



CENTER FOR
THE STUDY OF
DEMOCRACY

THE COMPETITIVENESS OF THE BULGARIAN ECONOMY 2014

Policy Brief No. 44, May 2014

1. Competitiveness profile and macroeconomic overview

In 2014 Bulgaria regained one position compared to the previous year in the economic competitiveness ranking of the World Competitiveness Yearbook (WCY), published by the Institute for Management Development (IMD). **The country is ranked 56th**, while in 2013 it was 57th out of 60 economies. **This is only a marginal improvement, and remains significantly lower compared its highest achievement in 2009 – 38th place** (Figure 1)¹. In 2014, Bulgaria is ranked higher than Croatia, Argentina and Venezuela as in 2013, and has surpassed its Southern neighbor Greece, which has fallen to 57th place, 3 places lower than 2013. There are no significant changes among the most competitive nations in 2014. The USA continues to hold the 1st position, as its economy is successfully recovering from the crisis thanks to a favorable business environment, characterized by a strong R&D culture and abundance of skilled labor as well as to a more accommodating policy stance in providing financial stimuli and lowering energy prices.

KEY POINTS

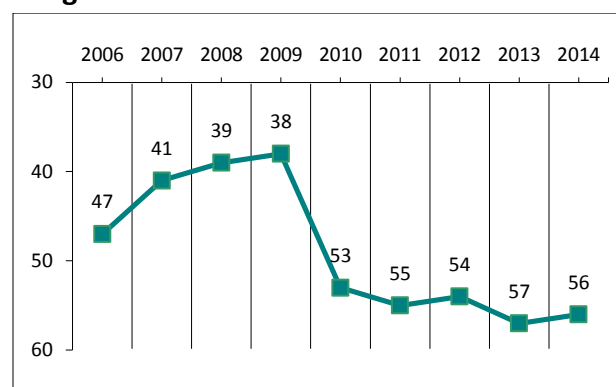
- Bulgaria ranks **56th** in the World Competitiveness Yearbook 2014 – a stagnation for a fifth year.
- Bulgaria's economy is reliant on **exports, offers low living costs, and stable public finances**. Its competitiveness remains narrow-based and unstable.
- **The labor market crisis caused by the financial downturn seems to have abated** but unemployment remains worryingly high.
- The economy is still suffering as a result of the **inadequate business environment** and the **lack of a strong institutional framework**, which could foster research, development and innovation activities, as well as adapt the educational system to the needs of the labor market.
- The 5 **main challenges** which Bulgaria faces in improving its competitiveness are:
 - Introduce **public administration reforms**, and more and better e-government services;
 - Initiate performance-based financing of education;
 - Reduce **energy security risks** through energy efficiency and diversification of supply sources and technologies;
 - Improve regulatory control and compliance quality;
 - Tackle high-level corruption and **market capture**.

¹ Source of data in Section 1 – World Competitiveness Yearbook, IMD, 2014 and National Statistical Institute (NSI)

The other most competitive economies according to the WCY are Switzerland, Singapore and Hong Kong, which stand in 2nd, 3rd and 4th place respectively. Their consistently high ranking is the result of a successful economic formula which includes long-term investments in R&D and innovation, stable public finances and a highly developed technical infrastructure. According to the rankings **the most competitive EU member states are once again Sweden (5th place) and Germany (6th place)**. Their success lies with a highly skilled labor force, predictable business and policy environments and focus on exports. Among the **Central and Eastern European member states** with a similar legacy to Bulgaria, **Estonia is the front-runner**, reaching 30th place, six positions higher than 2013. Its economic competitiveness continues to improve due to a competitive tax regime, political stability and business-friendly legislation. Bulgaria could also follow the example of successful economic policies from the Czech Republic, Lithuania, Latvia and Poland (ranked respectively from 33rd to 36th place), which include cost competitiveness but also developing a skilled labor force by investing in the national education system.

Among the 31 countries included in the overall ranking which have a **population below 20 mln, Bulgaria is in 29th place**, one place higher than 2013, ahead of Greece and Croatia. **Bulgaria ranks in 26th place out of the 29 countries with a GDP per capita of less than \$20,000** (in 2013 it was in 27th place out of 30 countries.) This is a much lower ranking than Bulgaria's best in this category, which was in 2009, when it was in 13th place out of 29 countries.

