.

Facing the disappointing reality the government decided to create an anti-crisis plan in order to counteract the economic downfall and hopefully to help the economic recovery. The plan was announced in the beginning of April 2010 and comprised a large number of measures. The way the plan was launched and the character of some of the measures created a lot of comments, rejection and controversy among the economists. This inspired the main idea of that paper to look more carefully in the plan. The paper deals with the global response to the financial crisis, the BG government anti-crisis plan, specifics and summary of the measures. In conclusion

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[2] I am grateful to participants in EAEPE Annual conference, Nov. 2010, Bordeaux and BU-HU bilateral workshop, Oct. 2010, Sofia for all the comments received; needless to say that all the responsibility for any reaming errors and views is solely with the author.

the paper tries to shed some light on the dominant economic thinking which shaped the plan in such a way.

The Global Response to the Crisis

It is very difficult to speak about a unified global response. The different countries reacted more or less independently and created their own plans reflecting their own understanding how to fight the crisis. Nevertheless, a tiny consensus emerged based mostly on the decisions taken at the meetings of G-20 (London, Pittsburg).

Since detailed view of the measures taken in response to the crisis by the most influential economies is beyond the focus here, just a few points are mentioned. The goal of the measures is targeted on creating of a "fundamentally stronger financial system than existed prior to the crisis", **(G-20, 2009, §13).** The member states emphasis their intention to have stricter risk-taking rules, compensations bonded on performance, stringent supervision on firms which could pose a financial stability risk. The member states pointed out the critical areas, which need to be addressed by their financial ministers and central bank governors. Among them:

- Creation and endorsement of Financial Stability Board to oversee not excessive risk-taking. "Excessive compensation in the financial sector has both reflected and encouraged excessive risk taking", **G-20, (2009,§13).** Reforming compensation policies and practices is an essential part of the effort to increase financial stability.

- Trading of all standardized OTC derivative contracts on exchanges or electronic trading platforms where appropriate, and clearing through central counterparties by end-2012 at the latest.

- Establishing crisis management groups for the major cross-border firms and a legal framework for crisis intervention as well as improve information sharing in times of stress.

- A single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011.

It is not difficult to notice, that the major effort is targeted on financial system. No matter what are the precise judgments about the mechanics which led to the financial crisis, it is quite clear, that a certain set of steps has to be done in order to achieve stability and safety of the financial system and those steps comprised quite a *reforming* ones. Such, that, to ensure the corporate management activities (including trade in some derivatives) are properly accounted and monitored for not excessive risk-taking and long-term value creation.

That general drift, of the reforming effort in the developed world, might not be enough to address the whole complexity of the problems encountered in the individual countries, but in any case it might provide a view point when debating Bulgarian plan.

Bulgarian Crisis-Fighting Plan

On 31th of March 2010, after a long and sometimes quite turbulent debates, the Bulgarian *"tristranka"* (a tri-party negotiating public body[3], comprising representatives of the government, syndicates[4] and employer organizations) announced a package of 60 measures covering various economic and social areas of activity.

That "bargained" plan was empowered by a government resolution **(Government of Bulgaria, 2010)** and soon afterwards the budget revision passed in the Parliament without further debate. This, non-traditionally adopted, anti-crisis plan bears a lot of peculiarities we later discuss in more detail, but one of them need to be mentioned right here.

While the plan was highly acclaimed as consensual, that was *not a political consensus.* And many of its measures were fiercely opposed by all possible groups of the political opposition and various *lobbyist groups* (LG). That is the reason that many of the measures were delayed, revised or even reversed. Moreover, even within the "tristranka" debate, consensus was not exactly the word. Both the syndicates and the employers parties continued to argue each other and with the government on certain measures and this also contributed for the failure of some measures. The government itself also seems revising its perception on many issues as we shall see. Hence, the plan was more or less *kind of "letter of intentions"* for the parties, which reserved (implicitly!) some freedom to deviate from the plan.

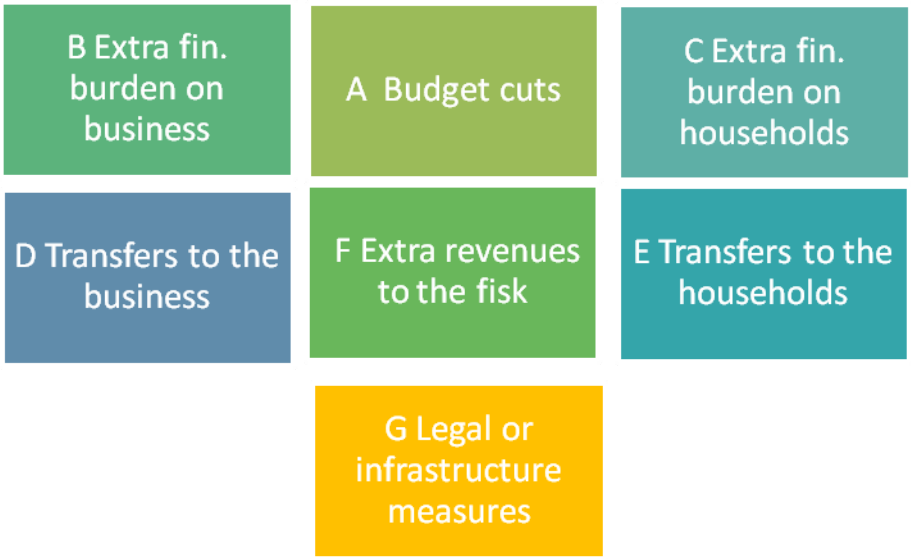
The total effect of the plan was estimated at 1.6bn BGN (€0.82bn) and it was bond *not* to involve an increase of the VAT rate; (currently at 20%). The measures were distributed among the following categories – raising the standards of financial discipline, support for the Treasury, public expense, real sector, households, labor market and social networks. That distribution is quite a "formal" one, since it does not answer clearly who will be affected, either positively or negatively by any specific measure; to say it other way - "Who will pay for each of the measures?" Of course, there is always someone to pay, but the plan does not identify them.

The above amount for the plan is quite a provisional one – many of the measures haven't had financial assessment nor at the moment of plan launch, neither later. About one third of the measures are regulatory ones, which means that they require creation of various registers, or lists, or launch of lasting reforms; those measures are typically without financial assessment.

[3] National Council for Tripartite Cooperation
[4] Bulgarian trade-unions called themselves syndicates at certain moment during the transition to a market economy.

The prospects for success of the anti-crisis plan depend heavily on the social support for it, and the latter is contingent on the way its burden is arranged within the society. This way, Fig. 1 shows an arrangement of the anti-crisis measures into seven groups, according to the affected economic agents.

Figure 1



The first row shows the measures likely to divert (or to shorten) the financial flows of certain economic agents, or more generally, of the society as in the case with the budget cuts. Roughly said, that row represents the austerity measures.

The second row represent the government intention to direct (or to increase) certain financial flows to specific target groups in order to help them to sustain the hardships of the financial crisis; one may see that as incentive measures.

Budget Cuts

Cutting of the 2010 budget seemed inevitable when the tax revenues started to shrink. The government adopted a general cut by 10% of all current expenses of budget institutions estimated at BGN450m; certain exceptions appeared, as of the Ministry of Interior budget **(Government of Bulgaria, 2010, meas. no.19)**.

This is an emergency measure and it was implemented quickly; in fact it was doubled, since later, the consolidated national budget was updated and the actual spending cut appeared 900 m leva (20% of the original).

Further budget cuts were done on smaller scale, as the one of political parties subsidy - about BGN7.5m, and it also went smoothly.

Another group of measures targeted on shrinking of the budget expenditures was devised for longer implementation. Among them most important is the introduction of the long-delayed e-government. Here, again, the anti-crisis plan has not shown estimates on the effect, but it was debated by the experts that total effect will ascribe to BGN2bn for a ten-years period. Unfortunately, the initial effect is expected to be reverse one, i.e. during the the slump and the immediate post-crisis period, since there are costs involved to develope the project itself.

Extra Financial Burden on Businesses

A number of measures, targeted on raising extra budget revenues, inflicted more or less bigger expenses through increased taxation or through introduced new taxes or regulations for carrying out of some business activities.

Among them, more significant looked the following:

- Extra taxation on gambling **(Gov.., 2010, meas. no. 8)**

Initially, the tax was expected to raise about BGN80m, if introduced from the mid-2010. Though at first glance it seems targeted on the customers (percentage from their profit), the businesses interpreted it as negative to them and opposed it severely. The government seemingly accepted, at least to some extend, this argument and firstly delayed its introduction, slashed the expected income and eventually suspended it.

- Reversed principle for taxation of insurance business **(Gov.., 2010, meas. no.9)**

Though the plan was not specific financially on that point, the experts estimated about BGN120m increase in the budget revenues till the end of 2010, as a result of its implementation. The measure was announced as complying with a EU directive, but again the strong lobbyist opposition delayed its introduction, then ensured changes, which are believed to shift the final effect towards the clients and eventually postponed for the 2011.

- Increase of a certain social security payment to the employees **(Gov.., 2010, meas. no.60)**

A measure targeted on curtailing the drainage of the social security system by false temporary disability. The measure was not no assessed in the plan but according to expert estimations its effect is about BGN2m annually. Regardless the opposition it was successfully implemented and even prolonged till 2012.

Extra Financial Burden on Households

- Suspension of certain pensions supplements **(Gov.., 2010, meas. no.59)**

Estimated on BGN142m in the plan. The measure was implemented and the amount of money was transferred to a social program, as discussed bellow.

- "Luxury" tax – the plan forcasts an effect of BGN35m**(Gov..,2010,meas. no.13).**

Highly acclaimed during the "tristranka bargaining" as a measure bearing relatively high effect and as a measure increasing the more even distribution of the of the crisis burden; desperately opposed by various Lobbying Groups (LG), branded as not-feasible, delayed (due to technical (!) problems), and eventually dismissed. Missing the irony, that it was him who negotiated the measure for the government in "tristranka", the finance minister announced *"After all we are a right-wing party and right government. The right governments do not raise the taxes."(bTV, 2010).*

- Cut of a certain social security payment to the employees about BGN15m effect. **(Gov.., 2010, meas. no.14)**

A measure quickly implemented, through an administrative regulatory change

Extra Revenues to the Fisc and Municipalities

During the creation of the anti-crisis plan it became apparent, that filling up the shortage of the revenues to the budget is not possible just by austerity measures and the government need to raise some extra cash. After a strong public campaign and various rumors of inevitable increase of the VAT rate, which created quite a gloomy perspective, the tripartite council announced that VAT *must* not be raised. Accordingly, it launched alternative measures:

- The **no.1 measure** in the plan, **(Gov.., 2010,)** defined as: "Raising of extra internal and external financial resource

The plan has not provide details here, thus fostering speculations, that this is just an euphemism for issuing more government debt. Generally, most of the observers believed the government will use this to untied its hands on rolling the debt, but they differed on the ways, this may be done; so the critics were more or less tempered. Soon, the government reserved the right to issue about BGN2bn for 2010 and another billion for the 2011. Eventually, it occurred that the actual issued debt for 2010 was about 1.5 billion leva and the financial minister declared that no debt will be issued for 2011.

- Second biggest source of extra finance envisaged by the plan consisted the sales of Assigned Amount Units, (CO_2), through the "green investments" program; about BGN500m. **(Gov.., 2010, meas. no.2)**

Unfortunately, the right of Bulgaria to sell those units was suspended by the European commission for many months, negating almost completely the effect of the measure.

- Extra revenue from privatization – 250m; **(Gov.., 2010, meas. no.3)**

Privatization is always a handy instrument, not just because of the extra revenues, but also because it fits well the general trend for shortening the role of the state. Although, it is a difficult one. There were no lists what and when to be privatized in the plan and by the end of the 2010 the results are symbolic. While, the intentions are renewed again, it becomes more and more apparent that this should not be considered as an anti-crisis measure.

- Extra revenues from land rentals and sales – 164m; **(Gov.., 2010, meas. no.7)**

The measure was not quite clear; *apriori,* it was believed that these are future revenues diverted to the current budget through a rearranged contracts. Actual implementation appears to be rather unsatisfying.

- Increased payments from rentals of government and municipal property (BGN25m) and from dividends (26m).

A measure claimed to restore the norms canceled by the previous government; implemented by administrative changes.

- Mining and infrastructure concessions BGN15m **(Gov.., 2010, meas. no.17)**

The measure seems useful but, there were neither lists for the intended concessions not the deadlines, hence it is not cleared how effective it is.

- More independence for local taxation **(Gov.., 2010, meas. no.34)**

Quite a controversial measure; in the beginning it was believed that it will lead to introduction of new principle for collection of the waste-tax by the municipalities - quite a questionable practice currently - and was highly acclaimed. In fact, the change was not done by the beginning of the following tax-year. Instead, an attempt (failed) to change the administrative taxable areas of the capital city was made, with an effect of an enormous raise of the municipal taxes (up to 50%) for many of the citizens.

Since, there were neither estimates of the people affected nor the effective rate of increase, the independent observers regarded that measure, simply, as a hidden tax raise, avoiding the official declarations; (see the above statement of Minister Djankov).

- Temporarily (till 2011) suspension of the decreasing of the social payments **(Gov.., 2010, meas. no.52)**

This tendency, or program, was not just suspended, but reversed; from the beginning of 2011, the pension security rate rose by 1.8%.

Transfers to the business, incuding:

- Three measures of the plan are aimed at clearing of budget payments in arrears – those due on completed contracts, on recovering of VAT to the business and on participation of the businesses in various program funded by the Euro-funds. Those measures have also institutional dimension, since they were bonded on creation of public registers for those debts.

No official estimation was provided, but the experts calculated between 500 and 600 millions Bulgarian leva. The measures are considered complete, though the amount of transfers is about 300m leva; the program envisaged a small discount for repayment, and apparently not all of the businesses joined it.

- Increasing of the capital of Bulgarian Bank for Development (BBD) in order to provide more resource for the Small and Medium Enterprises (SME). **(Gov.., 2010, meas. no.31)**

While the capital of the state-owned bank was raised (currently at 132m leva), it is not clear whatever effect it has on the SME; most of the time the bank was preoccupied to carry out the previous measure.

- Entrusting (?) of government services to private business **(Gov.., 2010, meas. no.16)**

Whatever does this mean, it was announced without any lists, financial estimates, or timing etc., just like that.

- Advancing of the sales of CO_2 quotas by the "Green investment".**(Gov.., 2010, meas. no.2)**

As mentioned above this was intended as a single, strongest, "incentive" measure for the business, but it was blocked for most of the time; few companies were able to take little advantage from the program and the effect is estimated at about 9m leva.

- Government support for the companies endangered by closing on ecologically grounds.

The intention is to give more time for the firms to adjust to more stringent rules in EU. The measure was envisaged as anti-market and heavily criticized, but in fact there were some cases of such support; no financial estimates were released.

- Financial support provided by the budget and EU programs, for the firms applying a "flexible" systems of employment.

Again there were no financial indicators, but the measure was reported complete through the year.

Transfers to the Households

The plan includes a number of measures targeted to support households during the crisis. The measures are income selective, but are not exclusively targeted at the lower level income groups.

- Additional subsidy to social networks - BGN142m.

The amount equals the resources spared from the above mentioned measure, cutting some pension payments. Hence, it may be regarded as redirecting of resource forced by the worsening of the economic situation.

- Removed cap on the payments for temporarily unemployment **(Gov.., 2010, meas. no.37)**

The measure (BGN45m) was highly acclaimed by all the partners in negotiation process and was implemented speedily.

- Liberalizing the regime for using of the "food vouchers" **(Gov.., 2010, meas. no.38)**

The measure, announced without financial assessment, was implemented on a later stage. Although, it is not clear has it achieved the goal to connect the newly opened working places with benefits of the program.

- Extra subsidized employment; the plan provided an amount of BGN10m.

- Measures for "employment preservation" – provided BGN14m.

The measure was aimed at keeping more people on the job, even if their company is not able to engage them efficiently in the working process, by "flexible" working time, involuntary leaves, etc. It also includes compensation for "specific" laid-offs. Actual interest in the measure was smaller than expected.

- Additional subsidy for free lunches for poor

The measure provided an amount of 0.45m leva for opening of temporary canteens for the people in need.

- Increased min salary from July 1, 2010 - BGN10m.

The extremely strongly opposed measure by the lobbying groups. The oposition was gladly accepted by the financial minister who announced, instead, a freezing salary policy not just for 2010, but also for 2011.

- Efforts (?) for freezing of state-regulated prices **(Gov.., 2010, meas. no.39)**

The quite a frivolous formulation of this measure suggests the results of its (non)implementation – more than twice bigger inflation than the projected one (4.5% on annual base by December). The prices escalated further in the beginning of 2011, including those of the regulated monopolies; reaching the prices in much richer European countries.

Legal or Infrastructure Measures

The last group consists of regulatory measures; some of them desperately needed. They include such long-time delayed ones, like starting reforms of pension system and of the health-care system; introducing of electronic health-care ID; dealing with the uninsured persons etc.

Another group of measures are targeted to support the business, like lowering the thresholds for A and B class investors or shortening, simplifying the insolvency procedure and temporary ease of some labor rules.

There are measures for rising the financial discipline, like introducing the obligation for the companies, which settled their accounts with the budget, to pay off their own debts to employees and contractors. In such a direction, is introduction of monitoring of unpaid remunerations.

A number of public registers is also introduced - the property one, the one on payments due by the budget.

The anti-crisis plan also initiated more intrusive regulation in the labor market - the government secured rights to "extended branch labor contracts" further to those branches, which could not get an agreement; to limit the number of *"gast arbeiters"*; to create a mechanisms for finding a "first job" for young people.

Some of the measures look like a bit awkward and it is difficult to understand what the negotiating party aimed at, like "introduction of rules to ensure loyal competition"(???); Bulgaria has a free-competition-protection law (and the appropriate committee), but apparently, some parties consider them inefficient. Also a bit strange, is the idea for "local and branch monitoring and distribution(???) of qualified labor"

As mentioned above most of the measures in that group, have neither financial estimation nor criteria for implementation, and most important, it will take a long time to be implemented. For example, the pension reform started, but without an important component written down in the plan, (its connection with the minim

wage); its effect is expected for 2013 and the reform in the health-care system seems to be put on hold after the strong resistance by the medical profession.

Specifics of the Plan

As mentioned, the plan was dubbed "unprecedented agreement", regardless of the way it was negotiated; and it was not fully quantified.

Moreover, the plan quite remarkably, was not a comprehensive one. Crucial measures left out of the program. To mention one - the wage freeze up to 2012. Under running inflation, this measure changed the effect of the others. Measures, which initially looked more balanced, as for example the increase of contributions for pension, which are withheld from the remunerations, received quite an austere effect on the household consumption, when were combined with the frozen wages.

Further, the plan encompassed too many not immediate measures; measures targeted on general improvement of the economic functioning rather, than on countering the crisis. Not surprisingly, the plan was described in the following way: 'The rhetoric is "anti-crisis", instead of being "reforming"'.

Spheres of application

The spheres of application are quite revealing about the character of the plan. As a plan, urging the government to start the reforms which it hesitated to start earlier, it focuses much on social spheres. To some extent this is a normal reaction since the crisis always requires attention of some old problems. Although, in our case it seems a bit exaggerated.

The initiated social reforms are certainly important, but should not be overwhelming. This obsession with the social security sphere creates the impression that the other sectors do not need attention. The plan completely turns back to any reform in financial and banking sphere. Although, as mentioned in the first section of the paper, this is a *major area* of intervention in the developed economies, since the crisis originated there.

Bulgarian plan takes very little action in financial sector – perhaps just the amended taxation of the insurance business; and that was done in response to the EC Directive 138/2009 - at least this was officially announced in the plan. Even though, the measure passed on very difficult, being opposed by any possible lobbyist groups, including political opposition. It was delayed and eventually applied in such a way, so to transfer the burden to the households.

The anti-crisis plan suggests no other problems in the financial sphere; this is definitely not the case. In Bulgaria, there is going a long-lasting debate, about the levels of interest rates, charged by the banking sector. They are considered unjustifiably high, provided the country is a member of EU, bears no extra political

risk and has a normal access to the international financial markets, through the large international banks, which hold practically about 80% of the sector.

The debate is heated further by the ever-rising share of not-serviced debt (approaching 12% currently) under decreasing, but still quite substantial, profits of the banking sector – BGN 617m for 2010. **(BNB, 2011, p.52**).

The plan leaves without attention, yet another important public finance sphere - the taxation system. After introducing of the flat rate tax at the lowest EC rate of 10%, the reform of tax system is completely out of public debate. Although, many social groups, including the trade unions, some political parties and economic experts oppose it as economically inefficient, socially inacceptable and complicating the situation under the economic crisis.

Sources of financing of the plan

At first glance, the Bulgarian anti-crisis plan seems quite neutral. The biggest source for supporting the economy in the hard times, is the increase of "unexplored" or "future" incomes; about one billion leva - sales of pollution quotas, privatization, higher and early-received contributions from state and municipal property.

The second biggest source, budget cut, also seems neutral, since it spreads equally among the country's economic activities, and, at least at first glance, it was not that severe – 10% of the whole budget.

Then, as a third source, it comes the extra financial burden on the households - through the cut of pension supplements and of some social payments and of added taxation etc. – about 200m leva altogether. The initial outline of the program envisage almost the same burden for the business in terms of some taxes – gambling, insurance.

Although, the actual application offeres a rather different picture – first, the extra finance, supposed to come from the "tiny air", has not come – neither came the pollution, nor the privatization, money. That fact, plus the ever falling budget revenues, forced the government to shift the weight of the program over the budget cuts and as a result they doubled them. Beyond the certain point the budget cuts become an austerity measure forcing some budgetary funded institutions to send people to involuntary leaves for some days every month and cutting their income drastically. This was the case, for example, with research institutions, some universities, etc., and caused massive protests.

Belt-tightening also came from the way some other measures were completed – the tax on insuring business was realised technically, in such a way, that it was transferred to the individuals. Actually, it has not contributed to worsening the households situation further in 2010, since the government was slow enough to introduce it, but nevertheless it shifted the balance between the measures on the

account of the households. In such a manner acted, also, the abandoning of other measures, as tax on gambling.

Targets

Understanding of what is the Bulgarian anti-crisis plan is impossible, without understanding of its goals, as they are represented by the plan targets. Doubtlessly, the main target is keeping the deficit within the certain limit – this became obvious just two months after the plan launch; it was denounced by the budget actualization. The latter simply cut as much as needed out of the expenditures, impeding and even blocking important social activities as healthcare and science.

Second target of the plan, appears to be paying off the outstanding government debt to the business. The problem is a more complex than it looks like at first glance. While, in a sense, such a debt is ever present in the Bulgarian economy (BGN432m as of 31.12.2010; **MF,2010)**, it was much aggravated by the government decision to keep the deficit low in order to apply for entering the ERM II. So they simply denied some 2009 due payments, on a ground of political and economical reasons mixture. In fact, the government could neither avoid the payment, nor to apply for the ERM II; they simply transferred payment to the 2010 budget, thus highly aggravating the economic situation.

Whatever the reason, the second major target of the anti-crisis plan was clearing off the mounting debts and as, it was pointed out in the previous section it was done relatively successful, even when the pollution quotas trade failed. The government just severed the budget cuts and issued some debt.

Support for the social activities and labor market, occupies the third place. It is important to point out that the biggest amount here, is a deviation of the resource originally designed for a kind of pensions supplement. That way, the actual "extra" finance for the activities in question was rather scarce.

Since it is generally believed, that the anti-crisis programs seek to support the consumption of the households, one may expect that such a target is also set in the plan. In fact it is difficult to detect it. Apart of some little resources for the unemployed and the poorest, there were no programs for keeping up the consumption. Regardless negotiating them, the important measures as increasing the minimal salary (lowest in the EU; currently at about 121 euro) and holding up the prices of regulated monopolies were not implemented.

The plan stated that the pension reform should include a connection between the minimal pension and minimal salary, but that was not achieved.

Measures, like removing the cap on unemployment payments, and abandonment of the "luxury" tax, which might be seen as a pro-consumption ones, had a limited scope and were applied to the relatively higher income social groups.

Summarizing the characteristics of the Bulgarian anti-crisis plan we should define it the following way. This is hardly a comprehensive model for getting out of the crisis, but rather a fire plan, comprised of a bunch of *neo-liberal* measures targeted on shrinking belts and relying on the self-sufficient ability of private business to overcome the recession.

Success with the Plan?

Before trying to find out, what are the chances for success of the plan, it seems a good idea to see what is the framework of both objective realities and subjective concepts within wich the plan was placed.

Objective determinants of the plan

Perhaps the most important objective of the plan is its little maneuvering space. The direct taxes are almost at the "ground zero", with the lowest rates in EC. With the constant reaffirming of the advantages of the "flat" taxation system the government could not use this fiscal instrument without serious opposition. Moreover, the indirect taxes [VAT] are at a quite high level (20%) and the government opportunities to manipulate them are, also, very limited. Perhaps, *the most important goal* of the whole plan for the government was to ensure that it will be able to cope with the deficit without changing the VAT rate.

Perhaps, the most important, constraint of the government anti-crisis policy is the sharp decrease of the foreign direct investments … €0.4bn for the first six months of 2010 – 4 times lower on yoy basis. The effect of the low level investment is even larger, since it is the main justification of the peculiar tax system. When introduced, the system was believed to encourage the independent investors. While doubtful, if it had any substantial effect ever, it is certain, that this taxation has not effect under the crisis conditions and the perspectives in short term are also not quite promising.

Next objective impediment for the anti-crisis plan are the not-reformed sectors; important spheres have, completely or partially, an anti-plan functioning, like the health-care [seen by many as a spending pump] or the pension system [with huge and permanent deficits].

Last but not least, Bulgarian society is far from affluent one; the least average income in EU, the low poverty line and the higher level of "families experiencing serious "financial difficulties" restrain the opportunity to encourage the economic growth through the consumption.

Framing ideologemes

The other side of the picture, explaining why the Bulgarian anti-crisis plan took such a shape is given by a number of statements, short, out-of-context assertions,

simplified and strongly motivated by the believes of their bearers. The history of Bulgarian transition to the market economy has been deeply penetrated by such pieces of ideology and one should be familiar with them when trying to understand many of the economic realities.

- All-stable", "retard", banking sector

That ideologeme emerged immediately after the beginning of the crisis. It was shortly announced in the public space, that the Bulgarian banks are not threaten at all by the crisis, since they were conservative enough to refrain from buying the complex and sophisticated instruments like CDO's, so they are safe of the infamous "subprime" mortgages. That concept, added with some ironic deliberations on "retardness", slowness, etc. of the banking system, were taken on arms by all sorts of lobbying groups and were used extensively to turn down the discussion about the needed reforms in the banking sector. And it was successful; practically, all what the reforming attempts achieved was introducing a quasi-reforming norm, requiring banks to publicize details about their interest rates.

- Obsession for indirect taxation

Bulgaria has quite a big ratio between the indirect versus the direct taxes; perhaps one of the most peculiar in EC. It is not easy to trace down how this concept got so spread; at least it is not known to me any official debate or decision why this should be a norm, but it is a fact and year by year this ratio gets bigger. The effect of this peculiar ration is quite unpleasant, not just when the economy is shrinking, but also in the situation of "export-growing" GDP. The issue is certainly more complicated, but doubtlessly, it is quite unhappy situation for the government to claim growth of the economy, and at the same time - falling revenues in the budget.

- The "sacred cow" of flat rate taxes

That ideologeme is really obsessing. Many groups within the society, including parties, scientists, trade-unions and more, disapprove flat rate tax, but regardless their arguments, the governments deny even the discussions about the possible alternatives.

- Mini-mini-min philosophy: lowest taxes-lowest social security payments-lowest wages in EU

This is the ideolgeme that hides behind the idea of attracting foreign investments. As it is clear now, lowering taxes was a long-standing Bulgarian strategy, apparently including comparing, and even competing, with the other "emerging" markets in the region.

Lowering the social security rates is something newer idea, but fascinating one. Even in the eye of the financial storm, the current government did not hesitate to reassure that policy with the 2010 budget; it was necessary budget deficit of

National Social Security Institute to hit almost 2 billion leva in order to stop and revise that policy. And it was done reluctantly, under the pressure of the trade-unions.

- LG's "all-market" phraseology

The crisis revitalized the old pro- and anti-Keynesian rhetoric, though, as one can see easily, the Bulgarian plan was everything, but Keynesian one. That rhetoric is active and harsh, and any attempt for defending a pro-consumption policy is beeing branded as "pro-deficit", "pro-crisis", etc.

- Coinciding (?) views between "left" and "right" political specter

Strange enough, on many issues the views from the left and from the right are close or coinciding. This is easily visible when one consider the support for the increase of the minimal wage. This is an approved by "tristranka" measure; one which played a role in convincing the unions to agree the austerity budget cuts. Nevertheless, neither the government nor any political party makes any serious effort to implement it.

- Liberal consensus

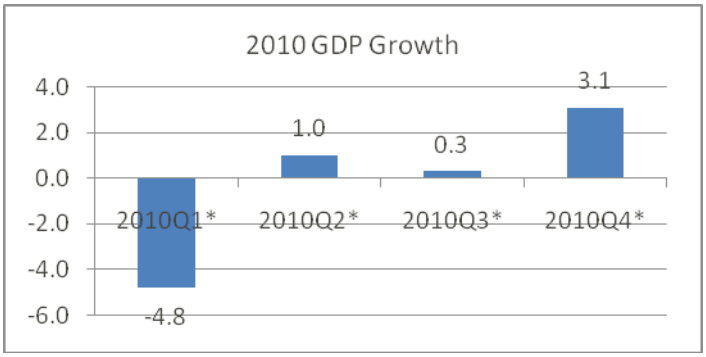
Each of the above ideologemes might find a good reasoning taken separatelty; each may have a "history" or path-dependent explanation, but taken all together they form a much more complex and long-standing philosophy. Given the uniform political support one may find on many crucial and important issues of that philosophy, and given its proximity to the main-stream neoliberal economic theory, it seems justified to determine that philosophy as a *liberal consensus.*

Some results of that policy

As long as the plan was not placed within a timeline, it is difficult to determine when one should try to assess its results. Nevertheless, appearance of some of the preliminary data for 2010, offers a good chance to browse into some of the plan results. Preliminary data for 2010 show a very little GDP growth for 2010 (0.2%); broken by quarters it may suggest a shift in the trend, but still rather indecisive.

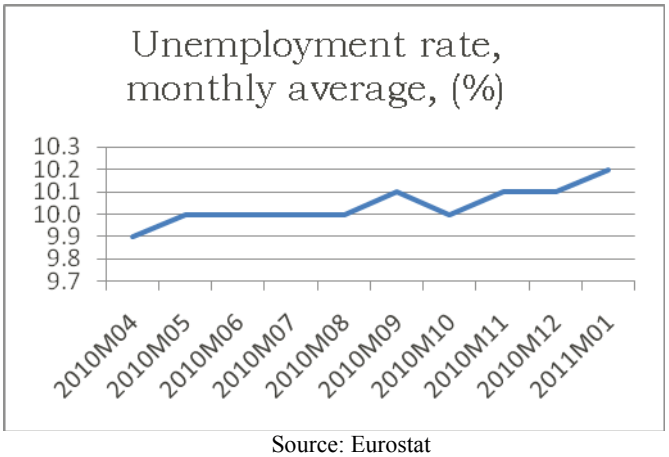
The dynamic of the unemployment (Fig 3) is also quite indecisive. Apparently, the plan played a restraining role in the first half of 2010 and the unemployment growth slowed down. But this effect seems to exhausted gradually and the last months show again an increase in the number of people registered with the labor offices in the country.

Figure 2



Source NSI (Bulgarian statistical office)

Figure 3



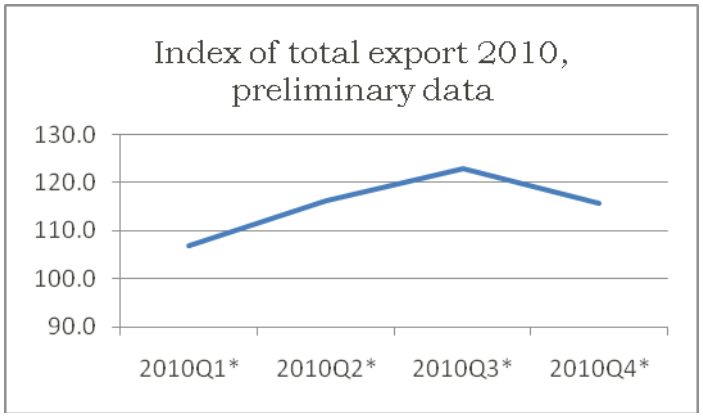
Source: Eurostat

That is a not-surprising effect, if one takes into account the recently published report of the world bank. It shows quite a controversial results for some countries, (Bulgaria included) in terms of household mechanisms coping with the crisis and the social policy in these countries. While, for example, the above mentioned effect provide for Bulgaria a moderate job loss, as a percentage of workers, the people reporting reduced earnings for the same or longer working time as well as those with reduced working time are much more. Thus, the actual group of people affected by all channels of the crisis labor market, is much bigger. And, as the report shows, the combained effect is worse compared to other east European countries, like Romania and Montenegro **(World Bank, 2011, p. 22).**

This result proves, that the labor market measures in Bulgarian plan are rather smoothing and postponing, than efficiently anti-crisis. This is further proven in the above report showing grim practices of crisis affected people reducing their use of prescribed medicines and reducing food expenditures **(World Bank, 2011, p. xxiii).**

It is interesting to mention another macroeconomic result of 2010; this is the appearance of economic growth, called by the Bulgarian finance minister an "exporting" growth. This dubbing came to explain why and how the Bulgarian export rose by more than 16% in 2010 (see Fig 4), and even more in the beginning of 2011, while the budget revenues continue to shrink. Of course, the better answer seems, the decreasing internal consumption, rapidly eroded by the running inflation.

Figure 4



Source NSI (Bulgarian statistical office).

The contribution of shrinking foreign direct investments for the unclear and irresolute picture of Bulgarian crisis-way-out is not last in the row; they would possibly reversed the negative growth trend in the last quarter of 2010, but are still very low - 58% of 2009 level.

The first cracks of Bulgarian anti-crisis policy

The Bulgarian anti-crisis plan reflects more or less an economic policy, and reveals the dominant views for economic development of the country. Regardless, what its creators recognize, it creates economic facts and provokes certain behavior in all the economic agents. And one should be quite an optimist not to expect such an austerity plan based on invariantly restrictive measures to remain without opposition. And namely it is the resistance of the measures which created first cracks of the plan.

The strong resistance among the medical profession and the patients practically led to a reverse in the health-care reform; to changes of responsible ministers, to a rejection of hospital closures and of the most severe budget cuts, and practically to a freeze of the radical reform.

The pension reform also suffered a number of changes in the policy. The hottest problem – abandoning of the early pensions was postponed, as was the increased

pension age. Instead, there were introduced rules increasing the number of years one should work before obtaining the rights to retire.

Maybe, the most interesting development is the openly stated differing position of the syndical economists. Many years, almost every important aspect of the social and economic policy went to the strange mechanism of tri-party negotiating. As this paper showes this "bargains" very often just mask, postpone or deform the problems, by issuing empty promises or simulating negotiations. The case for the minimal-wage-increase in the anti-crisis plan is just a striking evidence for such a policy. Therefore, in my opinion the open clashes between the government and syndicate ideologemes, is not just unavoidable but necessary and welcome.

Concluding Remarks

When launched, the Bulgarian anti-crisis plan looked unclear. It included measures, which could play a positive role for overcoming the slump. The restraining policy with severe budget cuts and frozen incomes, based on well-known neoliberal economic arsenal, offered as a deal accepted by all the economic agents, looked a strong one.

The more the plan was enfolding, the clearer became, that many of the measures were never intended to be implemented; some were distorted in peculiar way. Thus, the changes further aggravated the gruesome picture of austerity, performed on the people with poorest economy in EU.

The plan also shows that at the beginning the ruling party had quite some different perspective for the economy and that was reflected in the anti-crisis program. Apparently it started changing, almost immediately after its announcement. The character of this change is still unclear and seems forced by the circumstances. And definitely, it still does not show a rejection of the neoliberal policy.

The latest developments in the end of 2010 and beginning of 2011 clearly show that this policy is not able to ensure a serious reversal of the economic indicators. It might be OK as a temporary cushion, but the shrinking internal consumption simply could not provide incentive for a growth. Hence, the radical shift away from the neoliberal economic policy, seems more and more as an unavoidable decision.

