

INVESTMENT SCREENING IN BULGARIA

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While **sanctions** alone cannot stop Russia's war of aggression in Ukraine, they play an important role in deterring the regime in the Kremlin from further aggression and denying it the needed resources to continue threatening Europe. However, upholding the sanctions requires a coherent and well-functioning framework for sanctions enforcement across the EU. Enforcement capacity and quality are not the same across the bloc with notable **weak-link countries** such as Bulgaria—which still lacks practice and an effective investment screening mechanism framework implemented in its national legislation. The need for a secure and well-coordinated framework for **screening foreign investment** has already been gaining momentum across the world. Prior to the war in Ukraine and, together with other economic security instruments such as state aid, illicit financial flow monitoring, and anti-money laundering, foreign investment screening has been making its way to EU-level policymaking. Bulgaria needs to build upon and upgrade the EU's policy and legislative initiatives to ensure its economy does not become an enabler for sanctions evasion, or a **magnet for corrosive capital**, which would undermine the country's investment standing and growth prospects among its Euro-Atlantic partners. At the same time implementing such a regime, while urgent, needs to take into account the legitimate grievances and points of view of the private sector investors, so as not to become another tool of repression in Bulgaria's **immature democratic governance environment**.

KEY POINTS

- The Kremlin's war in Ukraine has demonstrated that **corrosive capital flows** are one of the most insidious weapons that undermine vulnerable democracies in Europe. In the run up to the war Russia has **weaponized** its **energy investments** and has activated numerous oligarchic networks across Europe.
- **Bulgaria** remains **one of the most vulnerable states** to corrosive capital inflows. The combination of persistent rule of law deficits, low policy and administrative capacity, capital scarcity, and low investment attractiveness has been compounded by a **history of unchecked investments** from authoritarian regimes and offshore havens.
- The EU has recently adopted the **FDI Screening Regulation**, followed by numerous non-binding documents, including Guidance for EU member states relating to FDI from Russia and Belarus.
- Bulgaria has implemented the bare minimum of these EU regulations, only setting up a coordination mechanism with the other member states. However, the Bulgarian legal framework **lacks any instruments for comprehensive FDI screening**, or appropriate safeguards against potential abuse.
- Bulgaria needs to **update** as a matter of urgency its **investment and national security strategies** to include a robust FDI screening mechanism as a main defense against foreign malign influence and an additional safeguard for boosting quality foreign investment. The government needs to **integrate the private and civil society sectors** in the development of the mechanism and ensure adequate transparency of the process.

The Corrosive Capital Poison Pill

The international trade environment has changed considerably in recent years. China and Russia have started using economic instruments not only for profit but as tools for economic coercion, which often corrode the democratic and market institutions of the recipient countries.^{1,2,3} The Chinese Belt and Road Initiative and the Russian state and oligarchic-driven investments in the European energy and media sectors exemplify such **corrosive capital flows**, creating economic dependencies that threaten national security and weaken the checks and balances of the democratic institutions of the recipient countries.⁴

The start of the war in Ukraine cleared the veil of the actual purpose of some Russian foreign direct investments in Europe.⁵ For decades, Russian companies, including state-owned monopolies, have been allowed unfettered access to Europe's markets, allowing the Kremlin to weave into them its networks of influence. As it has prepared its aggression against Ukraine, the Kremlin has increasingly resorted to **weaponizing** such **private and state-owned corporate networks** to sow division and panic in European economies and societies. In addition, such corrosive capital inflows have reinforced existing governance deficiencies in many European countries, compromising the market economy immune system of EU member states for attracting legitimate, higher quality, more competitive investors. Tackling these risks requires a **multi-pronged or holistic approach** involving the strengthening of existing and the setting up of new response mechanisms.

¹ Stefanov, R. et al., *The Kremlin Playbook: Understanding Russian Influence in Central and Eastern Europe*, Washington, DC: Center for Strategic and International Studies, 2016.

