Entrepreneurship does not Equal Development:

A Note on Bulgaria's EU Candidacy and Competitiveness

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Introduction

Looking backwards, it could be argued that after the change of the socialist regime the Bulgarian economy should have been approached as a developing economy rather than to assume that a change in ownership would result in an immediate technical restructuring of production. In any case, 14 years later, operating under the conditions of a currency board since 1997, and dealing with restricted sovereignty in policy formulation, Bulgaria faces problems resembling that of a developing country. Bulgaria's part of the 5th enlargement of the European Union (EU) makes developing concerns such as trade specialization even more relevant.

The European Commission Regular Report points out that overall, the Bulgarian economy will be better able to take on the obligations of membership the higher the degree of economic integration it achieves with the EU before accession. Integration is usually assessed in terms of the volume of trade with EU Member States. The questions standing ahead of Bulgaria are similar to those raised by Raul Prebish with regards to developing economies facing declining terms of trade and infant industry. How can the

country generate production for subsistence of its population and a capacity for competitiveness in the context of EU trade integration?

Competitiveness could be narrowly discussed as the country's overall productivity (final output per input of labor cost) of the business enterprises. It is particularly important for Bulgaria because the country needs to export and generate foreign reserves in order to sustain the implemented currency board. However, the broader approach to competitiveness related to the production and export structure of the country need more attention.

The Copenhagen Economic Criteria vs. Active Development Policy

The Bulgarian government signed the EU Treaty of Accession in April 2005. The second point of the Copenhagen economic criteria for accession refers to the existence of a functioning market economy as well as to the capacity of the country-candidate's economy to cope with competitive pressure and market forces within the EU. Formulated in such a way, the criteria do not actually convey an ambition for a developed competitive economy, but rather a capacity to "cope with competitive pressures." "Coping" could be subjected to various interpretations.

The EU assessment of the second Copenhagen criteria about the above noted capacity is based on the following sub-criteria. 1) Existence of a functioning market economy, with a sufficient degree of macroeconomic stability for economic agents to make decisions in a

climate of stability and predictability; 2) A sufficient amount at an appropriate cost of human and physical capital, including infrastructure, education and research, and future developments in these fields; 3) Extent to which government policy and legislation influence competitiveness through trade policy, competition policy, state aid, support to small and medium enterprises; 4) Pre-accession degree and pace of integration with the EU in terms of volume and structure of trade with member states; 5) Proportion of small firms as an indicator of the flexibility of the economy to adjust, and the scale of the expected benefits from enlargement. Ultimately according to the 2004 European Commission Regular Report, the ability to fulfill the second Copenhagen criterion depends on the existence of a market economy and a stable macroeconomic framework (EC 2004, 36).

In the analysis and policy recommendation by the EU and international financial institutions the existence of a market economy is associated with removal of price controls, trade and capital liberalization, and privatization. Progress in these aspects has become the ultimate unquestionable criterion for assessing the capacity of the Bulgarian economy to cope with competitive pressure within the EU. This is a reflection of the linkage between economic theory and policy that has evolved as a reaction to historical circumstances and has become the basis for Bulgarian policy documents[1].

[1] In 2002 the Bulgaria government approved a *Program for the Revival of the Bulgarian Industry*. In 2003 it has drafted a comprehensive program *Raising the Competitiveness of the Bulgarian Economy*. Also, Bulgaria has a *National Economic Development Plan* 2000–2006 which identifies competitiveness of the economy as a number one policy priority.

Bulgaria's competitive potential based on the Copenhagen sub-criteria together with other popular aspects of business climate are evaluated and monitored through various indexes, rankings, and surveys[2]. For example, the Growth Competitiveness Index (GCI) was developed by a team lead by Prof. Jeffrey Sachs and designed to provide an estimate of the underlying prospects for growth over the medium term (5–8 years). The 2003 GCI rankings place Bulgaria 62nd out of 80 countries in terms of mid-term prospects for growth. The GCI is based on new growth theory. In such a theoretical framework, growth prospects are mainly determined by the national savings and investment rates and the efficiency of monetary and financial system measured mainly by the interest rate spread and the business' perceptions about access to credit (usually grounded on crowding-out presumptions and not on endogenous money). Low national savings rate (13.8 % of GDP in 2001, ranked 71st), low investment rate (17.8 % of GDP, ranked 66th) are analyzed in the framework of loanable funds with causation from saving determining investment. For Bulgaria being among the countries at the bottom of such rankings, the push is toward closing a saving gap on the presumption that high interest rates will do the job.

