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Employment Policies of Acceding Countries – With Special Reference to Bulgaria

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1. Labour costs as determinants of foreign direct investment

1.1. General considerations

Maintaining low labour costs in order to attract foreign direct investment (FDI) has been a public policy goal in developing and transition economies. Most developing countries have been unwilling to implement the ILO conventions and recommendations setting minimum standards. They fear that any raising of labour standards will lead transnationals to shift their production to other countries where there is less regulation. Interestingly, some European countries have not ratified the ILO minimum wage Convention. Trade unions in developed countries have long maintained that countries with lower labour standards have an unfair competitive advantage in trade and that they attract jobs and investment at the expense of countries with higher standards. Is this true? A major OECD study (1996, 105) notes that "the view which argues that low-standard countries will enjoy gains in export market shares to the detriment of high-standard countries appears to lack solid empirical support". The key lesson is that low wages reflect low labour productivity (value added per hour worked). Workers in developed countries enjoy high wages and benefits, because of their high productivity (i.e. value added per worker). Thus, discrepancies in wages are not necessarily reflected in unit labour costs, defined as labour compensation over labour productivity. Multinational corporations searching for low labour costs (wages + social security contributions) find that you get what you pay for: low wages imply, in general, a less productive workforce. So, multinationals and other foreign investors found it profitable to turn to developing countries only for unskilled labour-intensive activities, particularly those where labour productivity was comparable to that in developed countries, but the average wage they had to pay was substantially lower.

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But, even when multinationals choose to invest in low-wage countries, the specific investment decision will take into account other factors too. Why? Because return on investment is also related to the availability and costs of energy and water supply, transport costs and infrastructures, availability and costs of technical and management staff, taxation (including preferential tax treatment) etc. Of particular importance in the case of transition economies is the regulatory environment. Most transition economies had started their adjustment spontaneously, by transposing Western norms for the protection of property rights, corporate and financial governance etc. Nevertheless, there seem to be problems in some transition economies with the enforcement of the aforementioned norms. The recommendations of the Round Table on Industrial Restructuring in European Transition Economies (UNECE 2002, 33-34), indicate that "Restructuring of the existing enterprises and the creation of new competitive industries depend in large measure on the regulatory and institutional environment created by Governments…Macroeconomic stabilization, undistorted price and tariff structure, competitive environment neutral to all resident companies, both domestically and foreign owned, sustainable enforcement of property rights, including the rights of minority shareholders and intellectual property rights, transparent rules governing new firm formation, and clear regulations allowing for an orderly market exit (bankruptcies) are the key preconditions of successful restructuring and attracting investment to the restructured enterprises, including the strategic direct investment from abroad". The lesson that can be drawn from the experience of transition economies is that countries with low standards or wages do not necessarily increase their share of foreign investment.

According to the most recent statistics, FDI in the CEE countries (acceding and non-acceding) slipped from a record high of 31 billion $ in 2002 to 21 billion $ in 2003, compared to a decline from 374 billion $ to 295.2 billion $ in the EU-15 (UNCTAD 2004: 72, box II.17). The decline in the CEE countries affected acceding countries, and, among non-acceding, Russia. FDI flows increased from 1.1. to 1.6 billion $ in Romania, and from 0.9 to 1.4 billion $ in Bulgaria. FDI flows accounted for 33.7% of gross fixed capital formation in Bulgaria, compared to 29.9% for the Czech Republic and 21.6% for Hungary (ibid. 73, figure II.25).

1.2. The case of Bulgaria

The motives and determinants of FDI vary according to business sectors, countries of origin etc. Investments in Bulgaria originated from the USA 15%, Belgium 11%, Germany 10%, Great Britain 9.4%, Cyprus 9.2%, Greece 8.1% and Turkey 6.7%. As far as labour costs are concerned, in 2002 the gross monthly average salary was 1357 euros in Greece, 489 in Hungary, 174 in Romania and 132 in Bulgaria (UNCTAD 2004: 77, figure II.11). Nevertheless, as pointed out earlier, such discrepancies in salaries are not necessarily reflected in unit labour costs. Minimum wages are also of interest to firms investing in low-skilled sectors. In Bulgaria the minimum wage in December 2004 was 120 levs (approximately 60 euros). According to press reports (New Europe 12-18 December 2004), the government's persistence to raise the minimum wage by 25% to 150 levs was strongly opposed by the IMF. Interestingly, in the World Development Report for 2005 it is mentioned that "The main goal of setting minimum wages is to promote decent jobs and reduce poverty among workers. But its effectiveness in many developing countries is questionable. Minimum wages represent a high proportion of the average wages in these countries, and any further increase shifts the wage distribution upward, punishing rather than helping the workers intended to be supported – young, low-skilled and female workers. When enforcement is weak, as is often the case, a hike in minimum wage encourages even more underreporting of wages and strengthens incentives for firms and jobs to remain in the informal economy" (World Bank 2004, 143).