Figure 1: Overall ranking of Bulgaria – rank assigned in IMD WCY



Source: IMD WCY 2014

Bulgaria's competitiveness landscape (figure 2) shows that there have not been any significant changes in the majority of the indicators, not only compared to 2013, but compared to 2010 levels, i.e. **the country's competitiveness is stagnating**. This indicates that the economy has still **not been able to create long-term competitiveness strengths**, and continues to rely on narrow cost competitiveness, which is very sensitive to economic downturns. The policies and measures introduced over the past 6 years, since Bulgaria became a EU member, have not resulted in any significant economic improvements. EU funds have helped progress in basic infrastructure, but do not seem to have made a difference for the country's competitiveness. Access to finance and labor market uncertainty weighs down on productivity and efficiency. With the exception of Poland, whose competitiveness ranking has improved since 2008, most of the EU member states from Central and Eastern Europe have fallen back in the overall competitiveness rankings and have not been able to return to pre-crisis levels.

A closer look at Bulgaria's competitiveness landscape reveals its principal strengths and weaknesses. Bulgaria's economy has improved its export position and public finances remain sound

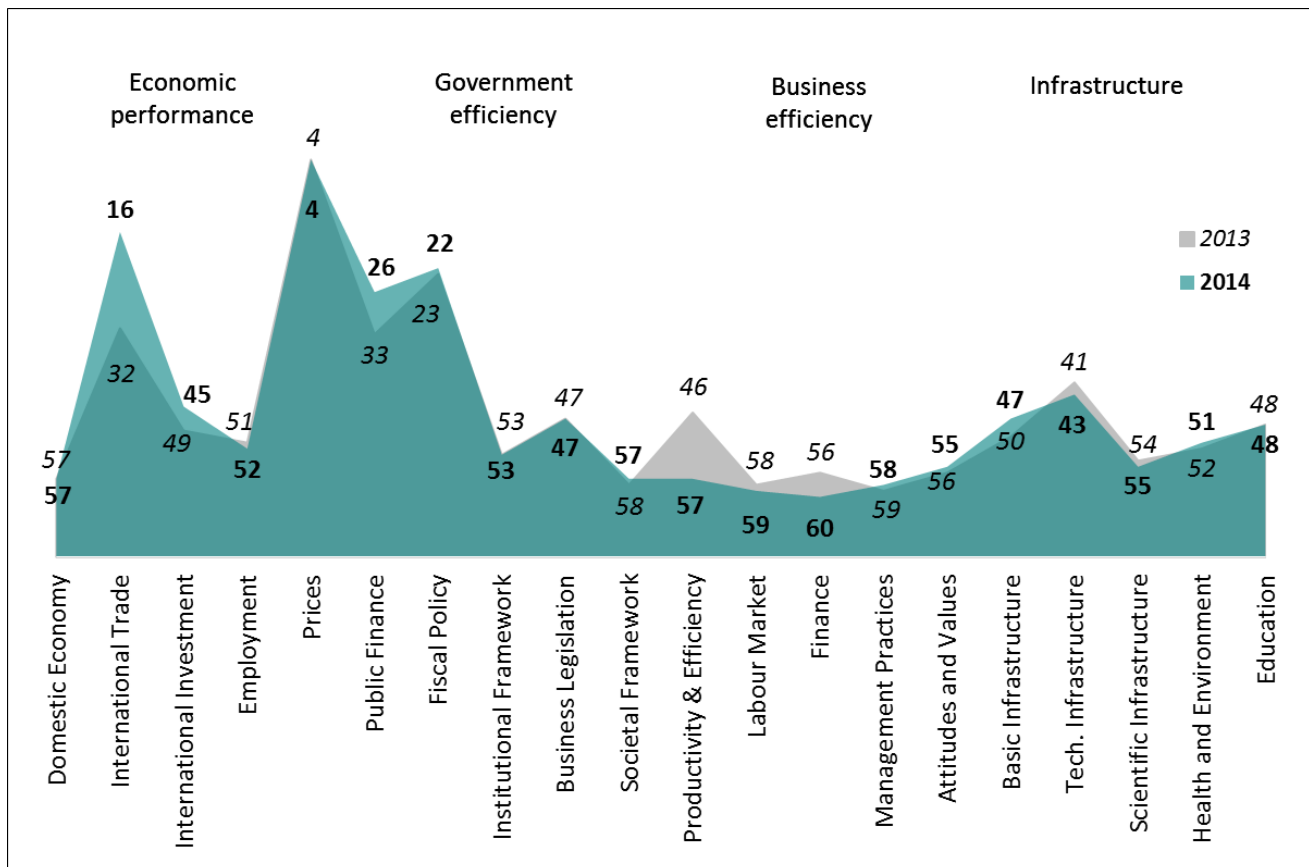
on the macroeconomic level. Long-term competitiveness factors such as environment, infrastructure, health, as well as business efficiency indicators, like management practices, attitudes and values are some of the lowest in the ranking, showing very serious long-term challenges.

Three factors emerge as particularly worrying in 2014. The **low level of education** remains a serious problem. **Lack of fresh financing options for businesses and deflation** on the back of administratively instituted squeeze on energy prices, as well as **very low trust in the overall government and institutional environment** have slumped profit margins and hold back short-term business development.

