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## **“MNCs and their Role in the Economies of CEE”**

### **(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, and improving the competitiveness of their exports, distributing the benefits of growth equitably by creating more and better employment opportunities.

An important factor for reaching these goals is not only the input and national endowments of the country but also 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 determinant for the success of the reforms. The reason behind it is the full exhaustion of the ineffective usage of the national resources (natural, human, capital, financial) in the old “socialist” model and the great economic and technology gap which has existed between the region and the rest of the developed economic world.

The purpose of the paper is to reveal the importance of MNCs activities in Central and Eastern Europe for marketization of the region and for effective integration in the globalizing world economy. The different aspects of MNCs’ impact on Bulgarian economy are examined with respect to their new comparative advantages. The main determinants of the investment climate in the country are also studied and the special accent is put on commenting the results of an empirical study of MNCs transaction costs activities in Bulgaria and the critical issues concerning a

better investment climate in the country. The last section of the paper deals with some conclusions and recommendations for more effective governmental policies towards MNCs as they are looked as “economic locomotives” of Bulgarian economy’s sustainable growth.

### **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 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. Among them the world’s 100 largest non-financial MNCs together held \$1,8 trillion in foreign assets, sold products worth \$ 2,1 trillion abroad and employed some six million persons in their foreign affiliates in 1998. They accounted for an estimated 15 per cent of the foreign assets of all MNCs and 22 per cent of their sales.

In 1998 the largest ten home countries generated four fifth of the global FDI of which \$ 460 billion inflows and \$ 595 billion outflows. International production of MNCs has different dimensions and it involves a package of tangible and intangible assets. On the production side , the value of the output amounts to about 25 per cent of the global output, one third of it in host countries. Foreign affiliate sales in domestic and international markets were about \$ 11 trillion in 1998, compared to almost \$ 7 trillion of world exports. Technology flow play also an important role in international production. FDI is increasingly geared to technology-intensive activities and technological assets are becoming more important for MNCs to maintain and

enhance their competitiveness. In this sense innovation and R & D are at the heart of the ownership advantages that propel firms to engage in international production. International trade is thus stimulated by international production because of the trading activities of MNCs. Trade within MNCs is estimated, for about two thirds of the world trade, and intra-firm trade, alone, one third.

Central and Eastern Europe 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). And this catching up may be even faster than data suggest because inflows into the region are often under-reported. (Table 1)

Table 1. FDI Inflows by Host Region and Economy.

(millions of dollars)

Host region/economy	'87-'92	1993	1994	1995	1996	1997	1998
Central and Eastern Europe	1576	6757	5932	14266	12406	18532	17513
Albania	-	68	53	70	90	48	45
Belarus	-	18	11	15	73	200	144
Bulgaria	34	40	105	90	109	505	401
Czech Republic	533	653	868	2561	1429	1301	2540
Estonia	-	162	214	201	151	267	581
Hungary	675	2339	1146	4453	1983	2085	1935
Latvia	-	45	214	180	382	521	274
Lithuania	-	30	31	73	152	355	926
Republic of Moldova	-	14	28	67	24	72	85
Poland	183	1715	1875	3659	4498	4908	5129
Romania	61	94	342	420	265	1229	2063
Russian federation	-	1211	640	2016	2479	6243	2183
Slovakia	91	168	245	195	251	177	466
Ukraine	-	200	159	267	521	624	743

Source: UNCTAD, FDI/TNC database

FDI inflows, however, 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. In Poland, by far the top recipient if measured on the basis of total inflows, the growth of FDI was relatively moderate (5 per cent); however, FDI commitments to this country

increasing by more than 50 per cent in 1998 indicate that the upward trend may be maintained in the near future. Despite of the negative GDP growth, the Czech Republic and Romania saw a significant increase of FDI inflows. The reasons were privatization programs, some of which included large companies and banks.

In seven other Central and Eastern European countries – Croatia, Estonia, Lithuania, Macedonia, Republic of Moldova, Slovakia, Ukraine, FDI also increased. In the other countries in the region, FDI inflows remained unchanged, or registered minor decreases.

