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ECONOMIC GROWTH THROUGH THE PRISM OF THE EXTERNAL SECTOR

This study considers the main economic growth models from the perspective of their relation to the external sector. It defines the advantages and drawbacks of the export-led model and of the import-substitution model and sheds light on the growth constraints ensuing from the balance of payments and the elasticities of imports and exports. It analyses the prerequisites for selection of one or another growth model and comes to the conclusion that Bulgaria will have to implement an export-oriented growth model within a medium-term perspective. In this relation, it makes proposals aimed at improving the country's foreign trade policy.

JEL: F4; O4

Economic growth models in a global perspective have undergone a number of changes in the recent decades. Right after World War II, a prevailing part of developing countries adopted an economic development model based on the so-called import-substitution model. The rationale of this model was to encourage domestic production and development of an own economic base. Corresponding to this view, large part of the developing countries enforced (to a varying extent) protectionist policies and ardently protected their newly emerging production and industries. In spite of the timely warnings by economists of potential losses owing to the unreasonable distribution of resources, the generally accepted view was that the benefits from increasing production output and ensuring domestic employment compensated for the losses resulting from ineffective distribution.

This model was widely used until mid-1970-ies, and later was gradually abandoned. Many economists united around the understanding that one of the main reasons for discarding this model of development lay in the two oil shocks during that decade, followed by a period of high inflation and low growth rates. In fact, this was the time when the faith (whatever faith there was) that government regulation could solve some of the inherent problems of market economy, and more specifically the economic growth rate cyclicity, was wearing thin.

The establishment of the so-called “Reaganomics” and “Thatcherism” was only one of the manifestations of the general attitude towards a break with the orthodox Keynesian economics. On its own part, the relation between “import substitution” and government regulation was quite strong as it presupposed the enforcement and maintenance of protection tariffs and quotas, which were incompatible with the principles of free trade. Approximately at the same time, the economic success started to stand out, first of Japan and later on of South Correa, Singapore, Taiwan, Hong Kong, which used an economic development model based on strong encouragement of exports. Soon after, the export-led growth models became the standard development models and were widely imposed by the International Monetary Fund (IMF) in the IMF-supported programmes implemented in developing countries.

Empirical data, however, could not fully confirm the assumption of the existence of any advantages of export-oriented models[1] over the import-substitution models, as according to data of the United Nations Conference on Trade and Development (UNCTAD) it turned out that economic growth rates slowed down after 1980 both globally and in the developing countries relying on such models. The slowdown of economic growth continued as late as the end of 1990-ies, when the impact of the inclusion of China and India in the international division of labour started to be strongly felt, pulling up the whole group of developing economies.

Even before the global financial crisis, there were signs of wearing out of the export-oriented growth model. Japan was the first country to evidence drastically reduced growth rates in spite of the great volumes of its exports. Similar trends were also evidenced in other countries, mainly Latin American ones, which brought again to the fore the issue of the nature and theoretical foundations of export-oriented growth, to the extent that great hopes were pinned on it for quickly exiting the crisis and ensuring a long run and sustainable economic growth.

Theoretical basis of export-led growth

Export-led growth is founded on encouraging and supporting exports to provide the necessary amounts of foreign currency. The rationale of this approach lies in the ability of foreign trade to drive economic growth, in the sense that it facilitates the more effective distribution of resources within a single country, and between different countries and regions. Besides, exports are an effective tool for introducing new technologies and acquiring new knowledge, which (from the perspective of the endogenous theories) stimulates growth. In other words, growth of exports plays an important role in the overall process of economic growth, with its positive impact on both demand and accumulation of capital. From another perspective, with exports growth the import capabilities of an economy also increase, which impacts positively growth.

Actually, the gradual implementation in the practice of export-oriented models can be considered a step back in history to the mercantilists' views and in the context of the *laissez-faire* doctrine. There are numerous studies establishing a high degree of correlation between exports growth and economic growth. According to the main theoretical suggestions (see Meier, 1995), the advantages of export-led growth models are owing to the following:

- The internal costs for providing a unit of foreign currency are lower than the savings from the same unit of currency;
- Overcoming the limitations of smaller economies in relation to the economy of scale;

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[1] There is an ample scientific research dedicated to the interrelation between exports and economic growth. The studies are usually based on the existence of a cause-and-effect relation and use the cointegration analysis techniques. Results, however, are rather controversial and uncertain both in terms of different periods and regarding different countries.