The lack of progress in long-term competitiveness factors, with the exception of continuing improvement in basic infrastructure, has exposed the vulnerability of Bulgaria’s reliance on short-term economic competitiveness on the macroeconomic level. Otherwise positive cost-competitiveness, the main competitiveness strength of Bulgaria in recent years has turned into a drag on business profits, as the Bulgarian government has embarked on controversial administrative pressure on energy prices. The government’s heavy-handed approach in dealing with structurally important Electricity Distribution Companies, has added to the pressure of administrative pricing decisions, poisoning further the business environment.

Expectedly, increased government deficit spending has not resulted in improvement in competitiveness as the labor market continues to stagnate, while public spending on education has declined.

Figure 2. Competitiveness landscape of Bulgaria 2013 – 14



Source: IMD WCY 2014

Bulgaria's long-term competitiveness deficits are so high that they require re-consideration of the meaning of short-term competitiveness factors. For example, two factors normally interpreted as strengthening of the economic competitiveness of the country are seen by many as a no confidence vote for the Bulgarian economy in 2014 – the redirection of capital abroad:

- a positive current account balance of 2.08% compared to -1.33 in 2013;
- a continuing growth trend of investment flows abroad which have increased from \$0.17 bln in 2011, to \$0.38 bln in 2012 and to \$0.64 bln in 2013.

Bulgaria is still facing serious structural challenges, which also hinder its competitiveness and economic growth in the short run. **The labor market crisis seems to have eased in the beginning of 2014** but the unemployment rate remains high. However, the economy is still suffering as a result of **the inadequate business environment and the lack of a strong institutional framework**, which could foster research, development and innovation activities, as well as adapt the educational system to the needs of the labor market.

Negative competitiveness developments have been exacerbated by worrying economic trends, which have not eased competitiveness shortfalls:

- the government deficit has gone from -0.8% in 2012 to -1.51% in 2013;
- government subsidies have increased from 0.86% to 1.24% in 2012 and 2013 respectively;
- expenditure on education has experienced a significant decrease from 4.7% to 3.5% of GDP between 2012 and 2013;

- transparency, government decisions and the hidden economy have worsened further.

2. The executives' view

The Executive Opinion Survey included in World Competitiveness Yearbook presents the assessment of the economic environment and policy measures in the country by a representative sample of managers of Bulgarian companies. Typically, they counterbalance statistical competitiveness factors by providing a more intimate and short-term view. The fact that Bulgaria ranks no higher than 57th place out of 60 countries in the rankings of **competition legislation (59th place), transparency (58th place), government decisions (58th place), brain drain (60th place), competent senior managers (60th place), knowledge transfer (60th place) and innovative capacity (59th place)**, all results from the executive opinion survey, shows that at the managerial level there is a very negative perception about the overall political and economic environment in Bulgaria, which impacts negatively on the entrepreneurial culture in the country.

Within the Executive Opinion Survey, the respondents are asked to identify the most attractive features of the Bulgarian economy. The most popular factors are primarily related to financial and economic indicators, including:

