OECD Economic Surveys
BULGARIA
ECONOMIC ASSESSMENT

JANUARY 2021

OECD

OECD Economic Surveys: Bulgaria 2021

ECONOMIC ASSESSMENT

BETTER POLICIES FOR BETTER LIVES

This document, as well as any data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Note by Turkey
The information in this document with reference to “Cyprus” relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the “Cyprus issue”.

Note by all the European Union Member States of the OECD and the European Union
The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

Please cite this publication as:
OECD (2021), *OECD Economic Surveys: Bulgaria 2021: Economic Assessment*, OECD Publishing, Paris, *https://doi.org/10.1787/1fe2940d-en*.

ISBN 978-92-64-72268-2 (print)
ISBN 978-92-64-40666-7 (pdf)

OECD Economic Surveys
ISSN 0376-6438 (print)
ISSN 1609-7513 (online)

OECD Economic Surveys: Bulgaria
ISSN 1995-3569 (print)
ISSN 1999-0626 (online)

Photo credits: Cover © RossHelen/Shutterstock.com.

Corrigenda to publications may be found on line at: *www.oecd.org/about/publishing/corrigenda.htm*.

Table of contents

Tables

Figures

Boxes

Follow OECD Publications on:

http://twitter.com/OECD_Pubs

http://www.facebook.com/OECDPublications

http://www.linkedin.com/groups/OECD-Publications-4645871

http://www.youtube.com/oecdilibrary

http://www.oecd.org/oecddirect/

This book has...

StatLinks

A service that delivers Excel®fi from the printed

Look for the *StatLinks* at the bottom of the tables or graphs in this book. To download the matching Excel® spreadsheet, just type the link into your Internet browser, starting with the *http://dx.doi.org* prefix, or click on the link from the e-book edition.

This *Economic Assessment* is published under the responsibility of the Secretary-General of the OECD. The economic situation and policies of Bulgaria were reviewed by the Economic and Development Review Committee on 23 November 2020, with participation of representatives of the Bulgarian authorities. The draft report was then revised in the light of the discussions.

The Secretariat's draft report was prepared for the Committee by Emily Sinnott and Mikkel Hermansen under the supervision of Patrick Lenain. Isabelle Luong provided statistical assistance and Stephanie Henry provided editorial support. The *Economic Assessment* benefitted from contributions by Emilie Cazenave, Carissa Munro and Giulio Nessi of the OECD Public Governance Directorate and by consultant Natia Mosiashvili. Other valuable inputs and comments were received from OECD's Centre for Entrepreneurship, SMEs, Regions and Cities; the Centre for Tax Policy and Administration; the Directorate for Employment, Labour and Social Affairs; the Directorate for Education and Skills; and the Directorate for Financial and Enterprise Affairs.

The previous *Economic Assessment* of Bulgaria was issued in April 1999. Information about other *Surveys* and more information about how *Surveys* are prepared is available at http://www.oecd.org/eco/surveys.

Basic statistics of Bulgaria, 2019*

(Numbers in parentheses refer to the OECD average)**

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	7.0		Population density per km² (2018)	64.7	(38.0)
Under 15 (%)	14.7	(17.9)	Life expectancy (years, 2018)	75.0	(80.1)
Over 65 (%)	21.3	(17.1)	Men (2018)	71.5	(77.5)
International migrant stock (% of population)	2.4	(13.3)	Women (2018)	78.6	(82.8)
Latest 5-year average growth (%)	0.7	(0.6)	Latest general election	March	2017
ECONOMY					
Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	67.9		Agriculture, forestry and fishing	3.7	(2.6)
In current prices (billion BGN)	118.7		Industry including construction	25.9	(26.8)
Latest 5-year average real growth (%)	3.5	(2.2)	Services	70.4	(70.5)
Per capita (000 USD PPP)	24.6	(49.1)			
GENERAL GOVERNMENT Per cent of GDP					
Expenditure	36.6	(40.6)	Gross financial debt (OECD: 2018)	30.2	(107.7)
Revenue	38.6	(37.5)	Net financial debt (OECD: 2018)	0.6	(68.0)
EXTERNAL ACCOUNTS					
Exchange rate (BGN per USD)	1.75		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	0.69		Machinery and transport equipment	22.9	
In per cent of GDP			Manufactured goods.	20.1	
Exports of goods and services	63.6	(54.2)	Miscellaneous manufactured articles	13.8	
Imports of goods and services	60.1	(50.6)	Main imports (% of total merchandise imports)		
Current account balance	3.0	(0.4)	Machinery and transport equipment	26.2	
Net international investment position	-30.6		Manufactured goods	16.7	
			Chemicals and related products, n.e.s.	13.9	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate (aged 15 and over, %)	54.2	(57.6)	Unemployment rate, Labour Force Survey (aged 15 and over, %)	4.2	(5.4)
Men	60.5	(65.6)	Youth (aged 15-24, %)	8.9	(11.7)
Women	48.3	(50.0)	Long-term unemployed (1 year and over, %)	2.4	(1.4)
Participation rate (aged 15 and over, %)	56.6	(61.1)	Tertiary educational attainment (aged 25-64, %, 2017, OECD: 2019)***	24.7	(38.0)
Average hours worked per year	1 645	(1 659)	Gross domestic expenditure on R&D (% of GDP, 2018)	0.8	(2.6)
ENVIRONMENT					
Total primary energy supply per capita (toe, 2018, OECD: 2019)	2.6	(4.1)	CO2 emissions from fuel combustion per capita (tonnes, 2018, OECD: 2019)	5.7	(8.3)
Renewables (%, 2018, OECD: 2019)	13.1	(10.8)	Renewable internal freshwater resources per capita (1 000 m³, 2014)	2.9	
Exposure to air pollution (more than 10 µg/m³ of PM 2.5, % of population, 2017)	99.8	(58.7)			
SOCIETY					
Income inequality (Gini coefficient, 2018, OECD: latest)	0.408	(0.316)	Education outcomes (PISA score, 2018)		
Relative poverty rate (%, 2018, OECD: latest)	16.7	(11.7)	Reading	420	(487)
Median disposable household income (000 USD PPP, 2018, OECD: latest)	12.4	(25.4)	Mathematics	436	(489)
Public and private spending (% of GDP)			Science	424	(489)
Health care (2017)	8.1	(8.8)	Share of women in parliament (%)	25.8	(30.7)
Education (% of GNI, 2018)	3.9	(4.5)	Net official development assistance (% of GNI, 2017)	0.1	(0.4)

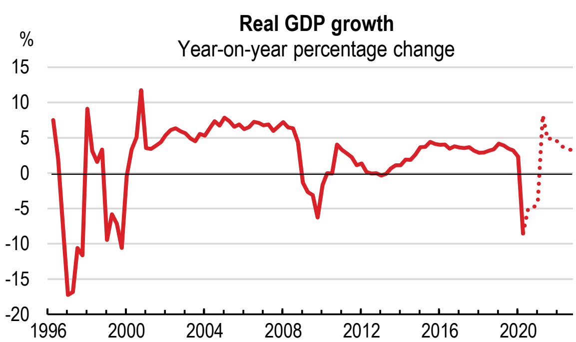
* The year is indicated in parenthesis if it deviates from the year in the main title of this table.
** Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 80% of member countries.
*** For Bulgaria, data refer to aged 25 and over.
Source: Calculations based on data extracted from databases of the following organisations: OECD, International Energy Agency, International Labour Organisation, International Monetary Fund, United Nations and World Bank.

Executive summary

The COVID-19 pandemic has interrupted an impressive progress

An open economy with a large manufacturing sector integrated in global value chains, Bulgaria has made strong income gains in the past two decades. A sound macroeconomic framework and deepening integration with the European Union have allowed progress towards euro area entry. Prior to the pandemic, unemployment had reached historical lows, and wages had grown substantially. Impressive structural reforms were made to boost productivity, increase income convergence and address social challenges. The COVID-19 pandemic has interrupted this progress, with an output fall not seen since the 1996-97 banking crisis (Figure 1).

Figure 1. GDP growth abruptly interrupted



Source: OECD, Economic Outlook 108 database.

StatLink https://stat.link/lyg6hk

Economic activity contracted sharply when confinement measures were first introduced to contain the pandemic. Travel, accommodation and food services suffered a large contraction. Manufacturing is mostly export-oriented and was hit by initial large volume and price declines. The scarring effects of the COVID-19 shock could be long lived. This makes it essential to press on with reforms facilitating the reallocation of factors of production, which is typical after large shocks.

Employment fell, eroding recent gains. Men and youth were affected the most by job losses. While the government's wage subsidy scheme protected a high share of jobs, the recovery of employment will require more active labour market policies. The workforce is ageing and the economy can little afford large-scale withdrawals from labour market participation.

A recovery is underway, but uncertainty is high. The re-opening of businesses and relaxation of containment measures over May-June was accompanied by a recovery of activity that gained momentum in July. Business and consumer confidence began to increase. Industrial production has started to recover though it remains below February 2020 levels. However, service and retail sector activity has been held back by consumer income losses, the rise in precautionary savings and continued restrictions on some activity. A continued high COVID-19 caseload could constrain the normalisation of domestic demand.

A sluggish recovery in the global economy is a downside risk. A highly open economy that is dependent on exports, particularly related to the processing and assembly of foreign inputs into manufacturing export goods, Bulgaria's recovery is vulnerable to further shocks to external demand.

Table 1. The recovery will be gradual

	2019	2020	2021	2022
Gross domestic product	3.7	-4.1	3.3	3.7
Private consumption	5.5	-0.7	2.7	3.1
Gross fixed capital formation	4.5	-8.4	5.8	4.4
Exports	3.9	-10.7	6.0	5.7
Imports	5.2	-9.9	6.1	5.3
Unemployment rate	4.2	6.4	6.1	5.1
Consumer price index	3.1	1.6	1.4	1.8
Current account (% of GDP)	3.0	3.1	2.9	3.1
Fiscal balance (% of GDP)	1.9	-4.4	-4.5	-2.6

Note: CPI data are period averages.
Source: OECD, Economic Outlook 108 database.