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 inward FDI stock reached about \$90 billion in 1998, and is expected to exceed \$100 billion in 1999. It is also concentrated in four countries – Poland, Czech Republic, Hungary, and the Russian Federation, which together account for three-quarters of the region's stock

Table 2. FDI inward stock by host region and economy

(millions of dollars)

Host region/economy	1980	1985	1990	1995	1997	1998
<b>Central and Eastern Europe</b>	-	-	<b>2959</b>	<b>3797</b>	<b>68613</b>	<b>83348</b>
Albania	-	-	-	211	349	394
Belarus	-	-	-	50	322	466
Bulgaria	-	-	4	337	951	1352
Czech Republic	-	-	1360	7352	9234	13457
Estonia	-	-	70	731	1148	1822
Hungary	-	-	569	11919	15882	18255
Latvia	-	-	-	616	1272	1488
Lithuania	-	-	-	352	1041	1625
Republic of Moldova	-	-	-	92	180	265
Poland	-	-	109	7843	16593	21722
Romania	-	-	766	1150	3617	4250
Russian Federation	-	-	-	5465	14365	13389

Slovakia	-	-	81	950	1597	2062
Ukraine	-	-	-	910	2064	2801

*Source:* UNCTAD, FDI/TNC database

The inward FDI stock of CEE countries is dominated by investors from the European Union, whose share accounted for almost two-thirds of the total in 1998. Next in line were investors from the United States, with 15 per cent. A sectoral breakdown of inward stock indicates that the primary sector is not very significant, except in Belarus and, to a lesser extent, in the Russian Federation. The secondary and the tertiary sectors are quite similar in terms of importance: manufacturing is the lead sector in six countries – Bulgaria, Croatia, Czech Republic, Poland, Romania and Ukraine, although in three of them – Czech Republic, Poland and Ukraine it is closely followed by the services sector. Services are dominant in nine countries – Bosnia, Estonia, Hungary, Latvia, Lithuania, Republic of Moldova, Russian Federation, Slovakia and Slovenia.

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 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. The experience in Ireland, Singapore and more recently in Costa Rica – suggest that promotion and targeting can be effective in raising the inflow of investment and its quality. Effective promotion should go beyond simply “marketing a country”, into

coordinating the supply of a country's immobile assets with the specific needs of targeted investors.

However, the objectives of MNCs often differ from those of the host governments and national firms: governments seek to spur national development, while MNCs look for enhancing their own competitiveness in an international context.

Crowding out effect on the domestic firms is inevitable and is an issue of concern. It can occur in two ways: in product markets, by adversely affecting learning and growth by local firms in competing activities; second, in financial and other factor markets, by reducing the availability of finance or other factors, or raising for local firms or both. The first issue reflects "infant industry" considerations but without the usual connotation of protecting new activities against import competition.

Crowding out can impose a long-term cost on the host economy, if it holds back the development of domestic capabilities or retards the growth of a local innovative base. This can make technological development dependent on decisions taken by MNCs. However, it is important to distinguish between affiliates crowding out potentially efficient domestic firms and affiliates out-competing inefficient local enterprises that can not achieve full competitiveness. One of the FDI benefits can be the injection of new technologies and competition that leads to the exit of inefficient firms.

MNCs can also crowd-in local firms if they strike up strong linkages with domestic suppliers, subcontractors and institutions. Crowding-in take place when foreign entry increases business opportunities and local linkages, raises investible resources or makes factor markets more efficient. Such effects are most likely when FDI concentrates in industries that are underdeveloped. Where local firms are well developed, but still face difficulties in competing with foreign affiliates, there can be harmful crowding-out.

A second variety of crowding-out reflects an uneven playing field for domestic firms because of a segmentation in local factor markets. MNCs can raise entry costs or simply deprive local firms of the best factor markets.



Similar considerations apply to mergers and acquisitions (M & As) of local firms by MNCs, including privatization by sale of state enterprises to foreign investors, a common form of foreign entry into Central and Eastern Europe. Some M & As that entail a simple change of ownership akin to portfolio investment can be of lesser developmental value. There may also be adverse effects on local innovatory capacity and competitiveness in trade as well as on employment. M & As can also have anti-competitive effects if they reduce substantially the number of competitors in a domestic market, especially for non-tradable products such as most services. But if the investor makes a long-term commitment to the acquired firm and invests in upgrading and restructuring its technology and management, the impact is very similar to a green field investment.

FDI related to M & As can play an important role in modernizing privatized utilities such as telecommunications, and public utilities. Foreign acquisition can prevent viable assets of local firms from being wiped out, This is particularly important in economies in transition.

FDI affect market structure of the host countries as well. Entry of large MNCs raises concentration levels within an economy and can lead to the abuse of market power.

MNCs can be efficient vehicles for the transfer of technologies and skills suited to existing factor endowments in host economies. They provide technology at very different levels of scale and complexity in different locations, depending on market orientation and size, labor skills available, technical capabilities and supplier network.

MNCs provide access for foreign markets. They have large internal (intra-firm) markets for some of the most dynamic and technology-intensive products access to which is available only to affiliates. MNCs have established brand names and distribution channels with supply facilities spread over several national locations. They can grant trade privileges in their home (or in third) markets.