- Exposing domestic producers to external competition results (in the general case) in increased effectiveness and reduced cost;
- It is empirically proven that foreign direct investments (FDI) increase in export-oriented countries;
- There is also empirical evidence of job creating possibilities, which increase with higher exports volumes;

At the same time, exports-led growth models have their serious opponents, bringing to the fore some inherent deficiencies of the model, the most important of which are (for more details see Palley, 2002; Singh, 1999):

- Developing of dependence on external demand by developed countries and increased volatility of growth rates;
- Slowdown of growth rates on the domestic market;
- Ferocious competition between the developing countries and appearance of striving towards "export displacement" of competitors, ultimately resulting in deterioration in the conditions of trade for all exporters;
- Exacerbation of global imbalances and negative impact on financial stability;
- The more countries are implementing this model the lower its effectiveness due to the constraints of global demand.

Exactly because of these drawbacks, in the recent years a proposition has gained more and more supporters that export-oriented growth models are exhausted and have to be replaced with domestic demand-led growth models. One of the major arguments is that China's entry into the international markets has significantly changed the "rules of the game". "The reasons for this lie in the hierarchical structure of this type of models, assuming the replacement of old players with new ones which offer lower costs per unit of output. Offering cheap, unpretentious and relatively well trained labour in China is practically unlimited, which places the other developing countries (both in the region and globally) in unequal position. There are already a number of examples – primarily in the light industry and more specifically in the production of knitwear – proving the assumption of "export displacement" (see Palley, 2000).

In spite of the existing shortcomings of export-led growth, it is clear that the developing countries (at least at a certain stage in their development) cannot function without developing export industries, to the extent those provide the necessary foreign currency. The question is in what context export stimulation is considered. From this point of view, international trade should be governed by the idea of economic development, rather than seeking at any cost comparative advantages in various activities and industries, as this often results in negative effects in the longer-term perspective. For the models based on domestic demand to be successful, they should be developed in conformity with the following principles (Palley, 2002):

- Optimization of revenues in the economy;
- Good governance (competent and uncorrupted);
- Financial stability;
- Providing prudent and bearable external financing.

These principles clearly outline the boundaries of applicability of the internal consumption development led models, setting significantly higher standards. That is, it is not just a question of desires and selection, but also of possibilities. It is hardly accidental that the prevailing part of highly developed industrialised countries rely much more on internal factors for economic growth, than on the vagaries of external demand.

On the selection of an economic growth model

Political factors influencing the selection of a development model are of great importance, if not even more important than economic ones. Government authorities, with no exception, always want to see surpluses on the current account of the balance of payments, and are concerned with having deficits, irrespective of their economic nature. This argument, no matter how trifling it may seem from economic point of view, very often turns to be decisive in making specific governance decisions. The reason probably lies in the view that by pursuing an export-oriented policy (instead of stimulating elements of domestic demand) can more easily ensure high employment rate without this causing any inflationary pressure in terms of payment of labour. This however presupposes (since trade globally is balanced by definition), that for each country implementing such a mercantilistic approach to the trade balance, there should be a country(s) ready to carry the burden of a trade deficit and to import inflation (deflation).

The issue actually boils down to the question why many countries consider trade balance surpluses a stronger instrument for increasing revenues, than domestic investments? The explanations that are usually offered are along two lines: first, trade surpluses to a great extent solve the problems with effective (unlimited by other markets) demand, and second, from the perspective of national accounting, the external account surpluses can be presented as external investments, which subsequently have a multiplication effect both on production and on employment. The logic here is: any increase in domestic economic activity leads to an increase in imports, thus any income and employment increase as a result of internal factors should be at least partially compensated by a decrease in external investments. On its part, any increase in trade surpluses due to increased exports does not lead to a decrease in domestic investments, but rather creates conditions for their increase, provided external demand remains stable.

