CENTER FOR THE STUDY OF DEMOCRACY

AMERICAN-BULGARIAN ECONOMIC COOPERATION FORUM:

Expanding Investment and Trade - How Can Institutions Help?

A Collection of Papers

Wednesday, December 7,1994

Sofia, Bulgaria

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AMERICAN-BULGARIAN ECONOMIC FORUM:
Expanding Investment and Trade - How Can Institutions Help?

Wednesday, December 7, 1994
Center for the Study of Democracy

Program

8:30 Welcoming remarks by Dr. Ognian Shentov, President of the Center for the Study of Democracy

8:40 First session chaired by the Ambassador of the United States to Bulgaria - Mr. William Montgomery

Current Economic Relations Between the United States and Bulgaria

Presentations by Mr. Kiril Velev, Minister of Trade and Chairman of the Bulgarian-American Trade and Investment Association (BATIA) and Mr. John Fogarasi, Commercial Attache, US Embassy

9:10 ***Improving the Legal Framework for Expanded Economic Relations***

Presentations by Mr. Stephan Kyutchukov, Center for the Study of Democracy, and Mr. Mark Beesley, American Bar Association, Central and East European Law Initiative (CEELI)

10:00 ***Addressing the Constraints to Investment and Trade***

(Part ***1)***

Ms. Daniela Bobeva, Foreign Investment Commission

10:30 Coffee Break

11:00 Second session chaired by the Ambassador of Bulgaria to the United States - Mrs. Snezhana Botousharova

Addressing the Constraints to Investment and Trade (Part 2)

Presentations by Mr. Ray Mazurek, President of the American Chamber of Commerce - Bulgaria, Mr. Ben Counter of Clarina (Coca-Cola), and Mr. John Wilton, Resident Representative, World Bank

11:45 Questions and discussions

13:30 Lunch at Royals Restaurant

15:00 Press conference at the Center for the Study of Democracy

18:30 Cocktail reception at the Center for the Study of Democracy

AMERICAN-BULGARIAN ECONOMIC COOPERATION FORUM:
Expanding Investment and Trade - How Can Institutions Help?

Wednesday, December 7, 1994
The Center for the Study of Democracy
Sofia, Bulgaria

Overview

This one-day forum will bring together approximately 30 representatives of American and Bulgarian institutions involved in promoting bilateral trade and investment. It is being organized at the initiative of the Bulgarian Ambassador to the United States — Mrs Snezhana Botousharova - with support from the Open Society Fund. The objective is two-fold:

-to identify those factors that currently constrain American investment in Bulgaria and hinder trade expansion; and,

-to define a framework of actions to be undertaken by the Bulgarian and American institutions to promote expanded bilateral economic cooperation.

The output of the forum will be a series of recommendations to be considered by governmental and non-governmental organizations to improve their coordination and effectiveness in trade and investment promotion activities. These recommendations will be circulated amongst concerned institutions and presented to the new Bulgarian government after the elections.

Discussion Topics

Representatives of organizations involved in American-Bulgarian economic cooperation will make presentations on three topics during the forum. Each topic will be addressed by two co-panelists, one Bulgarian and one American. This will be followed by a series of short commentaries by representatives of concerned institutions, and then questions and open discussion. Background papers on the topics will be distributed in advance.

Topics to be presented are outlined below. Through these presentations, the speakers will define and address a series of key questions about constraints and opportunities for improved economic relations.

1) Current Economic Relations between the United States and Bulgaria.
In 1992, Bulgaria took two important steps to improve its economic relations with the United States. It adopted a modern and liberal foreign investment law and concluded bilateral investment treaties with several countries, including the US. Despite these steps, levels of trade and investment remain low. Some observers cite constraints such as a lack of consistent government commitment to support investments, suspicion of foreign intrusion, and a lack of transparency in tax policies. The panelists will address these issues, providing information about the levels of bilateral investment and trade, and comparing them with levels in other Central European countries. They will provide examples of successful deals as well as missed opportunities, and discuss the possibilities for expansion in various sectors. The general constraints to this expansion will be explored, as well as the role of institutions in this process.

Panelists: Kiril Velev, Minister of Trade and Chairman of Bulgarian-American Trade and Investment Association (BATIA)
John Fogarasi - US and Foreign Commercial Service

2) **Improving the Legal Framework for Expanded Economic Relations.** Panelists will discuss the benefits and problems in the Foreign Persons' Business Activity and Foreign Investments Protection Act. They will address the issue of adequate protection for local companies created by direct foreign investment, as well as fund repatriation and international arbitration. They will outline the changes that are planned and make recommendations for improvements. Specific attention will be focused on problems of implementation of the laws. In addition, the panelists will describe Bulgaria's current status with the International Center of Investment Disputes (ICSID) and the General Agreement on Tariffs and Trade (GATT), and discuss how these organizations can be used to further Bulgaria's interests. The panelists also will talk about the Bulgarian and American institutions that are working to improve the legal framework for economic relations and assess their performance. They will suggest several specific measures for improvements.

Panelists: Stephan Kyutchukov - Center for the Study of Democracy
Mark Beesley, American Bar Association, CEELI

3) **Addressing the Constraints to Investment and Trade** . Panelists will explore why American investment and trade are so modest in Bulgaria, trying to pinpoint the key constraints, whether they are legal, bureaucratic, economic, informational or related to weaknesses in the banking or telecommunications sectors. The speakers will briefly summarize the critiques forwarded by agencies such as the Foreign Investment Advisory Service and assess their validity. They will examine the role of Bulgarian institutions that are attempting to facilitate trade and investment and discuss their effectiveness, particularly in the area of investor servicing and export finance. Next, the panelists will assess the effectiveness of the American institutions and programs involved in the promotion of trade and investment, and suggest steps to improve performance.

Panelists: Ray Mazurek — President of American Chamber of Commerce, and Ben Counter of Clarina (Coca-Cola), Mr. John Wilton, Resident Representative, World Bank, and Daniela Bobeva, Foreign Investment Commission

Format

Ambassador Montgomery will chair the forum during the presentations on the first two topics, between 8:30 and 10:30 a.m. Ambassador Botousharova will chair the forum for the third topic, to be presented and discussed between 11:00 and 13:00. Questions and comments will be welcomed following each topic. All proceedings will be in English to maximize the time available for discussions. At 13:30 lunch will be served at nearby Royals Restaurant.

The forum will conclude with an effort to develop consensus recommendations for steps to be taken by Bulgarian and American organizations to facilitate more effectively trade and investment. These recommendations will be presented to the new government, regardless of its composition, after the elections and once it is in place.

Invitees include:

1. Alexander Bozhkov, Former Executive Director, Privatization Agency
2. Ben Counter, Clarina (Coca Cola), Bulgaria
3. Daniela Bobeva, Foreign Investment Commission
4. Dimiter Kostov, Deputy Minister of Finance
5. Robert McCarthy, Bulgarian-American Enterprise Fund (BAEF)
6. George Prohasky, Executive Director, Open Society Fund - Sofia
7. George Pirinski, Former Deputy Prime Minister
8. Ivan Belchev, Deputy Minister of Trade
9. Ivanka Petkova, Program Director, Institute for Market Economics
10. Jack Godwin, Associate Director, Peace Corps Bulgaria
11. John Fogarasi, US and Foreign Commercial Service
12. John Kornish, General Manager, DHL, Bulgaria
13. John Tennant, USAID Representative, Bulgaria
14. John Wilton, Head of the Resident Mission, World Bank
15. Kamen Shopov, Assistant Director, Vidima Ideal
16. Kina Tchoutourkova, Supreme Court Judge
17. Krastju Mirski, Vice President, Committee of Posts and Telecommunications
18. Kiril Velev, Minister of Trade, and Chairman of BATIA
19. Lada Stoyanova, Program Specialist, USAID, Bulgaria
20. Lawrence Kent, Development Alternatives, Inc.
21. Lyubomir Philipov, Vice Governor, Bulgarian National Bank
22. Mariana Todorova, Advisor to the Executive Director, World Bank
23. Mark Beesley, American Bar Association, Central and East European Law Initiative
24. Nikola Tcholakov, Economics Expert, Union of Democratic Forces
25. Nickolay Savov, Bulgarian Business Systems/Apple Computer IMC
26. Ognian Shentov, President, Center for the Study of Democracy, (CSD)
27. Ray Mazurek, President, American Chamber of Commerce in Bulgaria
28. Robert Bose, Vice President, Caresbac
29. Robert Taylor, Colgate-Palmolive
30. Roumen Gechev, University for National and World Economy
31. Skip Kissinger, Private Sector Officer, USAID
32. Snezhana Botousharova, Ambassador of Bulgaria to the United States
33. Stephan Hadjitodorov, Member of Supervisory Board, Privatisation Agency
34. Stephan Kyutchukov, Head of Legal Program, CSD, General Counsel, Bulgarian-American Entreprise Fund
35. Svilen Parvulov, Member of Supervisory Board, Privatisation Agency
36. Tim Taylor, McDonalds-Bulgaria Ltd.
37. Todd Madden, Arthur Andersen, Sofia
38. Todor Tchourov, Ambassador at Large
39. Vesselin Gornishki, Head of Department, Minstry of Trade
40. Vladimir Yordanov, Applied Research and Communications Fund
41. William Montgomery, Ambassador of the United States to Bulgaria

"PERSPECTIVES ON U.S.-BULGARIAN TRADE AND INVESTMENT"

BY

JOHN J. FOGARASI, COMMERCIAL ATTACHE, U.S. EMBASSY

MADAME AMBASSADOR, MR. AMBASSADOR, MR. MINISTER, AND HONORED GUESTS,

THANK YOU FOR THE OPPORTUNITY TO PARTICIPATE IN THIS FORUM. FIRST OF ALL I WOULD LIKE TO COMMEND AMBASSADOR BOTOUSHAROVA AND THE ORGANIZERS, THE CENTER FOR THE STUDY OF DEMOCRACY, FOR THIS INITIATIVE ON DEVELOPING CONSTRUCTIVE SOLUTIONS TO THE ISSUE OF EXPANDED U.S.-BULGARIAN TRADE AND INVESTMENT. I APPLAUD THE FRANKNESS WITH WHICH THE ISSUES ARE BEING ADDRESSED HERE -- I SHARE THE PREMISE OF THIS EVENT THAT THERE ARE CONSTRAINTS AND HINDRANCES AT PRESENT, BUT I AM ALSO CONVINCED OF THE POTENTIAL THAT BULGARIA HOLDS FOR EXPANDED BILATERAL COMMERCIAL RELATIONS.

IN THE SPIRIT OF CANDOR SET FOR THIS FORUM, I WOULD LIKE TO COMMENT FROM A PERSPECTIVE OF A FEW YEARS OF GREATER AND LESSER SUCCESS IN PROMOTING U.S. TRADE AND INVESTMENT PROSPECTS. DURING THIS TIME, THE GENERAL UNDERSTANDING OF BULGARIA BY THE INTERESTED U.S. BUSINESS COMMUNITY WAS APTLY CHARACTERIZED BY DEPUTY SECRETARY OF STATE'S EAGLEBURGER'S COMMENTS AT THE U.S. CHAMBER OF COMMERCE -- BULGARIA IS THE BEST KEPT SECRET IN EUROPE. FEW COMPANIES KNEW MUCH ABOUT BULGARIA, LET ALONE ITS ECONOMIC STRENGTHS/WEAKNESSES BUT MANY WERE CERTAINLY INTRIGUED

BY THE APPEAL OF BREAKING GROUND IN A PIONEER MARKET AND BLAZING A TRAIL WHERE THEIR COMPETITORS HADN'T YET SET FOOT.

PERHAPS IN RECOGNITION OF BULGARIA'S POOR MARKETING EFFORTS IN THE PAST, INITIAL EFFORTS TO STIMULATE INVESTMENT WERE PRIMARILY BASED ON ATTRACTING INVESTMENT INTEREST AT THE EXPENSE OF WHAT TO DO WITH THAT INTEREST ONCE IT LANDED IN THE COUNTRY. THE ATTRACTION APPROACH EMPHASIZED THE BASIC ADVANTAGES OF BULGARIA, STRESSING FAVORABLE LEGAL STRUCTURES, SUCH AS THE LAW ON FOREIGN INVESTMENT; BI-LATERAL TIES; OFFERED BROCHURES OF COLORFUL DISPLAYS AND SCENERY; AND USUALLY INCORPORATED LONG LISTS OF FIRMS WITH VERY SIMILAR SOUNDING OBJECTIVES - LOOKING FOR JOINT-VENTURE PARTNER; NEEDS TECHNOLOGY, MANAGEMENT, AND MARKETING HELP.

UNFORTUNATELY, THE EXPERIENCE OF THE PAST SEVERAL YEARS SHOWS THAT THIS APPROACH, BY ITSELF, IS NOT ENOUGH. WHAT WAS MISSING WAS FOLLOW-THROUGH TO SECURE, SUPPORT, AND MAINTAIN INVESTOR INTERESTS, ESPECIALLY THOSE ALREADY IN THE COUNTRY. THESE FACTORS ARE ALL THE MORE CRITICAL IN LIGHT OF THE STRONG REGIONAL COMPETITION FOR INVESTORS - A FACT WORTH AMPLIFYING.

WHILE BULGARIA HAS GEOGRAPHICAL ADVANTAGES, STRONG HUMAN RESOURCE SKILLS, AND TRADITIONAL INDUSTRY BENEFITS, BULGARIA IS NONETHELESS HANDICAPPED BY A LACK OF TRADITIONAL LINKS WITH THE U.S. AND WITH MANY WEST EUROPEAN PARTNERS. SUCH TRADITIONAL TIES HAVE BEEN THE BASIS OF MUCH TRADE AND INVESTMENT FOR OTHER COUNTRIES IN THE REGION. POLAND, HUNGARY, AND THE CZECH REPUBLIC HAVE LARGE AND VOCAL EMIGRE COMMUNITIES THAT HAVE SERVED AS A BRIDGE AND STIMULI FOR COMMERCIAL ACTIVITY. ADDING TO THIS FACTOR WAS BULGARIA'S TRADITIONAL EASTWARD ORIENTATION, WHICH MEANT THAT MOST WESTWARD INITIATIVES WERE BEING BUILT ON FRESH COMMERCIAL GROUND. IN ORDER FOR BULGARIA TO COMPETE FOR INVESTMENT UNDER THESE CIRCUMSTANCES, A MUCH STRONGER STRATEGY BASED ON IN-COUNTRY FOLLOW-THROUGH, OFFERS OF SUPPORT, AND INDUCEMENTS WOULD HAVE BEEN REQUIRED. THE FACT THAT BULGARIA WAS LESSER KNOWN TERRITORY, WITH FEWER COMMERCIAL BRIDGES TO THE WEST, MEANT THAT WESTERN INVESTMENT VENTURES TOOK THE BETTER KNOWN AND LESS RISKY PATH WITH COUNTRIES WITH WHICH LONG-STANDING RELATIONSHIPS EXISTED, AIDED BY ETHNIC CONNECTIONS.

LOOKING AT THE U.S. BUSINESS COMMUNITY TODAY, THESE DRAWBACKS MIGHT SEEM LESS OF A CONCERN AND THE BUSINESS HORIZON SHOULD LOOK MUCH BRIGHTER. THE U.S.-CONNECTED TRADE COMMUNITY HAS GROWN SIGNIFICANTLY TO A NUMBER CLOSE TO 100, WITH MOST MAJOR ACCOUNTING FIRMS, MANY OF THE WELL-KNOWN SERVICE ORGANIZATIONS, TELECOM COMPANIES, AND OTHERS IN THE ENERGY, TRANSPORT,

PHARMACEUTICAL AND CHEMICAL FIELDS NOW RESIDENT IN BULGARIA. MOREOVER, THE AMERICAN CHAMBER OF COMMERCE IN BULGARIA HAS BEEN ESTABLISHED, AN ORGANIZATION WHICH SENDS A STRONG POSITIVE MESSAGE TO PROSPECTIVE U.S. BUSINESSES. THE U.S. BUSINESS COMMUNITY HAS ALMOST DOUBLED SINCE 1992, THOUGH MOSTLY IN TERMS OF LOCAL REPRESENTATION AND NOT EX-PATRIOT PRESENCE.

IN TRADE PROMOTION, THE U.S. PAVILION AT PLOVDIV HAS DOUBLED IN SIZE EVERY YEAR FOR THE PAST THREE YEARS, SURPASSED THIS PAST YEAR ONLY BY THE AUSTRIAN AND GERMANY PAVILIONS. MISSIONS FROM OPIC, THE ORGANIZATION OF U.S. STATES, CASE, THE U.S. TRADE DEVELOPMENT AGENCY, AND EXIMBANK HAVE ALL COME TO BULGARIA IN THE PAST YEAR.

YOU MAY ASK THAT GIVEN SUCH ACTIVITY, WHY SHOULD THERE BE CONCERN OVER OBSTACLES AND HINDRANCES. FIRST, THE EXAMPLES I HAVE MENTIONED ARE PRIMARILY TRADE ENTRIES; U.S. INVESTMENT STILL SERIOUSLY LAGS (SOMEWHERE BETWEEN 30-40 MILLION). SECOND, MUCH OF THIS ACTIVITY WAS INEVITABLE SPILLOVER FROM THE NORTHERN TIER, AS THOSE AREAS BECAME SATURATED AND WESTERN FIRMS BECAME MORE COMFORTABLE WITH TRANSITIONAL ECONOMIES, COMPANIES BEGAN TO LOOK TO NEW MARKETS IN THE REGION. BUT THAT GROWTH, I CAUTION, WILL ONLY BE SHORT-LIVED UNLESS THERE IS A REEXAMINATION OF THE CURRENT APPROACH TO FOREIGN INVESTMENT WHICH FOCUSES ON ATTRACTION AND MARKETING BULGARIA. INSTEAD CRITICAL ATTENTION

SHOULD BE GIVEN TO SECURING AND MAINTAINING THE EMERGING OR EXISTING FOREIGN INVESTMENT IN-COUNTRY. THE NEED FOR A BROADER APPROACH IS APPARENT WHEN ONE HEARS THE NUMEROUS PAINFUL CASES OF FIRMS WHO DESPITE THEIR BEST EFFORTS CONSIDER BULGARIA ONE OF THE TOUGHEST MARKETS TO DO BUSINESS. U.S. COMPANIES REGULARLY EXPRESS TO ME THEIR FRUSTRATIONS WITH GOVERNMENTAL RESPONSES TO THEIR SERIOUS INVESTMENT CONCERNS AS FRUITLESS, AND THE BEHAVIOR OF THE BUREAUCRACY AS BORDERLINE OBSTRUCTIONIST.

I KNOW THAT GENUINE EFFORTS HAVE BEEN MADE BY THIS AND PREVIOUS GOVERNMENTS AND BY MANY WHO ARE HERE TODAY. BUT THE BEST EFFORTS OF ONE DEPARTMENT ARE TOO OFTEN CANCELLED OR NEGATED BY OTHER MINISTRIES OR DEPARTMENTS WHO ARE LESS SYMPATHETIC TO FOREIGN INVESTMENT OR HAVE NO INTEREST IN SUPPORTING THEIR PROJECTS. THE ASSUMPTION IS THAT ONCE FOREIGN FIRMS ARE HERE, THEY SHOULD FEND FOR THEMSELVES; THEY SHOULD BE ABLE TO DEAL WITH THEIR VISA V PROBLEMS; NOT BE CONCERNED ABOUT SUDDEN CHANGES IN TAX LAWS; SOLVE INFRINGEMENTS OF THEIR PATENT AND INTELLECTUAL PROPERTY; SURMOUNT BUREAUCRATS WHOSE ONLY WISH IS ASSERT AUTHORITY AND CREATE BUSINESS DELAYS; DEAL WITH THE GROWING CRIMINALITY OF COMMERCIAL LIFE; AND, SCRUPULOUSLY ABIDE BY ALL THE REGULATIONS OF THE HOST COUNTRY, WHILE DOMESTIC COMPETITORS ARE SIDESTEPPING THE SAME REGULATIONS. THESE ARE SOME OF THE CONCERNS THAT I HEAR DAILY AND THEY ARE GROWING, I AM SAD TO SAY.

