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Foreign Investment Flows in Bulgaria and Participation in Global Value Chains

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Foreign investment flows play a significant role in the economic and political transformation of countries with a low level of economic development. Investments in transition economies in Central and Eastern Europe have helped create a functioning market economy and open them up to the global economy. Their presence in the Bulgarian economy is an important factor in the process of accession to the European Union (EU), changing the production structure in accordance with the requirements of the Single Market. At the same time, foreign direct investment has contributed to the inclusion of national production potential in global value chains (GVC). The creation of global value chains in practice makes the transition from product to vertical specialization in international trade. As a consequence, it moves to a functional division of the development of the new product, its production and sale.

Foreign direct investment has influenced the structure of foreign trade by orienting it to European global value chains with the potential to involve neighboring countries in the production process. Bulgaria's exports and imports are concentrated in EU countries, defining the country's foreign economic orientation. Therefore, the inflows and outflows of foreign direct investment provide an opportunity to assess the relationship of foreign financial flows with the processes of building a new economic structure of the country.

Investment Flows and Bulgaria's Accession to the European Union Bulgaria's accession to the EU has led to a significant reorientation of economic activity by former partners from Central and Eastern Europe to the Union's Single Market. The process involved adapting to the requirements of market regulations and reaching the standards that allow trade with member states. In addition, changes in the EU have affected the investment process by increasing regional competition to attract foreign direct investment. In this process, Bulgaria was ahead of the other countries in the region and had to adapt its economic structure to the conditions of the enlarged EU. For this reason, investment inflows intensified after the completion of the accession negotiations in 2004, reaching their peak with the country's full membership on 1 January 2007 (Fig. 1).

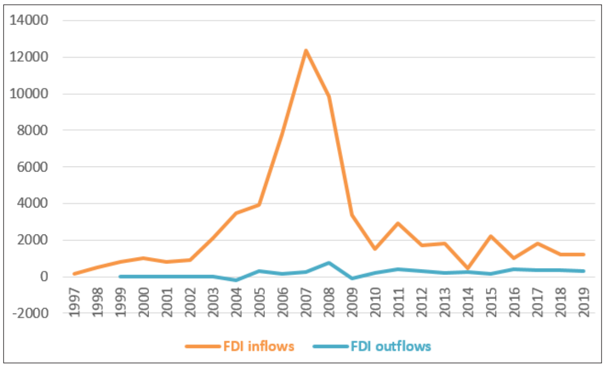

Figure 1: FDI inflows and outflows in Bulgaria

UNCTAD, World Investment Report, WIR/2020, and for the respective years. (Millions of dollars)

The data show a significant direction of flows of foreign direct investment, both in terms of the development of the integration process and the entry of European companies into the Bulgarian economy. This process was interrupted by the global financial crisis, which significantly reduced the investment flow in the country. The development of the sovereign debt crisis in the EU has significantly reduced investments in the Bulgarian economy and orients economic activity towards the restructuring of foreign economic relations.

The dynamics of Bulgaria's foreign trade (Fig. 2) is determined by the change in international specialization under the influence of competitive pressure on the Single Market and the concentration in certain functions. A factor for this is the inclusion in the European global value chains at certain stages of their activity. The period after accession is characterized by a growing EU presence in Bulgaria's exports and imports, which is already associated with changes in trade structure and international specialization. The global crisis of 2008 affected trade with the EU to a lesser extent and trade volumes recovered relatively quickly, while the upward trend continued. For the period considered, imports exceeded exports, as in general trade. In addition, there is a steady presence of foreign direct investment in non-financial enterprises engaged in foreign trade.

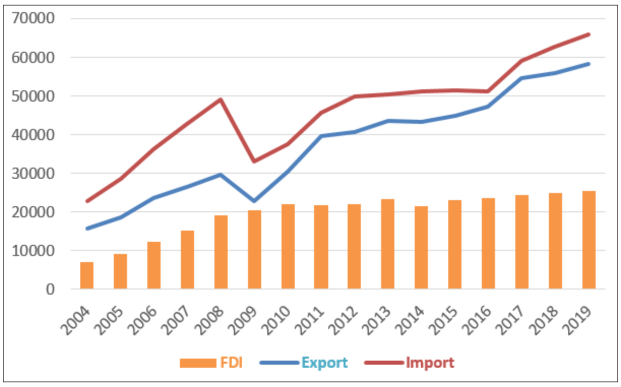

Figure 2: Bulgaria's Foreign Trade and Foreign Direct Investment

National Statistical Institute. INFOSTAT. Statistical yearbook for the respective years.

