Did Financial Incentives Affect Foreign Direct Investment (FDI) Inflows in Bulgaria?

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Abstract
Firms may need tax incentives to increase their viability and their profits and governments need those incentives to attract significant FDI inflows in order to decrease the unemployment rate, finance their deficits, increase their production, their GDP and thus to fine-tune their economic development. Although tax incentives in Bulgaria seem to be of less importance for the majority of foreign investors, those incentives do seem to be significant for enterprises, which belong to the textiles sector. MNEs established FDI projects in specific areas with high unemployment rates, creating an export base and exploiting mainly geographical proximity, tax incentives and low labor cost. This paper concludes that the non-fiscal incentives such as political and macroeconomic stability, functioning market economy, lack of corruption, bureaucracy and bribery or the prospects of a country to participate to the EU, together with its prospects for market growth, seem to be significantly considered by foreign MNEs.

JEL Classification: P2, F21, F23
Keywords: Bulgaria, Incentives, Legal Framework, Transition Economies, Planned Economy, Foreign Direct Investment.

1. Introduction
Governments have always used tax incentives to influence business relocation, expansion, and start-ups, or to promote some businesses’ initiatives over others, rescuing them from failure and bankruptcy or alternatively protecting them against competition (Buss, 2001). In Central and East European countries, incentives have been used in order enhance positive spillovers (technology transfers, decrease of debt, budget financing, gross domestic product (GDP) growth) and help in the transition to a market economy.

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In a review (UNCTAD, World Investment Report 1996) of the survey data, it was concluded that incentives played a limited role in the investment decisions of a country if we compare incentives with other factors. However, incentives are significant when other factors are more or less the same and when a foreign investor is considering investing in a region where different countries appear to offer the same investment opportunities.

Benacek et al. (2000) concluded in their literature review that according to Lankes and Venables (1997) “tax incentives for foreign investment are not considered important to the location decision in CEECs, although individual agreements between the investor and the government are significant for a small group of investors. This is especially the case in Hungary. The Czech Republic has offered little in the way of incentives for foreign investors, according to the 1998 CzechInvest survey. However, new incentives were introduced in April 1998”.

OECD (1997, p.101), concluded that “FDI incentives must not necessarily be seen as FDI promotion, but, for example, the consequent enforcement of the law on bankruptcy can work better than any FDI incentive… FDI incentive policies can drive an investor’s decision if investment attractiveness given by macroeconomic and political stability is achieved or other disincentives for investment are eliminated. [p.98]... if there are losses instead of profits, tax holidays do not help. If labor is not skilled enough and produces a low-quality product, who cares if it is cheap?”

On the other hand, OECD (1997, p. 96) pointed out that according to a survey carried out by Deloitte & Touche for foreign investors investing in Central and Eastern Europe the taxes in the host country constituted the single most decisive factor in the investment decisions of these investors. Moreover, most of the 100 respondents (50 MNCs) stressed the need for a stable and transparent legislative framework for investment. Half of the investors admitted that taxation influenced their decisions in a major way.

However, Brewer et al. (1997, p.178) argued that “… there is anecdotal evidence that, even when incentives may be strictly unnecessary to attract an investment project, MNEs will still (inevitably) attempt to maximize aid levels at the point of negotiation with host governments or regional authorities”.

When multinationals (MNEs) are to invest in a host country, they consider not only the fiscal incentives provided by the host country, but also the non-fiscal incentives such as the macroeconomic, legal, social, and political stability of the country. Thus, in order for a country to attract significant foreign direct investment (FDI) inflows it must first overcome, abandon or withdraw any obstacle or barrier derived from its economic-political environment (abandon monopolies and trade barriers, liberalize prices and exchange rates, and stabilize the economy). Furthermore, a country
should proceed to structural and institutional reforms such as privatization of state-owned enterprises (SOEs) in order to create a functional market economy, fight corruption, bribery and bureaucracy, provide stability, and protect/encourage foreign investment flows. The fiscal or tax incentives provided by the Bulgarian government to foreign investors have been shown by the author’s questionnaire research to have had limited success in attracting foreign investors. One exception was the accumulation of approximately two hundred small Greek textiles companies which have been registered in areas near the Greek-Bulgarian borders (Bitzenis, 2004b; Bitzenis 2003a).

Section 2 will examine the importance of non-financial incentives in relation to fiscal/financial incentives imposed by the host country. Section 3 provides information regarding specific fiscal and financial incentives provided by the Bulgarian government during its transition period. Finally, in Section 4, an analysis of the author’s questionnaire survey is presented. Here, we discuss the importance of fiscal incentives provided by the Bulgarian government. The conclusions can be found in Section 5.

2. The importance of non-financial incentives

Generally, the results indicate that when a host country provides incentives and especially tax incentives, the outcomes are infrastructure improvements, increased employment, growth, stability, and other positive spillovers due to the attraction of inward FDI flows. On the other hand, there are some professionals, economists and state officials who claim that tax incentives (corporate income tax exemption, job creation tax incentive exemption, equipment and machinery tax exemption etc.) are costly, ineffective and detrimental (Buss, 2001, p.90).

