

Expose of Kristofor Pavlov, Chief economist of UniCredit Bulbank for the Automotive industry conference held in Sofia on September 26, 2019

Those who spoke before me already pointed out that Bulgarian automotive sector has a very promising outlook and that if this very promising outlook materialize, automotive sector will play a more prominent role in the Bulgarian manufacturing sector and in the economy as a whole.

In the next ten minutes I want to shift your attention to two headwinds which are holding back automotive sector development. These two headwinds are the underperforming education sector and the rapidly shrinking and aging population. I also want to share some thoughts how these headwinds can be addressed from the view point of economic policy making and why addressing these two headwinds is important if we want to create an environment conducive to the development of the automotive sector in our country.

Let's take the underperforming education sector first. Underperforming education is a headwind to the automotive sector development, because it might prevent labor force to acquire the skills and the knowledge that it needs to remain competitive on the global market place. Without a well-educated and high-skilled labor the promising outlook for the automotive industry will fail to materialize, because the transfer of new technology and know-how, which is so fundamentally important for the normal functioning of the automotive sector all over the world, will be simply impossible to take place.

Bulgarian government is well-aware of the underperformance in the education sector and has already undertaken some steps to address it. Some of the results are very promising. For example, slowly but surely school dropout ratio is improving. In another positive example, the salaries of teachers have increased by more than 30% cumulatively over the past 2Ys. More increases are in the pipeline, which if implemented, should enable the government to fulfill its commitment to double the salaries of the teachers by the end of its current term in office in 2021.

Teachers' salaries are important because there is a strong cause and effect relationship between teachers' salaries and quality of teaching on one side and between quality of teaching and learning outcomes on the other. There is good reason to believe therefore that teachers' salaries increases will eventually translate into improved learning outcomes, which, in turn, suggests that labor force is likely to acquire those skills and the knowledge that are so important to help it to remain competitive in the future.

To me education should remain a key policy priority. The governments might change but the commitment to education should remain intact and education should remain high on the policy agenda of every successive government.

I think that teachers' salaries should continue growing at a rate which exceeds the rate of average wage growth in the economy. However, the future salary increases of teachers, those after 2021, should be linked to the improvements in the learning outcomes. The stronger the improvement in the learning outcome is the higher the teachers' salaries should go.

To measure the improvement in the learning outcomes we can use Bulgarian students' results from the international PISA tests. The share of those dropping out from education can also be used as an important additional benchmark to measure performance in the education sector. The increase in high school graduates, if achieved, should be also rewarded. Also any improvements of Bulgarian universities' performance in the world top university rankings, should be closely watched.

The second headwind that may prevent the promising outlook for the automotive sector to materialize, and which I want to discuss, is the rapidly shrinking and aging population. Rapidly shrinking and aging population may negatively impact the supply of high skilled labor, thus holding back automotive sector development. To address this headwind, in my view, we need to change our attitude toward labor. Let me be more specific what exactly I mean, when I say that we need to change our attitude toward labor force.

My story begins three decades ago when the inconsistent implementation of structural reforms, in the beginning of transition from central planning to market based economy, led to a very high increase in unemployment. As the chart on the screen behind me shows, the unemployment rate in Bulgaria remained in a double-digit proportion for an extended time period of almost 15 years and fell below 10% mark for a first time only in 2006, or only three years before the start of the global financial crisis which pushed unemployment rate to very elevated levels once again.

In the context of very high unemployment, the bargaining power of employees decreased. There were several workers competing for every vacant job position created in the economy. Income convergence slowed down because the pace of wages growth expansion lost momentum. Soon the prevailing view became that there is so much free and cheap labor that insufficient supply of high skilled labor is not among the factors constraining economic growth and income convergence.

As time goes by, the view that labor is a cheap and abundant production resource became so deeply entrenched that it eventually started to inflict sizeable and lasting damages to the Bulgarian economy. Emigration and brain drain increased significantly. Failure of policy makers to reduce very high unemployment to more tolerable levels for such an extended period of time eventually made households less confident as to how stable their incomes and jobs are which, in turn, pushed birth rates down.

The full scale of the damage became clear only last year, when the economy reached full employment only for a second time since the start of the transition in 1989. Suddenly, the labor force turned out to be a rare commodity. Its price started to increase at a faster rate, forcing companies either to become more efficient, by innovating their products, by introducing new technologies and organization of production, by increasing the share of

automation in the production process and in such a way remaining competitive in the context of the more rapidly rising labor costs, or to free the production resources they use to other companies, which are ready to try using these resources in a more efficient manner.

This needs to change. Bulgarian needs to focus on maintaining low unemployment or full employment (if you prefer the wording used in the USA) as an overriding economic policy priority. Focusing on full employment as an overriding policy priority will help the pace of income convergence and economic growth to shift to a higher gear. It will help emigration and brain drain to slow. It will increase the security of jobs and in such a way will also encourage young people to have more children. All these positive implications will help the supply of high skilled labor to increase which is fundamentally important in creating the conducive environment that the automotive sector in Bulgaria needs in order to prosper.

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