Comparing and analyzing the two alternative models is useful as it outlines the differences and offers possibilities to choose depending on specific conditions. However, there is another approach to analyzing export-led models, which is based on a more in-depth analysis of the balance of payments. The underlying idea here is that the condition of the balance of payments (in the context of an open economy) is a natural constraint of growth. Traditional theories of economic growth[2] to a great extent

[2] In the neoclassical growth models, the long run growth rate is set externally – either by savings (Harrod–Domar), or by technological progress (Solow-Swan). However, in both cases, savings and technological progress remain unexplained within the framework of the model, hence this type of models are known as

ignore the balance of payments, and by rule exclude monetary impacts. These models are demand-led and assign an auxiliary role to the balance of payments, assuming that it is self-equilibrating through the mechanism of domestic and/or external price adjustments. Thus, the relation is lost between the condition of the balance of payments and the accumulation of resources in support of economic growth.

The Keynesian approach puts the emphasis on demand, proceeding from the assumption that supply adapts to demand and not the other way round. From this perspective, economic growth should not simply be considered constrained by supply. This, of course, does not mean that there are no such constraints, but that they are not the determining ones. This approach is based on the understanding that usually the supply of labour in developing countries is more than sufficient, but there is no capital (or it's insufficient), which can be provided by imports, for which foreign currency is needed. The economically most advantageous and sustainable manner of providing the required financial resources is by stimulating exports, which ensure import of capital in the conditions of maximum employment. This is what ensures stable economic growth in a long-term. If exports cannot provide the necessary funds for imports (in the conditions of non-decreasing employment), incomes will start decreasing, which will cause a decline in the rate of imports and equilibration with the volume of exports. In other words, the equilibration of the external sector would come as a result of adjustment (adaptation) of incomes. The trivial conclusion regarding the economic policy is that if the economy develops below the levels of productive potential (i.e. when the constraints placed by supply are not of determining nature), then the economic growth rates will be determined by demand. From this point of view, the differing rates of economic growth between different countries are explained with the differences of aggregate demand. Therefore, the question boils down to: what constrains the implementation of an aggressive interventionist economic policy (both fiscal and monetary) in an open economy?

Until recently, the understanding that demand cannot be uncontrollably stimulated due to the constraints imposed (first and foremost) by the budget deficit and interest rate level was accepted as self-evident. However, theoretical and empirical research in the recent years increasingly drew the attention to the balance of payments as the main growth curbing factor (see Thirlwall, 1979; McCombie, 1997; Turner, 1999; Vera, 2006). The main idea of this approach is that the international financial markets' assessment of the external position of a country limits its economic growth to levels below the constraints set by employment and production capacity utilisation. These are the grounds for this:

- Balance of payments problems are relatively quickly passed over to the real sector (production and employment);

"exogenous". Endogenous models are trying to overcome this shortcoming by constructing macroeconomic models based on microeconomic foundations – households maximize utility, while companies maximize profit, and both sectors are subject to budget restraints. The main difference is that economic growth is set within the framework of the model and the changes in the technological level are explained by the costs of research and development (R&D), role of institutions, importance of human capital, etc.

• In a long-term perspective, sustainable economic growth cannot be maintained without an equilibrated balance of payments, as financing the increasing deficits leads to increase in the interest rates on this financing, which is acceptable only within a short- or medium-term horizon;

• High interest rates shift investors' interest to financial assets, which ultimately results in reduction of investments in real assets, respectively in lower growth rates.

The mechanism of implementing balance of payments constraints is relatively simple. If an economy starts facing BoP problems as a result of increased domestic demand (i.e. before reaching the short-term production capacity), aggregate demand shrinks, and aggregate supply is not used to its full extent. When this happens, investments decrease, thus directly affecting factor productivity, respectively growth. On the other hand, if an economy can increase its aggregate domestic demand to the level of the existing production capacity (i.e. without accumulating external sector imbalances), the pressure exerted by the demand will have a positive impact on production capacity, and hence on economic growth. Practice has proven this is possible under certain conditions, the most important being:

• Investments should be channelled into the tradable sector;

• Production factors are distributed with priority to the sectors with higher productivity;

Actually, the above conditions are the essence of the export-oriented growth model, in which growth of exports results in increased economic growth rates without any deterioration of the international investment position of the economy. However, it should be immediately underscored that the same rate of exports growth will not have similar consequences in different countries. This is due to the fact that different countries have different sensitivity of growth rates to imports – equilibrium growth from a BoP point of view will be reached on different levels in the growth rates of aggregate demand. The pioneering research in this area was made by Thirlwall and McCombie (1994), who proved that from the BoP perspective equilibrium growth Y_b is set according to the simple rule: $Y_b = \frac{\varepsilon}{\pi} z$, also known as the Thirlwall law, where z is the growth rate of global production (income), and $\frac{\varepsilon}{\pi}$ is the ratio between the income elasticities, respectively of exports (ε) and imports (π). If we assume that global production (income) increases at regular rates, then the equilibrium (sustainable) growth of an economy is determined by the ratio of elasticities of exports and imports.

