



Specialization of Bulgarian manufacturing sector in the EU market (relevant trends and likely evolution dynamics)

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Bulgaria is the lowest cost provider in the EU. In addition, it has relatively well educated labour force, favourable taxation, and is viewed as a gateway to the countries from the Black Sea and Western Balkans regions.

	Poland	Hungary	Czech rep.	Slovakia	Slovenia	Estonia	Latvia	Lithuania	CEE-8	Romania	Bulgaria	Croatia	Turkey
Population (mn, 2007)	38.2	10.1	10.3	5.4	2.0	1.3	2.3	3.4	73.0	21.5	7.6	4.4	70.6
Average age, years	37	39	39	37	40	39	40	38	38	38	41	40	29
Youth education attainment level, % ¹	69	60	59	52	68	63	65	69	65	47	49	55	27
Science and technology graduates ²	11.4	5.1	8.2	10.2	9.8	12.1	9.8	18.9	10.3	10.3	8.6	5.7	5.7
GDP per capita €, 2007	8.047	10.038	12.392	10.164	16.688	9.690	8.762	8.326	9.430	5.639	3.782	8.452	6.791
Gross monthly average, 2007	715	727	781	596	1 273	721	566	594	723	309	213	961	907
Labour productivity per person (EU25=100)	67	75	73	77	86	68	54	60	69	41	36	66	61
R&D expenditure, % of GDP	0.6	1.0	1.5	0.5	1.6	1.1	0.7	0.8	0.9	0.5	0.5	0.9	0.6
Corporate tax (%)	19	16 + 4	21 ³	19	22 ³	24 ⁴	15	15	19	16	10	20	20
EBRD Infrastructure reform index	3.3	3.7	3.3	3.0	3.0	3.3	3.0	3.0	3.3	3.3	3.0	3.0	n.a.
FDI/GDP(in %, avg 2005-'07)	4.4	5.7	6.3	5.2	2.1	14.0	6.9	5.0	5.2	7.2	19.7	7.5	3.1
GDP growth (avg. 2005-'07)	5.5	3.1	6.6	8.5	5.3	9.5	10.9	8.1	5.9	6.0	6.2	4.9	6.6

1) 2005, Percentage of the population aged 20 to 24 having completed at least upper secondary education;

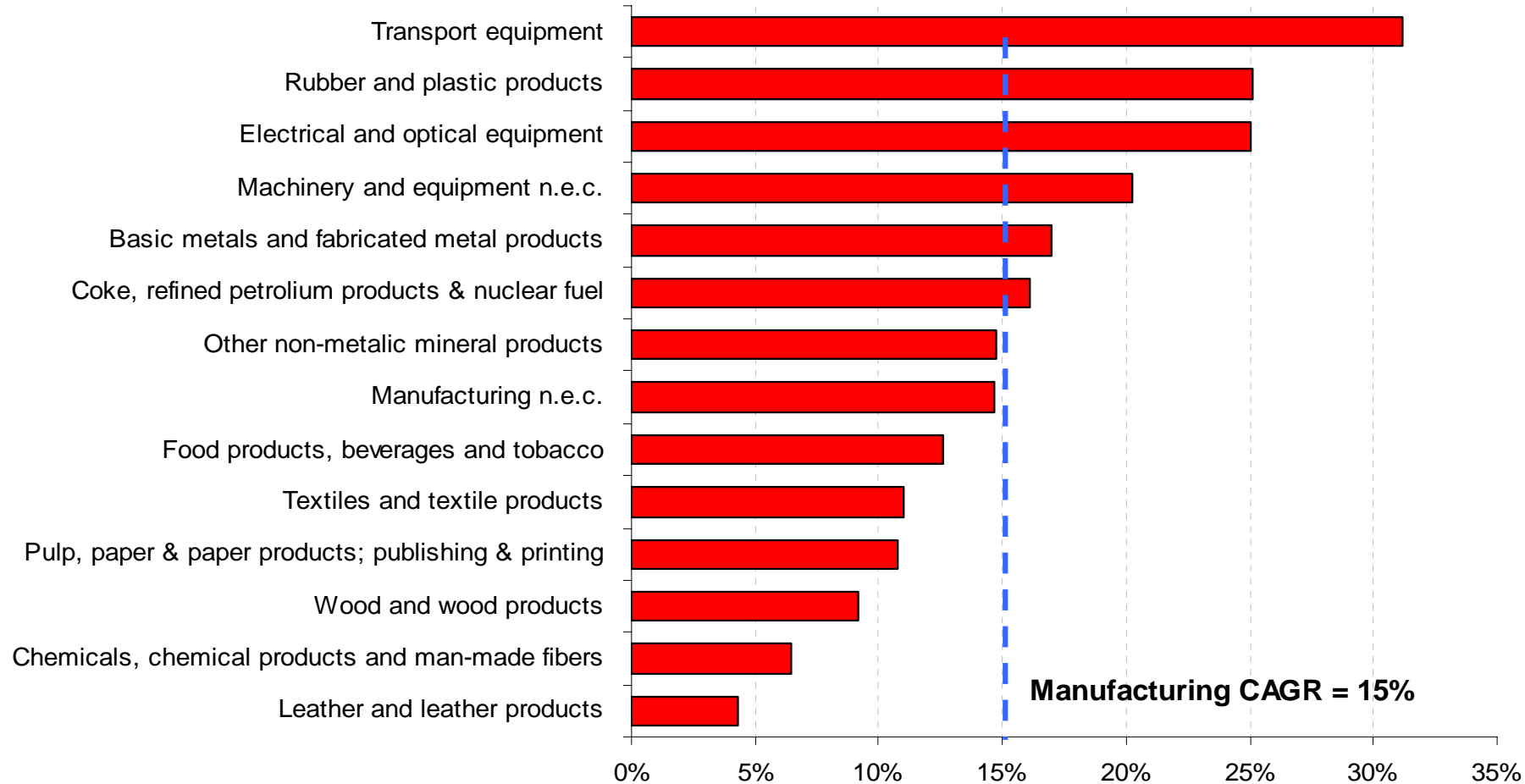
2) 2004, Tertiary graduates in science and technology per 1 000 of population aged 20-29 years;