But were low labour costs the determinant of FDI in Bulgaria? As regards investment by Greek firms, a distinction should be made between, on the one hand, market-induced investment by large firms in the food and service sectors (whose investments often originate from Cyprus, Luxembourg etc.) and, on the other hand, cost-induced investment by firms in the textile and apparel industry, as well as an important investment in the metallurgical industry. Small and medium sized Greek firms in the textile and apparel industries found that they could achieve substantial cost-cutting by outsourcing production to Bulgaria where the gross average salary is 10 times lower than that of Greece, according to the aforementioned statistics. In some cases, capital equipment was moved to Bulgaria and Greek company staff was rehired under worst conditions of work and pay.

In addition, however, to labour costs, other factors appear to have influenced investment decisions. Thus, after the political change of 1991, the Bulgarian regulatory framework offers a ten year protection to all foreign investments, as well as a number of incentives to foreign investors, such as exemption from taxation in the case of privatizations, exemption from the Value Added Tax (VAT) on the purchase of capital equipment etc. These incentives will have to be reconsidered following Bulgaria's accession to the EU. Recently, Bulgaria reduced the company tax rate from 19% to 15%. Moreover, since December 18, 2003 a new Act on the Limitation of Administrative Regulation and Administrative Control over Economic Activity is in force in Bulgaria.

2. Economic and social outlook of Bulgaria

2.1. Basic economic indicators

GNP GROWTH: The average growth rate is about 4%. In 2002 the growth rate was 4.8%. The main sectors contributing to GNP growth are industry (construction and production of electricity, gas and water supply) and services (communications in particular).

GNP PER CAPITA (ADJUSTED IN TERMS OF PURCHASING POWER):

	In 2001	**In 2003**
Bulgaria-5710	25% of the average EU-15	29% of the average EU-15
Greece-12250	56% of the average EU-15	79% of the average EU-15
Hungary-12250	56% of the average EU-15	61% of the average EU-15
EU-15-23210	100% of the average EU-15	109% of the average EU-15

INFLATION RATE: By the end of 2002 it was 3.8%.

WORK FORCE: In 2002 the percentage of employed persons aged 15-64 was in Hungary and Greece 56%, Bulgaria 50%, EU-15 average 65%, Lisbon target (2010) 70%.

UNEMPLOYMENT RATES: 19% (2002), 18.6 (2003), 11.94% (end of 2004).

SOCIAL EXPENDITURE: 13% of the GNP (in Hungary 22.5%, in the EU-15 27.4%,).

2.2. Wages and income support

Countries acceding to economic unions may find out that wages rise faster than productivity. This may be due to low productivity increases resulting from inadequate private investment and innovation; but it may also be due to wage-driven inflation related to factor-price equalisation occurring in economic unions. Thus, for example, in the case of Greece, it was not before its government submitted the first convergence plan (1994), with a view to becoming a member of the single currency area, that wage restraint occurred and productivity started rising faster than wages. Productivity rises are also related to shifts in employment from the agriculture sector (which is a sector of low productivity) to the services sector (which is a sector of high productivity). In acceding countries more than the 1/5 (22%) of the labour force is still employed in agriculture (for Bulgaria 26,7% and for Romania 44,4%), while the same figure for the EU-15 is 5%.

In the EU-15, substantial income support is provided to people who choose to remain working in the agriculture sector, in order to prevent high unemployment rates and maintain social cohesion. Thus, in a country like Greece where 16% of the labour force is employed in agriculture, approximately 50% of agricultural income derives from Community income support. But as far as acceding countries are concerned, the EU-15 decided that farmers of acceding countries will obtain equal treatment only after 10 years, that is gradually until 2013. At the same time, however, they will have to face strong competition from the EU-15 countries. The question therefore arises as to how people employed in agriculture will survive. Will they be able to adjust and modernize their business or will they abandon the agricultural sector and move to other sectors, or end up emigrating to the EU-15?

Bulgaria implements a social safety net comprising of minimum standards of social security and social assistance benefits. These are very low because of funding constraints; a gap should, at any rate, exist between the minimum wage and minimum social entitlements, in order to avoid the poverty trap. Bulgaria has also initiated a policy for the partial privatization of the social security system.