It is important to note that the effect of any changes in the exchange rate is eliminated in deriving this rule (law), as it is assumed that these changes do not affect significantly volumes. Empirical data unequivocally prove that the devaluation of the national currency can bring a short-lived improvement in the balance of payments,[3]

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[3] For devaluation to have positive effect on the balance of payments (more specifically on the balance of trade) the following condition should be met (known as the Marshall–Lerner condition): $e_x + |e_m| > 1$, where e_x and e_m are the price elasticities of exports and imports, respectively.

but this does not always have a positive impact on growth rates. It is so because the nominal devaluation rarely grows into real devaluation due to the strong inflationary effects it generates. This is also confirmed by the recent years' observations, showing that changes in the real effective exchange rate have a negligibly low relation to volumes of trade flows.

After 1980-ies, exchange rate changes were explained to a much greater extent with the changes in the short-term capital flows, than with trade flow changes. Taking into consideration the increased influence of capital flows in the recent decades, the Thirlwall law can be presented in a more detailed formula: $Y_b = \frac{\theta}{\pi}\varepsilon z + \frac{(1-\theta)}{\pi}f$, where θ and $(1-\theta)$ represent the share of exports and capital flows in the total volume of foreign currency incomes, and f is the growth rate of capital flows. This specific feature is interpreted in the sense that in the countries where economic growth rates exceed the equilibrium rates ($Y > Y_b$), capital flows increase at a quicker rate than exports volumes. In other words, the difference between the sustainable economic growth of the economy and the ratio between the elasticities of exports and imports can be explained only with the capital flows.

Having said all this, a conclusion can be made that from the point of view of this approach, economies of different countries grow at different rates because domestic demand grows at different rates, which, on its part, is constrained by the requirements of balance of payments equilibrium, in the sense of the Thirlwall law. Hence, the issue boils down to explaining why the constraints imposed by the balance of payments are different in different countries, i.e. why the elasticities of exports and imports differ. It is not easy to answer this question as it requires an additional analysis along the following lines:

- What types of goods are exported and how global demand for them is changing. In the simplest case, it is a question if primary products are exported or goods of high degree of processing;
- What are the characteristics[4] of exported products and whether they provide any competitive advantage in terms of "non-price competition".

Ultimately, a conclusion can be drawn that the elasticity of exports and imports reflects to a very great extent the differences in the so-called "non-price competition". The significance of this conclusion can hardly be overestimated. It turns out that supply is important only as much as the supply of production factors (investments in new technologies, R&D, education, etc.) can influence the elasticity of demand for exports which, on its part, is of crucial importance for the growth rate of exports, and from there for economic growth. This approach differs considerably from the

[4] In this case, under characteristics we mean all those non-price factors influencing consumer choice, and through it demand. It is a question of factors such as quality, reliability, standardisation, security and promptness of delivery, warranty and post-warranty services, development of a branch network, export lending and export insurance, etc. These are all subject to a specific foreign trade policy, which is not always within the power of an individual company and involves the interference of the state.

classical interpretation of supply, where the very growth of factors (labour, capital and technologies) explains economic growth by itself.

Clarifying the theoretical concepts as regards the possible types of economic growth and the constraints they impose are important from the perspective of formulating a specific economic policy. The issue that is most important for us as a society is whether at this stage Bulgaria can generate sufficiently high growth based on internal factors, so that we need not rely on the vicissitudes of external markets? Furthermore, a possible positive answer to this question requires an answer to another question – what should be the role of the government in pursuing such a policy.