3) In 2008

4) Estonia do not tax corporate income, except on the distribution of corporate income such as dividends and fringe benefits

Fastest growing export oriented industries are mid-to-high tech sectors which, however, start from very low base and thus still control relatively small part of total export.

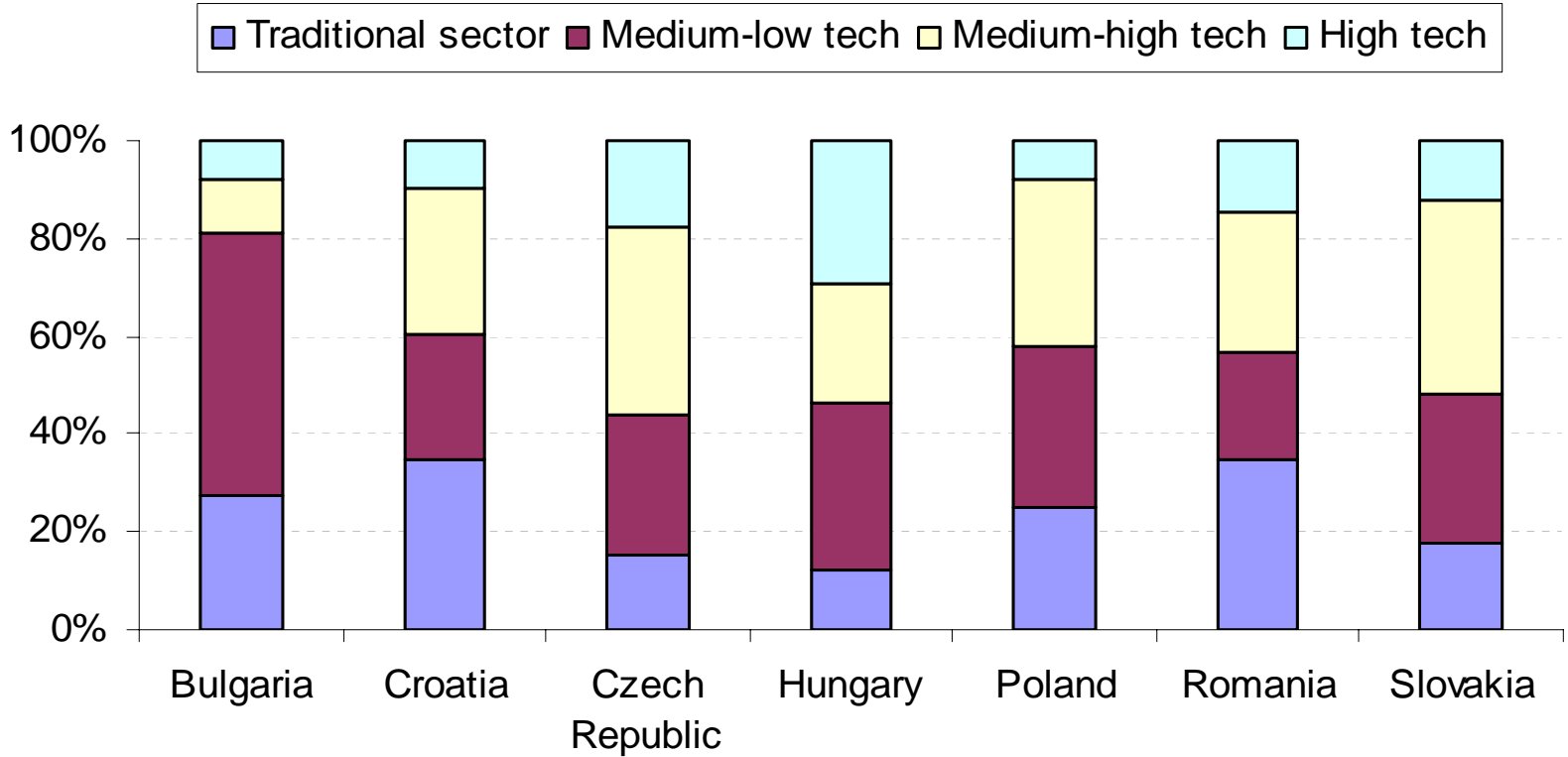
Compound Annual Growth Rate in Export, 2000-2007