The overall conclusion of the balance between the positive and the negative impact of the MNCs economic influence in the CEE countries as their hosts shows

that their presence is an important indicator of the degree with which the recipient countries can integrate into the world economic community and can close the gap in their technological and innovative development. The uneven distribution of FDI is one of the reason why the economic reforms were so contradictory in their success among the separate countries and why their chances to become full members of the European Union are so different. Bulgarian economy is a typical case which illustrates the relation between the lack of investment interest from the part of the biggest MNCs and the slow and very contradictory market reforms.

### **Determinants of the Investment Climate and the Impact of MNCs activities on Bulgarian Economy**

Bulgarian economy has never been potentially considered an attractive market for the big MNCs. The reason behind it that the country has been for a long time too oriented towards the former Soviet economic zone and has not established any economic relations with big Western firms.

At the beginning of the 80's when the Soviet-type economic model has shown more shortcomings than advantages and the technology gap between the Western and East-European countries has dramatically increased, the political regime in Bulgaria has tried to revise its economic policy towards West, and the MNCs, in particular. In 1986 the former socialist government issued the "famous" Decree 56 by which it institutionalized the new economic philosophy of a more balanced and Western oriented foreign economic policy. Decree 56 legitimized and promote joint ventures with Western firms, it gave way to the Western foreign investments, and encouraged the initiative and the entrepreneurship in the country. Thus at least legally the economy has been opened to the Western partners in the mid of the 80's several years before the political reforms in the country.

The real impact of Decree 56, however, was more on the side of the Bulgarians than on the side of the foreign firms as the political environment was too risky and the legitimate power of the Decree (not a law) too unstable. Later on at the

beginning of the market reforms the Parliament passed a Law for Foreign Investments (1992) which was too liberal in its contents and which offered a package of tax and fiscal incentives. The liberal legislation was not effective enough to stimulate and attract huge flows of investments as the neighboring countries were also very liberal and competitive in their foreign investments legislation. As it can be seen in the third paragraph (the results of the Survey) the legislation itself, no matter how liberal and stimulating it is, is not a main determinant for FDI, if it is not accompanied by quick and efficient procedures for its implementation.

The political context is also an important determinant of FDI in a country as foreign companies expect a good political will and a collaboration with the government. In Bulgaria the political factor is still very unstable – seven governments in ten years and an antagonistic bipolar political model which makes the national economic policy too inconsistent in its goals and objectives. The almost even distribution of Parliament's members between the two major parties – the Union of Democratic Forces and the Socialist party, whose alternative policies are often changed, can be seen as a symptom of a great political risk from the foreign investors.

No better is the macroeconomic environment which in most of the FDI studies is considered of greatest importance. Bulgarian market is small in size and the potential of the local demand is very low as per capita income is one of the lowest in Europe. The lack of natural resources and a modern and well established infrastructure is another obstacle for foreign FDI flows and MNCs presence. The Survey which was held among the biggest MNCs in the country (see the third paragraph) shows that the transaction costs for doing business are very high and the competitive advantages of the country too small.

During the last ten years of market reforms the economy shows a weak potential for restructuring and sustainable growth. The beginning was promising and the country was successful in its first attempts to liberalize the prices and privatize and demonopolize the state sector. The process, however, was stopped in 1993 and 1994 when the two governments – Berov's and Videnov's deliberately postponed the

reforms, giving birth to underground and criminal economy. As a result of the political instability the economy showed a negative growth, accompanied by hyperinflation and an increasing unemployment.

The currency board which was introduced in mid of 1997 brought the financial stabilization in the economy but was not able to boost the growth up. The new Kostov's government tried to attract strategic investors as the biggest and the most profitable state companies were put on sale. The inertia and the lost confidence, together with the war in Kosovo made these attempts unsuccessful and placed the country at the bottom of FDI ranking in the region.

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 – well established MNCs which can transfer the package of services needed for a competitive and dynamic market environment. Most of the investments are small in size and come predominantly from Russia, Turkey and Greece. They are oriented in trade, services and light industry where the free market niches give quick profits at the lowest risk. Most of the foreign capital in the country is privatization-led but there are also green field investments.

The absence of the biggest MNCs in the Bulgarian economy is one of the most important factor for the slow and rather contradictory market reforms. As it has been already pointed out, the MNCs presence in the host economy is not just a matter of investment injections to its economy but rather more a transfer of invisible assets – technology, know-how, management and market culture which are fundamental to

the process of marketization and global economic integration of the country. MNCs' intrafirm organization illustrates the highest world standards which can be used as an example for the local firms. The competition environment created by the MNCs serves as a strong stimulus for the local firms to enhance their market performance and innovate the production base.

MNCs have a great influence on the labor market too. Besides generating a new employment, they increase the local rate of the wages, stimulating the qualitative characteristics of the labor force. In order to hire the best professionals, the local firms must compete with the MNCs which means they must offer not only the same level of salaries but also good perspectives for a professional career.