No matter how convincing the arguments of the adversaries of export-led growth might sound, the unsavoury truth is that incomes in Bulgaria will remain at low levels, which would not allow (at least at this stage) to make full use of the domestic demand-led growth mechanism. The constraints set by the currency board arrangement and the impossibility (at least in the medium-term) to pursue an expansionist fiscal policy are additional factors in support of the conclusion that in the foreseeable future Bulgaria will have to rely primarily on its exports for ensuring economic growth based on economy of scale. From the point of view of the constraints imposed by the balance of payments, the message is clear – increasing the pace of economic growth is possible only if Bulgarian exports become more attractive and/or the elasticity of imports is reduced (in the best case scenario a combination of both). Otherwise, i.e. if production capacity is growing at a quicker rate than domestic demand (due to the constraints imposed by the balance of payments) unemployment will increase, which will further reduce consumption. In other words – it is not just a question of ensuring economic growth by more exports, but by the export of the right goods and services, those for which there is elastic demand.[5]

Economic growth and the external sector – possible policies

Although for a long period Bulgaria has not been developing according to the laws of market economy, the models of economic growth in the recent decades were analogous to the ones known in the world practice. The period of industrialisation after World War II coincided in terms of timing and essential characteristics with the flourishing of the import-substitution models. Later on, together with the other states from the so-called Comecon bloc, this country started implementing some of the methods typical of the export led growth models, however with no particular success. This is evidenced both by the decreasing rates of economic growth in the 1980-ies in comparison to the 1960-ies and 1970-ies, and by the fast accumulation of foreign debt.

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[5] The author has prepared a separate study on income and prices elasticities of exports and imports, which is due to be published soon.

No matter how controversial Bulgaria's specialisation within the framework of the Council for Mutual Economic Assistance (CMEA) may seem (from the present point of view), it did indeed ensure nominal growth rates, however at the cost of huge domestic and external imbalances. The existing model of economic growth collapsed with the disintegration of CMEA. For several years thereafter, Bulgaria registered negative GDP growth accompanied with increasing unemployment, galloping inflation and fast decapitalisation of the economy. The factors contributing to that downturn were many, not only economic. What was indisputable was the lack of a clear economic model to be followed by quickly changing governments. As late as the end of the 1990-ies, some growth model was shaped (although arbitrarily), which was based on increasing amounts of external funding leading to growing domestic demand and respectively to higher growth. That, however, was accompanied by sharp deterioration of the current account of the balance of payments and increase in external indebtedness of the private sector. In the conditions of quickly growing imports and increasing domestic demand, government budget revenues increased at higher rates than GDP, which resulted in budget surpluses. Despite the surplus budgets, the fiscal policy throughout these years was definitely procyclical, and the nominal amounts of surpluses could not compensate the overheating of the economy, expressed in rising price levels and growth of a prevailing part of financial and real assets.

The global financial crisis and its impact on the Bulgarian economy have actually put an end to a model of development, which obviously was unstable in a longer term

The main problem was due to the structure of foreign investments, not aimed at the tradable sector, but specifically at the real estate and the financial sector. Such a structure of investments encouraged mainly construction, which is a strongly procyclical sector, and it did not take long for the negative results to come. The current account deficit exceeded 25% of GDP, which in itself was very alarming, but the sharp deterioration of the international investment position, the negative values of which passed the limit of 100% of GDP, was even more worrying. If some positive conclusions can be drawn from the crisis, they would be related to the need of reconsidering the entire model of development that was established in the recent decade. To the extent the Bulgarian economy experiences shortage of capital, by necessity, external funding will continue to play an important role. Hence, the issue boils down to the form of funding – whether to opt for recovering the inflows of foreign direct investments, or for increasing exports, which would provide the necessary financial resources for the needed investments in real assets, that are to ensure economic growth.

Considering the possible policies in the short-term, perhaps we should remember again that the Bulgarian economy is characterised with a high degree of openness and foreign economic factors have always been of extremely crucial importance for development. That peculiarity of the national economy (which in

general is typical for any small economy) has been preserved and even increased in the last two decades, when the economy gradually transformed to a market-oriented one. The degree of openness is largely predetermined by both the historical development and the geographic location, as well as by a number of economic factors. The truth is that in practice the country has no reasonable alternative to a still closer integration in the European and global economy. Although this is understood and shared by all, economists and politicians alike, the consensus does not make the task for optimal use of the external sector less complicated. The role and significance of economic integration and of foreign trade in particular, have been subject of many research studies, including by Bulgarian authors. Almost everyone refers to the advantages of the international division of labour, specialization, concentration, co-operation, horizontal and vertical integration, etc. A subject of increasing popularity in the recent years is globalization, and how all countries, irrespective of the degree of their economic development, may benefit from it. Actually, the issues related to globalization are many and complex, and the benefits from it are in no way distributed equally among all the participants.[6]