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

ГОДИНА XX, 2011, 2

Stoyan Totev[1]

EU PERIPHERY, ECONOMIC PROBLEMS AND OPPORTUNITIES – THE CASE OF BALKAN COUNTRIES

The economic analyses outlined that the big differences between the Balkan countries economic structure and the average EU one is seriously negatively affecting their economic efficiency. It appears that the Balkan region is becoming the weakest European economic area – the new European economic periphery. It is outlined that the most proper policy that will not lead to problematic economic results for the lagging Balkans countries can be the one of making benefits from their geographical location. Firstly by realising economic cooperation within Balkan countries and secondly throw participating of the Balkans as a sub-regional structure in the Black Sea economic initiatives.
JEL: O47; R11; R58

The mainstream comprehension of the EU cohesion policy is linked with the paradigm incorporated in the neoclassical development theory; the economic growth is leading to diminishing regional differences and carrying out the effect of convergence (EC, 1999). In other words the maintaining of as high as possible growth within the EU countries will lead to the desirable economic convergence. However new theoretical and empirical researches support the understanding that the economic growth cannot be always related with accomplishing of economic convergence moreover, sometimes it can be the main reason for increasing of the divergences (Solow, 1999; Puga, 2001; Petrakos et al., 2005).

The economists are not united how the convergence-divergence processes are going in the EU framework – they do not provide synonymous answer to that. One can find in the literature quite contradictive statements whether convergence between the rich and poor countries is observed or not (Friedman, 1992; Quah, 1997; Bradley, Untiedt, 2008). The opinions differ also about the course of action, the object and the possibilities for realising convergence.

The mixed results from the empirical researches make most of the economists to come to the idea of the dualistic nature of the development in the EU framework – differences in the development of the North and the South or between the centre and the periphery. That means that convergence-divergence processes are determined by the level of

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development; development that in the European economic space to a great extent depends on the geopolitical location of the countries (Quah, 1997; Puga, 2001; Petrakos et al., 2005; Totev, Sariiski, 2008). The main question that still does not find acceptable answer is not whether the two processes exist simultaneously (convergence and divergence), something that already is accepted as a fact, but to make clear when and at what stage of the economic development these processes take place in the different EU countries.

Generally in the last decade it is observed decreasing of the differences of the GDP per capita and the labour productivity within the EU countries; this is before all due to improving the results for the lagging countries like Romania and Bulgaria. However, this process is not finding confirmation within the EU-15 countries. One can say that the convergence in EU framework is obvious when smoothing the big differences but not as a one-way process. So no matter how attractive it may sound to achieve convergence by means of a common growth, this is not at all supported by the empirical results.[2] This means that the EU regional policy pointed to facilitate the economic convergence should not rely on the economic growth to solve the problems by itself.

Convergence Processes and the Economic Production Structures

The economic potential of a country to a great extent is determined of its economic structure (EC 1999). The presumption is that the composing of one or another structure is a result of the comparative advantages of given country, respectively to its competitiveness in a given activities. After the labour productivity by various economic activities differs, the forming of different production structure by these activities is prerequisites for regional divergence as far as one or another production structure is decisive for the production efficiency – respectfully for the growth and the level of consumption (OECD, 1987; Pender, 2003; Canova, 2004; Totev, Sariiski, 2008; Moore, 2009).

The countries with more "effective" structure (higher share of sectors or branches with high labour productivities) are the developed countries and vice versa. It is quite interesting to define what production structures have the new member states

[2] The author of the paper has yielded to the temptation to discuss the beloved thesis of the Bulgarian economists – when the country will reach the average European level of GDP per capita. If one leave the exotic forecast for achieving convergence in the EU framework for two-three centuries (Fingleton, 1999) it can be underlined that in the foreseeable future Bulgaria will never reach the average income of the present EU countries. After all if it is average EU level, and having in mind that the big EU-15 countries are with stronger economies, this means that more than half of the EU countries should stay behind Bulgarian level of development. In this case more clearly this can be illustrated by pointing out that Bulgaria should leave behind countries like Check Republic and Slovenia (countries with the highest economic levels within the new member states) and to level its indicator with those of Italy, Spain and almost to reach the one of France.

and to analyse what economic prospects provide these structures.[3] The structural changes in the last decade is showing that the countries from Central and Eastern Europe are in a process of adaptation of their economic structures – adaptation that is accomplished in a different way. The Central European countries like Hungary, Check Republic, Slovenia and Slovakia managed to achieve structure close to the average EU one; that ensure them having the potential to reach the EU average competitiveness and efficiency. The rest of the new member states in one degree or another cannot accomplish such adaptation and their structures differ from the EU average.

Table 1

Labour productivity, labour productivity as a result of the structural differences and GDP per capita in PPS

	GDP per capita, 2008, % (in PPS)	Labour productivity, 2008, % (GDP per employed in PPS)	Labour productivity as a result of differences of employment structure by main sectors, 2008, %*	Labour productivity as a result of differences of employment structure of manufacture by its sub-branches, 2005, %**	General effect of structural differences, 2005, % (combined effect of col 3*** and 4)
Columns	1	2	3	4	5
EU – 27 average	100.0	100.0	100.0	100.0	100.0
Bulgaria	41.3	38.8	74.5	86.7	78.1
Check Republic	80.4	72.0	83.7	100.8	90.8
Estonia	67.4	64.0	91.0	88.6	93.7
Lithuania	57.3	52.1	93.0	87.3	97.5
Latvia	61.9	62.4	89.7	89.3	92.3
Hungary	64.4	71.9	91.1	103.0	94.7
Poland	56.4	62.2	82.3	96.7	88.5
Romania	44.3	50.3	66.9	90.1	74.0
Slovenia	90.9	84.9	81.2	97.7	82.5
Slovakia	72.2	79.4	84.1	99.4	89.7
Croatia	62.7	--	82.9	98.0	87.6
FYR of Macedonia	32.0	--	70.1	83.3	77.1
Turkey	45.5	--	74.4	88.5	73.1
Albania	--	--	60.1	--	--
Serbia	--	--	75.8	--	--
Moldova	--	--	75.3	83.9	77.0

Sources: EUROSTAT sources.

* labour productivity as a result of the differences of agriculture, business and finance services and other services – for Serbia and Moldova the figures are for 2005;

****** NACE classification for manufacture sub-branches (15-37) – DF 23 "Manufacture of coke, refined petroleum products and nuclear fuel" is not included;

*** The structural effect of the differences by main observed sectors for 2005.

[3] In the research are evaluated the differences in the labour productivity as a result of the differences of the structure by main economic sectors (agriculture, business and finance services and other services) as well as the effect from the differences of the structure of the manufacture by its sub-branches.

If one assumes that every country has equal productivity by each given sectors or manufacture sub-branches to the average EU one for those sectors or manufacture sub-branches, it can be estimated what will be the net effect on the labour productivity solely as a result of the structural differences for the observed sectors and manufacture sub-branches. In Table 1 are presented the estimated effects on the productivity for the EU Central and East European countries due to having different structures from the EU average – different labour productivity as a result of the differences by main sectors (differences of the shares of agriculture, business and finance services and other services), see column 3; as a result of the differences of the manufacture composition by its sub-branches, see column 4; general effect of the structural differences, see column 5 (combined effect of column 3 and column 4).

All Central and East European countries have lower structural labour productivity compare to the EU average (EU average = 100%) due to the differences of the structure by the main observed sectors. Most disadvantageous figures have Romania and Bulgaria – accordingly 66.9% and 74.5%, see column 3, Table 1. For Bulgaria that means that the total productivity of the observed sectors will be with 35 percents higher if the country has same structure to the average EU one. The picture for the rest of the Balkan countries that are not members of the EU is same, only Croatia has better figures.

It is observed a close relation between the production structure and the incomes and the latter somehow appears to be consequence of this relation. The coefficient of correlation between the structural effect and level of economic development is 0.85 (relation between columns 3 and 1, Table 1) and the coefficient of correlation between the structural effect and the labour productivity is 0.87 (relation between columns 3 and 2, Table 1).[4]

These results are showing that one cannot expect to have a convergence regarding the incomes in long-term perspective in case of existence of obvious process of increasing the production structure differences of EU countries (Totev, Sariiski, 2008). The economic analyses outlined that the big differences between the average EU economic structure and that of the Balkan countries will remain; that will seriously influence negatively the labour productivity for these countries in the future too.

Geography Matters

Bulgaria with Romania differ from the other Central European new member states in respect of their structural competitiveness. This is valid and for the other Balkan countries like FYR of Macedonia, Turkey, Serbia and Moldova (see Table 1). It is obvious a North-south divide between Central and Eastern European countries with the Balkan economies having a less advanced economic structure than the Central European ones and performing worse economically than them. The economic structures of the Balkan countries differ and from the lagging EU-15 countries like

[4] Coefficient of linear correlation estimated on the bases of data for the 27th EU countries.

Portugal and Spain. Given that within the EU-15 Greece is a case of structurally lagging behind country, it appears that in the new, slowly shaped, geography of Europe, the Balkan countries has the weakest economic structures; the Balkan region is becoming the weakest economic European area – the new European economic periphery.

Here arises the question what will be the prospects for the Balkan countries, are they going to eventually converge towards the more advanced European countries or to continuously diverge from them. The economic analyses are showing that in foreseeable future (10-15 years) the big differences in the structures by main economic sectors and by manufacture sub-branches will remain. One can say that the Balkan region will remain the one with countries with lagging economies within the EU space.

Here the paper is not going to discuss what economic policy can improve the structural competitiveness of the Balkan countries – policy with doubtful results when speaking about the implementation of new technologies, science intensive activities, etc. For example if one look to the priorities that the Bulgarian authorities put for the development in the future it appears that they are not realising the problem that stable convergence is not possible to be obtained with weak economic structure. It should be underline that the desire development not always is the possible one. The policy makers and authorities in Balkan countries also are paying tribute to the idea of developing advanced technologies (as an example in Bulgaria still is popular the idea of developing as a priority sector the nanotechnologies). Everybody will be happy if that becomes truth but this is hardly attainable goal. Such a populist ideas are not considered with the real potential of the countries and their real comparative advantages.

In the same time the truth is that the desired and expected structural changes and priority sectors in the Balkan countries are similar to a great extent. Speaking about priority sectors and comparative advantages something that can be called the myth of the priority sectors should be noted. The myth of the priority sectors is that every Eastern European country is outlining the unique possibility that have their countries to develop particular sectors. These sectors are more or less the same for most of the countries. The coincidence of these priority areas makes difficult for the Western investors to use these resources and factors endowments in every country as the national economists supposed. In the same time because of their proximity to the Western countries and stronger economies, the Central European countries are in a favourable position. In this respect the Balkan countries should try to take advantages from something that can be distinctive for them – namely taking specific advantages of their geographic location.

What Are the Prospects of the Balkan Countries in This New International Setting?

The development of relations within the Balkan countries is of vital importance for the small Balkan countries that are located peripherally to the European economic

gravity centre.[5] They cannot benefit like the Central European countries to be adjacent to the developed European countries, due to that the regional cooperation is an important option for realising economic advantages. So the Balkan countries have to define realistically their real priorities as well as regional orientation, which should be the Balkan region and the Black Sea Economic Area countries. This orientation should not be understood as an alternative to the main development direction – becoming full EU members for all Balkan countries.

Activities related with regional cooperation can be really beneficial for the Balkan countries and are not questionable like the attempt to realise comparative advantages by developing advanced technologies, science intensive sectors, etc. The idea for finding kind of regional agreements is not new for the Balkans. There are a lot of efforts to promote cooperation in the region that date back into the Ottoman period and since then have been numerous calls and proposals, some of them up to 1989 are:

- First effort to form a customs union was between Bulgaria and Serbia in 1905 but was aborted because of Austrian pressure on the Serbs;

- Second Balkan League in 1912 gained in military cooperation against Turkey collapsed because followed immediately of the second Balkan War;

- The formation of the first Yugoslavian Kingdom in 1918 might be considered more successful so far even though it failed in nowadays;

- After First World War Romania, Croatia, Bulgaria and Greece promoted proposals for Balkan political and economic cooperation – however the idea it remains in the sphere only of the good wishes;

- Greece, Romania, Yugoslavia and Turkey signed an agreement in 1934, which was supposed to provide a permanent Council, a Balkan bank, and legislative coordination. Unfortunately Italy opposed that, supported by France; the idea weakened and was not implemented;

- During the Second World War Yugoslav and Greek Communists proposed a Balkan Union – this idea failed with the failure of Greek communist to come to power;

- There was another idea in 1947 to extent the South Slav Union including Bulgaria, which failed because of Tito's break with Moscow;

- There were initiative for Greek, Yugoslavian and Turkey agreements but it failed with the Greco-Turkish conflict in 1955 and the Soviet initiative to improve the relations with Yugoslavia in the same year;

[5] Quite often as economic centre of Europe (gravity centre) is accepted the German town Frankfurt am Main – for example when using gravity models.

- In 1988 a meeting in Belgrade takes place to consider how greater cooperation could be of mutual interests.

In all cases somehow the Balkan countries did not manage to come to mutual agreement.[6] Even when there were good will among the Balkan countries there were pressure against them from Russia, Austro-Hungarian Empire, Italy, France ("Great Power" countries). At present such a pressure is not to be expected if we not count the Russian policy that have always "special interests" on the Balkans. Now the Balkan countries have for first time the possibility to find ground for such cooperation since they have mutual interest in joining the EU structures.

Since 1989 there were no shortages of initiative for regional cooperation most of them related with the Stability Pact or other EU initiatives. Unfortunately these initiatives more or less were realised to the extent allowing only to assimilate the provided funds for them. So one can claim that it is high time the regional cooperation within the Balkan countries to become a reality. For the Balkan countries that are characterised by small internal markets, inefficient cross border infrastructures and to some degree trans-border political tensions and conflicts, the elimination of the economic and political «border-effect» will enable the interaction of the integration between sub-regions belonging to different countries, strengthen the stability in the region, finding new markets for trade and becoming attractive for foreign investments.

The region's location of the Balkan countries presupposes also the development of the European economic relations with the countries from the Black Sea Economic Area. It is a regional possibility for the Balkan countries to search in making advantages of their geographical location by involving in the Black Sea economic initiatives, which are oriented in making productive use of financial and human resources as well as foreign investments. It is a cooperation scheme, which is part of the future European and Eurasian architecture.

The main directions of the Black Sea Economic Cooperation (BSEC) development are the speeding of the development of joint investment projects such as in the field of transport and communications and the building of their infrastructure. Participation in the creation of regional elements of cross European networks – transport, energy and telecommunications.

Prerequisites for a Successful BSEC and Obstacles to be Overcame

Main favourable settings

Geographical – Owing to its suitable location, region could be integrated relatively easy to the markets of Europe, Central Asia and Middle East. This offers a large

[6] Actually there was one agreement that can be considered as successful for the countries involved in it, the one during the Second Balkan War – almost all Balkan countries against Bulgaria.

potential for cooperation in the development of transport, telecommunications, infrastructure with regional and intercontinental importance;

Political – The end of the cold war era;

Economic – Complex of factors such as revolutionary progress in communications and information technologies, diffusion of modern technology, globalisation of markets, investment and product mobility, huge mineral and energy resource endowment, relative skilled and cheap manpower;

Cultural – Historical familiarity, cultural affinity and lingual similarity.

Unfavourable settings

Economic – Serious differences in incomes that can rise in course of time; economic difficulties can generate social tensions;

Cultural – Religious and ethnically heterogeneity, minority problems;

Institutional – Lack of basic legal and institutional framework, disharmony in the legislation of the member countries;

Financial – Most of the countries have limited financial resources; currencies, which are not fully convertible;

Political – Local conflicts and military instability.

What Prospects for Economic Development Provide the BSEC for the Balkan Countries?

The BSEC will encourage the mutual realization of the European initiatives in the regions and its links with neighbouring economic areas. What is more, the development of these relations could be a prerequisite for a future regaining of a part of these markets for the former socialist countries (namely Bulgaria and Romania).

Advantages that can be expected for the Balkan countries from their joining as a sub-regional structure in the Black Sea Economic Area is the speeding up their development by attracting foreign investment for realization of joint investment projects. The main economic and political importance of the Black Sea Economic Area for now is connected with the oil and gas transportation from the huge sources high quality oil fields, what requires a solution of the problem related to the route and way of its transportation. The main issue is that Black Sea Economic Area covers the countries that the oil and gas pipeline will cross and the interests are quite different literally speaking we are witnesses of a real struggle for the projects concerning the gas and the oil transportation.

Needs of Cooperation of Balkan countries within Black Sea Economic Area

Here one should clarify why it is important to realise Balkan countries (sub-regional) economic cooperation and this can be understood as a prerequisite for their participation in the Black Sea economic initiatives.[7]

- The greater degree of economic cooperation will be obtained within the Balkan countries the greater will be the possibilities to attract foreign investment for this sub-regional structure in its participation in the Black Sea Economic initiatives. In other words the Balkan economic cooperation gives a possibility in finding mutual interest as a sub-regional structure in these initiatives;

- Balkan countries are a lot more homogenous group in economic, social, traditional, cultural and religious aspects. More over they have a lot more motivations to create a regional economic space and if they did not find a way to obtain that, this will mean that the possibility of creating a real regional form of cooperation within countries in the Black Sea Economic Area will face a lot of difficulties. In other words the Balkan countries economic cooperation can be accept as a touchstone for the creating a mutual inter-regional relation within the countries in the Black Sea basin;

- If Balkan countries manage to realise kind of cooperation within them it will be easier to defend their interests when participating in the Black Sea economic initiatives. Up to now in the Black Sea Economic Area the Balkan countries (if we not count Turkey) did not manage properly to defend their interests separately. In the presence of big countries like Russia, Ukraine and Turkey the closer collaboration of the Balkan countries will allow them to follow mutual economic policy considered with the already settled Balkan economic priorities. This will help these countries in their future relation under the Black Sea Economic Area as economic potential and interests to have correspondence and equivalence with the big countries. Otherwise the Balkan countries in the Black Sea Economic Area will never have the power to counterbalance to the interests of these big countries. For example up to now by giving advantages to one and not to other countries the Russia is finding a way to oppose the interests of the Balkan countries in order to provide entirely its own one.

The participation of the Balkan countries in the EU structures – members, countries in accession, etc. is an unique possibility for using it to find ways for closer cooperation in the EU framework and further to use that in their participation in the Black Sea Economic initiatives. EU from the other hand is quite interested in such initiatives from its member (or future members), since BSEC is a scheme, which forms a part of the future European and Eurasian architecture.

The successful implementation and effectiveness of the regional integration and mutual participating in Black Sea initiatives depend significantly of the Balkan countries authorities understanding how to take advantage of the mutual geo-

[7] Turkey is not included when speaking about the Balkan countries cooperation.

strategic importance of the region in more adequate way, i.e. making the balance between national and regional interests. The Balkan countries should learn to behave in the Black Sea Economic Area following the maxim "Think globally, act locally".

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

ГОДИНА XX, 2011, 2

András Székely-Doby[1]

THE EU'S EXTERNAL RELATIONS: THE CASE OF BRIC COUNTRIES WITH SPECIAL EMPHASIS ON CHINA

The BRIC countries, and especially China, have significantly increased their share in the world economy. The Chinese model, with its special approach to development, can be seen as an accelerated version of the Japanese one, which has brought enormous success in Japan, and in the Tiger economies. In the past two decades China has become the EU's most important trading partner, and their relationship is getting more and more symmetric. Although there are areas where they have different approaches, there are much more issues with common interests, and room for cooperation. For Hungary China has been a special partner for decades. After the fall of communism the ties became weaker, and Hungary practically lost almost all of its previous advantage. The EU accession, however, opened up new possibilities, and new channels for the country, to pursue its interests, and regain at least some of its privilegized status.
JEL: F01; F15; F49

Introduction

The so-called BRIC countries, Brazil, Russia, India, and China, are increasingly important players in the world economy. Their significance has been growing in an astonishing pace, and they are threatening the traditional leading role of the United States, the European Union, and Japan. The Triad has been dominating the world economy since the 1960s, both in terms of GDP, trade, and investments. Nobody really thought that their leading role would be challenged already in the turn of the millennium. Though in relative (per capita) terms these countries are still miles ahead of the BRIC countries, the gap in absolute numbers has been heavily reduced in the last three decades. It was the breathtaking growth in China that led this turnaround, but also India has been showing remarkable performance since the beginning of the reforms in 1991. Besides, both Brazil and Russia are showing themselves as forces to be reckoned with.

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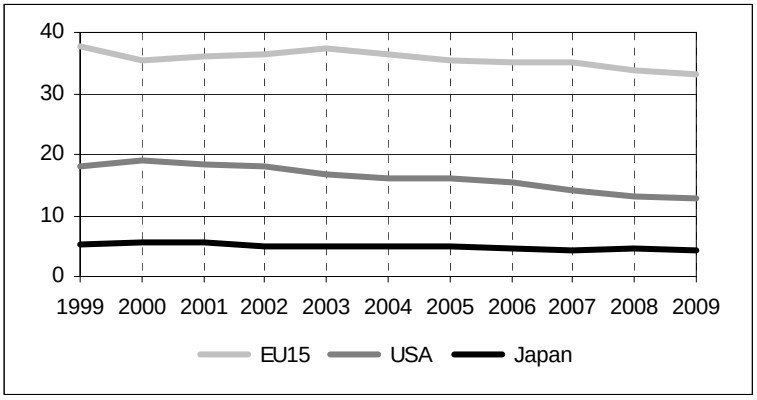
In this paper we will try to demonstrate that this shift of power has deep and relevant consequences not only in the realm of economic processes, but also in the way we think about them. In the first part we review recent trends in the world economy illustrating the shift of power from the traditional developed countries to the BRIC group of emerging countries. Of course it does not mean that either the US or the EU are to lose their leading role in the world, only a new, and significant trend seems to be emerging. The second part of the paper analyzes the bilateral relationship between China, and the EU, and touches some important questions regarding strategic considerations. In the third part we address a special issue: what role can a small, export oriented country like Hungary, play in shaping the policy towards China. We sum up our paper with a brief conclusion.

New Players in the World Stage

If we take a look at the Triad's (the United States, the European Union, and Japan) share in world trade, we can recognize a slow but significant decline. This pattern is clearly shown both in Figure 1, and Figure 2:

Figure 1

The Triad's share of world imports (%)

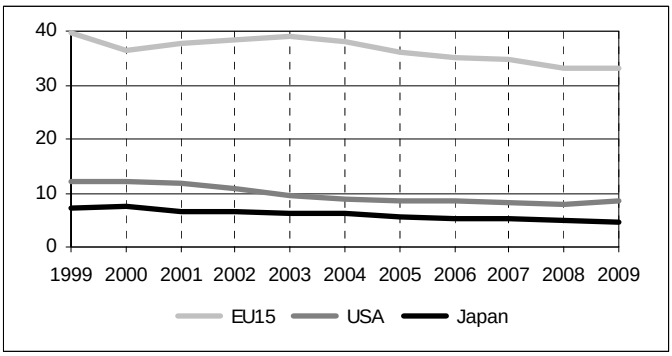


Source of data: World Bank (Web)

In Figure 1 we can see that although all three regions lost in terms of share in world imports, the biggest loser were the United States. During less than a decade their share decreased from nearly 19 percent to below 13 percent. Moreover, the decrease happened in spite of the strong consumption in the country, which underlines the rapid increase in imports in fast growing emerging economies. The EU lost 4, Japan 1 percentage points. Compared to their performance in world imports, the Triad's relative decrease in exports was even higher. Here it was not only the United States (with a decrease from more than 12 to 8.5 percent) that suffered heavy losses, but also the EU (from 40 to 33 percent), and Japan (from 7.3 to 4.7 percent). Altogether the Triad's share in world imports decreased from 60 to 50 percent, while in exports from 59 to 41 percent.

Figure 2

The Triad's share of world exports (%)

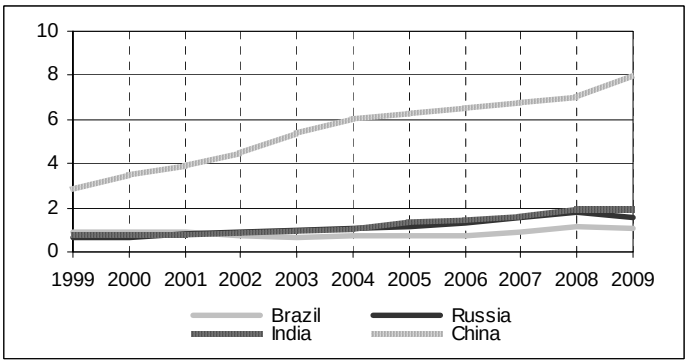


Source of data: World Bank (Web)

On the other hand, there are emerging countries that strongly increased their share in world trade. As far as the BRIC countries concerned, their performances are shown in Figure 3, and Figure 4. Though it was not only China that produced huge increases, its performance have been extraordinary. From a share of less than 3 percent in 1999 they went on to increase it by no less than 5 percentage points to more than 8 percent in a decade. The combined share of the remaining three countries also increased enormously, and almost doubled from 2.4 to 4.5 percent.

Figure 3

The BRIC countries' share of world imports (%)

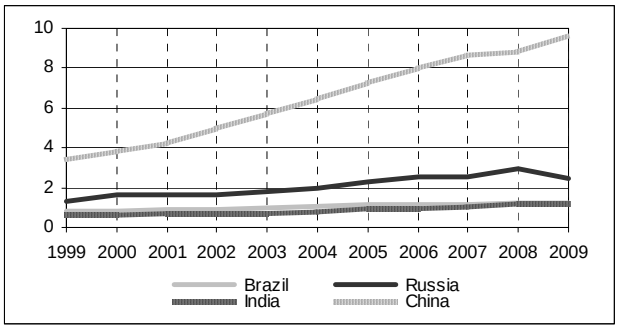


Source of data: World Bank (Web)

Because China is touted the factory of the world, and Russia is one of the most important oil and gas exporters, it is hardly surprising that the four countries' export performances grew even faster than their imports. In Figure 4 we can see that both China, and Russia have produced very rapid growth. Even if we take into account the relative setback of the Russian exports due to the financial crisis in 2009, the combined export share of these two countries has grown from 4.7 to 12.1 percent. Another good performer has been India, which has managed to double its share in world exports during the last decade reaching 1.2 percent.

Figure 4

The BRIC countries' share of world exports (%)



Source of data: World Bank (Web)

As we can see from previous data China has not only been the fastest growing emerging country in the last three decades but also had the fastest growing foreign sector in the world economy. China began its success story in the 1980s as a low cost exporter of light industrial products, mainly textiles. It was a sharp departure from the socialist way of industrialization with strong preferences to heavy industry. After the formation of the People's Republic of China, the new leaders, especially Mao, thought that heavy industry had to be created first to start the whole industrial process. This approach, however, had not been dropped, and after nearly three decades with poor, and declining industrial performances, still marked the thinking of the party nomenclature. But after Deng initiated the process of Reform and Opening up the situation changed.

China, at least in part, adopted an export oriented strategy, based upon its comparative, and competitive advantages. The whole state sector, however, remained intact, and the newly created Special Economic Zones served as a laboratory for experiments with capitalistic forms of production. Because the factories in the zones produced solely for exports, they had to be competitive in international markets. For this purpose they tried to make use of the cheap labor force of these areas, and invested heavily in textiles industry. Though initially there were no links between the Zones, and the traditional socialist part of the economy, the unexpected successes, and the increasing need for labor slowly began to transform the whole economy.

The strategy of the Zones based upon the highly successful Japanese model. Japan back in the 1950s started its trade expansion with low cost labor intensive products, like textiles. After a decade they were able to step up in the technology ladder, and launched an offensive in heavy industries. In the 1960s, and 1970s Japan emerged as a huge automobile exporter. They became fierce competitors of European, and American car manufacturers, and by the 1980s Japan became one of the most developed industrial country in the world. Due to their growing export operations, they were searching for additional ways to exploit their successes. They again made a step up in the technology ladder, and penetrated the electronics industry. So, during the past half of the century Japan has achieved enormous reputation in the

world economy, first as an exporter of light industrial products, later as an aggressive player in the machinery markets, and by the 1990s as a high tech exporter. We have to admit, however, that the Japanese industrial base were first created in the 1930s, and were destroyed during World War II. From this point of view they had to rebuild it from the ruins of the huge enterprise groups, the so called Zaibatsu, as opposed to the Chinese case, where there were no such antecedents of modern industrial development.

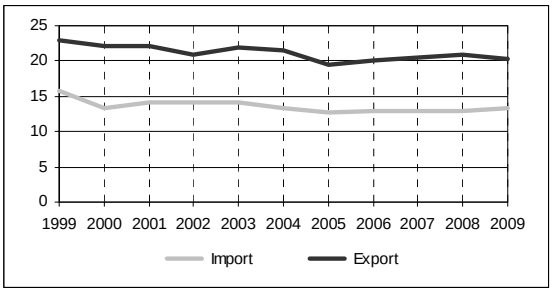
The development path of the Zones, and later the whole coastal region has been extremely similar to that of Japan, and later the so called Tiger economies (Hong-Kong, Taiwan, Singapore, and South Korea). China managed to build up a healthy industrial structure in these regions that was very competitive in international markets. They step-by-step moved upwards in the technology ladder, and by the turn of the millennium they had exported not only cheap labor intensive light industrial products, but more and more machinery and high tech goods. Though Chinese manufacturers are not yet among the leading innovators in the world, they are capable of producing high tech products with the help of foreign technologies. In this sense we can conclude that China has been able to go along the development path of an export oriented country during a time span considerably less than its predecessors. We can also see drastic changes in economic processes in the mainland, and rapidly shrinking differences between the mainly foreign invested sector, and that of dominated by the state owned enterprises. Despite being a communist country, China became the most successful representative of capitalism. In the next part we try to characterize the Chinese development from the point of view of Europe.

China and the EU

Unlike in the 19th century, after the reform process had begun in 1979, Europeans were not among the first movers in China. Hong-Kong, Taiwan, and the United States invested significantly more in the first years than European countries (see e.g. **Székely-Doby** (2009)). Though being somewhat late starters, Europe had been able to close up by the middle of the 1990s, and became the most important trading partner of China.

Figure 5

EU27's share in China's foreign trade (%)

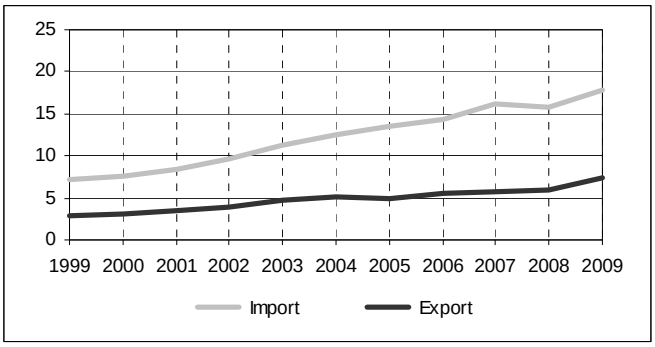


Source of data: European Commission (Web)

First, let's take a look at the graphs showing up in Figure 5. We can see that the 27 member states of the European Union give 17 percent of Chinese foreign trade. More than 20 percent of Chinese exports went to, while 13 percent of Chinese imports came from Europe in 2009. The importance of these countries were actually higher a decade ago, when their combined share stood at almost 20 percent. Despite the dynamic growth both in terms of exports, and imports (trade grew more than fourfold between 1999 and 2009) the relative decline of Europe can be attributed to the even stronger Chinese export performance vis-a-vis other countries, most notably the United States. Another interesting feature of the trend is the relatively stable pattern of trade shares during the crisis.

Figure 6

China's share in EU27's extra EU trade (%)



Source of data: European Commission (Web)

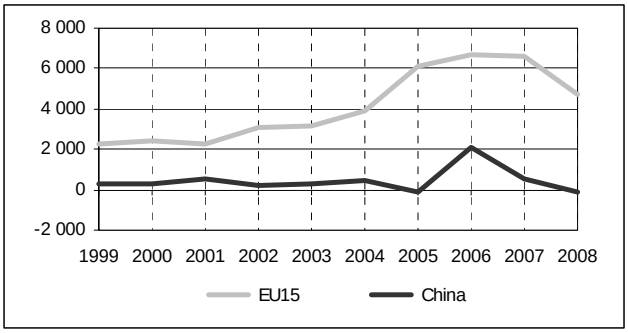
Much more interesting is China's rise as a trading partner of Europe. We can see in Figure 6 that the share of China in the EU27's extra EU trade was only around 5 percent in 1999. We refer here to the notion that European nations were late starters in China, so trade, which is directly influenced by direct investments, began to rise only after the middle of the 1990s. This relatively low share was further underpinned by the very strong ties that connected Europe to developed nations (most importantly to the USA, and Japan), and to petroleum exporting countries (first of all to Russia). So, the difference between the shares of China, and the EU in each others external trade is attributable to the mere size of their external trade sector. European external trade was more than four times bigger than that of China.

Taking into account this discrepancy it is even more striking to see that China's share has grown nearly threefold during the last decade. In 2009 it stood at 18 percent in imports, and 7.5 percent in exports. Compared to the data shown in Figure 5 we can notice a strong trend of leveling off. Though the relative importance of China as a trading partner of Europe is still lags behind that of Europe as a partner of China, the trends are very clear: differences are fading away. The asymmetric relationship which characterized the relationship between the EU, and China back in the 1980s has gone through a fundamental change, and has become much more symmetrical by now. As far as the balance concerned, there has always been a huge European deficit. In 1999 it stood at only 33 billion Euros, but a decade later it surpassed 130 billion Euros. Although we can conclude that the external trade of the

27 EU member states has the biggest deficit vis-a-vis China, in part this reflects the extensive investments and re-export operations of large European companies.

Figure 7

Bilateral FDI flows (million EUR)

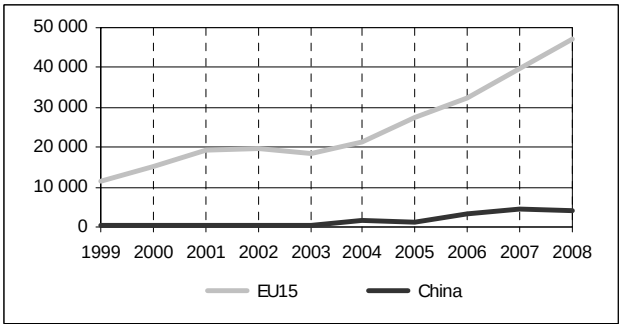


Source of data: European Commission (Web)

Because trade statistics alone between two regions never tells us the complete story we now turn our attention to direct investment flows, and stock data. In Figure 7 one can see that European FDI flows to China showed a quite stable pattern of around 2 billion Euros until the turn of the millennium. However, from this point on, investment flows had begun to increase, and surpassed 6 billion Euros in 2005. As a consequence of the financial crisis it dropped below 5 billion Euros in 2008 (the last year from which we have reliable data). Though significantly less than European investments in China, Chinese investments has also shown an increase in the last decade. Inflows have been in the region of 300-500 million of Euros for years, but both in 2006, and 2007 the amounts were considerably higher (2.1 billion, and 550 million Euros, respectively). We expect that the trend will continue, and Chinese investors will become much more active in Europe than before. This approach will be fuelled by the consequences of the financial crisis, namely the shortage of liquidity from the European side, and the huge foreign exchange reserves from the Chinese side. Chinese capital could be especially useful in financing the increasing budget deficits of some EU member countries.

Figure 8

Bilateral FDI stocks (million EUR)



Source of data: European Commission (Web)

The behavior of investment flows is reflected well by the stock data shown in Figure 8. Both European, and Chinese FDI stocks have shown rapid increase from 2004 on. This was the first year when cumulated European investments surpassed 20 billion Euros, and Chinese investments 1 billion Euros. In 2008 the former stood at 47 billion Euros, the latter at 4.7 billion Euros. Though both the EU, and China have investors more important, the relative importance of these two regions in their foreign investments has increased substantially.

After summing up the most important features of bilateral trade, and investment relations it is time to make some remarks about the strategic aspects of the relationship between China, and the EU. Following **Inotai** (2007) we can make three groups of strategic questions according to the level of cooperation and/or conflict. In the first group there are areas where common interests govern the processes. Both bilateral trade and strong commitment towards the fight against terrorism are good examples to continued cooperation of China, and the EU. In the second group there are strategic interests where elements of both cooperation, and conflict can be found. Perhaps the most notable area here is the somewhat different approach to international affairs. While the EU promotes multilateralism, the Chinese rather emphasizes multipolarism. Though the two concept have similar roots, and share numerous values, there are also marked differences between them. While the notion of multilateralism rests upon global governance, and increasing role of supranational institutions, multipolarism is based upon the concept of balance of power, where the main players follow their vested interests, and their actions are aiming to maximize utility. In the theory of international politics the former corresponds to the liberal, the latter to the realist approach (see e. g. **Brown** (2002)).

There are two additional areas where both cooperation, and conflict can be found. The first is the future of international organizations like IMF, and World Bank, where the EU, and China are in different positions, but have mainly common interests. The second one is energy. Here we can also find both conflicts and room for cooperation. At last, the third group of strategic concepts shows rather different interests. Here we can refer to different cultural characteristics, or value-systems. Though all the three groups consists of important questions, we are convinced that the need for cooperation between China, and the EU is stronger than the threat of potential conflicts.