2.3. Employment policies

A. Recent measures

Bulgaria has intervened in the labor market in order to improve the employability of its work force. It ensured that 100.000 long-term unemployed persons would receive vocational training; it also carried out special unemployment programs for the Roms, the disabled people etc. Bulgaria is striving to combat the black economy by issuing worker's certificates to all legally employed workers. Job creation has been satisfactory; 18.000 new jobs were created in Bulgaria in November 2004.

B. The First Employment Strategy Plan of Bulgaria

It covers the period of 2004-2010 and all actions and priorities are defined in the medium term for the 2004-2007 and the long term, by 2010. The Strategy will be implemented by means of annual national employment action plans. The main mid-term objective is the raising of employment and the curbing of unemployment, through economic growth; the main long term objective is the raising of the economic activity and the development of human resources.

The Employment Strategy Plan is structured in four main parts:

The first part contains an analysis of the current labor market situation. The second part presents an overview of the strategic goals (priorities) of the labor market development and formulates the general guidelines for measures and actions in order to achieve these goals. The specific tasks, that is the content of these measures, are presented in the third part, while the fourth part focuses on the necessary implementation prerequisites for enacting and evaluating the strategy.

C. Measures for promoting foreign investment and creating new jobs, with a deadline of 2010.

The Strategy mentions the specific measures that have to be taken as follows:

Drafting of programmes and measures for investment promotion.
Implementation of complex measures for advertising the opportunities and advantages that Bulgaria presents to foreign investors.
Facilitation of the administrative procedures, by for example: Reducing the time and costs of administrative services at the tax administration offices, the social insurance offices etc.
Providing assistance, advice, information to investors in their relations with government institutions, i.e. by providing 24hour access to information that concerns the tax and social insurance systems, the programmes and measures for promotion of entrepreneurship, sources of financing of small and medium sized businesses.
Providing assistance for the establishment of necessary infrastructure.

Which are the sectors that are of priority for Bulgaria?

The high tech industries.
Bulgaria would like to promote the participation of Bulgarian companies already working in the field of new technologies in new investments and, at the same time, to profit from the transfer of technologies, research, etc when foreign investments choose Bulgaria, and

The food industry, ecological tourism, production of phyto-products.

D. Measures for reducing regional disparities in employment, labor market and development in general
The aforementioned measures will involve:
- setting priorities and having a national and a regional strategy for regional development,
- developing regional employment strategies with active participation of the social partners, the local government and NGO's,
- financial decentralization,
- undertaking special actions for achieving balanced and sustainable development in the regions of Bulgaria, in particular regions experiencing industrial decline, in underdeveloped rural regions, mountain regions, border regions, by for example improving the infrastructure (local roads, communication, services, energy etc).

3. Epilogue
The chances of success of the Employment Strategy Plan of Bulgaria for the period from 2004 to 2010 are considerable. There are some positive background conditions which are likely to facilitate its implementation:
- low labor costs (wages and social security contributions),

- low energy costs (gas, electricity, atomic energy),
- low value of assets,
- low company taxation,
- presence of qualified workers.

Bulgaria shares the core social values and concerns of the EU-25 and is also confronted with the same basic socio-economic challenges, namely demographic ageing, a shrinking work force and the need to reform pension and health care systems in order to ensure their economic sustainability. The new member States, as well as those acceding in 2007, will not change the Union's demographic ageing trend, although their populations are younger than those of the EU-15. Furthermore, in our opinion, these states will fit into the European social model, or more precisely, into a welfare regime with somewhat lower standards, but, nonetheless, compatible with the basic European social rights. Moreover, given their working force reserves and high overall levels of educational achievement, they are well placed in the long term to become major drivers of economic growth and social improvement. This is also what is mentioned in the 5th annual report on the social situation in Europe of October 1, 2004, which covers, for the first time, all 25 member states.

The European social model is part and parcel of the social market economy enshrined in the draft European Constitution. There are, however, some indications of a retreat of the welfare state in the EU-15. Thus, in Germany and other EU member States there are on-going initiatives to increase working hours and to provide unemployment benefits on stricter conditions. On the other hand, in the logic of the social market economy, economic growth should benefit the whole population. This is the only way to ensure that far-reaching reforms, such as those undertaken in acceding countries, are securely in place. The latest progress reports of the European Commission on acceding countries stress this point, as well as the need for Bulgaria and Romania to improve their administrative and judicial systems and to combat corruption and organised crime, before they join the EU on 1.1.2007. These prerequisites could, in theory at least, delay accession: "This envisions a super safeguard clause with which entry can be delayed for a year", Deutsche Press Agentur quoting Commissioner Verheugen (reported in New Europe, October 10-16 2004). The prospect, however, that the accession of Bulgaria and/or Romania could coincide with that of Croatia, as mentioned recently, looks very remote indeed, at least as far as Bulgaria is concerned.

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