Bulgaria's trade flows are a response to the competitive pressure of the Single Market and the need to maintain the positions of the previous specialization as participation in trade in goods for further processing compensates for the limited opportunities for the sale of finished products. A significant factor in this process is the low investment activity in improving the technological condition and the need to specialize in stages of production. On the positive side, such fragmentation of the specialization with a focus on more products, but related to global chains, makes it possible to consolidate within established industry structures. In practice, global value chains spill over from one industry to another in order to optimize production links and suppliers of intermediate goods and use.

Regional economic integration helps to overcome trade constraints and widens the access of global value chains to national resources and markets. In practice, GVCs support the creation of regional integration alliances, which stimulates the liberalization of international trade and makes it dependent on the strategy of multinational corporations.

Current regulations in world trade are affected by changes in the production and economic structure of international relations. However, the current regulatory framework for world trade is inconsistent with changes in trade flows, which, along with goods, include investment, know-how, qualifications and other factors of production [1]. The development of this type of trade flows is due to the growing internationalization of production and the construction of international production structures, defined as global value chains. The participation of Bulgarian companies in European global value chains determines the changes in their international production specialization, the preservation and expansion of their foreign economic activity.

Investment Flows as a Function of Participation in Global Value Chains

The development of production and trade relations determine the search for an adequate theoretical approach to the impact of changes in the organization and efficiency of the production process on modern international trade. This is due to the processes of technology development, which allow the division of production and its integration into global value chains [2]. Changes in production models are the result of different forms of combination of production factors.

The current stage, known as Industry 4.0 is related to the introduction of information and communication technologies and digitalization of the process of production and sale of products. The contemporary industrial revolution is changing the functioning of global value chains both in terms of production and the interaction between individual actors. The "Supply Chain 4.0" model used in the current conditions transforms the chain management system into a linear type, in which the activities are carried out in sequence from supplier to manufacturer and distributor to consumer, and vice versa, to a more integrated model.

Following the global financial crisis, GVC growth declined and traditional trade in products created in one country and sold in another regained its position. The nature of the technologies used in the products plays a key role in determining the governance structure of GVC and the benefits of participating countries. The implementation of these technologies is carried out mainly by companies that are leaders in the management of the global value chain in developed countries.

At the same time, the division of the production of modules and their positioning in underdeveloped countries leads to a high degree of standardization through the separation of modules with extended functional autonomy. This reduces the costs of research and innovation and increases the opportunities for companies in the country to participate mainly through capital-intensive industries in GVC. At the same time, digital technologies are expanding the opportunities for small and medium-sized enterprises to be present in international markets.

Increasing the size and mobility of investment financial flows allows participants to transfer assets, costs, profits and liabilities across borders. Thus, financial flows overcome territorially fixed fiscal systems, which in practice divide the place of value creation and the geographical distribution of profits. Therefore, the possibility of locating production activities in different countries and their participation in the chains is related to the production positions. They are determined by the specifics of the product and the place in its realization. This determines the international specialization of the national economy and its competitiveness.

The fragmentation of production on an international scale determines the vertical specialization in trade. It takes into account the share of value added in the country and the value transferred from imports. This share is different for the individual industrial sectors - with the largest percentage in the exporting industries, but it must also take into account domestic industries involved in the successive phases of production (upstream). For Bulgaria, this is related to the estimates of the different share of exports and imports in individual industries, which in practice determines their dependence on trade flows. It is especially evident in the increase of imports in the sector "Mining and quarrying" (B) of the Bulgarian economy. The "Manufacturing" (C) sector provides the bulk of Bulgaria's exports and is also highly dependent on imports. Trade flows increasingly consist of intermediate goods, and information technologies and services increase the geographical mobility of a number of elements of economic activity and create preconditions for the development of new forms of international specialization.

The increase in trade in intermediate goods shows the improved degree of internationalization of production. This increases the share of value produced in other countries in the final product, which in turn reduces the share of domestic value added in exports. These processes are observed mainly in small open economies and determine the foreign trade dependence of national production [3].

Bulgaria's accession to the EU Single Market is related to the restructuring of the national foreign trade structure as the product specialization is assessed by the concentration of exports and imports in certain commodity groups. Such adaptability is associated with the presence of global value chains and the possibility of embedding certain sectors in their production sequence.

An important factor in stimulating restructuring processes is foreign direct investment in the industrial sector. The changes in it, related to the participation in the global value chains and significantly determine the domestic investment costs, compensated by the increase of FDI. Given their significant presence in foreign trade, our attention is focused on the sectors "Mining and quarrying" (B) and "Manufacturing" (C). Along with them, we pay attention to the services, especially the sector "Wholesale and retail trade, repair of motor vehicles and motorcycles" (G), which is directly related to the participation in GVC in the field of trade and service.