The Role of Hungary in the EU-China Dialogue

On 1st May 2004 Hungary became member of the European Union. From that point on Hungary, along with other Central European countries, has been empowered to directly shape the policy of the Union. Though their voting power are not too strong, they really have the possibility to shape their future. In this part of the paper we try to address the question: what a small, export oriented country like Hungary, can do to promote, and make use of the linkages between China, and the European Union.

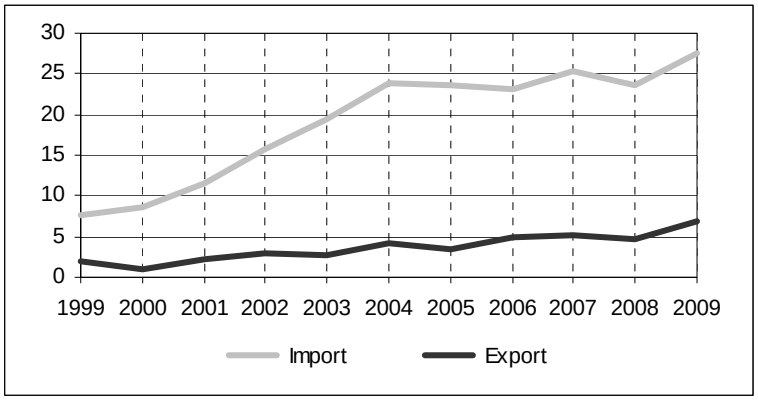
Traditionally Hungary and China have been in good relationship due to their common communist past. In addition, because ancient Hungarian tribes stemmed

from the borderline of China, they consider us as the descendants of the Huns. This special relationship resulted in tighter linkages in the decades after World War II, especially in the field of education. Lots of students from Hungary had the opportunity to study in China, and vice versa. Though trade linkages were not too strong, Hungary managed to achieve a special status from Chinese point of view in Eastern Europe. Interest became even higher when in 1968 Hungary tried to introduce a special kind of reform socialism, which meant a viable path for China to follow. Of course, by the launching of the reform process in 1979, they had learnt the lessons of avoiding mistakes, and have applied only elements of the Hungarian approach. In any way, on the eve of the systemic transformation, Hungary was in a very good position to build upon these close ties to China. Unfortunately after the transformation process had begun, Hungarian leaders had several other problems to solve, and let these opportunities unexploited (see **Székely-Doby** (2007)).

Joining the European Union, however, brought a new impetus to strengthening linkages with China. This opportunity meant not only that Hungary had equal rights in the policy process, and could shape European policy, but also opened up a new channel where Hungarian interests could be promoted. In fact as a full member of the Union Hungary had two levels to influence the relationship with China. We all know that stakes are very high. China has a huge market (perhaps sometimes a bit too big for a country like Hungary) with lots of unexplored export possibilities, and, at the same time, has a large capital pool, which is quite rare nowadays after the crisis. To mention some areas with excellent export prospects we refer to environmental technologies, first of all water cleaning equipments, but there are also good opportunities in the food industry. On the other hand Hungary offers a very good base for logistical centers, as well as transportation, redistribution, and packaging of Chinese goods. But perhaps the brightest prospects in cooperation appear in research, and education, because here one can build upon the successes of the past.

Figure 9

China's share in Hungary's extra EU27 trade (%)

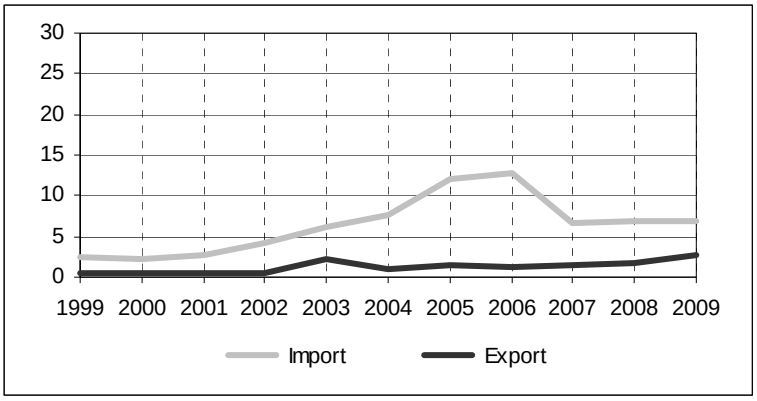


Source of data: European Commission (Web)

After talking about strategic issues let us take a closer look to trade issues. As we can see in Figure 9 in line with the EU accession process China's share in Hungary's extra EU27 trade increased significantly. In imports it exceeded 25 percent, and in export 7 percent in 2009. We saw earlier that the same numbers for the 27 EU member states were 18, and 7.5 percent, respectively. That is Hungary has relatively stronger ties towards China than the European average. Although it is rather the import side where China has relatively more influence in Hungary (the deficit was nearly 4 billion Euros in 2009), it can be seen as a substitute for more expensive import sources, and thus may be a favorable phenomenon. As a comparison it is worth to have a look at the data of a newly accessed European country, Bulgaria. Figure 10 shows that China is a significantly less important trading partner of Bulgaria than that of Hungary. Moreover, its share is much lower than the European average.

Figure 10

China's share in Bulgaria's extra EU27 trade (%)



Source of data: European Commission (Web)

Conclusions

The BRIC countries, and especially China, have significantly increased their share in the world economy, and in world trade as well. Though they are not yet ready to take over the leading role from the US, the EU, and Japan, this new trend of shifting power is undisputable. From the BRIC countries we can single out China with its extraordinary performance, and special approach to development. In fact, the Chinese model can be seen as an accelerated version of the Japanese one, which has brought enormous success in the so called Tiger economies.

In the past two decades China became the EU's most important trading partner. China's share in trade, and capital flows increased rapidly, and their relationship got more and more symmetric. Although there are areas where they have different interests, there are much more issues with common interests, and room for cooperation. For Hungary China has been a special partner for decades. After the fall of communism the ties became weaker, and Hungary practically lost almost all of its

previous advantage. The EU accession, however, opened up new possibilities, and new channels for the country, to pursue its interests, and regain at least some of its privilegized status.

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

ГОДИНА XX, 2011, 2

Iskra Christova-Balkanska[1]

EMIGRATION AND FOREIGN DIRECT INVESTMENTS: LINKS AND IMPACT ON THE BULGARIAN ECONOMY

Object of the study are international migration and FDI, as the main phenomena of the globalization of economic relations. Another aspect is tracking the link, established in recent years, about the relationship between international migration and FDI, as a consequence of the evolution of the concept of the international movement of factors of production. In connection with these conceptual aspects, attempts were done to establish whether there are some connections between the growth of Bulgarian emigration and the formation of the Bulgarian diaspora abroad and the FDI inflows in the country. In particular, in the first section some details were given about the increase of Bulgarian emigration. In the second section some concrete conclusions have been drawn about the impact of FDI on macroeconomic development in Bulgaria. In the third section some possible links between migration and FDI were developed, arguing that some effects of "complementarities" can be established. The fourth section is devoted to the main potential benefit for the Bulgarian economy by the increase in remittances from Bulgarian emigrants to relatives remaining at home. Conclusions were made as well as on the relationship between migration and Bulgarian FDI and the effects on macroeconomic development and the prospects of evolution and the benefits of FDI and remittances like an external financial inflows.
JEL: F21; F22; F24

1. Introduction

In economic literature international migration and FDI are the two much most important phenomena of the globalization and reveal the changes in international factor mobility theory and practice. For a long time, international factor movements have been accepted like a substitute for trade. For example, the international migration of labour has been considered as similar in its causes and effects to international trade based on differences on resources.

Labour moves from countries where it is abundant to countries where it is scarce. This movement raises total world output and generates income effects. International

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borrowing and lending also has been viewed as a kind of international trade. It is trade of present consumption for future consumption and the relative price of this intertemporal trade is the real rate of interest. When factors (labour and capital) are immobile between countries, free trade of goods will tend to equalize factor prices and there are no incentives for factors to move outside the countries, as it was postulated by R. Mundell's approach.

Traditionally, most workers remain in their country of national origin due to immigration restrictions, while capital controls have in some periods restricted international movements of capital. Income redistribution is likely to change over time in response to any shock to the system as a movement towards trade liberalization or free trade. Trade and factors movements are efficient and beneficial at least as long as some form of redistribution of income takes place. International factor mobility serves as a substitute for trade in some other sense in Hecksher-Ohlin-Samuelson model (H-O-S model), since an increase in the volume of factor movements can decrease the volume of trade. Subsequent development has demonstrated that models diverge from the standard H-O-S assumption and they result in complementary rather than substitutability between factor trade and goods trade.

The new international trade theory postulates the effects of market imperfections and product differentiation. Capital mobility and the different forms of capital transfer at international level do the difference. On the whole, factor movements are subject to more restrictions than the international trade, limits and barriers to trade between countries, transport costs, differences in technologies across countries, differences in the productivity of capital and labour.

The distortion of factor market structure induce inequalities between countries This movement raises total world output and generates income distribution effects which under the conditions of imperfect market arise income inequalities. In fact real wages in different countries which are diverging in a short and even medium term because of the disturbed factor market structure will tend to equalize in the long run if the law of the one price is not violated too. The speculative movements of capital between countries in search of higher return of capital are modifying the trend of the capital markets and create real interest rate differentials.

The analysis of the relationship between FDI and migration flows has been growing in the last years, although the number of contributions is still relatively limited. The discussion is held how this is related to the standard analysis of factor mobility of Heckscher Ohlin trade theory. Most contributions look at whether these flows are substitute or complements for a given location (country, province, region etc.) or pair of locations. The research of international trade with heterogeneous firms has been expanded with the link between FDI and migration at the firm level.

FDI and international migration are two important phenomena in the recent history of Bulgarian economic development and this article aims to reveal if there is a relationship between them. To what extent FDIs have an impact on Bulgarian economy and if FDI entries contribute for the limitation of Bulgarian emigration. If

there is evidence that Bulgarian migrants have been tempted to invest or to stimulate foreign investors to settle in their native country and how the conception of complementary or substitutability can be proved? Also how the counterpart of the Bulgarian migration process – the remittances helped to compensate the financial gap of Bulgarian households.

In the first part, a brief overview on Bulgarian integration to international migration process is presented. In the second part, some issues on FDI impact on Bulgarian economy have been revealed and whether there is a link between FDI and emigration in the Bulgarian case. The third part shows how remittances help for the overcome of economic and social problems of the Bulgarian households.

2. Inclusion of Bulgaria in the International Migration Process

The main reason for the increase of Bulgarian migration since the beginning of the 90s of the XX century is the political, economic and social instability in the country during the years of transition to market economy. The political perturbations provoked a sluggish economy with low or negative rate of GDP growth, high inflation, low wages, deterioration of external trade and an overall bad prospective for further development. However, the decision for emigration is much more complicated and depends also of other different personal reasons.

According the census of 1992 and 2001, 196 000 people expatriated and only 19 000 returned back to Bulgaria.[2] In the period 1992 – 2001, around 22 000 people have left Bulgaria yearly. Recent data from National Statistical Institute (NSI) are showing that the emigration process is ongoing and in 2007-2009, 24 109 people have emigrated from the country. In comparison with 2007, 15.35 % more Bulgarians left the country in 2009. Expatriated women exceeded by 7.07 % the number of expatriated men. (Table 1). According the census of 2011 for the period 2001-2011 the decrease of the population amount to 581 750 people or 7.91 % of the total population, by subtracting the natural growth, it appears that the population was reduced with 192 663 people (2.62 % of the population). We can presume that a significant proportion of those people actually have left the country.

Table 1

External Migration by Sex, number in 2007-2009*

	Total			Men			Women		
	Settled**	Emigrated**	Changes	Settled	Emigrated	Changes	Settled	Emigrated	Changes
2007	1561	2958	-1397	877	1119	-242	684	1839	-1155
2008	1236	2112	-876	674	766	-92	562	1346	-784
2009	3310	19039	-15729	1921	8353	-6432	1389	10868	-9297

* Include only persons who have declared before the administrative authorities to change the current address for abroad the country, NSI.
** Settled in the country, Emigrated from the country.

[2] Kalchev, Y. Census of Population, Housing Sector and Rural Entities (farms) in 2001, vol. 6 Sample studies, book 3 Territorial Mobility of Population, NSI, 2002.

Those data are not complete because no statistics are available about emigrants who left the country in various informal ways. According to unofficial data and without taking into account the old Bulgarian emigration, since the beginning of transition to market reform, the Bulgarian Diaspora is estimated at 1.2 million people or 15.8% of the population (2008).

In the early 90's, the first major group of Bulgarian emigrants headed to Germany, the U.S.A and to Canada. The desire for emigration to the USA continues to prevail even now in the mind of young Bulgarian families. USA remains preferred destination for highly skilled professionals because of the easy integration in a society built by immigrants, accessible programs for social inclusion, training opportunities and professional development and higher salaries.[3]

Attractive destinations for Bulgarian migrants were also Western European countries, but the objective of the authorities of several EU countries was to limit the stay of foreign workers in their countries in the early years of the Bulgarian emigration. The core of main European migrants policies was the adoption of the principle of rotation. After the prescribed period of stay for working, the foreign workers should return to their countries of origin and their jobs are occupied by others. However, the real life proved to be different. Since the early 60's more and more foreign workers haven't left their work and remained for years, living in their host countries. This practice served the interests of employers who prefer to retain professionally trained workers.

Bulgarian migrants prefer to settle and live in well organized state, attracted by the higher wages in the developed countries of Europe in comparison with those in their home countries, the good prospects for increasing incomes, the benefits of good social policy. The healthcare, the education for children, the better infrastructure and the possibilities for good professional realization are fundamentals and permanent factors that determine the willing of a growing number of Bulgarians together with their families to stay and work in the developed Western part of Europe. Moreover, another advantage is the proximity of the countries of Western Europe to Bulgaria.

One of the main attractive destinations for skilled Bulgarian migrants remains Germany.[4] In 1999-2007, Bulgarian immigrants in Germany amount to 46,818 people. For the same period, the absolute number of Bulgarian citizens living in Germany increased to 69.18%. Bulgarian students in Germany represent 2.0% of all the students in Germany (2007). In the years 2001-2003 Bulgarian students amounted to over 5% of all students in Germany. After the graduation, Bulgarian students rarely return back to Bulgaria and prefer to find jobs in Germany, somewhere in Europe or the U.S.A.

[3] National Strategy of RBulgaria on migration and integration, 2008-2015, p.5. Other data.
[4] I. Christova-Balkanska, P. Naidenova, Case Study on Bulgarian immigration to Gemany, In: Sustainable Development and Diversity in Bulgaria, Collected Papers, Ikopis, Sofia, 2010. p. 133-165.

Other destination for skilled Bulgarians in their will to find a better life and professional realization is to settle in USA. According to official data, Bulgarians in USA are nearly 95 000 (2008). More than half of Bulgarian immigrants in USA have a bachelor's degree. With the illegal immigration, the number of Bulgarian migrants in USA increases to 200,000. people. The level of education shows that Bulgarian migrants are qualified to work fairly well, and most of the low qualified workers also succeed to integrate the USA labour market. This determines the fact that many Bulgarians do not think to return back to Bulgaria (Table 2) .

Table 2

Number of Bulgarian Immigrants by Country for 2008

Germany	Over 50 000
Austria –	Around 25 000
Czech Republic	Around 10 000
Italy	Around 50 000
Slovakia	Around 3 000
Hungary	Around 5 000
Belgium	Around 4 000
Greece	Around 110 000[5]
United Kigdom	Over 60 000
Sweden	Around 2 000
France	Over 15 000
Portugal	Around 10 000
Spain	Around 166 000
USA	Non-official 200 000 Official 95 000 (2008)
Canada	Around 45 000
South Africa	15-20 000
Australia	15-20 000

Source: National Strategy of R. of Bulgaria on migration and integration, 2008-2015, p.5. Other sources.

After the accession of Bulgaria to the EU (2007), the shape, the trends, the preferred destinations of Bulgarian migration have changed. From permanent emigration, which prevailed in the past years, Bulgarian emigration became more seasonal and temporary. Unlike earlier periods, when the Bulgarian labour migration headed to Germany and the U.S.A in the years after 2000, significant number of relatively less skilled workforce from Bulgaria goes to Spain, Greece, Portugal, where workers were sought in economic sectors like construction, agriculture, household activities and other relatively low-skilled jobs. However, for many people the temporary stay, with the purpose to earn money for a fixed period of time, turned to be permanent. According to a report of V.Mintchev et al. (2003), relaying on two sociological surveys, “during the two years period (2001-2003) a trend is observed, although insufficiently clear-cut, towards a decline of settlers in favor of those, who prefer a temporary stay abroad”.

[5] According to some data, the number of Bulgarians residing long in Greece is estimated at about 200 000 people as 35-40% of them residing in Thessaloniki in Northern Greece.

Data from Table 2 show this trend. The mobility of low-skilled Bulgarian workforce and the increase of Bulgarian migrants in the countries of South Europe have been facilitated by the removal of Bulgaria from the "Schengen"list. The growth rate of less educated workers from Bulgaria amounted to 5.8% of the total number of Bulgarian emigrants. According to World Bank the main destinations for Bulgarian migration are now Spain, Germany, Greece, Italy, Great Britain and the USA.[6]

In general, according to World Bank data Bulgaria is among the ten countries in the region of Eastern Europe and Central Asia with the highest number of highly qualified emigrants - 8.6% of the population. Now a high number of highly educated medicine staff (doctors and nurses) is leaving Bulgaria. Factors, that stimulate the continuing emigration of highly educated people are associated with the low level of wages, the remaining uncertainties about their future professional and personal life and the overall fall in the level of education, healthcare and other social utilities.

The main relevant incentives for skilled and low-skilled Bulgarians to migrate consist of higher living standards and the resolve of material, financial, professional problems.

In the years after 2000, the economic situation in Bulgaria slightly ameliorates with the appearance of a real growth in the GDP and after 2004 it increases up to 6%. The inflation's controlling allows stabilization of consumption, incomes and investments. Unemployment has remained at an affordable level, and the government budget since 2002, ended the year with a surplus that allowed not to impair the integrity of the fiscal reserve at the BNB. (Table 3) The stabilization of the macroeconomic situation in Bulgaria, to some extent, reduces the rate of emigration and the attitude towards emigration.

Table 3

Macroeconomic Performance of Bulgaria

	2004	2005	2006	2007	2008	2009	2010	2011
Growth in real GDP (%)	6.66	6.2	6.5	6.4	6.2	-4.9	-0.8	1.7
Inflation (in %)*	0.1	5	7.3	8.4	12.3	2.6	3	5.1(Q1)
Unemployment (%)	12.2	10.7	9.1	6.9	6.3	9.1	9.2	12.6 (Q1)
Index of ind. Production (%) **	12.9	6.9	6	9.6	0.7	-18.3	2.1	15.1(Q1)
Cash deficit/surplus, % of GDP	1.7	3.1	3.4	3.3	2.9	-0.9	-0.8	-1.0

* Inflation, y/y change

** Index of industrial production, y/y change

Source: National Statistics Institute (NSI), Bulgarian National Bank (BNB).

The global financial and economic crises seriously have affected the economic and social life in Bulgaria. The deterioration of the business climate and the drop in the index of industrial production reverse the prospective for further positive development and amelioration of every day life. As it can be seen from Table 3 between 2008 and 2009 the decline in the real GDP amounted to about 12%, the

[6] World Bank, Development Prospects Group, 2008, Migration and Remittances Factbook, www.worldbank.org

industrial production fell to nearly 20%. An annual decline has been posted, given that a deficit in the budget appears for the first time since 2002.

Bulgaria, along with Romania, has the lowest, among the EU-27 countries level of GDP per capita, (calculated on the basis of the purchasing power parity), which is between 50 and 60% less than the average level of EU countries. In the period 2005-2009 years the poverty line gradually grows out despite the increase of social state assistances. Persons at risk to fall into poverty, after the receipt of social assistance, increased from 14 to 21.8% of the total population for the period 2000-2009.

Despite standards of living in EU15 have improved significantly over the past decade, based on the PPS, which makes international comparisons possible, EU standards of living significantly varies. In 2009, the GDP per inhabitant in Luxembourg, expressed in PPS (purchasing power standards) was more than two and a half times the EU27 average. Netherlands registered a level more than 30% above the average. New member states (2004) – Slovenia, Czech Republic, Slovakia, were between 10 and 30% lower than the EU27 average. Hungary, Estonia, Poland, Lithuania, Latvia were between 30 and 50% lower, while Bulgaria and Romania were between 50 and 60% below the EU27 average.[7] The EU is striving to narrow the gap between its rich and poor members, strengthen the European economy, make it more competitive and create more jobs, however Bulgarian skilled migrants (among the others) are keen to enjoy a better quality of life, not expecting the catching up process to be successful in the nearest future.

In 2009, Bulgaria is the poorest countries of EU 27, with the lowest real household income per capita, recorded income 60% below the EU average. The group of 9 EU countries with low real household income per capita cover about one fifth of EU population with income per capita 55% below the EU average.[8]

The deep economic crisis (end 2008) and the consequent increase in unemployment enhance the attitudes towards emigration. The main factors influencing emigration relate to future concerns about the everyday life because many workers were fired from their jobs. The further impoverishment of the population and the lack of prospective lead to finding ways to survive and one of them are through emigration.

Other factors stem from the comparisons of wages levels in Bulgaria relative to that in developed countries. The professional skilled and educated people sought mainly to increase the purchasing power of the received remuneration for their work, suggesting that in Bulgaria there is always a danger of inflation tendencies. The limited number of well-paid jobs also acts as a pushing out factor and increases the attitudes of young people to emigration

Referring to the theory, the ongoing trend of Bulgarian migration allows drawing some possible direct or indirect relationship and evidences between migration and

[7] Eurostat, Newsrelease, 195/2010, 15.12.2010.
[8] 9 poor EU countries – Bulgaria, Romania, Latvia, Poland, Estonia, Hungary, Lithuania, Slovakia, Czech Republic. Eurostat, Statistics in focus, 16/2011.

FDI. After 1990, the structure of the Bulgarian emigration is very heterogeneous in nature, but the highly educated persons, who are well integrated into the socio-economic and life of the host country and have a well-paid job perhaps, will be tempted by the experience to invest in their home country.

The Bulgarian migrants in Europe dispose with the necessary knowledge for the country cultural and traditional particularities of their native country and are aware about the size of the market. Nevertheless, Bulgarian migrants settled in other EU countries have more opportunities for contacts with partners from their home country. This allows supposing that some migrants may decide to start a business back home or to facilitate the entry of foreign investors from the host country in its efforts to shift production or services their home country. The geographical proximity is positively related to both FDI and migration flows and it is possible to find some relationship of complementarities, particularly between FDI and skilled migration. Is there any evidence that the growth of Bulgarian emigration leads to an increase in FDI inflows in Bulgaria, supposing that skilled Bulgarian migrants are tempted to start additional business and increase job opportunities and career in Bulgaria? The answer may be sought if we analyse the impact of inward FDI on the Bulgarian economy. Are there any possibilities to influence favorably the limitation of brain drain leakage by attracting FDI?

3. The Role and Impact of International Factor Mobility on Bulgaria. Is There a Correlation between Capital Inflows and Outflows of Workers Abroad?

3.1. Foreign direct investments – a way of overcoming the shortage of ffinancing and a tool for macroeconomic stabilisation

Attracting FDI is very important for the Bulgarian economy. FDIs arise mainly when multinational firm creates or expands a subsidiary in the host country. The FDI inflows result in setting up and/or developing new industries or other activities, being of benefit to the economy of the host country. The FDI enable the transfer of new knowledge and technologies, jobs opportunities and staff qualification.

The impact of foreign branches on the behavior of local firms is expressed through direct and indirect effects (spillovers). They influence on local industries and change the economic environment in the host country**.** The impact of FDI can be horizontal and vertical. FDI at horizontal level means when they are spread in depth at inter-production level. The vertical FDI reflect their spread in two different productions.

The connection between the foreign and local company is important for the technology transfer and the labor production. The new technological development of the host country pave the way for approving of the intra-industry linkages and increase the knowledge in economic sectors and may help to create more diversified export-oriented structure.

FDI can assist in helping countries with shortage of capital to build up their own research and development bases that can bring in new technologies. This is a very

crucial contribution as most of the countries are not able to perform these functions of their own. These impacts are important especially in the context of manufacturing and processing industries and services of the host country. FDIs influence on the qualification of the labor force. The activities of MNCs and FDI have an important impact on population's standard of living in the host country and socio-economic development.

At macroeconomic level, FDIs help to finance the deficit of the current account of the balance of payment. It is important to overcome the shortage of finance for the economy in order to provide a macroeconomic stability, to ensure an additional funding for the increase of investments, economic growth and employment. All these issues are closely related with diversity of countries' economic restructuring and diversification of production as well as the export orientation of industries.

Attracting FDI is considered to be one of the most important tools for economic restructuring, keeping the qualified workforce at home. Foreign investments in the real sector were expected to create additional opportunities for employment growth. Also, the opportunities for a new professional training provided by the foreign companies were expected to strengthen further the capabilities of the Bulgarian citizens to govern their lives in Bulgaria and to limit the attitudes towards emigration.

The temporary macroeconomic and financial stabilisation in Bulgaria and the accession of the country to the EU are factors that influence the attraction of significant volumes of FDI in the period 2004-2008. In the years 2000-2010 have been accumulated 37.326 billion EUR of FDI. The reinvested earnings amounted to 3.973 billion EUR, the equity capital - to 22.506 billion euros, the other capital amount to 10.847 billion EUR. The FDI entries were significant for the external financing of the Bulgarian economy and in the period 2000-2010 the yearly average of FDI amount 3.393 billion EUR. The impact of the global financial and economic crisis was severe and between 2007 and 2008, FDI fell to 73.86 % and between 2008 and 2010 the decline amounted to nearly 5 times.

FDI flows to the manufacturing sector seems to have a positive effect on economic growth. Indeed, most of the theoretical work on the benefits associated with FDI tends to be related to the manufacturing-industry sector. The macroeconomic literature focus on the fact that not all forms of foreign investment seems to be beneficial to host economies. The distribution of FDI by economic sectors shows that in the period 2000-2010, major foreign investments are focused in two directions - the purchase of real estates and financial intermediation. According to estimations, nearly 23% of FDI were directed towards the purchase of real estates and business services 19.09% of FDI to financial intermediation, nearly 18% in manufacturing, nearly 16% at retail trade, cars repairing and other motor vehicles, 6.9% of FDI to the construction, 6.4% to the production and the distribution of electricity and steam-heating, gas and water supply, 5.15 of FDI to the transport and storage. Other economic sectors such as health, education, activities related to social and personal and others have remained out of sight of the foreign investors. FDI in those sectors amounted to only 6.28% of the total FDI. (Table 4)

Table 4

FDI by Economic Sectors, million EUR

	2000-2010
Total	37325,4
Health, Social activities	10,5
Financial intermediation	7126,3
Activites related with the society and the others	314,9
Manufacturing	6552,3
Hotels&restaurants	584,4
Real estates&business services	8319,6
Education	14,8
Transport&warehouse&	1923,4
Electricity&Heating&Water supply	2372,1
Fishing	4,1
Construction building	2581
Non-classified	1266,5
Agriculture&Hunting&Wood Industry	206,4
Trade&Services on cars, motor vehicles&rRpairing	5843,8
Mining	205,6
Administarion&Army rule&Social security	0,0

Source: Calculated using data from BNB.

One of the positive sides of the stock of FDI in Bulgaria is the emergence of new investments, generated by the subsidiaries of foreign firms, settled in the country. Additional investments demonstrate the strategic considerations of the firm, such as enlargement or update improvement of existing industrial or service facilities.

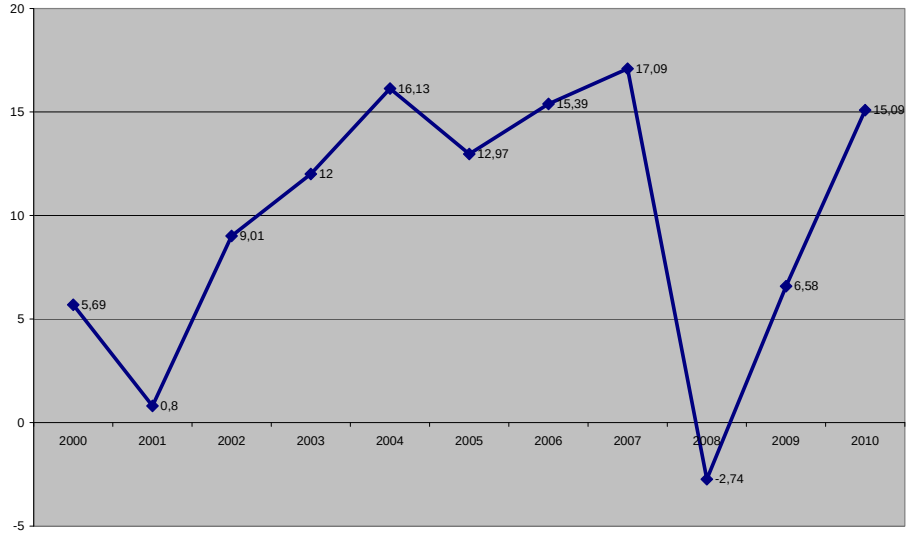
Reinvested earnings are a component of investment flows. In international business literature to date, "nothing has been written regarding the empirical importance of reinvested earnings, or what factors govern the decision of whether income earned at a foreign location is repatriated to the parent in the home country, or whether it is reinvested at the foreign location."[9] Six major macroeconomic factors can be mentioned, as a means of managerial control, which affect investment opportunities in the host country: the profitability of foreign investments, the exchange rates level, the different systems of corporate governance, the tax treatment of repatriated foreign income (intra-firm dividends), and the use of dividend policy. Reinvestments focus on factors that increase the attractiveness of the host country as investment location and as alternative of repatriation of capital. Figure 1 show that reinvested earnings in Bulgaria increased up till the fall in 2008 and starts to grow up again in 2009 and 2010. Reinvested earnings' growth reflects the raising functionality of foreign companies, the realized economic growth, and the favorable overall investment climate. Some economists emphasize the crucial role of low corporate tax of 10% in Bulgaria for the increase of reinvestments. (However, there are no special evidences that the low level of corporate tax was a particularly important factor, determining FDI increase.) It is widely recognized that the positive economic

[9] S. M. Lundan**,** Reinvested earnings as a component of FDI: an analytical review of the determinants of reinvestment,Transnational Corporations, Vol. 15, No. 3 December 2006.

real growth in Bulgaria in 2004-2008 was largely due to FDIs inflows. The economic sectors that have been the "locomotives" of this process were real estate purchases and investments in business activities, financial intermediation, and manufacturing sector.

Figure 1

Reinvested Earnings as a percentage of the total FDI in Bulgaria



Source: Own estimations on BNB Data.

The consumption and the investments' increase contribute for an upward positive economic trend, suspended sharply by the economic crisis. The ratio FDI /GDP shows a strong depending of Bulgarian economy from FDIs inflows. It is an indicator demonstrating the intensity and the integration of the domestic economy into the international investment market. Positive ratio of FDI to GDP reflects a good absorption capacity for foreign investments of Bulgarian economy. Table 5 shows that in the real sector have been accumulated FDI, which were the consequence of an active and subsequent capital transactions activity. Similar processes were observed in other countries of Central and Eastern Europe, which were showing the specificities of the industrial specialization of those countries, defining foreign investors' interest for FDI transactions in the region (Table 5).

Persistent current account deficits, driven mainly by the need for imports, have been characteristic in the years after 2000. FDI entries in the financial account permit to cover the shortfalls in the current account of the balance of payments.

Figure 2 shows that over the past decade, FDI covered the widening current account deficit of the balance of payments. The economic crisis was accompanied by a sharp fall in the industrial production, which demonstrates the decrease of foreign demand for the Bulgarian enterprises. The fall in import and export lead to a decrease in the level of the current account deficit. The reduction by nearly 12 times of current

account deficit (from -3477 to -282.7 million euros), due to the sharp fall in industrial production, the contraction of consumption and the fall in investments are the main reasons, explaining the decline in the ratio FDI/ Current account deficit of the balance of payments. In 2010, FDI inflows (EUR 1,360 billion) completely cover the current account deficit of the balance of payments, which reflect the squeeze of the economic activity.

Table 5

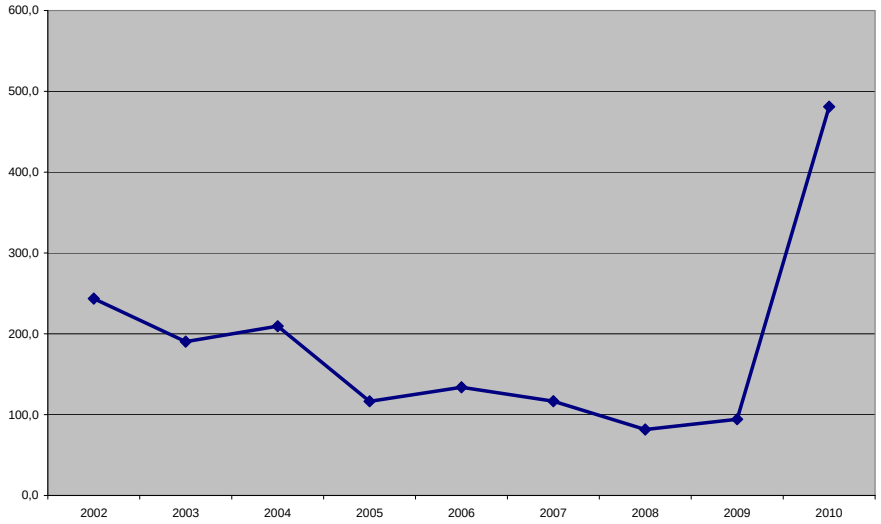
FDI in the real sector of the economy of some countries in Central and Eastern Europe and Baltic States – Industry and services (excluding financial intermediation), % of GDP

	2003	2004	2005	2006	2007
Bulgaria	81	98	85	84	n.d.
Czech Republic	183	200	241	252	n.d.
Estonia	3	3	3	1	1
Latvia	11	8	8	10	16
Lithuania	18	22	38	45	n.d.
Hungary	29	34	n.d	52	119
Poland	n.d.	n.d..	n.d.	n.d.	126
Romania	37	53	46	77	80
Slovenia	9	15		15	18
Slovakia	31	46	47	68	75

Source: Eurostat.

Figure 2

Relation between FDI and the Current Account of the Balance of Payments 2002-2010, %



Source: BNB.

Significant investors in the manufacturing and financial sectors in Bulgaria were coming primarily from Germany (29 companies), from Austria (12 companies), from the U.S.A (11 firms), Italy (8 companies), Switzerland (6 companies) UK (5 companies), Belgium (5 companies), Japan (4 companies) A few companies are coming from Denmark, the Netherlands, Iceland, Turkey, Russia, Czech Republic, Cyprus, Spain, Sweden, etc. Foreign investments are carried out mainly by developed EU countries.

The accumulation of FDI in Bulgaria was due to the combination of several complex factors from internal and external origin. The main reason for the increase of FDI entries in Bulgaria is related with the overall favorable international investment climate and the integration of Bulgaria to the EU, which undoubtedly reduce the investment risk for foreign companies. The low interest rates and relatively low feasibility of large gains in economically developed countries predetermined incentives for investments in the strategic plans for FDIs abroad. The increase of FDI in Bulgaria, actually, can be explained with the positive economic growth. Nevertheless, the insufficient and undeveloped hard infrastructure, institutional problems, a suspected corruption in the administration have worsened the business climate and exacerbated contradictions in Bulgarian society, which undoubtedly raise barriers behind some important deals with foreign investors to fail.

Bulgaria's membership in the EU and the reduction of taxes on corporate profits (from 15% to 10%) and income from sales of shareholdings (10%) made an attempt to elevate Bulgaria as an attractive destination for international business. Low labor costs constantly have been cited as a factor that attract foreign investors, but by itself this factor can not attract investors. On the contrary, they are associated with lower living standards and low quality production, which is not attractive for a "quality" class foreign investors.

In Bulgaria, savings of the population are low compared with those in developed EU countries and therefore the inflow of capital from abroad is a major engine for the economic activity. FDIs inflows were expanding opportunities to find new jobs, to ameliorate the standard of living etc. FDIs proved to be an important instrument for safeguarding the macroeconomic and social stability in Bulgaria.

3.2. Are there an economic impact and links between FDI and Bulgarian emigration?

As it was underlined, the role of factor mobility has always been crucial in the theoretical analysis of international trade and flows of FDIs across countries and regions. In order to reveal the possible links between FDIs and migration flows across locations, it is important to clarify the mean of substitutability and complementarity between labour and capital. Immigration in a given country and outward FDI from that country are sometimes considered as a complements and others as substitutes. Recently, some topics about the existing relationship between FDI and international migration flows have been clarified. Most of the papers in this

area look at whether these flows are substitute or complements for a given location (country, province, region etc.) or pair of locations.