WHAT THIS CIRCUMSTANCE DEMANDS IS A COHERENT NATIONAL FOREIGN INVESTMENT THAT IMPACTS ACROSS MINISTRIES AND DOWNWARD TO BUREAUCRACIES. TO BE CLEAR, SUCH A STRATEGY IS NOT ASKING FOR FAVORITISM OR SPECIAL CONCESSIONS, BUT AIMED TO ELIMINATE THE ONEROUS, THE INFLEXIBLE, AND OVERLY-LEGALISTIC CONDITIONS WHICH SO MANY FIRMS FACE WHICH UNDERMINE THEIR ABILITY TO CONDUCT NORMAL BUSINESS. SECONDLY, U.S. FIRMS SEEK PREDICTABILITY AND CONSISTENCY IN REGULATIONS AND WILL ABIDE BY THEM; RETROACTIVE OR AD HOC RULINGS ONLY RAISE SUSPICIONS OVER THE MOTIVES FOR SUCH ACTIONS. LASTLY, U.S. FIRMS WANT FAIRNESS; THEY SHOULD NOT HAVE THE IMPRESSION THAT THEY ARE BEING SINGLED OUT FOR COMPLIANCE TO SPECIAL REGULATIONS, OR ASKED TO PAY HIGH RATES BECAUSE OF A LOCAL ATTITUDE THAT FOREIGNERS BY DEFINITION SHOULD PAY ANY AMOUNT WITHOUT QUESTION. U.S. FIRMS WANT NOT ONLY TRANSPARENCY IN LAWS BUT ALSO IN ENFORCEMENT SO THAT DOMESTIC FIRMS ARE EQUALLY MEETING THEIR OBLIGATIONS.

TO FORM A NATIONAL FOREIGN INVESTMENT STRATEGY IS, ADMITTEDLY, A DAUNTING TASK. A STRONG FIRST STEP WOULD BE TO HAVE SENIOR GOVERNMENT OFFICIALS ASSERT THE IMPORTANCE OF FOREIGN INVESTMENT IN THE **BULGARIAN** ECONOMY. SUBSEQUENT STEPS MIGHT BE THE CREATION OF OPEN **AND** HIGH LEVEL CHANNELS OR INSTITUTIONS DESIGNED TO HELP INVESTORS **RESOLVE** THEIR LEGITIMATE CONCERNS. LONGER-TERM PROPOSALS **MIGHT** BE TO HIGHLIGHT SUCCESSFUL FOREIGN INVESTMENTS,

EMPHASIZING "THE GOOD CORPORATE CITIZEN" ASPECT AND THEREBY REBUT THE GROWING TREND THAT SUCCESSFUL FIRMS ARE FAIR GAME FOR ANY FORM OF CRITICISM, ESPECIALLY CRITICISM THAT TOO OFTEN FAILS TO PRESENT A BALANCE PICTURE.

ON OUR SIDE, WE ALSO RECOGNIZE THE NEED FOR FOLLOW-THROUGH AND IN-COUNTRY SUPPORT FOR TRADE AND INVESTMENT. OUR PROGRAMS SUCH AS THE "AMERICAN BUSINESS INCUBATOR" ADDRESS SOME THE FUNDAMENTAL OBSTACLES FOR FIRMS ATTEMPTING TO SET UP OPERATIONS - SUCH AS PROFESSIONAL OFFICE SPACE AND RELIABLE COMMUNICATIONS. TO DATE WE HAVE ASSISTED SUCH MAJOR FIRMS SUCH AS SPRINT, U.S. WEST, MCDERMOTT, AND ISCA AND WE INTEND TO EXPAND OUR EFFORTS TO OTHER FIRMS. SECOND, WE HAVE A PROGRAM THAT RAISES THE CHANCES OF A SUCCESSFUL TRADE RELATIONSHIP WITH THE UNITED STATES BY WORKING WITH THE BULGARIAN PARTNER, ENHANCING HIS TRADE SKILLS, BRIDGING THE GAP BETWEEN THE WAY BULGARIAN AND AMERICAN WAYS OF DOING BUSINESS, AS WELL AS PROVIDING THE BULGARIAN PARTNER WITH EFFECTIVE COMMUNICATIONS. FINALLY, THE EMBASSY IS WORKING HARD TO ESTABLISH CERTAIN INVESTMENT BREAKTHROUGH PROJECTS THAT CAN IN TURN TRIGGER EXPANDED INTEREST IN BULGARIA. SUCH PROJECTS INCLUDE ESTABLISHING EXIMBANK LENDING FOR BULGARIA, AS WELL AS MAJOR SALES OF AIRCRAFT, SO THAT U.S.-BULGARIAN TRADE HAS A HIGHER PROFILE AND PUTS BULGARIA ON THE U.S. TRADE AND INVESTMENT MAP. FINALLY, THE WHITE HOUSE IS HOSTING A MAJOR CONFERENCE IN JANUARY FOR CENTRAL AND EASTERN EUROPEAN COUNTRIES, WHICH WILL

BRING OVER 350 U.S. CORPORATE LEADERS TOGETHER WITH COMMERCIAL DECISION-MAKERS FROM THIS SIDE OF THE ATLANTIC. PRESIDENT CLINTON WILL PERSONALLY HOST THE CONFERENCE ON JANUARY 12-13, AND WE LOOK FORWARD TO STRONG AND PRODUCTIVE EXCHANGES WITH THE BULGARIAN DELEGATION.

BULGARIA IS AT A CROSSROADS TODAY; THE EARLIER TABLA ROSA VIEW OF BULGARIA WILL CHANGE INTO A DEFINED PICTURE IN THE NEXT FEW YEARS. THE EXPERIENCES OF THE FOREIGN COMMUNITY AND INTERESTED FOREIGN FIRMS WILL MARK BULGARIA, FOR BETTER OR WORSE. IN THAT REGARD, BULGARIA MUST GUARD AGAINST BEING LABELED XENOPHOBIC OR A DIFFICULT MARKET. RATHER WE SHOULD ALL BE AIMING FOR A BULGARIA WITH A REPUTATION FOR "GROWING PROSPECTS"; "OPEN FOR BUSINESS"; AND "SUPPORTIVE FOR INVESTORS". THE HARD FACTS ARE THAT INVESTMENT IS A COMPETITIVE GAME AND THERE ARE TOO MANY EAGER AND INVESTOR-FRIENDLY ALTERNATIVES IN THE WORLD TODAY. BULGARIA HAS TODAY AN OPPORTUNITY TO CAPITALIZE ON ITS GROWING FOREIGN INTEREST, ITS EXPANDED FOREIGN TRADE COMMUNITY, THE RESOLUTION OF ITS PRIVATE DEBT, AND THE UPCOMING PUSH ON PRIVATIZATION. ALL THESE ARE MAJOR POSITIVE ASSETS THAT CAN REINFORCE A NATIONAL FOREIGN INVESTMENT STRATEGY.

WHEN ONE AMERICAN RENT-A-CAR COMPANY ACKNOWLEDGED THAT ITS COMPETITION WAS MORE SUCCESSFUL, THE COMPANY, AVIS, DECIDED TO TURN DISADVANTAGE TO ADVANTAGE BY DECLARING TO CUSTOMERS THAT THEIR POLICY WAS TO TRY A LITTLE HARDER AND THEREBY BEAT THE COMPETITION. I BELIEVE THAT BULGARIA WILL SUCCEED WITH FOREIGN INVESTMENT AND ITS ECONOMY BECAUSE IT HAS THE STRENGTHS AND GREATNESS TO CARRY THROUGH WITH A COMPREHENSIVE AND MUTUALLY BENEFICIAL FOREIGN INVESTMENT PROGRAM.

Improving the Legal Framework for Expanded Economic Relations

— *Overview* —

-- *Discussion Paper* --

Mark K Beesley and Stephan Kyutchukov

AMERICAN-BULGARIAN ECONOMIC COOPERATION FORUM

December 7,1994

Development of Institutional Framework		
Institution	**Status**	**Recommendation**
Appellate Courts	Law on the Structure of the Judicial System was passed this summer. Procedural laws for the operation of the new court system are not developed. Court system constitutionally required to be in place by July 1992 is not in place.	Form expert group to draft three sets of procedural laws (civil, criminal and administrative procedures) for the administration of new court system. Establish individual courts of appeal.
Notary Public System	No private notary public system exists. Legislation creating private system submitted to parliament.	Pass draft law.
Central Registries	No central or computerized registries. Difficult to determine registry status and impossible to obtain registration information from central source.	Create a system of computerized central registries. Form working group to create uniform standards and format for national computer databases.
Institutional Efficiency	Clear operating procedures do not exist or are not standard in some central government institutions. Local practices and interpretation of laws on identical issues vary and cause confusion and duplication of efforts.	Develop standardized operating procedures. Create standardized forms and applications that clearly identify required documents.

Laws That Need to Be Implemented or Drafted		
Law	**Status**	**Recommendation**
Bankruptcy	Bankruptcy law adopted in August 1994. Most old insolvency cases rolled over under new law. No bankruptcy reorganization cases filed. General unfamiliarity with benefits of reorganization.	Organize a working group to educate and train judges, practitioners, creditors and debtors in principles of reorganization law. Conduct initial test reorganization case relying on teams of local practitioners and foreign experts. Develop court technology including bankruptcy database of status of pending cases.
Privatization	Mass privatization scheme adopted in June 1994; prior reliance on market privatization.	Develop combination mass- market privatization schemes.
Collateral/Secured Transactions	Outdated secured transaction law; no current plans for revision. No registries exist to register mortgage or other security interest in chattels. Perfected pledge requires non-foreign, non-bank creditors to take possession of chattel.	Organize a working group to draft and lobby for passage of a Bulgarian version of an internationally accepted model secured transaction law. Create and maintain a central registry to register chattel security interests.
Foreclosure	Outdated, debtor-oriented foreclosure law unsuitable for market economy, no current plans for revision.	Organize a working group to draft and lobby for passage of a modern foreclosure law.
Securities Markets and Regulation	The Law on Securities and Investment Companies has been drafted and submitted to Parliament.	Passage of draft law is important, particularly given expected trading due to mass privatization scheme. Create and maintain regulatory organization.
Leasing	No specific leasing legislation exists. VAT classification of finance leasing as non-financial transaction inhibits leasing deals.	Ability to enter leasing con tracts eliminates immediate need for specific law. Bulgaria Leasing Association should be revived to review industry problems and make specific recommendations. Consideration should be given to amending VAT law.
Foreign Trade	Bulgaria has not acceded to GATT.	Need to identify laws and regulations that effect GATT accession and take concrete steps to comply with GATT requirements.

**Improving the Legal Framework
for Expanded Economic Relations**

- Discussion Paper --

This paper briefly reviews (1) Bulgaria's progress toward developing an institutional framework to administer laws that affect foreign trade and the market economy, (2) several laws that will positively affect foreign trade and the market economy that require implementation and (3) laws that should be drafted to allow investors and markets to function efficiently. The paper also recommends that government institutions adopt uniform standards nationwide so that market requirements will be consistent and predictable.

There will be no quick fix to solve all of the problems of Bulgaria's legal framework. A number of laws have yet to be drafted and a number drafted and passed will take time to effectively implement. Finally, it may take years for some laws to "mature" and legal practitioners and courts to learn how they work. The goal, however ~ to achieve a uniform and predictable system in which a free market can flourish -- can be reached during the process of development.

This paper is a discussion paper. It is not an exhaustive research paper or report on all areas of Bulgarian institutional and legal development. Its purpose is to identify major targets that are ripe for change and offer possible reform recommendations so that the free market can develop during the transitional period.

I. Institutional Framework

Bulgaria has completed, by and large, building the institutional framework to implement laws. Many government institutions were in place before 1989. Others, such as the Constitutional Court, the Supreme Judicial Council and the Committee on Protection of Competition, have been created in the last four years and are now functioning.

Still, there remain gaps. Many such gaps are in areas directly related to commerce and investment and include completion of the structure of the judicial system, creation of a functioning notary public system and development of a nationwide commercial registry system.

A. Law on the Structure of the Judicial System

On occasion, the results of commercial activity are, unfortunately, commercial disputes. An efficient judicial system is necessary to build confidence that such disputes will be resolved fairly and efficiently.
One method to build faith in the courts and to improve their ability to resolve disputes is to implement a revised court structure.

1. Status of the Law

The Law on the Structure of the Judicial System was passed this summer. Several Constitutional challenges slightly revised the law, although its major purpose — to create a tier of courts of appeal ~ remains intact. The Bulgarian Constitution required the courts to be established by July 1992.

Bulgaria has chosen a four-tier system of courts to implement a three-instance procedure (that is, there are four different courts and everyone is guaranteed a trail and two appellate reviews). This choice is embodied in the Constitution and it should be implemented to comply with the Constitution and create a more efficient judicial system.

2. Recommendation

Creation of the Court of Appeal should take place as soon as possible. Implementation of such a court should be preceded, however, by the development of procedural rules (administrative, civil and criminal) tailored to meet the requirements of the new system. The development of procedural rules is possibly an area for which court administrators could seek foreign assistance.

B. Notary Public System

Like most countries, Bulgaria requires that real estate and automobile transactions, mortgage executions and other transactions take place before a notary public. The law also frequently requires that signatures be notarized, dates or contents of documents be verified or copies of documents be certified. Transactions that require a notary's seal are usually invalid if it is omitted.

1. Status of the Law

The government introduced to Parliament a Draft Law on Notaries. The draft law follows the model of Austria, Germany and other European countries and provides for the development of a private notary system. This law has not been passed.

While most of the rest of the world operates under privatized notary systems, Bulgaria relies on a very limited number of notaries who function as state officials. For example, in the City of Sofia, with a population of 1.5 million and a huge concentration of business, there are approximately one dozen notaries. It is not uncommon to wait weeks or even a month to execute a mortgage or buy real estate and even a simple notarization of a signature usually takes over an hour.

2. Recommendation

The government should pressure the legislature to pass the Draft Law on Notaries. With a private notary system transaction costs will decrease, a private administration system will develop and government will dispense with a burdensome responsibility.

C. Creation of Modern Central Registries

To determine who owns what property, its type, size or shape, or whether it is encumbered and to put people on notice of these facts, governments create property registries. Like most countries, Bulgaria requires that properties and information about them be registered.

1. Status of the Law

While registries exist in Bulgaria, there is no central system.

Information on real estate, for example, can be found in any of over 100 registries located throughout Bulgaria. To locate all property of a bankrupt debtor or learn of all property owned and encumbered by a prospective borrower, creditors — to do their job properly — are required to check each registry by physically visiting each location. Do most creditors do their job properly? No. It is nearly impossible, and thus, they are required to accept additional risk.

There are also 29 commercial registries located throughout the country. To conduct due diligence on the legal standing of a prospective partner or purchase, one might be required to visit a registry in Varna, Blagoevgrad, Russe — or almost anywhere else. This inconvenience makes conducting necessary due diligence difficult and time consuming; the result is that the due diligence is often not completed. Such inconvenience is not necessary in a country the size of Bulgaria and in a modern era of computer technology.

2. Recommendation

Ultimately, Bulgaria should create a system of computerized central registries. Such a project is ambitious and will take time and money.

One action that can be taken in the short term, however, is to create uniform formats for national computer databases. When such formats are developed, they can be made available to local registries that can begin recording information according to the standardized national form. When a national computer system is developed, the locally produced information should be easily transferred to the national system.

II. Laves Requiring Implementation

A. Law on Bankruptcy

Liquidation and reorganization procedures are common features of developed market economies and are viewed as essential to the functioning of an efficient economy. Such procedures also can be used as methods of privatization.

1. Status of the Law

In August 1994, the law on bankruptcy came into force. The law allows for restructuring or liquidating insolvent companies.

Bulgarian courts and practitioners are somewhat experienced in insolvency law. Reorganization, however, is different. No reorganization cases have been filed under the new law (and were not provided for under the old) and courts, practitioners, creditors and debtors will likely suffer because of initial inexperience.

Implementation of the law is likely to be hindered by judicial and practitioner inexperience and possible government attempts to save some large companies whose liquidation or even reorganization will boost social discontent and unemployment.

2. Recommendation

Bankruptcy courts and practitioners need to be trained in the intricacies of reorganization law. This training could be accomplished by traditional seminars and the "hands-on" experience of participating in test reorganization cases. An appropriate company could be identified for reorganization and taken through the process with training teams of appropriate judges, lawyers, trustees, creditors and debtors.

A large number of expected bankruptcies will most likely inundate Bulgaria's fledgling bankruptcy court system. To prevent overwhelming of the system — and accompanying delay — steps should be taken now to develop court technology including databases to inform courts, practitioners and the public of the status of pending bankruptcies. If such information is readily available, courts and practitioners will be able to better perform their jobs and public resistance to bankruptcy may decrease as some of its benefits become apparent.

B. Law on Transformation and Privatization of State- and Municipality-Owned Enterprises

Privatization is generally seen as a linchpin for attracting foreign investment.

1. Status of the Law

Bulgaria adopted a system of mass privatization in June 1994. This supplements a market privatization scheme that was adopted in April 1992.

Privatization has not had the success in Bulgaria that it has had in other Central European countries. Obviously, an efficient privatization system will increase opportunities for foreign investment.

2. Recommendation

An enormous quantity of ink and an endless number of opinions have been offered to explain Bulgaria's somewhat lethargic movement toward privatization. This paper will not attempt to add to the fray — much. It will suggest the rather obvious point that Bulgaria should pursue all privatization options including mass privatization, market privatization, combinations of the two and other methods such as bankruptcy liquidation.

III. Laws That Need to be Drafted

The remainder of the paper will review areas where either no commercial law exists in Bulgaria or where the current law is inadequate and needs replacement.

A. Collateral Law

Modern market economies are largely based on financing of projects with credit. The proper legal framework must exist, however, to provide security for lenders.[1] Good collateral or secured transactions law promotes commercial and private lending and enhances trade by allowing financiers, producers, distributors and retailers to

1 "Security encourages investment. A creditor who knows that he has legally recognised rights to turn to his debtor's assets in case of non-payment is more willing to invest than the one who cannot make such recourse. It must, therefore, be said that security is indeed a necessary element of the institutional framework of a modern market economy." J.M. Rover "Security in central and eastern Europe and the EBRD's Model Law on Secured Transactions".

increase operations by financing businesses and purchases on short term bases. "Bulgaria's current collateral law is inadequate for a market economy and needs to be replaced with a Bulgarian version of an internationally accepted law.

1. Status of the Law

The major body of collateral law is contained in the Obligations and Contracts Act of 1950 (OCA).

Two vehicles are available to creditors in Bulgaria to acquire security interest in physical property. The first, the real estate mortgage, applies to pledging real estate as collateral and is hardly different from mortgages elsewhere in the world.[2]

The second applies to the use of non-real estate (chattel) property as security. No adequate law exists in Bulgaria that allows for the use of chattel as security. To pledge chattel, the debtor must execute a pledge agreement. Under the "transfer of possession" rule, security interest in the chattel does not attach until the creditor, or a third party authorized by the debtor and creditor, takes physical possession of the collateral.[3]

The "transfer of possession" rule for chattel represents an insurmountable obstacle to securing commercial lending where the borrower often wants to pledge the assets acquired to obtain the lended funds. Under the current law, the debtor cannot use the pledged assets to generate revenue to repay the loan.

Additionally, the security interest is not perfected if the date of the pledge agreement is not certified. A "pledge agreement" includes information regarding all essentials including the specific items of collateral. Thus, acquisition of a perfected security interest in inventory is practically impossible: one must be able to prove the dates security interest attached to every item of inventory, a difficult task if inventory is continually turning.

No registry exists in Bulgaria to register security interest in chattels. Because no registry exists, it is impossible to determine whether collateral pledged to one creditor has been previously pledged to another. Thus, even though the transfer of possession rule does not apply to banks and foreigners under current law, the lack of a system to register acquired security interest effectively eliminates the use of chattel as security in all cases. Bulgaria's collateral law is undoubtedly costing it hundreds of millions of dollars of investment that it could otherwise secure.

Mortgages are entered in real estate registers; a security interest does not attach and is not perfected without proper registration of the mortgage deed in the register. Thereafter, every person who acquires any interest in the mortgaged property takes subject to the rights of the secured creditor. This portion of Bulgaria's collateral law is adequate.

The Law on Banks and Credit Activity of 1992 and the Law on Economic Activity of Foreign Persons and on Protection of Foreign Investment of 1992 provide banks and foreign persons with some favorable exceptions to the otherwise cumbersome mechanism of acquiring security interest in chattel. With respect to banks and foreign persons, the law waives the "transfer of possession" rule. A written agreement with a certified date that identifies the collateral is sufficient to create a perfected security interest in the collateral.

2. Recommendation

Organize a working group to draft and lobby for passage of a Bulgarian version of an internationally accepted model secured transaction law. Create and maintain a central registry to register chattel security interests.