Investment activity in the "Mining and quarrying" sector (Fig. 3) shows a clear link with these processes - the decline in the share of imports is related to the reduction of domestic investment expenditures, but there is a steady inflow of FDI related to imports in the sector and the increase the transferred value in exports, which leads to a slight increase in its relative share in the national dimension.

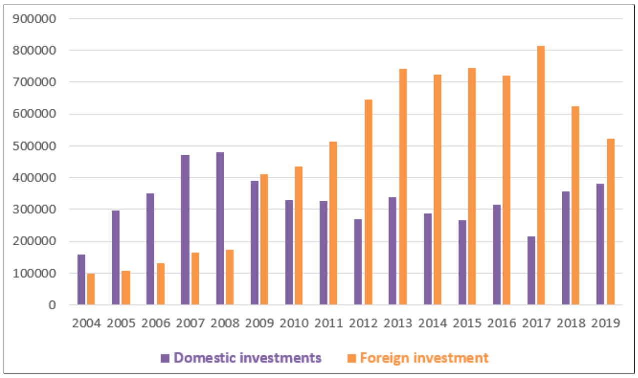

Figure 3: Domestic Investment and Foreign Investment In Mining And Quarrying

National Statistical Institute. INFOSTAT. Statistical yearbook for the respective years.

The investment activity in the „Manufacturing"sector (Fig. 4) illustrates both the connection with the European global value chains and the change in both sources. In the expenses for domestic investment there is an increase in the volumes in the period of preparation and the first years of EU membership. The change comes with the accession to the Single Market with a reduction in this funding in view of the restructuring in the sector, which is related to both the crisis and the connection with the European production structures. After 2011 there is a certain increase, which is associated with the significant presence of foreign direct investment, which is a result of this development in the sector.

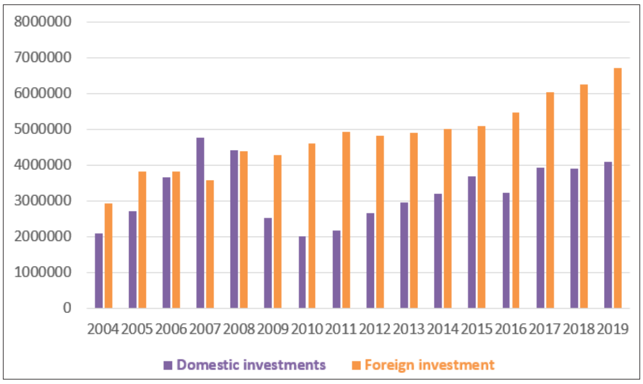

Figure 4: Domestic Investment and Foreign Investment in Manufacturing

National Statistical Institute. INFOSTAT. Statistical yearbook for the respective years.

The services sector with foreign trade has a significant presence in GDP from those considered so far, but with a modest presence in foreign economic activity. Therefore, it shows different trends in the investment process in the post-crisis years.

The most important is the presence of the sector "Wholesale and retail trade, repair of motor vehicles and motorcycles" (G), which occupies a stable position in exports and imports. This is due to the significant investment activity in FDI. In the sector it can be noted that after the country's accession to the EU the national costs for acquisition of fixed assets decrease, compensated by a significant presence of FDI (Fig. 5). This can be seen as a direct result of the crisis and the expansion of participation in global value chains.

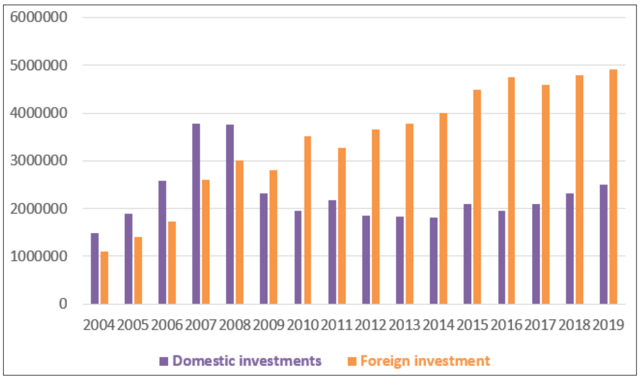

Figure 5: Domestic Investment and Foreign Investment in Wholesale and Retail Trade, Repair Of Motor Vehicles and Motorcycles

National Statistical Institute. INFOSTAT. Statistical yearbook for the respective years.

The importance of the services with foreign economic activity is conditioned by the fact that they support the export and import, which is indicative of the investment interest. FDI is growing especially in the Wholesale and retail trade, repair of motor vehicles and motorcycles, even in the context of declining national investment. This shows the adaptation of the services sector to the inclusion of national industries and sectors to global value chains. With a relatively stable national structure, these sectors will determine the directions of trade flows and opportunities for participation in international production processes.