We define migration and FDI flows as substitute when, seen from the perspective of a given location, they move in opposite directions (e.g immigration and outward FDI or viceversa) and as complements when they move in the same direction (e.g. immigration and inward FDI). [10]

The link between migration and FDI may be explained and qualified not only with the traditional approaches of international factor mobility, but also with some contributions on the possible mechanisms that might enhance either the substitutability or the complementarity between capital and labour movements. These impacts can be classified under the main effects on the countries with open economies, which are involved more or less in the international investments and migrations flows. "New trade theories and New Economic Geography stresses that, under certain circumstances (low congestion costs and trade barries), technological factors or pecuniary externalities may create agglomeration effects, attracting both types of flows." (Navaretti.G. B. 2007).

The relationship between FDI and migration at the firm level arise on the basis the huge literature of international trade with heterogeneous firms[11]. The theory of heterogeneous firms cover issues and paves the way for the analysis whether the firm should invest abroad and hire emigrants and if this are alternative or complementary strategy at the firm level. The relationship of migration and FDI is worth to be mentioned, but those questions are not addressed here.

We focus mainly on complementarities between capital and skilled labour arising from the point of view of the host and the home country of migrants. From the point of view of the host country, the existence of a large skilled emigrant agglomeration may lead to the opening of international schools and making this location attractive for foreign companies and skilled professionals. The FDI entries in the country of origin of migrants like Bulgaria and investments in upstream industries may contribute for the development of new knowledge and skills in new information technologies. The adoption of some skill intensive industries in Bulgaria creates new jobs opportunities and enhances the employment of skilled workers, reducing the

[10] It is important to clarify what is substitutability and complementarity of FDI and migration flows across locations. There is often some confusion on the meaning of these terms. For example, immigration in a given country and outward FDI from that country are sometimes considered as a complements and others as substitutes. We define migration and FDI flows as substitute when, seen from the perspective of a given location, they move in opposite directions (e.g immigration and outward FDI or viceversa) and as complements when they move in the same direction (e.g. immigration and inward FDI).

[11] "Heterogeneous firms" are related to the conception of "The knowledge-based theory of the firm" considering knowledge as the most strategically significant resource of a firm. Its proponents argue that because knowledge-based resources are usually difficult to imitate and socially complex, heterogeneous knowledge bases and capabilities among firms are the major determinants of sustained competitive advantage and superior corporate performance.

incentive of emigration of skilled people (the brain drain).[12] In the case of Central and East European countries, the assessment of integration with the EU passes through the search for complementarities between skilled labour force and strong capital inflows. A large brain drain from Bulgaria, since the early 90s probably reduced the prospective for investments by EU developed countries in EU to transfer industrial or trade activities. Complementarities were arising also when foreign producers transfer their activities in a less developed country in order to profit from the lower wages and the abundance of low qualified labour force. These complementarities effects are typical for Bulgaria. For example, the small and medium enterprises in the field of textile and dresses mainly with foreign capital in the towns bordering Greece and Turkey took advantage of the low costs for labour in Bulgaria.

The enlargement of Bulgarian migrant communities in Greece and Spain and the retention of migrants' links with their home country can be a prerequisite for the transfer of foreign investment and new professional experience and knowledge. Networking means a transfer of growth-enhancing technology transfer, trade and FDI to the country of origin of migrants. Migrants would prefer to trade or invest in their home country, thus spreading all over new opportunities for doing business. They contribute also for the removal of cultural and social barriers between countries. Among the largest Bulgarian community in Spain, Greece, Germany and others, a business community is already formed, that may assist to attract potential investors in Bulgaria and in many different ways to help to overcome the uncertainty that accompanies each new transaction undertaken by the international companies in their country of origin. It is known that multinational corporations are encountering a number of information and technical barriers when deciding to transfer activities abroad. Also, networking effects may arise when Bulgarian investors work with Bulgarian migrants settled in the host country in order to organize and to carry out foreign trade deal or to start some other business.

The theoretical debate between FDI and migration is recent and demonstrate new evidences of international factor mobility, arising from new emerging markets dependency of foreign capitals' inflows, as it is the case of Bulgaria too. In the same time, significant emigration process from Bulgaria raises on the agenda issues such as whether foreign investors can unfold their activities, if most of the skilled workforce were out the country?

What have been observed in Bulgaria is that FDI entries have been promoted by privatization of the big ex-state industrial entities and banks. The accumulation of new foreign capital in the years 2004-2007 was due mainly to the interest from foreign individuals or entities for buying Bulgarian real estate properties, which fuelled the construction sector of the economy. The reinvested stocks of FDI, however, demonstrate an increase of the absorption potential of Bulgarian economy for foreign capital.

[12] Baldwin and Venables in 1994 in their study looked the effects of economic integration on the role of FDI and the incentives of migration of skilled people for Central and Eastern European countries.

From one point of view, the rise of FDIs in Bulgaria have been an incentive for some well educated Bulgarian to remain at home, finding better paid jobs and good professional realization. The rising foreign investments in the IT sectors for example proved to be an attractive pole for good professional carriers. People with lower education, non-qualified workers were employed mainly in the construction building sector.

Although, the scarce data, there are some examples and indicators demonstrating that in the times before the economic crisis, Bulgarian emigrants invested in real property estates in home and thus increased FDIs' level. They have not been especially tempted in the start of some kind of small business in the country of origin, and even if they decided to do this, the realization of their investment projects was difficult, due to different bureaucratic and regulation practices. There have been some signs that skilled Bulgarian migrants helped and promote the implementation of business projects with foreign investors and this tendency will continue in the future.

For some extent, a large brain drain of skilled migrants reduced probably the incentives for developed countries' firms to transfer their activities to other less developed markets. In Bulgaria a virtuous transition path was not observed, characterised by large capital inflows and little migration. Skilled and unskilled migrants can bring in their home country new knowledge and investments in the economy, but even during the economic crisis, the ration of return migration was relatively low. It is not realistic to suppose that most of Bulgarian migrants will return and spread out an upward economic trend.

The economic development is determined by the industrial and technological base of the country and the working institutions and the implementation of a variety of business skills that may influence foreign investors' decisions to come in Bulgaria. The development of links between business communities of Bulgarian emigrants abroad and the implementation of investments in foreign capital in their home country can really help to strengthen the economic and financial potential. Although, the most representative and important instrument, having an impact on households' living standard and the overall economic and social development was the appearance of the remittances, driven by the work of Bulgarian migrants abroad.

4. Remittances – Are They the Positive Counterpart of the Large Scale Bulgarian Emigration?

Like most of the countries with small capability to be financed, remittances are one of the most important sources of external financing with FDI. For a big part of the relatively deprived Bulgarian population they are the largest source and have served as a cushion against the economic and social turbulence in the country, brought about by transition to market economy. Workers' remittances are current transfers by migrants who are employed or intend to remain employed for more than a year in another economy in which they are considered residents.

Bulgarian migrants are in constant struggle abroad to prove themselves in highly competitive and different cultural and traditional societies. Their standard of living is significantly better than the average in Bulgaria. That is why Bulgarian economic migration, in most cases, sends money back home for the financial support of their families. These cash transfers are financial flows that are moving in the opposite direction of the migration flows. For many Bulgarian households, the cash transfers send by their relatives abroad are essential for the maintenance of their socio-economic balance and standard of living.

Remittances appear in the balance of payments after 2000. For the period 2004-2010. Bulgarians, living abroad, have transferred to their home country a total of nearly 3.740.6 billion EUR. According some unofficial data money transfers of migrants were between 30 to 40% higher than the officially registered data. Bulgarian migrants, regardless of whether they live abroad permanently or temporarily, sent home to their families the net sum of remittances of EUR 701,7 million in the period from October 2009 to October 2010.[13] Previous transfers for 12 months (until May 2009) amounted to 693.4 million. Bulgaria is amongst the European countries in which money from migrant labour represent a significant percentage of GDP.

Table 6

Money Transfers from Bulgarians Living Permanently Abroad, % of GDP

Period	Remittances in million EUR	Remittances, % of GDP
2004	351.2	1.77
2005	369.5	1.69
2006	333.0	1.32
2007	634.7	2.21
2008	663.8	1.97
2009	693.4	2.07
2010	695.0	4.30

Source: BNB Current account, Personal estimations.

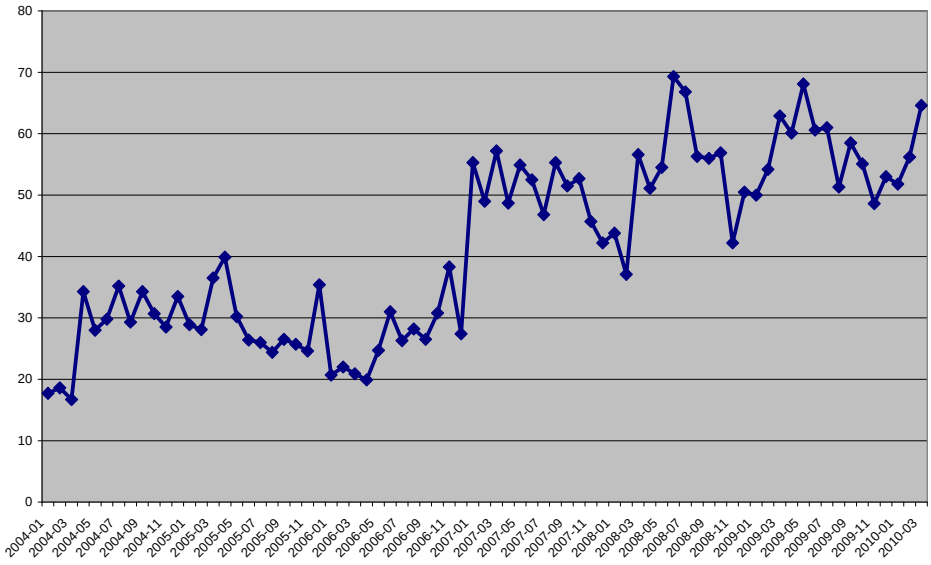
The monthly variations of remittances for the period January 2004-March 2010, demonstrate a net upward trend, even in 2010, when most of the EU developed countries and the USA experienced a fall in economic activity and employment.

Despite the economic crisis 2008-2009 and the squeeze in jobs offered abroad, Bulgarian migrants succeeded to find opportunities to keep their work and to remain on the labour market. If they were dismissed from a previous work, they have found the way to accept some other jobs, even if they are not so well paid as before. In most of the cases, Bulgarian migrants didn't stop to send money back home and as Figure 3 shows there is no a sensible decline in remittances' volume.

[13] Bulgarian Central Bank

Figure 3

Net Transfers from Bulgarians Living Abroad, million EUR



Source: BNB.

Similar information is shown on Figure 4, where workers' remittances, compensation of employees and comprise current transfers by migrant workers and wages and salaries earned by nonresident workers have been put in evidence.[14]

The increase in the volume of migrants' cash transfers is impressive and the comparison with other sources of external financing like FDIs and EU Structural Funds represent that remittances are a much more stable cash flow over time. Remittances are much higher than the net financing obtained by Bulgaria of EUR 432 million for a year up to May 2010 from EU Structural Funds. (Actually, Bulgaria received EUR 867 million for the period, but the costs amounted to EUR 435 million, earmarked for membership EU imports).

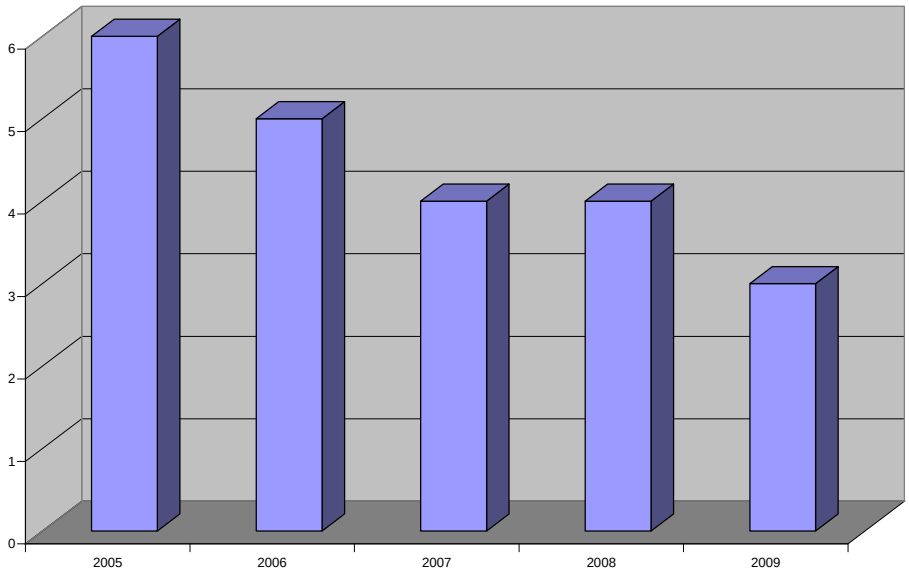
Remittances reveal to be most stable like external cash flows than FDIs entries. As it was underlined, during the economic crisis, FDIs fell sharply in Bulgaria. Here, we can put the question to what extent can we rely on FDI inflows like a main source of external financing, when many countries, also from Central and Eastern Europe, must enter in intense competitive struggle to attract FDIs of quality, view the exacerbated caution of foreign investors to undertake new deals abroad in the post crisis period. FDI can diminish or even stop with the change of the economic situation. The financing from EU Structural Funds is quite difficult to be obtained and can only partially assist in the financing of the economy. However, the main

[14] Data are the sum of three items defined in the fifth edition of the IMF's Balance of Payments Manual: workers' remittances, compensation of employees, and migrants' transfers.

source of financing of the economy in the years 2008-2009 revealed to be remittances. When we compare the remittances' flows with FDI inflows, the evidence is that the FDI level for 2010 is lower than remittances. For some other countries in South-eastern Europe like Albania, Moldova, the remittances' inflows from relatives abroad exceeds the volume of FDIs.

Figure 4

Workers' Remittances and Compensation of Employees, Received (% of GDP) for Bulgaria, 2006-2009



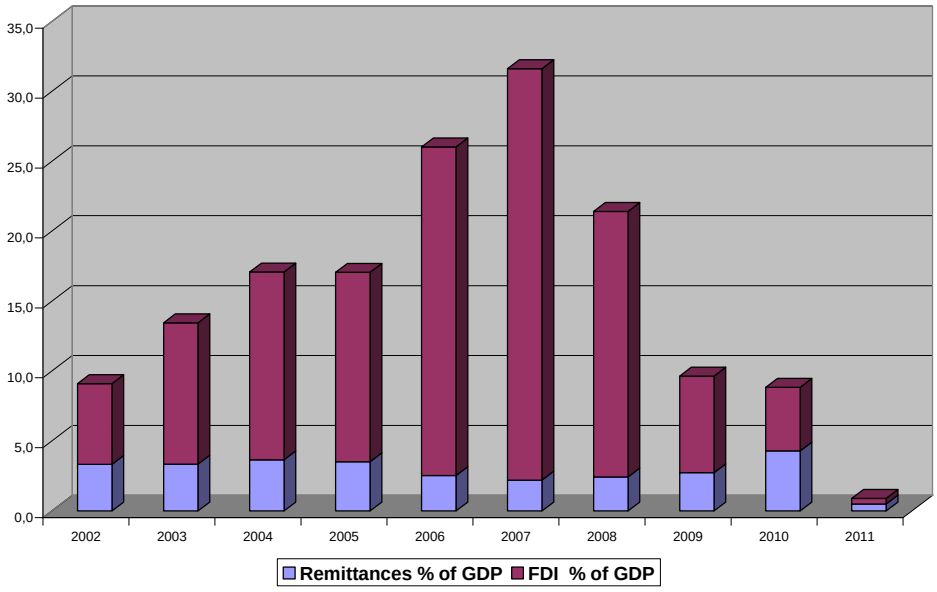
Remittances are classified as current private transfers from migrant workers resident in the host country for more than a year, irrespective of their immigration status, to recipients in their country of origin. Migrants' transfers are defined as the net worth of migrants who are expected to remain in the host country for more than one year that is transferred from one country to another at the time of migration. Compensation of employees is the income of migrants who have lived in the host country for less than a year.
Source: World Bank staff estimates based on IMF balance of payments data, and World Bank and OECD GDP estimates.

The rises in remittances brought back to Bulgarian households have a positive impact on the economy and expand people's spending. Emigrants' money is important for the increase of the net incomes of households and increase also household consumption. Remittances are used for buying food, paying bills, for overhead costs for medical care, education, and thereby for alleviating the deficits in the macro systems of social support, of health, and of education. Remittances from migrant workers are a lifeline to large sections of the Bulgarian economy, particularly the retail trade and the real estate market. Taking into account, that

Bulgaria has a high proportion of its population, living and working abroad, the country remains one of Europe's biggest recipients of remittances.[15]

Figure 5

Remittances (Current Transfers net) % of GDP and FDI % of GDP, 2002-2011



Source: BNB data.

Remittances appear to be a vehicle for the increase of real estate purchases or for the start up of a small business. According the hypothesis of complementarities, we can presume, that some of the migrants will try to invest in the country, being acquainted with the cultural and traditional particularities of their native country and trying to transmit and to apply contemporary business practices.

With Bulgaria joining the EU, it has been suggested that incomes will grow and respectively, the incentives for migration will decrease. However, emigration continues (though far from the pace of the last decade), to be an important factor due to the big differencial in wages between Bulgaria and the other EU Member States. Salaries in EU developed countries are nearly 14 times greater than those in Bulgaria. Table 1 clearly demonstrate that Bulgaria has the lowest GDP per capita. In 2009 GDP per capita amounted to nearly 40% of the average for the developed EU member states. Those facts report that remittances will be for a long time a safety net for Bulgarian households. Their contraction may have a significant negative effect on economic and financial situation, not only on Bulgarian households' welfare, but also on macroeconomic equilibrium.

[15] World Bank estimations

In general, remittances are considered as a real financial benefit for the country after the exodus of a substantial part of the skilled labour force, as well as workers with a lower professional qualification. Remittances are not only a monetary expression of solidarity, they have also a social dimension, representing the social ties of help, solidarity, reciprocity, concern, obligation that express the relationship between the members of one family, no matter that they live on different countries. Money transfers coming from abroad have a broader scope of action because they benefit not only relatives, over time remittances become a factor influencing the welfare of the community. Over time, the increased consumption and welfare because of the remittances influence the economy on macro level. The increase of money transfers continues to be clearly positive, despite some decline in 2011. The ratio of remittances to the GDP has gradually risen.

This explain partially the relatively better income position of one particular part of the population in comparison with people living only with their salaries and not receiving such funds. Remittances will continue to grow up during the next years. However, sooner or later, we suggest that they may start to stagnate with the diminution of relatives in the country of origin.

The scale of remittances raises important questions about the impact on Bulgaria's economy and whether or not remittances counterbalances the brain drain experienced by the country especially through permanent migration. Remittances can help financially households and contribute for macroeconomic stability; however they are not in a position to compensate the big losses for the economy because of the increased skilled migration. The leakage of nearly 16% of the population would have an unpredictable negative effect on the economy. The lack of skilled workforce may have adverse effects on the restructuring of the Bulgarian economy and the impossibility to overcome the gap in the productivity of labour between Bulgaria and other EU countries. New comparative advantages are needed in order to enhance economic development and living standard in Bulgaria. One main target is the retention of highly skilled workers.

As it was underlined, differentials in wages between Bulgaria and the other EU member states continue to be a factor, pushing out labour flows outside the country and the remittances will be an issue of financial and economic survival for households. However, the economic development of Bulgarian economy may lead to the enhancement of the economic role of the remittances. They can be used for most productive purposes, for investments and not only to cover the budget constraints. In a better organised state, remittances could be directed in real sectors of the economy and in welfare-enhancing directions. This will increase the role of migration in the economic process and reveal some positive factors of the complementarities between remittances and foreign capital inflows.

Conclusion

The traditional approaches of the international factor mobility were supplemented by new economic contributions, qualifying new possible mechanisms that might

strengthen either the substitutability or the complementarity between foreign capital and labour movements. For example, skilled migrants settled abroad enhance the knowledge and the interest of foreign companies towards their native country. This enhances the perspectives to orient foreign companies with upper technological level to invest in less developed countries like Bulgaria. Bulgaria's integration into the international market has increased its dependence on the movement of the international factors of production.

On one hand, Bulgaria succeeds to attract FDIs' flows and it contributes to economic development. The accumulation of FDI in Bulgaria influence positively the growth in GDP, boost ahead the development of the economy and restraint the leakage of labour force abroad in some years.

On the other, a huge numbers of Bulgarian people choose to emigrate driven by different motives. The most important incentives for emigration were economic reasons and the unstable economic and social policy of Bulgaria in the years after the transition to market economy. The emigration of skilled people in active age reduces the number of qualified staff in the country. Later on increase the emigration of low skilled people towards destinations in South Europe.

The formation of large Bulgarian migrant community in some host countries may lead to enhance the complementarities between FDIs and migration. The relationship between the large-scale migration outside Bulgaria, FDI growth is difficult to be estimated. In general this relationship was only mentioned by Bulgarian economists, but no actual works on the topic have been published. Although, the active purchases of Bulgarian real estate and industrial properties by Bulgarian migrants, fuelled the prices and activated the transaction processes. Foreign firms have been helped in their strategic plans to enter Bulgarian market by Bulgarian migrants and thus some incentives were created for the appearance of new jobs. FDIs of quality and reinvestments make Bulgarian labour market much more attractive for young fellows. This reality put some barriers on their willingness to find professional realization abroad. The complementarities effects may induce an opposite mobility of capital and labour force and in some cases FDIs and migration may move in the same direction. In this case the real economic growth and the economic development attract FDIs from developed countries, as well as inflow of skilled Bulgarian migrants, searching better job opportunities. This reduces the brain drain and increases economic growth and work prospects in Bulgaria. In all the cases there are complementarities between capital and skilled migration.

The evolution of the Bulgarian Diaspora abroad may lead to the rising of this kind of relationship like it was already observed in the other countries, namely by pushing in the intentions of Bulgarian migrants to invest more in their country and by creating a network for the development of a small business.

The economic crisis, which is by far, not completed in Bulgaria, pushed most of the foreign companies, view the fall of demand on the world market, to restrain their production capacities and activities in Bulgaria. This influenced unfavourably the labour market and the increases of the unemployed have been a new incentive for

emigration or at least to make such plans. The unemployment rise and the consequent impoverishment of the Bulgarian population related with the growing inflation may lead to further enlargement of the living standard gap between Bulgarian and the developed countries in Europe. This will continue to be a push factor for emigration.

Actually, remittances ease the immediate budget constraints and needs of families by bolstering crucial spending needs on food, health care, and schooling expenses for the children. Such a flow of money transfers is a source of small scale savings and contribute along with FDI for the internal economic sustainability of the country. They are a relief for a big part of the Bulgarian population and a safety net for Bulgarian relatively poor people.

FDI and remittances have a positive impact on the economic growth of Bulgaria. The increase of remittances positively influences GDP per capita. The appearance of remittances can not compensate the lost of population, which is clearly an unfavourable demographic, economic, social, political gap. Remittances are neither a panacea nor a substitute for the economic development and welfare amelioration of Bulgarian population.

Drastic change in economic environment, however, requires appropriate changes in the overall investment policy of Bulgaria. The slow recovery of the economy, the rise in unemployment, the low level of incomes require the implementation of special government policies for the improvement of migration policies, for the enhancement of the economic potential of the country, which may induce better absorption capacity of FDI and create stimulus for skilled Bulgarian migrant to be involved in the internal investment and remittances schemes. This will contribute for doing investments in strategic oriented export driven economic sectors which can keep the qualified labour force in the country and limit the migration flows.

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
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Csaba Weiner[1]

FOREIGN DIRECT INVESTMENTS IN RUSSIA AND THE HUNGARIAN-BASED INVESTORS[2]

After becoming the 5th largest FDI recipient worldwide in 2008, foreign direct investments in Russia have largely been impacted by the big crisis. To put these changes in context, this paper starts with an overview of foreign investments in Russia from the beginning. Analyzing the source countries, we argue that round-tripping and trans-shipped FDI significantly mask the real sources. In terms of the regional distribution, high concentration is stressed. Reviewing the industrial breakdown of FDI in Russia, we point out that the fuel industry, mainly the oil production, except for 1999, has had a prominent or a leadership role only since 2003. Despite the Russian natural resource base, foreign investors are now motivated mostly by market-related factors. Before the crisis Russian macroeconomic, fiscal and debt policies improved the investment climate, while the growing state control has had a negative effect. Red tape, poor infrastructure, corruption and complex tax system remained major obstacles. Until the early 2000s, government made few steps to encourage foreign investment. Amid and after the crisis it was explicitly acknowledged at the highest level that resource based Russia needs the West, the foreign investments and knowledge for its modernization. The paper finally turns to investments from Hungary. Despite the low share of Russia in outward FDI from Hungary, there are a few significant investments of Hungarian-based investors, worth to be surveyed.
JEL: G31; G32

Overview of Foreign Investments in Russia from the Beginning

Before the First World War foreign investments had a significant role in the Russian Empire (*Nove* 1972). The October Revolution of 1917 had severe consequences for the foreign ownership, and the Soviet leadership refused the reparation demanded by the Western states. But since Soviet Russia needed foreign capital, legal conditions

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[2] This article is a summary of a chapter of a forthcoming book written (in Hungarian) within the framework of the research project 'Russia in the Global System and in Europe. Main Factors Affecting the Relations between the EU and the Russian Federation and Their Effects on the Russian–Hungarian Relations' led by Academician Mihály Simai and supported by the Hungarian OTKA fund (under contract number 68923).

for concessions were set in 1920. Since 1928 new concession contracts have not been signed, and at the end of 1929, Stalin announced that the NEP era ended. The last concession company was wound up in 1944 (or according to another source, in 1946). The concession companies did not contribute measurably to the capitalization and modernization of the economy, and had no particular role in terms of the state budget (*Seres* 2007).

The beginning of 1987 brought a new turning point in foreign investments as in the spirit of Gorbachev's perestroika creation of joint ventures was accepted in the Soviet Union. The Presidential Order on Foreign Investments in the USSR of 26 October 1990 and the Law on Foreign Investments in the RSFSR dated 4 July 1991 were issued before the disintegration of the Soviet Union, allowing the presence of wholly foreign-owned companies and profit repatriation (*UNCTAD WIR* 1991; *World Bank* 1992).

Russia's GDP went through a sharp decline until 1996. The economy started to grow from a very low base in 1997, followed by the currency, fiscal, debt and banking crisis in 1998. However, between 1999 and 2008 an unexpected recovery was seen, which was consistently underestimated by most experts. Before the crisis World Bank warned that Russia showed all signs of overheating.

Amid the difficulties of the Russian economy but with signs of stabilization and following the reduction in FDI inflows in 1994, foreign direct investments jumped in 1995 in Russia. These investments were built on first-mover advantages (*UNCTAD WIR* 1996). It was an important step when Boris Yeltsin signed the Law on Production Sharing Agreements at the end of 1995.

In spite of the fact that the annual volume of FDI inflows was close to USD 5 billion in 1997, which seemed to be a promising year before the Russian crisis of 1998, yearly FDI inflows were only around USD 2–3 billion both in the second half of the 1990s and the beginning of the 2000s. Significantly increased cross-border M&A sales in 1997 were related to the privatization. In 1998, annual FDI fell by 43 percent as the crisis had an impact on FDI inflows through a number of channels (*UNCTAD WIR* 1998, 1999).[3] Although the State Duma and the Federation Council approved the draft Law on Investment Activities in the Russian Federation Implemented in the Form of Capital Investment in July 1998, i.e. one month before the extraordinary measures of the Russian government and the Central Bank in 17 August, the president signed it only at the end of February 1999. In the summer of 1999 the new Law on Foreign Investment in the Russian Federation was adopted and signed (*Ludvig* 2000).

In the 1990s, the role of FDI in Russia was minimal, limited to only a few sectors, and has not become the driving engine of the economy (*Ludvig* 2000). The turnaround occurred in 2003, with FDI inflows of nearly USD 8 billion into Russia.

[3] UNCTAD uses data from the Bank of Russia. It is important to emphasize that the Federal State Statistics Service of Russia (Rosstat) has different methodology when it comes to foreign direct investments.

Today Russia is one of the largest recipients of FDI in the world. While in 2000, Russia took only the 38th place with FDI inflows of USD 2.8 billion, in 2008 FDI inflows rose to a record USD 75.5 billion putting Russia in 5th place behind the United States, Belgium, China and the United Kingdom. In 2009, due to the crisis, the inflow of foreign direct investment in Russia nearly halved to USD 38.7 billion, but Russia was still the 6th most important host country behind the United States, China, France, Hong Kong and the United Kingdom (*UNCTAD, WIR Annex Tables* 2010).

After many years FDI outflows exceeded inflows again in 2009. This gap, however, reaching USD 7.3 billion has never been so wide (according to the *Bank of Russia*).

Rosstat data indicate that in 2009 the share of FDI inflows in foreign investments in Russia was at 19.4 percent, compared to just 1.1 percent shares of portfolio investments. All the 'rest' belonged to other investments, namely mainly to trade and other credits. The Central Bank of Russia reports that the share of reinvested earnings in FDI in non-banking corporations reached 45.1 percent both in 2007 and 2008, but it declined to 36.3 percent in 2009.

In the 1990s, the share of FDI inflows in gross fixed capital formation climbed above 10 percent only in 1999. However, before the crisis unfolded it has significantly jumped exceeding 20 percent in 2007 and 2008, while declining in 2009 to 14.7 percent (*UNCTAD, WIR Annex Tables* 2010). In the years before the crisis Russia's GDP showed large growth despite the low investment rate (particularly compared to South Korea, China and India) (*World Bank* 2008).

Inward FDI stock in Russia rose to USD 491.1 billion by the end of 2007 representing a 15-fold increase from USD 32.2 billion at the end of 2000. Despite record transactions it fell to USD 215.8 billion in 2008 due to the depreciation, and crept back up to USD 382.5 billion in 2009 (source: *Bank of Russia*). In terms of IFDI stock, among the BRIC countries Brazil and China are ahead of Russia, but India lags far behind Russia (*UNCTAD, WIR Annex Tables* 2010). The UNCTAD's World Investment Prospects Survey (WIPS) indicated Russia for FDI to be the 4th most attractive destination for the years 2007–2009 and 2008–2010, and the 5th for the periods 2009–2011 and 2010–2012. A darker picture is painted by A.T. Kearney. According to its so-called FDI Confidence Index, measuring the likelihood of direct investment over the next three years, Russia fell to 18th in 2010 from 9th in 2007.

Various figures for the Russian M&A market come from various institutions based on their methodology. Nevertheless, these figures clearly show that in contrast to China, a significant part of the foreign investments in Russia is related to cross-border M&A transactions (*Skolkovo* 2009). According to UNCTAD, the number of cross-border merger and acquisition transactions, carried out in Russia during the crisis in 2009, continued to increase, but the total value of M&A sales fell strongly. However, Russia was still ranked 6th in the world in 2009. Ernst & Young points out that despite the crisis, the number of FDI projects also increased in 2009, but fewer jobs were created than in 2008. In terms of the number of FDI projects Russia was the 5th most attractive destination in Europe.

Source Countries and Regional Breakdown of FDI in Russia

Rosstat data suggests that the most important source countries of inward FDI into Russia are the Netherlands, Cyprus and Germany. The key role of the Netherlands and Cyprus calls attention to two problems: the phenomenon of round-tripping and trans-shipped FDI. The former one makes the assessment of the real magnitude of FDI difficult because of capital of Russian origin coming back, while the latter (also) obscures the country distribution, i.e. the real source countries. Our research shows that the largest investors are (still) from the EU (also see *de Souza* 2008). Looking ahead, however, the data of A.T. Kearney warns. While for the European investors in 2007 Russia was the 3rd main destination over the next three years Russia slipped to the 10th place in 2010.

The spatial concentration of foreign direct investments in Russia is quite strong. According to our calculations based on Rosstat data, Moscow accounted for the largest share (36.9%) of cumulative FDI inflows to Russia (consisting of 83 'federal subjects') for the period 1995–2008, followed by the Sakhalin Oblast (17.6%) and the Moscow Oblast (8.7%), then St. Petersburg (3.5%), the Omsk Oblast (2.7%), the Krasnodar Krai (2.6%), the Tyumen Oblast (2.4%), the Chelyabinsk Oblast and the Leningrad Oblast (2.1% each) and Tatarstan (1.3%).

Industrial Breakdown of FDI

Rosstat data indicates that in the 1990s, food industry was the most attractive investment area, however, trade and catering also had a significant share. Between 1999 and 2001 transportation received a sizable share of foreign direct investments. The fuel industry, mainly the oil production, except for 1999, has had a prominent or a leadership role only since 2003. In 2007, almost half of the FDI inflows took place in the mining of energy resources. In 2008, the major sectors were the real estate and business services (18.7%), the mining of energy resources (17.2%), the wholesale and retail trade and repair (14.8%), the electricity, gas and water supply (8.6%), and the financial activities (6.3%).

Foreign direct investments in the electricity sector were related to the unbundling and sale of the monopoly RAO UES of Russia, giving opportunities for the German E.ON, the Italian Enel and the Finnish Fortum to acquire assets.

Within the mining of energy producing materials, foreign direct investments typically went into the oil production. Surge in oil and gas prices after 2003 also stimulated foreign companies, however, oil companies are burdened strongly by the extraction tax and in particular the export duty.

Manufacturing of food products, beverages and tobacco is the most important branch within the manufacturing sector.

Multinational companies are already either market leaders or significant players in many segments of the Russian consumer sector (*PwC* 2009*b*). Although share of foreign direct investment in the Russian transport equipment manufacturing is not significant, the role of foreign capital in the automotive industry has been dramatically increasing from year to year. The share of foreign brands in the passenger car production in Russia has already reached 47 percent in 2009 (*Ernst & Young* 2010). Changes in the automotive industry created expansion opportunities for the automotive suppliers, and several foreign component manufacturers took the advantage of these opportunities (*PwC* 2008).

Russia does not allow foreign banks to open branches in Russia. Moreover, foreign insurance firms are subject to a 49 percent equity limitation (*Office of the U.S. Trade Representative* 2010). By the end of August 2010, 220 out of the 1158 registered credit institutions in Russia had foreign stakes in authorized capital, of which 82 were wholly foreign-owned and a further 25 had more than 50 percent foreign participation (source: *Bank of Russia*). A considerable part of the Russian banking system is under state control. Almost half of the Russian domestic loan market is in the hands of the state-controlled banks. 6 of the 10 largest banks are controlled by the state. 2 out of the other 4 are foreign-owned (UniCredit Bank, Raiffeisenbank). Overall, a quarter of Russian banking sector's assets belongs to foreign ownership (*Fungáčová–Solanko*, 2008).

So far only a limited number of multinational players are present in the Russian retail market. While India and China are faced with intensifying competition from global entrants such as Wal-Mart, Carrefour and Tesco, in Russia Wal-Mart and Tesco have not had a single store, and the new-comer Carrefour swiftly withdrew from the market (*PwC* 2009*b*; *PwC* 2010). In food retail only Metro, Auchan and the Rewe Group have significant positions (*PwC* 2009*a*).

Motivations

Russia's macroeconomic stability, sound fiscal policy, the external debt management and the accumulation of huge foreign exchange reserves substantially improved the investment climate (*Tarr–Volchkova* 2010). The WIPS report declares that foreign investments in Russia are motivated mostly by market-related factors. In the 2009 survey (for 2009–2011), the main location criteria were the size and growth of the local market, the presence of suppliers and partners, the access to international/regional markets and the following of the competitors.

Svetlana Ledyaeva argues that "the leading factors stimulating the sharp FDI increase in 2003–2005 were market size, big city advantages and Sakhalin region's production sharing agreements in the oil industry" (*Ledyaeva* 2007).

Purchasing power of the Russian population increased considerably in the 2000s but from a low base following the collapse of the Soviet Union and the crisis of 1998. Per capita retail sales in Moscow are the largest. Russia had 11 cities with more then million people (Moscow, St. Petersburg, Rostov-on-Don, Ufa, Kazan, Nizhny

Novgorod, Samara, Yekaterinburg, Chelyabinsk, Novosibirsk and Omsk) in early 2009 and 3 cities with nearly 1 million inhabitants (Volgograd, Perm and Krasnoyarsk).

Russia is increasingly turning to the import substitution industrialization, and actively imposes import restriction measures. The pursuit of import substitution is a stated goal in many sectors. It is enough to see (1) the development strategy for the pharmaceutical industry up to 2020 approved in October 2009, (2) the food security doctrine signed by President Dmitry Medvedev in early 2010 or (3) the automotive industry protected by custom duties and supported by scrapping incentive programme. In this situation, import substitution FDI has an important role.