** Data source: NSI

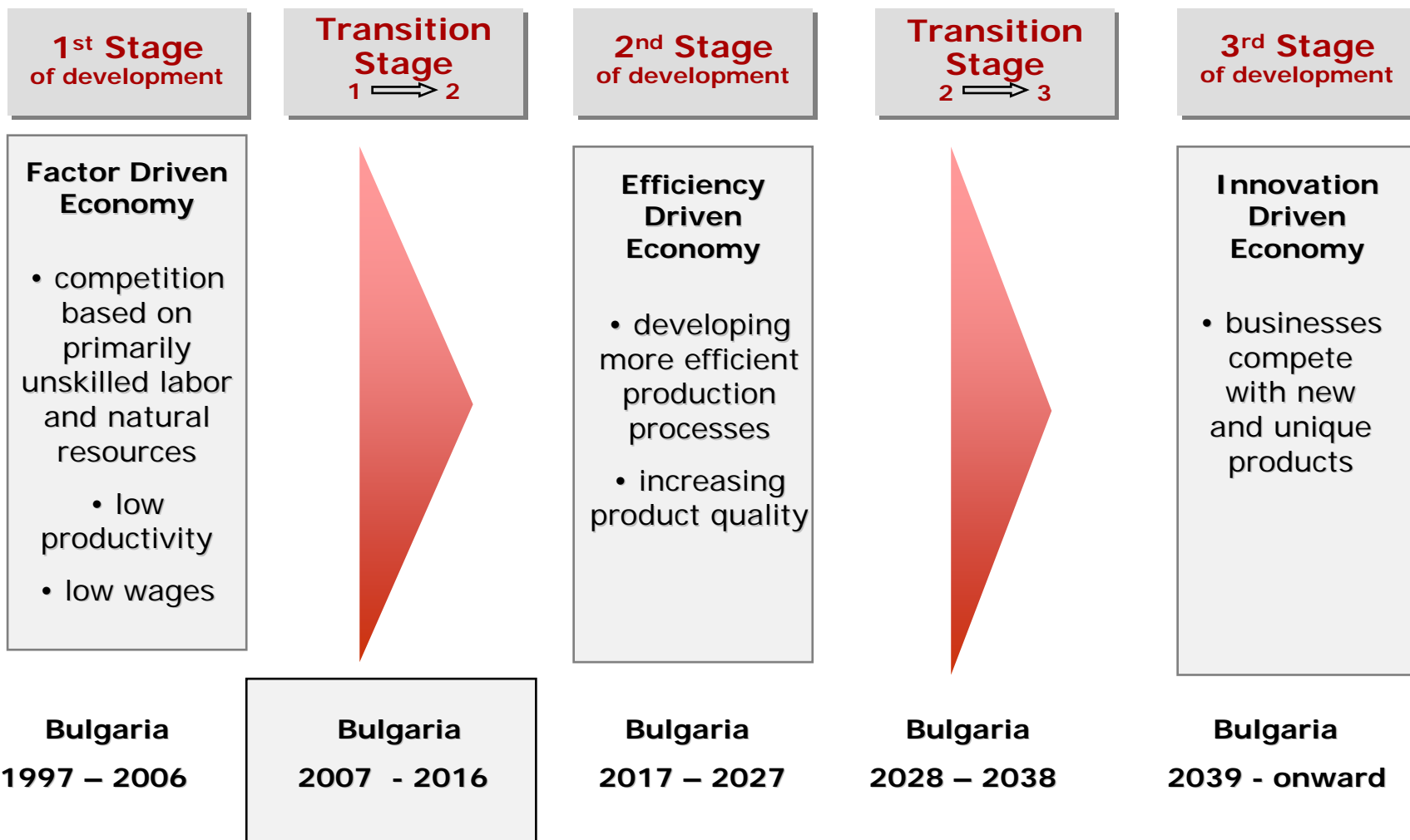
The relative share of high-to-medium tech manufacturing products is around 20% of total merchandise export, which unfavorably compares with countries in CEE where it is between 40% and 55% of total export volumes.

Country Export Shares in Manufacturing, 2007



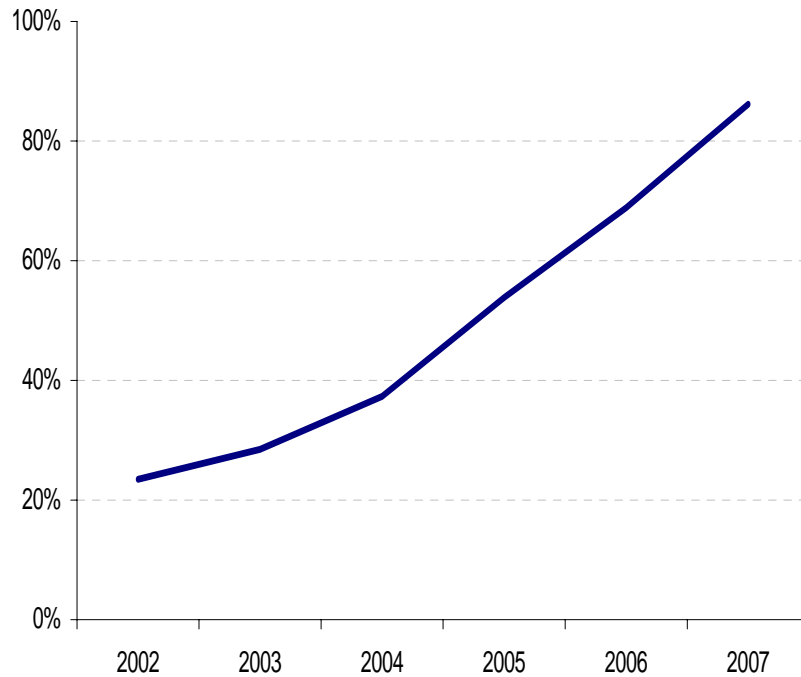
Data source: NSI; High-tech consists of Electrical Equipment; Medium-high tech of Transport Equipment and Machinery and Equipment; Medium-low tech of Coke, Petroleum Products and Nuclear Fuel, Chemicals and Chemical Products, Rubber and Plastic, Other Non-Metallic Mineral Products and Basic Metals; Traditional consists of Food, Beverages and Tobacco, Textile and Textile products, Leather and Leather Products, Wood and Wood Products, Paper and Paper Products, Publishing and Printing and Manufacturing n.e.c. (Furniture mainly).