Buss, (2001, p.92), has also argued that there is little risk to politicians when incentives fail because failure can be blamed on economics, market forces, or dysfunctional corporate behavior. Actually, according to the Association of State Development Agencies (NASDA), there are few countries that have conducted rigorous evaluations of the cost and benefit of incentives offered to private enterprises (Buss, 2001, p.93).

Buss (2001, p.101), has also pointed out that “taxes should matter to states, but researchers cannot say how, when, and where with much certainty. Firms may need tax incentives to increase their viability in some locations, but researchers cannot definitively say which businesses or which locations”. Thus, it is important for the government to evaluate the costs and benefits of different types of incentives that it

1. The term fiscal incentives can be used to mean tax holidays, reduction in social security contributions, deductions from taxable earnings (significant number of employees), investment allowances, income tax reductions, import or export duty exemptions, etc. On the other hand, the financial incentives can take the form of direct subsidies, subsidized loans, government credit, equity participation, etc.
will offer to foreign MNEs and to decide if there is a necessity to offer the incentives in a specific time period.

Governments in transition economies are much more motivated to use FDI incentives than governments in western countries. In transition countries there is a need for modernization, structural reform, improvement of infrastructure, increase of capital, know-how and managerial knowledge, all of which can be provided by foreign MNEs.

However, in the 1997 OECD report, FDI incentives are claimed to be more generous when offered by western countries than by transition countries due to the fact that budgetary constraints are tougher in transition countries. Thus, there is a negative aspect to financial incentives for transitional economies in the sense that the wealthier nations will most probably spend significantly more than poorer countries and consequently, will offer more generous incentives. Obviously, richer countries can reduce tax rates (income, profit tax rates) more significantly as their economies will more easily offset the negative effects of decreased revenues from limited tax payments.

All the Central and East European (CEE) economies concluded that FDI inflows are an important factor in the transformation and restructuring of their economy. From the experience of 12 years of transition, however, there is still no conclusive evidence regarding the schedule and the type of incentives that each country requires in order to attract foreign investors, or to limit the cost of these policies. On the contrary, the study of the transition of the Bulgarian economy strongly suggests that the imposition of fiscal/financial incentives has only moderate results and thus the Bulgarian government has recently diminished or eliminated most of them.

Incentives, provided to foreign investors in general, can be granted to all investors or selectively to specific foreign investors (specific country of origin of MNEs). Alternatively, incentives can be offered to certain investors if they fulfill certain conditions. It is common for transitional economies to recognize that a lot of fake joint ventures appeared as a result of those governmental laws which discriminated against domestic entrepreneurs (OECD, 1997, p. 92). These fake joint ventures enjoyed the advantages of the FDI incentives. Another specific problem, apparent in transitional economies during the imposition, enforcement, and application of these incentives is the problem of bureaucracy, corruption and bribery. There is a selective approach for choosing specific investors to whom the incentives will apply. This selection procedure opens up the possibility of time wasting as well as problems of corruption and bribery. OECD (1997, p.92), argued that “the greater the number of conditions to be fulfilled by the investor, the less the transparency and the greater the possibility of manipulation. In addition, selective approaches also postpone decisions and, in reality, dissuade investors while serving primarily to demonstrate who decides what in the country: the market or the bureaucrat?”
MNEs often invest in host countries that provide a stable economic and political environment. Countries introduce in their transition policies measures to remove or eliminate obstacles and barriers that may discourage foreign investors. Thus, it is of high priority for MNEs and/or governments to pay attention to other kinds of incentives (not imposed by the governments, but imposed by the overall current situation in the country or in the region) such as adequate infrastructure, privatization programs, granting of monopoly rights, protection from import competition, geographical proximity, lack of investment interest, lack of local competition, special concessions on the repatriation of the profits and closing the market to further entry (which Rover (UK) requested of the Bulgarian government), etc. Such incentives can be called non-financial incentives (OECD, 1997, p.90) or alternatively incentives that are derived from passive governmental behavior (OECD, 1997, p.98). They are measures that limit competition and thus reduce uncertainty and risk for the business operation through the provision of monopoly or other preferential modes of treatment. The abolition of a monopoly, the low price of a privatisation deal, the low cost of acquisition of land, a chance to secure a new market, the liberalization of trade and business activities or a more transparent legislation are also defined as non-financial incentives.

A fact which confirms the results of the author’s own research is that financial incentives are not as preeminent in investment decisions as are non-financial incentives. Indeed, investors tended to find alternative ways to avoid taxation and thus overcome tax incentives. First of all, there is a suspicion that profits are under-reported and transferred abroad before taxation. Another way of avoiding taxes is transfer pricing which is usually done by over-invoicing the imported material supplies or the imported machinery and under-invoicing the exports back to the foreign subsidiaries. A further supporting argument (regarding the limited interest of tax incentives) is the fact that foreign investors spent a large sum of money in the initial investment years and, thus, due to the depreciation of their capital, they transfer losses in those years. Offshore companies and double taxation avoidance agreements are also factors that make investors indifferent to the tax incentives offered by the host governments. Frequently, financial incentives, although significant in amount or in percentages, are minimal in the final outcome if we consider that in the specific host country there is political, legal, social and macroeconomic instability or a high risk environment discouraging foreign investors in general.

