

# THE INTERNATIONAL INVESTMENT POSITION OF BULGARIAN ECONOMY IN THE PERIOD FROM 2010 TO 2019

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**Abstract:** The period from 2010 to 2019 may be defined as a post-crisis stage in the historic development of the global economy. This refers to Bulgarian economy as well, which went through a recession to then reach a situation of full employment. The recovery of global markets is obviously a major factor which raises the interest of both local and foreign investors. The dynamics and the structure of the capital funds invested in the local economy and those invested abroad are indicative of the confidence in the domestic market. They give an accurate idea about the economic environment in the country and the mid-term prospects for its development. The main objective of this research is to analyse the characteristics of and the trends in the changes of capital funds invested in Bulgaria and those invested in foreign economies and markets.

**Key words:** foreign investment, investor interest, equity, debt instruments.

**JEL:** F21.

## Introduction

Bulgarian economy has been functioning and developing under a currency board for more than two decades now. Despite the discipline which the currency board system has established, its operation has also posed certain restrictions on business, financial enterprises, the Central

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Bank (CB), and the Government of the country. It has become virtually impossible for the banking sector to support its operation through discount loans, which is a major monetary policy instrument. Commercial banks, enterprises and the government budget have lost their access to cheap financial resources, which is a major prerequisite for the significant price spreads we are currently witnessing between the average interest rates on the domestic credit market and the credit markets on the EU-28 Member States. This affects directly the overall competitive potential of local industrial enterprises which have a long way to go to improve their production and market performance, yet, in our opinion, the issue has been largely underestimated so far.

In addition to the key role which the government has in terms of supporting the business and raising its competitive potential, it is easy to identify the different sectors of Bulgarian economy that attract foreign investment. The role of foreign investment may be approached from two perspectives: (1) they are fresh financial resources that may be used to stimulate consumer and investment demand and (2) inward cash financing and foreign equity participation are accompanied by know-how, successful market practices, progressive corporate culture, quality-based corporate management, etc. If adopted and effectively employed by local entrepreneurs, all these could contribute immensely to Bulgarian enterprises, gaining valuable competitive advantages on the global market.

The main tasks of this research are determined by the importance of foreign investment for the dynamic development of Bulgarian economy. Therefore, they could be defined as:

- **First.** Providing a detailed review of the international investment position of the country, i.e. the assets and the liabilities, which present a systematic summary of the position which Bulgarian economy holds on the international arena.
- **Second.** Conducting an up-to-date analysis of the foreign exchange reserves held by the Bulgarian National Bank due to their primary significance for ensuring and maintaining the financial viability of the country and maintaining the normal performance of the currency board monetary system.

## 1. Dynamics of Changes in the International Investment Position of the Country – Assets and Liabilities

The statement about the international investment position of the country is regularly compiled and reported on a quarterly and annual basis by the Bulgarian National Bank (BNB). These data are processed by the 'Balance of Payments and External Debt' Division within the Statistics Directorate of the bank in maintaining full confidentiality. The functional categories of assets and liabilities include: direct investment; portfolio investment; financial derivatives and other investment, as well as the reserve assets of the country (BNB, 2011).

### External Assets

The analysis of changes in the external assets of local residents in the period from 2010 to 2019 reveals that the total volume of outward investment grew at a rate of 54.74%. A further analysis of changes in the elements of the assets formed as a result of the international cooperation of local economic agents with their counterparts abroad leads to several conclusions:

- **First.** Over the entire reviewed period, there was a positive trend in the changes of the components of the international investment exposition of the country that constitute the value of assets.

The dynamics in the data about the size of local funds for investment purposes that were invested in foreign economies and generated incomes to local residents, i.e. foreign direct investment (FDI), is presented graphically in figure 1 (BNB, Potok na prekite chuzhdestranni investitsii po vid investitsiya - godishni dannii, 2020).