Not less is the impact of the MNCs on the local consumption and the world standardisation of the local production. The transfer of the latest technology in the country and the high quality of the foreign goods are great stimuli for the development of the national economy and its integration in the world market. Local firms can be competitors to the MNCs but they can also be their partners. The establishment of market or intrafirm relations with MNCs mean a penetration of the MNCs' corporate culture within the local market environment. This is especially important for countries like Bulgaria in which concepts like rational behavior, gains and costs, market culture etc. are just getting their practical sense and the market institutions are seen in the public eye more like a source of exploitation and one side enrichment than as means of defending mutual interests and trust.

An overall conclusion can be drawn that the scale and the scope of MNCs presence in the Eastern Europe region, and in Bulgaria in particular is a factor of extreme importance for the success of market reforms and for the fast and effective integration into the world economic community. Such a hypothesis can be defended by investigating the reasons why so few of the biggest MNCs are investing in the Bulgarian economy ten years after the reforms and what are the main obstacles which hinder their further development strategy.

## Bulgaria as a Host Country – Some Results and Some Lessons

According to a data base of the Foreign Investment Agency in Bulgaria there are only 51 big firms with more than one million US dollars invested in the country and with at least two foreign affiliates. ( see the list). These two parameters of transnationality, although very loose, can be taken as a framework for the Survey, more over that according to the initial MNCs hypothesis, it is not the size of the FDI flow but the package of MNCs services that influence the host country performance.

The Survey was undertaken during the period January 15 – February 15, 2 000 including 46 of these firms, which is considered a standard statistical excerpt, representative enough, for drawing some realistic conclusions about the attractiveness of Bulgarian economy for FDI. 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 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 comprised 52 different questions and which was structured according to mode and results of two comparative surveys of CEE countries.

The first Survey was held within the World Economic Forum in Davos-Switzerland on world competitiveness. An index, based on 8 indicators was estimated<sup>2</sup> which for 1998 ranked Bulgaria on 56 place out of 59 investigated countries. Bulgaria shares the company of countries like Russian Federation, the Latin American countries, and Ukraine concerning **the quality of economic environment**,

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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)

<sup>2</sup> These indicators are: openness of the economy, finances, infrastructure, government, technological development, labour force, firm management and institutions.

in which concept are including also: legal environment, property rights protection, business information access, opportunities to start a new business. Legal system in Bulgaria was evaluated as inefficient, and infrastructure and technology – old fashioned.

The second Survey was made by the Economist Board of Central European Economic Review and on a comparable level it ranked the CEE countries on basis of different criteria. The attractiveness of the country was estimated on such indicators as: economic growth, balance of payments, business ethic, legacy and order. In the context of the transition risk these criteria illustrate to what extent the economic, tax and other kinds of legislation attract or distract foreign investors who are very sensible about guarantees for protection of their investments and interests in the host country. It is more important the economic legislation is acting effectively and not only how it is formulated. The continuous corrections and changes of laws are also a source of suspicion for the investors. The ranking has a maximum of 10 points and Bulgaria is at the bottom 10<sup>th</sup> place with 5.91 points.

Thus having in mind the results of the two comparable surveys and the overall economic performance of the Bulgarian economy during the last ten years of market transformation, our preliminary hypothesis was that one of the main reason for attracting so few FDI in the country was **the high transaction costs of market entry** in which concept we focused not only the economic but also the legal, political and socio characteristics of the emerging Bulgarian market model.

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 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 may 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 are mentioned to a problem by 23.7 per cent. Research information is not considered an important source of information which illustrates the weak linkages between MNCs and the research institutions in the country.

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.

2. Question 32 is related to the average costs needed for negotiating a single transaction. The rate turns to be about \$500. One fourth spend between \$500 and \$1



000 while bigger firms (23.5%) spend \$1 000 and more. 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 behavior.

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 which is a negative characteristics of the economic environment in Bulgaria and confirm the results of Central European Economic review.

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 behavior. However, opportunism still exists 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 comes 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 11.4 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 answered 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 lie 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 MNCs are equally divided in their opinion for the effectiveness of the Bulgarian institutions, closely related to MNCs activity. About half of the firms (52.2%) see the institutions useful and effective, while the other 47.8 per cent oppose this opinion. The Agency for Foreign Investments is considered to be the institution with low reputation among the firms.

**The communications and the infrastructure** are 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. Question 24 “Is the technology transfers part of

your activity?” is answered positively by two thirds of the respondents. Some 46 per cent of them see technology transfer the most important part of their activity .

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. Half of the firms are planning to expand their activities in the next year, 43.2 per cent – in the next two to five years and only 2.7 per cent of MNCs do not have any future plans.

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 .

### **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 behavior i.e. corporate culture.

The business interests 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

are confronted with 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 efficient implementation.

Another big issue is the corruption of the government bureaucracy and the heavy licensing 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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