² Stefanov, R. et al., *The Kremlin Playbook 2: The Enablers*, Washington, DC: Center for Strategic and International Studies, 2019.

³ Goldstein, A., and Hontz, E., "Corrosive Capital: Known Unknowns", Washington, DC: Center for Strategic and International Studies, November 2022.

⁴ Center for the Study of Democracy, *Policy agenda for countering media capture in Europe*, Policy Brief No. 116, October 2022.

⁵ CSD, *Energy and Climate Security Risks*, 2022.

A Wake-Up Call for the EU: Introducing FDI Screening

The resurgence in global superpower competition, the authoritarian turn in China and Russia, and the war in Ukraine have resulted in a shift in the perceptions towards FDI in the market-economy democracies of the West. The United States, the European Union, and Japan have reviewed their security doctrines, putting an emphasis on **economic security** and the **reduction of strategic dependencies**. The EU has begun the adoption of adequate defensive instruments (such as the FDI screening mechanism, the international procurement instrument, and the anti-coercion instrument). The EU's framework for 'strategic autonomy'⁶ defines China as a 'strategic competitor' and Russia as a '**systemic rival**'. One of the most recent economic security instruments adopted by the EU is the EU FDI Screening Regulation.⁷ It complements other similar tools, such as the European Anti-Money Laundering Authority, the European Public Prosecutor's Office, etc.

In 2020, with its coming into force, the FDI Screening Regulation established a **framework for FDI screening at the level of member states** in order to ensure legal certainty and EU-wide coordination and cooperation.⁸ The regulation does not introduce a centralized FDI screening mechanism, and there is no 'one-stop shop' in the European Union that would permit the European Commission, the EU's executive arm, to make its own decisions or even block FDI into the European Union. Member states remain solely responsible for protecting their national security. As of 2022, nine member states do not have screening mechanisms, but **only Bulgaria and Cyprus are without a screening mechanism** and any legislative developments aiming to set up such a mechanism.⁹

⁶ The concept of "strategic autonomy" is used in: EU, *Shared Vision, Common Action: A Stronger Europe: A Global Strategy for the EU's Foreign and Security Policy*, 2016, pp. 9, 19, 46.

⁷ Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019, establishing a framework for the screening of foreign direct investments into the Union, OJ L 79 I, 21.3.2019, pp. 1–14.

⁸ Röhling F., and Salaschek U., "The Foreign Investment Regulation Review: EU Overview", *The Law Reviews*, October 21, 2022.

⁹ European Commission, Directorate-General for Trade, *Reports from the Commission to the European Parliament and the Council: first annual report on the screening of foreign direct investments into the Union and report on the implementation of Regulation (EU) 2021/821 setting up a Union regime for the control of exports, brokering, technical assistance, transit and transfer of dual-use items*, Publications Office of the European Union, 2021.

The EU and member states' FDI screening mechanisms should address **four major economic security concerns** with respect to investors from third countries, which vary depending on the parties involved.¹⁰

- **Distorting competition.** Foreign investors may be subject to less stringent competition and state aid regulations in their home countries than in the EU. This concern also includes the possibility that foreign governments may use state aid to facilitate investments in sectors of strategic importance for their foreign policy.
- **Lack of reciprocity.** The EU and its member states are becoming increasingly reluctant to offer foreign investors a treatment that their home countries do not offer EU investors in return.
- **Objectives detrimental to EU interests.** There is a concern that investors or their home country's government might be pursuing goals that could be detrimental to specific EU interests. These EU interests seek to safeguard in particular **sensitive assets**, which range from narrowly defensive to 'critical' to 'strategic'.
- **Safety of private information.** Foreign investors may compromise the privacy of EU citizens, including by transferring data to their home country, where EU data protection standards do not apply.

EU stakeholders have repeatedly stressed that the EU FDI Screening Regulation and its newly introduced screening grounds referring to 'security' and 'public order' are **not sufficient to address these four major concerns**. Therefore, member states need to regard the mechanism as the very bare, and insufficient, minimum, which they should implement to safeguard their economic security interests. Member states, such as Bulgaria, which face considerable corrosive capital risks, should adopt FDI screening mechanisms, which address these concerns in a much more significant manner than the EU regulation alone.