B. Foreclosure Law

Foreclosure is a difficult process in Bulgaria. Confidence in the legal mechanism for enforcing rights is low and private "enforcement" and racketeering groups flourish. The result of the difficult foreclosure process is that commercial turnover slows down. Businesses attempt to avoid situations where money would be owed to them for fear that commitments will not be honored and enforced.

1. Status of the Law

Foreclosure law is contained in the Civil Procedure Code of 1952. Some foreclosure rules are also identified in the bankruptcy legislation passed in August 1994.

The existing foreclosure law does not recognize or allow for non-judicial methods of foreclosure. Every creditor who has procured a writ of execution, regardless of whether it is a secured creditor, must go through a lengthy judicial process. Sale of a debtor's assets must be effected at a court appointed auction. The initial auction price must be determined by a court appointed expert. If a creditor must foreclose on a combination of real estate and chattel, this must happen in two different procedures which do not necessarily run parallel in time. Debtors are not allowed to bid and creditors' rights to bid are limited. Foreclosure on bank accounts is practically unworkable.

The foreclosure playing field is tilted in favor of the debtor. Debtors have numerous opportunities to prolong the procedure. Fines for violation of procedural rules are outdated and low and do not deter procedural violations. Even when, after a lengthy process, the court has scheduled an auction, a debtor — whose assets may exceed the value of the creditor's claim — may delay the process by another two years. If before the auction occurs the debtor pays 20 percent of the claim and commits to pay ten percent every quarter, foreclosure is stopped. The result can be that a poor creditor is forced to accept payments over a two-year period from a wealthy debtor.

Written to service a 1952 command economy, the law is unsuited for 1994 market realities.

2. Recommendations

Organize a working group to draft and lobby for passage of a modern foreclosure law.

C. Securities Markets and Regulation

A statute of Edward I, in 1285, authorized the Court of Aldermen in London to begin registering brokers. Since then, hundreds of statutes and regulations have been enacted throughout the world to regulate the securities industries. A draft Bulgarian law has been in the works for nearly two years.

1. Status of the Law

A draft Law on Securities and Investment Companies has now been submitted to Parliament. Its basic tenants proscribe affirmative disclosure of essential corporate information to prospective investors and provide a policing system to protect investors from unscrupulous dealers and budding pyramid and other schemes.

2. Recommendations

Passage of the draft law is important. Because of the mass privatization scheme and an improving economic climate, securities trading cannot help but increase. After adoption of the law, however, it will be important to create and maintain an effective regulatory body to help instill faith in the system and prevent potential early abuse.

D. Leasing

Leasing is used in western economies as an effective means of "pay as you go" financing. It is particularly attractive for small and medium size companies. Bulgaria has a long tradition — over ten years — of leasing in comparison to its Central European neighbors.

1. Status of the Law

Regulation of leases in Bulgaria is addressed in two pages of the Obligations and Contracts Act (OCA) and discussed in the National Accountancy Standards, § 11. The OCA does not allow a lease to continue more than ten years. While law regulating leases is slim, the Value Added Tax (VAT) negatively affects Bulgarian leasing prospects.

Under VAT, finance transactions are tax exempt. Finance leasing transactions (where, simply put, money is borrowed to finance the purchase of equipment), however, are not classified as finance transactions under Bulgaria's VAT law. The result is that a finance lease cannot compete with a finance loan. This is because when a buyer makes a purchase with a loan, it pays VAT on the purchase price of the product, but it does not pay VAT on the "cost" of the loan (the lender's interest rate). When a buyer (or lessee) makes a purchase with a lease, however, it pays VAT on the "cost" of the lease (the lessor's profit).

Furthermore, a lender is not required to acquire the financed product and pay VAT on the purchase price. A lessor is. It pays 18 percent of the price of the goods to VAT. While the lessor eventually gets a refund, it is not paid interest on its refund and it must go through a complicated refund process which costs it (and the state) time and money. The process is complicated and expensive for both the lessor and the state and the cost is not justified because the state cannot expect to make a gain.

Demand for financial leasing should be high in Bulgaria primarily because (1) the country faces a lack of financial resources for starting businesses, (2) suitable financing is difficult to obtain from Bulgarian banks and the lack of a secured transactions law makes it hard for borrowers to provide acceptable security guarantees to lenders and (3) the process for obtaining bank loans is usually long and arduous.

Leasing has been used in Bulgaria since 1989 as a quasi method of privatization. In typical a rendre agreements, state-owned properties — most of them green grocers or other retail outlets ~ are leased — usually to business employees — for a percentage of profits. As restitution of property has become more a reality, lessee faith in such agreements has declined.

2. Recommendations

The ability to enter leasing contracts probably eliminates immediate need for a specific leasing law. Attempts should be made to revive the Bulgaria Leasing Association so that it can review industry problems and make specific recommendations to develop the industry. Consideration should be given to amending the VAT law to allow financial leasing to compete with other forms of financing.

E. Foreign Trade

The General Agreement on Tariffs and Trade (GATT) emerged in 1947 as a way 23 nations decided to deal with world trade problems on a mass scale. GATT sets general rules for world trade, holds periodic rounds of tariff negotiations and helps bring emerging nations into the world trading community. One hundred and twenty three countries have acceded to GATT.

GATT provides secure access to markets of member countries on a most favored basis. An unwritten, but significant benefit is that member nations are identified as having trade laws that meet GATT-accepted standards.

GATT requires that positive measures should be adopted to facilitate the expansion of trading opportunities for developing nations and offers technical assistance to enable developing nations to maximize benefit from liberalized access to markets. Furthermore, GATT allows a less rigorous accession policy for developing nations and allows them to introduce some trading restrictions to satisfy development needs.

1. Status of the Law

Bulgaria has not acceded to GATT.

2. Recommendations

Bulgaria first needs to identify all trade laws and regulations that must be changed to accede to GATT. Second, it should develop a plan to revise those laws and regulations in a way to comply with GATT requirements.

IV. Efficiency of the Institutional Framework

Institutional efficiency is as important as the presence or absence of government institutions themselves. One way to foster institutional efficiency in Bulgaria is to develop uniform operating systems in all institutions.

A. Administrative Uniformity

1. Status of the Law

The United States is composed of 50 jurisdictions that have 50 different sets of laws. In theory, Bulgaria should not have this problem. In reality, it sometimes does. For example, an investor who has to deal with, say, real estate, may be surprised to find that notaries in different parts of the country interpret the same law in any number of ways. The investor will also discover that the type and number of documents required at different locations for what is otherwise an identical transaction can vary enormously. A similar situation exists in Bulgaria's 29 district courts where the investor must go to register his or her company.

This, of course, results in inefficiency of the market and its agents. No entity can develop standard operating procedures for standard types of transactions. What should be routine processes need to be learned and re-learned every time they are applied in new venues.

In a different situation, central government institutions often must perform administrative functions related to commerce. They grant import/export or trading licenses, give permission, provide information, and exercise other forms of control. These functions may be discretionary or non-discretionary. Regardless, the applicant must furnish such an agency with information and documents. The foreign — and even domestic — investor will sometimes be surprised that when approaching the same agency for identical reasons, but on different days, the requirements have changed. The change is not because policy has changed or government employees are malicious, but because there is no clear standard for some administrative requirements. The obvious result is multiplication of the applicant's efforts and resources spent on obtaining approvals from the central government.

2. Recommendation

A possible way of fighting internal and external institutional inefficiency is the creation of standardized operating procedures. A starting point will be to create standardized forms. As a result, the inefficiency due to difference in practice of institutions performing identical functions in different venues will be dramatically reduced. Also, the practice of all institutions will become consistent and predictable. The overall result will be that agents on the market will be able to develop standard operating procedures equally workable at any point in time and at any location. The social cost to transacting business will be decreased.

Introduction of standardized forms and list will also help institutions to increase their internal efficiency. It will take much less time for employees of a central government institution to process documents when they are familiar with standard forms. Standardization will also contribute to the simplification of internal procedures.

AMERICAN INVESTMENT IN BULGARIA

Points for Discussion

Daniela Bobeva, Foreign Investment Commission

December 1994

Total Investment Inflow

From 1990 until the end of September 1994, sixty-nine investments of declared American origin were registered at the Ministry of Finance. Forty-three of them were made in Bulgarian Leva. The total volume of American investment is 18,662,000 USD, or 6.5% of the total foreign investment inflow to Bulgaria (in comparison, Germany invested 177,305,000 USD). The United States place fifth in terms of invested capital in Bulgaria.

Thirty-eight of the declared American investments consisted of 50,000 Leva, each. American investors bought two Bulgarian enterprises. One of the transactions (Magnetic Heads) was a complete failure. It had a negative effect on the confidence of the Bulgarian privatization authorities in American investors. The case was broadly discussed in the mass media.

American investment in Bulgaria is insignificant in size and strange in its sectoral structure.

Sectoral Structure

There are no American investments in key branches of the Bulgarian economy. Coca-Cola, American Standard Inc., Kraft General Foods, and Bulgarian-American Foods (Struma Food Co.) are the biggest investments in industry.

AMERICAN INVESTMENT COMPANIES BY SECTORS

SECTOR	NUMBER OF COMPANIES
Trade	32
Consultancy	14
Finance	4
Industry	4
Computer Servicing	4
Communications	2
Tour Operators	2
Insurance	1
Medical Services	1
Publishing	1
Interpretation	1
Agriculture	1
Other	4
TOTAL	69

Note: The investments made by the BAEF are not registered as investments because, according to the Bulgarian Foreign Investment Law, only long-term investment is considered as such.

As seen from the table above, the service sector rather than industry is the most important area of activity for American investors in Bulgaria.

Is Bulgarian Less Attractive to American Companies Than the Other Central and East European Countries?

The data for the recent EUROSTAT conference on foreign investment shows that American investments are widely present only in few countries in the region. Unfortunately, Bulgaria does not appear to be a priority country for American investment. One of the reasons might be the limited size of the Bulgarian market. American investors prefer larger markets.

In Romania American companies have invested 107 million USD. The three largest investors are Coca-Cola with 32 million USD, Amoco with 17 million USD, and Colgate Palmolive with 17.4 million USD.

In the Czech Republic American investments comprise 25 percent of the total amount of foreign investment, ranking second after Germany with 627.9 million USD.

In Hungary the biggest American investor is general Electric - Tungsram.

In Poland American companies make up the largest part of foreign investment. Coca-Cola invested 235 million USD, IPC - 193 million USD, the Polish-American Enterprise Fund - 180 million USD, and Curtis - 100 million USD.

In the other Central and East European countries American investments are insignificant.

The data provided indicate that Coca-Cola is the biggest American investor in Central Europe. The other big investors also tend to be the kind of companies that operate only on the domestic consumption market.

Conclusions

- Many American investors have not registered their investments, thus violating the Foreign Investment Law. Article 16 Paragraph 2 provides for a fine of 10% of the amount of unregistered investment. Bulgarian authorities have not yet undertaken steps to apply the Foreign Investment Law in this part.

- There are very few real investments from the United States to Bulgaria. Institutional investors rather than real investors prevail. Higher interest is expressed by multi-national companies, for which Bulgaria is simply a 'link in the chain'.

  American investors are connected primarily with the domestic Bulgarian market and onl\ feu of them contribute to Bulgarian exports.

- The experience of the Foreign Investment Commission has proven an explicit interest amongst American companies visiting Bulgaria to invest here. They come mostly through the prominent consultancy companies.

The Main Obstacles and Reasons for the Current Situation are:

- The lack of interest on the part of American investors, rather than domestic obstacles;

- The lack of promotional activities that could generate such interest;

- The lack of special guarantees and mutual funds for foreign investment coming from the USA;

- Too many American institutions and consultancies; improper investment strategy; a lot of mistakes come from poor legal advice;

- Insufficient efforts of the Bulgarian side to deal with the 'bad cases'.

FOR CONSIDERATION: RECOMMENDATIONS TO FACILITATE FOREIGN INVESTMENT AND TRADE EXPANSION

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December 1994

1. This short paper presents recommendations to facilitate expanded trade and investment between Bulgaria and foreign companies, particularly American companies. It focuses on practical steps that can be taken in the short- to medium-term. The recommendations are drawn from several sources, with particular reliance on the Foreign Investment Advisory Service (FIAS) report of February 1994. The recommendations are presented for discussion, debate, and consideration during the Bulgarian-American Economic Forum.

The Foreign Investment Commission (FIC)

2. **Investor "servicing" should be institutionalized as a central function of the Commission.** Such servicing consists of assisting new and existing investors to overcome problems, particularly ones caused by various other parts of the government bureaucracy. Currently, the Commission's legal charter does not list the job of assisting, or "servicing," potential investors as a key function. This should be changed. The Commission should move from being a source of ad-hoc help during acrimonious disputes to becoming an agency which places investor servicing at the heart of its program to attract foreign investment .

3. "Service-oriented" investment commissions have proved very successful in Ireland, Malaysia, Thailand, Chile, and elsewhere. One approach that has shown good results is making a single agency responsible for helping investors to obtain all approvals and registrations from other government departments. **Bulgaria's Foreign Investment Commission should become a sort of "ombudsman" for helping investors within the existing government structure.** Instead of

waiting until problems arise, the FIC should offer to help investors from the beginning, when they first arrive at the airport.

4. **The Commission should not limit its assistance to new investors, but should also support existing foreign investments, helping to keep them happy and profitable.** This will help overcome current perceptions that there is a lack of consistent Bulgarian government commitment to support investments, once made. Potential investors talk with existing investors. They are more likely to be attracted by effective servicing and reports of satisfaction among existing investors than by elaborate promotional materials.

5. **To become more service oriented, the Commission should make organizational changes.** First its permanent offices should be moved from their present location in a restricted-entry building to quarters that are accessible to the public. Second, the Commission should organize itself around the concept of "account managers" assigned to support specific investments throughout the entire investment process, even into the life of the investment. Third, the size of the permanent staff should be slightly increased to allow sufficient attention to individual investors. Fourth, the staff should be provided training in international business issues and the driving causes of foreign investment.

6. **The Bulgarian government should ensure that the head of the FIC has the political support necessary to be effective when addressing bureaucratic problems with diverse ministries.** This may require more frequent and prominent statements by the Prime Minister and the Minister of Finance in favor of foreign investment and its facilitation by the FIC. All line ministry officials need to understand that actions to obstruct or complicate foreign investment are in clear contradiction with government policy and the national interest.

7. **Donors, including American agencies, should assist in the transformation and strengthening of the FIC.** The initiative for this change, however, must come from the Government of Bulgaria.

Investment Procedures

8. **Foreign investors consider acquiring land as one of their most acute problems. A solution would entail several steps.** First, the Government should complete the restitution of land on which industrial enterprises exist. Second, the legitimate owners should be paid a fair market value to sell the land. Third, ownership of land should be vested in the industrial enterprises built on it. The goal is to enable investors to negotiate with only one party when privatizing a company or establishing a joint venture.

9. **The process of approving joint-ventures should be streamlined.** Currently, complex paperwork requirements impose an overwhelming burden on potential investors, and the Ministry of Industry is ill-prepared to evaluate the slew of information it requires for joint-venture proposals. This results in delays, frustrations, and missed investment opportunities. **A solution is to allow investors to negotiate and strike a deal with a firm's managers, and to limit the involvement of the ministries to approving (or rejecting) the deal within thirty days.** These accelerated procedures will allow more rapid progress in revitalizing Bulgarian companies.

10. **The Commercial Law should be modified to overcome problems stemming from the valuation of non-monetary contributions, such as intellectual property rights and good will.** Difficulties frequently arise when court-approved appraisers set a lower value on non-monetary contributions than investors, raising problems for apportioning the equity in joint ventures and establishing a firm's creditworthiness. This situation has delayed and prevented the conclusion of several foreign investment deals. **A solution is to permit investors to set their own valuations, with stiff penalties for misrepresentation, as done in Poland and Hungary.**

Foreign Investment Law

11. **The foreign investment law in Bulgaria — Foreign Persons' Business Activity and Foreign Investments Protection Act — is reasonably sound.** Investors' true problems are more often related to implementation, enforcement, and bureaucratic obstacles, and not the Protection Act itself. This is why developing a service orientation at the FIC is so important. **Nonetheless, there are areas where the foreign investment law should be improved.**

12. **The Protection Act should be amended to define foreign investment as the transfer and investment into Bulgaria of economic value from outside the country, so as to ensure that foreign investors retain access to the law's benefits even if they establish themselves as local companies (which they are required to do as a means to own land).** Currently, the Act does not offer equivalent rights to local companies created by and receiving foreign investment. These companies lose, for example, their ability to establish security interest in chattel without taking possession as well as certain foreign currency transaction rights.

13. The Protection Act authorizes unrestricted repatriation of funds — a key attraction for foreign investment. This benefit, however, appears to be weakened by currency regulations contained in Ordinance 15, as amended by Ordinance 240, which require permission from both the Bulgarian National Bank and the Ministry of Finance prior to remitting funds in certain cases (eg., insurance proceeds). **These ordinances are worrisome for foreign investors and should be reconsidered.**

14. **Bulgarian authorities should establish a record of vigorous enforcement of their current Intellectual Property Rights (IPR) legislation.** Trademarks, patents, licenses and good will are some of the most important contributions that foreign investors can bring to Bulgaria. If IPR are not protected in practice, these benefits will be slow in coming.

15. Other areas of legal reform, such as development of a secure transaction law, improved recognition of secured interest in chattel property, and creditors' ability to seize property, are of potential interest to foreign as well as domestic investors. These issues are addressed in a separate paper prepared for the Bulgarian-American Economic Forum (Kyutchukov and Beesley).

Support Programs and Non-Governmental Organizations

16. According to the FIAS report, the Foreign Investment Commission should gather and disseminate information on: (a) inflows of foreign direct investment, and (b) how to invest in Bulgaria. All other information materials should be left for private-sector intermediaries to provide for their clients. **Non-governmental sources of information are important because they are considered to be more objective and responsive to the needs of clients.** These sources are often more permanent than government agencies where turnover is high, and departing officials often bring their files (and institutional memories) with them.

17. Non-government sources include lawyers, accountants, bankers, and consulting firms as well as not-for-profit organizations such as the American Chamber of Commerce in Bulgaria (and its Business Incubator), the Bulgarian International Business Association (BIBA), the Center for the Study of Democracy, the Bulgarian-American Trade and Investment Association (BATIA), and others. **These organizations should develop their abilities to complement the "servicing" activities of the FIC, and provide relevant information to potential investors.** They should also serve as continual facilitators of dialogue between foreign investors and the government on regulatory and other policy issues. Their efforts in this regard deserve the support of the donor community, the investor community, and the full cooperation of the government of Bulgaria.

18. **Similarly, those organizations which facilitate direct contacts between American investors and Bulgarian enterprises deserve support and cooperation.** On the American side, these include the US & Foreign Commercial Service , the Bulgarian-American Enterprise Fund, the US Peace Corps, the International Executive Service Corps, the Citizen's Democracy Corps, and

PROSPECTS FOR FOREIGN INVESTMENTS IN THE BULGARIAN PRIVATIZATION PROCESS

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Bulgaria welcomes foreign investment in the ongoing process of privatization, including, of course, American investment. This short paper describes Bulgaria's privatization regulations, the transactions completed to date, the program for 1995, and three new instruments in privatization, namely: (a) the mass privatization scheme, (b) internal debt-for-equity swaps, and (c) foreign debt-for-equity swaps. We hope that this information will be of interest to the participants in the Bulgarian-American Economic Forum.

The paper argues in favor of foreign investment in the privatization process for several reasons. First, this involvement can accelerate the process. Second, the attracted foreign capital can be an important way of overcoming the inherited isolation of Bulgaria from Western markets. Third, foreign debt-for-equity swaps can reduce Bulgaria's current credit burden. Fourth, and perhaps most importantly, foreign investment can transfer modern know-how, revitalize struggling companies, and lead to more employment and new products and services for the Bulgarian economy.

So far capital privatization has been accepted as the chief form of privatization in Bulgaria, unlike other Central and East-European countries, where mass privatization was mainly supported. Underlying this decision is the conviction that Bulgarian enterprises will come to be owned by persons potentially capable of ensuring prosperity through investments and modern management, and this fact alone counts more than the speed of privatization alone. Among the important aspects of privatization legislature are:

- equal opportunities for investors, be they Bulgarian or foreign;
- opportunities for employees to acquire shares under preferential conditions (50% discount);
- sound procedures ensuring public control and transparency.