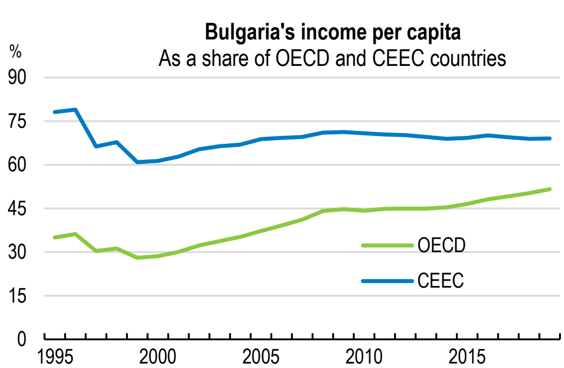
The government has put in place a fiscal stimulus estimated at 3% of GDP. This has reduced job losses, increased the resources for health care and eased financial pressures for the most impacted firms and households. Prudent budget execution prior to the pandemic has provided Bulgaria with ample fiscal space to respond to the crisis. In 2019, a budget surplus was recorded and public debt was lower than in most OECD economies. Fiscal support measures should not be withdrawn prematurely. Increasing investment related to transport infrastructure, energy efficiency, the digital economy and innovation could make for a more robust economic recovery, and are likely to receive substantial resources from the European Union Recovery and Resilience Facility.

Bulgaria is in a strong position to benefit from joining the euro area. Bulgaria joined the European Exchange Rate Mechanism II in July 2020 and the European Central Bank and the Bulgarian National Bank have established cooperation over banking supervision. For over twenty years, it has maintained a currency board with a fixed exchange rate to the euro. Supervision of the financial sector has improved and the sector is well capitalised. Given that the long-term interest rate differential with the euro has fallen to zero, it seems unlikely that euro entry will attract large inflows of speculative funds. The challenge is that wages, which are currently much lower than elsewhere, will rise as Bulgaria converges towards the euro area. To ensure competitiveness and avoid macroeconomic imbalances, labour productivity will have to keep up with real wage pressures.

The business environment needs improving

Boosting income convergence will require ambitious reforms. Several years of robust economic growth has lifted income per capita above half of the OECD average (Figure 2), but productivity had trailed that of faster-converging Central and Eastern European peers. Recovery plans from the pandemic should focus on modernizing the business environment.

Figure 2. Convergence had increased



Note: CEEC is the average of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
Source: World Bank, World Development Indicators database.

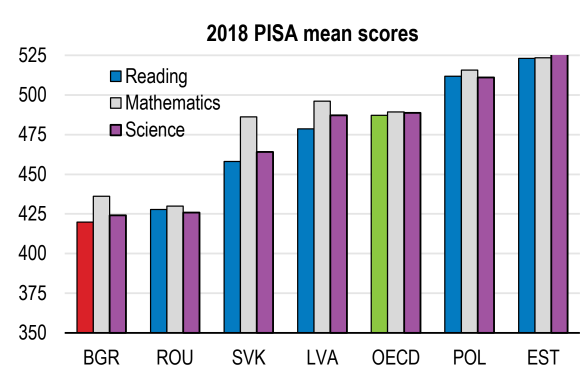
StatLink https://stat.link/xway02

Barriers to competition are high. Reducing regulatory barriers and improving competition policy would stimulate business dynamism and support a more efficient allocation of resources in the economy. Public policies should make sure to level the playing field among different stakeholders, particularly by building on significant action to modernise and improve public procurement in recent years.

Insolvency reform has become all the more pressing. The government has identified gaps in the insolvency framework and has set up a roadmap for reforms. A more rapid and effective bankruptcy framework would help non-viable firms in financial difficulties to shut down and avoid zombie firms from holding back resources and impairing banking system credit. Easing access to firm rehabilitation and debt forgiveness proceedings would allow more businesses that face solvency problems to exercise the option of restructuring their financial obligations with creditors outside of a full formal insolvency process. Like in other countries, measures should be put in place to help firms in financial difficulties due to the pandemic, including out-of-court settlements with creditors.

Skills need to be improved. The effectiveness and provision of education and training throughout the lifecycle should be increased. Poor PISA scores (Figure 3), high dropout rates in secondary education, and the large proportion of NEETs (young people neither in employment nor in education or training) are worrying indicators for a country facing ever-shrinking younger cohorts.

Figure 3. PISA education scores are low



Source: OECD (2019), PISA 2018 Results (Volume I): What Students Know and Can Do.

StatLink https://stat.link/h45xzf

The economy is carbon- and energy-intensive. Coal continues to account for almost half of energy production, though the share of renewables has increased above the OECD average. The potential to improve energy efficiency is large. The COVID-19 recovery presents an opportunity to decarbonise the economy, especially the energy mix and housing stock, which could benefit from abundant EU green funds.

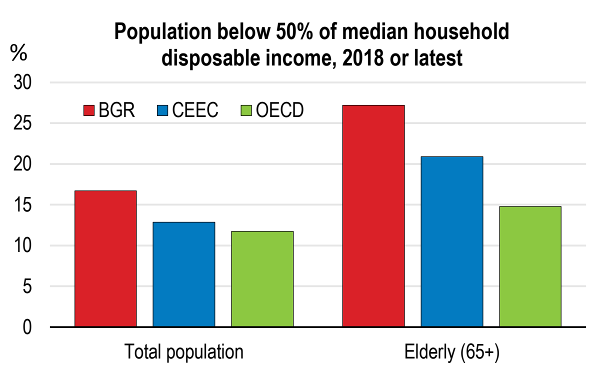
Efforts made to fight corruption and organised crime should continue. Important steps have been taken to reform the judiciary, but more is needed to strengthen accountability and safeguard judicial independence, and to establish a coherent public integrity system.

Reducing poverty and raising regional development require more reforms

The booming economy translated into robust household disposable income growth. However, income inequality exceeds almost all OECD countries. Regions with large cities are driving growth in Bulgaria, while many rural regions suffer from depopulation and rapid ageing.

Poverty remains elevated, particularly among ethnic minorities, the elderly and children, and in rural areas. Cash transfers to protect the most vulnerable from income shocks are low and restricted. The combined average income tax and social contribution rate for lower-wage workers is comparatively high and does little to reduce income inequality.

Figure 4. Relative poverty is high

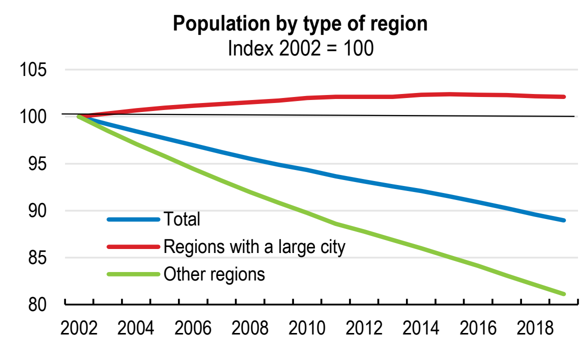


Source: OECD, Income Distribution database.

StatLink https://stat.link/6po4tl

Investments in infrastructure and housing reform would help to boost mobility and strengthen linkages to national and international supply chains. Regional income differences in Bulgaria are larger than in most OECD countries and growth has been lower in regions without larger cities. Increasing the long-term value-added of tourism and agricultural activities can assist in local economic development. Improving living standards for all regions will require better coverage and access to public services, notably in health and long-term care.

Figure 5. Depopulation and urbanisation



Note: A large city has at least 250 000 inhabitants.
Source: Bulgarian National Statistical Institute.

StatLink https://stat.link/2540ik

The Roma, making up one-tenth of Bulgarians, live in socially excluded neighbourhoods. Improving their economic integration is important as the Roma are an increasing share of the working-age population. Most Roma lack proper housing and almost 25% of houses in segregated Roma neighbourhoods remain illegal. Roma face difficulties also in accessing healthcare services and social benefits, and are likely to have weaker education outcomes, often dropping out before finishing school. This is a particular concern among young Roma women.

Health care needs to be strengthened. Hospital capacity is high, but primary care is underdeveloped due to significant gaps in health insurance coverage and large out-of-pocket payments. To address the pandemic, the government made treatment of COVID-19 available to all. Yet, access to health care is restricted in many regions, due to low numbers of general practitioners, which results in frequent hospital visits.

Residential mobility is very low in comparison with OECD countries. While Bulgaria has a high number of dwellings per capita, overcrowding is common and a large share of young adults live with their parents. High homeownership and low affordability are the main obstacles to residential mobility and resolving housing market imbalances. Housing allowances and social housing are underdeveloped. The targeted heating allowance increased substantially in 2019, but is the only support programme of significant size and distorts incentives for energy renovation.