FDI in Bulgaria

As a cash and capital-strapped economy, Bulgaria has sought to follow an aggressive market-oriented strategy for attracting FDI since it began its transition to a market economy in 1989.¹¹ Governments in Bulgaria have seen **FDI as both a principal objective and an indication of achievement**. However, over time primarily due to inefficient policies and corruption Bulgaria has become **one of the less desired destinations for investment** in eastern Europe. This trend is particularly evident in terms of gross capital formation when Bulgaria is compared to its neighbors (Figure 1). For the past decade, gross capital formation in Bulgaria has dipped slightly below 20% of GDP, similar to but lower than the EU average. For the Bulgarian economy to catch up with the rest of the union, it **needs a higher level of investment**. New member states, such as Romania, Hungary, and Czechia, have seen a rising share of gross capital formation, well above 20%. Considering the competition for investments in the region, Bulgaria has been hard pressed for accepting any sources of capital, in effect exacerbating adverse selection biases. This has exposed the country to **higher corrosive capital risks**, which have not been addressed by adequate investment screening instruments.

Bulgaria was a **late FDI starter** in Central and Eastern Europe. FDI in Bulgaria only began to grow after 1996, when the country started its privatization process and adopted more active policy measures for incentivizing investments. FDI surged with Bulgaria's accession to NATO in 2004 and to the EU in 2007. Yet, it **declined considerably** in the aftermath of the global financial and the Eurozone crisis of 2008 – 2010, and has since remained stable at these lower levels.

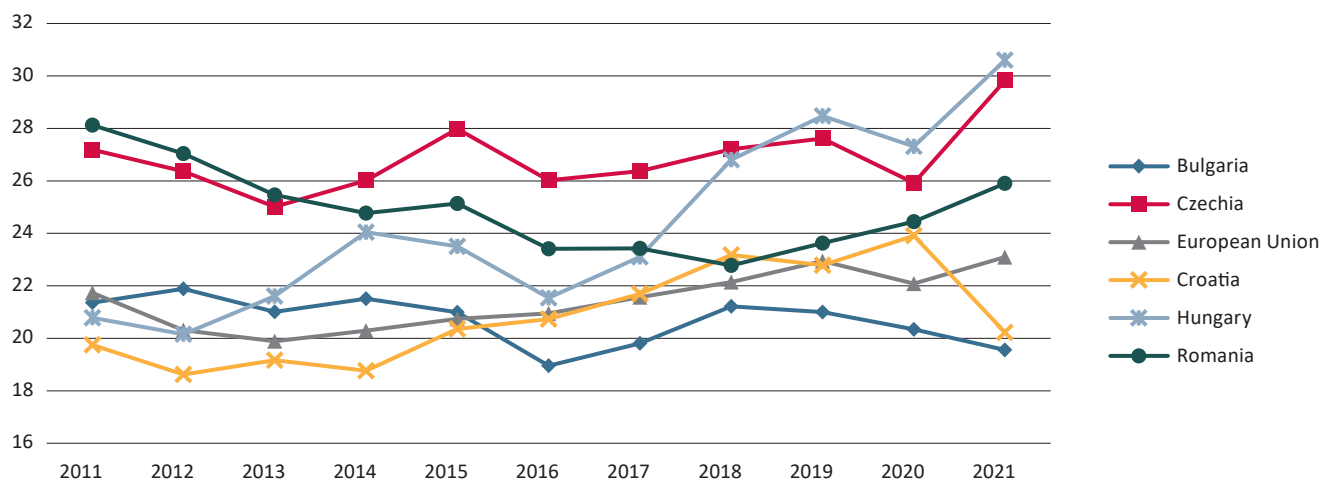
The country's low FDI attractiveness and the lack of sophisticated investment policies have allowed for FDI from Russia, China and offshore havens to hold considerable sway in the Bulgarian economy. This influence has been most visible in **Russia's presence in the Bulgarian energy sector**.¹² Bulgaria's economy has been almost exclusively dependent on Russian oil and gas. Other than monopolizing the market, these foreign direct investments prevented Bulgaria from diversifying its energy markets, leading to a spike in gas and energy prices prior to the start of the war in Ukraine.