An active process of commercialization (corporatization) of state and municipal enterprises has been going on in Bulgaria. Up to now about 95% of the state firms have been transformed into public and private limited companies, where the state owns the shares. This allows for the implementation of standard procedures for transfer of property under the Privatization Law and the Commercial Code.

The Bulgarian Privatization Law envisages the concept of multicentrism of the organization and implementing of privatization activities. The Act and the complementary regulations issued by the government extensively define the prerogatives of state and local government taking into account the specifics of forms of public property in Bulgaria and of the economic sectors supervised by different branch ministries.

The institutional scheme for privatization in Bulgaria provides good opportunities for flexibility, the application of different techniques and restricting the danger of bureaucratization of the process. Practically all government institutions are more or less actively involved in the process of privatization. This fact motivates them in assisting and enhancing it, as well as improving their expertise.

The main government institution in charge of privatization in Bulgaria is the Privatization Agency. It is a state institution with the Council of Ministers but the way its ruling bodies are constituted and the main functions defined within the Law render it virtually independent.

The Privatization Agency is responsible for:

- the general organization and control of privatization of all state enterprises;
- the elaboration of annual privatization programs;
- the privatization of state-owned enterprises, provided their fixed assets exceed 70 million BGL;
- managing the fund covering the expenses for privatization of state enterprises;
- licensing of appraisers;
- collecting information on the entire process of privatization in the country.

The sector ministries are in charge of the privatization of state-owned enterprises whose long-term assets do not exceed 70 million BGL. In their structure they have departments specialized in organizing and implementing privatization transactions.

The Municipal councils are in charge of privatizing enterprises owned by the municipalities. All common procedures envisaged by the Privatization Act for the state-owned enterprises are applied in the privatization of municipal enterprises as well.

The Law provides the possibility for the managing bodies of enterprises and/or the employees to motion decisions for the respective enterprise. Most of the enterprises within the programs for 1993, 1994 and 1995 have been proposed by their managers and employees. One of the principles underlying the Agency's decisions on privatization is to take into account the considerations of managers and employees, although the law does not explicitly state this.

The Law furnishes certain possibilities for "privatizing privatization". The institutions in charge of making privatization decisions may authorize other persons to make privatization transactions. The evaluation of enterprises to be sold is almost entirely "privatized" owing to the special requirement that it should be performed by independent appraisers, most of whom are individuals and private consulting firms. The appraisers for each privatization project are chosen by competition.

Significant amendments of Privatization law took place in June 1994. Some of them were aimed at clarifying and speeding up the procedures and improving the effectiveness of privatization institutions. Special provisions made employee participation in privatization more attractive and favorable. The most important amendment concerned mass privatization and made the implementation of the Check-style scheme possible. This means that Bulgarian citizens will have opportunities to chose among different investment solutions, more or less risky, requiring a different amount of information and knowledge. It could be expected that the likely mass privatization program, if realized within the original scope of design, will have significant macroeconomic implications.

Privatization activities completed to date

The first steps of privatization in Bulgaria were marked by an opportunistic approach - privatization started wherever immediate interest existed. The same was observed in Central European countries. This approach can be justified to a great extent, as the process develops quickly and privatization criteria and technologies will thus crystallize.

Nevertheless, within the center of attention is now coming the systematic approach towards privatization, based on sector projects. It will allow government institutions and potential investors to form a clearer picture of the respective market - its size, level of competition, prospects, substitutes, suppliers, etc. - factors which are relevant for the organization of privatization and estimation of the prospects for investment. The Privatization Agency and some branch ministries put considerable efforts in elaborating analyses and programs for different sectors. Institutions like USAID have made important contribution to this process.

By the end of October 1994 decisions for privatization have been taken concerning 838 state enterprises and units and 177 privatization transactions have been signed. The net revenues for the budget from the finalized privatization transactions are about 4 bin. BGL. The investors are obliged to invest more than 4.6 bin. BGL during next 5-6 years and to maintain and create about 14, 000 jobs. Most of the biggest transactions have been made with well-known foreign companies like Amilum, Nestle, Kraft Jacobs Suchars, Willy Betz, Brewinvest (a Greek subsidiary of Heineken and Coca-Cola), and some others.

The privatization program for 1995

The draft program for 1995 is based on the assumption that enterprises to be privatized as a priority should be:

- performing in sectors with comparative advantages;
- their privatization could affect positively other companies, technologically and financially linked with them;
- they should be attractive for investors;
- they should not be in or cannot exercise monopolistic position;
- their privatization will not result in significant jobs reduction.

The program for 1995 is based on the new strategy of moderate expectations. The total number of privatized enterprises is expected to be 400-450 (12-13% of the state-owned enterprises). The Privatization Agency itself is to privatize 100-120 enterprises. The total revenues from privatizing state-owned enterprises in 1995 are planned to be 12-15 bin. BGL. About 10-12 bin. should come from transactions performed by the Privatization Agency.

Among the enterprises which could be excluded from the privatization list for 1995 are those in defense industry, oil processing industries, power plants and railway transport.

New instruments in privatization

There are three large scale operations pending that can reshape the Bulgarian privatization. All of them will occasionally coincide and become active probably in 1995. All of them will create additional instruments of payment in privatization and will significantly substitute the expected payments in cash. All of them have a clear macroeconomic impact. These are:

1. The mass privatization scheme.
2. The internal debt-for-equity swaps.
3. The foreign debt-for-equity swaps.

The mass privatization scheme

The Bulgarian mass privatization is based on the parallel implementation of two basic schemes of participation - direct and indirect. The supply side of the mass privatization (selection of enterprises, legal analysis, restitution claims) and the demand side (printing and distribution of the means of payment, establishment and licensing of the financial intermediaries, control) will be institutionally separated. The supply side could be carried out by the Privatization Agency and the final word will be for the Parliament, while the demand side is to be managed by the recently established Center for mass privatization.

rdiag to *the* lav/ all adult Bulgarian citizen have the right to participate on an equal basis if they register in a special registration network and possess a privatization certificate with face value of 25 000 BGL. After registration the certificates will not be tradable, but can be trusted to the established intermediaries - investment funds.

About a quarter of the state-owned equity in the real economy is concentrated in the enterprises selected for mass privatization. The program will cover about 500 state-owned enterprises from all the sectors and branches of the real economy.

According to the preliminary time-table the whole process will last between 12 and 15 months. A successful implementation of the scheme would mean that within one year a dramatic increase in the speed of privatization can be expected. Through acquiring shares - directly in the enterprises or indirectly from the privatization funds - the citizens will be involved in the securities market and hopefully in the corporate governance.

Internal debt-for-equity swap

At the end of 1993 the Parliament adopted the Law on restructuring of the non-served loans negotiated until 31 December 1990. Debts owed by the enterprises to the banks totaling 32 bin. BGL and 1.8 bin. USD were taken by the state, and transferred into debts owed by the state to the banks. To cover the debt the Government issued 20-year bonds with front loaded reduced interest.

As the privatization law allows the creditors of the state debt to swap it for equity in a way determined by the Council of Ministers, a Decree was issued to regulate the procedure. The bonds will thus be an eligible means of payment in all the privatization deals. In this case they will be counted at face value in spite of their market price.

At the time being the internal debt bonds are widely used in privatization transactions and are an important factor for speeding up the process.

Foreign debt-for-equity swap

According to the agreement between Bulgaria and the commercial bank-creditors two kinds of government bonds could be used by investors in privatization transactions - collateralized discount bonds and front loaded interest reduction bonds. Recently the Council of Ministers adopted special regulations on this matter.

The foreign debt-equity swaps - often opposed on the grounds of "national sovereignty" - could significantly accelerate privatization and the inflow of foreign investments. On macro-level they could reduce the credit burden in the critical phase of the economic reform. The attracted foreign capital is an important way of overcoming the inherited isolation from the world markets. On micro-level they can be a good criterion for choosing prospective long term motivated foreign partners.

In the present situation within a restrictive macroeconomic framework and lack of reliable foreign investors, all the additional payment instruments can accelerate privatization. Vouchers in mass privatization scheme and bonds in debt-equity swaps offer a premium to the investor ranging from 95% to 30%.

Because of the chances it gives to foreign investors to gain positions on the Bulgarian market within a relatively short time and the new debt-equity swap options, privatization should generally be preferred to greenfield investment or joint ventures with Bulgarian enterprises (mostly state ones). Such investment may often prove to be a quick solution to the problems of state firms and prevent their closing down.

Hence, the government, and especially the Privatization Agency, consider privatization transactions within a framework of priorities, foremost among which is the investor's willingness to take a long-term perspective of the firm's future by transferring modern know-how, maintaining and increasing the number of employees and offering new products and services on the Bulgarian market.

Some recommendations

Bulgarian and American organizations could facilitate more effectively the process of privatization along the following lines:

1. Establishing effective information systems about:
   - American companies planning investments in certain industries in Eastern Europe;
   - checking the reliability and investment potential of interested companies;

2. The Bulgarian Embassy should organize a publicity campaign to present the Privatization Agency, its work and investment opportunities in Bulgaria.

3. Wide distribution of printed materials publicizing privatization in Bulgaria.

4. The organization and funding of sectoral analyses and privatization projects with the participation of Bulgarian experts in project teams.

Yhe United States Is Already Among Our Major Foreign Trade Partners

BY VALERI KOSTOV

Valari Kostov

Though situated much further away than Western European countries, the United States first became Bulgaria's trading partner back at the end of last century. Before World War I its relative share in Bulgaria's commodity turnover was less than 1%. In 1919 it boosted to 25% but, in the 20's it remained on the 2-3% level and then dropped again. After World War II U.S. role in Bulgarian foreign trade grew slower and accounted for 4% of trade. But over the next two decades its relative share was 0.1 - 0.5%. During the 80s there was some change observed in the U.S. role as Bulgaria's trade partner and it accounted for 0.2% of Bulgarian exports and 1% of its imports. This trend continued from 1990-1993 when the U.S. share of Bulgarian exports grew from 1.7 to 3.3% and in its imports from 1.5 to 3.4% respectively. These numbers place the U.S. in Bulgaria's ten priority foreign trade partners.

Even during the periods when the U.S. played a more noticeable role in Bulgarian trade the amount of mutual trade between the two countries fluctuated and did not show clearly expressed trends. This characteristic feature existed in the 80s and the beginning of the 90 s From US$115 million in 1991 Bulgarian exports to the U.S. dropped to US$80.5 million in 1992 and increased to US$118.7 million in 1993. Imports also boosted from US$77.5 million in 1991 to US$147 2 million in 1992 levelling off at US$147 9 million m 1993.

The unstable dynamics of imports and exports always resulted in fluctuations of the trade balance between the two countries. From the beginning of the century until the 50 s it frequently turned from negative to positive and vice versa. A negative balance of trade prevailed over the last 4 decades. Thus at the end of the 80s Bulgarian exports to the U.S. amounted to 0.18% to 0 4 5\ of its import. Against this background the years 1990 and 1991 were exceptions as exports became 3 2 and 1.5 times larger than imports respectively In 1992 and 1993, however, there was also a negative balance and the export volume was respectively 0 55 and 0.80 of the import volume.

The unstable development of trade between Bulgaria and the U S was a result of the activity of existing geographic factors and much more so of the state and peculiarities of the import and export commodity structures. The commodity structure of Bulgarian imports from the U.S. has shown significant changes over a short period of time. Examples are liquid and fossil fuels and ores whose relative share varies largely. The same is observed in agricultural imports like maize, soy beans, soya groats, and lately of tobacco and tobacco products, beverages, meat, etc. A little more stable though at a lower level is the relative share of the import of chemicals, which mainly includes organic chemicals, plastics and other chemical substances. The relative share of the commodity group called "Other products" is relatively stable and includes Pharmaceuticals, staple fibres, printed products, movies, etc.

The machine building industry is practically the only commodity group whose share of Bulgaria's imports from the U.S. over the last few years marked a stable trend of development. Imports include electronic and technical appliances, technological equipment for various industrial branches, medical equipment, electronic equipment and parts, but priority is now given to cars, air transport vehicles and a wide range of instrument building products, measurement devices, etc.

The current year's commodity structure of Bulgarian exports to the United States is almost as unstable as that of imports. This refers mainly to the export of liquid fuels,and ferrous and non-ferrous metals, whose share varies substantially. The share of chemicals is also fluctuating but still an upward trend has been observed over the last 4 years. Bulgarian exports of chemicals to the United States mainly consist of non-organic rather than organic chemicals, and primarily fertilizers.

The wide range commodity group of "Other products"* also experiences an upward trend though it fluctuates somewhat. These exports include marbles, perfumes and cosmetics, including rose and lavender oil, herbs, furniture, medicines, and most recently knitwear and other ready mades, woolen and cotton materials, and staple fibres. Bulgaria's attempts to export machine building equipment, however, are still unsuccessful. Foodstuffs such as dairy products, beverages, tobacco, etc., still remain among the most exported goods. But even their export share has sharply dropped over the last three years.

Latest practice clearly shows that Bulgaria's attempts to improve its trade balance with the U.S. through the export of fuels and metals has been unsuccessful. With the exception of the year 1990 exports have always been smaller than imports. The export of machine building products has always been smaller than imports. This is essentially the major factor in the formation of the total negative trade balance. The chemicals, the great variety of products under the name of "Other products", and foodstuffs turn all to be a much better reserve for improvement of balance, exports being larger than imports. This also provides conditions for a more stable and balanced development of mutually advantageous trade between Bulgaria and the United States. The solution of this problem is topical at the present stage of development of Bulgaria's foreign trade as the significance of non-European markets is growing. This is a result of a global and regional restructuring of exports, and the United States are without doubt going to strengthen their role as Bulgaria's major trade partner outside Europe.

A second major factor in the development of Bulgarian-American trade relations is the substantial improvement of trade and political relations between these two countries, including certain duty exemptions on imports. Only a few years back the U.S. was the only country whose exports to Bulgaria were treated according the "fourth column" of the then acting customs tariff. Duties in this column were much higher than those in the other three, reaching 80 to 100% for some goods, i.e. these duties were discriminatory and prohibiting. Now customs treatment of U.S. products exported to Bulgaria is much more favorable. This is a result of the fact that both countries granted each other "most favoured nation" status whereby imports are treated most favourably compared to imports from a third country. This is one of the founding principles of modern world trade, providing maximum equality between trading partners and improving their access to national markets.

Trade relations between Bulgaria and the U.S. can also improve substantially with the gradual overcoming of export restrictions recently applied by the industrially developed nations through their COCOM organization. Thus access to our country to promising technology and techniques, for which the U.S. is world renowned will be provided.

Bulgaria's joining of the General Agreement on Tariffs and Trade (GATT) will turn our country into a part of the whole system for regulation and development of world trade. This will be yet another step forward towards the complete regulation of trade and political relations not only between Bulgaria and the United States, but also between Bulgaria and a number of other countries.

COMMODITY STRUCTURE OF TRADE BETWEEN BULGARIA AND THE UNITED STATES

	1986	1988	1990	1991	1992	1993
Export share in %						
Machinery, transport vehicles, tools, apparatuses	2.00	3.00	8.00	4.50	10.80	7.40
Metals, fuels, minerals	36.70	0.00	72.70	15.10	4.10	16.60
Chemicals, fertilizers, plastics, rubber	5.70	23.60	4.70	9.00	8.80	21.00
Foodstuffs, beverages, tobacco	46.70	65.60	16.40	57.60	49.20	32.60
Other products*	8.30	7.80	5.30	13.80	27.00	22.50
Import - share in %						
Machinery, transport vehicles, tools, apparatuses	7.30	7.80	15.80	13.00	25.30	35.50
Metals, fuels, minerals	27.80	4.00	54.70	80.40	38.50	17.60
Chemicals, fertilizers, plastics, rubber	9.50	4.80	9.80	0.50	4.20	5.70
Foodstuffs, beverages, tobacco	40.30	76.70	13.90	5.40	26.30	35.00
Other products*	13.90	6.70	5.80	0.70	5.70	6.10
Export/Import Ratio %						
Machinery, transport vehicles, tools, apparatuses	0.12	0.10	0.16	0.51	0.23	0.17
Metals, fuels, minerals	0.51	0.00	4.27	0.28	0.06	0.75
Chemicals, fertilizers, plastics, rubber	0.23	1.34	1.55	25.93	1.15	2.93
Foodstuffs, beverages, tobacco	0.45	0.31	3.77	15.97	1.02	0.75
Other products*	0.23	0.23	2.85	27.72	2.58	2.95

** Includes mineral raw materials and their products: ceramics and glass, products ol wood, paper, leather textiles, ready mades. shoes, furniture, pharmaceutical products, perfumery and cosmetics, and other industrial consumer goods.*

15,000 American Companies Receive Information about Bulgarian Enterprises Free of Charge

An Interview with Mr. JAY A. BURGESS, Director at the East European Division of the U.S. Department of Commerce and Mr. JOHN FOGARASI, Commercial Attache at the U.S. Embassy in Sofia

(2 Would you please describe the assistance program of the U.S. Department of Commerce to Bulgaria?

BURGESS: One component of the assistance program that we are involved in Bulgaria is the support that is given for the Eastern Europe Business Information Center in Washington. That center gives information on trade and investment activity in the region. It has a library of materials.

To give you an example of how it works: a company calls and says it needs information on doing business in Bulgaria. When we first set up the center some 5 years ago, an analyst would assemble our Bulgarian materials, put them into an envelope and mail them to the company that was making the enquiry. Now we have an automated fax delivery system that provides quick access to time-sensitive information. The person who asks for this information, is able using a touch-tone phone, to get immediately over the fax the menu of all the items that we have on Bulgaria. Then that person looks at that menu and decides that s/he likes the publication "Doing Business in Bulgaria" or "US Firms with Offices in Bulgaria" and so on. Then again hits the touch tone numbers on the phone and by fax receives this information immediately.

This is a service under the American Business Initiative. Also under it there is the "Eastern Europe Looks for Partners" program and there is an employee of our office here whose sole job is to go out throughout Bulgaria and cover the new commercial opportunities in this country and to develop information on these new companies. That information is then sent back to Washington. Once every two weeks a bulletin is published "Eastern Europe Looks for Partners". This we consider to be a highly effective way of covering new Bulgarian enterprises. They don't have to be private, they can be state enterprises, or privatized as well. Anyway that information is put in this bulletin which has a distribution base of over 15,000. In that way new Bulgarian enterprises are reaching out to thousands and thousands of American companies who are possibly interested in mutual interactive activity. And that service, I should add, is free of charge for American companies. Its a tremendous service. I can't imagine how Bulgarian companies or Polish, Hungarian or other companies in the region could possibly get that much exposure.

Q/Mr. Fogarasi how does you office coordinate its activities with the other U.S. programs in Bulgaria.

FOGARASI: Let me actually put it in practical terms. There are many U.S. organizations involved in assistance to Bulgaria. For example The Peace Corps, The Citizen's Democracy Corps, The PRAGMA Corporation, The International Executive Service Corps, The University of Delaware, etc. The USAID is the administrator of these programs and monitors them. In the practical world when we have an enquiry for a Bulgarian company we have the contacts but we also cooperate and coordinate with these groups that I mentioned. So for example, we have a program called "The Export Express Program" which is in cooperation with the Peace Corps.

At the Plovdiv Fair where the major trade events for the year take place for us and for the Bulgarians, some of the mentioned organizations exhibit jointly among the private companies. So again we like to reinforce each other. They operate their programs but there are areas where we can reinforce them and in reverse when they can help us, they do so. So we interconnect.

Q:What other activities do you carry out? Do you, for example, organize exhibitions to promote American products?

FOGARASI: We do. First of all, the major one is at the Plovdiv Fair. We consider that it provides us with the maximum exposure. This year's Plovdiv Fair will be the largest project that we have ever had. We have moved into Hall #7 of the Fair. Now we have a whole building.

In cooperation with other associations, groups and missions we all have special programs. For example some U.S. states that have representations in Western Europe come to our area here. Last April we had a very successful program with several U.S. states.

We also coordinate with trade associations. We were participants in the program "American Technology"^ trade show held last March at the Vitosha hotel in Sofia. This was a pitch at the advertising of hi-tech, computer and instrumentation companies. It was a very strong show. We regularly support trade missions that come to us. We also initiate programs on our side, we bring groups here or at least exchange information

&• Do you have activities in the field of investment?

FOGARASI: On the investment side, as Mr. Burgess mentioned, a primary program is "Eastern Europe Looks for Partners" and there are other programs that relate to it. And there are investment programs that are internationally funded. Those programs we prioritize to highlight. We also look at other priority sectors such as investment into the environmental field or investment into sectors such as computers, where we are particularly strong.