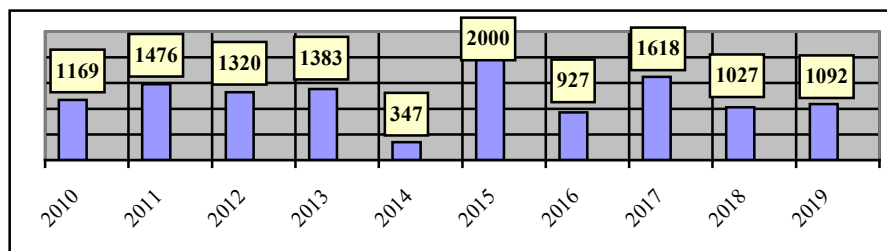


Figure 1. The trend of changes in foreign direct investment, 2010 – 2019 (millions of euros)

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It is worth noting that during the researched period, the flow of FDI<sup>2</sup> fluctuated significantly over the years. To some extent, this indicates that local investors were not confident in the long-term market prospects for the development of the global economy. Thus in 2019, for example, the total volume of proceeds from outward investment amounted to nearly 6 billion euros, yet the volume of capital investment was only 1,092.4 billion euros (see the data presented in figure 2). The share of capital investment in the sum of the assets thus amounted to the extremely modest 1.97 %.

- **Second.** From 2015 onwards, there was a steady trend of reinvesting the annual earnings of Bulgarian companies abroad. Over the researched period, the total size of reinvested earnings after taxes amounted to 4,921 billion euros. On the one hand, this could be interpreted positively, since it indicates the long-term prospects of planning the economic activity of Bulgarian companies abroad. On the other hand, such an investment strategy creates jobs and adds value in favour of foreign economies. There was a slight decline in the amount of reinvested earnings at the end of the period, which was in line with the expected downturn in global economy, including as a result of the Covid-19 pandemic.

- **Third.** The capital attracted from foreign companies in debt instruments purchased by local physical and legal entities continued to be the major factor which influenced the overall exposition of asset outflows. Over the period from 2010 to 2019, the net amount of attracted foreign capital in debt instruments amounted to 1,313.60 billion euros. Their volume is predicted to increase substantially in 2020 as a result of the debt financing for the recovery of the European economy.

Figure 2 (BNB, *Mezhdunarodna investitsionna pozitsiya na Balgariya, 2020*) presents the dynamics of the changes in the assets which establish the total volume of the foreign funds invested in Bulgarian businesses over the last ten years. Their growth rate from 2016 onwards is worth noting.

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<sup>2</sup> The funds invested directly in the local economy by a foreign resident, including those for the acquisition of minimum 10% of the shares of a company, author's note.

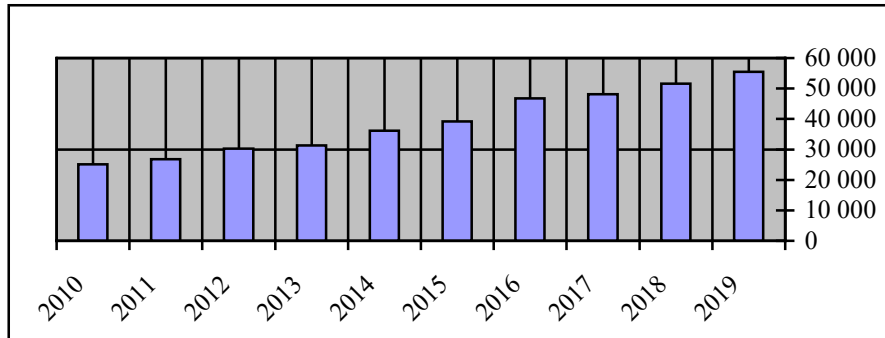


Figure 2. The trend of changes in assets, 2010 – 2019 (millions of euros)

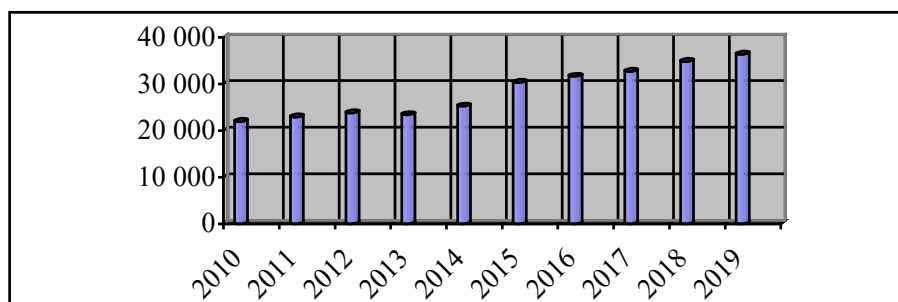
### External Liabilities

Over the period from 2010 to 2019, the size of the liabilities incurred as a result of the international activity of economic non-residents grew from 60,270.3 million euros at the beginning of the period, to 74,691.70 million euros at the end of 2019, which was an increase by nearly 24%.