3. Fiscal incentives provided by the Bulgarian government for FDI projects

All countries who wish to attract FDI include in their regulations some incentives for potential investors. Presented below are most of the incentives provided by the Bulgarian government during its transition years.
According to the Law on Foreign Investments\textsuperscript{2}, 1997 and Article 18 regarding Priority Investment Projects, “Priority shall be investment projects who meet at least one of the following requirements: 1. amount of the foreign investment over 5 million US dollars; 2. creation of more than 100 new jobs; 3. investment is in areas designated by the Council of Ministers as having a high level of unemployment exceeding the average level of unemployment for the country.” Moreover, Articles 19 and 20 referred to these priority projects and mentioned that there is a reduction of 50\% on the amount of corporate profit tax for a period of 10 consecutive years. This law provided incentives for foreign companies to make large investments in specific regions for the sake of creation of new jobs and minimizing large local unemployment rates. After only a year, however, there was a break in the above settlement of priority investment projects and these incentives were repealed by a Bulgarian law in 1998\textsuperscript{3}.

According to the Law on Corporate Income Tax, promulgated in 1999, and Article 17 on Priority Application of International Tax Treaties\textsuperscript{4}, “Whenever in a tax treaty for avoidance of double taxation or in another effective international instrument, ratified by the Republic of Bulgaria and promulgated in the State Gazette, there are provisions differing from the provisions of this Law, the provisions of the respective international treaty or instrument shall apply.” This law ensures the avoidance of double taxation whenever a treaty exists in order for foreign companies to extract more profits when investing in Bulgaria. It also allows for offshore companies to be taxed under the regime of the tax haven. Bulgaria might lose money from the limited taxation, but gains from the actual investment and its consequent positive spillovers.

According to Article 38, para 1, 1998\textsuperscript{5}, in Loss Carryovers for future tax periods “any negative annual financial result of a tax liable person, before adjustment for tax purposes (losses), shall be deducted over the next five tax years, and in case of banks over the next ten years, after being adjusted with the amounts under Art. 23, para 2, with the exception of the amounts under Art. 23, para 2, subparas 3, 17, 15, 18, and 22.” This law allows companies to transfer their losses in the following five or ten years thus providing them with some security and liquid funds (cash) in the first difficult years of foreign investment. Simultaneously, the risk of the investment in the

\textsuperscript{2} The law was passed by the XXXVIIIth National Assembly on 16 October 1997 and the State seal is affixed hereto.

\textsuperscript{3} Law on Foreign Investment supplemented with SG No. 153 of 1998.


\textsuperscript{5} (1)Amd. – SG No 153/1998, effective from 1.01.1998
initial stage is reduced due to the lack of information about the business environment, the small percentage of the market share at the beginning, limited revenues, etc.

A number of tax concessions were offered to provide foreign subsidiaries and companies with “an option” to have an increased participation in the privatisation of State Owned Enterprises (SOEs). For example, Article 107 of Decree 59 on economic activities stated that “the profits of subsidiaries of foreign persons or companies with foreign participation above 49 per cent and above USD 100,000 or the equivalent in some other currency, were charged at a rate of 30% (privileged tax rate at that time).” There were also provisions according to which profits from economic activity on the territory of the duty-free border zones were exempted from tax profits in the first five years, and were subsequently charged at a rate of 20 per cent. These provisions were later abolished. The above law encouraged investors to make large investments and have significant participation in local companies in order for the country to ensure the remarkable transfer of intangible assets a foreign company might hold. In this way, foreign MNEs have strong investment and profit interest and participate in the management board of the company influencing corporate decisions. The rationale behind the application of this law was that the more the foreign company risks, the larger its investment interest in the local company and minimal is the tax rate on profits.

There is also a tax concession in the event of privatisation of a trade company with a state or municipal participation of not more than 33% of the total number of shares. In this case there is no tax on profits during the first three years of operation, and for the following two years only half of the tax is due (50%). This “tax holiday” was conditional upon meeting the commitments of the privatisation deal and will be applied under certain conditions related to the execution of the obligations under the privatisation transaction. This clause applied from 1 July 1996 to 31 December 2001 irrespective of the privatisation date. Companies which were privatised before the law was enforced on 1 July 1996, enjoy the tax incentives for the remainder of the five-year period. The “tax holiday” also applied to:

- companies with registered capital of no less than 5 million USD and at least 50% foreign participation if they invest in fixed assets at least 50% of the tax allowance
- co-operatives and their enterprises (established according to the Law)
- companies employing labour of rehabilitated or disabled persons.

This law provided incentives for foreign investors to participate in privatisation in order to assist the acceleration of the very slow process (up to 1997) (Bitzenis, 2003b).