Generally speaking, our role in investment is not as strong as our role in exports. Traditionally our service has been focused primarily on exports.

We will respond to a U.S. company which is interested in investment, we will create programs for them but we do not necessarily take an active role in looking for investments here. We consider that to be primarily the role of the host country.

Q/What about Overseas Private Investment Corporation (OPIC) ?

FOGARASI: Yes, we had an OPIC mission here last October. It was a good example of how we respond tointerestfromthe U.S.Itis a very strong program, a key instigator of investments. We had here a full program of meetings held at the Sheraton hotel. The Vice President of OPIC was here and had a chance to meet with the Prime Minister. There was strong interestfrom both the public and private sector and good support from the government.


Focus: Manufacturing, Energy and Environment July 1, 1994

Eastern Europe Looks for Partners

Eastern Europe Looks For Partners

Q'The Japanese have a very interesting form of studying foreign markets. They send a delegation of senior level businessmen who go all over the country to see which plants and companies are good for investment. Do you think that such a study of the concrete facilities and plants could be useful for American investments?

FOGARASI: To be honest with you, the problem is to get attention for Bulgaria. To have companies come here on exploratory missions and see what is here, is difficult to do. Rather, a very clear way of attraction is when you identify something which companies are interested in. In a very specific way, your chances are much better than having a company come here, with only the right map and tell them there are some wonderful opportunities here but you must go and find them yourselves. In my estimation this is less targeted, less efficient. There are so many other places in the world where it is much easier to do business. It is better if we identify the specific opportunities for U.S. companies here.

Q: But how can Bulgarian institutions promote more efficiently the investment opportunities in Bulgaria.

BURGESS:We've just come froma meeting with the Investment Commission at The Council of Ministers. It is an excellent step forward in terms of promoting and alerting people to investment opportunities in Bulgaria. I'm impressed by the Bulgarian investment package. But it's really only a beginning and I think that the Investment Commission and bodies like it and all the people involved in seeking to attract investment have to take into account a long range approach and deal as I have pointed out on several occasions: First, you have to try to attract new investment. Second, you need to concentrate on investment that is currently being considered, or you've already attracted, or is in the midst of negotiation and needs finalizing. Thirdly, and very importantly, investment that exists already needs to be very closely monitored, so that the investor remains happy and profitable. In other words, new regulations should not hinder the activities of those who are already operating here. It is really those three areas: attracting investment, helping facilitate investment that is about to go into operation and then keeping investors happy. Perhaps the latter, the third pointis perhaps the most effective kind of advertising for investment.

If a company is considering investing somewhere one of the first places they go is to people who have already done it. Business is competitive but they also talk to each other a lot and one of the best ways to attract new investment is to be able to point to existing investment that is profitable and is working.

Let's be honest, this is a new market for many, many companies both the U.S. and from throughout Western Europe and from elsewhere. This marketneeds exposure,itneeds to project itself.

FOGARASI: You have to go over there and do some research. There is also a second dimension to this which is an attitudinal one. On the surface you find that there are very good words at the level of this activity from the leadership here, that they solicit and welcome foreign investment. But the practice, unfortunately, is that foreign companies have a lot of problems when beginning to start their operation, in putting their program into implementation. These exist on all levels.

There are also questions of the role of foreign investment here. Questions of let's say motivations, questions about successful companies. And I think it takes the leadership in the government here to show thatforeign investmenthas animportant and vital role in the economy. Many people aren't completely convinced of that. It seems like foreign investment is an element that should be done but the meaning behind it is not there. The meaning is that you need to support it, you need to attract it, and if you don't, then all the good words that may provide it, will not be translated into action.

BULGARIAN
AMERICAN
ENTERPRISE
FUND

Fall 1994

INVESTMENT UPDATE

As we enter our third full year of operations, we have a growing sense of optimism for Bulgaria and for the Bulgarian-American Enterprise Fund's long-term prospects. An additional $6.6 million in investment was approved at our September board meeting, raising total approvals to $18 million. The Fund has extended money to more than 200 private ventures throughout all key regions of the country. Today, Bulgaria is poised for the growth and private seaor development that has been so long anticipated.

"The Fund has extended wney to more than 200 private mtures throughout all key regions of the country.

BULGARIAN REALITIES: MISSION AND APPROACH

When the BAEF began operations in Sofia in die summer of 1992, the Fund encountered different challenges than those found in the more developed economies of Poland, Hungary and the Czech Republic. There was little tradition of private enterprise — only about five percent of businesses were in private hands, mostly those of small merchants. Rather, the economy was dominated by large, state-owned enterprises, with near total collectivization of the agricultural seaor. Meanwhile, Bulgaria's major export markets, the former Soviet and COMECON countries, were collapsing and/or disappearing. These economic problems were exacerbated by the war in Yugoslavia and the Serbian embargo. In response to these circumstances, Bulgaria looked to the West for assistance but had little exposure to Western business concepts and suffered from a low profile as compared to its better known Central European rivals. Political turmoil and institutional gridlock added to the difficulties faced by the BAEF.

The role of the BAEF in this challenging environment was and is to help promote the market economy in Bulgaria through investment and technical assistance activities. In carrying out this role, the BAEF has a responsibility to use the monies provided by U.S. taxpayers judiciously and prudently. Ideally, the Fund's pool of capital will grow through sound investing and then be recycled for the benefit of those in years to come.

With the conditions it faced in Bulgaria, a U.S. style venture capital approach as practiced by enterprise funds in Poland, the Czech Republic and Hungary proved unfeasible. Consequently, the BAEF reoriented its programs in late 1993 to reflect what Bulgaria needed. We thus began to emphasize small business programs, particularly where some common theme of geography, sector, or delivery system would permit efficient and credit-worthy investment. These programs now include:

- the micro-lending program, Nachala, or "Beginnings"
- the small and medium enterprise bank program, Kompass
- sector-specific lending programs such as the hotel and tourism program and dairy development program
- selected venture capital investing
- tie Young Entrepreneur Award
- technical assistance to encourage business activity and to supplement the business needs of the companies in which the Fund invests.

As conditions improve, this strategy will be adjusted to meet the evolving needs of the Bulgarian private sector. BAEF's investment strategy is complemented by its policy initiatives to encourage and support the privatization effort, without whicn Bulgaria's long-term opportunity for investment and growth will be severely limited.

RECENT RESULTS EMPHASIZE FOUNDATION BUILDING

The programs of the BAEF are focused to participate in the mainstream of the country's revolutionary transformation. We started with small loans to start-up businesses, but increasingly, small and medium-sized private firms are emerging with the track record and operational experience to warrant greater funding. Therefore, we think it likely that a broad mix of investments from the very small to me very large is in the making, a vision that will result in a continuing escalation in the size of our investment portfolio and our technical assistance programs. The variety of and growth in BAEF involvement is reflected in much of our assistance to date:

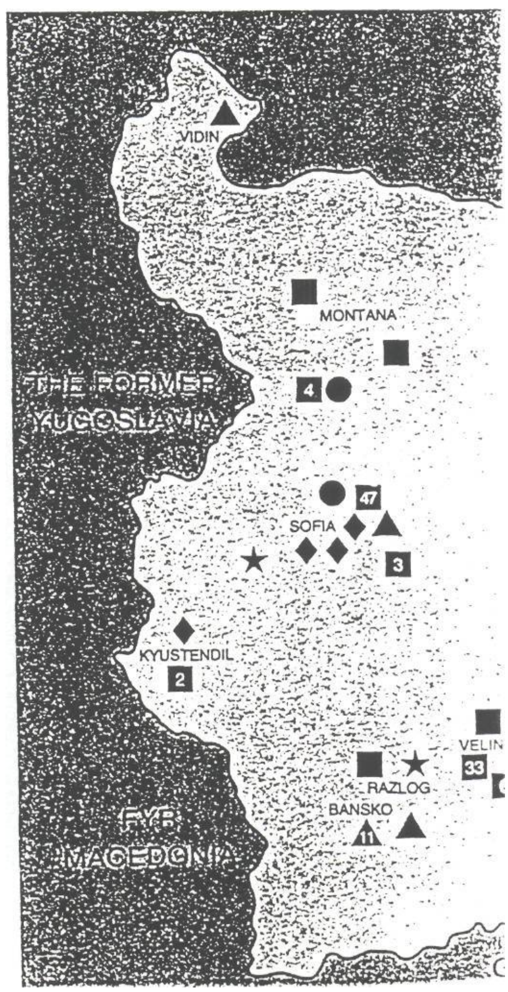
1. *Micro-lending.* Under the Nachala, or "Beginnings," micro-lending program, BAEF has worked with Opportunity International to establish lending offices in three cities. Loans of up to 325,000 and averaging about $6,000 each are given to small enterprises, most of which are start-ups. Examples of typical Nachala loans include a S 19,725 loan to a women's apparel manufacturer to purchase additional sewing machines, a $9,900 loan to a printing company to purchase a print

The programs of the BAEF are focused to participate in the mainstream of the country's revolutionary transformation.

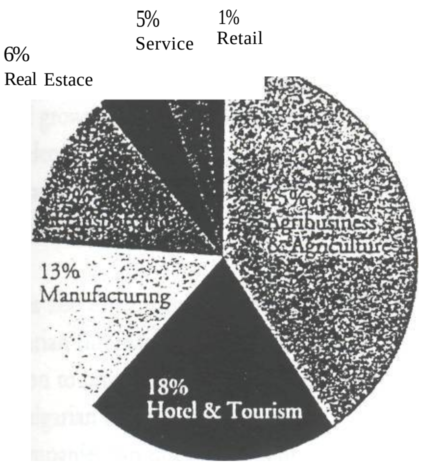
ing press, and a $2,000 loan to a private dentist for the purchase of dental equipment. Nachala made its first two loans in July of 1993 and has since approved a total of 149 loans in 23 cities. BAEF has allocated $1.5 million to fund Nachala loans and $300,000 to Technical Assistance.

2. *The Kompass program.* This program provides capital to existing businesses and encourages the development of Bulgaria's capital markets by improving the capabilities of local banks. Working with Shorebank of Chicago, BAEF provides training and other technical assistance in credit evaluation and loan processing to four Bulgarian banks. These banks serve as the vehicle for BAEF's small business lending in the 525,000 to $250,000 range and, through their locations around the country, ensure broad geographic coverage. The program is designed to approve ten loans per month. An early example is a loan to a trucking company to acquire an additional semi-trailer truck for international deliveries. The first Kompass loan was made in September of 1994, with ten additional loans approved in October. The BAEF has initially earmarked $5 million to the Kompass program and will consider additional funding should the program prove successful and the need continue to exist.

3. *Family and small business hotels.* With Bulgaria's skiing, beaches, and historic sites, the country has been a traditional tourist attraction for East and West Europeans. BAEF identified a unique opportunity to help private landowners convert their properties into small business and "bed and breakfast" style hotels. Already, BAEF has made 18



SECTOR INVESTMENT As A PERCENT OF TOTAL DOLLARS



loans totaling more than $800,000 to finance development in six tourism and business centers.

4. *Dairy program.* The Fund is providing an initial $250,000 line of credit to make loans to dairy farmers. The American cooperative Land-O-Lakes assists in identifying qualified farmers to participate in the program. The first loans were approved in May of 1994 and we anticipate a rapid increase in activity in the coming year.

5. *Larger investments.* Notwithstanding the difficulties of making direct investments in the Bulgarian private sector, the BAEF continues to participate in larger deals. Representative examples include:

• an $800,000 investment with San Francisco-based Tri-Valley Growers to pacbge fresh and processed cherries for export to Western markets

5355,000 in loans ro a two-year-old Bulgarian embroidery company, a frozen food distributor, and a parquet floor manufacturer

a $310,000 investment in the Bulgarian-American Development Company (BAEF and its Bulgarian partners have created a first in Bulgarian housing development with the building of four townhouses in the Sofia suburbs)

1 a $5.6 million loan to be disbursed over eight years to a recently privatized winery cooperative for wine production equipment, vineyard development, cheese processing equipment, and other infrastructure investments.

In addition, the BAEF created and organizes the "Young Entrepreneur Award," stimulating die development of

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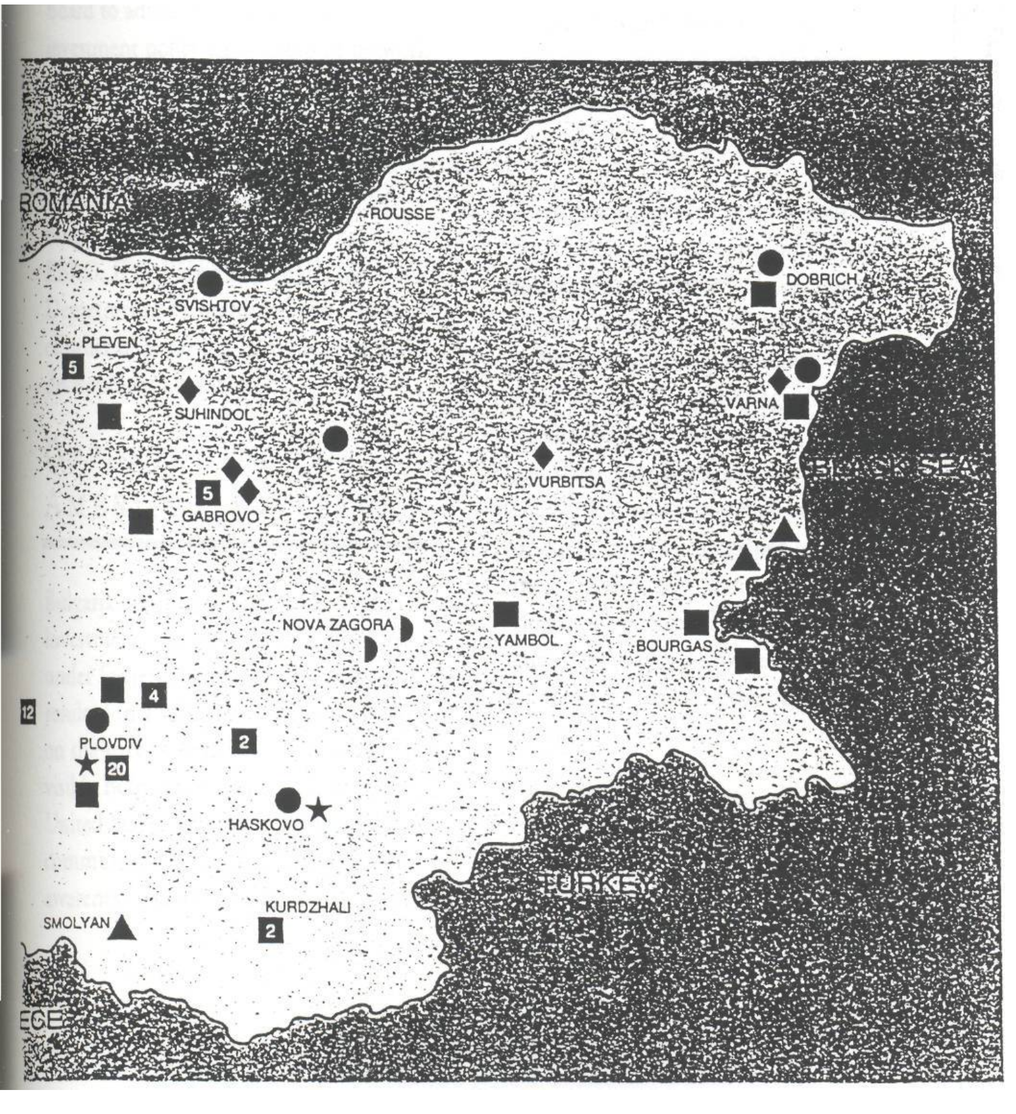

LEGEND

- Nachala Loans
- Entrepreneur Award
- Kompass Program •
- Large Investment
- Hotel Loan Program
- Dairy Lending Program

hundreds of business ideas and plans by Bulgarians 18-29 years of age. Similarly building at the most basic level — the next generation of entrepreneurs — BAEF has attracted Outward Bound to Bulgaria to introduce leadership, teamwork and self-reliance programs that can form the foundation for entrepreneurial development and growth. Outward Bound has trained selected Bulgarians to run the program and utilizes former state-controlled outdoor facilities.

BAEF was also instrumental in founding the Bulgarian International Business Association to provide a forum through which Bulgarian businesses and international companies can discuss issues of importance and speak with a unified.voice on economic policy matters. In addition, we are establishing a Bulgarian Advisory Board to advise the BAEF Board on investment policy and expand its network for project referral.

BAEF continues to leverage its resources through other groups contributing to Bulgaria's development, such as the EBRD, IFC, PHARE, USAID, the U.S. Department of Commerce, and a variety of other bilateral and non-governmental development organizations.

OPPORTUNITY FOR AMERICAN INVESTORS

Bulgaria offers great opportunity for U.S. investment. Its isolation from the West under Soviet communism, however, has resulted in a substantial "familiarity gap" on the part of Americans. There are few visible Bulgarian communities in the United States, and the U.S. business community displays a general lack of awareness about the country.

The BAEF has sought to remedy this problem through its outreach program. Its Board of Directors has been particularly aggressive in spreading the message of the opportunities in Bulgaria to colleagues in American and foreign corporations. Such outreach involves undertaking speaking engagements and hosting meetings between U.S. executives and Bulgarian officials and businesspeople.

Today, the BAEF is participating in the establishment of the new American Chamber of Commerce in Bulgaria. Approximately 100 American firms are operating there, and the BAEF is serving as a resource to new arrivals as they seek to understand the Bulgarian marketplace and investment opportunities. As other markets in the region become saturated, Bulgaria — at the crossroads of Europe, Central Asia and the Middle East — continues to represent one of the best opportunities for American investment.

When the Bulgarian-American Enterprise Fund embarked on its mission, few people could predict the pace and direction Bulgaria would take in its transformation to free enterprise and democracy. The Fund was alone in providing risk capital to existing Bulgarian private entrepreneurs and start-ups. Although the economic landscape is now improving, other sources of capital have not developed to any meaningful extent. Consequently, the Bulgarian-American Enterprise Fund continues to play a unique and vital role in the development of the Bulgarian private sector.