Attached to a crowding-out concerns about the level of government activity, this argument for increasing the saving in the country is indeed contra-active to any development policy, and specifically to government industrial planning of the sort practiced by western economies during industrialization (see Balance 1982) and the East-

[2] See Pashev (2003) for discussion on indexes that are measuring competitiveness and Bulgaria's performance.

Asian Tigers (see Alice Amsden). Thus, the assessment according to the sub-criteria of the second Copenhagen criterion about the capacity of the country to cope with competitive pressure within the EU needs to be distinguished from any considerations about active economic development policy.

Based on Neoliberal understanding about the role of competitiveness and the ways it can be achieved, the above mentioned criteria are indeed a reaction towards the active developing policies in the 40s, 50s and the 60s. Neoliberalism and neoclassical economics which inform the mental leap from liberalization and privatization to efficiency, and from efficiency to competitiveness, did not sprung spontaneously in a political and historical vacuum. However, habitually analysts treat these linkages as technically given.

Privatization as a Fundament

As Jan Kregel (1999, 111) points out, in Eastern Europe there is not an economic driving force equivalent to the role played by the introduction of machine production described by Karl Polany's *The Great Transformation*. "The decision to introduce the 'market' as well as the decision to do it by means of a 'market shock' was not an economic imperative, it was a political decision" (Kregel 1999, 111).

Privatization of state owned enterprises usually is referred to as "restructuring." Equating "privatization" with "restructuring" is a manifestation of the political rather than a

technological content of the reforms as it is based on the assumed linkages between a) ownership and efficiency and b) between individual interest and industrial (including environmental) efficiency. The share of employees working in the private sector, the percentage of privatized state-owned assets, and the private sector's share in gross value added are the usual reference points for assessment of progress.

In Bulgaria the share of employees working in the private sector increased from 46% in 1999 to 64% in March 2004. The private sector's share in gross value added grew from 63.4% in 1997 to 73.3% in 2003. The percentage of privatized state-owned assets (excluding infrastructure) calculated from their value in 1995 was 86% at the end of June 2004. Further, since land restitution was finalized in 2000, houses and land are largely privately owned. In addition, between January 1993 and June 2004, 5,107 privatization deals for state enterprises were concluded. Finally, the financial sector is now almost completely privately owned (to a large extent by foreign banks) (2004, 33).

Bulgaria was preoccupied utilizing different schemes – voucher privatization, manager employees' buy-outs, and direct negotiations. Most of the FDI came through privatization deals. In addition, large part of the FDI deals were in fact portfolio investment with the expectations for returns from appreciation rather than capital returns from investment. These processes have not been conducted in the framework of a development strategy oriented towards securing a competitive export structure but were excused through stimulating entrepreneurship as an end-in-view.

By 1996–1997 the Bulgarian economy ended up with 34 % drop in real output relative to 1990, significant price instability, and failure of one third of the banks. This liquidity crisis, which arguably could have been prevented by international financial institutions acting as lenders of last resort, instigated a political change that facilitated the introduction of Currency Board Arrangement (CB) on July 1 1997. Privatization had to take off considerably after the adoption of the CB, as there was a need for foreign reserves to sustain the CB.

Private ownership has become predominant in Bulgaria, but the country now faces problems of deindustrialization and deterioration in education. High level of long term unemployment, low living standards and brain drain through emigration are the symptoms of these problems rooted in the austere macroeconomic policy and the shift of the Bulgarian export patterns as discussed bellow.

Technological Innovation vs. Entrepreneurship

The number of registered innovation patents by Bulgaria has shrunk since 1980. The GCI index is actually useful to illustrate this because it has a technology component consisting of innovation, technology transfer, and ICT sub-components with various weights. As noted by Pashev (2003) Bulgaria ranked 25th together with Singapore in the number of registered innovation patents in the ten-year period of 1980–1989. By 2001 it has dropped to 51st position, while Singapore ranks 14th among core innovators. Thus, in

terms of US utility patents Bulgaria lost a lot of its innovation potential in the years of transition. As Pashev (2003) notes innovation has limited weight of 1/8 in the overall technology index and the technology transfer component (based on judgment by the surveyed business representatives) has a three times higher weight. The third component – the ICT sub-index has biggest weight of 1/2 in the overall index[3]. According to the GCI there are core innovators - 24 countries, whose companies have registered at least 15 US utility patents per million population. The technology sub-index has 50 % weight, while the other sub-indexes have 25 % each. The technology sub-index has two components: innovation and ICT. Innovation is presumed to have primary importance for growth for these countries[4]. For the countries, which are catching up with the core economies, the GCI assumes that growth is driven much more by technology transfer than by innovation. Also, for these lagging countries growth is said to be largely determined by investment together with technology, therefore the index attaches equal weights of 1/3 to technology, public institutions and macroeconomic environment. Hence the great importance those policy recommendations give to FDI. Of course, the theories of investment and their linkage to the focus on fiscal austerity play their role in the GCI assessment and in formation of the priorities of Bulgaria as an EU candidate. Furthermore, the emphasis on

[3] See Pashev (2003) for further discussion on GCI and Bulgaria's performance.