¹¹ The first Foreign Investment Law was adopted by the National Parliament in 1991. The Center for the Study of Democracy participated in the development of this first law. For more information see CSD, *Law on Economic Activity of Foreign Persons and on Protection of Foreign Investments: Translation and Comments*, Sofia: Center for the Study of Democracy, 1992.

¹² See: Shentov, O., Stefanov, R., and Vladimirov, M. (eds.), *The Russian Economic Grip on Central and Eastern Europe*, Routledge, 2019.

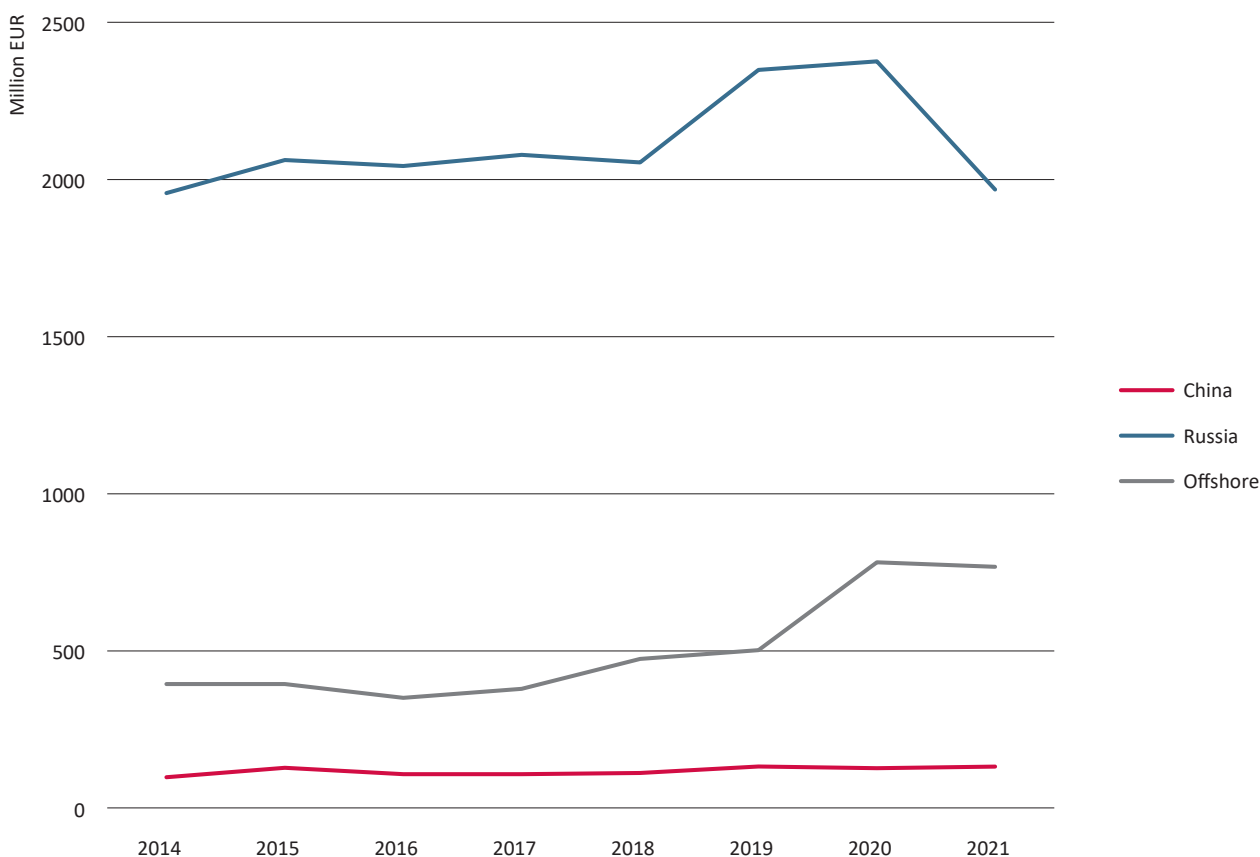
¹⁰ Velten, J., *Screening Foreign Direct Investment in the EU: Political Rationale, Legal Limitations, Legislative Options*, European Yearbook of International Economic Law Monographs – Studies in European and International Economic Law 26, Springer, 2022.