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BULGARIA

THE CLIMATE FOR FOREIGN DIRECT INVESTMENT

Diagnosis and Recommendations

February 1994

Foreign Investment Advisory Service

a joint service of
International Finance Corporation
Multilateral Investment Guarantee Agency
World Bank

TABLE OF CONTENTS

EXECUTIVE SUMMARY

i. As Bulgaria enters the fourth year of its transition to a market economy, the Government faces difficult challenges, among which is the effort to attract foreign direct investment (FDI). Such investment can make a critical contribution to helping reshape the economy, adding not only capital, but also management skills and links to export markets.

ii. To advance its efforts for stimulating such investment, the Government requested assistance from the Foreign Investment Advisory Service (FIAS), a joint venture of the International Finance Corporation, the World Bank and the Multilateral Investment Guarantee Agency. Specifically, FIAS was asked to examine Bulgaria's regime for foreign investment and to diagnose any problems that may affect it, with a view to offering possible solutions. The present report is based on information gathered during a mission in October, 1993, and contains FIAS's findings.

iii. Bulgaria has not received much foreign investment, relative to either its neighbors or its own potential for hosting such investment. Allowing even for under-reporting in official data, Bulgaria is not among the major destinations in Central or Eastern Europe for multinational companies.

iv. The explanation for this lackluster performance lies in part with problems endemic to the broader economic situation of the country. Falling output, rising unemployment, increasing inflation, high indebtedness, unstable exchange rate - all act to discourage ". potential foreign investors. Added to these macroeconomic problems, the political turmoil in the immediate region also acts as a drag on possible foreign investment

v. But apart from these overarching problems, foreign investors in Bulgaria also must contend with specific difficulties that can frustrate their potential interest in the country. These difficulties affect the ease by which investors can enter and operate in Bulgaria. Specific investment-related obstacles often require a year or more to surmount, according ' to many foreign companies.

vi. While solutions to broader economic and political problems may require several years to affect, and may in varying degrees be outside the Government's control to achieve, **the** alleviation of specific, investment-related difficulties could be readily provided and is entirely within the Government's will and ability to deliver. On this basis, FIAS recommends that the Government should concentrate immediately on removing obstacles to the entry and operation of foreign investment, in anticipation of the time when broader problems will be resolved and investors' interest in,Bulgaria will rise.

vii. Among the investment-related problems is the difficulty investors face in concluding i either a joint venture with state-owned companies or the privatization of such companies. While the Government, as represented by its various ministries and agencies, has an obligation to assure itself that any deal is concluded under appropriate terms, the procedures to which investors are subjected are unfailingly time-consuming, frequently confusing, and rarely transparent. The expected introduction of mass privatization may help to accelerate and regularize the process for firms under the program, but serious attention also must be given to developing better procedures for privatizing and concluding joint ventures with the companies that remain outside the mass privatization scheme.

viii. Another major weakness is a requirement forcing companies to obtain a coun-mandated valuation of all non-monetary contributions to their registered equity. Such contributions, including intellectual property rights, patents, trademarks and goodwill, arc among the most important benefits that Bulgaria can expect to receive from foreign investment. Difficulties frequently arise when court-approval appraisers set a lower value on non-monetary contributions than investors, raising problems for apportioning the equity in joint ventures and for establishing a firm's creditworthiness. The most far reaching solution would be to permit investors to set their own valuations, with stiff penalties for misrepresentation, as done in Poland and Hungary.

ix. Additionally, the report proposes suggestions for alleviating a number of other investment-related problems. Among these are:

a. Revise the Foreign Persons' Business Activity and Foreign Investments Protection Act to assign benefits and obligations to foreign investments, not to foreign persons, as a way to avoid definitional problems that can lead to a loss of coverage under the present Act

b. Strengthen the guarantee on the freedom of capital movements in the Act by revoking parts of certain currency regulations that appear to weaken this benefit. This guarantee is extremely important to foreign investors. Today's open market for buying and selling foreign exchange is one of the most attractive features of Bulgaria's investment climate.

c. Expand the benefits of the Act by granting access to international arbitration to all foreign investors. Bulgaria already permits this under various bilateral investment treaties, and now should "multflateralize" this benefit.

d. Clarify the licensing provisions under the Act to reduce uncertainty over their application; develop standard procedures for screening investments in a transparent manner.

e. Give top priority to encouraging foreign banks to establish in Bulgaria; besides putting pressure on local banks to increase efficiency, foreign-owned banks can form an important bridge to foreign investors.

f. Promulgate as a matter of urgency laws addressing investment in exploration and exploitation cf hydrocarbons and minerals.

g. Accelerate efforts to join international bodies and accede to international conventions of importance to foreign investors, including the General Agreement on Tariffs and Trade (GATT) and the International Center for the Settlement of Investment Disputes (ICSID).

h. Focus on rapidly settling private and municipal claims to land on which industrial enterprises have been built. Vest ownership of this land with the enterprises, so as to enable potential foreign investors to negotiate with only one party for the entire package of the enterprise and its underlying land.

i. Give private investors who participate in joint ventures the right of first refusal over purchasing the entire venture and/or the state-owned partner, in the event that the state-owned partner is privatized.

j. Stabilize the rates and rules for taxing companies and individuals, in order to facilitate long-range financial planning by investors; ensure that effective tax burdens are aligned with the norms for European countries.

k. Amend laws and procedures that delay the enforcement of legal judgements, in order to enable investors to expedite recovery of court-sanctioned awards.

1. Accelerate passport inspection procedures at the international airport, to give foreign investors an impression of government efficiency and friendliness.

x. Following discussion of these investment-specific problems, the report examines **the** institutional framework for foreign investment, focusing particularly on the Foreign Investment Commission (FIC). While the Commission has the potential to perform a vitally needed function of assisting investors to overcome obstacles, FIAS found that the Commission was not yet effectively organized to carry out this task.

xi. Indeed, the Commission's mandate, as spelled out in its legal charter, does not list the job of assisting, or "servicing", potential investors to be a key function. Yet, in the midst of the general economic and political situation confronting Bulgaria, and in light of **the** specific problems facing potential investors, this task of providing conscientious care for investors is the single most important function that the FIC could perform.

xii. The FIC is providing some assistance to select investors on an ad hoc basis, but this role has not been institutionalized as the FIC's core function. In general, the Commission seems only to become involved when individual cases reach the point of acrimony between potential investors and parts of the government bureaucracy. Rather than wait till serious problems arise before stepping in to offer assistance, the FIC should routinely work, from the beginning, to facilitate all investments of particular significance to Bulgaria.

xiii. Focusing chiefly on providing investor servicing will model the FIC along lines similar to many of the world's successful investment agencies. For example, Ireland's Industrial Development Authority (IDA).has made high-quality servicing the centerpiece of its program to'attract foreign investment. Other agencies, pursuing similar paths, can be found in Malaysia, Thailand and Chile.

xiv. Indeed, the strategic basis for emphasizing investor servicing in Bulgaria is well-founded. Recognizing the presently uncertain economic and political climate, as well as taking account of the time needed to resolve investment-specific problems, it would be premature for Bulgaria and the FIC to embark on an extensive and expensive campaign of investment promotion. While occasional forays outside Bulgaria may have some merit, particularly if they are low-cost, the FIC should not use scarce resources to stir up interest, abroad among large numbers of investors, many of whom, if they choose to visit Bulgaria, would only be disappointed by unresolved problems.

xv. Before beginning such active promotion, the FIC should work with the rest of the government to "prepare the product for market", that is to address both the broad and the investment-specific problems facing the country. While in the process of effecting such reforms, the FTC should focus its main energy on assisting those investors who come to Bulgaria on their own.

xvi. To implement a strategic priority for delivering high-quality services, the FIC would need to make some adjustments in its present circumstances. These would include making the FICs offices more easily accessible, increasing slightly the number of its permanent staff, initiating a training program for these employees, developing explicit procedures for screening license applications, and developing a simple method for qualifying enquiries to determine which investors deserve servicing.

CHAPTERI

INTRODUCTION

1. Bulgaria is about to enter its fourth year of transition to a market economy. Government officials have had to deal with a dizzying array of problems, some of which have been solved, but many of which continue daily to confound easy answers. One of the issues with which policy makers have struggled is how to attract foreign direct investment (FDI) to aid in the transformation of Bulgaria's economy. With unemployment above 16% and hundreds of state-owned companies withering for lack of capital and management skills, the Government recognizes that the need for foreign investment is acute.

2. Indeed, in making the transition to a market economy that can function efficiently and competitively with the rest of the world, Bulgaria needs FDI. FDI brings capital, technology, management skills, and access to export markets. These crucial inputs are needed both for privatizing existing Bulgarian enterprises and for creating new ("greenfield") productive facilities.[1] As many countries have learned, FDI brings much more than just new machinery and/or finance. To produce goods or services that other companies will buy, enterprises in Bulgaria will need to be able to make continual technological and design progress, at world-competitive standards. Management needs also include elements that are scarce or almost unknown in Bulgaria today, such as inventory control, quality control, accounting, marketing strategies, sales management, financial control, and financial planning. By bringing foreign companies that have these skills into ventures where their profits depend on the success of their enterprises in Bulgaria, FDI can provide these inputs.

3. Accordingly, the Government requested assistance from the Foreign Investment Advisory Service (FIAS), a joint service of EFC, MIGA and the World Bank, to undertake a diagnostic study of barriers that may be blocking foreign investment. For this purpose, a mission visited Sofia in early October, 1993. Its members met with a broad host of government officials, including Deputy Prime Minister Valentin Karabashev, and with numerous people in the business community.

4. This report contains the findings of the mission. Pan II sets the stage with an assessment of the general economic and political conditions affecting foreign investment, as well as prcsentirg an analysis of the pattern of foreign investment to date. Part III evaluates the legal context for such investment, with particular attention to weaknesses in the principal law governing the rights and obligations of investors. Part IV then investigates the realm of investment procedures, identifying difficulties acquiring land, investing.through privatization and joint ventures, and valuing non-monetary contributions to equity. Next, Pan V examines problems with the operating conditions that face foreign investors, looking panicularly at the

' [1] The term "greenfield" refers to investments in which the investors bring money, machinery, and/or know-how to create new productive facilities. It is in contrast to privatizations, where the investors buy existing productive facilities.

problems of a porous border, changing tax rates, weak infrastructure and the slowness of enforcing legal judgements. Part VI explores the institutional context for foreign investment, assessing both the mandate and structure of the Foreign Investment Commission. Finally, Part VII offers a concluding perspective on the road that Bulgaria must travel to reach its potential for attracting foreign direct investment.

CHAPTERH

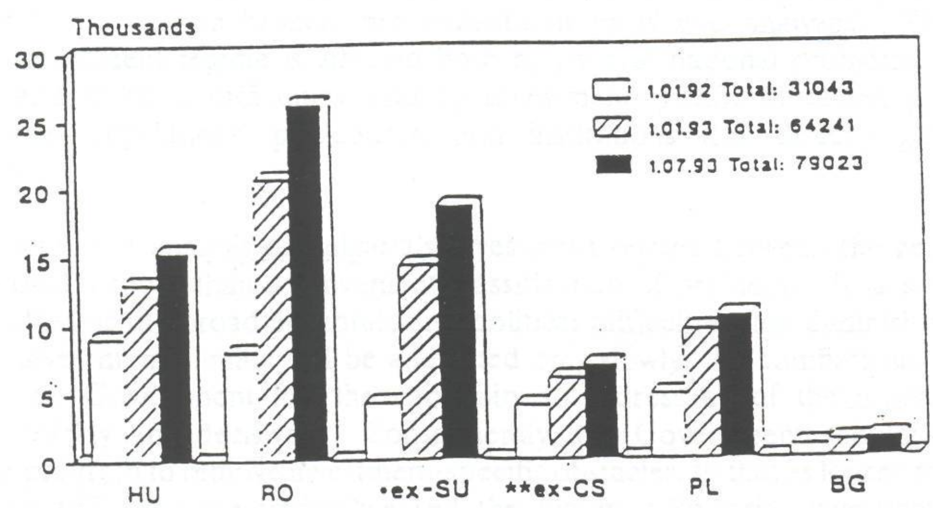
GENERAL CONDITIONS FOR FOREIGN INVESTMENT

A. Investment Performance To Date

5. Bulgaria has fared poorly to date in attracting overseas investment. Government statistics put total foreign direct investment for 1992 at $41 million. Poor reporting and classification procedures suggest that much of the total investment flow may not have been captured, and that the actual amount may have been two or three times higher. Nevertheless, even if the Sgure approached $150 million, this still would be extremely low, compared not only to other countries' performance, but also to Bulgaria's own economic potential.

6. Relative to other countries in the region, Bulgaria has received scant foreign investment, as seen in Chart 1, prepared by the United Nations Economic Commission for Europe.

CHART 1
ECE ECONOMIES IN TRANSITION
Growth of Foreign Investment



Registrations by Number

•ex-SU data include those for Baltic . States. CIS States and Georgia

****ex-CS: Czech and Slovak Republics**

Source: United Nations Economic Commission for Europe

7. Relative to its own potential, as suggested by the size of its economy, Bulgaria also is faring poorly at attracting foreign investment, as indicated in Table 1 (sec page 5), prepared by the Organization for Economic Cooperation and Development.

8. Beyond this comparative date, some rough outlines are visible, revealing the pattern of foreign investment in Bulgaria. Examined project-by-project, most foreign investments are strikingly small; for example, out of a total of 1346 joint ventures recorded up until July 1993, 76% had fixed capital df up to only $2,500.[2] This confirms frequent observations that much of foreign investment may be composed of shopkeepers from surrounding countries (particularly Turkey), who are establishing small retail stores in Bulgaria.

9. Apart from these small investors, a few multinational companies are prospecting in Bulgaria. Some view its location in South-Central Europe as a possible springboard for sales throughout the Mediterranean basin. They are progressing, however, very cautiously, testing the waters thoroughly before committing to any major investment. At the time of the FIAS mission in the Fall of 1993, fewer than a dozen large-scale foreign investments had occurred, not counting enclave investments exploring for off-shore oil and gas.

10. Bulgaria's poor performance in attracting foreign investment is a reflection of investors' concerns about the quality of the country's investment climate. To improve its performance, the country must address these concerns and thereby alter perceptions of the quality of its climate.

11. While notions of quality may be too subjective to be measured on a quantitative scale, they nevertheless can be broken into constituent parts and analyzed. The quality of Bulgaria's investment regime is affected both by general national problems, consisting of economic and political difficulties, and by investment-specific obstacles, present in the •policies, laws, regulations, procedures, and institutions that directly govern foreign investment.

12. Dividing the analysis of Bulgaria's investment regime between the general and the specific provides more than a convenient classification of problems. It lays the basis of a strategy. Most of the broad economic and political difficulties that diminish the quality of Bulgaria's investment climate will be alleviated only slowly. By comparison, if it is willing to do so, the Government has the capability to redress all of the investment-specific problems quickly and decisively. Consequently, the Government should undertake an immediate program to remove investment-specific obstacles, so that as longer-term economic and political difficulties are gradually eased, the quality of Bulgaria's investment climate will steadily rise and its performance in attracting foreign investment will increasingly improve.

[2] "Joint Ventures, Representative Offices and Branch Offices in Bulgaria," Foreign Investment Committee, July 1993.

Table 1

Breakdown of total foreign investment flows (cumulative)
by country, 1990-1993
(% of GDP)

Country	Date	FDI value in mn. US$	Percentage of estimated GDP
Poland	01.90 01.91 01.92 01.93	100 352 680 1400	NA NA 0.6 1.3
ex-Czech and Slovak Federation of Republics	01.90 01.91 01.92 01.93	256 436 1100 1900	NA 1.5 3.4 5.8
Czech Republic	01.93 04.93	1669 1919	6.7 7.0
Slovakia	04.92 10.92 01.93	123 203 231	1.4 2.2 2.6
Hungary	01.90 01.91 01.92 01.93 03.93	550 1460 3000 3423 4623	NA 3.3 10.0 11.4 15.4
Romania	01.91 01.92 01.93 04.93	112 269 538 575	0.2 0.6 1.3 1.3
Bulgaria	01.93	57	0.2
Albania	11.92	37	0.3

Note: Rounded percentages and GDP estimates at current US dollar prices.

Source: Organization for Economic Cooperation and Development

13. The remainder of this section identifies the general economic and political problems affecting foreign investment, while subsequent sections highlight investment-specific obstacles and offer recommendations for their elimination.

B. Economic Conditions Affecting Foreign Investment

14. There is a disparity in perspectives between how government officials and foreign investors might view Bulgaria's economy. To national officials (and to international agencies working with them), the progress of economic reform gives cause for modest optimism. Most of the basic legal framework is in place, tariffs and duties are set mostly at reasonable levels, an open market for foreign exchange exists, inflation is high but not out of control, and plans are in process for a mass privatization program.

15. To most potential foreign investors, however, the view is far gloomier. Foreign investors tend to look at a country's economy with a narrow field of vision. They are concerned only with the attributes relevant to their businesses and pay little attention to extraneous factors. Long-term prospects are deeply discounted if the concrete situation here-and-now is negative. Accordingly, when investors evaluate the possibility of entering Bulgaria, they see an economy that has lost its main markets in the East, that is struggling with a difficult transition to a market system, plagued by high unemployment, shrinking GDP, large external indebtedness, and constant inflation.

16. One of the few bright spots from an investor's perspective is an open market for buying and selling foreign exchange. This is one of the key concerns that investors have in any country, since they require foreign exchange to pay for imports and to transfer abroad profits, interest and fees. On this crucial aspect, Bulgaria ranks among the best in Central and Eastern Europe, allowing investors to fully convert local currency and to move hard currency in and out of the country, complying with only minimal requirements.[3]

17. Another positive attribute for foreign investors is the emergence of a domestic private sector. While this would not be an important factor in most countries, it is significant for foreign investors looking at the former centrally-planned economies, since it signals the rise of conditions conducive to the establishment and operations of privately owned businesses. In 1993, estimates indicate that the private sector in Bulgaria accounted for around 20% of GDP.

18. Apart from these two favorable points, however, most foreign investors see a difficult economic situation. Bulgaria's, GDP has been declining steadily for several years, while inflation has been high. In 1992 alone, GDP shrank 5.7%, and domestic prices rose 79%. When this macroeconomic data is .translated into real-world business terms, it raises several serious concerns for potential investors, among which the chief four are:

[1] For further discussion on foreign exchange availability, see page 14.

1) Scant Consumer Purchasing Power - The typical Bulgarian has little disposable income left after meeting necessities. While poverty is not prevalent, neither is luxury. Real wages have riot risen in recent years so effective purchasing power is not expanding to facilitate increased consumption. While this austerity may be necessary, it curtails foreign investors' interest in producing new products for the Bulgarian market, although wage containment may be attractive to export producers.

2) Fear of Higher Taxes - Generating tax revenues to finance the public budget continues to be difficult. The weakness of the state-run sector of the economy, which still accounts for over 80% of GDP, is largely to blame. Additionally, tax avoidance may be a problem. The Government also will need additional resources when Bulgaria reaches a settlement with its international creditors and begins repaying its sovereign debt. While the introduction of a VAT system may improve revenues, foreign investors are deeply concerned that the Government will try to make up part of the general shortfall by taxing them at higher levels.*

3) Exchange Rate Volatility - After a couple years of appreciating in real terms, the value of the leva began declining rapidly in late 1993. While this decline, in and of itself, is not discouraging to foreign investors, the impression of a volatile exchange rate is. Although foreign investors do not expect any country's currency to maintain a constant value, they favor predictable situations, where fluctuations are small enough not to upset long-term financial planning.

The decline of the leva is perhaps overdue, given the appreciation that had occurred in the face of sustained inflation. A lower leva makes Bulgarian exports more' competitive and reduces the foreign-currency price of purchasing Bulgarian assets. But its abrupt decline causes potential investors to wonder whether further fluctuations may occur, upward or downward, given the unsettled macro-economic environment. Wide swings in either direction would be troublesome, since an appreciation could damage an investment's competitiveness, while a depreciation would reduce the accounting value of an existing investment measured in foreign-currency terms.

4) Absence of Export Financing - Foreign investors frequently rely on government credit programs to help them to finance machinery and other equipment used in making investments. Small down-payments and low interest rates play an important role in enabling investors to reduce the up-front costs of their projects. Bulgaria, however, is disqualified from most OECD government credit programs because of its arrears on repaying international debts. As a result, potential foreign investors are denied access -to this lucrative benefit.

[4] For further discussion of taxation, see page 24.

19. In general terms, these four problems will be solved as macroeconomic stability ' advances. Improved purchasing power, tax constancy, exchange rate normalcy and access to export financing will all arrive as part and parcel of general economic improvement. Indeed, studies show the inflows of foreign investment are highly correlated with robust domestic growth. But general growth must also be accompanied by the removal of investment-specific barriers, as detailed in subsequent sections.

C. Political Conditions Affecting Foreign Investment

20. In addition to economic concerns, investors' perceptions of an investment climate are also influenced by broad political conditions. Investors' concerns under this heading can be divided into two categories: external political developments impacting on Bulgaria, and the country's internal problems.

21. Starting with outside events, the protracted Balkans conflict is impairing investors' perceptions of Bulgaria. From beyond the immediate region, the country is seen as part of, or at least too close to, a zone of unresolved hostilities. While the eventual cessation of fighting there, as well as a broad peace accord in the Mideast, may give companies operating in Bulgaria good access to starved markets in these areas, most investors are too troubled by today's international risks to think about positioning themselves to exploit uncertain future opportunities.

22. Domestically, political risk is also considered extremely high. Although there is no scientifically precise way to measure this, the FIAS team gauged that political concerns were more pressing in the minds of the foreign businessmen whom it interviewed in Bulgaria, than was evident in similar FIAS exercises in the three Baltic countries, Hungary, the Czech and Slovak Republics, or Poland.

23. The following paragraphs report what foreign businessmen told FIAS about the political situation in Bulgaria; FIAS has not attempted to verify the underlying accuracy of these views. In accessing the quality of an investment climate, perceptions are at least as important as facts.

24. The heart of the matter was often expressed by businessmen in the form of a question, addressed as much to their own personal doubts as to the members of the FIAS mission, about whether the Government of Bulgaria sincerely wants foreign investment Apart from the pronouncements of official rhetoric, businessmen are not convinced that the government truly favors foreign investment. They sense that top officials may be politically bound by alliances with various parties and labor unions that commit them to limiting the scope of foreign investment, particularly in regard to privatization.

25. Many investors further feel that official neglect, by offering no assistance, clears a path for untoward actions against foreigners. -Specifically, they complain about public corruption, which they believe could be reduced if the government really wanted foreign investment, and they worry about rising property theft, which they think could be contained if the government were willing to better protect foreign interests.