MAIN FINDINGS	KEY RECOMMENDATIONS
Fiscal and financial policy to mitigating the impact of COVID-19	
Bulgaria entered the pandemic in a strong fiscal position and has put in place a fiscal support package during the pandemic.	Extend duration of fiscal support measures to families and firms, and expand them in case of a resurgence of the pandemic. Ensure an effective and rapid use of the available European Union funding to support the recovery. Once the recovery is well underway, move back towards a balanced budget by increasing revenues and improving spending efficiency, and longer term continue ensuring fiscal sustainability.
The 60:40 wage subsidy scheme has protected jobs and household incomes from the impact of the COVID-19 shock.	Establish additional benefit and employment programmes to protect those not covered by the social safety net and help people move to new jobs.
Non-performing loans have been reduced, but remain well above OECD average levels. Deteriorating economic prospects are expected to adversely affect asset quality in view of the potential worsening of the financial situation of firms and households as a result of COVID-19 pandemic.	Deepen liquidity support to firms and households through the financial sector, if warranted.
Improving the business environment and governance for a stronger post-COVID-19 recovery	
Competition in product markets is low, with regulatory barriers to competition that are higher than in nearly all OECD countries.	Put in place the implementing arrangements for the 2019 Law on Public Enterprises for the relevant public agencies, including municipal bodies. Increase the Competition Authority's detection and enforcement of sanctions on cartels and firms abusing monopoly/market dominant positions.
Increasing the availability of skilled workers is a key priority for enterprises. Basic education is not providing a firm foundation for skills The VET system could better respond to labour demand.	Provide universal access for four-year olds to early childhood education. Increase secondary school teacher training for teaching special needs students. Deepen the role of workplace training in vocational education and training provision. Invest more in coverage and quality of active labour market policies.
In spite of significant governance reforms, key integrity and anti-corruption institutions are not forming a coherent public integrity system, resulting in fragmented action and limited impact.	Provide the integrity and anti-corruption institutions with the necessary responsibilities, coordination mechanisms and resources to fulfil their role.
Judicial reform has made substantial progress, but accountability needs further strengthening and judicial independence needs to be safeguarded.	Implement an effective and transparent accountability mechanism for the Prosecutor General in line with international standards. Enhance judicial independence in relation to the probation period in appointing judges and the composition of the Supreme Judicial Council.
Several cases of vested interests between businesses and political elites have been identified in recent years. There is no regulation of lobbying activities and international rankings suggest challenges in ensuring media freedom.	Introduce lobbying regulation, including a code of conduct for the engagement of lobbyists with members of Parliament. Protect the independence of media to ensure the integrity of public decision-making processes.
Whistle-blowing mechanisms and protections are comparatively weak.	Implement the EU whistle-blower Directive and launch a campaign to enhance officials and the public's acceptance of whistle blowing.
Supporting decarbonisation of the economy	
Coal accounts for almost half of energy production and is an important source of high air pollution and greenhouse gas emissions. Pricing of the environmental costs of fossil fuels is uneven across sectors.	Gradually remove support for fossil fuels and align carbon prices for sectors outside of the EU Emissions Trading System (ETS), while protecting poorer households. Support reskilling and relocation of displaced workers in coal regions.
Energy efficiency is lower than in most OECD countries, notably in the residential building sector.	Continue to support housing renovation and improve targeting to low-income groups. Provide information about the benefits of energy saving investments to households.
Promoting regional development and improving inclusiveness	
Transport infrastructure is underdeveloped and lacks maintenance. The number of traffic fatalities is high.	Promote the connection of remote regions to national and international supply chains with investment in transport infrastructure and digital connectivity.
Municipalities have limited opportunities and incentives to collaborate on efficiency-improving service delivery.	Improve the system for inter-municipal co-operation by reducing regulatory barriers and enhancing fiscal incentives for efficiency improvements.
The flat personal income tax of 10% with no basic tax allowance combined with social security contributions places a high tax burden on lower-income households compared to other countries. Nonetheless, potential gains from a reform need to be weighed against the advantages of the current tax system.	Consideration should be given to reducing the tax burden for lower-income individuals in the medium or longer term.

Spending on social protection benefits is comparatively low and benefits are poorly targeted to the lowest income households, reflecting high non-take up combined with limited and ineffective means testing.	Relax entitlement criteria and increase generosity of social benefits. Streamline and simplify multiple and complex means-tested social benefit schemes, notably for families with children.
Up to 14% of the population, and almost half the Roma, lacks health insurance coverage, while out-of-pocket payments, mainly on medicine, are among the highest in the European Union. Hospital capacity is high, while some regions have an acute need for more general practitioners.	Increase effectiveness of public healthcare spending to improve coverage and reduce out-of-pocket payments for low-income and vulnerable groups. Gradually consolidate the hospital sector and shift focus from inpatient to outpatient care.
Roma face a high risk of poverty and social exclusion. Coordination of Roma policies across line ministries is weak and projects are highly dependent on European Union-funding. Many Roma households live in illegal housing and local authorities often resort to demolitions.	Enhance the governance and capacities of the National Council in coordinating policies for integration of Roma and involve all relevant stakeholders. Provide technical, legal and financial support to municipalities and Roma households to resolve property rights.

1 Key Policy Insights

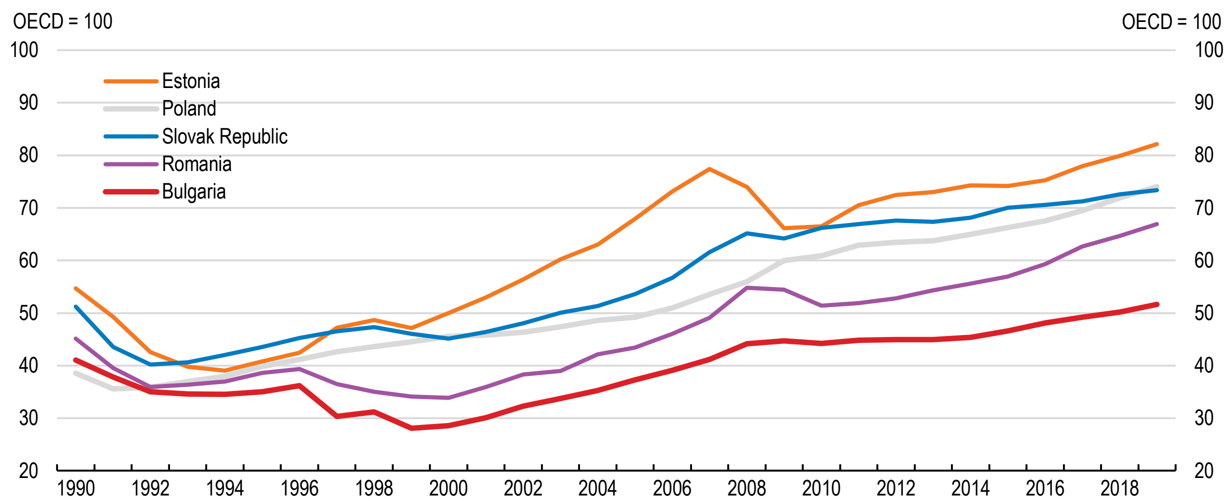
The coronavirus outbreak abruptly stopped several years of robust economic growth, which had lifted income per capita above half of the OECD average. Although cases were fewer and containment measures less severe than in other countries, the economy contracted strongly in the second quarter of 2020. Public finances are sound and the government took rapid action to support firms and households. Coping with the pandemic and strengthening the recovery will require continued fiscal support, public investment and the advancement of priority reforms. Bulgaria also faces the challenge of how to sustain and ultimately enhance improvements in living standards for all to tackle rising inequality and persistently high poverty. Tackling obstacles to business sector growth will be key to attract investment, boost productivity and provide people with skills to take advantage of new job opportunities.

The COVID-19 crisis has hit the economy

The COVID-19 pandemic hit at a time when the Bulgarian economy was performing strongly: economic growth had exceeded 3% annually for five years, real wages had been rising rapidly and unemployment had fallen to historically low rates. Convergence with OECD income levels had accelerated since 2014 (Figure 1.1) and Bulgaria was making sufficient progress in financial sector, insolvency and institutional reforms to gain membership of the European Exchange Rate Mechanism II (ERM II) and the Banking Union in July 2020.

Figure 1.1. Income convergence had increased from 2014

GDP per capita relative to the OECD average, computed at 2017 USD PPP



Source: OECD; World Bank, World Development Indicators database.

StatLink https://stat.link/tomdrv

The booming economy translated into robust household disposable income growth, although the most affluent households benefitted the most and income inequality now exceeds almost all OECD countries. Relative poverty is also higher than in many OECD countries, with particular challenges in health outcomes and housing. Life expectancy remains relatively low, while more than half of the population report low life satisfaction, the highest share in the European Union (EU). Gender equality performance is better, with gaps in labour market participation and wages below the OECD averages.

Bulgaria avoided the worst of the initial COVID-19 outbreak, with a comparatively low number of cases and deaths. The first cases were reported on 8 March 2020 and the country quickly moved to introduce confinement measures on 13 March 2020. The shutdown lasted two months, but was less strict than in hard-hit EU countries. Following the easing of confinement measures, new cases began to increase in July and an upsurge in infections occurred from October. While the country benefits from having a large number of acute care hospital beds, the sharp rise in infections is proving challenging for the health sector. Capacity issues are being reported in some places, perhaps reflecting problems in accessing health care across the country (Chapter 3) and a high prevalence of COVID-19 among medical personal is putting pressure on the system. The positive test rate was very high by November, reaching above 40%, indicating that testing was far too low. The government responded by introducing a comparatively mild set of containment measures at the end of October followed by a closing down of shopping malls, hospitality establishments and stopping physical presences at kindergarten, schools and universities at the end of November.

A sharp drop in economic activity occurred in Bulgaria as the COVID-19 pandemic hit Europe in March 2020. The economic consequences of the pandemic impacted severely service sectors most exposed to disruption from containment measures, especially hospitality and transportation and storage, and had wide implications for the economy given the curtailment of economic activities and a weakening in external demand. The large uptick in cases that began in October has dampened the recovery and if not suppressed could lead to a prolonged negative impact on growth.

The government moved quickly to put in place fiscal measures to support firms and households when it declared a state of emergency in March and has progressively increased and extended support as the enduring impact of the pandemic became clear (Box 1.1). Huge uncertainty surrounds the future course of the virus and, therefore, policy support should not be withdrawn too early. Bulgaria has ample fiscal space to extend the duration of its stimulus package in response to the crisis and to expand the response if required. Poverty and social exclusion remain high and the most vulnerable in the economy will require continued support in the face of such a large income shock.

