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**MNCs IN CENTRAL AND EASTERN EUROPE – A CHALLENGE OF  
DEVELOPMENT AND SUSTAINABLE GROWTH  
(THE BULGARIAN CASE)**

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After nearly a decade of profound economic changes and a market transformation, the countries in Central and Eastern Europe now face the challenge of development and sustainable growth. The development priorities include achieving a high income growth for their economies by raising investment rates, strengthening technological capacities and skills, improving the competitiveness of their exports, creating more employment opportunities.

An important factor for reaching these goals is the world economic environment and the main economic participants in it as for most of the transition countries (the smaller ones, in particular) the exogenous impetus turns to be the main determinants for the success of the reforms. The reason behind it is the full exhaustion of the national resources (natural, human, capital, financial) in the old “socialist” model and the great economic gap which has existed between the region and the rest of the economic world.

The purpose of this paper is to analyse the importance of MNCs activities in Central and Eastern Europe for Marketization of the region and for its effective integration in the globalizing world economy. The authors argue the necessity for more effective actions and policies implementation from government’s side to attract strategic investors. The last section deals with the results of an empirical study of MNCs transaction costs activities in Bulgaria and the critical issues relating to the establishment of a better investment climate in the country.

## **The MNCs Activities at the End of 90's and Their Impact in Central and Eastern Europe**

As a phenomenon of the 50's, the contemporary MNCs are now world main economic actors, accumulating an enormous economic power and setting up the rules of the world market game. Their activities have revolutionized the international economic relations after the World War II within which FDI and international production have become the core. At the end of the 90's MNCs which comprise over 500 000 foreign affiliates established by some 60 000 parent companies are the main channel through which the flow of goods and services, financial assets, technologies and market management and skills is carried out.

Central and Eastern Europe is a new challenge for economic invasion of MNCs. Overall FDI inflows to the countries of Central and Eastern Europe (CEE) are still relatively small in 1998, registering to about \$18 billion. The region is catching up with the rest of the world as evidenced in the growth rates of FDI inflows in 1993-98: over the period the inflows increased faster (28,6 per cent per year) than those of the developing world (23 per cent), the developed countries (16 per cent), and the world as a whole (19 per cent).

FDI inflows remained unevenly concentrated in a few countries. Five countries Poland, Czech Republic, Romania, Hungary and the Russian Federation accounted for 74 per cent of the total FDI flows into the region.

Compared with the size of domestic economies, and the level of domestic investment, FDI inflows play a significant role in at least half of Central and Eastern European countries. In 1995-97, the ratio of FDI to gross fixed capital formation exceeded 40 per cent in Latvia, 30 per cent in Hungary, and 15 per cent in Estonia, Poland and Bulgaria. The average of this ratio for the region as a whole (9 per cent) compares well with those of other regions; it is slightly higher than the average of developing countries and significantly higher than the world average.

The new, more competitive environment of liberalizing and globalizing world economy in which the CEE countries now work imposes considerable pressures on

them to upgrade their resources and capabilities. This new global context is characterized by rapid advances in knowledge, shrinking economic space, and changes in competitive conditions. FDI and international production of MNCs can play an important role in complementing the efforts of national firms and governments in this respect. Influenced greatly by the new international environment MNCs are changing their ownership advantages – rapid innovation and deployment of new technologies in line with logistic and market demands are more important than before.

A striking feature of these is how MNCs shift their portfolios of mobile assets across the globe to find the best match with the immobile assets of different locations. They also shift some corporate functions to different locations within internationally targeted production and marketing systems. While a large domestic market is still a powerful incentive for foreign investors MNCs increasingly look for world class infrastructure, skilled and productive labor, innovatory capacities and a concentration of efficient suppliers, competitors, support institutions and services. Low-cost labor remains a source of competitive advantage but its importance is diminishing, moreover it does not provide a base for sustainable growth since rising incomes erode the edge it provides. The same applies to natural resources.

FDI made by the MNCs comprise a package of resources and they are not just a channel for obtaining access to production factors. The attributes of MNCs are numerable and difficult to separate and quantify. FDI contain a bundle of assets, some proprietary to investor – technology, brand names, specialized skills etc. and others not – finance, capital goods intermediate inputs and the like that can be obtained from the market. Taken together, these advantages can contribute significantly to economic development in the host CEE countries.

Some of the countries in the region (Bulgaria is one of them) may not be able to attract FDI in the volume and quality that they desire for one of the following reasons:

*High transaction costs.* – While most FDI regimes are converging on a similar set of rules and incentives, there remain large differences in how these rules are

implemented. The FDI approval process can take several times longer, or entail costs many times greater in one country than in the other with similar policies. After approval, the costs of setting up facilities, operating them, importing and exporting goods, paying taxes and generally dealing with authorities can differ enormously. An important part of competitiveness strategy thus consists of reducing unnecessary, distorting and wasteful business costs, including among others administrative and bureaucratic costs, and corruption.

*Market failures in information.* – MNCs face market failures in information. Information provision is not the same as giving financial or fiscal incentives. In general, incentives play a relatively minor role in a good promotion program, and good long-term investors are not the ones most susceptible to short-term inducements.