3.1 Tax policy of the Bulgarian government

The low taxation rates on income should be a major goal for countries with a preference for attracting significant FDI inflows. The Profit Tax envisaged in the Law on
Profit Tax enforced on 1 July 1996 is paid by all local legal citizens and foreign citizens operating in Bulgaria according to the amount of profit made in the country. According to Article 87 of Decree N 56 on Economic Activity, the profit tax “is charged on the annual profits as the difference between total revenues and the expenses under sections I, II, and III of the Income-Outcome Statement (addendum to art. 40, par. 1, sec. 2 of the Accountancy Law). The resulting net profits are subject to restructuring under art. 73, par. 5 of the Rules for the Implementation of Decree N 56 on Economic Activity”. “The profits tax is charged at a rate of 40 per cent, the banks and persons specified under art. 1, par. 4 of the Bank and Credit Activities Act pay at a rate of 50 percent, and the State Savings Bank at a rate of 70 per cent profits tax.”

During the past few years the corporate tax was reduced from 40% to 23.5%, which is satisfactory since it is now placed among the relatively low rates in Europe. According to the latest Law on Corporate Income Tax, promulgated 1999, Article 44 (1), “the rate for taxation of profits shall be 25 per cent. (2) The profits tax of tax liable persons, exclusive of banks and other financial institutions, shall be 20 per cent if their income from sales for the previous year does not exceed 50000 BGN.” According to article 45 of the same law “the rate of the municipal tax shall be 10 per cent”.

3.2 Law on Value Added Tax (VAT)

A high VAT rate in a country may be considered as an extra barrier for some MNEs (especially in specific sectors), in their decision to undertake an FDI project in that country. On 1 April 1994, the Bulgarian turnover tax and excise duty system was abolished entirely and replaced by VAT and a new harmonized excise duty system. Although Bulgaria is not a member of the European Community, the VAT legislation closely follows the provisions of the sixth VAT Directive. The VAT law is comparatively simple, but its application by the tax administration is problematic. Value Added Tax on April 1, 1994 was 18%. According to the Value Added Tax Act and its amendments in 1996, all transactions with merchandise and services executed on the territo-

6. Under the Bulgarian Corporate Income Tax Act (CITA) all companies and partnerships (including non-incorporated partnerships) are liable to corporate income tax. The corporate income tax rate is 15%. In addition to the corporate tax there is a municipal tax at 10%, which is deductible from the taxable base for corporate income tax. Thus the aggregate tax rate (including corporate and municipal tax) for the annual taxable income is 23.5%.
ry of Bulgaria are liable to VAT at the increased rate of 22%, except for export and relieved transactions. Later, in June 1999, VAT became 20%. The competent parties are considering restoring VAT to 18%, the level in most developed countries. Nowadays, Bulgarian legislation under the Law on Value Added Tax\(^9\) allows exemptions from VAT, according to the Import Exemptions cases. In these cases (Art. 59), there is VAT exemption when a different law or an international agreement is applicable and/or goods come from a region outside the territory of the country into free areas, free warehouses or businesses licensed for foreign exchange trade. The same applies when there is an importation of life-saving and life-supporting pharmaceutical products, consumables and medical equipment, etc.

4. Examining Tax Relief and high taxation in the case of Bulgaria; Questionnaire survey analysis and discussion

For the purpose of examining whether foreign entrepreneurs in Bulgaria considered the financial incentives provided as significant in their investment decision or if they perceived high taxation rates as an entry barrier, a questionnaire was designed\(^10\) to


\(^10\) The questionnaire used in the research study consisted of three parts. In the first part, the questions provided necessary background information on certain issues that were considered important in characterising the sample population. In the second part, one question included seven groups of sub-questions with related factors that were considered to be of major importance and allowed the managers of the enterprises to select the most appropriate for their case. These groups of sub-questions were initially selected based on Dunning’s theory, but necessary amendments were made during the research period of eighteen months (the research begun in January 1998, six months were needed for the construction of the questionnaire. This included studying the theories and deciding the way of contacting the companies and creating the sample. Twelve months were needed for the interviews and the statistical analysis of the results of the questionnaires). Similarly, part three contained only one question with a group of factors that describe the barriers discouraging the firms from investing in Bulgaria. More specifically, in the first part there are questions addressing some general characteristics of the company, such as the sector that the company belongs to, the year of investment, the amount of investment, the home country of an MNE, entry mode etc. In the second part there is the theoretical part of the questionnaire survey. In this second part, seven groups of hunters (seekers) have been created: (Dunning, 1998) Locational hunters (historical links, cultural closeness or distance, geographical proximity, stability, climate etc.), factor hunters or natural resource hunters (access to low cost of acquiring natural resources and raw materials, market hunters (size of the market, prospects for market growth, increasing market share), strategic market hunters (follow the competition, follow the clients, a way to survive, acquisition of assets, international pressures, globalisation etc.), efficiency hunters (economies of scale, of scope, risk diversification), exploitation of the ownership advantages (brand name, know-how, past experience, existing business links etc.), hunter of financial aspects (favourable investment law framework, subsidies, tax exemptions). In the third part, there are twenty entry barriers (instability, bureaucracy, corruption, unstable legal system, etc.). The construction of the questionnaire was based on Dunning’s theory [the eclectic theory (OLI – eclectic paradigm of international production)]. According to Dunning, we have: Lo-
solicit precise information regarding the determination of FDI in Bulgaria during the post-communist period 1989-1999. Its purpose was to identify the kind and the type of incentives and entry barriers for inward foreign direct investment, considered by foreign MNEs in order to establish whether they should make an investment or not in Bulgaria. From an official document collected from the Bulgarian Foreign Investment Agency (BFIA), a list with 110 foreign companies was compiled. This list contains the enterprises that according to the BFIA had invested over one million US$ dollars (each MNE) in Bulgaria until mid June 1998. The total invested capital from these enterprises amounts to around 70% of the total volume of foreign investments in Bulgaria at that time (more than 75%, end 2001).