26. At the juncture between politics and economics, many foreign investors (and domestic businessmen) are deeply troubled by the strong influence that members of the former communist party seem to exert, over the largest private companies in Bulgaria. Many investors spoke of the pervasiveness of this influence, which appears to be directed toward gaining dominance over the economy, including the goal of excluding foreigners from lucrative opponunities. A foreign investor even spoke of an offer he received from one of the largest business groups jo smuggle imports for him in exchange for shares in his company's profits.

27. Finally, most investors are concerned about the outcome of future elections. No consensus seems to have emerged among voters about the proper course for economic development, and the electorate appears to be split among not only competing but contradictory visions of how to manage the economy. This suggests that economic policy may swing in wide fluctuations for some time to come, making a stable business climate unlikely.

CHAPTER ffl

THE LEGAL CONTEXT FOR FOREIGN INVESTMENT

28. This section begins the discussion of investment-specific problems. The legal context for foreign direct investment in Bulgaria is reasonably sound, with a few notable exceptions. The Government, in conjunction with assistance from multilateial lenders, has devoted considerable effort to fashioning a legal framework for a market-driven economy. Some critical pieces of legislation are still in the works, such as a bankruptcy law, but by and large the major task of drafting legislation is complete.

29. The focus on the legal context has perhaps had the unfortunate consequence of detracting attention from the treatment that foreign investors actually receive. Good laws are needed, but they form only the backdrop against which the action of investment occurs. Yet, since so much energy has been expended on the legal context, it is sensible to begin a diagnosis of the particular problems of Bulgaria's investment regime by examining the normative framework. Subsequent sections will then examine problems arising from how investors are actually treated.

A. The Foreign Investment Law

30. General Provisions: The Foreign Persons' Business Activity and Foreign Investments Protection Act (hereafter, "Protection Act") serves as the general law governing both direct and portfolio investment in Bulgaria. This law advanced important strides in the treatment of foreign investment compared to its predecessor, the Foreign Investment Act, notably by substituting a "negative list" of restricted activities in place of a pervasive regime of licensing. Nevertheless, the Protection Act is weakened by two fundamental problems.

31. First, the Act accords rights only to the foreign persons making foreign investments, and does not assign rights to the local company (or "national legal person") created by and receiving such investment. This focus on foreign persons and the exclusion of national persons is found, for instance, in Article 10, which offers protection for the expropriation of "(P)roperty of foreign persons," and Article 13, which covers foreign exchange, stating "(A) foreign person shall be entitled to buy currency" and "(T)he foreign person may transfer the currency abroad."

31 Second, the Protection Act tries to define foreign investment by listing the objects that such investment may acquire (such as shares, property rights, etc.) without ever stating what foreign investment actually is. The Act tries to sidestep this problem by declaring that a foreign investment is the product of any investment made by a foreign person, but this avoids the problem and only adds confusion since pointing to the "doer" of an action still tells little of what is "done."

33. The failures of the Act either to define foreign investment properly or to accord benefits to national persons created by and receiving such investment leads to two undesirable outcomes:

(1) A Bulgarian national residing permanently in Bulgaria can obtain all of the benefits of the Act, even though the investment is made entirely in *leva.*

(2) A foreign investor making an investment entirely in foreign exchange is unlikely to be able to benefit from the Act.

34. The first of these outcomes would arise if a Bulgarian citizen establishes a company outside of the country (i.e., creates a foreign legal person) and then carries out an investment in this company's name. This would be simple to accomplish; any number of foreign jurisdictions offer shell companies for sale to businessmen seeking off-shore vehicles. Once established as a foreign legal person, a Bulgarian investor may proceed to make an investment in *leva,* and this investment will qualify for full benefits under the Act, since the Act defines foreign investment as any investment made by foreign persons, regardless of the national origin of the investment capital.

35. The second outcome, depriving foreign investors of the Act's benefits, will frequently arise because a particular provision in the Act compels such investors to establish and operate as local companies, thereby losing the privileges granted to foreign persons. Specifically, in order to own land, foreign investors must set up a Bulgarian company and carry out their investments through it, as specified in Article 5(2).[5] Most foreign investors will need to have title to land, rather than lease it, because sole possession may be the only way under present circumstances to clarify ownership rights.[6] Yet, as soon as foreign investors establish local companies to own land, they lose the benefits for foreign persons in the Act, even though they may make their investments entirely in foreign currency.

36. The Protection Act needs to be redrafted to avoid these unproductive outcomes. First, a better definition of foreign investment is required. Article 9 tries to define foreign investment by enumerating the various uses of such investment; the list, however, quickly becomes repetitious. For example, the difference among shares in commercial enterprises, stakes in commercial enterprises, property rights, and ownership of enterprises is slight, if any.[7]

[5] Also, foreign investors will prefer to establish a local company as a means of shifting liability from the foreign parent.

[6] Refer to IV. A "Acquiring Land" for discussion of land, see page 17.

[7] The definition also tries to encompass foreign portfolio investment in real estate, government securities, and corporate shares. The differences in form and function between direct foreign investment and portfolio investment are so great that most countries use separate laws to govern these. As a capital market develops in Bulgaria, especially with the advent of mass privatization, a separate law covering portfolio investment will be needed.

37. Attempting to define foreign investment by its uses is tike trying to define water by listing the kinds of containers it can be poured into. A clearer definition would pin down foreign investment by describing how such investment is made. Particularly, a foreign investment would be defined as -the result of a specific activity, regardless either of who performs the activity (foreign persons, local persons, branches, etc.) or what the activity produces (shares, stakes, property rights, etc.). The activity should be described as the transfer and investment into Bulgaria of economic value from outside the country, irrespective of whether this lvalue is in the form of cash, goods, or invisibles, such ?< intellectual property.[1]

38. Second, the basic premise of the Protection Act needs to be rethought to give benefits not only to foreign persons but also to national persons that are created by and receive foreign investment. In fact the best solution may be to avoid any reference to foreign or national persons, and instead convey rights simply to any company established by foreign investment and to the company's direct owners.

39. At the same time that the Act's coverage is broadened to include national persons, a reasonable ownership threshold also must be established, so that a national person (i.e., company) receiving a minimal amount of foreign investment (say, only 1% of its total capital) is not entitled to the Act's benefits.

40. Article 9 presently sets the threshold at 50%, requiring half of an enterprise to be owned by foreign persons before qualifying as a foreign investment. This threshold is too high. It limits the opportunities of existing Bulgarian companies to seek foreign partners, since Bulgarian firms would have to forfeit controlling interest in order for foreign partners 'to obtain legal protection under the Act. Moreover, with the advent of mass privatization, foreign investors may find it difficult to amass over 50% of a firm's equity, thereby preventing them from being covered by the Act.[9]

41. The task of setting a proper threshold is difficult. In theory, the threshold should be set at the percentage of shareholding that constitutes controlling interest, since the ability to exercise such control is the feature that distinguishes direct investment from portfolio investment. In practice however, the percentage of ownership that yields a controlling interest will vary from case to case. Some governments have set the minimum as low as 25 percent. Consequently, setting any given percentage would be arbitrary.

42. Some governments have tried to sidestep this by setting the threshold at a fixed dollar amount of investment. This will still be arbitrary, since a fixed dollar amount will represent different degrees of ownership in different firms, but it does have the virtue of being easily monitored (with records of currency transfers) and of insuring that a significantly large enough investment has occurred 'to warrant protection under the Act. The Bulgarian

[1] The definition also should include the re-investment of earnings produced domestically from economic values that originally come from outside Bulgaria.

[9] For further comments on privatization, see page 18.

Government, therefore, may want to consider going this route by setting the threshold for foreign investment somewhere in the range of $100,000 to $250,000.

43. As a final point in discussing general coverage of the Protection Act, it should be noted that none of the changes proposed here preclude Bulgarian citizens from being covered if they invest flight capital held abroad, so long as this capital reenters as foreign currency and exceeds the dollar threshold. Encouraging this capital to return to Bulgaria is a worthwhile objective, which many other governments have also provided in their investment laws.[10]

44. Benefits: The Protection Act provides two chief benefits, compensation for expropriation and the right to transfer currency abroad. While in principle these are important guarantees for foreign investors, neither one is framed adequately in the Act.

45. In the event of an expropriation, investors cannot take disputes to international arbitration, but must rely only on the domestic legal system. While in many of its bilateral investment treaties (BITs), Bulgaria grants access to arbitration, this right is absent from the Protection Act.

46. There is no reason to restrict this important guarantee to bilateral treaties. As a bargaining point in negotiating BITs, access to arbitration holds little leverage, since this is a standard provision in most treaties. Even if Bulgaria were to conclude BITs with all of the developed-country governments, such an elaborate network of agreements still would not provide an adequate guarantee in case of expropriation. Many foreign companies channel their investments through tax havens, thus falling outside the coverage of BITs. To provide a secure and attractive framework for international investment, Bulgaria should consider "multilateralizing" access to arbitration by including it in the Protection Act.

47. Moreover, arbitration should be available not only in the event of expropriation, but also to settle any dispute between a foreign investor and all actors in Bulgaria's public sector. For the near future, almost all important foreign investments will require an agreement with some part of the Bulgarian government, whether in the case of privatization or a joint venture. Investors should automatically have the ability to submit any disputes over such agreements to arbitration.

48. At present, the Bulgarian government requires special legislative approval for any agreement that the government might conclude to refer disputes with foreign investors to international arbitration. The legal systems of several other countries, for example Spain and the United States, contain similar restrictions on the power of the central government

[10] Once again, though, it may be necessary to separate direct and portfolio investment with different laws^since it is not clear that Bulgarians who engaged in capital flight should now be rewarded with legal benefits simply for investing in real estate, passive shares or bank deposits.

to submit to arbitration. In many more countries, however, there are no such obstacles to governmental submissions to arbitration, and the governments concerned can much more readily conclude arbitration agreements with foreign investors. This obviously can help to attract foreign investment, given the general preference of investors for arbitration as a means of settling disputes with the host state. It is therefore not surprising to find in the investment laws of many such countries references to arbitration as a means of resolving conflicts between the host government and foreign investors. In Eastern Europe and the former Soviet Union, the countries that have investment laws with such references to arbitration include Albania, Belarus, Estonia, Hungary and Russia.

49. The second benefit, covering the right to repatriate funds, is fundamentally important to foreign investors. The Act permits unrestricted transfers, upon evidence that taxes have been paid. This benefit, however, appears to be countermanded, or at least compromised, by currency regulations contained in Ordinance 15, as amended by Ordinance 240. These require investors to obtain permission from both the Bulgarian National Bank and the Ministry of Finance prior to remitting funds.[11]

50. Although one may try to dismiss the contradiction between the Act and the Ordinances by arguing that a law of the General Assembly will take precedence over a decision by the Council of Ministers, such legal hermeneutics are unlikely to give foreign investors peace of mind. Indeed, the very fact that the General Assembly and the Council have different views about repatriating funds should prove worrisome to many investors.

51. Presently, the unrestricted provisions of the Act seem to apply in practice. The ease of repatriation is one of the most favorable attributes of the Bulgarian investment climate. To solidify this benefit and ensure its continuation, Ordinances 15 and 240 should be amended to coincide with the guarantee contained in the Protection Act

52. <u>Licensing</u>: The Act requires foreign investors to obtain a license from the Council of Ministers for four kinds of activities: production of armaments, banking, exploiting natural resources, and acquiring immovable property in geographic zones designated by the Council of Ministers. This "negative list' is not unreasonable and, in fact, resembles lists in other countries. The implementation of the list, however, raises some concerns.

53. First, it appears that armament production is being broadly defined to encompass the conversion of military industries to civilian production. As a result, the Ministries of Defense and Industry have advised several foreign investors to apply to the Council of Ministers for a license to form joint ventures with military plants for the production of such mundane items as buses. In many cases, military factories command some of the most advanced technology and best trained workers in Bulgaria. It would be unfortunate if efforts to attract foreign investment to convert these factories to civilian uses were delayed by the need to

[11] Ordinance 15, Article 3, paragraph (3), point 4; Ordinance 240, Article 1, paragraph

obtain licenses. The scope of this category should be narrowed to cover only investment in military production.

54. Licensing the off-shore exploration, development and extraction of natural resources serves a necessary public function, since these resources are owned by the State and are non-renewable. In many countries wiiere such licensing occurs, however, decision-making is not in the hands of a high-level political body, such as the Council of Ministers. Investment rights are allocated by the relevant ministry or department, acting on clearly-defined procedures. These agencies can bring to bear a professional knowledge of resource management, which is more relevant to b'censing than the political considerations residing with cabinet bodies.

55. In Bulgaria, though, the problem of managing natural resources cuts even deeper. There is no law governing either the development of hydrocarbons or mineral deposits. Consequently, all activities, including millions of dollars of extensive drilling in the Black Sea are being carried out on an ad hoc, basis. The absence of a legal framework is compounded by the relative weakness of the Committee of Geology and Mineral Resources, which is short of trained staff and budget.

56. A draft law on natural resources is apparently working its way through the National Assembly. This draft should be reviewed by experts to ascertain that it meets international standards, and should be enacted into law as quickly as possible. As a central tenet, the law should provide clear standards for investors and should base any government approval on transparent and automatic mechanisms.

57. Finally, licensing the purchase of real estate in certain areas of the country has the potential to become problematic for foreign investors. Presently, the Council of Ministers has not yet designated any zones for licensing. There is an expectation that the border areas will be chosen, as a means of preventing the purchase of Bulgarian real estate by residents of surrounding countries. There also is discussion of designating "strategic" zones in the interior.

58. The absence of any designation adds to the uncertainty of the investment climate. The Act gives the Council of Ministers the power to declare any pan of the country at any time to be a zone liable for licensing. This raises a concern among potential investors that,, just before they initiate an investment, the Council could declare that their project falls into a special zone, thereby requiring them to obtain a license. There is also a concern that a special zone is declared with retroactive effect on existing foreign investment projects.

59. The transparency of the investment climate would be enhanced if the Council of Ministers were to designate zones immediately and bind itself with a declaration that no additional areas will be designated for at least a two-year period. If the Council cannot identify any zones requiring restriction, then it may be worth considering amending the Act to completely remove this provision for licensing.

B. Other Laws Affecting FDI

60. In addition to the bankruptcy law and a law (or laws) on hydrocarbons and minerals, the Government should ensure that the legal context for foreign investment is complete. Significantly, this involves not only enacting domestic legislation, but also ratifying international agreements and joining international bodies. For example, Bulgaria is in the arow-ss of joining the International Center for the Settlement of Investment Disputes (ICSID) and the General Agreement on Tariffs and Trade (GATT). All effort should be made to accelerate the process of joining these bodies.

CHAPTER IV

INVESTMENT PROCEDURES

61. Despite a relatively favorable .legal framework, foreign investors confront extreme difficulties in Bulgaria. The most severe problems arise during the initial investment process. Indeed, the procedures for carrying out an investment raise obstacles so significant that very few major investments have actually occurred.

62. The investment process frequently takes more than a year to complete. When investors finally succeed in overcoming obstacles, they are left in an embittered mood. They tell new, potential investors of their hardships, thereby discouraging them. If Bulgaria is going to succeed in attracting sizeable amounts of foreign investment, then the Government must first act decisively to streamline investment procedures. This should be a matter of utmost priority.

63. This section addresses four of the most troublesome aspects of investment procedures: acquiring land, privatizing a state-owned company, establishing a joint venture with a state-owned company, and valuing non-monetary contributions when registering a new company.

A. Acquiring Land

64. Every investor interviewed by the FIAS mission ranked acquiring land as the most acute problem faced in the investment process. This was the case whether investors were developing greenfield projects, privatizing an asset or forming a joint venture.

65. The basis of the problem is founded on uncertainty over existing ownership. Essentially, foreign investors are unsure from whom they must purchase title to land. During the communist period, industrial holdings were frequently restructured and ownership of the underlying land was shuffled from one large controlling unit to another. In the process, clear title was lost.

66. Today, local municipalities often lay claim to industrial land, asserting that it was confiscated from them during the communist period. In some cases, individuals also believe that they hold rightful title. The process of researching claims and satisfying all parties often takes months. This burden is felt not just by foreign investors but also by the Privatization Agency, which must settle the land issue prior to offering a company for sale. In some (apparently many) cases, claimants often seek unreasonable prices for the land, well in excess of the price of similar plots elsewhere.

67. A solution would entail several steps. First, the Government should complete the restitution of land on which industrial enterprises exist. Second, the legitimate owners should be paid a fair market value to sell the land; municipal claims might be paid at a discounted rate, since an overriding public interest is involved. Third, ownership of land should be

vested in the industrial enterprises built on it.[12] The goal is to enable investors to negotiate with only one party when privatizing a company or establishing a joint venture. Eliminating the need to locate the "landlord", and strike a separate deal with him will streamline the investment process. It also will eliminate eventual hurdles to mass privatization and to the liquidation of non-economic firms.

68. With respect to greenfield investments, clearer procedures should be developed for re-classifying agricultural land as industrial land. Presently, the process is haphazard. In the absence of standard and automatic rules, investors must rely on permission from government officials to designate land for industrial purposes. This contributes to the lack of transparency in the investment climate and opens the door to corruption.

B. Privatization

69. Privatization is moving at a snail's pace. Only three major companies have been sold, and the prospect of additional deals appears limited to a small handful of firms. Plans for mass privatization are in preparation, which could potentially accelerate the pace, but for the moment they seem only to add uncertainty, which in turn further discourages foreign investors from seeking to purchase state-owned companies.

70. It would be beyond the scope of this report to engage in a full analysis of the various dimensions of Bulgaria's privatization program. Yet, a few, fundamental points that focus on the participation of foreign investment in the program are relevant and noteworthy. Indeed, the success of the program will depend in part on the willingness of foreign investors to participate in it.

71. Some foreign investors report that the attractiveness of state-owned companies has deteriorated sharply in recent years. Although statistical evidence is lacking, it appears that assets of these companies may have been stripped away by their managers, who have transferred these assets at very low cost to so-called joint ventures, which these managers or their friends own as private individuals. This process of "spontaneous privatization" runs the risk of leaving state-run companies as no more than shells, with liabilities far in excess of their going value.

72. This practice has been allowed to become prevalent because of the failure to establish responsible control mechanisms to safeguard the interests of publically-owned firms and the state. Issues of corporate governance have not been adequately addressed. There are few guarantees to ensure that managers and supervisory boards act appropriately.

[12] It may be necessary to prevent companies from mortgaging the property they are given for a certain period of years, in order to ensure that the value of the land stays within the firm.

73. If foreign investors do succeed in finding a company that they want to buy, they complain that the process of concluding a sale is horrendously difficult. Among other problems, they Dnd that they must contend with obstacles raised by labor unions, which appear able to exercise considerable political influence on the government to affect the terms of privatization. This often seems to result in imposing employment guarantees in the sales contract, which investors may find excessive.

74. Setting a reasonable Celling price also appears to be a problem. The government relies on lengthy and expensive valuations that often result in setting higher prices than the private valuations undertaken by potential investors. Rather than work to find a compromise with such investors, there seems to be a greater emphasis on obtaining the full appraisal price, even if this means losing a potential deal. In negotiations, foreign investors find that government officials are more concerned about playing to public perceptions than they are in concluding a sensible sale.

75. Next, foreign investors are concerned about the environmental liabilities that accompany many state companies. Sales contracts can promise to indemnify investors against any future claims, but investors worry that a subsequent law may be adopted to override these terms, forcing them into a dispute with the government. This concern should be addressed in the environmental legislation that the government is in the process of developing; a guarantee should be included relieving domestic and foreign purchasers of privatized companies from responsibility for pre-existing pollution.

76. Finally, foreign investors are concerned about mass privatization. In principle they know from their experiences in Czechoslovakia that mass privatization can be beneficial, but they are worried about, and confused by the wrangling among competing plans from different quarters of the Government of Bulgaria. They are uncertain about how mass privatization will be carried out, and what role, if any, they will be allowed to play. At a time when privatization is beginning to gather momentum following the sales of a few firms, the introduction of mass privatization poses a new element of uncertainty for the foreign investment community. At least some of these doubts could be allayed by keeping firms in which there is an active foreign interest out of the mass privatization program and continuing to make them available for direct sale.

C. Joint Ventures

77. Given the numerous problems with privatization, and the resulting slow speed of transactions, many foreign investors have opted to try establishing joint ventures with state-owned companies. The procedures here, however, are just as fraught with problems and encumbered with delays. In effect, attempts at joint ventures arise as a fallback, because privatization is stalled, but even this avenue is virtually closed to investors.