In their support to the recovery, policymakers will have to balance the need to protect workers and firms and the risk of hindering the reallocation of resources that is always needed after a large shock. Helping workers to find new jobs should prioritise their retraining and upskilling, with a focus on reducing skills mismatches and providing fast-growing sectors with needed talent, for instance Bulgaria's successful digital sector. Improving access to insolvency and rehabilitation for firms impacted by the crisis is also a priority given the slowness of bankruptcy proceedings and lack of debt restructuring options available to viable, but overly indebted, firms. In addition, boosting support to energy conservation and renewable energy would not only hasten the country's decarbonisation, but it would also foster innovation. The country should ensure an effective and rapid use of the substantial European Union funding that is available to support the recovery. Once the recovery is well underway, the country should move back towards a balanced budget through a combination of increased revenues and improved spending efficiency, and longer term, continue to ensure fiscal sustainability

Box 1.1. Fiscal policy responses to the COVID-19 pandemic

The government put in place a comprehensive package of measures designed to protect households and firms and to ensure adequate health and other services are in place to respond to the pandemic. The main policy measures are:

- The 60:40 salary support scheme is the most important tool to support businesses and employees during the crisis. Introduced in March 2020, the government pays 60% of salaries and the employer's social security and healthcare contributions for employees who face being laid off, with employers covering the remaining 40%. The scheme covers companies engaged in retail, transportation, hotels, restaurants and bars, cinemas, tourism operators and trade fair organisers, private education, human health services, cultural activities, sports and other recreational activities. Companies should have experienced a 20% fall in sales in March 2020, compared to the same month of 2019, to be eligible. Firms need to retain all their staff to qualify. It is expected that the scheme will be applied until the end of March 2021. (cost of 0.6% of 2019 GDP in 2020 and 0.3% of 2019 GDP in 2021)
- Additional remuneration costs for staff in the ministries of health, interior and social protection for pandemic-related activities, and expenditures on health, social care, education, tourism and other sectors. The measure is due to remain in place until 2021. (cost of 0.6% of 2019 GDP).
- A monthly pension supplement of BGN 50 (about EUR 25) to all pensioners from August until December 2020 and for the first quarter of 2021. (cost of 0.4% of 2019 GDP in 2020 and 0.3% of 2019 GDP in 2021)
- The standard 20% VAT rate was reduced to 9% on 1 July 2020 for printed and digital books and textbooks, restaurant and catering services (excluding alcohol) as well as food and hygiene products for babies and small children. On 1 August, the reduced rate of 9% was extended to fees for gyms and other sports facilities, tour holidays and wine and beer served in restaurants and cafes. The reduced rates are due to be in place until 31 December 2021. (cost of 0.1% of 2019 GDP in 2020 and 0.2% of 2019 GDP in 2021).
- Deferral of tax return and payments for corporate income taxes and personal income taxes for sole traders from April 2020 until end-June 2020.
- The government has provided liquidity support to firms and households through a capital increase of BGN 700 million (0.6% of 2019 GDP) for the Bulgarian Development Bank. Of this, BGN 500 million is destined for the issuance of portfolio guarantees to commercial banks to allow more flexible conditions for business loans and BGN 200 million to guarantee non-interest consumer loans up to BGN 4500 (about EUR 2300) for employees who have gone on unpaid leave as well as for self-employed. The capital injection is expected to increase the availability of credit to firms and households by up to BGN 2.2 billion (EUR 1.25 billion).

Although Bulgaria was performing strongly before the pandemic, it was nonetheless facing a number of structural changes, which will need to be tackled once the economy recovers from the current crisis. Two key long-term challenges are discussed in this *Economic Assessment*. With an ageing and one of the world's fastest-shrinking population, Bulgaria will need to put a strong emphasis on increasing productivity growth to generate future growth in living standards; productivity would be stimulated by reforms that improve the business environment (Chapter 2). Demographic decline is having a striking impact on rural regions, with large areas suffering from depopulation due to migration and a rapid ageing of remaining inhabitants. Regional income differences are larger than in most OECD countries and they have increased more across regions with differences in access to larger cities. Future recovery plans should ensure that lagging regions are not left behind. Improving their connection to supply chains through better transport and ensuring that there is enough affordable housing, especially in cities, for workers taking up new jobs, will be essential (Chapter 3).

Against this background, the main messages of this *Economic Assessment* are:

- Macroeconomic support should not be withdrawn too early. The government plans to extend COVID-19 response measures to 2021, by continuing support programmes, and providing enhanced social benefits. There is fiscal space to expand further the stimulus package, if needed. Large flows of European Union resources are expected to fund substantial public investment. Like in other countries, future recovery plans should be well targeted, with a focus on measures to modernise the economy, make it more productive, and accelerate its decarbonisation.
- The government should facilitate the reallocation of production factors, which is inherent to post-crisis recoveries. Access to retraining and upskilling will help workers migrate to new jobs and reduce the pervasive problem of skills mismatches. Improving the regimes for insolvency and firm restructuring is also important after a large crisis. Improving competition, fighting corruption, reducing red tape and improving state-owned enterprises (SOE) governance will also help the reallocation of resources across sectors.
- The government's recovery plan should avoid that large groups are left further behind, in particular regions already suffering from ageing, depopulation, and poor connectedness. Policy action is needed to integrate vulnerable populations, such as the Roma, who make up around one-tenth of the population. New approaches to tourism and agriculture provide an opportunity to spur on long-term growth in lagging regions.

The economy requires continued macroeconomic policy support

Hit by considerable economic volatility in the 1990s, the economy stabilised in the 2000s and proved resilient to a number of domestic and external shocks. A Currency Board arrangement has been in place since 1997, with the BGN initially fixed to German mark and subsequently to the euro, following the introduction of the euro as the single currency for the euro area. The Currency Board supported by prudent fiscal policy, has led to a stable exchange rate, low inflation and moderate public debt (Box 1.2). Bulgaria joined the European Union in 2007, the Bulgarian lev was included to ERM II in July 2020, and the European Central Bank (ECB) and the Bulgarian National Bank have established a close cooperation over bank supervision as of 1 October 2020, an important policy goal of the government.

Prior to the COVID-19 pandemic, the economy was growing robustly; employment was high and unemployment was at historical lows. Economic growth had been above 3% since 2015 and convergence with OECD incomes had accelerated (Figure 1.2, Panel A and Panel B). Growth became increasingly driven by domestic demand (Figure 1.2, Panel C) as private consumption grew strongly driven by the rise in employment and the substantial rise in real wages that had occurred due to tight labour market conditions and a large hike in public sector pay (Figure 1.2, Panel D). Consumer and mortgage credit growth has been strong given high wage rises and historically low interest rates. Inflation had begun to moderate due to a deceleration in food prices and lower rises in regulated energy tariffs. The external position remained positive, with the country running continuous current account surpluses over the past seven years. However, export performance had declined, hit by the slowdown in the country's main trading partners.

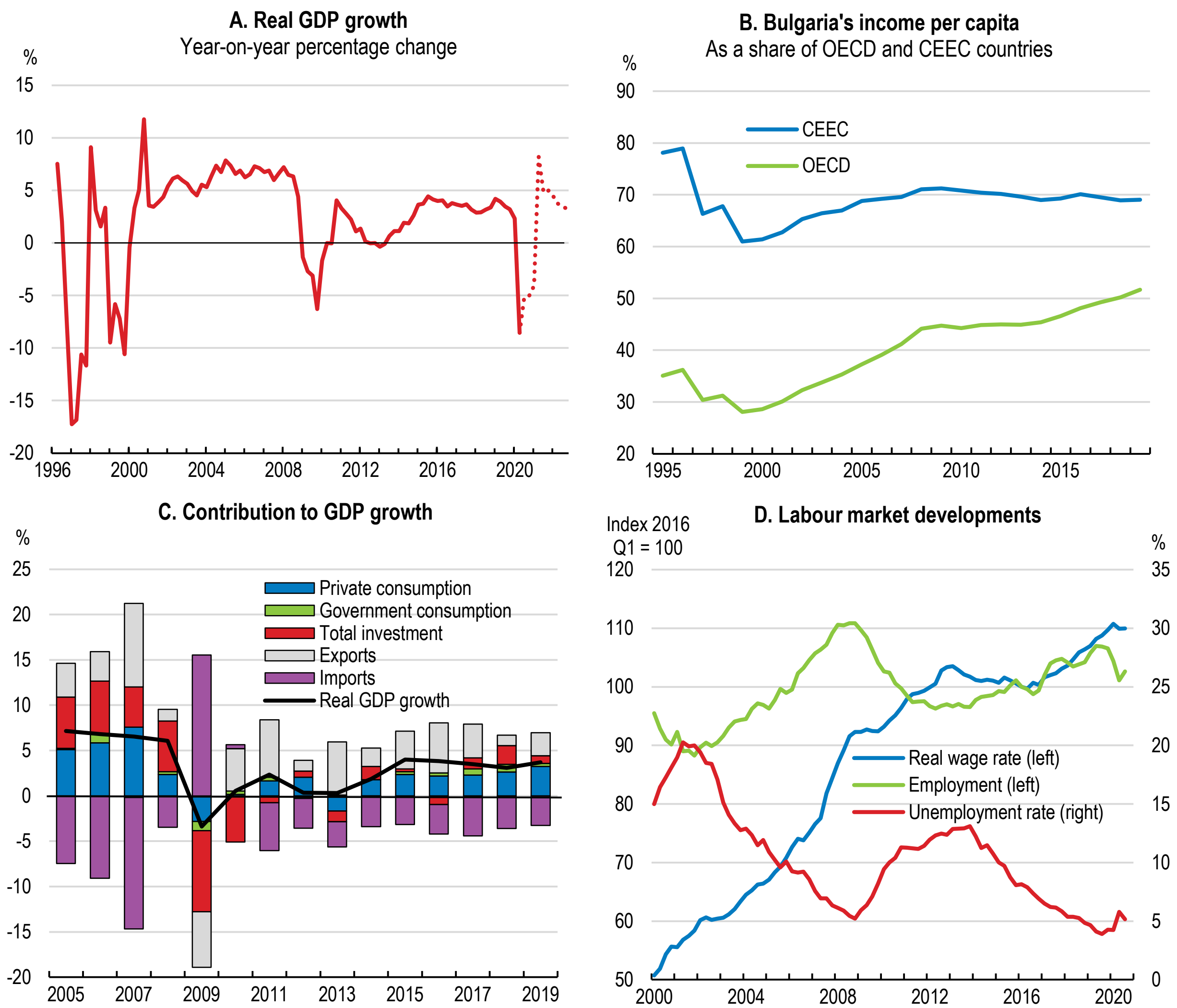
Box 1.2. From the currency board to adopting the euro

The currency board was introduced in 1997 as part of a stabilisation package, following a period of output volatility, macroeconomic imbalances, and very high inflation. Under this arrangement, the central bank holds only foreign assets and commits to buying and selling domestic currency against the reserve currency (the Euro) at the fixed exchange rate. The central bank does not regulate the money supply through open market operations or the extension of domestic credit as it holds no domestic assets. The ability of the central bank to act as lender of last resort to commercial banks is constrained to the excess foreign exchange reserves.