Obviously, with a limited domestic market, any export-led economy needs a broader access to international markets, and foreign trade (particularly exports growth) turns into one of the most important factors of economic growth. For a national economy to be able to benefit from its natural specifics and its production specialisation, it needs an adequate foreign economic policy. This, on its part, necessitates adopting the requirements and rules of globalisation and the world trade system related to it. Large part of the issues[7], concerning primarily trade flow liberalisation, were resolved by Bulgaria's membership in the World Trade Organisation (WTO) and EU accession. Another part however, maybe the most important one, relating to formulation and implementation of a specific state foreign trade policy, remained unresolved. We set aside the issue whether a national strategy of the foreign economic policy is needed at all. Examples from world practice (Japan, Korea, China, the Asian tigers, and a number of other countries) are a persuasive example of the benefits of such a policy.

Empirical data definitely prove that the openness of an economy and export-oriented growth brought considerable benefits to a number of developing countries. There are numerous examples both in Southeast Asia and in Central and South America. In the recent several decades there is not a single example of an economy to have registered high and stable economic growth rates, without this being

[6] These considerations are not aimed at taking sides in the debate on the pros and cons of globalisation, but serve the less ambitious task to assess how Bulgaria integrates in the whole process and if those in power (present and former) manage to derive maximum benefits from Bulgaria's participation in the international division of labour.

[7] The undisputable successes in this area are the reduction of tariffs, limiting the imposition of non-tariff barriers, facilitating the exchange of goods and services, Bulgaria's accession to Art. VIII of the IMF Articles of Agreement (liberalisation of current transactions) etc.

accompanied by a significant growth of foreign trade volumes. No matter how indisputable the success of export-oriented economies might seem from growth perspective, the questions over which there are still discussions refer to the long-term sustainability of this model of development and the appearance of a new type of dependence of the developing countries from the developed ones in terms of demand. Fears of the emergence of a new type of colonialism were exacerbated after the break of the global financial crisis when global trade volumes shrank abruptly, primarily due to the shrinking demand in the developed countries, which gave grounds to many economists to predict the revival of protectionism as an economic policy.

At the same time, it should be noted that in spite of the collapse of global trade immediately after the beginning of the financial crisis, the system of the WTO, established prevailingly based on rules, proved its strength, and the fears of protectionism turned to be rather exaggerated. It should not be forgotten that all this happened in spite of the failure of yet another round of negotiations on elimination of trade barriers, known as the Doha Development Round.[8]

Surveys indicate that countries with more open economies in general were worse hit by the crisis. Could this mean the end of the trend, manifested in recent decades, of growing openness of national economies on global scale? It is early to say with certainty – at least several years have to pass in order to see if and to what extent the developing countries have made steps towards change in their economic growth model.

The standard recipe prescribed by the international financial institutions (particularly by the IMF) in the conditions of crisis is to strengthen macroeconomic fundamentals. This standard response is formally correct, but its practical usefulness is rather poor. Bulgaria has been maintaining strong macroeconomic indicators (even at the height of the crisis) for years, but the perception of economic stalemate and being in a fix is quite palpable. Implementing the historically most important task facing modern Bulgaria – achieving nominal and real convergence with the other EU member states – remains far away ahead in the future. Obviously just maintaining strong economic fundamentals is not enough. If we assume that keeping to the export-oriented growth model (with all its deficiencies) in the coming years is inevitable, then what comes to the fore is the question how to ensure optimum diversification of trade flows (and especially of exports) in a manner ensuring high and stable growth rates.

Global practice has long proven that the relation between the degree of openness of an economy and the volatility of economic growth is as weaker as diversification is higher. From this perspective, it is very important to maintain a