78. Joint ventures require the approval of the relevant ministry or committee.[13] It is not sufficient for investors to negotiate and strike a deal with a firm's managers; all terms must be reviewed by the ministry or committee, which holds the final authority to approve joint ventures. In many cases, the ministry or committee requires draft contracts to be completely renegotiated.

79. There are a dozen separate ministries and committees empowered to create joint ventures. All of them lack clear procedures and transparent criteria for evaluating potential deals. Most of them do not even have set procedures for how investors should apply. As a result, decisions are delayed; files accumulate and are shifted from one officials' desk to another. Investors frequently feel that they are being intentionally stalled or avoided, when in fact the officials in charge are often just as confused and frustrated as the investors.

80. The Ministry of Industry has tried to address this chaotic situation by proposing internal guidelines for approving joint ventures. These guidelines, however, compound the problem by imposing an overwhelming burden on potential investors. An elaborate technical and financial feasibility study is required, including descriptions of equipment, justifications of intellectual property, sources of raw materials, marketing plans, sales forecasts, and revenue projections.

81. The Ministry is ill-prepared to evaluate the slew of information that it requires for joint-venture proposals. Presently, the relevant department employs seven professionals, who are overwhelmed with more than 130 proposals. The level of technical and financial detail that receives scrutiny slows substantially the evaluation process. Accordingly, at the time of the FIAS mission, the Ministry had been able to analyze and approve fewer than five joint ventures, even though many of the most attractive state-owned companies fell under the Ministry's control.

82. The long-term solution to the problem of joint ventures lies in successful privatization, which will enable investors to purchase state-owned companies outright, and thereby eliminate the necessity for partnership agreements. Until this materializes, joint ventures can be accelerated in the short run by a two fundamental reforms. First, better corporate governance needs to be ensured, to put in place professional managers and responsible boards that can negotiate joint-venture agreements in their firms' best interests. Second, the role of the ministries must be restricted to "Voting" simply in favor of, or against, a specific joint venture agreement.

83. As exclusive shareholders of public enterprises, the ministries cannot be excluded from the joint-venture process. Their involvement, however, should consist solely of assenting (or rejecting) a deal negotiated by managers, just as shareholders do in other countries. The ministries should not have a hand in negotiating with private investors.

[13] In some cases, the requirement for ministerial or committee approval has been decreed in ordinances, such as by the Ministry of Industry, while in other instances the requirement is informal but no less real.

Moreover, ministries should face a specific, short, time limit for giving their decision, say - thirty days.

84. Adopting these accelerated procedures for joint ventures may concern some Bulgarian officials, who feel that stricter controls are needed. It is inconsistent, however, with a transition to a market economy for a centralized public body, such as a ministry or committee, to exercise control over productive assets. Company managers may not always negotiate perfect deals, but mistakes are part of the free enterprise system. Besides, it is far from clear that ministry officials are less error prone. The objective is to proceed as rapidly as possible with revitalizing Bulgarian companies, while providing in the process some checks to abuse, but not permitting these safeguards to frustrate overall progress.

85. Finally, procedures must be developed to secure the interests of private parties in joint ventures if the public party is privatized. In principle, the private partner should have the right of first refusal to purchase the public company. Unless this right is guaranteed, the private party may find that the public half of the joint venture is purchased by an unfriendly buyer or perhaps even a direct competitor.

86. The right of first refusal must be contained in more than just the joint-venture contract. The contract is signed with the public partner, but that partner cannot obb'gate itself in case of its own privatization. Privatization is the decision of the owner or ministry/committee, and the seller (Privatization Agency or an investment fund under mass privatization). Therefore, a new legal or regulatory instrument is needed to protect the rights of private parties in joint ventures. This should be enacted immp.riiate.1y to remove any uncertainty.

D. Valuing Non-Monetary Contributions

87. Modern investment frequently includes non-monetary contributions, such as intellectual property rights (patents, trademarks, licenses) and good will. Whenever a new firm is registered in Bulgaria, the Law on Commerce requires the court to appoint three experts, who must independently set a value on an investor's non-monetary contributions.[1]* Unless investors are willing to accept this valuation, they cannot register their companies.

88. This requirement posses an additional and often fatal obstacle to an already onerous investment process. Assuming that a foreign investor succeeds at the difficult chores of acquiring land and obtaining approval for a privatization or joint venture, this obligation may then pose a final hurdle that cannot be surmounted. Indeed, the FIAS mission spoke with several business lawyers, who indicated that the problem of valuing non-monetary contributions was preventing several of their foreign clients from completing investments. This conclusion is echoed in a study by the Center for the Study of Democracy, which found:

[u] Article 72, paragraph (2).

> The impediments to non-monetary investment ... cause particular problems in the area of foreign investment. The loss of control, delay, cost and uncertainty of the existing system dissuades, foreign firms or businesspersons from making such investments in Bulgaria.[15]

89. In the best of circumstances, valuing non-monetary contributions is exceedingly difficult. It is far from simple to ascribe a precise value to an intangible concept, such as good will. In Bulgaria, this difficulty is compounded by the lack of international business experience of the court appointed experts, who usually are retired civil servants. These experts appear routinely to place low values on non-monetary factors. Yet the values they set serve as the basis for determining shares in a joint venture or for fixing compensation in the event of an expropriation. Also, banks and suppliers use the registered value of a firm to determine creditworthiness, so undervaluation may affect an investors ability to borrow funds.

90. Investors have no recourse against an evaluation that they consider to be low. Their only choice is pull out of the investment, which many foreign firms appear to be doing. Given the seriousness of this problem, a half-hearted solution will not be enough. It would be insufficient to give better training to the evaluators. Instead, the only immediate, effective solution would be to eliminate this obstacle by dropping the requirement for expert evaluation.

91. Many countries permit companies to register based on a self-declared worth on non-monetary contributions. Poland and Hungary, for instance, allow this; they permit investors to perform their own valuation and then impose tough penalties if these values are later discovered to have been inflated.[16] Bulgaria should follow this model and amend its Commercial Law as a matter of top priority.

[15] Meyer, William, D., "The Treatment of Non-Monetary Contributions", Center for the Study of Democracy, Issue No. 2, February 1992, p.3.

[16] Ibjd, p.5.

CHAPTER V

OPERATING CONDITIONS

92. If foreign investors make it through the difficulties of the investment process, they will still face a number of critical problems affecting operating conditions. The existence of these problems may, in fact, discourage some potential investors from even beginning the process of establishing themselves in Bulgaria. Accordingly, this section identifies the most pressing difficulties in the country's operating conditions, as a prelude to recommending ways of easing them.

A A Porous Border

93. Goods frequently escape duties at Bulgaria's border. Many consumer items seem to enter the country free of charge and then are sold without sales tax. Smuggling and other illegal activities account for only part of the explanation.

94. Many legal means exist to import and sell goods without any form of tax. These used to include some loopholes that were recently plugged by placing restrictions on non-profit foundations and limiting blanket exemptions in the free-trade zones. However, several vehicles for duty-free entry continue to exist. Among these are the ability of political parties (which may be formed by as few as five people) to import unlimited quantities of duty-free goods and the somewhat more limited duty-free privileges given to branches of foreign companies.

95. The profits from duty-free importation are so large and easy to earn that numerous individuals have set up fictitious political parties and established bogus company branches as means to import such items as cigarettes, liquor and electronic devices. Additionally, these legal avenues are compounded by nearly uncontrolled smuggling, often with the complicity of customs officials. As a result, Bulgaria's border has become porous.

96. This defeats interest by potential foreign investors to produce consumer goods. No legitimate investor, who pays duties on imported raw materials, and sales tax, and profit tax, can compete against someone who pays none of these. Legitimate investors should not need high duties, but they do require the Government to enforce the same rules of the game on all competitors.

97. Unless this problem is remedied, Bulgaria is unlikely to receive the type of consumer-goods investment that has flowed into other Eastern and Central European counties. Whereas the first round of foreign investment in many of these countries was focused on satisfying pent-up demand for goods such as processed food, personal care products, and electronic items, Bulgaria will be denied these investment opportunities so long as its border is porous.

98. The solution is clear; it consists of a combination of eliminating the abused channels for duty-free entry, such as the provisions for political parties and branches of foreign companies, and instituting tighter controls against smuggling. Duty-free privileges should be maintained only for companies that are predominantly export-oriented. This should be accompanied by an active program to improve the professionalism of the customs service.

B. Instability of Tax Rates

99. Tax rates in Bulgaria have been highly volatile over the past two years. Over this period, foreign investors have seen the levels of corporate and personal taxes rise on their projects and on themselves. For example, in October, 1993, the tax on profits earned by foreign-invested companies increased from 30% to 40%. At the same time, the possibility of 5-year tax holidays was eliminated.

100. Such instability severely discourages long-term investment. Corporate planners forecast rates of return based on existing tax rates; dramatic changes throw financial plans into disarray, prompting investors to cancel projects.

101. To date, many of the changes in the Bulgarian tax system have been unavoidable. In fact, most of the increases for foreign-invested firms were necessary to set their tax burdens on par with private Bulgarian firms. Further increase may also be warranted to increase state revenues. In general, Bulgaria should aim to align its rates and rules for taxation with the general trends prevalent in Western Europe. Once a non-discriminatory regime with adequate rates is established, the Government should take decisive steps to convince all companies (foreign and domestic) that rates will be constant for a sustained period.

1G2. Indeed, uncertainty over taxes was cited as one of the chief deterrents to new investment by the foreign investors whom FIAS interviewed. Investors are concerned by a drastic decline in state revenues, brought on by the collapse of the public sector, and a fast rising government deficit. They see a growing gap, and they are afraid that they will be forced to fill it through still higher taxes.

103. Once the tax reforms are complete, the Government should announce its intention not to change rates for at least a three year period. Such a pledge, in combination with sound fiscal management of the public budget, may persuade potential investors that they will not be required to shoulder an unbearable tax burden.

C. Enforcement of Judgements

104. Investors must be confident that they will receive prompt restitution if they or their interests have been injured. There appears to be no problem obtaining fair judgements in Bulgaria. Both the courts and arbitration centers seem to operate competently and impartially, although the growing volume of cases may soon present delays. Difficulties arise, however, in enforcing judgements. Adjudged parties can impose numerous obstacles to prevent injured parties from collecting their due.

105. This poses a significant barrier not only to foreign investment but to all commercial activity. Contracts are worthless if they cannot be enforced. Businessmen must be assured that they will be compensated if agreements are broken. This means that judgements not only must be rendered, but they also must be upheld.

106. The legal traditions of Bulgaria point to the origin of the problem. The evolution of law in European countries developed a kind of paternalism toward poor individuals. A range of defenses was created to protect such individuals against harsh treatment. Today, these defenses remain intact in modern Bulgarian law, and they provide the basis for delaying, and even avoiding, the enforcement of legal judgements. Such defenses are used not just by poor people for whom they were created centuries ago, but also by large companies, which take advantage of these atavistic legal provisions to escape from judgements against them.

107. The relevant statutes should be reviewed to bring to light the problematic provisions. These should then be amended, with a view to limiting defenses against legally rendered judgements and expediting the recovery of court-mandated rewards.

D. Business Infrastructure

108. Both foreign and local businessmen face the daily hardship of underdeveloped infrastructure. The worst of the problem is not with conventional facilities, such as asphalt highways with which Bulgaria is well-equipped, but rather with modern infrastructure, including the electronic highways that carry the information traffic of contemporary business.

109. Difficulties begin as soon as potential foreign investors arrive at the airport. Immigration services, which form part of the general business infrastructure for executives who must travel frequently in and out of Bulgaria, function poorly. Excessive time is spent" clearing passport control, even when proper documents are presented. Foreign businessmen are treated with suspicion reminiscent of the previous regime. This detracts from the image that Bulgaria should try to convey of a hospitable investment climate.

110. Weaknesses in telecommunications present a serious obstacle. Investors are unable to contact their parent companies, outside suppliers or foreign customers with any reliability. Timely information is the key to successful business. The anticipated introduction of cellular service and the installation of a new satellite link in 1994 should go far toward addressing this problem. The Government must monitor these developments to ensure that adequate telecommunication services are established.

111. Banking services are a part of a country's business infrastructure, and in Bulgaria they are a source of constant complaint. Foreign investors find that most of the banks rely on inefficient practices, lacking even basic computerization. As a result, simple transactions consume significant time, and routine procedures, such as obtaining an account statement, are overwhelmed with difficulties. Moreover, investors lack fundamental confidence in the fiduciary security of banks. Rumors circulate about risky lending practices, and the general perception of insecurity rises as bank regulations appear not to be fully enforced. Yet,

investors have no choice except to work with Bulgarian banks, since they must usually meet their payrolls in cash, and no foreign banks have established subsidiary branches.

112. The government should assess the adequacy of banking regulations. Public supervision has an essential role to play in ensuring the soundness of the banking sector and re-assuring business on the safety of tneir deposits. Additionally, the Government should devote priority attention to determining why foreign banks have not yet entered Bulgaria- Such banks can form important bridges to international investors. Immediate effort should be focused on overcoming any problems that may be discouraging foreign banks from locating in Bulgaria.

CHAPTER VI

THE INSnTUTIONAL CONTEXT

A- General

113. As previously noted, ohe of the chief complaints of foreign investors is the slowness of decision-making by the government machinery. Institutions do not appear to be functioning efficiently. The investment bureaucracy seems tied in a Gordian knot of ambivalent policies, ambiguous procedures and amiss practices. Rivalry among institutions appears to be more prevalent than cooperation, with investors often caught in the cross fire. Officials reportedly act with more concern for self-aggrandizement than institutional goals. The result is a highly dysfunctional institutional context for foreign investment.

B. Foreign Investment Commission

114. The Foreign Investment Commission (FIC) was intentionally created to try to overcome the institutional problems facing Bulgaria. It is headed by the Deputy Prime Minister, has two permanent staff members, and ten working-level experts from key public agencies.

115. The FIC's mandate is spelled out in the "Program for the Foreign Investment Commission Activities," issued in June 1993. The agency is responsible for evaluating projects and issuing licenses under the Protection Act, for developing investment policy, keeping investment statistics, and promoting foreign investment This list of functions is notable for the absence of a key responsibility, namely "investor servicing", that is present in the mandate of most investment agencies around the world.

116. Investor servicing is the function of assisting new and existing investors to overcome problems, particularly ones caused by various other parts of the government bureaucracy. It is the task of facilitating investment. Many of the world's best investment agencies focus much of their attention on investor servicing, with the calculation that the payoff from assisting interested investors is higher than the returns from external promotion or image-building through advertizing and public relations.

117. Indeed, agencies such as Ireland's Industrial Development Authority (IDA) and Singapore's Economic Development Board (EDB) have put investor servicing at the core of their strategy for attracting foreign investment. They have found that investors respond very favorably to being offered timely and comprehensive assistance in carrying out their projects, and that the sense this conveys of being welcomed and well-served by the government may be more important to investors than incentives like tax holidays.

118. The recognition that investor servicing can influence investors' attitudes about a country, and thereby shape investment decisions, has occasioned a powerful trend in recent years by developing countries to create "one-stop shops" that try to offer complete servicing.

In some cases, this has entailed trying to centralize all approval and registration responsibilities in a single agency, while in others it has consisted of a less ambitious effort to make a single agency responsible for helping investors to obtain all approvals and registrations from other government departments. The first of these approaches has largely floundered, having run into bureaucratic intransigence against transferring regulatory and reporting functions to a single agency[4], but the latter technique has worked reasonably well by creating a sort of "ombudsman" for helping investors within the existing government structure.

119. In comparison to the surge of interest around the world in investor servicing, the FIC falls short of the full attention it should devote to this function. While servicing is not listed in its official mandate, the Commission does offer occasional help to investors, but this activity is performed on an ad hoc basis, rather than as a routine or institutionalized responsibility. In panicular, the FIC appears to offer assistance once a potential investor has hit a point of frustration, or even acrimony, in dealings with the bureaucracy.

120. Instead of waiting till problems arise, the FIC should offer to help investors from the beginning, when they first arrive at the airport. Given the shortcomings of the present investment climate, well-organized servicing is crucial for giving potential investors the sense that the Government wants them to locate in Bulgaria. Indeed, more than any other function, this would be the most useful role that the FIC could play for increasing foreign investment in Bulgaria.

121. In addition to adding investor servicing to its mandate, and making this the centerpiece of its activities, the FIC needs to reassess how it carries out its other functions. First, as a matter of priority, the Commission should develop explicit criteria for issuing licenses under the Protection Act. Decree No. 74 (May 11, 1992) was ostensibly promulgated for "governing the conditions and the order of granting licenses", but it offered no specificity. Criteria are urgently needed to make the decision process transparent and automatic.

122. Second, the FIC should downplay the function of investment promotion, at least in the near term. Presently, and so long as the investment climate remains problematic, the FIC would largely be wasting resources by engaging in expensive promotional campaigns outside Bulgaria. No amount of overseas seminars and glossy publications can change the reality of fundamental economic and political problems at home.

123. In fact, such efforts not only would be wasteful, but they may actually be harmful to Bulgaria's reputation and credibility in the international business community if companies see the FIC trying to promote a country that still has serious difficulties. The Commission would be better advised to wait until reforms succeed in making Bulgaria an attractive "product." Then, a carefully-targeted promotion program would make sense. Until this point, a few promotional forays outside Bulgaria might be attempted with low expectations and at low cost, but a substantial program should definitely be avoided.

124. Third, the function of producing and publishing information materials should **be kept** to a minimum. The FIC should concentrate on gathering and disseminating two principal kinds of information: data on inflows of foreign direct investment and instructions on how to invest in Bulgaria. All other' information materials should be left for private-sector intermediaries (lawyers, accountants, bankers) to provide for their clients. The FIC should especially avoid publishing expensive, glossy booklets, such as those produced by agencies in some other countries. Even in places where the investment regime is favorable and stable, it is not clear that these booklets are worthwhile; but certainly in Bulgaria, where the message still is not entirely positive and the rules are rapidly evolving, it would be a mistake to invest heavily in extravagant brochures or other expensive materials. The FIC would fare better by producing low-budget materials that can be easily discarded as the policy environment changes.

125. To make these adjustments in its functions, and particularly to give dominance to the task of investor servicing, the FIC will need to make a few changes. First, its permanent staff will have to move offices from where it now sits in a restricted-entry building to quarters that are accessible to the public. Second, the Commission should organize itself around the concept of "account managers." Typically, agencies in other countries assign a single staff member to be the account manager for a specific investor; this person is then responsible for working with the investor throughout the entire investment process, even continuing on into the life of the investment.[17]

126. Third, the size of the permanent staff may need to be slightly increased. By no means should the FIC become a large agency, but a slight expansion may be necessary in order to have enough account managers to handle the flow of serious investors. The FIC should gauge how many such investors visit Bulgaria over the course of a year and then use this information to determine how many account managers are required. On average, most agencies that are dedicated to providing top-quality servicing find that a single manager can handle around 10-15 investors per year.

127. Finally, the FIC should invest in training its staff. The investors with whom the staff will be working are usually sophisticated businessmen, and the staff should be prepared to engage them in dialogue about strategic issues affecting their businesses. Essentially, the staff should be in the position to explain why choosing to invest in Bulgaria would be the best course of action in an investor's specific situation. This means the staff needs to know not only the particular details of investing in Bulgaria but also must be knowledgeable about international business and the driving causes of foreign investment.

[17] Since not all potential investors turn out to be serious ones, the FIC will need a method of qualifying inquires, so that it can concentrate on servicing only likely candidates whose investments will be consequential for Bulgaria.

CHAPTER VII

CONCLUSION

128. Bulgaria is falling short of its potential for attracting foreign direct investment. Some reasons lie beyond the government's ability to alter, such as war in the Balkans, and others can be redressed only through long-term economic reform. Other causes arc within the Government's control to alleviate, including problems in the legal context, procedural modes, operating conditions and institutional framework for investment. Since these shortcomings fall within the government's ability to fix, progress can be made toward improving the investment climate, if the political will exists. No one would expect Bulgaria to become an investor's paradise overnight, but the investment-specific flaws are not so dramatic that they could not be confronted with a dedicated effort over a six-to-nine month period. This will lay a solid foundation for the time when broader economic and political problems lessen. As this occurs, Bulgaria could then emerge from its present situation, as one of the poorest performing economies in the region for attracting foreign investment, and become one of the brighter points among the economies in transition. Along this way, FIAS stands read to provide, at the Government's request, additional assistance toward improving the foreign investment regime.