If we take Michael Porter's theory for stages of development Bulgarian economy is in the transition phase between the so called *factor-driven* and *efficiency-driven* stage of development. Only until recently competition was entirely based on low prices, while selling very basic products.

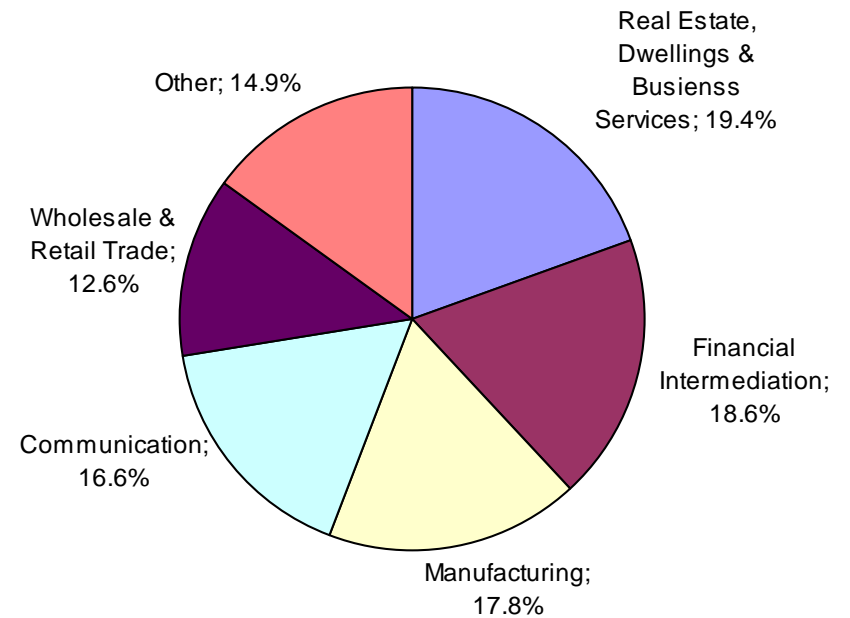


The stock of FDI is one of the largest among all emerging economies in CEE and therefore we can safely draw the conclusion that Bulgaria was one of the countries that benefited mostly from the global shift in capital flows to the east.