Dunning (1988, 1993) has also defined natural resource seeking (vertical integration, availability, cost), market seeking (market size and characteristics, investment incentives, efficiency seeking (economies of scale and scope, risk reduction through product diversification and strategic asset seeking (gains of new product lines or markets, economies of synergy, economies of common governance, improved competitive or strategic advantages, reduction or spread of risks. The questionnaire was also based on the Universal model that appeared in Bitzenis, (2003a). At this point, it is worth saying that the researcher spent a lot of time explaining to all the interviewers the questionnaire’s questions and the questionnaires were completed in the presence of the researcher. The statistical analysis establishes possible relations between the variables for the 64 questioned companies. The nature of the relation between the variables, if any, was investigated with the chi-square statistic, which is regarded as the most suitable for this kind of data. Instead of using a statistic method like correlation coefficients, which requires data collected in a continuous form, the chi-square test allows for making inferences about the population of interest, in this case foreign investors in Bulgaria, by making use of the categorical data. The results are valid in most of the cases at 0.01, 0.05 and 0.1 levels of significance and the inferences about the population were based on the results of the p-value. There are reported to be some 110 foreign enterprises in Bulgaria, according to the official catalogue obtained from the Bulgarian Foreign Investment Agency (BFIA) mid 1998, which have invested over 1,000,000 US dollars. For the purpose of this questionnaire research, the author used an extended catalogue of 131 foreign investors in Bulgaria, which was comprised from the official BFIA catalogue mentioned above, and another 21 investors mainly of Greek origin, whose data was collected from a one to one interview (5 companies, which were excluded from the old BFIA catalogue in mid 1998, have been included in the new BFIA catalogue, end 2000). These 21 other investors did not form part of the BFIA official published data of foreign investment in Bulgaria due to the inefficient data collection expected in such a difficult task, and due to all the other reasons mentioned in Bitzenis (2001). The response rate was 48.9% of the updated catalogue. Literature has shown that this response rate in the subject area is extremely large and according to statistics a sample size (response rate) of 10% of the population of interest is regarded as large enough to allow secure inferences about the population of interest. Our response rate was 48.9% of the updated catalogue. The sample is very representative since it comprises companies that have invested a very significant amount of US $ by Bulgarian standards. The invested volume of the 131 companies amounts to 70% of the total foreign invested capital in Bulgaria (Total FDI inflows in Bulgaria: 1.7 billion US$ in mid 1998). The questionnaire was originally based on the author’s knowledge of the ample literature regarding FDI theories and following the Dunning theory regarding the possible reasons and entry barriers for foreign investment in Bulgaria.
According to the existing literature\textsuperscript{12}, there has been no other statistically analysed research for Bulgaria with such a magnitude (64 companies have been interviewed using a questionnaire) and a statistically significant sample. Other surveys tried to determine incentives and barriers for more than one country simultaneously with less than 64 MNEs for a specific country (Bitzenis, 2003c). Our sample is very representative since it comprises companies which invested a very significant amount of US $ in Bulgaria. Moreover, the sample is also representative because the answers\textsuperscript{13} collected and analyzed belonged in almost equal proportions to the sectors of industry, services and trade (see endnotes for more details\textsuperscript{14}).

Moreover, it was enriched and updated according to the answers received in the course of time from the investors. The survey lasted 18 months (time period January 98 – June 99), but most of the questionnaires were completed in the period Jan ‘99 - June ‘99. The total invested amount for the 110 foreign companies was 1,283,419,173 USD$ and for the 21 enterprises 47.6 million USD$. The statistical sample with 64 companies consists of a total investment amount equal to 863 million USD$, which is 64.7% of the total investments of these 131 companies or 50.7% of the total Bulgarian FDI inflows (BFIA catalogue, Foreign Direct Investments over 1 million USD$ (as of 30 June 1998)). The whole statistical research appears in Bitzenis (2003d).