Until the early 2000s, the government made few steps to encourage foreign investment. Attitude towards foreign capital has recently changed considering FDI as a means to achieve modernization goals. Despite the negative experience of the former Free Economic Zones (FEZ) in Russia (except for the Kaliningrad FEZ and the Magadan FEZ), Russia in the mid-2000s was determined to create special economic zones (SEZ). SEZs still offer very little to the foreign companies, which in turn are rarely located in them (*Liuhto* 2009). It is no coincidence that the Russian parliament in December 2009 amended the Law on Special Economic Zones to simplify the establishment and to be open to a broader scope of investors (*UNCTAD WIR* 2010).

PricewaterhouseCoopers states that Russia's well-educated workforce is an important asset for the long-term growth. The relatively low-cost and generally highly skilled workers are one of the main attractions for investment. The latter's top importance is not confirmed by the WIPS 2009 report. Moreover, a spring 2008 survey by the Foreign Investment Advisory Council (FIAC) emphasizes that a majority of respondents indicated that recruiting talented managers and/or people with necessary technical skills has become one of the toughest challenges for foreign investing companies. In order to attract foreign specialists migration legislation was simplified in 2010. This was proposed by the Russia Ministry of Economic Development that thinks modernization is impossible without smart personnel (*The Moscow Times*, 6 May 2010).

Difficulties

While in recent years foreign investments have significantly increased in Russia, problems have been articulated more loudly in the media than opportunities. This was mainly thanks to the particular democracy model of Russia (the theory of sovereign democracy replaced that of the managed democracy in 2006) and the growing state control.

According to Igor Bunin and Yevgeny Yasin, a new period in the state-business relations began in 2003. State capitalism – which is the 4th period in the post-communist Russia – is characterized by assertion of dominance by the state with the threat of expropriation (*Hanson* 2005). Anders Åslund divides three energy models

of which state capitalism followed the liberal-oligarchic model that was dominant between 1994 and 2004 (*Åslund* 2006).

Two laws impose limitations on foreign investment were adopted in April 2008, and Putin signed them just before his departure from his presidency. The package was a milestone, but investment restrictions started well before this (see *Gati* 2008).

The Russian government has also significantly increased its role in the economy through the state strategic corporations. State corporations are often dominant and may have access to budgetary support, so that the private companies, including the foreign ones, may have more difficulty to compete with them. The lower competition may be detrimental to efficiency, resulting in higher prices and lower quality (*Tarr–Volchkova* 2010).

Although Russia terminated the provisional application of the Energy Charter Treaty in 2009, Russia should apply the "Investment Promotion and Protection" as well as the "Dispute Settlement"[4] for 20 years following the effective date of termination to any investments made in its area during the provisional application by investors of other signatories.[5]

Russia has been on the verge of joining the WTO for years. Russia is the only one of the G20 that is still outside the organization. An emblematic issue is the intellectual property rights. U.S. copyright industries estimate that approximately 65 percent of sound recordings in Russia are pirated. Internet piracy is a serious and growing concern. Counterfeiting of trademarked goods is still a problem (*Office of the U.S. Trade Representative* 2010).

The corruption market is worth USD 300 billion annually in Russia, so, this is the most remunerative business (*The Moscow Times*, 24 April 2009). According to the Corruption Perception Index of Transparency International Russia has had the worst year in 2008 since 1999. Foreign companies in particular suffer from the corruption-laden environment. For this the case of IKEA is emblematic and well known.

Different surveys show that bureaucracy and administrative barriers prove to be greater problems than corruption (*RIA Novosti*, 17 January 2007; *FIAC* 2008). The construction permits and the trading across borders are in the worst situation (*World Bank–IFC* 2010). As far as customs procedures are concerned, roughly twice as many documents are required than in developed countries, and about 44 percent of shipments are inspected in Russia (*The Moscow Times*, 17 August 2010). Some say that the Russian tax system is so complex that it is almost impossible to do everything properly (*FIAC* 2008). A 2008 survey of German firms running their business in Russia shows the complex tax system and the frequent tax inspections to be one of the main obstacles (*Kotov* 2009). However, considerable simplifications and reductions were made in the tax system.

[4] See Part III and Part V of the Energy Charter Treaty.
[5] For more on this, see the works of Andrei Konoplyanik.

In addition to red tape, another major obstacle facing foreign investment is the poor infrastructure (*The Moscow Times*, 10 November 2009). In Russia there are uncharted territories by the transnational capital mainly due to the lack of infrastructure (and large distances).

Hungarian Investments in Russia

According to the Central Bank of Hungary, Hungary's outward FDI stock in Russia experienced a jump in 2006 from EUR 16.6 million at the end of 2005 to EUR 139.6 million at the end of 2006. In late 2008 it stood at EUR 205.5 million accounting for 1.7 percent of Hungary's total outward FDI stock. After years of minimal investments, FDI outflows to Russia amounted to EUR 411.1 million, EUR 114.3 million and EUR 239.3 million in 2006, 2007 and 2008, respectively. But data for 2009 was negative. Hungarian investments were also impacted by the big crisis.

The Hungarian Ministry of National Economy (and ITD Hungary) states that Hungarian-based big business invests in the energy, financial, construction, pharmaceutical and agro-industrial sectors of Russia.

The main Hungarian actors in Russia are the oil and gas company Mol, the OTP Bank, the real estate developer TriGránit and Mr Sándor Demján's interests, as well as the drug makers Richter and Egis.

Since 2000, Richter has had its own production facility located about 100 kilometres from Moscow, which already began exporting from Russia in 2004, too. Richter has nine representative offices in Russia; owns a 49 percent stake in OOO Pharmarichter, a company in Moscow that makes promotion of pharmaceutical products; and has a 5.6 percent stake in Protek, which is one of the largest pharmaceutical companies in the pharmaceutical wholesale and retail trade in Russia.

Egis, having been under the control of Servier since 1995, uses its independent marketing and commercial network in the CIS and Hungary. Egis currently operates only one representative office in Russia, located in Moscow. OOO Egis-Rus, which is a dormant company, was founded in 2007. Egis has one consignment store in Russia. In August 2004 Egis got an 87.5 percent stake in the Russian company Serdix founded by Servier. The production unit in Moscow Oblast was established within the framework of Serdix. However, Egis' ownership in Serdix dropped to 18.3 percent in 2007 and to 5.4 percent in 2010.

Mol turned toward Russia according to its new strategy, announced in October 1999. Mol has either a 50 percent or a 100 percent ownership interest in at least six Russian companies. Zapadno-Malobalikskoye/ZMB (50%), Mol-Zapadnaya Sibir (100%), Baitex (100%) and Matyushkinskaya Vertikal (100%) are involved in exploration and production in Russia. Surgut Trading (50%) is interested in trading oil products, while Mol-Russ (100%) was founded to provide management services.

ZMB, Mol Zapadnaya Sibir and Matyushkinskaya Vertikal operate in Western Siberia, Baitex in the Volga-Urals region, and Mol-Russ is established in Moscow.

OTP Bank acquired two banks in Russia: first Investsberbank for USD 477.5 million in 2006 then Donskoy Narodny Bank, a leading bank in Rostov Oblast, in November 2007 for USD 40.95 million. The latter transaction was completed in May 2008.

The TriGránit's plans in Russia were moved to the focus of attention in 2007. In January 2007, the TriGránit and Gazprombank-Invest, subsidiary of Gazprombank signed an agreement establishing a joint venture. TriGránit announced that it was planning to invest EUR 5 billion in Russia. Krasnodar was the first concrete point. The building site is there but the project suffered a delay.

In September 2007, TriGránit acquired half of the company Torgoviy Kvartal. At that time TriGránit expected more than EUR 1 billion investment in the "coming years" by the partnership. But pursuant to a decision at the end of 2009, the joint activity came to an end even before the implementation of the projects. The Russians have not bought out TriGránit's share, but split up the projects. By this, the shopping and entertainment centre named Torgoviy Kvartal in Naberezhniye Chelny in Tatarstan, the second phase of this project and the project of shopping and entertainment centre in Omsk came under the ownership of TriGránit. At the crisis time, company Torgoviy Kvartal stopped the construction of the shopping and entertainment centres in Domodedovo and Omsk and the second phase in Naberezhniye Chelny (*BN.ru*, 12 July 2010).

In early April 2008 TriGránit announced plan to build a shopping centre called Mozaika in Moscow. Because of the crisis this project also suffered a delay. In mid-August 2010 the start of construction was expected to be at the beginning of 2011.

TriGránit's intentions in St. Petersburg became known in June 2007, when the Governor of St. Petersburg and president of TriGránit signed a framework agreement, followed by a cooperation agreement in December 2007. TriGránit tries to come forward with two projects, one on the Vasilyev Island and another on the site of the Badaev warehouses.

Russian state lottery Gosloto is controlled by Mr Demján. In 2008, Demján acquired a majority stake in the Russian Orglot company by buying out Gazprombank's stake.

In September 2006 Euroinvest, which handles the investments of Mr Demján, signed a cooperation agreement about building a large sugar factory in Russia. Euroinvest got a 51 percent in the company Ryazhskiy sakharniy zavod. In December 2007, yet it was thought that the sugar factory will be built for (more than) EUR 200 million and the start of production could be in the 4th quarter of 2009.

Summary and Outlook

The crisis put an end to the dynamic growth of foreign direct investment in Russia that has been shown since 2003. Russian GDP shrank 7.9 percent in 2009, more than in 1998, but less than in the years after the collapse of the Soviet Union. Russia saw a budget deficit (of 5.9 percent of GDP) in 2009 after being in surplus since 2000. The economic recovery after the 1998 crisis was more smoothly than now (*World Bank* 2010).

Figures of the Central Bank of Russia show that after the sharp fall in 2009, FDI inflows in H1 2010 (USD 19.1 billion) slightly exceeded that of the H1 2009 (USD 18.5 billion), but they fell far short of the performance of the same period of 2008 (USD 44.1 billion). However, according to the Rosstat data, FDI inflows still decreased (by 11 percent) in H1 2010 (to USD 5.4 billion) from H1 2009.

Russian Finance Minister and Deputy Prime Minister Alexei Kudrin believed in February 2010 that annual volume of FDI inflows will return to the pre-crisis level of USD 60–70 billion in the next 2–3 years (*RIA Novosti*, 3 February 2010). In early October 2010 Kudrin expected FDI inflows to be more than USD 40 billion in 2010 and over USD 50 billion in 2011 and 2012 (*Rg.ru*, 5 October 2010).[6]

Moscow continues to play a leading role in foreign investment in Russia. Experience has shown that regional authorities have an important role in the development of foreign investments in the regions. It also appeared that Russia is still not an investment area for the layman and the small foreign actors.

Being the largest investor in Russia, for Europe it is particularly important how Russia develops. At present, issues related to the Russian–Kazakh–Belarusian Customs Union may also cause problems.

Maxim Medvedkov, Russia's chief WTO negotiator said in early October that Russia could join the WTO in 2012 (*Prime-Tass*, 7 October 2010). Russia will join separately as a sovereign state.

In September 2009 President Medvedev in his manifesto identified corruption and the raw material-based economy as the two main problems facing Russia, and declared that foreigners would be offered "the most favourable conditions for establishing research and design centres in Russia". After the crisis but in the midst of modernization and diversification challenges as well as budget deficits, Putin in October 2010 promised "a really open and attractive investment environment with maximally liberal regulation, with appropriate taxes, and high-quality work by the state" (*The Moscow Times*, 19 October 2010). It is sure that it will be very hard to reduce the role of the 'fuel and energy complex' to the level envisaged by the drafters of the "Energy Strategy of Russia for the Period up to 2030" approved in November 2009.

[6] Definitely, Kudrin uses the methodology of the Bank of Russia.

Now amendments of the law on the limitation of foreign investments should be followed as the law is too strict from the domestic viewpoint. Putin promised revisions by the end of 2010 (*RIA Novosti*, 21 May 2010). However, most prized assets will not be available in the future and in the mineral sector well-established institution of asset swaps remains (*Reuters*, 22 December 2009).

It is a question how the privatization (worth of USD 50 billion) planned for the next five years will be realized and what role foreigners can play in it.

Finally it has to be said that while there are many problems that foreign investors have to face in Russia, (as Sándor Réthi, a Hungarian expert on the Russian market warns) in many cases behaviour of large foreign companies also leaves much to be desired.

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

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Attila Hugyecz[1]

STRATEGIES OF OIL AND GAS CORPORATIONS. A REVIEW OF THE LITERATURE

In our paper we seek to answer the question of what the publicly available literature says about the upstream and downstream strategies of oil and gas corporations in the first decade of the 21st century. We would like to know what energy source or technology do national and international oil companies focus on in producing hydrocarbons or replacing their hydrocarbon reserves (conventional vs. non-conventional oil or gas, renewables, gas-to-liquid, coal-to-liquid, biofuels, deepwater drilling etc.). Our further question is how the geographic location of upstream and downstream assets changed between 2000 and 2010. In addition, we would like to know how international oil companies (IOCs) and national oil companies (NOCs) cooperate.

We found that there is quite an extensive literature on the cooperation of NOCs and IOCs, mostly focusing on future expectations and assuming that the groups of IOCs and NOCs are homogeneous. Further, although the questions raised are of crucial importance for oil companies, there is a lack of publicly available research on how individual firms compete, how and whether their focus on different energy sources changed (e.g. from oil to gas), what upstream technology they develop and how they locate their upstream and downstream assets.

JEL: Q01; Q48

Introduction

An average oil field can produce oil for 10-15 years, the natural decline rate is roughly 5% annually.[2] Global oil demand – now forget about the rare crisis years – increases by an annual rate of 1-2%. All this implies that if an oil company seeks to keep its market share in oil production steady, it has to enhance its production base

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[2] Norman J. Hyne (2001): Nontechnical guide to Petroleum Geology, Exploration, Drilling and Production, 2nd edition, PennWell Corporation, USA, pp. 419.

annually by approximately 7%. The natural decline rate of gas fields is lower, around 3% annually but increase in gas demand changes between 2 and 4% yearly.[3]

By analyzing the oil industry supply chain you will find that roughly three quarters of the profit made by oil companies stems from the upstream sector[4]. This is the reason why you can call the upstream departments of oil companies the department of the most and strategic importance.

Based on this, it is obvious why the most crucial task of oil companies' top management is to find and choose new exploration and development (E&P) projects and financing methods reducing or rather diversifying geological, technological, financial and geopolitical risks.

Therefore, in our paper we are examining what – if anything – the literature says about the upstream (oil and gas exploration and production) strategies pursued by oil companies between 2000 and 2010. We are expecting to get an answer to the question what technology oil companies are developing to replace old hydrocarbon reserves (gas-to-liquid, coal-to-liquid, biofuels, deepwater drilling, conventional vs. non-conventional oil or gas, renewables etc.). Further, we would like to get to know how the oil companies' upstream assets' location changed in the first decade of the 21st century. Another subquestion refers to the cooperation partners of oil companies and the characteristics of the projects in which they work together.

Our second question is what downstream strategies were pursued by oil companies between 2000 and 2010. Within this, we seek answers to the question whether and how the geographic location of the downstream assets (refineries, petrochemical plants, fuel station networks etc.) of oil companies changed and whether there were any changes implemented in them (capacity enhancement or reduction, increased production of certain products etc.).

The Literature on NOCs and IOCs

You can find many papers on the future of national oil companies (NOCs) and international oil companies (IOCs) and the expected cooperation emerging between them[5]. However, many of these papers unsaid assume that the group of both the NOCs and IOCs is a homogenous one. We do not share this view but as these papers are relevant for us (because this is a crucial point in the strategies of oil companies) we are beginning our review with them.

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[3] BP (2010): BP Statistical Review of World Energy June 2010, London.

[4] See for instance here: http://www.petrostrategies.org/Learning_Center/oil_and_gas_value_chains.htm (downloaded: 11th November 2010).

[5] See e.g.: David Ledesma (2009): The changing relationship between NOCs and IOCs in the LNG chain, Oxford Institute for Energy Studies, July 2009, NG 32.; Isobel Rea (2008): Accessing oil and gas reserves: rethinking upstream offers by international oil companies, Accenture; Mikkal E. Herberg (2007): The rise of Asia's national oil companies, Energy security survey 2007, NBR Special Report No. 14., December 2007, Washington.

Rawi Abdeal et al. (2008) conclude[6] in their paper that the countries, companies, including oil companies of the Gulf Cooperation Council are set to rise and change the whole world in the future fundamentally. According to the authors the biggest IOCs are going to play a secondary role in the global energy industry. The key of their survival is technology, this could be the main source of their competitive advantage.

In his paper *Majed A. Al-Moneef (1998)*[7] analyses the strategies of national oil companies with regard to vertical integration. The author reveals that after the 1970s (after the petroleum industry nationalization era) IOCs began to seek upstream assets, whereas NOCs bought/built downstream assets. The core of the strategy of oil companies was to increase vertical integration[8]. Further, the author describes the advantages and disadvantages of vertical integration.

Finally, the author concludes that as the market share of the big oil producers in oil production is expected to rise, demand for refineries fine tuned for their oil is set to increase, as well, therefore an increasing vertical integration of national oil companies of oil exporting countries might be advantageous. However, since the paper was prepared in 1998, it only projected a further vertical integration.

The authors of *Deloitte (2008)* conducted research on the group of national oil companies, as well[9]. According to their paper, NOCs will have to face six main challenges in the future.

- Managing risks, reporting and corporate governance (health, safety and environment, because of their global activities and access to capital markets);
- Replacement of qualified oil industry workforce (aging current employees, people from different cultures working together, employment of local workers);
- Relations with IOCs;
- Financing, their relationship to capital markets, international tax harmonization (as NOCs are increasingly privatized, unlike earlier, it is important how much tax and dividend they pay), oil price volatility in absolute terms and the way of managing it;
- Control of activities far from the headquarter, corporate image, compliance, corporate social responsibility, environment;

[6] Rawi Abdelal – Ayesha Khan – Tarun Khanna (2008): Where oil-rich nations are placing their bets, in Harvard Business Review, September 2008, pp. 119-128.
[7] Majed A. Al-Moneef (1998): Vertical integration strategies of the national oil companies, in The developing economies, No. XXXVI-2 (June 1998), pp. 203-222.
[8] The author defines vertical integration as follows: built-in refinery capacity per day / oil production per day (integration ratio).
[9] Deloitte (2008): Seizing opportunities: A new era for national oil companies, Dubai.

- Fight against climate change.

The authors argue that national oil companies have to create their strategies on how to handle these challenges and have to find answers to them. Further, the authors point out that NOCs are increasingly internationalizing the portfolio of their assets and activities, increasing vertical integration and seeking financial sources from the global capital markets.

In her paper[10] *Dr. Valerie Marcel (2009)* analyses the investment and financial challenges of NOCs and the answers they give. Her main conclusions are as follows:

- The main goal of the oil companies during the crisis beginning in 2008 was cost saving,

- New reserves are more and more costly to produce (for NOCs with conventional reserves an oil price of at least $30 per barrel is necessary to start a project, for NOCs with unconventional sources it is $60 per barrel. If the company has to take even the government budget into account, it is $80 per barrel.),

- Key is the ability to finance new projects – this could be a source of competitive advantage for IOCs, opening up new opportunities in cooperating with NOCs.

Based on access to capital and operating costs, the author classifies some NOCs. It is revealed that NOCs are increasingly creative in finding new sources of financing (see e.g. loan-for-oil financial products or the idea that an oil company creates a subsidiary in which it outsources assets and this subsidiary takes credit securing it by these assets etc.).

According to the author there are 5 ways in which NOCs access capital. Marcel assigns these ways to several oil companies. For this see the table below.

Figure 1

Financial Sources of Some NOCs

	Government budget allocation	Retained earnings	Cooperation with foreign partners (PSA, JVs etc.)	Loan and bond markets	Stock markets
Pemex	X			X	
NIOC	X		X	X	
KPC		X			
Saudi Aramco		X			
Petronas		X			
Sonatrach		X	X	X	
Petrobras					X
CNPC (Petrochina, CNOOC)		X		X	X
PDVSA		X	X	X	

Source: Dr. Valerie Marcel (2009): The national oil company investment challenge, KPMG, pp. 16-18.

[10] Dr. Valerie Marcel (2009): The national oil company investment challenge, KPMG.

The table above helps to decide, to what extent are these companies internationalized. Companies being able to finance themselves from the stock market are presumably more internationalized than their counterparts. However, taking only the financial sources into account is by far not enough to make a decision about the internationalization of the company[11]. For this you need to analyze the expertise in technology, the ability to implement difficult projects alone, the ability of an NOC to provide services, earlier offered solely by IOCs, etc. Consequently, to decide to what extent an NOC pursues an internationalization strategy, Marcel gives some help but – as not this was her goal – it is by far not enough.

In the research of *Ernst&Young (2009)* it is – among others – revealed[12] that the strategy of Petrobras is focused on Brazil: 90% of its capex are expected to be spent in Brazil, mainly on developing its pre-salt formations. But in sum, this paper can be ranged among the papers which deal with the players of the oil market generally, without identifying any oil companies.

In 2007, the *The James A. Baker III Institute for public Policy of the Rice University* conducted research[13] on several national oil companies, their paper cited here sums up the conclusions from the background papers. Its main conclusions are as follows:

- NOCs have noncommercial objectives, too.
- Due to the noncommercial objectives they are not as efficient as they could be.
- Some institutional structures could serve as an incentive for NOCs to be efficient. E.g. the existence of multiple NOCs within one country or the partial privatization of NOCs can enhance competition and efficiency.
- More and more NOCs are accessing capital from the international capital markets. This helps to improve compliance with international standards of corporate responsibility.
- NOCs tend to be mostly involved in upstream activities, while the downstream sector tends to be associated with IOCs. This could be a possible field of cooperation, as NOCs (too) are striving for higher vertical integration.
- Due to the increasing role of NOCs, future global oil production is increasingly affected by noncommercial factors. Consequently, oil importing countries have

[11] Internationalized national oil company (INOC): we can call companies an INOC if they are able to implement a technologically complex, difficult petroleum industry project (e.g. building an LNG train) without the help of IOCs in financing, technology or project management.
[12] Ernst&Young (2009): Investing for the upturn, Oil and gas companies' investment plans, London.
[13] The James A. Baker III Institute for public Policy of the Rice University (2007): The changing role of national oil companies in international energy markets.

to be prepared for the vulnerability of oil imports. NOCs seek to purchase downstream assets. The costs and benefits of this have to be subject to discussions in importing countries and they have to adjust their energy strategies accordingly.

The background papers of the research have been published, as well, you will find them below. Answers from this paper to our questions include that NOCs tend to look for ways to increase vertical integration.

David Ledesma (2009) interviewed[14] managers of several oil and gas corporations. He asked seven questions related mostly to the LNG value chain. The questions and the answers given are as follows:

1. How has the relationship between NOCs and IOCs changed? During the common projects earlier NOCs gained experience and knowledge and recently they seek to make more and more on their own, with a bigger share in the project. They tend to request less from IOCs.

2. What are the key skills that IOCs bring into a project? Risk capital, financing, technical expertise, relationship with LNG customers. In addition, trust, credibility that the project will be carried out, corporate image, best practice, cost efficiency, customers, investment into the country, employment due to local content requirements. For all this, IOCs require something in return, this might create conflicts between the IOC and the NOC.

3. Which companies have done well and which not so well? In the LNG business, oil-focused companies have done not so well as their gas-focused counterparts. That is why Shell and ExxonMobil has done well (Exxon became a gas-expert through the acquisition of Mobil[15]). BG has done well in the US, as well.

4. How important is culture and individual contact vs. more commercial factors? Personal contact is crucial in the LNG business, however, CEO-level trust is of the most importance. Further, it is important that senior level managers negotiate and that they are eligible to make important decisions without the need to make phone calls to the headquarters. Rotation is expressly unsuitable as the relationship between the negotiating partners can not develop. Knowledge and acceptance of the culture of the partner country and of the company is important. However, how an IOC manages its relationships with NOCs is vital, therefore often confidential.

5. What will the role of IOCs be in the future? There is not an accepted IOC role, it depends on the country and the project. IOCs itself have to explore what the NOC aims at and not how the project benefits the IOC.

[14] David Ledesma (2009): The changing relationship between NOCs and IOCs in the LNG chain, Oxford Institute for Energy Studies, July 2009, NG 32.
[15] The acquisition of XTO did not yet mean a real advantage in this / at that time.

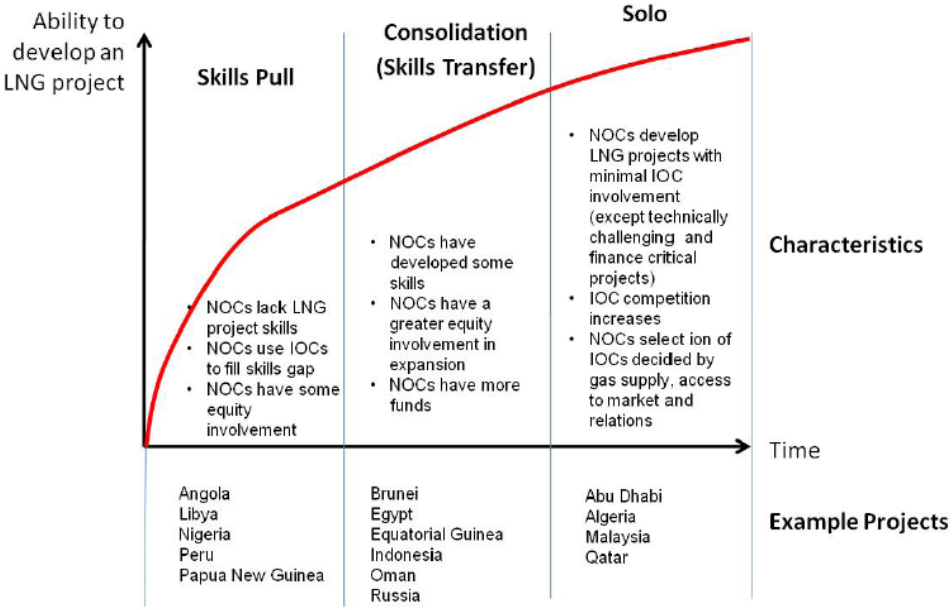
6. Will NOCs operate without IOCs? In the near future, no, they will not because 20-25 years of experience are necessary for being active in the LNG business and NOCs do not have it yet. However, more and more NOC-NOC relationships emerge. Crucial is whether they can show up enough expertise, customers and financial sources. Many times, NOCs choose those IOCs for partner with which they already have worked together (Brunei: Shell) but it is not always the case (Qatar: involvement of ConocoPhillips and Shell). Even a deliberate diversification of partners can occur. In times of low oil and gas prices NOCs are in stronger need for IOCs.

7. Does the focus by NOCs on the domestic market reduce the role of IOCs? Yes, perhaps. NOCs are able to build a power or methanol plant using foreign equipment suppliers. Rules in several countries prescribe that part of the produced gas has to be marketed on the local market. This opens up the opportunity that utilities moving into the upstream business and cooperating with NOCs exclude those IOCs from gas projects which earlier served as intermediaries between upstream focused market players and utilities.

Based on their global activities, their expertise and functions in the LNG value chain, the author characterizes some national oil companies. This is drawn in the figure below.

Figure 2

Stages of NOC development



Source: David Ledesma (2009): The changing relationship between NOCs and IOCs in the LNG chain, Oxford Institute for Energy Studies, July 2009, NG 32, pp. 24.

The author shares the view that NOCs first gain competencies from IOCs, then take responsibility for more and more in the LNG value chain and finally make everything by themselves.

According to Ledesma, gas utilities in many countries were state monopolies and they are able to effectively cooperate with NOCs. This could result in the exclusion of IOCs from the LNG business as there is no (need for) IOCs between the gas producing NOC and the gas utility. Ledesma argues that until recently several companies operating in only single elements of the LNG value chain have moved into other parts of the value chain (e.g. RWE). According to the author, the key for the survival of IOCs is that they adjust themselves to the needs of NOCs.

Isobel Rea (2008) explains[16] in her paper that in the future IOCs have to modify their bids if they want to be competitive in bidding for oil and gas assets. According to the author's opinion IOCs can learn from NOCs: while making their bids they have to concentrate not only on the oil and gas sectors but on the needs of the host country, as well. In some places they have to build roads, railways, in other places hospitals. However, they have to take their core competencies into account, too, and involve players of industries into the bidding and bring them into the country with which synergies can emerge. Suitable partners therefore could be actors of the chemical, mining, steel, renewable energy industry or electricity utilities.

This could be an advantage while bidding, however, no analysis is available in the paper whether IOCs pursue such a strategy.

According to a research[17] by *Ernst&Young (2008)* it is less and less characteristic for national oil companies that the main area of their activity is their home country.

The authors describe Petronas of Malaysia as an integrated, international, fully state-owned national oil company. The company operates in 33 countries, it has upstream assets in 22 countries and operates downstream assets in more than a dozen of countries (it has gas supply infrastructure and LNG-assets in Europe and Asia). In 2007, 25% of its oil and gas reserves were located outside its home country, 34% of its production came from abroad. In 2006, Petronas bought shares in Rosneft for $1,1bn, in 2007 it acquired Star Energy Plc. with interests in British gas storage for Ł354m.

The Chinese CNPC (along with Petrochina) operates in 27 countries. It provides oilfield services, design and engineering services in almost 50 countries. Ahead of ONGC of India and Lukoil of Russia it bought PetroKazahstan for $4,18bn in 2005. PetroChina managed to collect $8,9bn in a public stock offering on the stock exchange of Shanghai. It plans to spend this money on financing upstream and downstream projects in China and abroad.

[16] Isobel Rea (2008): Accessing oil and gas reserves: rethinking upstream offers by international oil companies, Accenture

[17] Ernst&Young (2008): Are national oil companies the new international oil companies?

The Brazilian national oil company, Petrobras operates in 20 countries and plans to spend $15bn (13% of its capex) on projects outside its country in 2008-2012. 70% of this amount are assigned to upstream assets. The main focus of its strategy is deepwater drilling and production. In the period mentioned, it plans to spend $1,3bn on renewables, primarily on the marketing and distribution of biofuels.

Compared to other NOCs, the activities of Gazprom are more concentrated, geographically more focused. It seeks to secure markets for its natural gas, in Europe by building gas pipelines, in Asia by creating alliances. It has upstream assets in Libya, India, Venezuela and Vietnam. Its main research areas however include the arctic regions and continental shelf of Siberia. Through the acquisition of OAO Sibneft and having bought stocks in the electricity focused OAO Mosenergo Gazprom diversified its activities and doubled its oil reserves.

According to the authors, NOCs are new, international NOCs, in other words INOCs. They discuss the challenges emerging during this transition process in detail, and make suggestions how NOCs should overcome them. They describe the driving forces behind the internationalization. They assume that NOCs are going to gather capital from the international financial markets therefore they have to become like IOCs. During this process they will become more transparent and will behave like real IOCs.

In our view, the authors analyze a pretty short time period and underpin their opinion on the strategies of oil corporations with only few data. For instance, it can be disputed that Petrobras is a well internationalized company, as it spends 87% of its capex within the borders of Brazil. Further, the authors do not write about the past of the companies, consequently e.g. the process of geographical diversification could not be proved.

In his paper[18] *Mikkal E. Herberg (2007)* sums up the tenor of a conference in May 2007. According to him, the Asian NOCs are increasingly driven by commercial objectives; government control is complex and country- or rather company-specific. The Chinese NOCs are active globally, the Indian ones regionally. The Japanese ones are weak; their expansion is hampered by several factors. Although the Chinese and Indian firms are in the process of internationalization, the relationships between the home and host countries not necessarily become strategic. According to the author, NOCs will in the meanwhile not become competitors of IOCs as IOCs are even able to carry out complex projects (project management abilities) and their expertise in technology is indispensable for NOCs. Therefore, IOCs are going to determine LNG production, heavy oil production, deepwater production and the development and production of giant offshore gas fields (the gas of which can only be marketed in the form of LNG). However, several Asian oil companies are able to fill the gap created by the flight of IOCs (e.g. from Venezuela), moreover, they are ready to get into operations in countries which, due to an embargo imposed, are inaccessible for Western companies (e.g Sudan, Myanmar, Iran).

[18] Mikkal E. Herberg (2007): The rise of Asia's national oil companies, Energy security survey 2007, NBR Special Report No. 14., December 2007, Washington.

Based solely on bidding, IOCs are more successful but as NOCs offer the building of infrastructure and the development of the economy they can grasp oil production rights ahead of the IOCs. NOCs obtain competitive advantages through the cooperation with other industries (steel, power, construction etc.).

In the author's view, NOCs can not replace IOCs as they can not abolish their lag in know-how.

According to us, the activities and the abilities of Petrobras or Petronas do not underpin this view.

Not even *Alexandre M. Oliveira, Melissa Stark, Claire Lawrie (2006)*[19] share the view of Herberg. Although they show that once IOCs were the partner of choice for resource holder NOCs because IOCs were able to carry out technologically new and groundbreaking oil and gas projects. However, in the decade before 2006 things changed. In many cases, oil services companies became the owners of technology and even the capabilities of many NOCs grew. IOCs therefore became to some extent replaceable. In addition, NOCs became increasingly internationalized and also consortia of NOCs emerged. As a consequence, IOCs have to work on a more competitive market; not only IOCs but also NOCs wish a share from oil and gas resources: they also take part on biddings offered by resource-rich countries.

According to the research and interviews made by the authors, the objectives of NOCs are quite different: the top three priorities of individual NOCs are never the same. Therefore, IOCs not only have to offer technological expertise but they also have to have in-depth knowledge on the host country the NOC is focused on.

It is more often that between the NOCs emerge long-term relationships whereas NOC-IOC cooperations are transaction-based, short-term and this is unfavorable for IOCs. The Chinese CNPC for instance pursues local economic development: it builds power plants, chemical plants, railways and pipelines. IOCs are important for the NOCs because IOCs possess downstream assets and technology, among them LNG, gas-to-liquid, different EOR technologies, knowledge on non-conventional oil, ultra deep offshore, renewable energy etc.

According to the Accenture therefore, IOCs can be successful in building good NOC-IOC relationships by keeping in mind the following:

- They gain knowledge on the home country of the NOC.
- They tailor a strategy on the targeted NOC,
- They integrate vertically because high vertical integration can be attractive for the NOC (having downstream assets opens up opportunities for upstream-

[19] Alexandre M. Oliveira, Melissa Stark, Claire Lawrie (2006): The rise of the national oil company, Accenture.

downstream (NOC-IOC respectively) asset swaps through which NOCs can enter in new markets and gain knowledge on new technologies),

- They broaden local content (skills development, local suppliers),
- They remain leaders in technology (GTL, hydrogen etc.) and excel in the management of complex projects.

Also these authors refer to NOCs and IOCs as homogenous groups, the correctness of which is highly disputable.

As you can see, many of the papers above study the cooperation between NOCs and IOCs, why it is cooperation advantageous for them, how IOCs should behave in order to build a fruitful relationship with NOCs, how to modify their bids etc. However, according to our opinion, the group of IOCs or NOCs is not homogeneous. You can not compare and put into one group for instance Saudi Aramco with CNPC. The company histories are different, their objectives might be different, their views on the future of oil and gas markets might be different and one is resource-rich while the other is resource seeking. Next, PDVSA sets its focus on extra heavy oil, Petrobras on deepwater drilling, ExxonMobil on gas. In addition, setting a focus on something verbally does not mean that the company pursues this strategy successfully. See for instance PDVSA which has several times announced[20] that it was going to develop its gas business but not much has happened until recently.[21]

Further, the authors above rarely underpin their views with detailed data or examples.

The Literature on Individual Oil and Gas Companies

There are only few publicly available papers analyzing the strategies of individual oil companies. For our literature review, we chose ten giant oil and gas companies, both national and international ones. We seek to find answers to our questions analyzing the literature on them.

Petróleos de Venezuela S.A. (PDVSA)

The country analysis brief[22] (2010) by the *Energy Information Administration* takes a snapshot view on the Venezuelan oil sector. Although the authors describe the tendencies in oil and gas production of the country (and not that of the PDVSA itself) and mention the cooperation of the company with other NOCs, they do not

[20] See e.g.: Joshua Mellars: South America: A flair for gas, in Petroleum Economist, Vol. 67., Iss. 5., May 2000, pp. 30.
[21] Robert Cauclanis: Grand plans crumble, in Petroleum Economist, Vol. 75., Iss. 2., February 2008.
[22] EIA (2010): Venezuela, Country analysis briefs, February 2010.

compare them with the past. As the paper is a snapshot, the answers to the questions we raised (strategy between 2000 and 2010) are missing.