FDI Stock / GDP, %



FDI Stock share by sectors, % 2007

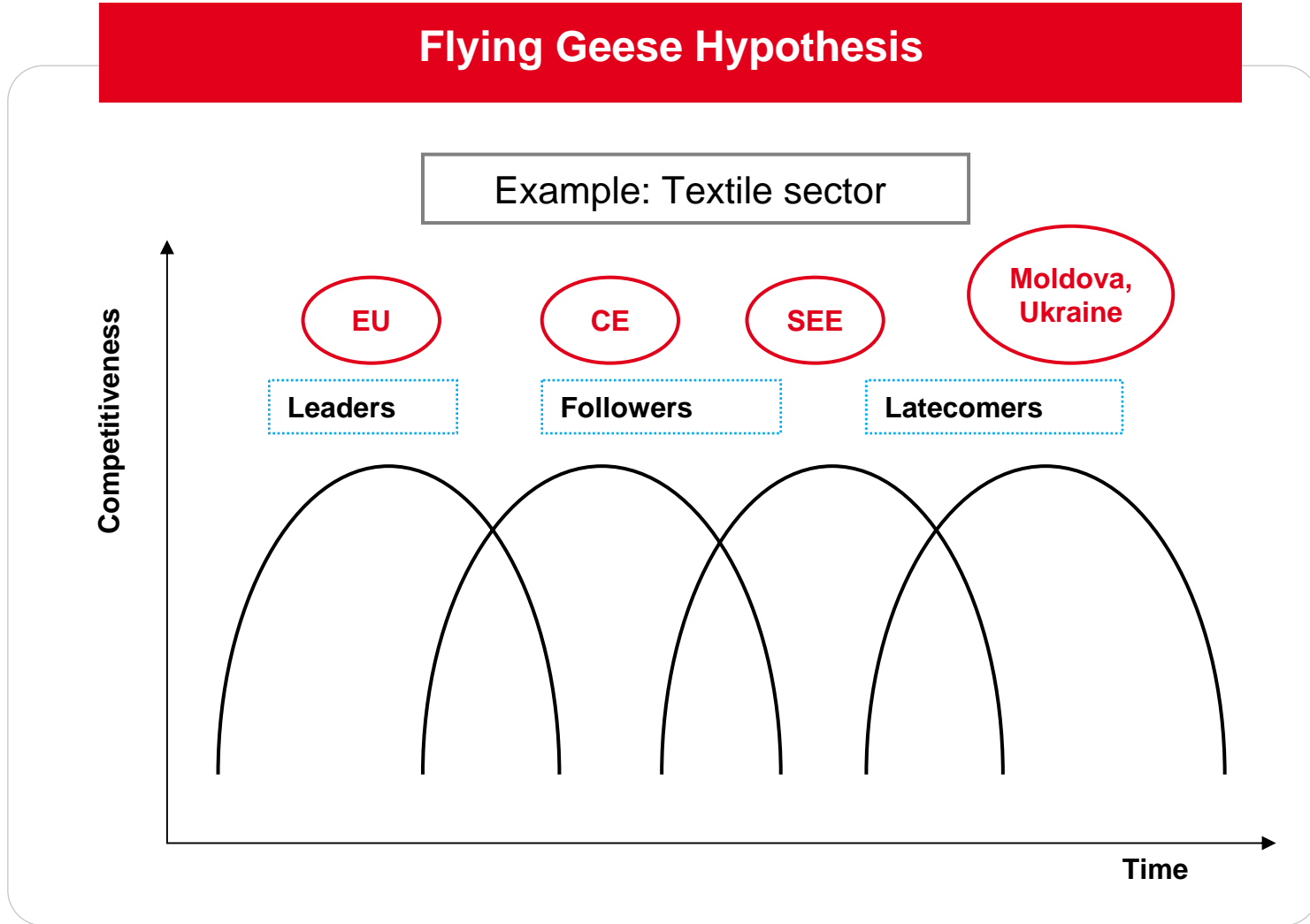


Source: Central Bank

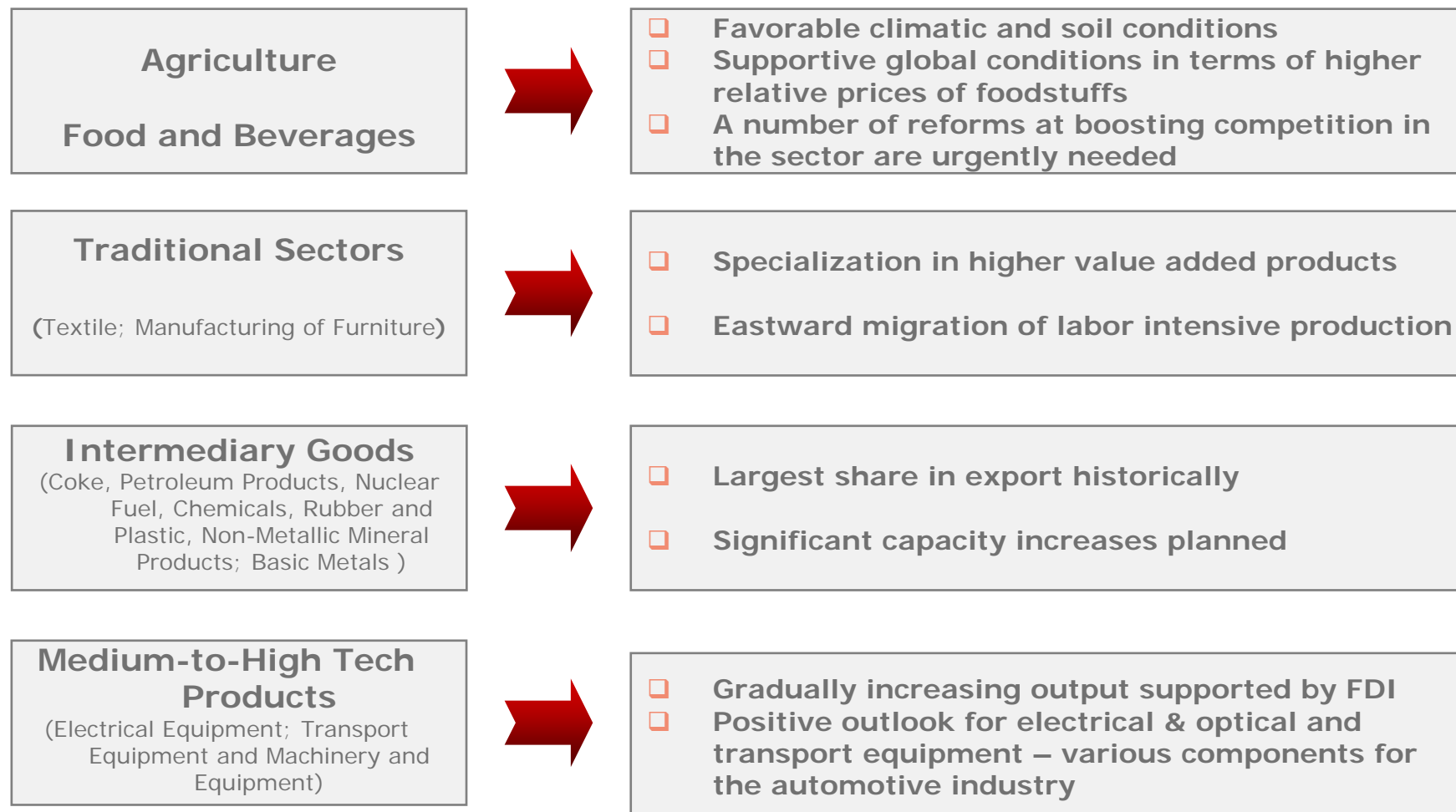
The model of presence of Italian investors in Bulgaria...

- Since the start of transition areas of specialization in the Bulgarian economy and its sources of competitive advantage mostly seems to have favored the Italian model of internationalization and vertical disintegration of production processes, where the focus has been on labor intensive manufacturing sectors.
- Italy is the second largest export trading partner as it moved part of labor intensive production phases here, especially in the textile and wearing apparel industry.