\textsuperscript{12} (1) Lankes and Venables (1997) found that tax incentives for foreign investment are not considered important to the location decision in CEECs, although individual agreements between the investor and the government are significant for a small group of investors. This is especially the case in Hungary. (2) In April 1998, KPMG International (Consultant Company) initiated a survey on foreign investors in Bulgaria in order to identify key factors such as major incentives and barriers to foreign investment, present business opportunities and further investment considerations. The skilled labour force has been one of the driving considerations for more than a third (36%), followed by low labour cost (34%), former business contacts (34%), strategic geographic location (31%), good local market 29%, proximity to home operations (9%) and tax incentives (only 2%).

\textsuperscript{13} (3) Andersen (OECD, 1994, p. 50) in an OECD survey using 162 interviews, argued that 45% of corporations (73/162) were aware of the availability of investment incentives and benefited from them. The most common types of incentives were: tax holiday (48/73), concessions in respect of import/export duties (14/73) and profit repatriation guarantees (5/73).

\textsuperscript{14} (1) The usual way of replying to questionnaires in any research study, i.e. by post, failed (i.e. only 4.7% of the companies replied in this way). Hence, it seems that the best replying rate came from one to one interviews (35.9% of the total response rate, followed by e-mail or www with 29.7%). The fax and telephone methods had success in about 30% of cases. Due to the above bad response rate by post (despite the fact that the questionnaire was sent to all the companies) and the possibility of a failure to collect the sufficient data, a multiple approach of the target group was decided by applying some pressure with various methods of contacting and getting their attention.

From the questionnaire survey the services sector accounts for 28% and the FDI inflows in Bulgaria in the same sector were 18% (Finance 11.4%, Tourism 5.1%, Telecommunications 1.8% =18.3%). Trade in the questionnaire survey accounts for 36% and the FDI inflows in Bulgaria in the same sector were 19.2%. Finally, the answers from the industrial sector were 22% and textiles 14% (total 36%) and at the same time the FDI inflows in Bulgaria in the industrial sector were 55% of the total.
Among the 64 interviewed companies, 37 were of Greek origin. Of those 37 companies, 29 were entirely Greek MNEs and the other 8 were either registered companies in offshore centers (i.e. Cyprus or Luxembourg) but with an approved Greek component or joint-ventures and/or consortiums with a Greek partner (i.e. Alico/CEH that bought Postbank, the management and 43% of the shares belong to the Greek Eurobank and the remaining to the American Insurance Group (AIG) and its subsidiary ALICO), (Bitzenis, 2002, Bitzenis, 2004a).

The managers of MNEs interviewed were asked to mention any number of incentives they considered to be the most decisive for their company in their decision to undertake an FDI project in Bulgaria. Therefore, the sum of percentages of the results found in Figure 1 is not equal to 100%.

**Figure 1.** Groups of Incentives from Questionnaire Analysis (Ranking) - 64 MNEs

![Figure 1](image_url)

*Source: Bitzenis’ Questionnaire Research*

According to the above figure (Bitzenis, 2003c), foreign investors in Bulgaria have proved to be market hunters (80%), followed by factor hunters (62.5%), locational hunters (50%) and strategic market hunters (33%). At the same time, 20% of those MNEs invested in Bulgaria in order to exploit their ownership advantages and 18% to exploit financial advantages. Only 3% of the investors were efficiency hunters.
From Table 1, we can conclude that these 64 MNEs, which invested in Bulgaria were not important financial aspect hunters\(^\text{15}\). Only 11/64 (17.2\%) of the total MNEs considered financial incentives in their decision for undertaking an FDI project in Bulgaria. However, we can argue that mainly Greek MNEs (10/37, 27\%) considered these tax reliefs. There was only one [1/27 (3.7\%)] foreign MNE [other than of Greek origin] that considered financial incentives to be significant. Thus, it can be argued that the origin of MNEs played a significant role and it is evident that only Greek MNEs considered financial incentives when investing in Bulgaria. From the statistical point of view, we can reach the same conclusion, when the p-value (Fisher’s exact test used) is 0.018 and thus <0.05. Therefore, we accept the Ha hypothesis, and so, there is an association between the two variables (the origin of the MNEs and the consideration of financial incentives as a reason for FDI) at a 5\% level of significance.

Moreover, it is necessary to examine if the sector\(^\text{16}\) that each MNE belongs to (especially for those 11 MNEs that considered tax reliefs as a decisive incentive), also played a significant role in the consideration of these incentives.

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\(^{15}\) Financial Aspect Hunters’ group includes: favourable investment law framework seekers together with several specific tax reliefs applicable to the Bulgarian case.