The assessment of the impact of GVC on the industry structure can be made from the point of view of the product composition of trade flows. Bulgaria's exports report an increase in the share of Intermediate goods, which have the greatest sensitivity to the international situation and cover over 50% of the commodity structure of exports. Imports illustrate the significant connection of the national economy with GVC, which can be seen from the predominant nature of intermediate goods, which are linked to exports and account for about 60% of imports (Fig. 6). This increases the geographical concentration and regional affiliation of the Bulgarian economy and determines the need to direct the foreign economic orientation of the country to dynamic regional markets.

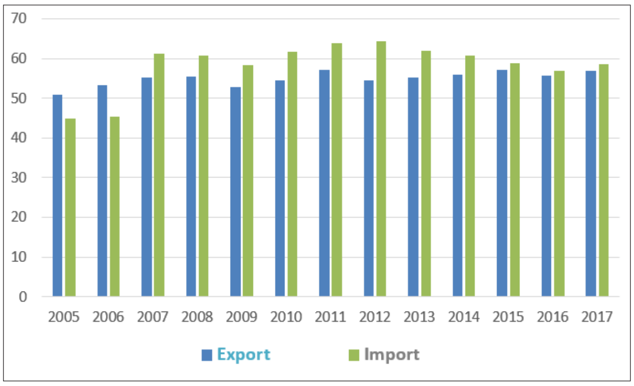

Figure 6: Relative Share of Exports and Imports of Intermediate Goods

OECD.stat Export. Dataset: Bilateral Trade in Goods by Industry and End-use (BTDIxE), ISIC Rev.4.

The structure of imports (Fig. 6) illustrates the significant connection of the national economy with GVC. This can be seen from the predominant share of intermediate goods, which are tied to exports and account for about 60% of imports. The sharp increase in intermediate goods and the decrease in other goods is related to the country's accession to the EU and is indicative of the impact of the Single Market on the national production structure.

The presented tendencies confirm the strong interconnection of the branches in the Bulgarian economy with the European global value chains, especially in the line of trade in intermediate goods. The group of goods with mixed-end final consumption mitigates the negative external influences and gives a sustainable character to the trade flows. This increases the regional affiliation of the Bulgarian economy and determines the need for foreign economic reorientation of the country to dynamic markets in regions outside the continent.

The leading foreign trade industries in Bulgaria show a high industry commitment to industries dominated by value chains such as automotive, metals and textiles. It is noticed that the exchange of goods with the leading trading partners takes place in the same commodity groups, which shows the different functional connection in the upstream and downstream. In the automotive industry, Bulgaria specializes in the low stages of production in the upstream flow - production of parts and components, as well as in the last positions of the downstream - sales and service. These stages are associated with a low share of value added in the goods produced at these stages, including the export of these products.

Within the framework of the presented tendencies in the trade of Bulgaria it can be seen that the connection with the main trade partners from the EU in practice determines the international specialization of a number of sectors of the national economy. This raises the question of the national policy to increase the country's competitive position. If the current model of specialization in the lower stages of the functional chain is followed, the quality required by the next stage of production is achieved - respectively the external partner. This determines the desire to attract activities and investments from the subsequent stages, which in most cases depends on external factors, rather than on the offered competitive advantages.

Foreign direct investment is a determining factor in Bulgaria's broad participation in European global value chains. GVC largely determine the changes in the national sectoral structure and the nature of the foreign economic activity of the economy. The most significant result of this participation is the serious increase in the exchange of raw materials and goods for further processing. Participation in GVC is defined mainly by the manufacturing industry, whose growing presence plays an important role in foreign trade. The services related to the foreign economic activity do not occupy a significant place in the foreign trade of Bulgaria despite the positive tendencies after the accession to the Single Market.

FDI is a prerequisite for the inclusion of Bulgaria in the international production and economic structures will become a prerequisite for building regional production systems as part of global value chains. This determines the need to develop a targeted foreign economic strategy that combines the attraction of foreign investment with the expansion of the country's presence in other regions and countries [4-7].

Building a successful model of international specialization could include both components of industrial policy in the context of Industry 4.0 (reindustrialization) and the development of foreign trade policy, which extends the benefits of the already established specialization. It is essential in this process to accelerate the investment process and partnerships resulting from changes in global value chains. In the conditions of membership in an integration structure, more active participation in the Single Market is needed to expand the benefits of market regulations, thus redirecting investment resources to innovation processes to develop successful forms of international specialization.

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