Figure 1. Gross Capital Formation in Selected CEE Economies 2011-2021 (Share of GDP)



Source: The World Bank. Gross Capital Formation (% of GDP).¹³

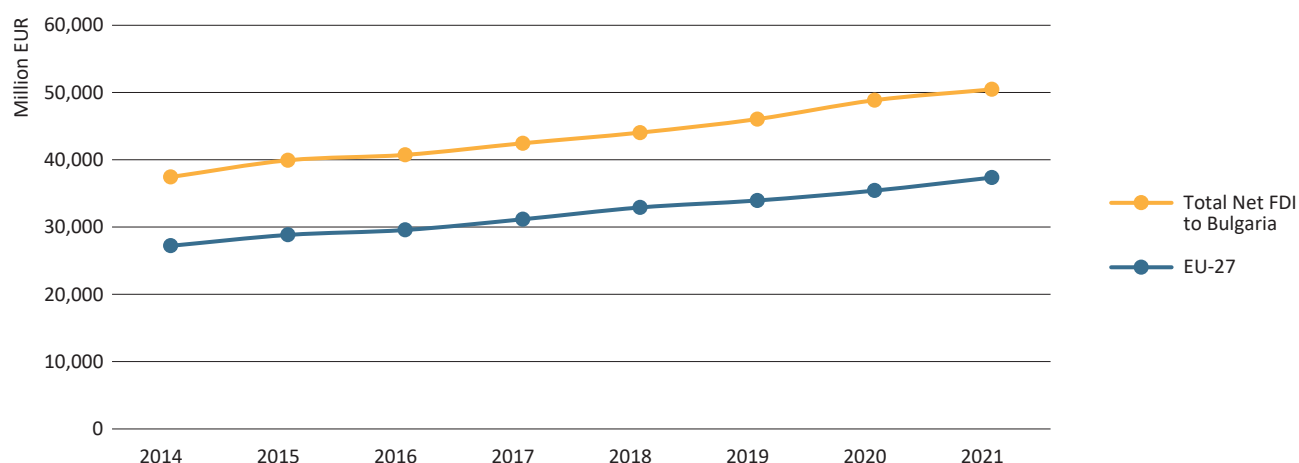
Figure 2. Net FDI Stock in Bulgaria from China, Russia and Offshore Territories (2014-2021)¹⁴



Source: CSD, Based on Data from the Bulgarian National Bank.

¹³ The World Bank, [Gross capital formation \(% of GDP\) - Bulgaria | Data \(worldbank.org\)](https://data.worldbank.org/BD/GCFCV?locations=BD), 2022.

¹⁴ Offshore includes data on: Antigua and Barbuda, Bahamas, Brunei Darussalam, Vanuatu, Virgin Islands (US), Dominican Republic, Liberia, Maldives, Marshall Islands, Oman, Cook Islands, Panama, Pitcairn, St. Lucia, Hong Kong. The list comprises of offshore zones that do not cooperate with the EU, has not fully met its commitments or has pending commitments. Based on offshore blacklist of the EU. See more at: Council of the European Union, [EU list of non-cooperative jurisdictions for tax purposes](https://ec.europa.eu/eu-anti-tax-avoidance/docs/20220324_eu_blacklist_of_non-cooperative_jurisdictions_for_tax_purposes.pdf), 2022.