Table 2. Financial Hunters and the sector that an MNE belongs to

<table>
<thead>
<tr>
<th>Kind of business</th>
<th>Productive/Industry+Textiles</th>
<th>Services/Bank</th>
<th>Trade/Food</th>
<th>Total</th>
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<tr>
<td></td>
<td>Count</td>
<td>No</td>
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<td>No</td>
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<td></td>
<td></td>
<td>18</td>
<td>5</td>
<td>18</td>
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<td></td>
<td>%</td>
<td>19.0</td>
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<td>14.9</td>
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<tr>
<td></td>
<td>%</td>
<td>28.1%</td>
<td>7.8%</td>
<td>28.1%</td>
</tr>
</tbody>
</table>

Source: Bitzenis

From Table 2, it is arguable that MNEs belonging to the services sector (mainly banks) showed no interest at all in financial incentives (0/18). On the other hand, a significant percentage (6/23, 26.1%) from the trade/food/retail sector and 5/23 (21.7%) from the industrial/textile sector were interested in considering financial incentives. Thus, it can be said that the sector to which an MNE belongs also plays a significant role in the consideration of financial incentives as a reason for undertaking FDI. From the statistical point of view, we can underpin our conclusion, when according to the Pearson chi-square test the p-value is 0.069 and thus <0.1. Therefore, we accept the Ha hypothesis, and so, there is an association between the two variables (there is an association between the sector that an MNE belongs to and the financial incentives) at a 10% level of significance.

In order to determine if the origin of MNEs or the sector that an MNE belongs to was the factor that affected significantly the decision to invest in Bulgaria because of certain tax reliefs or other financial incentives, we have to examine Tables 3 and 4.
Looking at Table 3, we can argue that 5/9 (55%) textile companies considered Bulgaria mainly because of the specific favourable tax framework and the specific tax reliefs offered by the Bulgarian government.

Finally, from Table 4, we can conclude that 8/9 (88.8%) textiles companies were of Greek origin. Thus, with the help of the above Tables (1-4), we can summarize that mainly MNEs from neighboring countries such as Greek MNEs from the textile sector or the food/trade/retail sector prefer to invest in Bulgaria in order to exploit certain tax reliefs and to establish export bases.
barriers that the investors had to deal with in the Bulgarian market. These barriers are shown in Figure 2. The biggest obstacle (according to our survey) was the unstable legal system in Bulgaria (74%), followed by bureaucracy (58%), corruption, crime and mafia (53%) and the high investment risk with 52%. At the same time, high taxation rates and a high VAT rate ranked 8th, with a percentage of around 30%. This occurred mainly because at the time of the survey (1998-1999), there was a high VAT rate of 22% and high corporate taxation rates which, as mentioned above, have now been reduced to only 23.5%.

**Figure 2.** The Most Important Barriers, Obstacles or Disincentives for Bulgarian FDI Inflows (Research from 64 MNEs)

<table>
<thead>
<tr>
<th>Barrier</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>unstable legal system</td>
<td>73.44%</td>
</tr>
<tr>
<td>bureaucracy</td>
<td>57.81%</td>
</tr>
<tr>
<td>corruption, crime, mafia</td>
<td>53.13%</td>
</tr>
<tr>
<td>high investment risk</td>
<td>51.56%</td>
</tr>
<tr>
<td>limited purchase power</td>
<td>50.00%</td>
</tr>
<tr>
<td>lack of infrastructure</td>
<td>42.19%</td>
</tr>
<tr>
<td>macroeconomic instability</td>
<td>31.25%</td>
</tr>
<tr>
<td>high VAT, high taxation</td>
<td>29.69%</td>
</tr>
<tr>
<td>behaviour against consumption, labour</td>
<td>26.56%</td>
</tr>
<tr>
<td>lack of managerial skills</td>
<td>20.31%</td>
</tr>
<tr>
<td>low progress in transition</td>
<td>15.63%</td>
</tr>
<tr>
<td>political instability</td>
<td>6.25%</td>
</tr>
</tbody>
</table>

*Source: Bitzenis’ Questionnaire Research*
Table 5. High Taxation rates, high VAT rate, etc. as a barrier for FDI and the sector that an MNE belongs to

<table>
<thead>
<tr>
<th>Kind of business</th>
<th>Count</th>
<th>No</th>
<th>Yes</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Productive/Industry+Textiles</td>
<td>18</td>
<td>5</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>16,2</td>
<td>6,8</td>
<td>23,0</td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>28,1%</td>
<td>7,8%</td>
<td>35,9%</td>
<td></td>
</tr>
<tr>
<td>Services/Banks</td>
<td>17</td>
<td>1</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>12,7</td>
<td>5,3</td>
<td>18,0</td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>26,6%</td>
<td>1,6%</td>
<td>28,1%</td>
<td></td>
</tr>
<tr>
<td>Trade/Food</td>
<td>10</td>
<td>13</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>16,2</td>
<td>6,8</td>
<td>23,0</td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>15,6%</td>
<td>20,3%</td>
<td>35,9%</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>45</td>
<td>19</td>
<td>64</td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>45,0</td>
<td>19,0</td>
<td>64,0</td>
<td></td>
</tr>
<tr>
<td>%</td>
<td>70,3%</td>
<td>29,7%</td>
<td>100,0%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bitzenis

However, in order to determine if the origin of MNEs or the sector that each MNE belongs to matter, we have to statistically examine Tables 5 and 6. Thus, from Table 5, we can argue that MNEs belonging to the trade/food/retail sector were mostly affected by high taxation and VAT rates (13/23, 56.5%), when at the same time only 1/18 (5.6%) from the services sector/banks and 5/23 (21.7%) from the industrial/textile sector considered the above as a barrier. From the above, we can conclude that an important variable is the sector each MNE is located in, when considering high taxation and VAT rates as a barrier of FDI. From a statistical point of view, we can conclude the same. According to the Pearson chi-square test, the p-value is 0.001 and thus <0.01. Therefore, we accept the Ha hypothesis, and so, there is a strong association between the two variables (there is an association between the sector that an MNE belongs to and the high taxation, VAT rates) at a 1% level of significance.