The currency board proved to be a valuable tool. Inflation was quickly reduced and there was a sharp fall in interest rates following its introduction. The government has generally maintained a fiscal surplus and gross public debt has decreased from 63% to 30% of GDP over 2000-2019. There was no deviation from the fixed exchange rate and the currency board has weathered a series of external and domestic shocks. The Bulgarian Lev was included in the European Exchange Rate Mechanism (ERM II) in July 2020, and, as of 1 October 2020, Bulgaria joined the Banking Union following the implementation of reforms to strengthen financial sector supervision and the macroprudential framework, and to improve the legal frameworks for the governance of state-owned enterprises and anti-money laundering. The central rate of the BGN is set as the rate fixed by the currency board, with a standard fluctuation band of plus or minus 15 percent. Bulgaria has chosen to join ERM II with its existing currency board arrangement remaining in place, as a unilateral commitment, implying no additional obligations on behalf of the European Central Bank.

Preparations for euro area entry will entail continued implementation of institutional reforms, including putting in place a new insolvency framework, as well as maintaining sound economic policies. Real wage and price pressures are likely to re-emerge following the recovery from the COVID-19 crisis given the large differentials in incomes and the price level between Bulgaria and the euro area. To make the convergence process sustainable, increasing productivity, particularly in the non-tradeable sector will therefore be of paramount importance for Bulgaria.

Figure 1.2. The economy was doing well before the COVID-19 pandemic



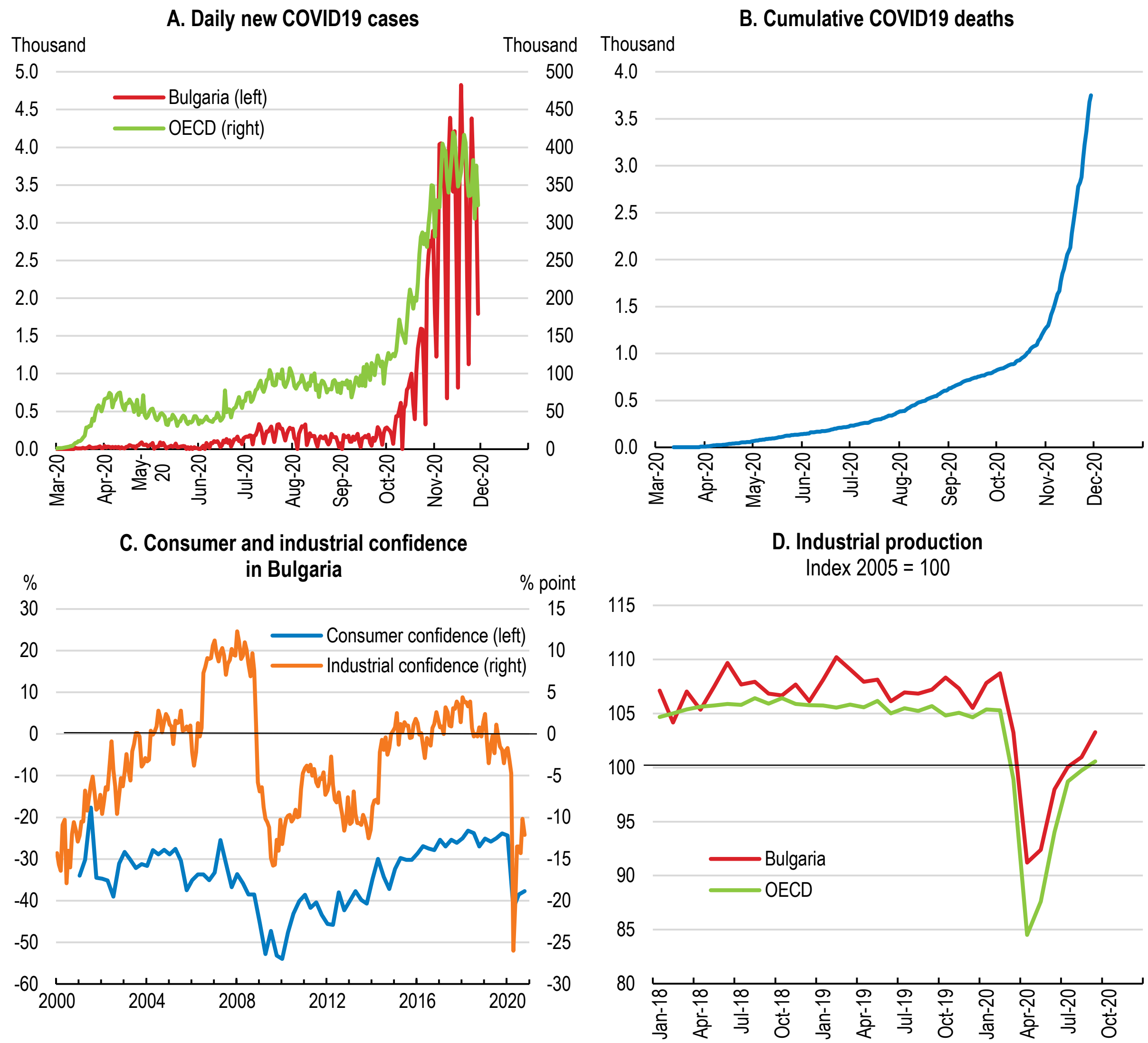
Note: Panel C: total investment also includes changes in stocks. Panel D: employment and unemployment rate refer to the 15-64 age group.
Source: OECD, Economic Outlook 108 database; World Bank, World Development Indicators database.

StatLink https://stat.link/krs7gt

The initial COVID-19 pandemic outbreak was more limited in Bulgaria than in most OECD countries, but a large increase in cases began in October 2020. In the first half of 2020, the number of confirmed cases was lower than in many OECD countries (Figure 1.3, Panel A) and there was a low number of deaths (Figure 1.3, Panel B). However, an upsurge in new cases began in October, deaths began to rise and the health system came under pressure. A relatively mild set of measures, compared to similarly affected European countries, was put in place at the end of October to combat the spread of the pandemic, and subsequently, strengthened at the end of November.

Confinement measures began to affect the economy in March 2020, with the economy contracting by 10% in the second quarter of 2020, as domestic and external demand were badly hit – a contraction not matched since the worst quarter decline during the 1996-97 crisis in Bulgaria (Figure 1.2, Panel A). Household consumption suffered not only due to restrictions on economic activity, but also as labour market conditions deteriorated and uncertainty rose. Deteriorating labour market conditions were eased by the large-scale wage subsidy support programme (Box 1.1). Employment fell by 1.5% between end-2019 and the third quarter of 2020, while unemployment rose from 4.3% in fourth quarter of 2019 to 4.8% in the third quarter of 2020 (Figure 1.2, Panel D). Inflation fell, driven by the fall in international energy prices, the slowdown in core inflation and the cut in regulated natural gas and heating prices.

Figure 1.3. After a low initial outbreak, COVID-19 infections began to increase in October 2020



Source: OECD, Main Economic Indicators database; CEIC; https://ourworldindata.org/coronavirus-source-data.

StatLink https://stat.link/3g5wku

Service activity fell by 10% in April 2020 compared to the previous month. Manufacturing activity, mainly oriented at export markets, declined across the board in April and May, with the exception of some niche subsectors, such as pharmaceuticals. Declining industrial turnover occurred due to both lower volumes and prices. Exports were hit hard by the fall in production and external demand, but the decrease in imports was larger in the first seven months of the year, narrowing the trade deficit. Private investment fell sharply as enterprises dealt with an abrupt decline in activity and a high degree of uncertainty. This was somewhat compensated for by the increase in public investment fuelled by EU funds.

Considerable uncertainty surrounds the recovery

A recovery is underway, but its path remains highly uncertain given the rise in COVID-19 infections and the revival in confidence remains vulnerable. The re-opening of businesses and the relaxation of containment measures was accompanied by a recovery of activity that took on momentum in July 2020. Business confidence sharply increased in June and consumer confidence also started to rebound, even though the fear of unemployment went up (Figure 1.3, Panel C). Industrial production increased, though it remains below February 2020 levels (Figure 1.3, Panel D). Service sector activity, particularly restaurant and accommodation activity, likely will be slow to rebound substantially until the pandemic eases. The economy had contracted by 5.2% by the third quarter of 2020 compared to the same quarter in 2019 based on seasonally adjusted data, a contraction slightly higher than the European Union average of 4.3%. The decline in activity was driven by a fall in the investment and exports, with private consumption contracting by less than in many European Countries given the milder initial pandemic and containment measures.