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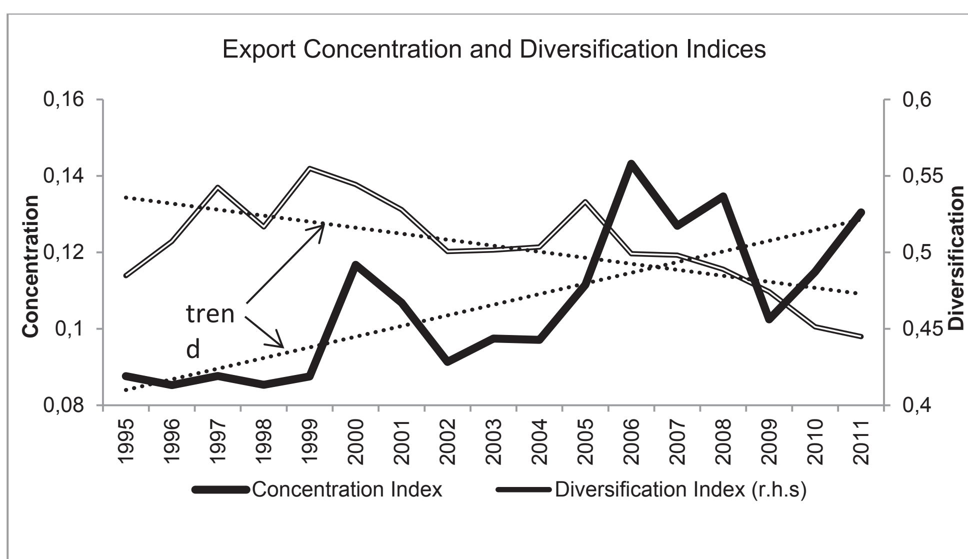
[8] This round of negotiations started in 2001 but no agreement has been reached so far. The main controversies between the developed and the developing countries are related both to the tariffs on industrial goods, and to the so-called non-trade barriers. There are considerable differences between the EU (mainly France) and the other developed countries (mainly the US and Canada) with regard to subsidies for agriculture.

high degree of diversification in terms of both products and markets in which we trade.

Regretfully, recent years' data indicate a clearly outlined trend towards reduced diversification of Bulgarian exports and a trend (not so clearly outlined) towards increased concentration.



Source. UNCTAD.

Another unfavourable trend concerns the specialization of Bulgarian exports. The gradual depletion of the extensive possibilities of the economy, the lack of innovative products, and the improperly oriented specialisation are the most probable causes of exports stagnation in recent years. Changes in the commodity structure can serve as a good reference point in the analysis of the possibilities for exports to become a sustainable driver of economic growth. For decades this has been the typical structure for a developing economy with a prevailing share of raw and other materials (mainly primary products and metals), i.e. production with low degree of processing and with low value added, respectively. In the long-term, this type of structure cannot generate sustainable economic growth as it strongly depends on price fluctuations in the international markets, characterised with strong procyclicity. The UNCTAD data on Bulgaria's Trade Specialisation Index[9] speak for themselves.

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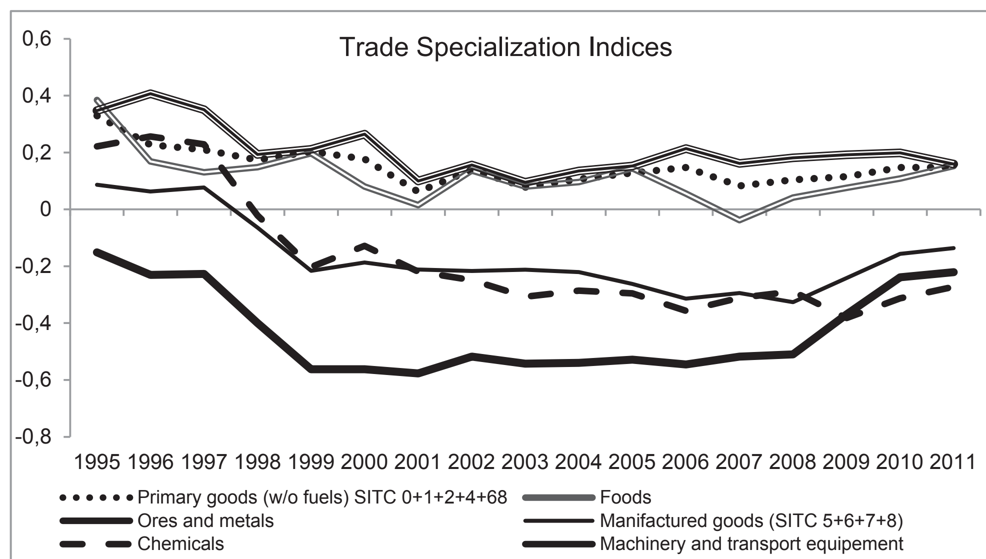
[9] This index (also known as normalized trade balance) compares the net trade flow (exports minus imports) with the whole flow (exports plus imports). It can take values from -1 to +1, where positive values indicate specialisation within a specific group of goods.