A careful analysis of the dynamics of changes in the data about the constituent indicators reveals that, except for the liabilities incurred from transactions in financial derivatives, all the other components of the liabilities reported as a result of international economic activity followed a positive trend in their development. The dynamics of the changes in the indicators leads to four major conclusions:

- **First.** In terms of the liabilities incurred from direct investment, we should note that over the entire researched period, their size grew as an absolute value and as percentage indicators when compared to the base year 2010 (see figure 2). This was largely due to the increase in the volume of the equity and the reinvested earnings of domestic companies with foreign shareholders' participation. Their total volume amounted to 21,921.63 million euros in 2010 and reached 36,345.18 million euros at the end of 2019. Such a growth rate of nearly 40% may be accounted for with the trend towards a recovery of the global economy, which obviously had a positive impact on the development of local enterprises as well.

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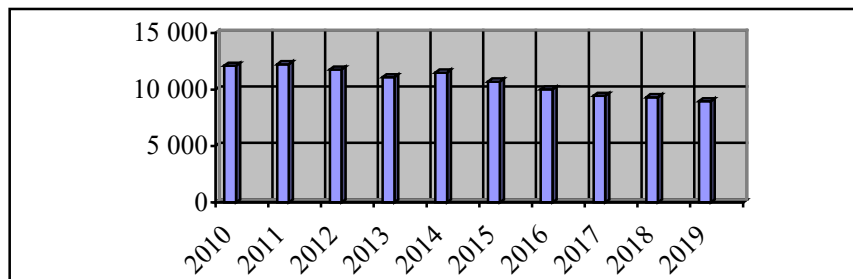
Source: BNB, *Mezhdunarodna investitsionna pozitsiya na Bulgariya, 2020*.

Figure 3. The trend of changes in equity and reinvested earnings, 2010 – 2019 (millions of euros)

- **Second.** The dynamics of changes in the liabilities incurred from financial debt instruments is easy to notice. Those are predominantly financial loans extended for refinancing the activity of commercial banks and enterprises in the country, including legal entities' debts to suppliers. We should note that over the entire analysed period, the average share of liabilities as a percentage of the total annual liabilities incurred from direct investment fluctuated between 25% and 30%. The constant share of incurred costs on debt instruments was mainly due to the need of refinancing of local commercial banks which are predominantly owned by foreign banking institutions that regularly extend to them financial resources for their activity. Obviously, the positive trend in the development of the Bulgarian economy, in addition to the foreign and domestic consumer and investment demand which naturally encourage the aggregate supply of goods and services for intermediate and for final consumption, had a key role in the incurrence of liabilities from debt instruments.

- **Third.** When analysing the international investment position of the country, we should pay attention to incurred annual liabilities which are reported in section "Other sectors" by the Bulgarian National Bank. In 2019, they amounted to 8,959 million euro, which equaled nearly 12% of total liabilities. Financial investment included public and private sector debt exposures and government-guaranteed loans, though we need to point out

that those data only include information declared at the Central Bank. We should also note that there was a downward trend in the total credit exposure from 2015 onwards (see figure 4). One of the main reasons behind that trend was the recovery of Bulgarian economy which was accompanied by the reduction in the debt burden between the companies in the country. Those data should be approached extremely carefully, though, since they predominantly reflect intercompany indebtedness in the country, and, more specifically, the corporate debt exposures of a number of local enterprises to foreign creditors.



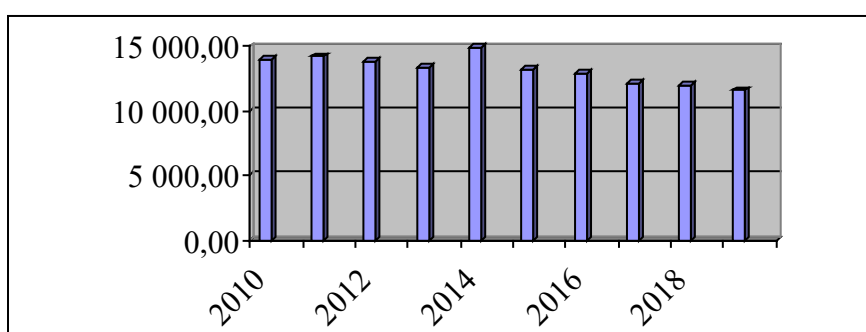
Source: BNB, *Mezhdunarodna investitsionna pozitsiya na Balgariya*, 2020.