From Table 6, we can argue that 19/64 (29.7%), approximately 1/3 of the total MNEs, informed the author that the high tax rates, or the high VAT rate was a barrier for their investment projects. As mentioned, our questionnaire research took place during 1998-1999, when the VAT rate was 22%. In June 1999, the Bulgarian government reduced the rate from 22% to 20% and currently there are rumours that the rate will be reduced to 18%. 5/27 (18.5%) of foreign MNEs (other than Greek MNEs) along with 14/37 Greek MNEs (37.8%) mentioned the high taxation and VAT rates as an important barrier for FDI. The consideration of the origin of MNEs was indifferent
due to the fact that the above difference in percentages is only a result which is connected with the sector that an MNE belongs to (see Table 5). From the statistical point of view, we can conclude the same, when the p-value (continuity correction, 2x2 Table) is 0.163 and thus >0.1. Therefore, we neglect the Ha hypothesis, and there is no association between the two variables (no association between the origin of MNEs and the consideration of the VAT and tax rates as an obstacle for FDI).

Table 6. High Taxation rates, high VAT rate, etc. as a barrier for FDI and the origin of MNEs belongs to

<table>
<thead>
<tr>
<th>Origin of MNEs</th>
<th>Greece</th>
<th>Count</th>
<th>%</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Taxation Rates</td>
<td>No</td>
<td>Yes</td>
<td>Total</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>14</td>
<td>37</td>
<td></td>
<td></td>
</tr>
<tr>
<td>26,0</td>
<td>11,0</td>
<td>37,0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>35,9%</td>
<td>21,9%</td>
<td>57,8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Europe &amp; Other</td>
<td>Count</td>
<td>%</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>5</td>
<td>27</td>
<td></td>
<td></td>
</tr>
<tr>
<td>19,0</td>
<td>8,0</td>
<td>27,0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>34,4%</td>
<td>7,8%</td>
<td>42,2%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>Count</td>
<td>%</td>
<td>%</td>
<td></td>
</tr>
<tr>
<td>45</td>
<td>19</td>
<td>64</td>
<td></td>
<td></td>
</tr>
<tr>
<td>45,0</td>
<td>19,0</td>
<td>64,0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>70,3%</td>
<td>29,7%</td>
<td>100,0%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Bitzenis

5. Conclusions

In general, our statistical analysis of the questionnaire survey shows that MNEs do not look upon financial incentives as a major reason for undertaking FDI projects in Bulgaria. Moreover, MNEs of Greek origin that belong to the textile sector or the food/trade sector, considered high VAT and taxation rates as a significant barrier for their FDI projects. Furthermore, from the analysis it was clear that MNEs prefer to invest in a stable economy with prospects for market growth and simultaneously exploit regional agreements with neighboring countries.

Results indicate that the provision of tax incentives to establish foreign direct investment projects in specific areas with a high unemployment rate, attracted a group of investors, belonging to enterprises from the textile sector with a neighboring country origin. Although the government is trying to limit tax incentives by claiming that they are costly, ineffective and detrimental, the author’s questionnaire survey proved that around 200 small firms from the textile sector established business activities in specific areas in Bulgaria directly to exploit these financial incentives.

Our results are in line with OECD (1997, p. 30), as here they argued that “the impact of investment incentives on the volume of investment is probably stronger
than most empirical surveys seem to suggest though not as strong as investment promotion agencies would make believe. One reason is that investors would understandably tend not to mention incentives as a significant factor in site selection when countries offer roughly similar incentive levels. With competition among countries driving the level of incentives even higher, their importance would correspondingly grow. This is particularly so when export-oriented (factor seeking) investment projects are at stake and the investor may choose between different locations within the same world region where other (than incentives) policies and non-policy conditions converge. …(p.29) in the established hierarchy of investment motives, incentives consistently rank far below core FDI determinants… incentives are typically regarded as “sweeteners” or “icing on the cake” with marginal impact at best… (p.25) FDI which was located in a country only because of high incentives will be especially sensitive to higher incentives which may be given elsewhere, later on.”

Lastly, OECD (1997, p.33), concluded that “CEE countries should rather put their money and efforts in streamlining the investment procedures and in the elimination of obstacles to foreign (and domestic) investment… a reduction of investment incentives can be achieved in an easier way if international agreements on binding rules for the case for FDI are concluded. The most effective way to handle this problem seems to be cooperation among the core CEE states since they are immediate competitors for mobile investment”.

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