Figure 3. Net FDI Stock to Bulgaria from the EU-27 and Total Inward FDI (2014-2021)

Source: CSD, Based on Data from the Bulgarian National Bank.

Evolution of Bulgaria's FDI Legal and Institutional Framework

In the initial stage of its transition to a market economy, Bulgaria applied **one of the most liberal FDI regimes** in the region. The first FDI law was introduced in 1991 and was subsequently renamed and amended numerous times.¹⁵ The early versions of the FDI legislation did not specify targets or priority economic sectors or activities, the number of incentives was limited, and there was no differentiated approach in their implementation.¹⁶ The lack of market experience and regulatory capacity coupled with the overly liberal legislation has laid the foundations for an inadequate sectoral and regional policy towards FDI that, to this day, **lacks selectivity, strategic focus and coherence**. This has had significant implications for the structure and origin of investments, as the legislation was based on the presumption that FDI only leads to positive economic and social effects.

In the period of intense FDI inflows before the global financial crisis in 2008, government efforts were mainly focused on setting quantitative targets

vis-à-vis FDI inflows, with **little attention paid to attracting quality FDI** that would support specific national development goals.¹⁷ As a result, Bulgarian privatization and other major FDI deals have raised numerous, repeated concerns about the origin of the funds involved. Countries with off-shore like regimes with high secrecy on ultimate beneficial ownership, such as Cyprus, Luxembourg, the Netherlands, Switzerland, etc. have topped Bulgaria's foreign investment ranking throughout the years. Three of the five general prosecutors of the country since the start of its democratic transition have announced intentions to revisit the whole privatization process, alleging **considerable inflows of corrosive capital** and related losses of public welfare. Only after 2007 did the changes in the law set concrete objectives related to the general strengthening of the country's economy.¹⁸ In the years that followed, amendments and additions were made to the law, emphasizing efforts to create new jobs, encourage investment in high-tech activities, stimulate economic growth, and reduce regional disparities.

¹⁵ The first law was the Foreign Investment Act of 1991, which was then replaced by the Promotion and Protection of Foreign Investments Act in 1992, followed by the Investment Promotion Act of 1997. The latter has been amended more than thirty times since its inception, including its title in 2004.

¹⁶ Mihaylova, S., "Analysis and assessment of the policy towards foreign direct investment in Bulgaria in the period 1990-2018" [Анализ и оценка на политиката към преките чуждестранни инвестиции в България в периода 1990-2018 г.], *Electronic Magazine Dialogue*, Issue 1, Svishtov: Academy of Economics Dimitar A. Tsenov, 2018.

¹⁷ Kolev, K., "The role of multinational enterprises for regional development in Bulgaria", *Eastern Journal of European Studies*, 1(2), 2010, pp. 119 – 138.

¹⁸ The main objectives of the law are: 1. to increase the competitiveness of the Bulgarian economy by increasing investments for technological development in industries and services with high added value in compliance with the principles of sustainable development; 2. to improve the investment climate and overcome regional disparities in economic development; 3. to create new and high-performance jobs.