It is interesting from this perspective to analyze the investment climate regarding the above mentioned critical issues and their interpretation in the opinion of the existing MNCs in Bulgarian economy.

### **Bulgaria as a Host Country for MNCs – Some Results and Some Lessons**

At the beginning of the market reforms (1991) Bulgaria had modest investments in the West estimated to about \$55 millions which however, had been distributed to 96 different countries. Most of the were in commercial - \$22 millions, finance - \$12 millions, manufacturing - \$16 millions. In the next years most of the investments were wiped out and the outflows in 1995 was only \$8 million, in 1996 - \$29 million, and in 1997 only \$2 million. The seven different political governments did nothing to promote the native business abroad, and especially to support and encourage the big corporate business which was considered a threat to the political status quo in the country.

Not better is the situation with FDI inflows. Bulgaria ranks 4<sup>th</sup> from the bottom among the CEE countries with its low and rather cyclical rate of FDI inflows which is only 2.5 per cent of the GDP. In absolute terms the average sum for the period 1987-92 is \$34 millions which in 1994 raised to \$105 millions, decreased in 1995 to \$90

millions and then augmented again in 1996 - \$109 millions, \$505 millions in 1997 and \$401 millions in 1998. The geographical distribution is uneven too. More than half of the inflows came from the EU – 63 per cent of all FDI of which Belgium, the Netherlands and Germany had the greatest share. Second rank the USA and Cyprus with 7 per cent each, CEE countries with 4 per cent, among them Russian Federation with half of it.

The structure of the investments shows fragmentation and absence of strategic investors. According to a data base of the Foreign Investment Agency there are only 51 big firms with more than one million US dollars invested in the country and with at least two foreign affiliates.

A survey was undertaken during the period January 15 – February 15, 2 000 including 46 of these firms. Having in mind the main determinants of FDI, suggested in the early and more contemporary field studies on MNCs<sup>1</sup>, the Survey focused on the **cost factor** investigation, introducing the concept of **transactional costs** as a dominant one. The reason behind this idea is the hypothesis that was checked in that Bulgarian market is an “expensive” market in Coase’ s theoretical sense so the high transaction costs make FDI in the country undesirable by the big MNCs.

A questionnaire was made which comprises 52 different questions and which was structured in a way to give some evidence about the cost of doing big business in the country.

The Survey included firms from different country origin – 9 American, 5 German, 4 Turkish, 4 Dutch, 3 Belgian, 3 Greek, 3 Austrian, 3 Cypriot, 3 British, two from South Korea, France, and Sweden, and one from Ireland, Denmark and Switzerland – total of 46 MNCs.

Most of MNCs are symmetrically distributed in light industry and services – consumer goods, drinks, tobacco, and trade - 22.7% Relatively high is the percentage

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<sup>1</sup> There are a lot of surveys done by different researchers on MNCs which are selected in different groups according to the factor they are stressing on. Most important are: **Market Factors Surveys** – where are investigated such determinants as: size of market, market growth, exports base for neighbouring markets etc; **Barriers to Trade** , **Cost Factors** – source of supply, availability to labour, raw materials, capital, technology, financial inducement, **Investment Climate** – political stability, limitation on ownership, currency exchange regulation, tax structure etc. ( see John Dunning’s book “MNCs in a Global Economy” 1996)

of the firms which invested in paper production and publishing – 9.1%, black and ferrous metals – 6.8%, hotels and restaurants – 6.8% and communication – 6.5%.

30 per cent of the total number of the investigated MNCs invested up to two million dollars, 34 per cent – more than \$10 million and another 36 per cent – between \$10 and \$44.5 millions. The major part of the firms – 90% have made direct investments, 7 per cent – have delegated licensing rights, and only 2.3 per cent have own trade affiliates. In most of the cases the direct investments are results of privatization in the Bulgarian economy.

The main results of the Survey can be summarized as following:

1. Nearly half of the firms confirm the market information is available to them (56.5%) while another half (43.5%) think there is no access to it. Some 90 per cent agree the information about Bulgarian markets is a strategic advantage to them. The prevailing opinion – 80.4 per cent is that the establishment of trade contracts in Bulgaria is relatively easy. The time factor, however, is also important. Half of the firms (56.5%) need six months to find a trade partner, while for 34.8 per cent of the firms one month is just enough. Only 8.7 per cent spend nearly a year but none has to wait more than a year. Negotiating terms of trade is another focus on the Survey. Some 56.5 per cent do it easily but the rest – 43.5 per cent have considerable problems. For most (68.4 %) the problems arise from misunderstanding of the market principles from the side of the Bulgarian partners, negotiating incapability's – 44.7 per cent, and contradictory business interests – 34 per cent. The language barriers is mentioned to a problem by 23.7 per cent.

2. The annual costs for providing the information is rather high according to the Bulgarian standards. Some 17.4 per cent of the firms spend more than \$20 000. The same percentage of the firms give between \$10 000 and \$20 000 while 59 per cent pay less than \$10 000. Most of the money goes to consultant services – 30 per cent of all costs, and among them – 70 per cent are costs for lawyers. The MNCs prefer to negotiate “face to face” – 91 per cent and only 8.7 per cent – through fax but none of them – through telephone. It is obvious that the lack of business trust and the

irregularities of the transactions make the foreign partners rely on less risky behaviour.