Figure 4. Dynamics of changes in public and private debt to foreign creditors, 2010 – 2019 (millions of euros)

- **Fourth.** Another important element of section “Other investment” that gives approximately comprehensive and indicative information about the international investment position of the country is loans from non-residents, which are invested in the banking sector and the enterprises in Bulgaria. The volume of loans from non-residents varied over the past ten years, their share in the total size of external liabilities being 19.74 % over the period (total liabilities amounted to 668,381 million euro, of which the sum of borrowed funds was 131,972 million euro). Most of them were invested in the banking sector, which was able to finance its activity from the international money market since the limited domestic market and the negative real interest rate on the deposit market weakened the power of savings as an instrument for promoting the development of

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the sector. We should also bear in mind that forecasts about a longer recession in the world economy as a result of the economic slowdown, which started at the end of 2019, and the closure of markets during the first six months of 2020 could also contribute to a major shrink in the volume of loans from non-residents, especially those to be invested in the real sector of the economy in the country.



Source: BNB, *Mezhdunarodna investitsionna pozitsiya na Balgariya, 2020*.

Figure. 5. The trend of changes in loans to non-residents, 2010 – 2019 (millions of euros)

## 2. Foreign Exchange Reserves of the Bulgarian National Bank

The international investment position of any economy has an immediate impact on the foreign exchange reserves of its central bank. As we noted earlier, the currency board system virtually minimises the ability of the Bulgarian National Bank to conduct an active monetary policy. This is also the case with the opportunities for providing financial incentives through 'injecting' liquidity into the markets, i.e. by increasing the money supply. The latter is essential due to the beneficial effect of a similar measure during an economic recession. The only opportunity to increase the money supply in the country currently is by increasing the foreign exchange reserves of the Central Bank. This implies that the condition of



Bulgarian economy on an international scale is of key importance to its mid-term and long-term development.

The foreign exchange reserves of BNB have another significant dimension. The Bank is responsible for maintaining the foreign exchange reserves at a level that would be sufficient to completely back all the Bulgarian currency in circulation. This legal requirement is further evidence of the significance of the international investment position of the Bulgarian economy, which is of an explicitly open foreign-trade nature. This exposes the economy to various external risks with no real opportunity for the institutions to respond to any adverse global developments.

Figure 6 (Infograf, 2019, BNB, Mesechni balansi na upravlenie "Emisionno", 2020) presents data about changes in the reserve assets of BNB in the period from 2010 to March 2020. As we can see from the figure, the assets of the Bulgarian National Bank began to increase from 2013 onwards. In our opinion, this was due to the recovery of the global economy (1) and the improved export positions of local enterprises (2) whose revenue from sales on the international market in 2019 accounted for nearly 50% of the Gross Domestic Product (GDP) of the country.