[4] It should be noted though that the line between innovation and enclosure has been thinning with the intellectual property rights extending to life forms and processes that have been long in use, and that such distinction is important for the purpose of assessing technological progress.

institutions is in terms of facilitating entrepreneurship opportunities rather than capacity for learning and implementing technological processes and blueprints.

The creation of entrepreneur opportunities for making money should not be conflated with the development of competitive production and export structure. But this is the general tone of the EU industrial policy which is expressed in the Communication 'Industrial Policy in an Open and Competitive Environment: Guidelines for a Community Approach' of October 1990. The emphasized instruments are those of government policy toward business which " … aim to provide the framework conditions in which entrepreneurs and business can take initiatives, exploit their ideas and build on their opportunities" (Eurostat).

In this spirit, policy notes (see CEC, 2004) give a great deal of attention to the formation of small and medium sized enterprises, which for the size of Bulgaria would be corresponding to family business for the purpose of subsistence. However historically, development in industrialized countries did not occur by large number of small competitors (see Balance, 1982). I would note that creation of opportunities for households to speculate with their livelihood should be viewed as an accessory towards the economic development process and not as its basis.

Furthermore, as Pashev (2003) points out Bulgaria has traditions in education and engineering capacity which are quickly disappearing. He rightly argues that "[i]n some cases short-term public expenditure priorities may need to be reconsidered in the context

of long-term competitiveness needs" and that "… the government should start today to lay the foundation of sustainable innovation-driven competitiveness in the long run." Pashev (2003, 29) finds that the major responsibility of the government in this field is to invest in quality of education and the relevant policy environment for R&D infrastructure. Deterioration of the education capacity of the country however is partially a result of the changing production and export structure of the economy.

Changing Export Structure

After the introduction of the CB, the structure of the economy has changed in terms of production. The agricultural sector's share in gross value added has more than halved, from 26% in 1997 to 11% in 2003. The share of industry (including construction) has remained at between 28% and 30% over this period. Services have expanded from 44% in 1997 to 59% in 2003. This shift did not show in terms of employment. Employment in agriculture increasing from 25% to 28% and in services from 43% to 45%, while there was a decrease in industrial employment from 32% to 28% (CEC 2004). A possible explanation of these changes is the labor intensive character of agriculture, especially after the land restitution resulted in smaller plots unsuitable for mechanic cultivation. In addition, this could be an expression of a deteriorating machine base in agriculture and its substitution with human power. The increase of employment in services is probably due to increase in retail, including small vendors. Although the total share of industry has not changed substantially, its composition has. This is related to the changing export structure of the country. Thus, while the share of industry has slightly increased, the decrease in

employment in industry maybe a result of “restructuring” of state owned enterprises resulting in lay-offs, as well as a result of the changing composition of the industry.

There has been a noticeable shift in the Bulgarian export pattern especially due to the increase in clothing – from 13.8 % in 1990 to 36 % of total exports in 2002. There is also a shift away from exports of machines, equipment and appliances; there export share was 59.1 % in 1990 and shrunk to 15 % in 2002 (See Table 1).

Table 1

SHIFT IN BULGARIA'S EXPORT PATTERN 1990–2002

(percent of total exports)

	Food, beverages, tobacco	Machines, equipment, appliances	Metals, fuels, mineral raw materials	Chemicals, fertilizers, plastics, rubber	Textiles, clothing, leather, medicine, cosmetics
1990	14.7	59.1	7.7	3.9	13.8
1995	21.6	12.3	28.3	15.8	21.9
2002	5.0	15.0	31.0	12.0	36.0

Source : (Pashev 2003, 14, Table 1)

Despite the rapid increase in export in ready to wear apparel and footwear, the value added from their production has fallen through these years. This is the result of the pressure coming from foreign partners to reduce prices. The EU applies its own trade defense instruments against non-member countries (especially the “sensitive” sectors, the most labor intensive ones) including textiles. The protective instruments are designed to contribute to the EU competitiveness by creating a stable and predictable investment climate. This effect will be extended to the new Member States following enlargement,

and thus presumably to Bulgaria in 2007. However, the changed structure of exports would still matter: how much process and product innovation could you make in the production of clothes and footware? Thus, today's changes in the export pattern of Bulgaria are important also for the determination of the composition of capital investment for the future. For example, the investment in the textiles is directed mainly to the delivery of sawing machines which has resulted in partial technological renovation of the older equipment in the textile enterprises. At the same time there was a shift out of exports and towards imports of equipment.