Ramón Espinasa (2009) reveals in his paper[23] that the oil production of PDVSA was significantly reduced between 1998 and 2008 and states that extra heavy oil production increased but he does not compare this with the past. Ha completely ignores the natural gas business, foreign activities, international cooperations of PDVSA and its relationships with other oil companies.

Pascal et al. (2008) highlight[24] that PDVSA seeks to have a relation with other national oil companies but the authors are not sure whether these companies possess the capabilities necessary to produce the Venezuelan extra heavy oil. Pascal et al. completely ignore about PDVSA's plans in foreign markets and the gas business is left out, as well.

David Hults (2007) in his paper[25] concludes that the downstream strategy of PDVSA had not changed between 2000 and 2006 (the end of his research period). After the apertura (opening) process of '90s refineries in foreign countries had not been sold. In contrast with this, cooperation in the upstream sector shifted from international oil companies to national oil companies. Therefore, in 2006 PDVSA had common projects with Enarsa (Argentina), Belarusneft (Belarus), CNPC (China), Petropars (Iran), Gazprom and Lukoil (from Russia), Repsol YPF (Spain), Petrovietnam (Vietnam), Petrobras (Brazil), ONGC (India) and ANCAP (Uruguay). Unfortunately, the author underpins this cooperation with NOCs only with one single example (Magna Reserve project of the Orinoco heavy oil belt). According to us, even if we know that this project is of high importance for PDVSA, it is not enough as only a small portion of PDVSA's oil production came from the Orinoco belt in 2006 and many of the mentioned partnerships related to oil reserves certification and not oil production.

David R. Mares és Nelson Altamirano (2007)[26] prepared an excellent paper in which they analyze the history of PDVSA, the financial data of the company available until 2003 and show the strategy pursued by the company until the end of 2006. According to the authors, PDVSA switched its focus to the production of heavy and extra heavy oil in the last years of the research period. In the upstream, the

[23] Espinasa, Ramón (2009): The performance of the Venezuelan oil sector 1997-2008: Official vs. international and estimated figures", Center for Hemispheric Policy, University of Miami.

[24] Pascal, Larry B. – Azpurua, Ramon A. (2008): The Venezuelan oil and gas sector – Are there still opportunities in the era of petronationalism?, in Latin American Law&Business Report, Vol. 16., No. 6-7.,

[25] David Hults (2007): Petróleos de Venezuela, S.A.: The Right-Hand Man of the Government, working paper, No. 70., November 2007, Program on Energy and Sustainable Development, Stanford University, Stanford.

[26] David R. Mares – Nelson Altamirano (2007): Venezuela's PDVSA and World Energy Markets, Corporate Strategies and Political Factors Determining its Behavior and Influence, The James A. Baker III Institute for Public Policy and the Japan Petroleum Energy Center, Rice University, March 2007.

Venezuelan company seeks to cooperate with national oil companies, mostly with the ones of Chavez-friendly governments (from Latin-America) but the diversification of oil sales is important, as well. Therefore, PDVSA tries to involve Chinese NOCs into Venezuelan heavy oil projects and hopes for new oil export contracts with the Far-Eastern giant. The authors argue that the downstream strategy did not change between 2003 and 2007, PDVSA sold its share in only one US refinery (42,1% share in the Lyondell-CITGO refinery, capacity sold amounts to 109 300 bpd[27]). In this period, PDVSA sought to increase its oil export to Latin-America.

As the paper was prepared in 2007, the authors could follow the company's strategy only until the end of 2006 and were not able to evaluate the new developments in the PDVSA-NOC cooperation.

Petrobras

The SWOT-analyses by *Datamonitor (2008)*[28] gives a snapshot view on Petrobras. You can not get any information on how e.g. the production of different energy sources had changed until 2008 or what corporations the Brazilian company cooperates with.

Similarly, the authors of *PennEnergy (2009)* report on the state of affairs in the Brazilian company[29]. According to them, Petrobras is an oil company with an excellent financial performance, and excels in its expertise on deepwater drilling and production. The company has upstream assets mostly in Brazil, its exposition to foreign markets is low. The authors show that Petrobras is involved in the production of renewable energy sources (wind energy), too, moreover, it is a significant producer and exporter of ethanol. The core of its strategy is human capital. The paper helps to understand Petrobras better but it is not enough to answer the main questions of Petrobras' strategy.

Petronas

The paper of *Von der Mehden et al. (2007)*[30] reflects to the geographical expansion of Petronas in the upstream and downstream sector. The authors show that the company became internationalized between 1993 and 2007 and began activities in several countries. However, it is not clear, which countries or regions are the main focus, when the company entered the regions or whether these foci had changed

[27] According to 2003 data, the total refinery capacity of PDVSA reached 3.1 mbpd. Besides this refinery, PDVSA sold its small share (7000 bpd) in a refinery in Antwerp in 2004.
[28] Datamonitor (2008): Petrobras (Petroleo Brasileiro S.A.), Company profile, New York.
[29] PennEnergy: Special Report: Pemex, PDVSA, Petrobras: how strategies, results differ, http://www.pennenergy.com/index/articles/display/8973023650/articles/oil-gas-journal/volume-107/Issue_29/General_Interest/Special_Report__Pemex__PDVSA__Petrobras__how_strategies__results_differ.html , downloaded: 8th January 2011.
[30] Von der Mehden, Fred R. – Al Troner (2007): Petronas: A national company with an international vision, The James A. Baker III Institute for Public Policy, Rice University és Japan Petroleum Energy Center, March 2007.

during the years until 2007. Similarly, there is no information revealed on the cooperation partners of Petronas. The tendencies in the production of energy sources in the last 10 years are missing, too.

Saudi Aramco

Jaffe et al. (2007) describe the strategy of Saudi Aramco (and its home country) in the right way[31]. The authors show that in the 2000s, Saudi Aramco sought to increase its natural gas production, however, at the same time it planned to significantly rise its oil production capacity, too. You get to know that Saudi Aramco's main objective in the 90s was to diversify its customer base. At that time, its vertical integration (downstream expansion) increased but remained low. The research of the authors covered a period until the end of 2006 and thus could partially answer our questions concerning the period between 2000-2010.

The paper of *Yoshikazu Kobayashi (2007)*[32] reinforces the view of Jaffe at al. According to him, the main objectives of Saudi Aramco until 2006 were to enhance oil production capacity, to expand its downstream operations locally and internationally, to develop the gas business and to enhance its operations in the petrochemical sector.

Valerie Marcel (2006) finished her research one year earlier, at the end of 2005, and in her book, Oil Titans[33], she agreed with the views of the two authors above.

The papers mentioned here give answers to our questions concerning a period until 2006. Further research is therefore necessary to figure out the strategy of Saudi Aramco after 2006.

National Iranian Oil Company (NIOC)

Valerie Marcel (2006) shows in her book (see above) that although the National Iranian Oil Company (NIOC) increased the share of its foreign downstream interests in its total downstream assets in 1993-2003, the foreign downstream expansion was not a priority. In the upstream, NIOC remained an Iran-focused company although Marcel, based on interviews with NIOC managers, expected a change in this. That is why a NIOC subsidiary, Petropars was merged with PetroIran into the new NICO E&P with the task to take part in foreign upstream projects and to gain knowledge and experience in such projects. However, operations of this new subsidiary could not have been analyzed.

[31] Jaffe, Amy Myers – Elass, Jareer (2007): Saudi Aramco: National flagship with global responsibilities, The James A. Baker III Institute for Public Policy, Rice University és Japan Petroleum Energy Center, March 2007.
[32] Yoshikazu Kobayashi (2007): Corporate strategies of Saudi Aramco, The James A. Baker III Institute for Public Policy, Rice University és Japan Petroleum Energy Center, March 2007.
[33] Marcel, Valerie (2006): Oil titans: National oil companies in the Middle East, Brookings Institution Press, Washington.

Brumberg et al. (2007) show in his paper[34] that the top 3 obejctives of NIOC in 2002-2006 were the revival of old oil fields, maximization of the gas business and the rise of the Iranian refinery capacity to meet local refined product needs. At that time, Iran invited several foreign (both national and international, among others French, Italian, Japanese, Russian and Chinese) oil companies into the country to explore for oil. The authors in their analysis, however, put emphasis on the relationship of NIOC with policy-makers and the role of the company in Iran, and dealt less with the foreign operations of NIOC.

China National Petroleum Corporation (CNPC)

Yoshikazu Kobayashi (2008) makes a SWOT-analyses[35] of CNPC in a presentation. He shows that part of CNPC's strategy is a downstream expansion into South-Eastern China. Further plans refer to its global expansion, the downstream gas business and its engagement into the LNG-markets. The author makes it likely that on the medium and long run the company is going to aggressively make acquisitions in foreign upstream assets. Due to his method, SWOT-analyses, he gives a snapshot view of the company, makes projections and does not strive to find the origins of future tendencies in the past. Not even does he describe the tendencies of the past 10 years.

Datamonitor (2008) gives a more detailed picture on the foreign expansion of the company (CNPC), among others about the beginning of upstream (deep offshore) operations in Myanmar and the acquisition of upstream interests in Venezuela[36]. The authors conclude that these contracts assure that the company can increase its oil and gas production and make it possible to successfully pursue its strategy based on meeting the increased refined product needs of the Chinese market. However, in our understanding the authors do not correctly underpin their view: the exploration of the history of the company and the past tendencies characteristic for it is missing; further, we do not get a picture about whether CNPC is an oil or gas-focused company and whether this focus had changed in the years until 2008.

The paper of *Steven W. Lewis (2007)*[37] gives an analysis about how the growth of the three Chinese oil companies (CNPC, Sinopec and CNOOC) was affected by Chinese political, economic and social institutions. The author analyses the internal (Chinese) motivations of the „going abroad" strategy. The author describes the downstream integration (ordered by the government) and foreign expansion of the company but does not give a complete picture about it.

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[34] Brumberg, Daniel – Ahram, Ariel I. (2007): The National Iranian Oil Company in Iranian politics, The James A. Baker III Institute for Public Policy, Rice University and the Japan Petroleum Energy Center, March 2007.

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[36] Datamonitor (2008): China National Petroleum Corporation (CNPC), Company profile, 15th July 2008.

[37] Steven W. Lewis (2007): Chinese NOCs and world energy markets: CNPC, Sinopec and CNOOC, The James A. Baker III Institute for Public Policy, Rice University and the Japan Petroleum Energy Center, March 2007.

BP, Chevron, ExxonMobil and Royal Dutch Shell

Standard setting books on the international oil companies, such as *The Seven Sisters* or *The Prize*[38] help to understand their operations and strategy. These books are indispensable to answer our questions, however, due to their date of publishing (1975 and 1992 respectively), they are by far not enough.

The analyses made by *Datamonitor* in 2008-2010 give a snapshot view of these companies. However, tendencies, ambitions, objectives can not be read out of them and the strategies of the individual companies do not become distinct from them. However, you will find the company-related parts of the SWOT-analyses in them.

As these companies are listed, you can find several analyses of the strategies of these companies, mostly made by consultancies, investment banks and brokerage firms. However, the papers are never published and accessible for free. You will hardly find any related accessible analyses for free on the internet or in the scientific databases of university libraries and academies of sciences. All in all, you will find few analyses on the company-level strategy of oil and gas industry corporations.

It is much easier to find literature on the strategies of NOCs and IOCs as homogeneous groups, their relations and their expected future cooperations.

Conclusion

As shown above, in the literature we could only rarely find correct analyses to answer our questions considered strategically. Often, we cold find analyses discussing a part of these strategic issues (e.g. foreign expansion of different NOCs), however, rarely attracts attention how the focus of the companies on oil or gas or other energy sources changes, how different companies seek to replace their hydrocarbon reserves and what technology they are developing for this. There is a real lack of literature on the company-level analyses of petroleum industry corporations, it is rarely discussed where oil companies place their upstream or downstream assets, or more importantly, how the geographic distribution of these assets changed recently.

Consequently, it is necessary to conduct research on the question raised. This could help to understand how oil and gas companies see the future of the oil industry, what they think the energy source of the future will be and what are the main challenges for the petroleum industry. Through the understanding of the interests of different companies, policy makers could more easily figure out the objectives of oil companies from emerging markets, which could alleviate the mistrust towards them. Politicians might get to know that these companies are not enemies undermining national energy security goals, but potential cooperation partners of the future.

[38] Anthony Sampson (1975) The Seven sisters, The great oil companies & the world they shaped, The Viking Press, New York and Daniel Yergin (1992): The Prize, The epic quest for oil, money & power, Free Press, New York.

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

ГОДИНА XX, 2011, 2

Virginia Ivanova Zhelyazkova[1]

THE FUTURE ENERGY PROJECTS OF BULGARIA – OPPORTUNITIES BEYOND FRONTIERS

Bulgaria is situated in a geopolitical crossroad. This creates opportunities that can be beneficial not only for the country, but also for the region and beyond.

One of the spheres that Bulgaria can take advantage of is the development of energy projects. This can happen in two main directions:

- *By serving as an energy hub for the region and by distributing natural gas brought via pipelines from Russia and the East.*
- *Exporting electricity produced in the upgraded production facilities as well as in the nuclear power plant in Belene at present under construction.*

The role Bulgaria could play in the energy market as key transit country is due mainly to two factors:

- *The geographical location at a crossroad that facilitates it being a mediator between Europe and Asia.*
- *The present situation on the energy market that leads the European countries to seek alternative routes as well as suppliers for vital energy resources.*

Whether and how much Bulgaria is going to utilize its position is a matter of political will in the first place. The opportunities lying ahead and are ready to serve for the prosperity of the region.

JEL: Q4

Bulgaria is situated in a geopolitical crossroad. This creates opportunities for the country that can be beneficial not only for it, but also for the region and beyond.

One of the spheres that Bulgaria can take advantage of is the development of energy projects. This can happen in two main directions:

- Serving as an energy hub for the region and by distributing natural gas brought via pipelines from Russia and the East.

- Exporting electricity produced in the upgraded production facilities as well as in the nuclear power plant in Belene at present under construction.

[1] *Virginia Ivanova Zhelyazkova has PhD from Economic Research Institute at BAS.*

There are a number of energy projects that are currently under preparation. The largest and most significant are the following:

1. South Stream Project.

2. Nabucco project.

3. Connecting the Bulgaria gas infrastructure to the gas pipe Turkey-Greece-Italy, supplying gas from the Caspian.

4. Projects meant to improve the security of gas supplies to Bulgaria.

5. The nuclear station in Belene.

One could easily see that these projects will affect the whole energy mix. Their proper implementation will not only improve it but will also create opportunities for additional export revenues and can potentially favor the neighboring countries.

The role Bulgaria could play in the energy market as key transit country is due mainly to two factors:

- The geographical location at a crossroad that facilitates it being a mediator between Europe and Asia.

- The present situation on the energy market that leads the European countries to seek alternative routes as well as suppliers for vital energy resources.

In order to be able to assess the current situation and hence – the importance of the large energy projects in Bulgaria, looking at some key figures from the energy market in Bulgaria is going to be insightful.

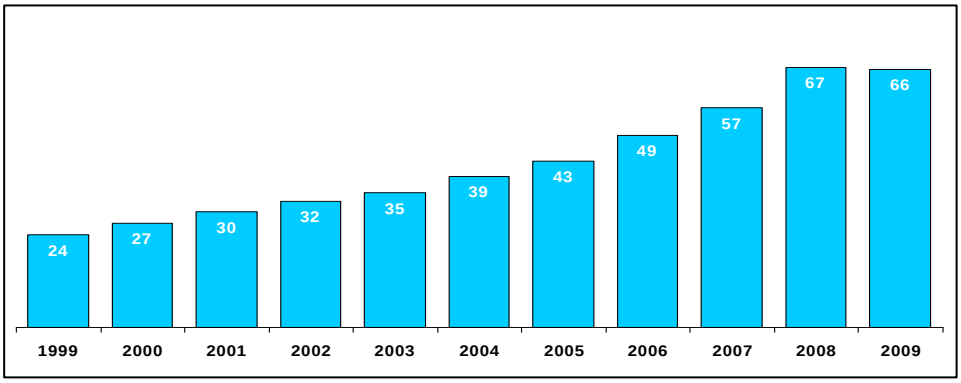
The current energy mix of Bulgaria is well balanced despite the fact that the country is poor in natural resources and is forced to import almost 100% of its oil and gas. Coal extraction is reduced only for lower qualities of coal such as the lignite that are being used primarily for electricity generation.

Neither total primary energy production, nor consumption and consequently exports, have changed significantly for the last 5 years. Consumption patterns have proved to be steady and this should be attributed to the lack of growth in the industrial and transportation sector, the two being the biggest energy consumers. The economy of Bulgaria was growing in nominal GDP terms primarily due to heavy inflows of FDI in the real estate and financial services sectors. Both sectors are comparatively low consumers of primary energy. Closer look at some key indicators reveal the framework of the picture.

Although the nominal GDP shows an upward tendency for the previous 10 years (see fig. 1), during the last 3 years real GDP growth exhibits downward trend (see fig. 2).

Figure 1

Nominal GDP in billion BGN (EUR 1 = BGN 1.95583)

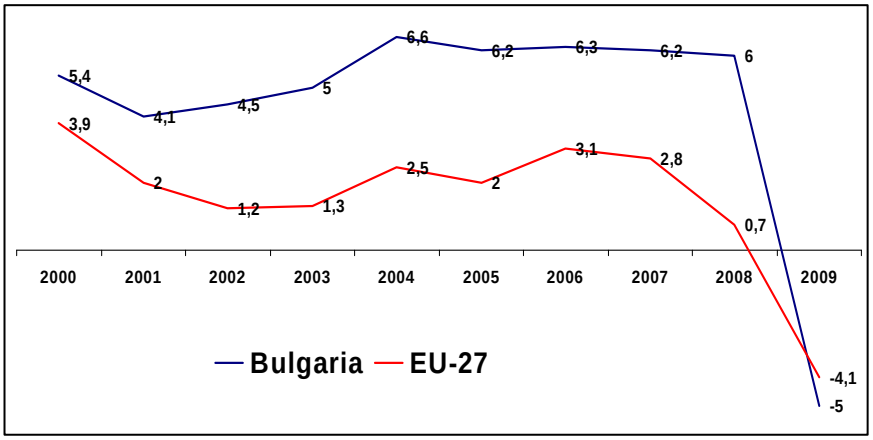


Source: Ministry of Economy, Energy and Tourism of the Republic of Bulgaria, 2010.

In a recent analysis performed by the Ministry of Economy, Energy and Tourism of the Republic of Bulgaria the possibilities for development of the Bulgarian economy were outlined. The sectors deemed most promising in terms of chances for growth are the information technologies, innovations, light industries as well as green technologies.

Figure 2

Real GDP Growth



Source: Ministry of Economy, Energy and Tourism of the Republic of Bulgaria, 2010.

Neither of these sectors is specifically energy intensive. Growth, consequently, in these areas is not going to hit ostensibly the energy balance of the country. If we

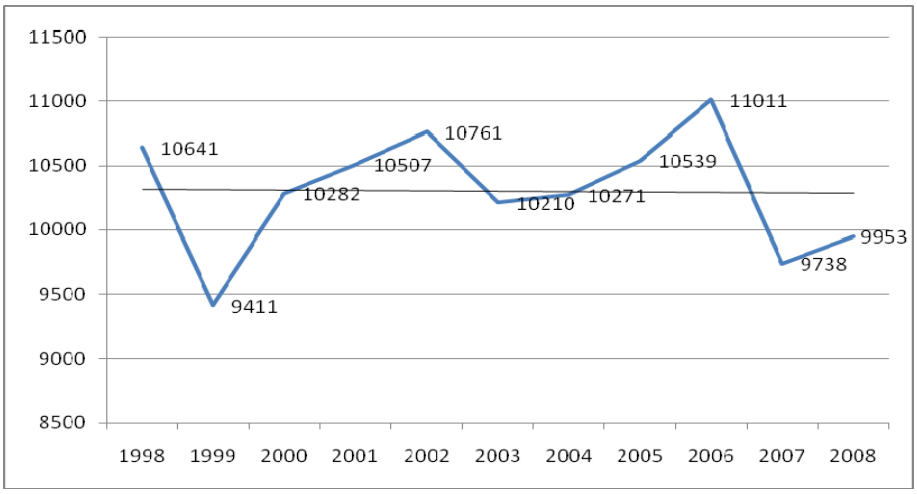
assume that the economy is going to develop in the way outlined in the strategy of the Ministry of Economy, Energy and Tourism, then evaluation of the energy mix and energy strategy should be performed considering more or less the present state of affairs in Bulgaria.

What are the specific characteristics of the current energy production, consumption and export patterns in Bulgaria?

Production of primary energy as a whole has been fluctuating around 10 300 ktoe for the last few years (see fig. 3).

Figure 3

Production of Primary Energy, ktoe (1998-2008)



Sorce: National Statistical Institute,
http://www.nsi.bg/otrasal.php?otr=30&a1=175&a2=216#cont

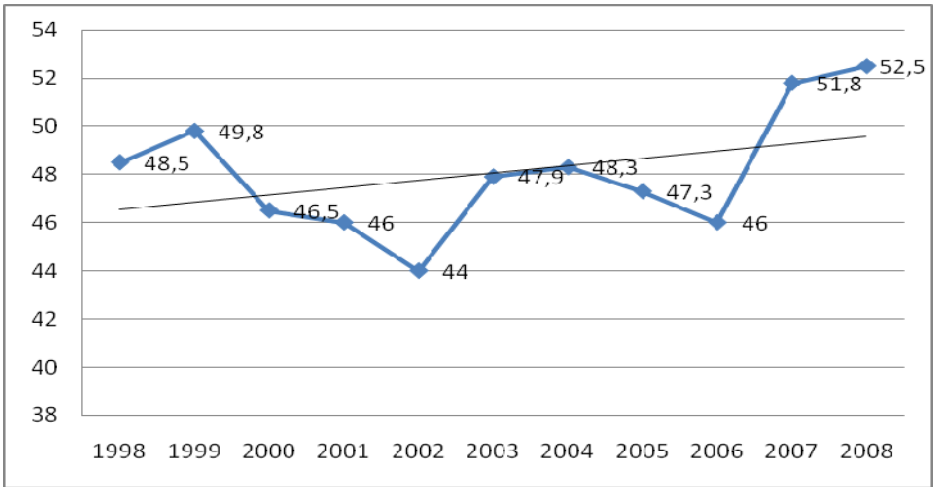
Another important observation refers to the energy dependency of the Bulgarian economy, or the share of energy import to total consumption, – for the last 10 years it has grown from around 45% to almost 53% (fig. 4).

The structure of the final energy consumption in Bulgaria (fig. 5) reveals the importance of petroleum products for the economy while the share of natural gas remains low and this explains the big in comparison to other EU countries share of electricity.

Similar inferences can be drown regarding the energy inputs for the production of final energy. Petroleum products and coal retain the dominant position with 36% and 35% respectively, while natural gas hold only a tiny fraction of around 5%.

Figure 4

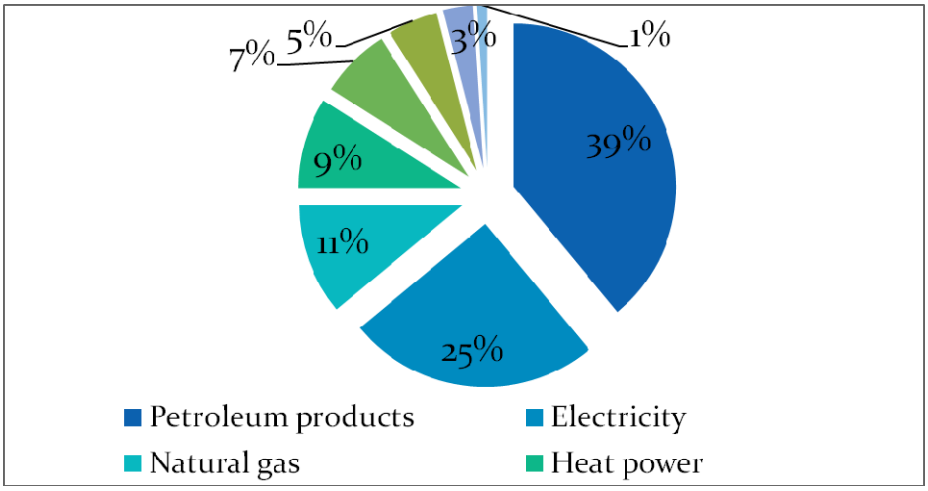
Energy Dependency of the Bulgarian Economy



Source: National Statistical Institute,
http://www.nsi.bg/otrasal.php?otr=30&a1=175&a2=216#cont

Figure 5

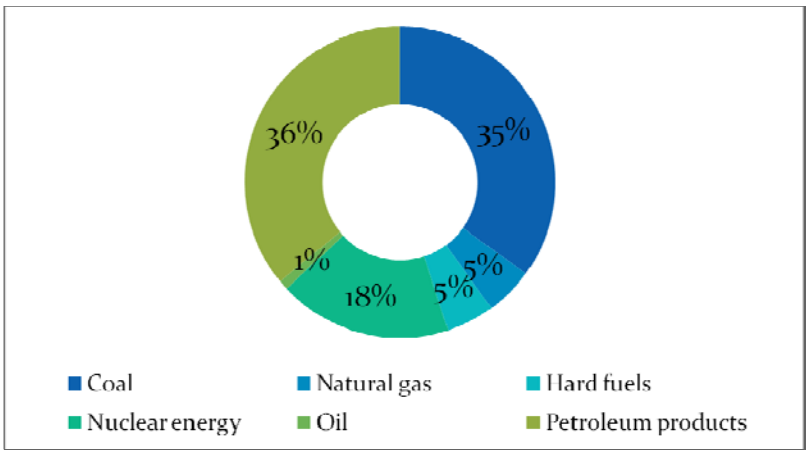
Structure of Final Energy Consumption in Bulgaria



Source: Bulletin for the Current State and Development of the Energy Sector in Bulgaria. Ministry of Economy, Energy and Tourism of the Republic of Bulgaria, March 2009.

Figure 6

Energy Inputs for the Production of Final Energy

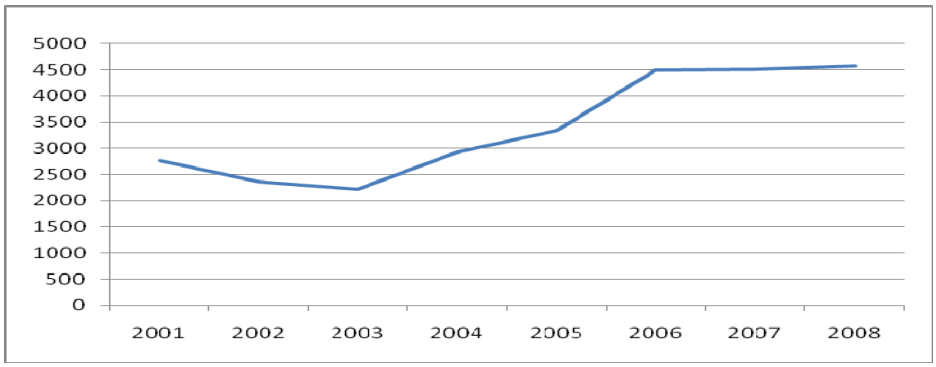


Source: Bulletin for the Current State and Development of the Energy Sector in Bulgaria. Ministry of Economy, Energy and Tourism of the Republic of Bulgaria, March 2009.

Energy exports exhibit upward trend for the last 10 years, the increase between 2001 and 2008 reaching almost 40%. This is a source of revenue for the state that facilitates the already (from the start of the crisis) worsened trade balance.

Figure 7

Energy Export of Bulgaria, ktoe



Source: National Statistical Institute, http://www.nsi.bg/otrasal.php?otr=30&a1=175&a2=216#cont

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Which are the areas in the energy mix to which special focus is placed in the project for energy strategy under development by the Ministry of Economy, Energy and Tourism?

The main starting points of the analysis are that:

1) According to Eurostat most recent data, when calculated based on the gross energy consumption, Bulgarian economy is 5.6 times more energy intensive compared to EU-27 average

2) Gas consumption in the country is times lower than the average for the European Union. Currently only 1.5% of the households in Bulgaria have access to natural gas. For EU this indicator is 55%. Low gas consumption by households is the reason for high electricity consumption (40%) in comparison with EU (11%).

3) The EU has set a target for Bulgaria of achieving 16% share of renewable sources (currently 9.4%) in the energy mix as well as decrease of the CO2 emissions to 20% compared to the base 1999

Considering this, emphasis is to be placed on:

1) Development of additional gas supply routes to feed the expanding delivery network in the country

2) Environmentally friendly energy projects. Apart from developing wind, solar and biomass facilities, a viable and important source of additional nature-friendly energy is nuclear power

It is not surprising then why the key and largest projects that the Bulgarian government is undertaking are in these two fields: natural gas pipelines and nuclear energy. The development of both directions requires foreign resources and vast capital expenditures in order to materialize.

Natural gas remains primarily an import item (approx. 85% of total domestic consumption), despite the discovery and recent development of the local sources. Bulgaria is relying on Russia for deliveries through one route that crosses Ukraine. Geopolitics have shown that this route contains risks that should not be neglected when the issue is related to the security of supply for the economy of the country. The smoldering conflict between Russia and Ukraine poses uncertainties for the deliveries also to other countries final consumers of Russian gas and forces them to seek alternative routes. That is how the two big European project – Nabucco and South Stream were born and why the Bulgarian governments have been placing pronounced attention to them.

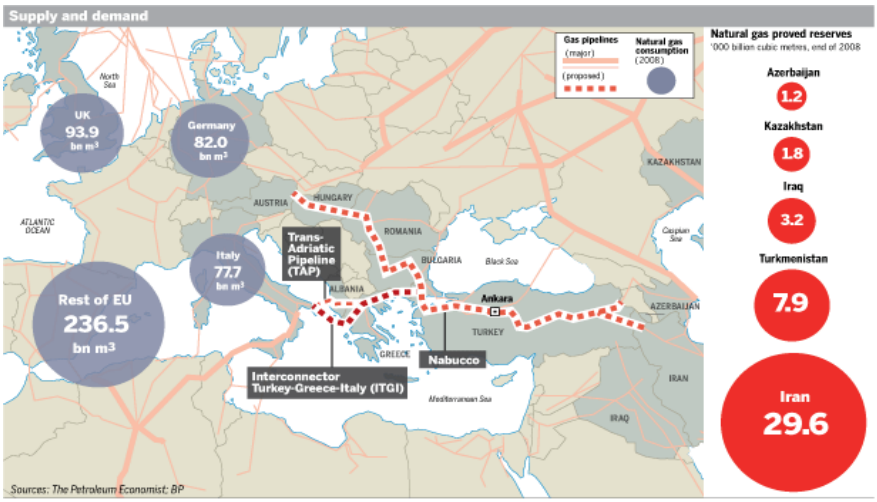
Materializing these 2 projects is vital not only for Bulgaria, but for the other European countries that will benefit from them. Fig. 8 below reveals the natural gas demand patterns in Europe in a nutshell.

South Stream Project

The project was initiated in 2007 after a memorandum was signed between the Italian company ENI and Russian Gasprom for the delivery of natural gas to Italy. Gas is planned for extraction by ENI in Kazakhstan and the pipe is going to be filled additionally with gas from the Caspian region bought by Gasprom. The carrying capacity of the pipeline is approx. 63 bil. cub. m. per year. It is not a negligible amount considering the consumption in Europe.

Figure 8

Supply and demand of Natural Gas in Europe



Source: British Petroleum,
http://www.bp.com/bodycopyarticle.do?categoryId=1&contentId=7052055

The additional gas that is meant to flow through the South Stream will bring a breath of fresh air for the importing countries as it is going to provide an alternative to the existing rout crossing Ukraine. The investment is planned for development by ENI and Gasprom that are sharing 50% each in the undertaking. Fig. 9 shows the routes that South Stream is planned to take as well as those planned for the other big transeuropean projects – Nabucco and Nord Stream.[2] It will start from Beregovya on the Black Sea coast in Russia, cross the Black Sea and reaches Bulgaria somewhere near the port of Varna. From there it is going to traverse the territory of Bulgaria. In Bulgaria it is planned to split in two sleeves – one running through Serbia towards Austria and another stretching south to the territory of Greece and from there to Italy.

[2] Nord Stream project is mentioned only for illustrative purposes in the present text and is not going to be considered further.

Figure 9

Routes South Stream Pipelines, Nabucco and Nord Stream Pipelines
Data are for South Stream

Connection:
Russia-EU (via Black sea)

Transport capacity:
63 billion cubic meters/year

Partners:
Gazprom 50%, ENI 50%

Scheduled for operation:
End of 2015

Source: Europe's Energy Portal. http://www.energy.eu/

Until present (Nov. 2010) Russia has signed intergovernmental agreements for the transportation of natural gas not only with Bulgaria, but also with Romania, Serbia, Hungary, Greece, Slovenia, Croatia and Austria.[3] This is an evidence of the importance of the project and its pan European significance. Bulgaria has started negotiations for its particular participation in the project much earlier, back in the beginning of 2008 when it signed with Russia an agreement for cooperation on the construction of gas pipeline through its territory. The agreement is signed with 30 years validity with the option to extend it for another 5 years. In case Russia fails to fill the pipeline to 31 bcm, it shall pay Bulgaria on 'transit or pay' principal. This agreement has been followed by another won in 2009 which stipulates that Bulgaria and Russia through the respective companies, will owe equal share in the development of the pipeline and will have equal weigh in the governing bodies charged with decision taking. The Ministry of Economy, Energy and Tourism of Bulgaria defines this as an important step towards materializing the goal of the country to become regional hub for energy transit. It outlines the significance of the progress on South Stream project as key to the success of its strategy in a broader aspect. The other project that is considered vital, for the realization of Bulgaria's aspiration to dominate the regional energy market is Nabucco.

[3] „Южен поток": Ябълка на раздора или плод на диалога Русия-ЕС. Гласът на Русия. 23.11.2010. http://bulgarian.ruvr.ru/2010/11/23/35488802.html

Nabucco project provides laying a pipeline stretching 3 300 km to transfer gas from the Caspian region, Iran and the Middle East through Turkey and Bulgaria to Austria, and from Austria – to Western Europe. It is scheduled to start transferring gas from 2015 on. Nabucco is the largest European infrastructure project in terms of countries involved. Apart from the other positive effects, it will support further European integration

When operating at full capacity, Nabucco will transport 1,550 bcm to Europe over the next 50 years or an economy the size of Germany could be supplied solely with Nabucco gas for over 16 years. Through its operation Nabucco will make a considerable contribution to the security of supply for Europe.[4]

Nabucco has long been considered as a rival to the South Stream project as its goal is to bypass Russia and ensure deliveries of gas to Europe from an alternative source through an alternative route.

Figure 10

Nabucco Pipeline Project

Source: Ministry of Economy, Energy and Tourism of the Republic of Bulgaria.

The Europen Union which imports approximately 30% of its oil and gas from Russia, has been striving for the implementation of this project as it regards it as means to shift away at least partially from its dependence on Russian resources. In the course of time however the understanding in the EU has changed to finding South Stream a necessary and important project, too. This has been made ostensible in the recent speech of the EU Commissioner on energy Mr. Gunther Oettinger on

[4] Nabucco Gas Pipelines. Facts and Figures. Novembre 2010. http://www.nabucco-pipeline.com/portal/page/portal/en/press/Facts%20_Figures

the occasion of the 10th anniversary of EU-Russia energy dialog when he emphasized that blocking South Stream is not in the interests of the EU. The only issue that needs consideration in his opinion is how to accommodate the project within the legislation of the EU.

The advantages of South Stream have been acknowledged and this is evident from the fact that a number of EU-member countries have already signed agreements with Russia for the development of the pipeline. Nabucco and South Stream, as Turkey energy minister Taner Yildiz has pointed out lately, should not be considered as rivals but as projects beneficial for all the countries in Europe.[5]

Thus by present the importance of Nabucco has received another nuance – not as a rival of South Stream but as a separate and equally important undertaking that needs common efforts in order to materialize. This view currently supported by the EU is facilitating Bulgaria's stance in the overall picture of strategic energy actions. The country can now fully embrace the two projects and work for their implementation on its territory. Nabucco is planned to carry 31 bil. cub. m. per year of which the transit countries are planned to receive approximately 12-15 bil. cub. m., the rest to be transported to Central and Western Europe. The cost of the project is estimated at around 8 bil. euro and the funds are to be drown from the companies participating in the venture. One of the key problems Nabucco is facing is of purely technical nature – will there be enough gas to fill the pipe. Azerbaijan is regarded as instrumental in this respect due to it well developed gas fields and its political stability. The project is going to be implemented by a company Nabucco Gas Pipeline International GmbH positioned in Vienna and on the part of Bulgaria participation is to be effected though Bulgarian Energy Holding, a state-owned company in charge of all energy projects in the country.