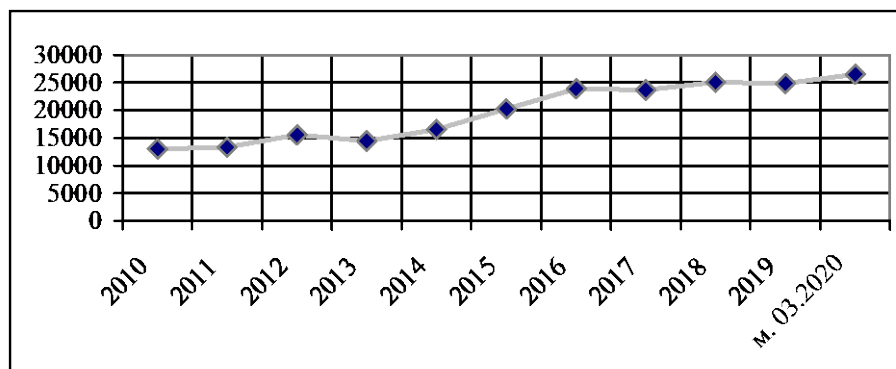


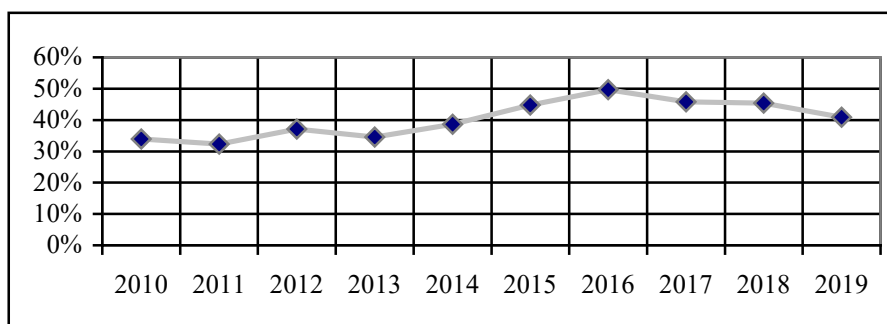
Figure 6. The trend of changes in the reserve assets of the BNB, 2010 – March 2020 (millions of euros)

It would also be interesting to analyse changes in the sum of reserves held by the CB as a percentage of the GDP of the country over

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the same period. The dynamics of the changes in the indicator is presented in figure 7 (Infograf, 2019, NSI, BVP - Proizvodstven metod - natsionalno nivo, 2020).



*Computations made by the author*

*Figure 7. Changes in the reserve assets held by the BNB, 2010 – 2019  
(as a % of the GDP)*

The data presented in the figure above indicate that since the beginning of the recovery of Bulgarian economy in the period from 2014 to 2016, there were several peaks in the values of the reserve assets held by the Bulgarian National Bank compared to the GDP of the country. The upward trend was then followed by a gradual decline and in 2019 the volume of reserve assets stood at the 2014 level. The explanation for that development must be sought in the dynamic development of the economy of the country.

Although the share of the reserves in the GDP declined at the end of 2019, there are no grounds for concern in terms of backing the money in circulation with foreign currency, since available reserves ensure backing of nearly 150%. This implies that BNB is able to maintain the fixed exchange rate at 1.95583 Bulgarian levs/euro, and hence, the Currency Board system in the country.

## Conclusion

Over the last decade, Bulgaria's economy made a transition from a state of recovery to a stage of functioning at optimum employment, mainly due to the positive development of global markets. We should note though, that obviously the economy could not make the most of the favourable external economic environment. The low remuneration of labour and the fact that Bulgarian enterprises are lagging behind in terms of technological development continue to be two of the major features of the economy as a result of poor government management, a volatile investment environment and ineffective corporate management.

The explicitly open nature of the national economy renders it highly dependent on any adverse external conditions. What is more, in a situation of a global crisis, the institutions in the country are virtually unable to implement any decisive measures for overcoming or mitigating any negative external effects or shocks. We, therefore, believe that a government policy oriented towards joining the Eurozone exposes both the economy of the country and its international investment position to serious risks. A Central Bank with no sovereignty, which is largely the case under a Currency board system, is not in favour of Bulgarian economy. Undoubtedly, joining the Eurozone has its advantages (mostly macroeconomic ones), yet, in our opinion, joining the EU monetary union at a moment when large European economies like those of Italy and Spain are struggling with serious fiscal and monetary problems and Greece is facing an unpredictable future would best be preceded by joining the ERM2 Exchange Rate Mechanism, i.e. the 'waiting room' to the eurozone, so that the country could gain some more time while processes in the eurozone settle down over the next few years.

The findings of the research we conducted indicate that the overall international investment position of the country is stable, which renders it relatively easy for local and foreign investors to predict further developments in Bulgarian economy. It is worth noting that the volume of external assets doubled in the period from 2010 to 2019. There was a similar trend in the volume of the foreign exchange reserves held by the Bulgarian National Bank, which indicates that the Currency Board system is

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functioning well. This claim is supported by the volume of the reserves held by BNB as they act as a financial buffer against potential risks that may threaten the real and the financial sectors of the economy.

There are, however, several matters of concern that should not be ignored. One of them is the fact that the net international investment position of the country remained negative over the entire researched period, although the negative value of the indicator was nearly twice as low at the end of 2019. This indicates that due to its marked openness, Bulgarian economy will remain strongly dependent on the situation on the global markets. It also implies that the investment climate in the country needs to improve dramatically. The latter is a major requirement for reducing the net difference between the sum of local residents' outward investment and the sum of inward investment made by non-residents of our country.

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