3. Business ethics and trust are important factors for evaluating the level of the transaction costs on the Bulgarian markets. Nearly half of the firms (54.3%) deny the existence of business ethics and trust. Despite the lack of trust the infringement of the treaty is a rather seldom phenomenon – only 26 per cent of the respondents declare it. This speaks of relatively low transaction costs **ex poste** and not very high level of opportunistic behaviour. However, opportunism still exist and it appears more often on the side of the Bulgarian partners than on the side of the foreign ones. 74 per cent of the investigated firms think the infringement of the treaties come from the side of the Bulgarian partners. That is why most of the MNCs prefer to substitute Bulgarian partners to foreign when it is possible.

In the context of the transaction costs the illegal payments made for doing business, enter a market or conclude a contract are also a component. The corruption is an important element of the business environment. Question 39 “Did you ever pay to government officials or other man in power?” deals with this critical issue in the Bulgarian economy. The answer is positive to 21.4 per cent of the respondents who have paid for solving legal or contract disputes. Another 25 per cent have made different payments for their normal business activity. Nearly 25 per cent of the firms have not answer this question. A conclusion can be made that the corruption is a well spread phenomenon in Bulgaria which increases the transaction costs of doing business in the country.

4. Several questions treat the issue of how often foreign MNCs have to apply to different jurisdictional institutions in connection with unfulfilled contracts. Less than half (43.5% ) confirm they have often problems of such matters, while 56.5 per cent answer negatively on these questions. The reason may lies in the fact that in most of the cases the partners are reliable in their duties but another explanation may be the ineffectiveness of the legal system in the country and the opportunities for seeking other methods for settlement of such disputes. The losses MNCs endure from unfulfilled contracts for nearly 90 per cent of them are less than \$50 000 and for the



rest 10 per cent – more than \$100 000. Twelve out of 46 firms have brought the case to the court once, 5 firms –twice, 4 firms – 3 times, and another four firms – more than three times. 42 per cent of the MNCs never do it. The duration of the court cases for 60 per cent of the firms last between 6 months to one year, for 17 per cent it is less than six months, and for 23 per cent it is more than one year. The empirical data does not show any symptoms of an inefficient and bureaucratic legal system as six months is the average period for solving cases like that.

The overall opinion of the high level of the transaction costs of doing business in Bulgaria is supported by 90 per cent of the respondents of the Survey. The foreign firms confront a considerable risk in doing market transactions and face extremely high level of uncertainty which is in full accordance with our initial hypothesis. To some extent the uncertainty is the result of slight knowledge of the local conditions and the significant difference in the surrounding business environment. Some 80.4 per cent of the firms think business environment in Bulgaria is much more different in comparison with the one in their native country.

5. The communications and the infrastructure is another issue which has a close connection to the level of the transaction costs. Only one third of the MNCs consider the quality of communications satisfactory and 8.7 per cent express the same opinion for the existing infrastructure. A definite conclusion can be made that as a whole the active MNCs in the country face a wide range of obstacles (economic, legal, political, cultural and socio-identical) which hinder to a great extent their future development strategy. The prevailing recommendation is for more openness and transparency in contract procedures, strictly adhering to the norms of Competition Law and Anti-trust policy. Another suggestion is to watch closely and monitor corruption cases in the regional courts. The MNCs expect government to be more active in establishing the legal framework of market mechanisms, and the control of underground economy. Better financing, communications, broader availability of market information, better infrastructure is also suggested.

### **Some Concluding Remarks**

The analysis of the MNCs activities in the Central and Eastern European countries and their impact on the development of this transforming region during the last decade has shown that MNCs can be looked upon as a decisive factor for providing a full package of business services including investments, technological innovation, marketing power and know how in management and organizational behaviour.

The attraction of these firms in each country is not just a matter of giving preferences but rather more a question of providing a normal market environment whose competitiveness, openness and transparency are sufficient enough characteristics for making MNCs interested in investment and doing business.

For a number of reasons ( more of them non economic) Bulgaria is one of the CEE countries in which the MNCs activities is not expanding the way the government see it as the transaction costs of doing business are very high and the foreign investors face many obstacles of legal, cultural and ethical nature. The policy implication in this sense should be focused more on enhancing the existing legislation and what is even more important to its faster and more efficient implementation. Another big issue is the corruption of the government bureaucracy and the heavy liscencing regime in country. Although in the last two months more than 140 restrictions have been abolished the current policy of the government is too restricted and burdened with a lot of bureaucracy. After ten years of economic market reforms in the country the lack of factor markets and the quasi character of a large number of product markets do not ease the creation of an adequate market culture and economic rationalism of the Bulgarian nation. The strong monopoly power of several state firms (electricity, communications, tobacco) do not allow a market entry and foreign competition in these industries. Privatization is not accomplished too. Some of the biggest and the most attractive firms are not sold yet, which further impede the structural adjustments in the economy.

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