Bulgaria's interest in participation in the project is obvious – the country will ensure not only an alternative to the gas supplied from Russia but will fortify its central position in the region as an important transit country. This explains all the efforts by the Bulgarian governments in the direction of the implementation of the project. Both South Stream and Nabucco will have overall positive effects to the economy – they will lead to the creation of new jobs both directly in the construction and operation of the pipelines and also indirectly through the multiplier effect. For a small economy like Bulgaria, such projects are significant both in absolute terms as costs and labor, and in terms of positive externalities.

Participation in big energy projects that will diversify supplies and ensure additional deliveries is one side of the Bulgarian energy policy. Another important direction is towards ensuring local gas security. This is planned to happen in two ways, by:

1) Expanding existing gas storage facilities.

[5] Проектите на „Южен поток" и „Набуко" не са конкурентни. Гласът на Русия. 25.11.2010. http://bulgarian.ruvr.ru/2010/11/25/35641305.html

2) By connecting the Bulgarian gas grid to the grids of the neighboring countries so that in case of gas shortage (similar to the one experienced during the Russian-Ukranian strain in relations in 2009) to have vital supplies for solving immediate needs.

As regards the first point, at present there is one big gas storage facility in Bulgaria that is situated in Chiren. The government is currently working on expanding it to accommodate 850 mil. cub. m. of gas in order to be able to meet higher demand for a longer period of time. The project is estimated at 250 mil. euro and Bulgaria succeeded in November 2010 on financing it from the European Bank for Reconstruction and Development.[6]

Another project is related to the construction of a completely new gas storage facility in Galata for up to 500 mcm active gas in total. In such a way, upon completion of the projects, Bulgaria is going to have approximately 1 350 mcb of gas stored for emergency cases. This will significantly improve the level of security of gas supplies in the country.

With reference to the second point, Bulgaria is working on establishing reverse connection to the Italy-Greece-Turkey (IGT) pipeline that delivers supplies from new sources in the Middle East. This new connection will have the capacity to provide additional 5-9 bcm of gas per year to Bulgaria **or approximately 4% of the total consumption.**

Another project is related to the gas pipeline connection between Bulgaria and Romania through the Danube river with min. capacity 1.5 bcm per year, **or 1% of the total consumption.**

As a result of all the measures that have been taken until present, Bulgaria is now capable of ensuring supply equal to 9 mcm. of gas per day which is 90% of its needs thanks to:

1) Local production for approximately 15% of consumption of 1.8 mln. cub. m. per day.

2) Improved gas storage facilities ensuring 400 mln. cub. m. per annum.

3) Connection to the gas distribution grid of Greece for around 2 mln. cub. m.

4) Existing 2 mcm gas in the local distribution system[7].

[6] Газохранилището в Чирен ще увеличи дневния си добив. Mediapool. 25 November 2010. http://www.mediapool.bg/show/?storyid=172990
[7] Ibidem.

Nuclear Power Plant in Belene

Discussions about the construction of a second nuclear power plant in Bulgaria were initiated in the 70s the previous century and works actually started in 1980. Stopped in 1990 due to financial difficulties, the project was renewed in 2002 and since then it is under consideration for reasons of primarily financial viability. The project plans the construction of 2 blocks of 1000 MW each, which will ensure the possibility for Bulgaria to have additional revenues from electricity export.

Belene project has long been debated not only with regards to whether the investments are going to be paid back but also whether it is environmentally safe. The latter issue has been considered within the broader framework of nature friendly production and potential threats to the environment.

On the question regarding the danger of using nuclear power there are certain facts that are less well-known that, however, give an insight on the applicability of the this type of energy. More than 300 nuclear reactors are being used for scientific experiments in more than 50 countries around the world for the purpose of diagnosing and fighting cancer. More than 400 ships use nuclear reactors safely for their operations. In this respect, it is interesting what is the stance the European Union has taken towards the use of nuclear power.[8] In its strategy 'Energy 2020', the importance of development of the nuclear power production has been articulated. It has been stressed that the share of nuclear energy holds 1/3 of the total energy production in the EU and 2/3 of the low carbon energy produced.[9] In order to maintain these shares, importance should be placed in renewal of existing facilities as well as developing new ones. According to the latest Eurobarometer poll, every 2 out of 3 EU citizens consider the role of nuclear energy key for reducing dependency on fossil fuels and tackling climate change.

The fact that the EU regards nuclear energy as a key source that needs to be utilized and further developed in the future presents answer to the doubts and questions on its environmental safety and viability. The question currently (November 2010) ahead of the Bulgarian government is properly estimating the total cost of developing the nuclear power plant in Belene and agreeing on the financial parameters with the Russian partners from the company Atomeksportstroi which is to be in charge of the development of the construction. Enhancing the capacity for electricity production will create conditions to increase exports to neighboring markets that are interested in imports. The point in question is can the Bulgarian government secure future export revenues by reaching long term agreements with interested parties. This is the primary case for concern when taking the decision for the future of the plant.

[8] See: Official Site of the Nuclear Power Plat in Belene. АЕЦ „Белене". Енергия за бъдещето. http://www.belene-npp.com/index.php?lang=1&pid=39

[9] European Strategy. Energy 2020. http://ec.europa.eu/energy/strategies/2010/2020_en.htm

Conclusion

The development of the Bulgarian energy projects is going to benefit not only Bulgaria but other countries, too in the following main ways:

- The construction of the gas pipes through Bulgarian territory will ensure a **secure route for supplies** to the other countries involved.

- Connecting Bulgaria to other pipelines such as the TGI is not only an opportunity for our country but also for the others as it is a prerequisite for future reverse transfers from the Bulgarian network.

- Producing more electricity from an environment friendly source such as the nucleus will provide more supply of electricity to the regional market that is thrusting for it.

The Bulgarian energy projects currently under preparation should be regarded not only as a means to fulfilling indigenous needs, but as a bridge to the economies of the region and beyond that is meant to facilitate enough blood for their operations – energy. Whether and how much Bulgaria is going to utilize its position is a matter of political will in the first place. The opportunities are lying ahead and are ready to serve for the prosperity of the region.

ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
ECONOMIC STUDIES

ГОДИНА XX, 2011, 2

Ivanka Petkova[1]

EFFECTS OF DIFFERENT CURRENCIES AND EXCHANGE RATE REGIMES IN POST YUGOSLAV COUNTRIES DURING THE GLOBAL FINANCIAL AND ECONOMIC CRISIS

The paper examines the national currencies and their exchange rate regimes in the successor countries of the Socialist Federal Republic of Yugoslavia, which experienced a shift from an optimum currency area to a variety of national currencies. The effects of the existence of several national currencies and of sharing a single currency both unilaterally, and officially, on trade in the region are evaluated. The role of the national currencies and exchange rate regimes in regional economic links are elaborated. Channels through which the substantial instability and excess volatility, as well as the de facto euroization are influencing the banking sectors during the global financial and economic crisis are discussed.
JEL: E32; F31; F41

Introduction

In monetary terms, the successor states of the Socialist Federal Republic of Yugoslavia faced two crucial issues to decide on after the wars in the 1990s: the choice of the national currency and of an exchange rate regime.

In this paper the discussion on the role of exchange rate regimes is restricted to the experience of ex-Yugoslav countries in moving from an optimal currency area to the introduction of several currencies and exchange rate regimes (ERR). The analyses are based on the evidence that there are three categories of exchange rate regime – floating, firm fixing, and intermediate regimes (Frankel, J 2003). The paper is profiting on three basic conclusions reached in studying the experience with exchange rate regimes in emerging economies (Frankel, J, 2003). First, all the categories of exchange rate regimes are appropriate for some countries. Second, the choice of appropriate regime cannot be made independently of knowledge of the circumstances facing the country in question. Third, no single regime is right for all countries, and even for a given country, it may be that no single regime is right at all times

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1. Currency and Exchange Regime Options

The targeted countries are applying two main types of ERR: a flexible or floating exchange rate with emphasis on price stability as the final goal of monetary policy and several types of fixed exchange rate regime, in which the exchange rate is the anchor of monetary policy, thus the intermediate target of monetary policy is the exchange rate stability.

The choice of a fixed exchange rate or a managed floating appears to be a practical recognition of the fact that in a highly open economy, there is a close relationship between the external value of the currency and the domestic price level. This (together with the fact that the external value of the national currency is more easily monitored on a day-to-day basis than its internal purchasing power) can justify the pursuit of exchange rate stability as an intermediate target.

The second currency regime option is the adoption of the euro as the national currency. Among the ex-Yugoslavia countries only Slovenia is member of the European Union (EU) and member of the European Monetary Union (EMU). Since the other countries are not members of the EU, EMU membership is ruled out. There is however another option – unilateral adoption of the euro as a national currency and legal tender. In this case the respective country is joining an asymmetric (Buiter, W. H., 2000) monetary union. In practice this is an unilateral euroization with different outcomes for the euroizing country. Net effects for the country are an empirical question depending on a number of conditions and primarily on the degree of monetary, real, and institutional convergence already achieved beforehand. Positive net advantages may be expected especially by smaller countries that are either already converging, or are distant but wish to use a single currency to speed up convergence (Nuti, M.,2002). Estimation the impact of common currencies on bilateral and intraregional trade and economic integration in the Western Balkans some authors come to the conclusion that unilateral euroizaition alone can not deliver economic growth (Ilirjani, A. 2005).

One of the negative consequences is that unilateral euroization would not provide a share of the seigniorage revenues of the common currency area. Second, there would be no automatic access to the discount window of the European Central Bank (ECB). Third, the ECB would not have any lender of last resort responsibilities vis-à-vis the financial institutions of the respective euroizing country. Fourth, there would be no seat on the ECB Council or Executive Board. Fifth, monetary policy by the ECB would be conducted without any reference to the economic conditions in the euroizing country, unless this were in the national interest of Euroland, as perceived by the ECB. It must be stressed that in 2000 the EU (ECOFIN Council) articulated a negative position to unilateral euroizatioon. On the one hand, it is not compatible with the Treaty, and on the other, countries cannot use this way around to avoid the convergence process.

The unilateral euroizaition can be contrasted with a full and formal monetary union, a (formally) symmetric (Buiter, W. H., 2000) monetary union. In such a type of

monetary union participating nation states acquire several advantages. First, they share the costs and benefits of the monetary union in a way that represents their economic size or weight. Second, their representation on the decision making council of the supranational central bank (the ECB) likewise reflects their economic importance in the union. Clearly, in a formally symmetric union between countries of very different economic size, the larger member(s) will be the dominant partners (Buiter, W. H., 2000). With EU and EMU membership, the respective country would get its fair share of the Euroland-wide seigniorage; financial institutions in this country would have access to the discount window of the ECB on equal terms; the ECB would act as lender of last resort on the same terms and conditions in all member nations, and the monetary policy of the ECB would be directed at price stability and economic activity in Euroland as a whole, which would give a small weight to small countries like the ex-Yugoslavia countries.

There are many other arrangements countries can make choose. For example, an adjustable currency peg to the euro can be an alternative. Another option is a currency board arrangement (CBA) under which the exchange rate is fixed (to the euro) by law. The CBA requires a 100% reserve backing of domestic currency issue. A regime with a exchange rate fixed by law can be chosen, but without 100% reserve backing of domestic currency issue. This option gives room for domestic credit expansion.

Within the type a floating or flexible exchange rate regimes, there are many possible objectives and monetary instruments which can be considered. As most applicable in practice are known single nominal targets, such as inflation targets.

2. From an Optimal Currency Area to a Diversity of Currencies

Economic agents and households in the Socialist Federal Republic of Yugoslavia enjoyed the advantages of an optimal currency area with the Yugoslav Dinar as a legal tender in all of the republics constituting the federation. After the wars in the 1990s from the former Yugoslav medium-sized economy, 7 small open (dependent) economies emerged. The national states building process started also the move from the optimal currency area to introducing new domestic currencies (see table bellow):

Currency choices by the successors of SFR of Yugoslavia

New national currency	Official euroization		Two currencies within a federation
	bilateral	unilateral	
Croatia, Macedonia, Serbia, Slovenia (until 2006)	Slovenia (since 2007 member of the EMU)	Montenegro, Kosovo	Bosnia and Herzegovina, Montenegro (until 2006)

In some cases the choice of the currency was imposed by the reality of a dominating foreign currency (DM in Montenegro within the federation with Serbia, Convertible marka in Bosnia and Herzegovina).

In other cases new national currencies has been created: Croatian kuna, Macedonian denar, Serbian dinar, Slovenian tolar. In the federation of Bosnia and Herzegovina no optimal currency area has been created, instead two kinds of banknotes and coins of the Convertible marka are in circulations – on a federal level, and within Republica Srbska.

The third group encompasses successors of Yugoslavia, who adopted the way of official bilateral or unilateral euroization. Slovenia preferred to went the classical way of adopting the euro by becoming first member of the EU and then to meet the Maastricht criteria and join the Eurozone member countries. Montenegro unilaterally adopted the Euro as its national currency in 2000, by replacing one foreign currency circulating as a legal tender (the DM) by the successor of the DM (and of the national currencies of the EMU member countries). This adoption was carried out in a period, when Montenegro was part of the federation with Serbia and again within the federation no optimal currency area was chosen. Instead, within the federation two currencies were simultaneously used: in Montenegro – the Euro, and in Serbia – the Dinar. The second case of unilateral euroization is Kosovo, where the euro has been adopted after the war in 1999 and with the introduction of euro banknotes and coins in 2000.

This diverse picture of currency choices in post-Yugoslav countries necessitates a clear answer on the role they can play in fostering or hampering regional cooperation. Regional economic cooperation has been imposed by the EU as a precondition for membership. As all of these countries see their future in the EU, the analysis of the issue is of particular importance. The first remark is, that the national currencies of Croatia, Macedonia, Serbia, Bosnia and Herzegovina do not intermediate the economic relations among the respective countries or among all the successors of SFR Yugoslavia: they are not applied either as a currency of transaction, nor as a currency of payment in trade or in foreign investments. Second, as regards the role of their currencies in regional cooperation, the countries mentioned have disadvantages towards those of the successors of SFR of Yugoslavia, who bilaterally (Slovenia) or unilaterally (Montenegro, Kosovo) use an international currency (the euro) as their legal tender.

The euro plays main role in economic relations of post Yugoslav countries with the EU. As a result, the three countries enjoy the same benefits EMU member countries are enjoying in their economic relations or in their external economic relations, where the euro is used as a currency of transaction or as a means of payment. In bilateral exports and imports or in foreign direct investment projects in the region the euro plays a dominant role. Third, a next competitive advantage even to EMU member countries is that in exchange of adopting the euro unilaterally, euroizing countries (Montenegro, Kosovo) do not have to meet or keep meeting any of the Maastricht criteria. Fourth, the issue is open on what would be the requirements to unilateral euroized countries when they become members of the EU. Will they be

obliged to follow the prerequisites for a membership of the EMU or a different approach will be applied to them by the EU institutions.

3. The Exchange Rate Regime Choice

Experience shows that for countries at a relatively early stage of financial development and integration into the international markets of goods and services, fixed or relatively inflexible regimes seem to present a tool for reaching anti-inflation credibility without damaging growth. Later, when countries attain a higher level of economic development flexible exchange rates can bring substantial economic advantages. Among the targeted countries only Serbia has chosen the option of a flexible exchange rate regime with inflation targeting. The actual applied regimes in the rest of the targeted countries rather cover the types of inflexible regimes, under which the exchange rate is the anchor of the monetary policy.

More concrete and according to the IMF classification, the post-Yugoslav countries apply 5 out of the 8 possible exchange rate arrangements (IMF, 2008):

B&H	• CBA • ER anchor of the monetary policy
Slovenia	Independently floating (2006) Member of the Eurozone (2007)
Montenegro (2001), Kosovo(2002)	No separate legal tender (unilateral euroization)
Croatia	• Managed floating with a de facto peg to the Euro • ER anchor of the monetary policy
Macedonia	• Managed floating with a de facto peg to the Euro (around Den 61= 1Euro), • ER anchor of the monetary policy
Serbia	• Managed floating with no pre-determined path for the exchange rate • Inflation targeting

3.1 Currency board arrangement (CBA)

The CBA is the mist rigid exchange regime. To the adoption of this exchange rate regime Bosnia and Herzegovina has been forced by the uncompleted state building process. It was applicable to Bosnia and Herzegovina, because it depoliticize the monetary system by depriving the government of the power to exercise pressure on the central bank to print money.

3.2 Official Euro/Euroization

Among the targeted countries there are examples of both unilateral adoption of the Euro, and by a full, formally symmetric monetary union. Existing literature reveals

that there is insufficient knowledge about the various dimensions of euroization in the region but investigations show that what regards cash and deposit holdings the euro plays a more substantial role in SEE than in Central Eastern European countries (Dvorsky, S., Thomas Scheiber and Helmut Stix, 2008).

At the same time, there are plenty of theoretical and case studies (regarding particular countries) analyzing the pros and contras in joining a monetary union. In cases of bigger economies scholars (Buiter, W.H. 1999) clearly define the advantages and disadvantages for being part of a monetary union. Microeconomic transactions costs savings argue in favor of either form of monetary union. Seigniorage considerations argue against unilateral adoption of the US dollar, but in favor of a formally symmetric monetary union. Loss of the lender of last resort is a powerful argument against unilateral monetary union. The optimal currency area arguments (which concern the macroeconomic stabilization aspects of a permanently fixed exchange rate) probably favor either form of monetary union. The shock-absorber properties of a flexible exchange rate are dominated by the extraneous instability and excess volatility inherent in a market-determined exchange rate when financial markets are highly integrated.

Diverse determinations and implications can be observed from the practice of the small economies in the SEE region. In Slovenia the driving force for choosing formally symmetric monetary union was the advanced relations with the EU, determining a clear vision on formally joining the EMU according to the requirements of the Treaty. In December 1997 the European Council in Luxembourg adopted the recommendation of the European Commission to officially begin negotiations with six countries, including Slovenia. In March 1998 Slovenia started negotiations and in May 2004 became full fledged member of the EU. The motivation of the society and the political goal was to be at home in Europe (doma v Evropi). After that Slovenia became the first new member county to formally join a formally symmetric monetary union, entering the third stage of the EMU in January, 2007. Slovenia was obliged to join the EMU as soon as it fulfills the Maastricht criteria for monetary, fiscal and exchange rate convergence. The question arises: why did Slovenia want to join the EMU as soon as possible and why the country achieved a smooth EMU accession? One of the reasons could be that in developing countries and emerging markets monetary policy is usually a source of volatility, rather than an instrument of macroeconomic stabilization in the case of exogenous (asymmetric) shocks (De Grauwe, P. and Gunther Schnabl, 2004). This means, that if membership in the monetary union incorporates a significant degree of macroeconomic stabilization the gains from joining the monetary union are substantial.

A different case is Montenegro, because this country started with unilateral (de facto) euroization (first accepting the DM) even fare before becoming independent state in 2006. The case is interesting also in view of distinctive proofs compared to that one can find in the literature. In some analyses (Kotios, A. , 2002) main attention is paid to the preliminary theoretical examination of factors determining the decision to unilaterally euroize or not and its implications. The costs and benefits, the implication of unilateral euroizatation on monetary policy, on growth

are scrutinized. Based on the future economic advantages/disadvantages of the political decision these kind of analyses rather concentrate on the possible future outcomes supporting or opposing the decision, while missing the two important features of unilateral euroization. The first one regards the role of the historical experience in adopting a foreign currency and its causes. The point here is whether the respective country or region has been subjected to adopt a foreign currency, is the experience positive or negative, whether the choice(s) was (were) based on less sensitivity of citizens on the notion of loosing national sovereignty, independent monetary policy etc. Some authors (Stix, H., 2008) support the view, that the persistence of the use of foreign currency is driven to a large extent by factors that are related to the past (Stix, H., 2008

The second one concerns the practical evidence, that in most cases this is a process of a spontaneous euroization. As other authors (Feidge, E.L. and James W. Dean ,2002) indicate, unofficial (de facto) euroization results from individuals and firms voluntarily choosing to use a foreign currency for the monetary services of domestic currency. Authorities then are forced to take the decision on unilateral euroization, because economic agents and households has taken it earlier, before the official adoption of the preference to replace the domestic currency is taking place. This sequence is typical for the countries of post-Yugoslavia, where the decision on unilateral euroization has been prepared by the specific conditions of wars and loss of confidence in the domestic currency dominating the region in early 90-ies. The decision to euroize was incorporated into the aim to build a nation state (Montenegro, Kosovo). For example, in Montenegro, the authorities accepted officially the DM even at a moment, when Montenegro was part of the Republic of Yugoslavia, where the dinar was the legal tender.

There is also another aspect worth mentioning – the attitude to the euroization of the EU institutions in charge. At the beginning of the third stage of the European Economic and Monetary Union the European Commission was against unilateral euroization and persisted on the fulfillment of the Maastricht criteria. On the other hand, countries (Bulgaria), which were in the process of negotiations and tried to make it visible that they meet the Maastricht criteria, have been reminded that they have to stick to the Copenhagen criteria first and foremost. The understanding of the European Commission was that countries have first to become EU members and only after that step they can start preparing for the EMU accession.

Another peculiarity in euroization is based on the distinction between currency substitution and asset substitution. Even after the stabilization of the economy in mid-1990s, economic agent and household in Croatia continued to use foreign currencies because of the important role of network effects and of remittances (Stix, H., 2008). Similar effects can be observed in Serbia.

As a result, there are three varieties of euroization in place in the targeted countries. In the case of Slovenia there is a bilateral official euroization reached by joining the EMU. Alternatively, Montenegro euroized unofficially, de facto and then an unilateral decision followed to accept the Euro without joining the EMU and without

explicit prior sanction by the EU authorities. In the case of Croatia and Serbia, the euroization takes place in the form of an asset substitution .

3.3 Managed floating (de facto peg)

Very often countries announce a different exchange rate regime than they actually implement. This is the case with Croatia and Macedonia, which adopted a de jure policy of floating regime of their national currencies but use domestic monetary policy to smooth exchange rate fluctuations. There are several reasons for this. However, usually countries declare a de jure float as a result of external pressure from bilateral investment treaties or the IMF. Inconsistencies between the official and actual regimes could come up when real pressures occur and guide the movement of the exchange rate in a different direction than a nominal pressure would lead.

3.4 Managed floating with no pre-determined path for the exchange rate

This regime has been chosen by Serbia, together with the decision to move towards inflation targeting. The monetary policy is based on the inflation anchor although the central bank has been heavily intervening on the market to withstand the depreciation pressure on the dinar particularly since end of 2008.

4. The Implications of De Facto Euroization (asset substitution)

De facto euroization heavily manifested itself during the pre-crisis period both in banks and in the corporate sector. There are several motives for holding either cash or deposits , or receiving credits in foreign currency. Among foreign currencies cash holding in euro are preferred in the region and are more widespread in in the SE countries than in the CEE countriesd. Studies (Dvorsky, S., Thomas Scheiber and Helmut Stix, 2008) show that cash holdings in euro dominate in Macedonia (49%).

More serious implications has de facto euroization in the form of bank deposits and loans. This is particularly true in the cases when the foreign exchange rate risk is turning out to become a solvency risk. For example, during the depreciation of the national currency the degree of solvency risk for a bank can increase as a result that its corporate borrowers became overleveraged in foreign currency. The extent of exposing to this risk is tightly connected with the level of asset substitution in the respective country. Not only banks, but also companies can be offended by high levels of de facto euroization, because it negatively influences their economic performance and burden their export capacities. The process has been accelerated during the credit expansion pre-crisis period. Credit boom was typical for all emerging Europe countries. However, in the post-Yugoslav area it has been bold by the extensive de facto euroization. (about three fourths of bank loans in Serbia are in foreign currency or foreign exchange related). For example, about three fourths of bank loans in Serbia are in foreign currency or foreign exchange related (IMF,

2008). The accumulated potential of foreign exchange risk before the crisis manifestated them to a bigger or less extent in the form of credit risk the region.

Vulnerabilities occurred well before the crisis, but their importance has been (in most cases) neglected. One typical risks economies in post Yugoslavia countries have been exposed were the currency mismatches in the banking sector. Currency mismatch is usually referred to the extent to which an economy's liabilities are denominated in foreign currency while its assets are denominated in domestic currency. This is one of the main mechanism through which emerging economies are exposed to systemic risk.

In the pre-crisis period, lending activities of banks were based on the expectation that returns are high, and companies can serve their credits and pay back. However, this was not the main factor boosting credit expansion. The access of foreign bank subsidiaries to cheep funding on the international markets and the competition for acquiring larger market shares on the host countries' markets enhanced lending directly in foreign currencies. While this factor was typical for the behavior of foreign bank subsidiaries in emerging Europe, critical for the post-Yugoslav countries was the behavior of potential borrowers induced by the lack of sufficient trust in local currencies.

Recent research presents evidence that an economy might have a low foreign currency debt relative to its net exports, but the risk can arise from the fact that its debt might be concentrated in borrowers with no foreign currency income (Ranciere, R. Aaron Tornell and Athanasios Vamvakidis, 2010). Some of the authors (Prat, St., 2007) concentrate on sectoral analyses and calculate banks' currency mismatch as the share of their foreign currency liabilities not covered by their foreign currency assets. However, this literature does not take into account foreign currency loans made to unhedged borrowers. If debtors cannot effectively hedge their exchange rate risk, banks are indirectly exposed to exchange rate risk through credit risk. Thus, there is a *de-facto* systemic risk, which is not reflected in a notional currency mismatch measure that focuses only on banks' balance sheets (Ranciere,R. Aaron Tornell and Athanasios Vamvakidis, 2010). At the same time, in countries where financial markets are underdeveloped and economic agents do not have the opportunity to hedge their open positions in foreign currency, they face high foreign exchange risks.

This is the typical experience in South Eastern European countries. During the pre-crisis years banks in SEE (like in the rest of emerging Europe), used the worldwide period of cheep money to borrow in foreign currencies and to grant loans denominated in foreign currencies both to the corporate sector and to households. In 2007 the share of foreign currency lending in total lending to the non-financial sector attained to more than 50 percent in most of the countries. A considerable part of the credits was granted to clients with no foreign currency revenues or channeled to finance consumption and investment in nontradable goods.

Another type of vulnerability could take place as a result of the sovereign debt crisis in the Eurozone. Foreign banks are regarded to have played a positive role during

the global financial crisis. However, the Greek sovereign debt crisis since the beginning of 2010, is creating concerns that the large presence of Greek banks entails considerable risks for the banking systems of those countries where their share is dominating the bank assets. Those countries could suffer from a potential withdrawal of Greek parent banks and declining exports to Greece.

5. Role of National Currencies and Exchange Rate Regimes in Regional Cooperation

One of the characteristic feature of the region is that the markets in the successor states of Yugoslavia are of a small scale and of a fragmented nature in some cases. Before the global financial and economic crisis growth was underpinned by large capital inflows.

National currencies are not used in intra-trade or foreign direct investments between countries from post Yugoslavia. However several exchange rate levels to the main currencies used in international trade (USD, Euro, CHF etc.) exist (105 RSD = 1 USD, 1.95830 KM = 1 USD, 7.42 HRK = 1 USD, 61.5050 MD = 1 USD). This presumes that under more flexible exchange rate regimes exchange rates of national currencies (to the main international currencies) can be managed in favor of national exporters to get competitive advantages towards their counterparts from the region.

Countries with CBA (Bosnia and Herzegovina) and de facto peg (Croatia and Macedonia) have no, respective less maneuvering room to reach this goal. In the region this rather feasible for Serbia due to the flexible exchange rate regime.

Exporters or investors from countries, which have unilaterally (Montenegro, Kosovo) or bilaterally (Slovenia) adopted the euro as their legal tender do not have to and are not able to influence the exchange rate of the EUR to other main currencies used in international economic relations. In equal terms, exporters and investors from these countries definitely are gaining on avoiding foreign exchange risk in comparison to their competitors from countries with national currencies and flexible exchange rate regimes.

One of the main channel currencies and exchange rate regimes are influencing economic cooperation in the region could be the positive effect of currency depreciation on exports. For several reasons the exchange rate of the Serbian dinar has been diverging from other flexible currencies in the region. The Serbian dinar is depreciating since 2009 and this process has been boosted also by the Greek crisis (from 95 RSD to the EUR in early 2009 the exchange rate reached the level of 107 RSD to the euro in late 2010). However, despite the depreciation exports are increasing slower (19%) than imports (34%). This means that exports of Serbia are not sensitive to price advantages of depreciation.

Another channel is the impact of depreciation on corporate performance. The depreciation of the Serbian dinar negatively affected balance sheets of corporations. Their extensive borrowing in foreign currency both from domestic banks and

directly from international parent banks (36% of GDP) was not hedged because of the lack of a local foreign exchange forward market liquidity. Due to the foreign exchange risk balance sheets became overleveraged - corporations were incapable of servicing their credits with available capital sources. In the most cases debt rescheduling is needed.

The depreciation channel is also influencing inflation. Continuing depreciation pressure on the Serbian dinar generated on negative impact on domestic inflation expectations. Inflation volatility undermines the government policy measures on de-euroization of the economy.

Adverse effects can be observed in countries, in which the euro is adopted as national currency. The elimination of foreign exchange transaction costs and of the foreign exchange risk bring considerable advantages to investors and from these countries in the region. In 2009 the amount of foreign direct investments of Slovenia to Bosnia and Herzegovina surpassed those of Germany and Montenegro has been ranked on 11 place out of 18 foreign investors with investments exceeding 1 million euro. Undoubtedly there are more import driving forces (than the advantages of using the euro as national currency) behind the position of Slovenia and Montenegro as foreign investors in the region. The geographical proximity and the historical ties, the existing and newly established networks definitely play a essential role and the impact of these invisible assets can be observed on the foreign direct investments of Croatia and Serbia, together they would occupy the second place, after Austria. However, the benefits of the official euroization in such cases in comparative terms cannot be neglected.

In countries with national currencies, de facto euroizaition is a key source of vulnerability of corporate borrowers. It hampers imports used for export production and creates currency mismatches of banks.

Conclusion

The national states building process in post-Yugoslav countries has been accompanied by switching from an optimal currency area of the Yugoslav dinar to the introduction of new domestic currencies. The picture of currency choices made is diverse including four national currencies, one case of official and another of unilateral euroization, and in one federal successor state there are two kinds of banknotes and coins of the national currency in circulation (one on federal level, and another one in only a part of the territory).

Even more rich are the choices of exchange rate regimes covering almost the whole range of options existing among the members of the IMF. Starting from the bold rigid form of fixed exchange rate (CBA), representing a member of the Eurozone and of the unilateral euroization, to end at managed floating with de facto peg to the euro, managed floating with no pre-determined path for the exchange rate, and independently floating rate.

The role of the euro is visibly important for the economies from the region. The de–facto euroization in some countries with national currencies dominates in the form of cash euro holdings (Macedonia), and in the others (Serbia and Croatia) in the form of bank credits (and deposits) in foreign currencies, mainly in euro.

Official euroization, both bilateral (Slovenia) and unilateral (Montenegro, Kosovo) could inspire national market agents (exporters and investors) to deepen cooperation with post-Yugoslav counterparts, provided they possess adequate potential and interest to channel their efforts to. Both de-facto and official euroization leads to the elimination of foreign exchange transaction costs, which is a competitive advantage for exporters and investors from the respective countries.

Despite a proliferation of new currencies and varying exchange rate regimes, during the global financial and economic crisis countries from the post –Yugoslavia area did not experience uncontrolled devaluations and systemic bank failures.

During the crisis main possible channels influencing the regional economic cooperation among post Yugoslav countries could be depreciations of national currencies and the usage if the euro as legal tender in some of them. Empirical evidence shows that countries with flexible exchange rate regimes could not make use of depreciation because of the low level of price sensitivity of exports. At the same time depreciation increased inflation expectations, increased interest rates made credit more expensive, which hampered production also for export. Depreciation discovered potentials of foreign exchange risk to become a credit risk, damaging the performance of overleveraged corporations and detecting the risks banks have been accumulating through currency mismatches during the pre-crisis period. In countries where the exchange rate is the anchor of monetary policy, actions of the central banks were constrained by the need to maintain the de facto fixed exchange rate, which revealed also a persistent euroization.

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ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ
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THE DEVELOPMENT OF EDUCATION AND SCIENCE – AN IMPORTANT WAY FOR INCREASING THE INFLUENCE OF SMALL COUNTRIES IN THE EU. THE CASE OF BULGARIA

The report concerns the issue of the significance of education and science for the socio-economic development. The accent is put on their progress as an important way for increasing the influence of small countries in the EU. The study is focused on the case of Bulgaria. Some of the most important problems in the education and science fields in the country are outlined and analysed, such as the absence of strategies for their development, the existing financial barriers, difficulties with the personnel, output and quality, etc. Possibilities for overcoming the existing problems and barriers are presented as a conclusion.
JEL: O32; O33; I2

The world socio-economic practice and the economic development trends show that in conditions of deep transformations the resources directed to intellectual branches increase. The statistical data demonstrate that the expenditures on education and science grow. The process of globalization that is characteristic for the contemporary stage of development of human society is a process of substantial social and economic transformations. Today one of the main factors of development becomes knowledge.

The economic theory and practice outline the main stages of development of the world economy. That process passes through agricultural, industrial, post-industrial, technological, etc., and now we speak about knowledge, economy, where knowledge becomes the most important factor for fast and sustainable development, for raising competitiveness.

There are many theoretical studies which prove that knowledge increases productivity as well as the capacity of the economy to develop and implement new technologies. The results of a number of econometric investigations demonstrate that

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a higher capacity for absorption of new technologies is related to a higher educational level.[2]

The main components of the knowledge economy are knowledge and information. Countries that make more investments in knowledge (which means in education, skills and science) gain more benefits in economic and social aspects. These investments ensure benefits for the society as a whole and not only for the individuals. That is why the most effective modern economies are those that create most knowledge and information.[3] Many of the economic studies, including recent ones, prove that the R&D expenditures generate a significant part of the labour productivity growth, determine considerable positive developments in other areas of the economy, and have markedly positive influence on the GDP dynamics.

These are the conditions in which the European Union (EU) determines its goals and directions for development. One of the main goals of the EU for its economic and social development is the building of knowledge economy. It is presented and described in the main documents, such as the Lisbon strategy (2000) and its revision (2005), Europe 2010, Europe 2020, etc.

The main goal of the Lisbon strategy is to become the most competitive knowledge-based economy by encouraging research and establishing a favourable climate for innovation (by dedicating 3% of the national GDP to R&D – one of the main permanent goals of the Lisbon Agendas). One the EU headline targets of the new European strategy for jobs and growth (Europe 2020) is "improving the conditions for research and development, in particular with the aim of raising combined public and private investment levels in this sector to 3% of GDP". Another important target is "improving education levels, in particular by aiming to reduce school drop-out rates to less than 10% and by increasing the share of 30-34 years old having completed tertiary or equivalent education to at least 40%".

The development and improvement of education and science are indispensable for the achievement of these goals. This is so, because knowledge which is the basis of knowledge economy can be created, accumulated, disseminated, and put into practice in and through the systems of education and science.

The world economic trends and the EU goals for future development are directed towards improving competitiveness, building knowledge economy, increasing investments in human capital, in education, science, innovations, etc.

In these conditions for small countries, such as Bulgaria, the development of education and science should become a national priority. Some important reasons for making such a conclusion are:

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[2] See for example Crespo-Cuaresma, J., N. Foster, J. Scharler. On the Determinants of Absorptive Capacity: Evidence from OECD Countries. Workshops, Proceedings of OeNB Workshops, Current Issues of Economic Growth, 5 March, 2004.

[3] See Schleicher, A. The Economics of Knowledge: Why Education is Key for Europe's Success. Lisbon Council Policy Brief, The Lisbon Council, Brussels, 2006.

- On a world scale, the process of economic development goes through different stages. Today, it reaches the stage when knowledge becomes the main factor for economic and social development, for competitiveness and welfare.

- The main (economic) goal of the EU is the building of competitive knowledge economy.

- Small countries have less and limited resources (such as oil, gas, gold, etc., including even human resources), so knowledge could be a good advantage for improving competitiveness, achieving sustainable growth, raising welfare, etc.

Bulgaria is an example of a small country with relatively limited resources, negative demographic developments and perspectives. The main indicators for its economic and social development (such as GDP, productivity, incomes, etc.) are below the European average. Under such circumstances the development of its education and science could be a real advantage and good possibility for achieving sustainable growth, rise in productivity and competitiveness, increase in its influence, etc.

What is the situation of education and science in Bulgaria at present?

There are many and deepening *problems* in these fields in the country. Some of the most important that should be mentioned as needed to be overcome are:

- There are no national priorities for economic development, and there are no strategies for the development of education and science in accordance with national priorities (which is connected to the legal bases of these spheres and their imperfections). This absence creates difficulties with the directions for the development of science and of education, especially of vocational and higher education, with the personnel, financial provision, output and quality, etc.