Investment Screening in Bulgaria

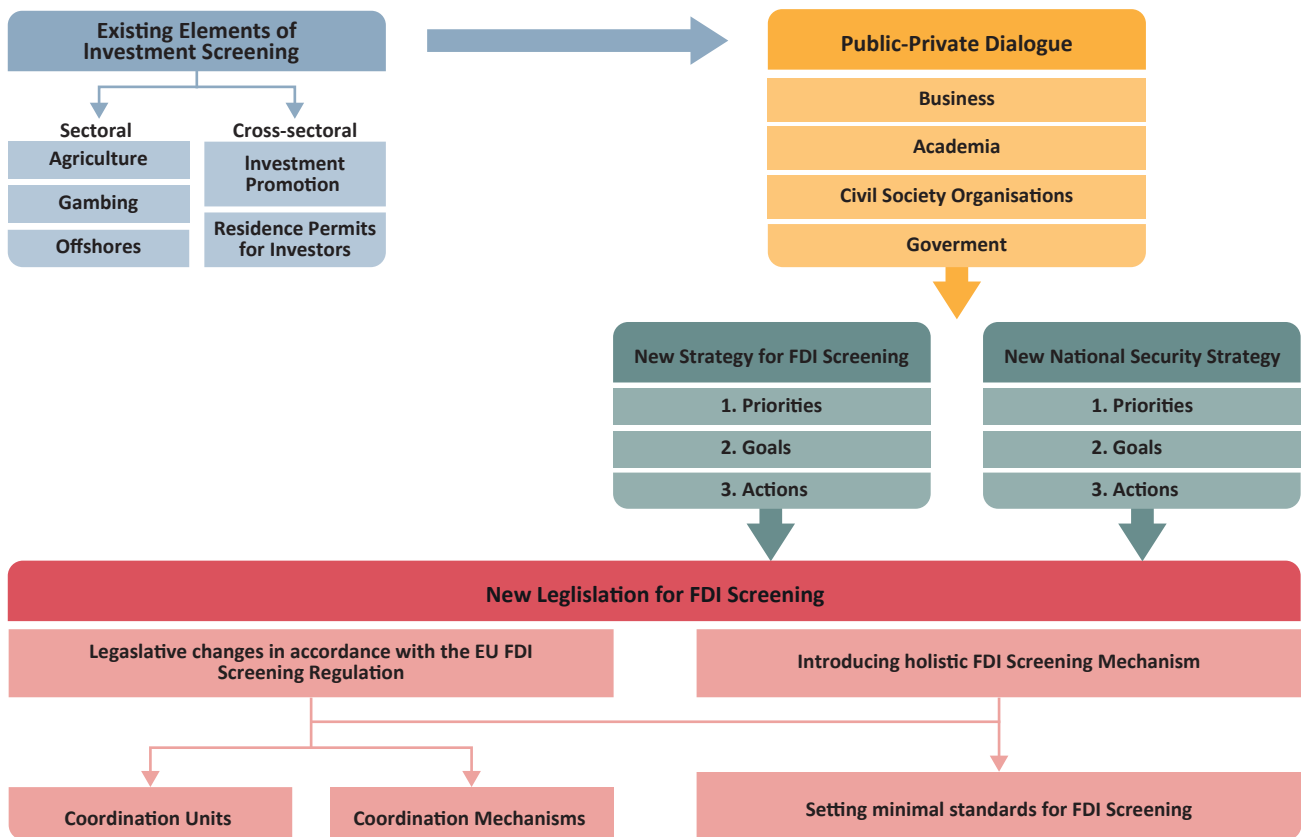
The current Bulgarian legislation does not provide for the necessary holistic FDI screening mechanism to address the risk of corrosive capital inflows. There are some procedures in various laws that introduce FDI review or stricter rules for foreign investors, which resemble certain **elements of investment screening**.¹⁹ Such rules are for example:

- **Restrictions on offshore companies.**²⁰ According to the law, companies, registered in jurisdictions with preferential tax regimes (tax heavens) and the entities under their control are restricted from engaging in 27 different economic activities in Bulgaria.

- **Gambling restrictions.**²¹ According to the law, foreigners may not have any interest in a locally licensed gambling operator unless they have invested at least €10 million in other activities in Bulgaria and have created at least 500 jobs or unless they own a hotel rated with four or more stars and operate a casino in it.

- **Farmland restrictions.**²² Foreigners and foreign legal entities, as well as entities owned by them are restricted from acquiring farmland in the country, unless expressly permitted by an international treaty to which Bulgaria is a party.

Figure 4. Pathway for Introducing a Comprehensive Bulgarian FDI Screening Mechanism



Source: Center for the Study of Democracy.