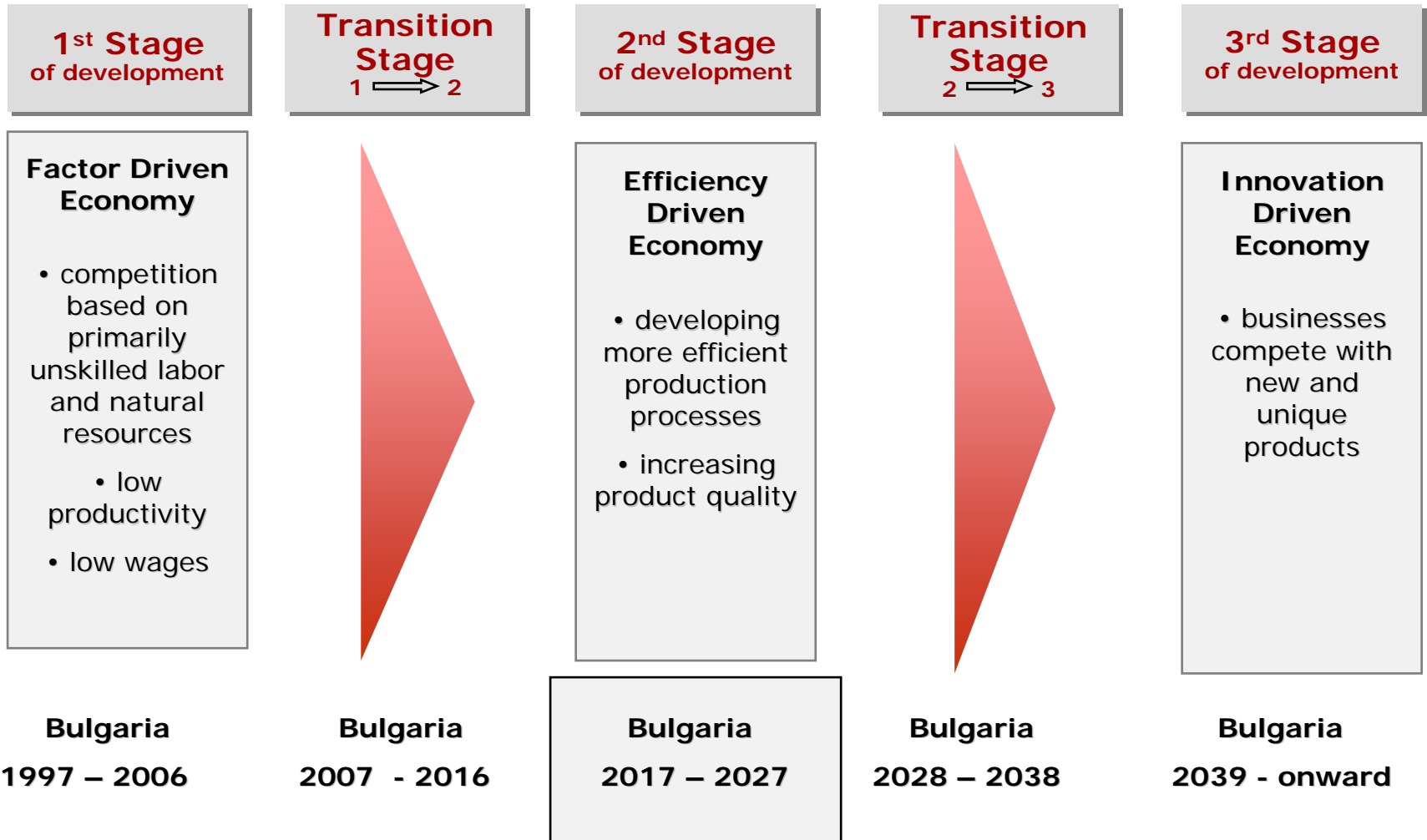
Countries, which passively receive external investments thanks to labor cost competitiveness initially, follow the pattern of the leading country and with time lose comparative advantages in production of different products and technologies across sectors and gain advantages in others.



Based on this theory we are on the view that in 10 years Bulgaria will continue to have an important share in manufacturing of intermediary goods. At the same time, share of high-to-medium tech manufacturing products will increase.