  For the last ten years three drafts of national strategies for the development of these spheres have been initiated. The draft of a National strategy for scientific studies 2005-2013 declares that there is no overall complete policy in the area of science in the country and that there is a necessity of adopting such national strategy. However, in the next version of a draft of such strategy for the period 2009-2019 it was not mentioned anything about the importance of science for the strategic development of the country. There was also a draft of national strategy for development of higher education in the country (1999). However, none of them was adopted.

- The substantial structural changes of the economy for the last two decades and the absence of national priorities for its future development create problems before the adaptation of these systems to the necessities of the economy, especially of education. The existing mismatch on the labour market, the

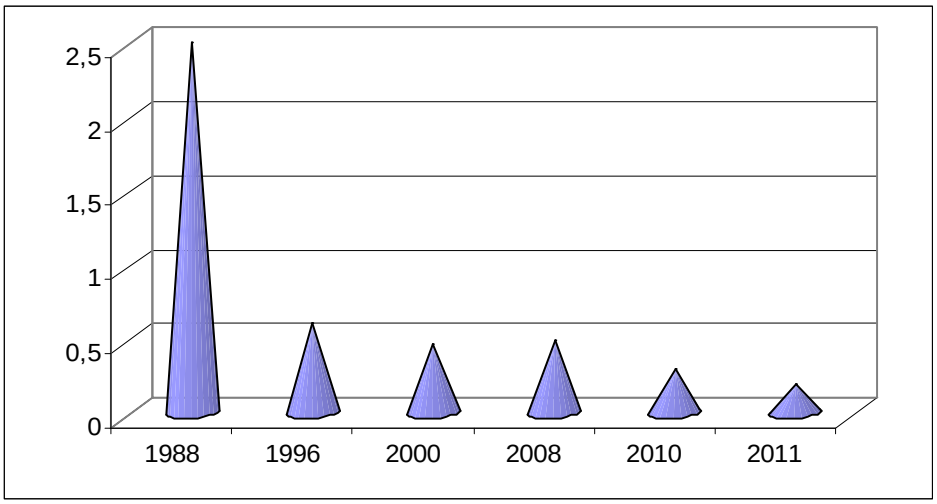
unsatisfied necessities of the employers, and the results of some inquiries[4] are indicative of that.

- There are financial barriers before the development of education and science. The financial resources directed to them are very limited. The EU goal is to achieve 3% of the GDP directed to the development of science. In Bulgaria this percentage is below 0.5, and moreover, it has dropped significantly for the last 20 years. The draft budget for 2011 envisages a new drop to 0.2% of the GDP (fig. 1). The political explanation given is that in time of crisis all public expenditures should be cut down. The world practice however shows that exactly in periods of crisis or deep transformations the funds directed to education and science increase or at least do not decrease, and such a recommendation has been made to Bulgaria by famous international economists.

However, a significant decrease in the expenditures for the Bulgarian Academy of Sciences is observed – its budget was lessened from BGN 84 to 59 million just during 2010 (with the revision of the budget in July 2010).

Figure 1

Expenditures on R&D, % GDP (Bulgaria)



Source: Ministry of Finance.

About 2/3 of the expenditures for R&D comes from state sources. Before 1990 industry[5] ensured about 65-70% of the expenditures on R&D. Between 2000-2005 this percentage was about 20% and after that it decreases. At present this is

[4] See for example the results of an inquiry carried out in 2007 among teachers, lecturers and students that show a comparatively low and unsatisfactory level of adequacy of education to the necessities of the economy and of the labour market. Matev, M., I. Zareva. Education and Science in Bulgaria. The View of Teachers, Lecturers, Students and Researchers. S., 2010.

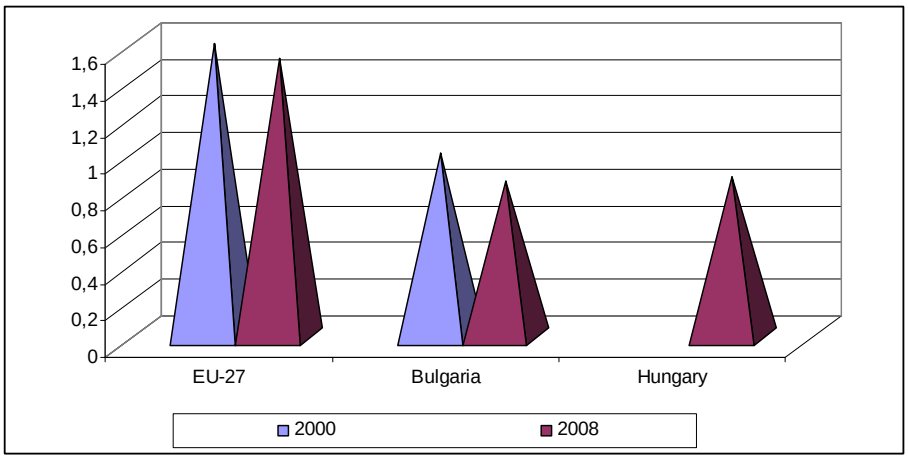
[5] The business enterprise sector.

connected of course with the economic crisis to a great extent. Before the crisis about 90-95% of these resources go for wages and salaries, and insurances. Now, it is nearly 100%.

The predominant part of the financial resources for R&D in Bulgaria comes from the government budget, for one or another reason. However these funds are absolutely not sufficient not only for the development but even for maintaining the existence of this sphere. The share of government budget appropriation or outlays on research and development (as % of total general government expenditure) is about half of the EU average and despite of that it even decreases during the last years (fig. 2). The foreseen percentage for 2011 is about two times lower than that in 2008. These expenditures are not sufficient for generating growth and competitiveness. This conclusion is made in many other studies on the Bulgarian R&D sphere. One such inference is that "… the governmental expenditures in the country … are not expenditures for growth but rather expenditures for maintaining a minimum operational level of the existing state R&D."[6]

Figure 2

Share of Government Budget Appropriation or Outlays on Research and Development (% of total general government expenditure)



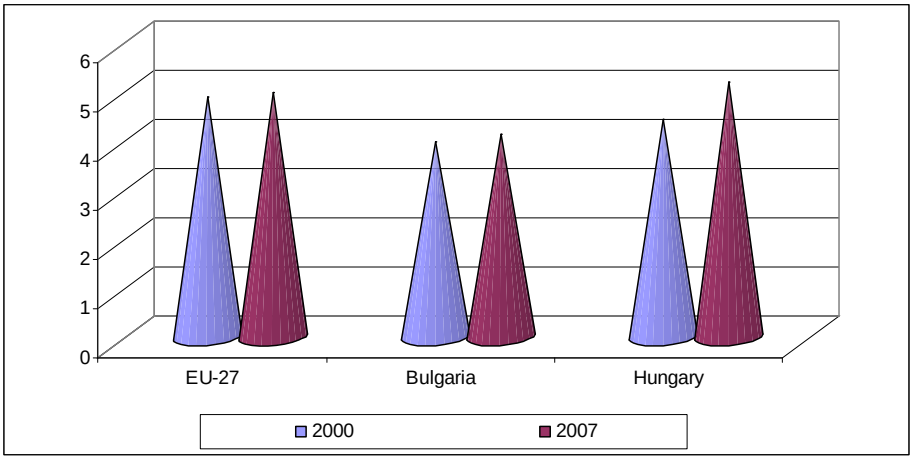
Source: Eurostat.

For education Bulgaria spends 5.4% of the GDP at the beginning of the transformations. After 2000 this percentage stays in the range of 4-4.4%. For 2009 it is 4.1%. It is nearly 1% lower than the EU average. The Eurostat data show that in 2007 the EU average was 4.96%, In Bulgaria this percentage was 4.13%, and in Hungary – 5.20% (fig. 3). The foreseen percentage for 2011 is only 3.3%.

[6] See Expenditures on R&D and Economic Growth – an International Comparison. – Economic studies, 4/2007.

Figure 3

Total Public Expenditure on Education (% of GDP)

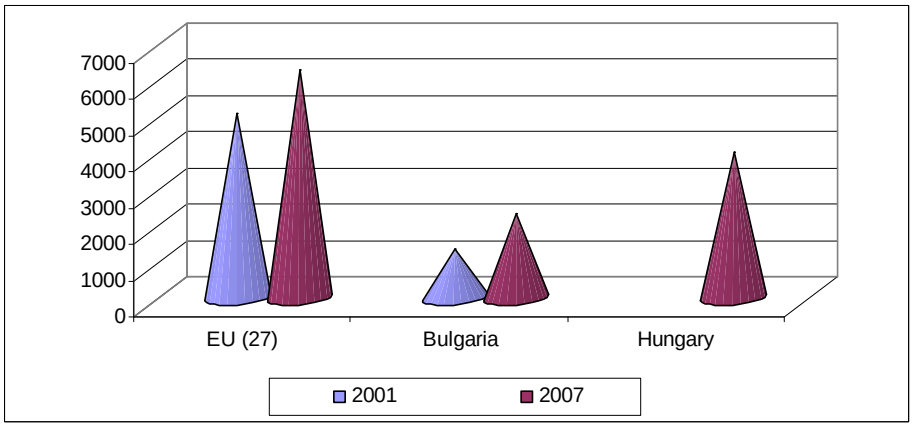


Source: Eurostat.

The lagging behind is more obvious when the expenditures per student are compared. The data demonstrate that the Bulgarian students receive nearly three times fewer resources than the EU average (fig. 4). That limitation creates barriers for the quality of education and the possibilities for its improvement.

Figure 4

Annual expenditure on public and private educational institutions per pupil/student (PPS based on full-time equivalents)



Source: Eurostat.

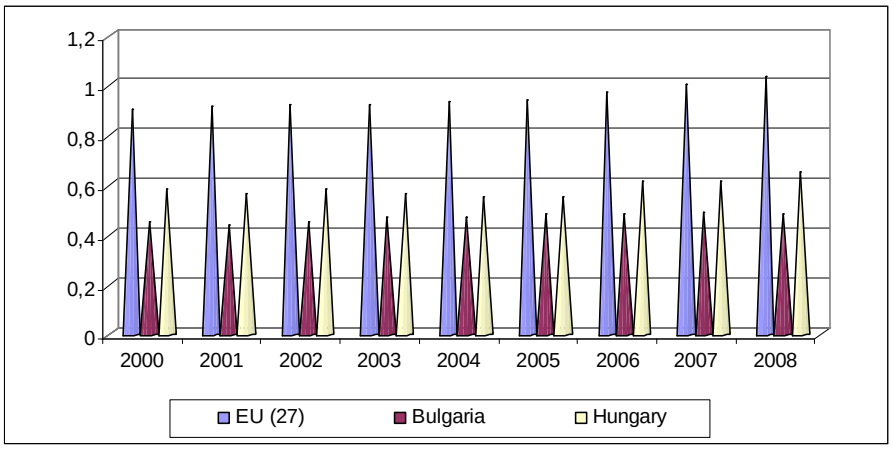
- There are significant difficulties with the staff in education and in science. Its number decreases continuously for the last 20 years. For the education this process can be explained to some extent with the demographic changes in the country (at present the share of the population over working age is around 22-

23% and that of the population under working age is less than 15%) and with the constantly decreasing number of youngsters. However this tendency was broken in the last 2-3 years which means that new teachers will be needed after some years.

Many of the scientists and researches went abroad and now Bulgaria has a very low number of R&D personnel (as % of the labour force). (Fig. 5.)

Figure 5

Research and development personnel (% of the labour force)



Source: Eurostat

Another negative phenomenon in Bulgaria in this aspect is the lagging behind the EU average with the doctorate students in the science and technology fields. Despite the relative increase Bulgaria is still behind the EU average figures (fig. 6). This situation premises limitations before the future development of science and the pool of human resources in science and technology fields.

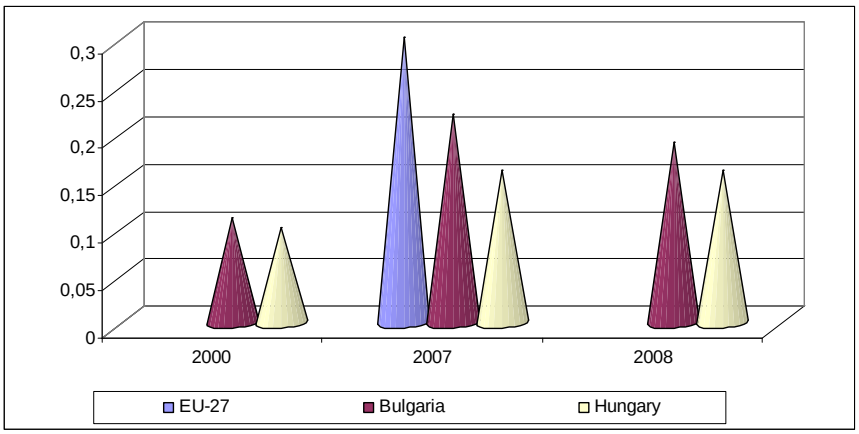
The data about the mobility of the Bulgarian students outline a risk for the future availability of sufficient human resources in science and technology. A challenge is the drastically increasing number of Bulgarian students going abroad to study. The Eurostat data show that for the period 2000-2007 the number of Bulgarian students who study abroad increases by about 270%, which is more than 2 times higher than the EU average (fig. 7).

Whether these young people will turn back to Bulgaria is a question. The results of the above mentioned inquiry among the Bulgarian students, made in 2007, show that about 20% of the interviewed students declared that they will go abroad to continue their study or to look for a job. They said that they probably would come back to Bulgaria if the socio-economic conditions in the country and their possibilities to find an appropriate job become better, when their work would be valuated in a proper way and their families will have better ("normal") conditions of life (that

means higher living standards). A significant part of them foresee that they probably will be engaged in scientific and research work.

Figure 6

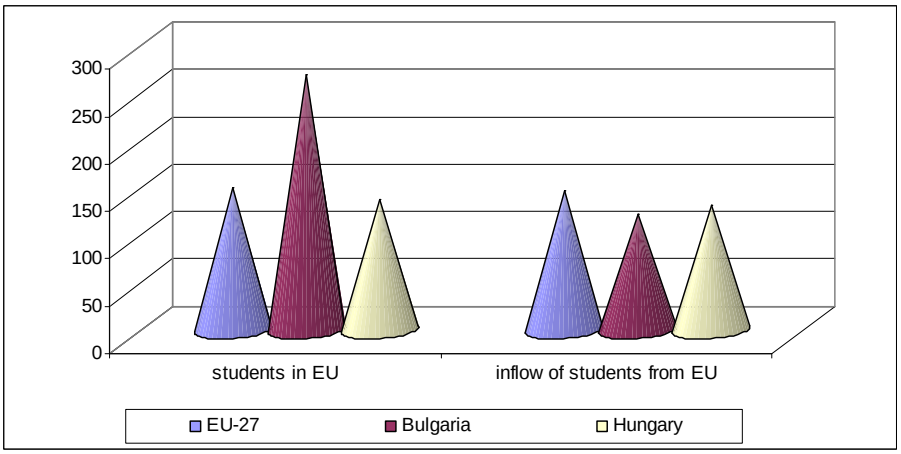
Doctorate Students in Science and Technology Fields
(% of the population aged 20-29)



Source: Eurostat

Figure 7

Mobility of students in Europe (tertiary students studying in another EU-27, EEA or Candidate country) percentage change for the period 2000-2007



Source: Eurostat

The age structure of the personnel in education and science is worsening. The share of the teachers of the age group above 50 years increases and that of the younger ones decreases. The biggest percentage is of the age group 40-60 years (about 40-48% are at the age of 50 and over – for the different grades of education), and among the professors even of the age group 60-69 years.

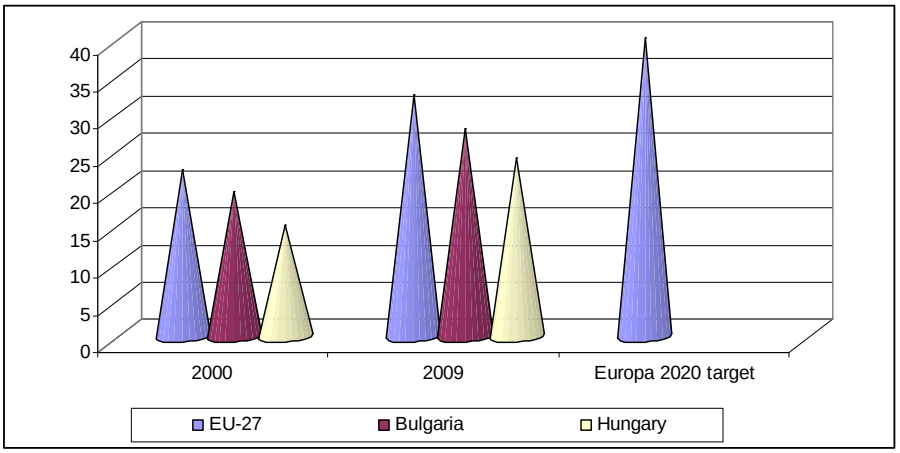
The latest data indicate that about 2500 teachers go on pension each year. Simultaneously, during the closure of around 400 schools during the last 2-3 years almost 6000 teachers were dispensed. At the same time, according to the data of the teachers syndicate and the regional employment service, in one town of Varna, alone, there are 152 vacancies for teachers at the moment. All these figures show that there is an insufficiency of teachers at present and that in the near future this problem could deepen even more.

- All such barriers lead to problems with the output of these systems.

One of the five main targets for the EU in Europe 2020 is to achieve at least 40% of 30-34–year-olds completing third level education. Despite the constantly improving educational structure of the population in Bulgaria, the country still has problems with the younger cohorts. An example is the lagging behind in the share of the population aged 30-34 years who have successfully completed tertiary or equivalent education compared not only with the target 2020 but also with the contemporary situation in Europe (fig. 8).

Figure 8

Tertiary Educational Attainment of the Population Aged 30-34 Years (%)



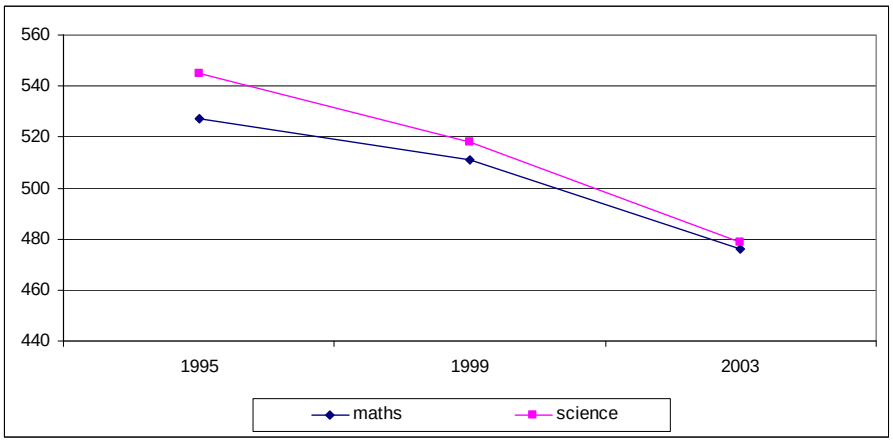
Source: Eurostat

Negative phenomena are observed not only in quantitative but also in qualitative aspect. The quality of education in the country decreases (fig. 9) An important premise for that are the restricted financial resources.

The truth is that the Bulgarian students win prizes at almost all Olympiads and international competitions but the average quality of education decreases. This situation suggests that the problems are not related to the abilities of the Bulgarian youngsters but to the transformations and the financial insufficiency of the education system.

Figure 9

Change in the Scores of 8th Grades in Mathematics and Science



Source: TIMSS, results for the corresponding years.

The quality problems in education are not problems only of the system itself. The process of education is a long-term one and its results will be obvious after five, ten, or even more years. This means that in the near and/or mid-term future problems could appear with the quality of the labour force in the country, with the adequacy of the labour force to the needs of the economy and of the labour market. On its part this suggests that problems could appear with the competitiveness of the Bulgarian economy and of course with the possibilities and perspectives for the development of science. The pool of highly educated and qualified specialists (human resources) that are able to create, disseminate, and implement knowledge and science will be reduced.

The accumulation of such difficulties could lead to many efforts, resources (including financial), and for a long period of time for their overcoming. That would eventually mean real and significant losses for the economy, for its competitiveness and for the welfare of the nation.

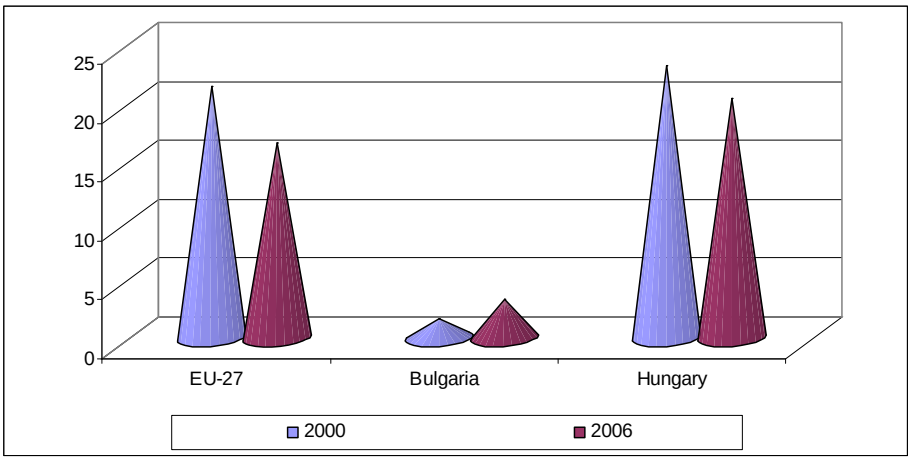
Indicative of the negative consequences from the problems with the outputs of the systems of education and science are the data about the high-tech employment and exports.

The figures about the employment in high- and medium-high-technology manufacturing sectors and in knowledge-intensive service sectors, and especially about the high-tech exports are significantly lower that the EU average and than those in Hungary. The employment in high- and medium-high-technology manufacturing sectors in Bulgaria (as % of the total employment) is 1.6 percentage points lower than the EU average and 3.7 points lower than that in Hungary. The employment in knowledge-intensive service sectors is about 2/3 of that in the EU (average figure) and in Hungary. The share of high-tech exports (as % of total

exports) is negligible compared to those in the EU (average) and in Hungary (fig. 10).

Figure 10

High-Tech Exports (% of total exports)

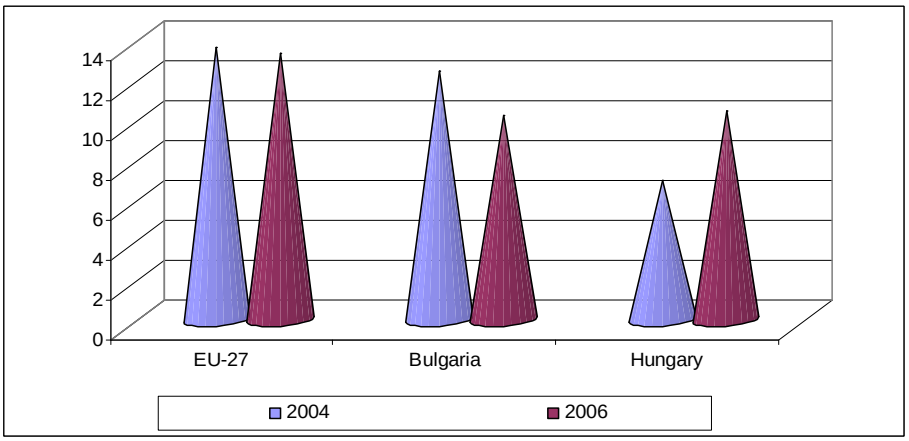


Source: Eurostat

Another negative phenomenon in this respect is the lower and moreover decreasing share of the turnover from innovation[7] in the country. The Eurostat data are indicative for this lagging behind (fig. 11).

Figure 11

Turnover from Innovation (% of the total turnover)



Source: Eurostat

[7] Eurostat defines this indicator as the ratio of turnover from products new to the enterprise and new to the market as a % of total turnover. An innovation is a new or significantly improved product (good or service) introduced to the market or the introduction within an enterprise of a new or significantly improved process.

Remarkably in these conditions the Bulgarian scientists and researchers succeed to work and to do their job in a proper way. A good example is the Bulgarian Academy of Sciences (BAS).

The BAS was assessed by the European Science Foundation and the European Federation of National Academies of Sciences and Humanities at the end of 2009. The general observation is: "The Review Committee has come to the unambiguous conclusion that the majority of BAS Institutes perform valuable research as judged by international standards. In some cases the panels found research groups that operate at the forefront worldwide. This overall result is regarded by the review team as an impressive achievement, considering the particularly difficult circumstances for research in Bulgaria."

However the absence of national strategy for the development of science and the ongoing restructuring of the Academy in such a situation as well as the existing financial restrictions pose substantial challenges before its future functioning and development, and even existence, thus creating serious problems to scientific activity in the country.

*

The development and improvement of education and science is one important way for increasing the influence of small countries in the EU. In the case of Bulgaria however, there are many problems and barriers that should be overcome for that purpose.

Education and science should become national priorities for future development. The most important premises for achieving that goal are: attaining political will and support, and getting legal and financial provision.

The society as a whole and especially politicians should realize that education and science must be one of the most important national priorities for the future economic and social development of the country. That will be in accordance with the economic development trends of the developed countries, with the main goals of the EU, with the national needs and interest in fast and sustainable growth and competitiveness. This is the way to ensure possibilities and resources for the development of education and science. If they become national priorities and get sufficient financial provision they will get the opportunity to improve their material basis, to attract younger qualified personnel, to increase their output and quality. Consequently, the country will obtain better chances for sustainable development, for improving the competitiveness and raising the welfare, for developing knowledge economy.

SUMMARIES

András INOTAI

THE MANAGEMENT OF THE COSTS OF CRISIS MANAGEMENT EUROZONE, EU 2020 AND THE FUTURE OF EUROPEAN INTEGRATION

Although the European Union (EU) was not the main source of the global financial and economic crisis, as one of the leading economic players, it was fundamentally affected by the immediate and longer-term consequences of the crisis. Similarly, it is expected that it would play an important role in how to get out of the crisis (not yet clear, whether a passive or an active one).

Almost all areas of community-level and member-state-based economic policy were affected by the crisis. Three of them have been chosen to be addressed in this paper. First, the challenge to the Eurozone and the common currency, as an immediate impact of the crisis will be dealt with. Second, as a coordinated answer to crisis management and post-crisis coordinating (and decision-making) mechanism, the idea of European Economic Governance will be analyzed. Third, in a longer-term perspective of post-crisis sustainable growth, the EU 2020 project will be shortly described and assessed.

JEL: O57; F43; F36

Krisztina Vida

EU DECISION-MAKING AFTER THE EASTERN ENLARGEMENT: INTERESTS AND INFLUENCE OF THE NEW MEMBER STATES

This article is a shortened version of a summary that was published in July 2010 as part of an extensive research report carried out by the Institute for World Economic at the order of the Foundation for European Progressive Studies. In this paper four categories of influencing EU affairs by a Member State were introduced, namely agenda-setters (innovative behaviour), decision-shapers (creative influence), decision-takers (passive approach) and decision-blockers (or veto players) reflecting a kind of rigidity in the name of defending national interests. This behaviour was tested on selected policy areas with a view to identifying the new Member States' impact on European integration so far.

JEL: F15; O11

Tamás Novák

IMPACTS OF THE GLOBAL CRISIS: SPECIAL FOCUS ON CENTRAL EUROPE AND HUNGARY

The Central and Eastern European countries outside the Euro area were hit particularly hard by the global credit crunch; their previously fast growth was replaced by a recession, putting their catch-up as part of the integration process into a completely different context. The crisis has made it clear for some of the Central and Eastern European newcomers that growth cannot be maintained based on generous inflows of capital. The abundant international liquidity that marked the years before the crisis vanished, FDI in the region plunged dramatically, and the drying-up of the government bond market imposed extremely tough limits on the external funding of budgetary overspending. The crisis hit Hungary especially hard as this country was already at a low growth path after the 2006 stabilisation package.

JEL: O18; O57

Plamen D. Tchipev

FIGHTING THE ECONOMIC CRISIS: COULD BULGARIA BE A NEOLIBERAL SUCCESS STORY?

In April 2010 Bulgarian government announced an economic and social plan targeted on counteracting the swift economic downfall and hopefully, on helping the economic recovery. The way the plan was launched and the character of some of the measures created a lot of comments, rejection and controversy among the economic agents in the country. That inspired the main idea of that paper - to look more carefully into the plan. First section outlines roughly the global response to the financial crisis. Section 2 observes the government anti-crisis plan in some detail; the third features plan's specifics summarizing it as a fire plan, comprised of a bunch of neo-liberal measures targeted on shrinking belts and relying on the self-sufficient ability of private business to overcome the recession. Section 4 tries to answer the question – why the plan is as it is - and pays attention to the objective determinants of the plan, to the "ideologemes" which frame the economic thinking of policy makers and points out the first results and the first cracks of that plan. Finally, the paper concludes that, a radical shift away from the neoliberal economic policy seems more and more as an unavoidable decision.
JEL: B52; E32; E61; E65; E66

Stoyan Totev

EU PERIPHERY, ECONOMIC PROBLEMS AND OPPORTUNITIES – THE CASE OF BALKAN COUNTRIES

The economic analyses outlined that the big differences between the Balkan countries economic structure and the average EU one is seriously negatively affecting their economic efficiency. It appears that the Balkan region is becoming the weakest European economic area – the new European economic periphery. It is outlined that the most proper policy that will not lead to problematic economic results for the lagging Balkans countries can be the one of making benefits from their geographical location. Firstly by realising economic cooperation within Balkan countries and secondly throw participating of the Balkans as a sub-regional structure in the Black Sea economic initiatives.
JEL: O47; R11; R58

András Székely-Doby

THE EU'S EXTERNAL RELATIONS: THE CASE OF BRIC COUNTRIES WITH SPECIAL EMPHASIS ON CHINA

The BRIC countries, and especially China, have significantly increased their share in the world economy. The Chinese model, with its special approach to development, can be seen as an accelerated version of the Japanese one, which has brought enormous success in Japan, and in the Tiger economies. In the past two decades China has become the EU's most important trading partner, and their relationship is getting more and more symmetric. Although there are areas where they have different approaches, there are much more issues with common interests, and room for cooperation. For Hungary China has been a special partner for decades. After the fall of communism the ties became weaker, and Hungary practically lost almost all of its previous advantage. The EU accession, however, opened up new possibilities, and new channels for the country, to pursue its interests, and regain at least some of its privileged status.
JEL: F01; F15; F49

Iskra Christova-Balkanska

EMIGRATION AND FOREIGN DIRECT INVESTMENTS: LINKS AND IMPACT ON THE BULGARIAN ECONOMY

Object of the study are international migration and FDI, as the main phenomena of the globalization of economic relations. Another aspect is tracking the link, established in recent years, about the relationship between international migration and FDI, as a consequence of the evolution of the concept of the international movement of factors of production. In connection with these conceptual aspects, attempts were done to establish whether there are some connections between the growth of Bulgarian emigration and the formation of the Bulgarian diaspora abroad and the FDI inflows in the country. In particular, in the first section some details were given about the increase of Bulgarian emigration. In the second section some concrete conclusions have been drawn about the impact of FDI on macroeconomic development in Bulgaria. In the third section some possible links between migration and FDI were developed, arguing that some effects of "complementarities" can be established. The fourth section is devoted to the main potential benefit for the Bulgarian economy by the increase in remittances from Bulgarian emigrants to relatives remaining at home. Conclusions were made as well as on the relationship between migration and Bulgarian FDI and the effects on macroeconomic development and the prospects of evolution and the benefits of FDI and remittances like an external financial inflows.
JEL: F21; F22; F24

Csaba Weiner

FOREIGN DIRECT INVESTMENTS IN RUSSIA AND THE HUNGARIAN-BASED INVESTORS

After becoming the 5th largest FDI recipient worldwide in 2008, foreign direct investments in Russia have largely been impacted by the big crisis. To put these changes in context, this paper starts with an overview of foreign investments in Russia from the beginning. Analyzing the source countries, we argue that round-tripping and trans-shipped FDI significantly mask the real sources. In terms of the regional distribution, high concentration is stressed. Reviewing the industrial breakdown of FDI in Russia, we point out that the fuel industry, mainly the oil production, except for 1999, has had a prominent or a leadership role only since 2003. Despite the Russian natural resource base, foreign investors are now motivated mostly by market-related factors. Before the crisis Russian macroeconomic, fiscal and debt policies improved the investment climate, while the growing state control has had a negative effect. Red tape, poor infrastructure, corruption and complex tax system remained major obstacles. Until the early 2000s, government made few steps to encourage foreign investment. Amid and after the crisis it was explicitly acknowledged at the highest level that resource based Russia needs the West, the foreign investments and knowledge for its modernization. The paper finally turns to investments from Hungary. Despite the low share of Russia in outward FDI from Hungary, there are a few significant investments of Hungarian-based investors, worth to be surveyed.
JEL: G31; G32

Attila Hugyecz

STRATEGIES OF OIL AND GAS CORPORATIONS. A REVIEW OF THE LITERATURE

In our paper we seek to answer the question of what the publicly available literature says about the upstream and downstream strategies of oil and gas corporations in the first decade of the 21st century. We would like to know what energy source or technology do national and international oil companies focus on in producing hydrocarbons or replacing their

hydrocarbon reserves (conventional vs. non-conventional oil or gas, renewables, gas-to-liquid, coal-to-liquid, biofuels, deepwater drilling etc.). Our further question is how the geographic location of upstream and downstream assets changed between 2000 and 2010. In addition, we would like to know how international oil companies (IOCs) and national oil companies (NOCs) cooperate.

We found that there is quite an extensive literature on the cooperation of NOCs and IOCs, mostly focusing on future expectations and assuming that the groups of IOCs and NOCs are homogeneous. Further, although the questions raised are of crucial importance for oil companies, there is a lack of publicly available research on how individual firms compete, how and whether their focus on different energy sources changed (e.g. from oil to gas), what upstream technology they develop and how they locate their upstream and downstream assets.

JEL: Q01; Q48

Virginia Ivanova Zhelyazkova

THE FUTURE ENERGY PROJECTS OF BULGARIA – OPPORTUNITIES BEYOND FRONTIERS

Bulgaria is situated in a geopolitical crossroad. This creates opportunities that can be beneficial not only for the country, but also for the region and beyond.

One of the spheres that Bulgaria can take advantage of is the development of energy projects. This can happen in two main directions:

- By serving as energy hub for the region and by distributing natural gas brought via pipelines from Russia and the East.
- Exporting electricity produced in the upgraded production facilities as well as in the nuclear power plant in Belene at present under construction.

The role Bulgaria could play in the energy market as key transit country is due mainly to two factors:

- The geographical location at a crossroad that facilitates it being a mediator between Europe and Asia.
- The present situation on the energy market that leads the European countries to seek alternative routes as well as suppliers for vital energy resources.

Whether and how much Bulgaria is going to utilize its position is a matter of political will in the first place. The opportunities lying ahead and are ready to serve for the prosperity of the region.

JEL: Q4

Ivanka Petkova

EFFECTS OF DIFFERENT CURRENCIES AND EXCHANGE RATE REGIMES IN POST YUGOSLAV COUNTRIES DURING THE GLOBAL FINANCIAL AND ECONOMIC CRISIS

The paper examines the national currencies and their exchange rate regimes in the successor countries of the Socialist Federal Republic of Yugoslavia, which experienced a shift from an optimum currency area to a variety of national currencies. The effects of the existence of several national currencies and of sharing a single currency both unilaterally, and officially, on trade in the region are evaluated. The role of the national currencies and exchange rate regimes in regional economic links are elaborated. Channels through which the substantial instability and excess volatility, as well as the de facto euroization are influencing the banking sectors during the global financial and economic crisis are discussed.

JEL: E32; F31; F41

Irena Zareva

THE DEVELOPMENT OF EDUCATION AND SCIENCE – AN IMPORTANT WAY FOR INCREASING THE INFLUENCE OF SMALL COUNTRIES IN THE EU. THE CASE OF BULGARIA

The report concerns the issue of the significance of education and science for the socio-economic development. The accent is put on their progress as an important way for increasing the influence of small countries in the EU. The study is focused on the case of Bulgaria. Some of the most important problems in the education and science fields in the country are outlined and analysed, such as the absence of strategies for their development, the existing financial barriers, difficulties with the personnel, output and quality, etc. Possibilities for overcoming the existing problems and barriers are presented as a conclusion.
JEL: O32; O33; I2

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КЪМ ЧИТАТЕЛИТЕ И АВТОРИТЕ

Списание ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ се издава от Икономическия институт на БАН. В четири книжки годишно се публикуват резултати от научни изследвания, посветени на важни и интересни съвременни икономически проблеми. Списанието публикува и студии на английски език. Всички студии се рецензират анонимно от двама рецензенти.

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