¹⁹ Boycheva I., and Terziev P., *Investment Screening in Bulgaria: Policy options, Institutional and Legal Framework*, Sofia: Center for the Study of Democracy, 2022.

²⁰ Economic and Financial Relations with Companies Registered in Jurisdictions with Preferential Tax Treatment, their Related Parties and heir Beneficial Owners Act [Закон за икономическите и финансовите отношения с дружествата, регистрирани в юрисдикции с преференциален данъчен режим, свързани с тях лица и техните действителни собственици], 1 January 2013, last amended 13 November 2018.

²¹ Gambling Act [Закон за хазарта], 30 March 2012, last amended 2 August 2022.

²² Ownership and Use of Agricultural Land Act [Закон за собствеността и ползването на земеделските земи], 1 March 1991, last amended 16 February 2021.

Bulgaria also has some **rudimentary cross-sectoral elements of investment screening**. These include: (i) the certification process of investors under the Investment Promotion Act, so that they can gain access to certain investment incentives; and (ii) the procedures for granting the so called ‘golden passports’, which was discontinued in 2022 under pressure from the EU.

In addition, the Bulgarian **national security legislation** mandates the State Agency National Security, among others to protect the country’s economic, financial and environmental security, as well as its critical infrastructure and assets.²³ However, the law does not provide any further details on the specific steps and mechanisms for enforcing this mandate. The agency is among the primary stakeholders of a potential future investment screening mechanism as it also hosts the country’s financial intelligence unit and monitors dual use technologies and goods. The Security Council at the Council of Ministers is the body that can ensure the necessary wide coordination among different stakeholders in a comprehensive investment screening mechanism. So far, under the EU FDI Screening Regulation Bulgaria has only ensured the functioning of a **national contact point** at its Ministry of Innovation and Growth, which reviews and responds to requests from other member states.

What’s Next

Developing an effective investment screening mechanism in Bulgaria requires coordinated efforts on a strategic, policy and a practical, process level:

- **Setting strategic priorities.** Bulgaria needs to embed investment screening in both its national security and its investment promotion strategy, neither of which has been updated in the past five years. The Security Council at the Council of Ministers seems to be the institution best suited to perform this strategic review. The strategic discussion needs to take into account the risks for Bulgaria’s economic security and its investment needs in the coming

decade. It should also consider the existing national capacity and experience with investment screening, and the country’s obligations in this area as an EU and NATO member.

- **Engaging the private sector and civil society.** As possibly the main drivers for success of any future investment screening mechanism, their main role would be to ensure the establishment of a mechanism, free from state interference in the extent that the latter might curb investment. Introducing legislative changes, however, would also demand the involvement of public institutions such as the Security Council, the State Agency for National Security, the Ministry of Innovation and Growth, the Ministry of Defence, the Ministry of Finance, and the Invest Bulgaria Agency.
- **Drafting comprehensive legislation.** Based on public-private dialogue, an analysis of the current legislative framework and an in-depth economic analysis of the trends of FDI in Bulgaria should be conducted, as they would provide the foundation for legislation that matches Bulgaria’s national security needs.
- **Building on EU and international best practices.** Mapping European investment screening policies and collecting good practices would help adopt the model most relevant to the Bulgarian context. Suitable knowledge hubs for this effort would be the Center for International Private Enterprise in Washington D.C. and the CELIS Institute in Europe. The experience of Central European countries, in particular success or failure factors, can also be drawn upon, as they have recently introduced such investment screening mechanisms.
- **Developing the mechanism.** The Security Council at the Council of Ministers in cooperation with the private sector should draw up a document with the key elements of an effective national investment screening mechanism. It should set the goals for investment screening in Bulgaria and establish a common ground for national, EU and NATO partners.

²³ The two laws regulating national security in Bulgaria are the Management and Functioning of the System of National Security Protection Act [[Закон за управление и функциониране на системата за защита на националната сигурност](#)] and the State Agency for National Security Act [[Закон за Държавна агенция „Национална сигурност“](#)].