Sawing locally and exporting ready-to-wear clothes is the *maquiladora* model towards "integration". Going this road leads to some accumulation of external reserves, and makes the unemployment numbers look not so devastating, but does not secure the path towards development of competitive production. Productivity due to low labor costs is not a long term solution because it does not have the design component of manufacturing that increases the value added. These types of gains in productivity do not lead to capital formation necessary for growth.

Concerns about the Reproduction of the Labor Force

The International Monetary Fund (IMF) 2003 Review under the Stand-by Agreement states that: "The Bulgarian economy remains competitive, as labor productivity growth has outstripped the real effective exchange rate appreciation, and wage increases remain moderate" (IMF 2003, 5). Wages in Bulgaria remain low on international standards,

begging questions about the reproduction of the labor force, which is one of the major concerns of development economics. In 2000 Bulgaria had the lowest average monthly wage of all accession countries. Its wage level was 42–43 % of the level of the lowest income countries of the first accession group (Slovakia, Latvia and Lithuania). According to Eurostat's Labor Costs survey for 2000, among the candidate countries, the labor cost per hour is the lowest in Bulgaria (1.35 euro) and Romania (1.51 euro), and the highest in Cyprus (10.74 euro) and Slovenia (8.98 euro) (Eurostat, 2003).

Measures oriented towards further reduction of production costs mainly through cutting labor costs are promoted as way to eliminate the presumed labor market rigidities. But reduction of the non-wage labor cost under the condition of balance government budget and occasional surpluses since the implementation of the CB would mean that government subsidies most probably would not be accepted as a way to decrease the non-wage component of the labor cost. The alternative of course is for workers to decrease their consumption; to "choose" not to get sick and have children; or to absorb the decreased non-wage labor cost through unpaid domestic labor in the form of altruistic care. Despite its cumulative 64 % nominal increase between 1997 and 2002, overall manufacturing wages had negative growth in real terms in 2000–2001, and in 2002 stood only 7.7 % above their 1997 level (Pashev, 2003, 25). Considering that the 1996–1997 financial crisis resulted in a 33 % collapse in real wages, the wage expansion in 1998–2002 is a recovery of the pre-crisis 1995 level rather than income expansion (Pashev 2003, 29). Thus, most households will find it increasingly difficult to assume the non-wage portion (unpaid domestic work) of the labor cost that goes into the reproduction of the labor force. They will need to work longer hours or their consumption would need to

shrink, making them more susceptible to sickness which will require further unpaid care work.

Conclusion

The paper argued that the second Copenhagen criterion about the capacity of the country to cope with competitive pressure within the EU needs to be distinguished from considerations about active economic development policy. Such a policy would have as goal competitiveness defined in broader terms that go beyond considerations about productivity based on decreasing labor cost.

We can describe the objective in the transition program that has been practiced up to now as transforming the role of money from a numererie and means of exchange into a unit of account and a store of value. When price liberalization occurred, the variation in expectations about future supply and demand prices of commodities was introduced. Under these conditions, uncertainty gave rise to asset speculation and the function of money as a store of value came to play. However, this effectively could be done only with the existence of private property and debtor-creditor relations, hence the connection between price liberalization, capital liberalization and privatization in the transition agenda.

Within such logic, there must be financial assets that correspond to the distributed private property. With an abdicating state, the capital liberalization is necessary for the institutionalization of the debtor-creditor relations in the economy and for the existence of speculative opportunities. External creditors coming from economies based on capital

accumulation (with ability to borrow abroad) extend credit to local agents who become debtors with the expectations for higher future demand prices and for monetary returns. The investment decisions in the local economy become a function of speculative expectations (Keynes's "animal spirits"). The fetish for liquidity is introduced into the economy and the currency board had facilitated this.

The introduction of the currency meant a political agreement on maintaining a balance between foreign reserves and reserve money in the economy. The Law forbids the central bank financing of budget expenses either directly or through purchases of government securities or in any other form. The procedure of commercial banks' refinancing is outlined by the Law and it requires high-grade collateral. This effectively means that the premium needed to persuade investors to part with liquidity is high and creates a bias toward high liquidity preference that is an obstacle to investment in productive assets.

Under these conditions, the question is: how could the economy secure reproduction of its labor force and how can it find its way toward competitiveness beyond productivity based on low labor costs. Further, now that the production and export structure of the country have changed towards low value added sectors, what will be the consequences for the Bulgarian economy as a future member in the EU?

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