A recovery is underway, but its path remains uncertain, particularly given the current large rise in COVID-19 infections. The economy is expected to shrink by 4.1% in 2020 (Table 1.1), but is projected to recover to its pre-crisis level in 2022. Fiscal support will determine the strength of the recovery, with a large shift from pre-crisis fiscal surpluses to projected deficits of about 4% of GDP in 2020 and 2021. The surging pandemic will weigh on business confidence and private investment, and sporadic outbreaks will hold down growth until vaccination against the virus becomes general. Strong public investment, financed by European Union resources, will then drive the revival of investment. Trade is set to recover gradually, contributing positively to growth in 2021 and 2022. The prolongation and deepening of containment measures is a significant downside risk that would constrain the normalisation of domestic demand.

Table 1.1. Macroeconomic indicators and projections

	2017	2018	2019	2020	2021	2022
	Current prices BGN billion	Percentage changes, volume (2015 prices)				
GDP at market prices	102.3	3.1	3.7	-4.1	3.3	3.7
Private consumption	61.6	4.4	5.5	-0.7	2.7	3.1
Government consumption	16.0	5.3	2.0	4.1	3.7	3.0
Gross fixed capital formation	18.8	5.4	4.5	-8.4	5.8	4.4
Final domestic demand	96.4	4.8	4.6	-1.4	3.5	3.4
Stockbuilding[1]	1.6	1.1	0.0	-2.6	-0.3	0.0
Total domestic demand	97.9	5.8	4.6	-4.2	3.1	3.4
Exports of goods and services	68.9	1.7	3.9	-10.7	6.0	5.7
Imports of goods and services	64.4	5.7	5.2	-9.9	6.1	5.3
Net exports[1]	4.4	-2.5	-0.7	-0.8	0.2	0.5
Memorandum items						
GDP deflator	-	4.0	5.3	1.6	1.5	1.9
Consumer price index[2]	-	2.8	3.1	1.6	1.4	1.8
Core consumer price index[2]	-	2.1	1.8	1.2	1.4	1.8
Unemployment rate (% of labour force)	-	5.2	4.2	6.4	6.1	5.1
Household saving ratio, net (% of disposable income)	-	1.2	1.0	1.6	-2.6	-4.3
General government financial balance (% of GDP)	-	2.0	1.9	-4.4	-4.5	-2.6
General government gross debt (% of GDP)[3]	-	31.8	29.9	34.4	38.6	40.7
General government debt, Maastricht definition (% of GDP)	-	22.3	20.2	24.6	28.9	31.0
Current account balance (% of GDP)	-	1.0	3.0	3.1	2.9	3.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Period averages, the core consumer price index excludes food and energy.
3. Consolidated gross financial liabilities of the general government sector.
Source: OECD Economic Outlook 108 database.

The global economy faces an uncertain outlook, its recovery depending on the size and length of new COVID-19 outbreaks, the extent of containment measures put in place, the time it takes to provide vaccines and/or attain more effective treatments (OECD, 2020a). The main downside risks facing the economy are a protracted global slowdown due to COVID-19 and a continued high COVID-19 caseload that would constrain the normalisation of domestic demand. Aside from these bigger risks facing the economy, there are additional potential vulnerabilities, with low probabilities, that could have large implications for the economy (Table 1.2).

Table 1.2. Low probability vulnerabilities

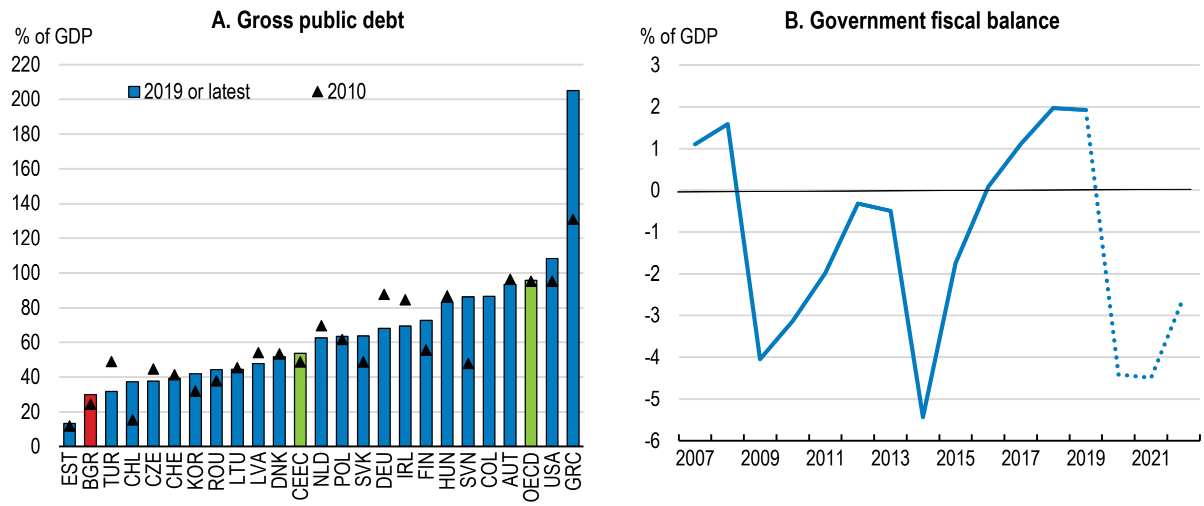
Shock	Possible impact
Health pandemics	The coronavirus outbreak stressed the risks and economic costs from future pandemics. Even if Bulgaria would contain a new outbreak, the shock to tourism and supply chains could be huge.
Political instability	Absent a resolution, the current political conflict and social unrests could lead to a prolonged period of political instability and pause the structural reform agenda.
Disruptions to international trade due to a growth in regional and global trade tensions	A small, open economy, which is deeply integrated in global values chains, Bulgaria would suffer from a decrease in trade due to increased tensions.
An extreme natural disaster	Areas of the country are vulnerable to earthquakes, flooding and forest fires. A severe natural disaster would require large disaster relief, putting pressure on government finances, and could negatively impact on regional long-term growth.

Fiscal space permits a large pandemic response

Bulgaria has reduced its vulnerability to shocks through prudent fiscal policy that has decreased public debt significantly and minimised sovereign financing risks. Fiscal rules put in place from the early 2000s onwards restricted deficits and brought down public debt. In addition to complying with the limits set by EU's Growth and Stability Pact, with the latest amendments in the Public Finance Act the country has a deficit ceiling of 3% of GDP for the cash-based deficit under the consolidated fiscal programme and an expenditure ceiling of 40% of GDP for spending under the consolidated fiscal programme excluding expenditures made from EU funds accounts as well as expenditures under other international programmes and treaties with a regime of EU funds accounts and the national co-financing related to them. Gross public debt fell from 63% to 30% of GDP over 2000-2019; only one OECD country has lower public debt levels (Figure 1.4, Panel A). The country entered the COVID-19 pandemic in a strong fiscal position, having run a general government surplus of 2% of GDP in 2019 (Figure 1.4, Panel B). Fiscal reserves provide an additional buffer and stood at EUR 7 billion or 11% of GDP at end-September 2020 based on Ministry of Finance data.

The government's fiscal support in response to COVID-19 was rapidly enacted: measures to protect households and firms were introduced in March 2020, subsequently increased in summer 2020 and extended into 2021 in November 2020 (Box 1.1). The budgetary constraints established by fiscal rules at the EU level have been lifted for all countries to allow them to respond to the pandemic. Financing for the overall stimulus package, which is estimated to have a budget cost of about 3% of GDP in 2020 and 2.5% of GDP in 2021, has come from national and EU resources. A fiscal deficit of about 4% of GDP is expected in both 2020 and 2021. The government intends to avoid removing temporary support too quickly.

Figure 1.4. Sound public finances leave room for fiscal stimulus



Source: OECD, Economic Outlook 108 database.

StatLink https://stat.link/4c5n9e

Bulgaria is set to receive substantial support from EU funds. Resources from the EU are expected to total EUR 24.1 billion or 39% of 2019 GDP over 2021-2027. Under the Multiannual Financial Framework, Bulgaria is expected to receive EUR 16.6 billion or 27% of 2019 GDP, with the biggest components being resources for Cohesion Policy and the Common Agricultural Policy. The new recovery instrument NextGenerationEU is expected to provide an additional EUR 7.5 billion in grants, with further potential lending of EUR 4.5 billion. Of this, the European Union Recovery and Resilience Facility is to provide resources of about 10% of pre-crisis GDP. A draft national plan has been drawn up for using the Recovery and Resilience Facility resources and is due to be submitted to the European Commission following public consultations. The draft plan foresees a substantial amount of resources going to make the economy greener, large investments in innovation and regional connectivity, such as improving transport and digital connectivity, and substantial assistance to increase the inclusion of disadvantaged groups and individuals in the economy.