Source. UNCTAD

Given the degree of openness of the economy, it would hardly be exaggerated to say that the domestic economic policy should become a function of the foreign trade policy, i.e. the measures of domestic policy should be targeted at achieving the priorities set by the foreign policy. In this relation, three main milestones can be outlined in the development of Bulgaria's foreign economic relations, which should determine the foreign economic policy in the future: globalisation, European integration, regional cooperation. The globalisation processes generate the need of trade liberalisation by tariff reduction, limiting the use of non-tariff barriers, facilitating the exchange of goods and services between countries. Presently, the foreign economic relations globally are to a great extent systematised within different multilateral agreements, regional arrangements and bilateral treaties. The strictly laid down rules of trade underlying them provide conditions of predictability, and thus facilitate the business environment. Based on these arrangements, good access to markets of counterparties has been achieved, and conditions are provided for increasing exports. All this helps in making the Bulgarian market an integral part of the single European market, which is an area without internal boundaries, where the free movement of goods and services, people and capital is guaranteed. In a more specific aspect, there are various approaches to stimulating economic growth by more active inclusion of the Bulgarian economy in the international division of labour. The more important directions can be systematised as follows:

- A key factor of increasing productivity and competitiveness through implementation of state-of-the-art technologies and innovation. In addition to

traditional instruments (foreign direct investments, transfer of technologies and know-how) the state should play an important role in encouraging R&D activities. The ultimate goal of this policy is to break with the years-long practice of export of labour-intensive goods with low added value in favour of capital-intensive products with a dominating share in the foreign trade of the EU.

- Mitigating and subsequently overcoming the issue with the low competitiveness of Bulgarian products, particularly agricultural produce. Achieving this goal will require a step-by-step but stable increase in the absorption of resources from EU Funds and pursuing a policy targeted at the development of rural areas;
- Facilitating access of Bulgarian companies to the EU single market by more active participation in the system of mutual recognition of certificates and certification procedures. This will reduce significantly the costs of exports particularly in the dairy, meat production and meat processing industries, with a recognised enormous potential;
- Identification of companies having a potential to enter and be competitive in the common European market. These companies should be assisted under target programmes and projects, including by establishing partnership relations with leading foreign companies;
- Encouraging the use of instruments like public-private partnership in the realisation of projects financed from EU Funds;
- Stimulating initiative and proactive behaviour of Bulgarian companies for finding suitable contractors, their inclusion in high technology subcontracting chains and in the development and operation of industrial clusters and entrepreneurial networks;
- Eased granting of export credits and providing diverse financial instruments;
- Providing state guarantees and insurance of export credits aimed at corporate and bank loans with the purpose of providing additional incentives not only for exporters but also for the finance and credit institutions;
- Seeking possibilities for tax and customs relief for exports, including exemption from customs duties, taxes, charges and excise taxes; refunding of already paid export taxes and duties; provision of tax, customs and other preferences to foreign investments with a view to increasing competitiveness and exportability of domestic production;
- Specific forms of export preferences – privileged access to produced raw materials, utilities (power and water supply, etc.); transport of export goods at lower tariff rates; passport, visa and other preferences;

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Drawing on all said so far, one can convincingly affirm that export-oriented economy means not just high rates of exports, but is related first and foremost to providing all necessary conditions for improving the effectiveness of exports in a manner that makes them a driver of economic growth. Implementing this seemingly simple idea requires providing a number of prerequisites. Economic growth rates will

be related to the growth of export volumes only after the strategic export industries for the economy have been determined. This is the only way to eliminate sporadic and campaign-driven measures for stimulating individual productions and for achieving short-term effects on the BoP current account, and to develop a purposeful policy of long-term effects on the overall economic development. From this perspective, the policy of export-oriented growth should not be based on an individual successful trade breakthrough, but rather on a comprehensive strategy for identifying, developing and establishing market positions. One of the main difficulties to be overcome in case of an export-oriented trade policy is related to the restructuring of import- and export–oriented product range, but this is an issue that goes beyond the scope of this study. And last but not least, the various forms that an export-oriented policy can take, are determined by both the nature and specifics of the economy and by the existing connections and relations between the government and the business – an issue that has not yet found any acceptable solution.

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