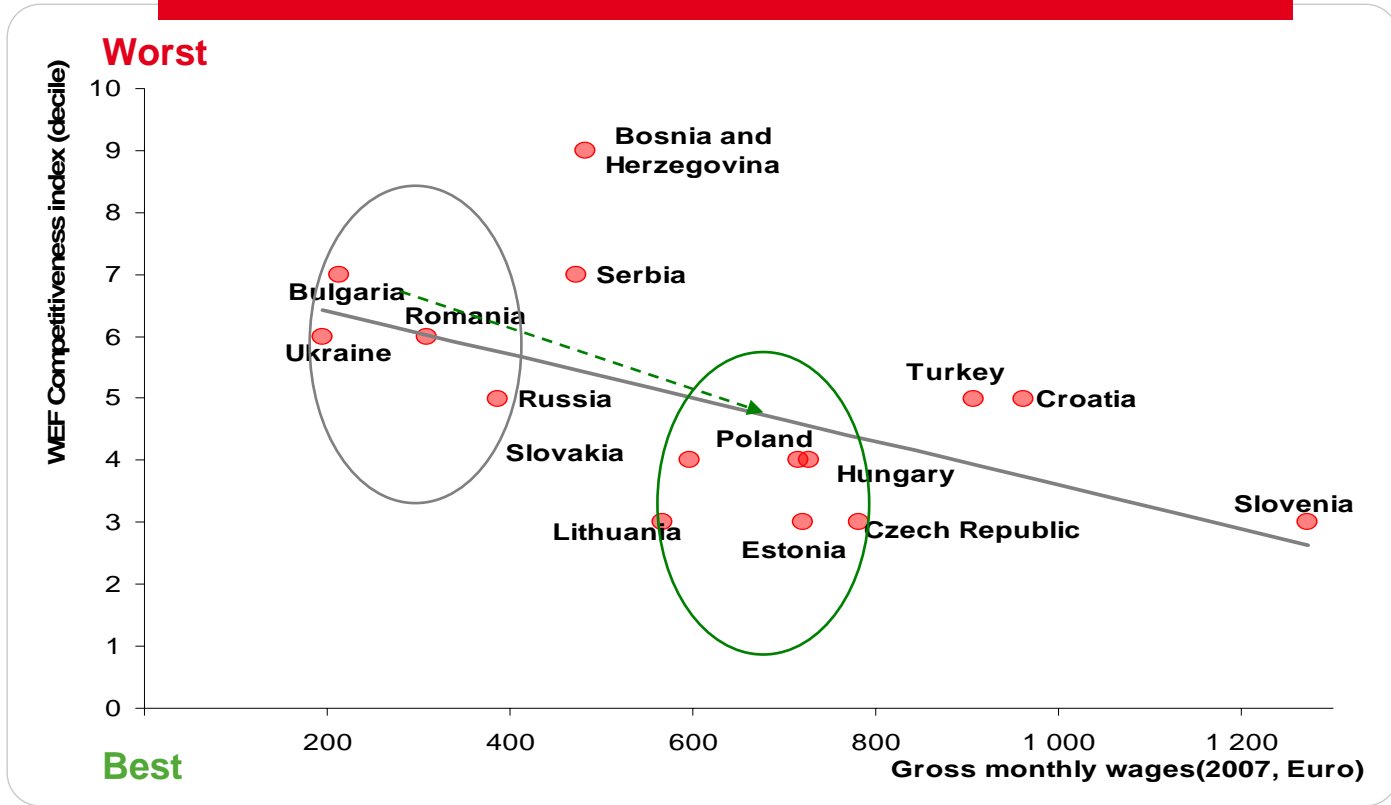


If we take once more Michael Porter's theory on stages of economic development in 10 years Bulgaria is likely to be in the *efficiency-driven* stage with start of the transition period toward reaching the most advanced *innovation-driven* stage being some 10 years ahead.



Therefore, Bulgaria have to develop new sources of competitive advantage because low labor costs is simply not enough, given the existence of countries like China and India and is moreover inconsistent with aspirations of Bulgarian society to improve its income levels and living standards.

The competitiveness-wage trade-off



And the trade-off between costs and quality of the business environment to shape the future evolution of comparative advantages if Bulgaria is to be successful.

Competitiveness index (WEF): it takes into account 90 variables, among which infrastructure, technological development, macroeconomic context. It covers 131 countries and it is produced annually by the World Economic Forum.

Looking at the Global Competitiveness Index Report, Bulgaria compares unfavorably with the other EU accession countries in three key areas *quality of institutions supporting free market, infrastructure and education levels*, particularly higher education.

Global Competitiveness Index 2007-2008 (Best country ranking -1; Worst ranking - 131)

	Estonia	Lithuania	Latvia	Czech Republic	Slovak Republic	Hungary	Poland	Croatia	Romania	Bulgaria
Overall rank out of 131 countries	27	38	45	33	41	47	51	57	74	79
Institutions	34	58	59	69	60	54	82	65	94	109
Infrastructure	36	48	56	41	58	54	80	53	100	84
Macroeconomic stability	14	38	44	43	62	107	56	73	84	47
Health and primary education	30	43	45	29	39	41	36	44	52	56
Higher education and training	23	25	29	28	41	33	35	46	54	66
Goods market efficiency	27	44	47	38	35	59	69	71	74	90
Labor market efficiency	26	44	36	35	25	58	49	56	85	73
Financial market sophistication	31	54	38	53	33	51	64	68	78	74
Technological readiness	19	38	40	35	36	41	51	49	59	65
Market size	91	67	82	38	57	41	22	64	43	61