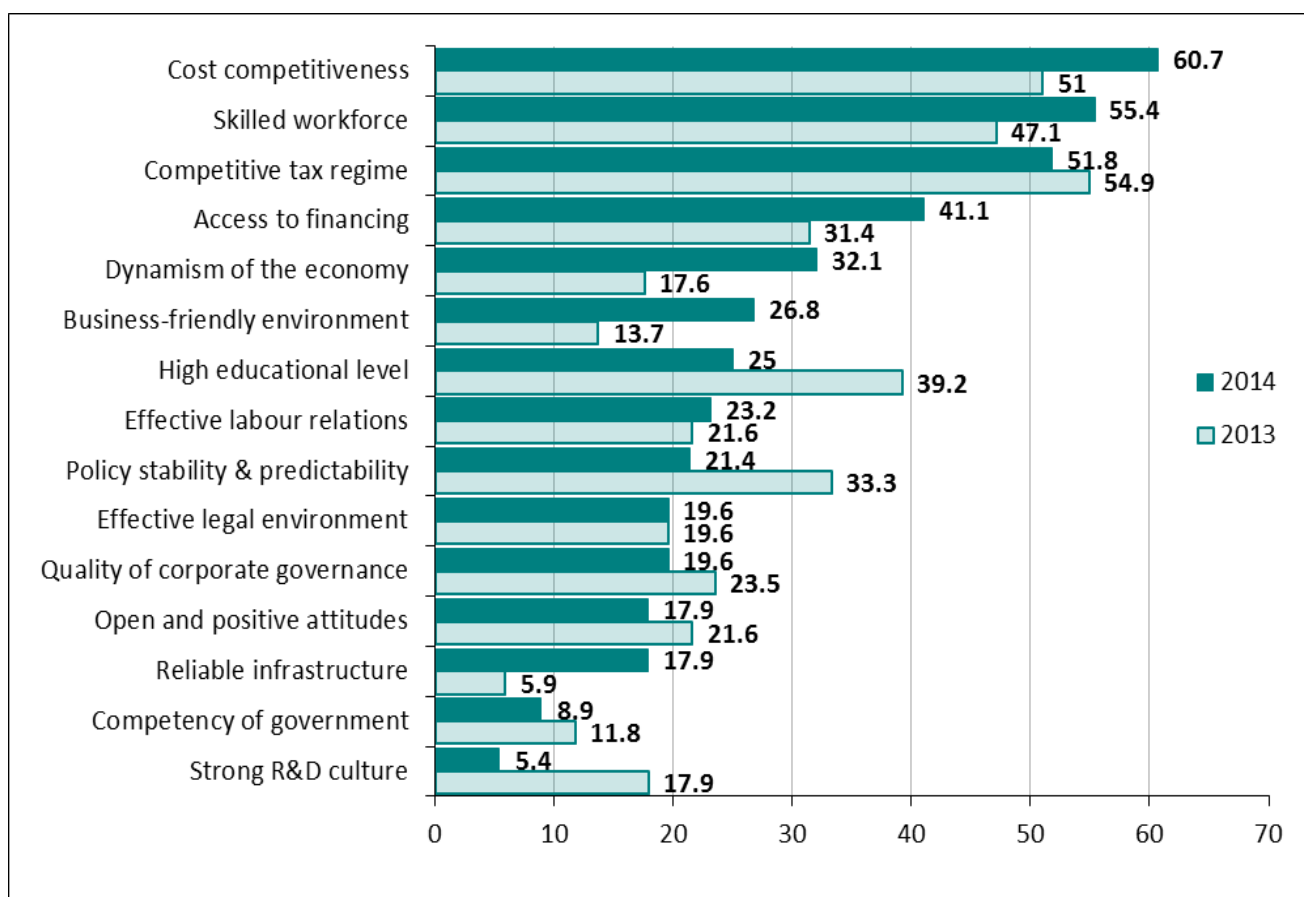
- cost competitiveness (60.7% of respondents);
- skilled labor force (55.4% of respondents);
- competitive tax regime (51.8% of).

On the other hand, the respondents have indicated that the least attractive aspects of the local economy are related to the political environment. These include:

- policy stability and predictability (21.4% of respondents);
- effective legal environment (19.6% of respondents);
- reliable infrastructure (17.9% of respondents);
- competency of government (8.9% of respondents);
- strong R&D culture (5.4% of respondents).

Bulgaria’s persistently low competitiveness ranking and continuing low GDP growth (around 1% on an annual basis in 2013 and the beginning of 2014), mainly based on deflation, show clearly that its **economy is stagnating**. Continuing deflation, the result of decreased spending at the height of the economic crisis but exacerbated by government decisions on freezing energy prices, could lead to a long-term fall in profits, closing of businesses and consequently growing unemployment. If this trend persists, cost competitiveness will no longer be an attractive factor of the Bulgarian economy, but rather a hindrance to its growth. The decrease in labor productivity is also a worrying factor, which is a sign of reduced spending and investments aimed at the development of new technology and human capital, another one of the main reasons for Bulgaria’s low competitiveness in comparison to its peers.

Figure 3. Key attractiveness indicators for Bulgaria 2014



Source: IMD WCY 2014

While foreign trade continues to grow, it is not sufficient to sustain long-term economic recovery and growth. These economic problems are further exacerbated by a series of governance issues such as hidden economic practices, corruption, bribery and lack of transparency, which result in an unstable and unpredictable business environment. Furthermore, entrepreneurship is hindered by burdensome business legislation and difficult access to funding. The lack of business opportunities in turn causes significant brain drain, leading to a labor market paradox of high unemployment coupled with a lack of skilled labor.

security, corruption in the private and the public sector and hidden economy practices. This would require sustained collective efforts and common vision among political and business leaders in the next decade.

3. Competitiveness challenges and policy recommendations

The Center for the Study of Democracy has identified five key challenges, which hinder the competitiveness of the Bulgarian economy:

- Introduce **public administration reforms**, and more and better e-government services;
- Initiate performance-based financing of **education**;
- Reduce **energy security risks** through energy efficiency and diversification of supply sources and technologies;
- Improve **regulatory control** and compliance quality;
- Tackle high level **corruption** and market capture.

Addressing these challenges has the potential of improving the competitiveness profile of the Bulgarian economy with regards to energy