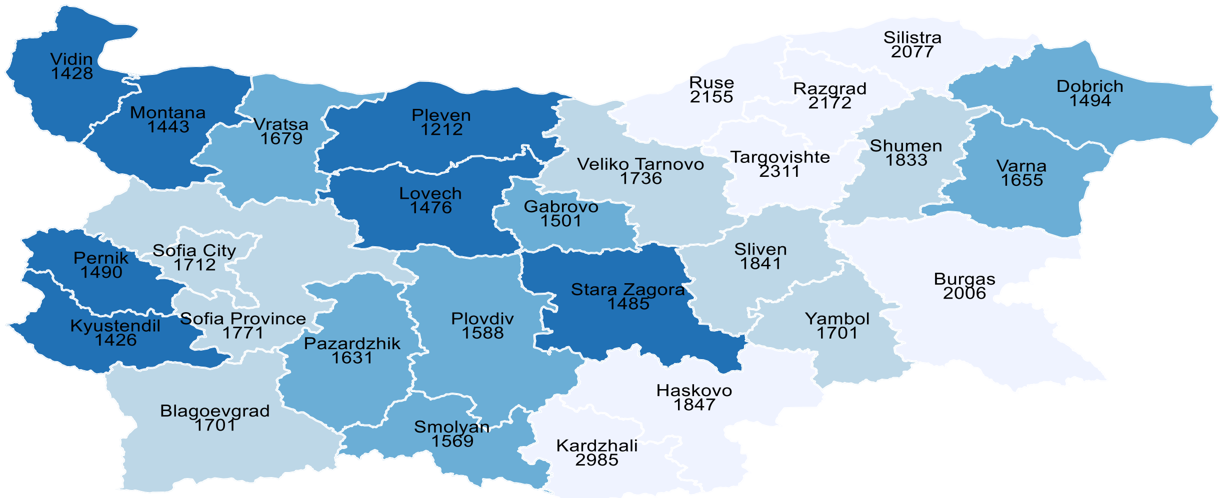
Ensuring access to health care is a priority during the pandemic

Spending on health is relatively low and further funding may be necessary to deal with the pandemic as it unfolds. Increased health and related sector spending (0.6% of 2019 GDP) has allowed the government to extend free access to primary care services related to COVID-19, introduced early on during the pandemic. Supporting the population to access COVID-19 related health services is important given that out-of-pocket payments are high, accounting for almost 40% of current healthcare expenditures in 2018, among the highest shares in the EU (Chapter 3).

Accessing primary care can be difficult, with a low number of general practitioners, particularly in rural areas. The population per general practitioner varies from almost 3 000 in the southern Kardzhali region to 1 200 in Pleven (Figure 1.5). General practitioners play an important role in managing COVID-19, given that it is either they or an emergency care unit that has to prescribe a test for the state budget to cover it. The lack of primary care carries with it the risk that those impacted by COVID-19 may go straight to emergency facilities, a concern should the number of cases increase substantially. During the first wave, the health system was able to cope with a comparatively low number of hospitalisations. Hospital capacity is high, with 7.6 beds per 1 000 population, well above the OECD average of 4.7. However, several hospitals came under pressure as the number of cases increases rapidly during the second wave of the pandemic.

Figure 1.5. Access to general practitioners is unequal across regions

Population per general practitioner, 2019



Source: OECD calculations based on Bulgarian National Statistical Institute.

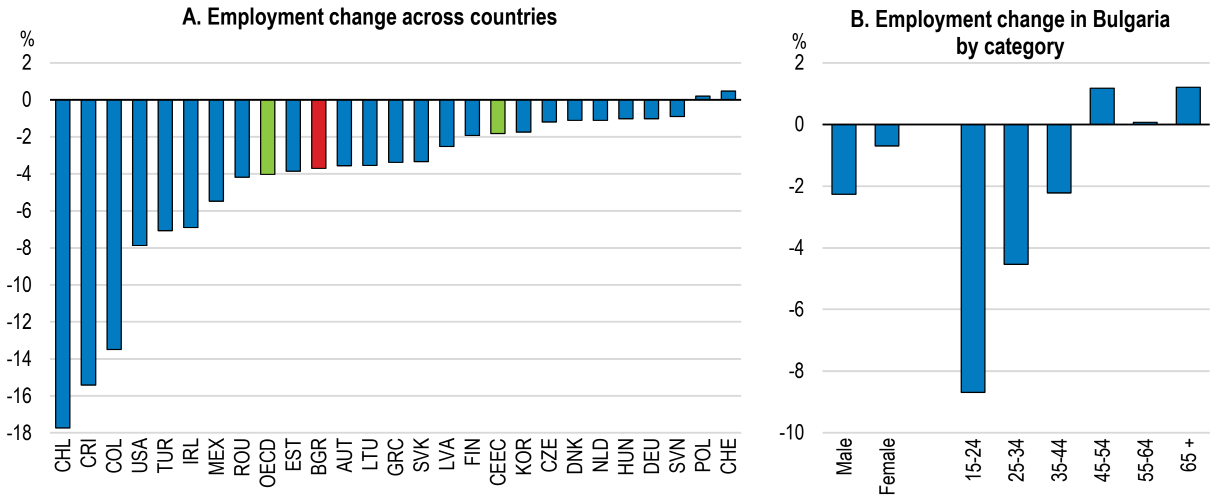
A wage subsidy scheme has prevented a large rise in unemployment

The government's wage subsidy scheme (Box 1.1) has prevented a much sharper rise in unemployment and a larger deterioration in household incomes, while supporting the most impacted firms with their costs. It protected 7% of workplaces in 2020 Q2. The programme is due to be applied until the end of March 2021. For the tourism industry, the compensation rate was increased to 80% (Chapter 3).

Employment of men and youth has been hit hardest by the economic contraction. Employment of 15 to 64 year olds fell by 1.5% by the third quarter of 2020 compared to the last quarter 2019. The fall in employment is on the lower side compared to OECD countries (Figure 1.6, Panel A). In contrast to many other OECD countries, men's employment has fallen by more than that of women between the last quarter of 2019 and the third quarter of 2020 (Figure 1.6, Panel B). As with many OECD countries, youth are losing out: the employment of those aged 15-24 has fallen by more than five times the national average (Figure 1.6, Panel B).

Figure 1.6. Employment situation of the young most negatively affected

Percentage change between 2019 Q4 and 2020 Q3



Note: 2020 Q3 data for Austria, Denmark, Greece, Ireland, Mexico, Romania, Slovak Republic, Turkey and CEEC are estimates.
Source: OECD, Economic Outlook database; National Statistical Institute.

StatLink https://stat.link/h3eqrm

The pattern of informality in the economy limits the income replacement rate of the 60:40 wage subsidy scheme for many workers. Informal employment is mainly due to an additional payment not included in a worker's contract on which taxes, health and social insurance contributions is not paid ("envelope wages" or "under declared work") (Box 1.3). Many workers in the hard-hit sectors are reported as earning only the minimum wage, despite usually receiving top-up payments and thus now have to survive on lower incomes. This presents a dilemma for policymakers. It is important to offer appropriate protection, but a strong incentive for formality in Bulgaria is the link between the amount of social contributions paid and the benefits received.

The discretionary 60:40 wage subsidy scheme is critical for the protection of the population given that there are limited automatic schemes that kick in for those who suffer income loss in downturns. The size of automatic income stabilisation has been found to be the lowest in the EU (European Commission, 2017). Many do not qualify for unemployment schemes; means-tested benefits are low with a small share of the population benefitting. There is a high risk of poverty in the economy and so the retention of some type of discretionary scheme will be important, particularly to protect low-income households.

Across OECD countries, direct and indirect support for wage costs has been the key intervention to provide liquidity support to firms. If demand takes a long time to re-emerge in some hard-hit sectors, the challenge will be for policy to strike the right balance between supporting viable jobs and enterprises and not inhibiting re-allocation of workers into new jobs.

Box 1.3. The informal economy is sizeable

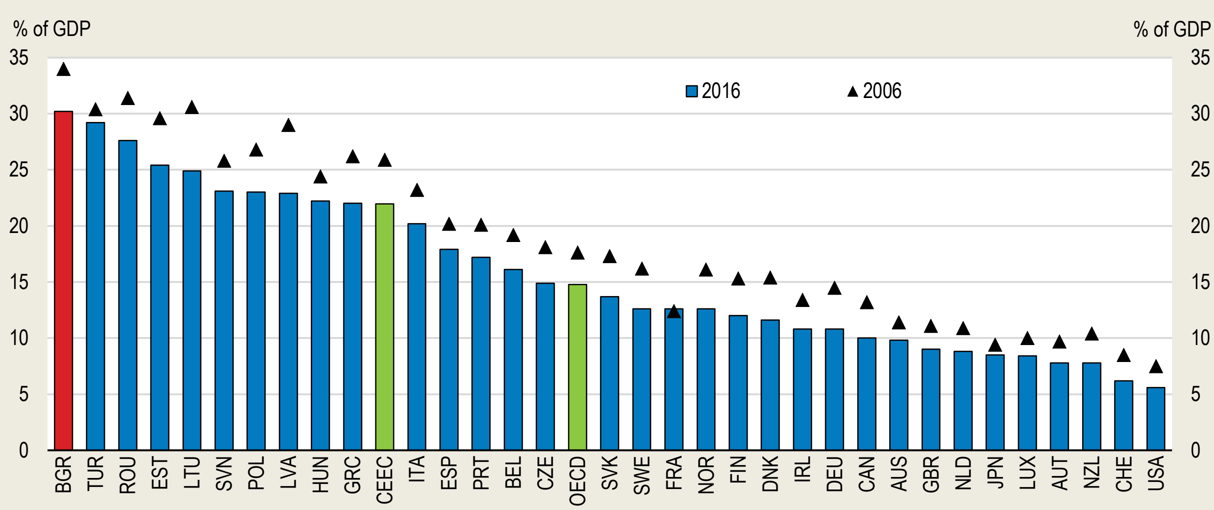
Bulgaria has a large informal economy compared to most OECD countries (Figure 1.7). Still, informal activity has declined over time and the degree of informality is in line with the country's level of development (Medina and Schneider, 2017).

The pattern of labour informality differs from other EU countries in that the incidence of partly undeclared (envelope) wages is high, while working without a contract is rare according to surveys. Only 1% of workers reported being employed without a formal written contract in 2019, among the lowest shares in the EU (European Commission, 2020a). By contrast, Bulgaria stands out with only 80% of employees denying receiving undeclared cash payments, well below the EU average of 95%. In another survey, almost 15% of employees reported receiving an envelope wage with the mean amount undeclared composing 30% of their net income (Williams and Yang, 2017). Moreover, in nearly one third of cases, the employee took an active role in initiating the illegal practice.