Source: Global Competitiveness Report 2007 – 2008 - World Economic Forum

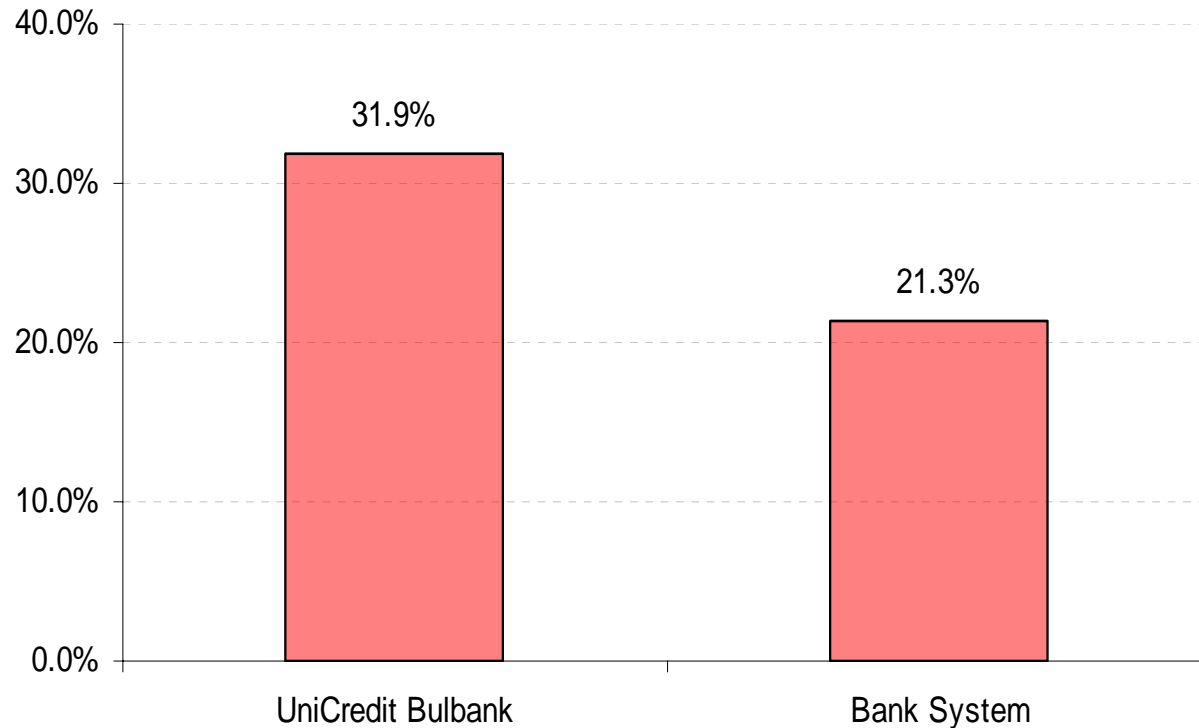
What the government should do to facilitate the process of swapping low cost competitive advantage with improving quality of business environment like in the other more advanced accession economies?

Problematic areas	Notable Competitive Disadvantages (Best Ranking – 1; Worst Ranking – 131)																		
<p>Overall rank in QUALITY INSTITUTIONS</p> <p>Rank: 109</p>	<table border="1"> <tr><td>Organized crime</td><td>121</td></tr> <tr><td>Efficiency of legal framework</td><td>113</td></tr> <tr><td>Transparency of government policymaking</td><td>110</td></tr> <tr><td>Diversion of public funds</td><td>109</td></tr> <tr><td>Favoritism in decisions of government officials</td><td>108</td></tr> <tr><td>Wastefulness of government spending</td><td>108</td></tr> <tr><td>Judicial independence</td><td>105</td></tr> <tr><td>Property rights</td><td>98</td></tr> <tr><td>Burden of government regulation</td><td>83</td></tr> </table>	Organized crime	121	Efficiency of legal framework	113	Transparency of government policymaking	110	Diversion of public funds	109	Favoritism in decisions of government officials	108	Wastefulness of government spending	108	Judicial independence	105	Property rights	98	Burden of government regulation	83
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<p>Overall rank in EDUCATION and TRAINING</p> <p>Rank: 66</p>	<table border="1"> <tr><td>Extent of staff training</td><td>119</td></tr> <tr><td>Quality of management schools</td><td>83</td></tr> <tr><td>Local availability of specialized research and training services</td><td>76</td></tr> </table>	Extent of staff training	119	Quality of management schools	83	Local availability of specialized research and training services	76												
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Source: Global Competitiveness Report 2007 – 2008 - World Economic Forum

What is the role of the local banking sector in facilitating the evolution of the economy – it should simply follow the example of UniCredit Bulbank - which channels its portfolio increasingly toward Manufacturing at the expense of smaller exposures in Real Estate.

Share of loans* in the Manufacturing sector end of 2007



Data source: BNB, UniCredit Bulbank

* Share of loans to non-financial entities only

UNICREDIT BULBANK IS THE NUMBER ONE FINANCIAL PARTNER IN BULGARIA

UniCredit Bulbank – at a glance



- **Employees:** ~ 4000
- **Customers:** over one million
- **Branches:** ~ 260 all across Bulgaria
- **Number one in assets:** over BGN 9 billion*
- **Number one in total loans:** ~BGN 5.2 billion*
- **Number one in shareholders equity:** BGN 1.2 billion*
- **Leading positions in deposits:** BGN 6.3 billion*
- **Number one position in Corporate banking**
- **Number one position in Investment banking**
- **One of the strongest players in retail banking** in Bulgaria

*Unconsolidated audited figures as of end 2007

RECOGNITION



Selected Recent Awards

- **Euromoney: Best Bank in BG, 2006, 2007**
- **Euromoney: Best Investment Bank in BG, 2007**
- **The Banker: Bank of the Year in BG, 2007**
- **Global Finance: Best Bank in BG, 2007**
- **Global Custodian: Best Custody, 2005, 2006, 2007**
- **Banker weekly: Best Banker in BG, 2007**
- **Manager Magazine: Best Manager in BG, 2007**

Thank you for your attention!

If you want to know more about Bulgarian economy and its financial industry turn to the publications of UniCredit Bulbank research office in Sofia which are available on <http://bulbank.bg/index.jsp?id=1.7.1>