Undeclared work is more commonly reported in more labour intensive, lower skilled sectors. Workers admitting to carry out under declared work are in construction (35%), agriculture (17%), retail or repair services (13%) and personal services (13%) (European Commission, 2020a). While no information was available for the hospitality sector, a sizeable share of undeclared work is likely, notably in seasonal tourism jobs. For agriculture, an amendment to the labour code in 2015 to permit a daily labour contract for seasonal work resulted in a large increase in registered workers.

Figure 1.7. The informal economy amounts to almost one-third of (official) GDP

Estimated size of the informal economy



Source: Schneider, F. (2016), "Estimating the Size of the Shadow Economies of Highly-developed Countries: Selected New Results", CESifo DICE Report, ifo Institut - Leibniz-Institut für Wirtschaftsforschung an der Universität München, München, Vol. 14, No. 4, pp. 44-53, https://www.econstor.eu/handle/10419/167285.

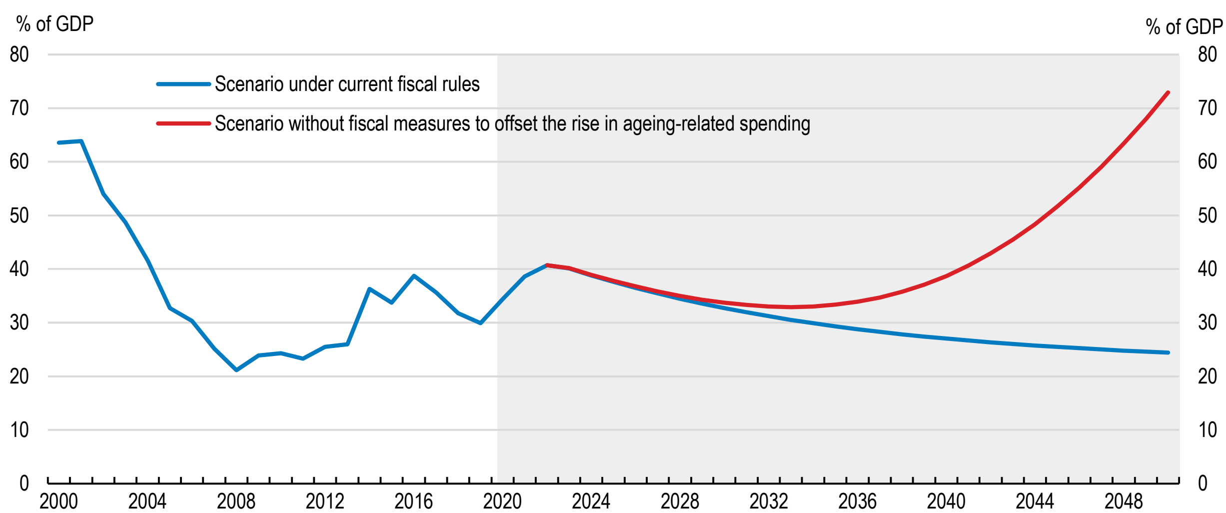
StatLink https://stat.link/q3x9fl

Long-term public finances are sound but subject to uncertainties from ageing

Public debt is projected to remain low in the medium-term despite the sizable fiscal response to COVID-19, though rising ageing costs are likely to lead to higher spending pressures going forward. Lower output and fiscal deficits of 4% of GDP in 2020 and 2021 lead to a rise in public debt. The projections incorporate an increase over time in pension and healthcare spending due to ageing and a rise in the demand for public services based on the OECD long-term model (Guillemette et al., 2017). In the scenario showing the debt trajectory under current fiscal rules, the ageing-related spending rise is offset by revenue increases and/or spending reduction measures. Under this scenario, the structural primary deficit is projected to be eliminated by 2024 and gross government debt is then expected to follow a declining path (Figure 1.8). To illustrate the large potential impact of ageing-related spending pressures, a scenario is included showing the effect of an increase in ageing-related spending occurring without compensating increases in revenues and/or expenditure savings. This would push the public debt trajectory higher. A large degree of uncertainty must be attached to any long-term simulations at this point in the pandemic and so the long-term debt path is subject to risks. Certain public monopolies or SOEs established by a special law are legally protected from insolvency and so their liability is a contingent liability to the state (OECD, 2019a). The aggregate debt of SOEs was 13% of GDP in 2016 (OECD, 2019a).

Figure 1.8. Ageing-related spending pressures could push up public debt

Gross government debt



Note: The projections incorporate actual outcomes until 2019, OECD projections until 2022 and from 2023 are based on the OECD long-term model estimates (Guillemette et al., 2017). Ageing-related costs for pensions and health care are expected to rise in both scenarios. The difference between the two scenarios is that in the scenario simulating the public debt path, “under current fiscal rules” assumes that offsetting revenue increases and/or spending reduction measures are put in place to compensate for the rise in expenditures due to ageing.
Source: OECD calculations based on OECD Economic Outlook 108 database.

StatLink https://stat.link/4kcel8

Population ageing is likely to pose a large longer-term fiscal challenge. Despite having a population that is rapidly growing older, Bulgaria is projected to remain at the lower end of ageing spenders under the latest EU ageing fiscal cost projections (European Commission, 2018a). However, greater spending pressures are likely to emerge than projected in the EU ageing exercise for long-term care, health and pensions.

Long-term care services are provided informally, often by family members, and formal provision is low (Chapter 3; European Commission, 2018a). Long-term care is excluded currently from the health benefits' package. Spending on long-term care is not projected to rise much above the current 0.4% of GDP in the

EU ageing scenario, which remains well below the EU average of 1.6% in 2016. Pressure to increase the public provision and financing of long-term care services may grow by more than expected in coming decades as the country becomes richer and the opportunity cost in terms of foregone formal employment increases for the large proportion of female informal carers. In addition, the costs of providing long-term care services may increase towards those of the EU average as living standards increase in Bulgaria.

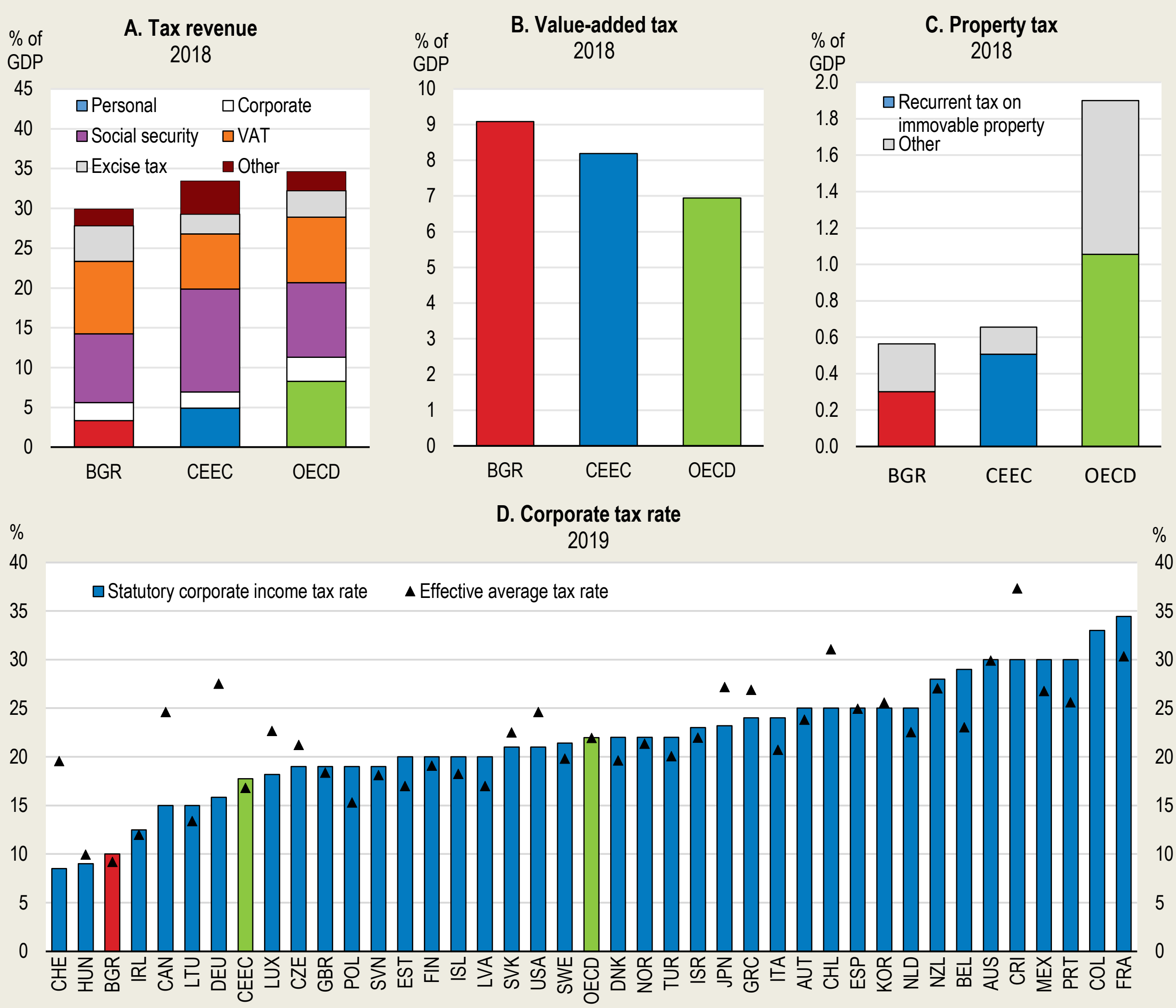
Pension spending will face additional pressures as an increasing share of the population reaches retirement age in the coming decades. The three-pillar pension system consists of a pay-as-you-go, statutory state pension, a mandatory supplementary scheme based on individual retirement savings accounts, and supplementary voluntary pension insurance, funded personal and occupational schemes. The statutory pension age is 61 years and six months for women and 64 years and three months for men in 2020. A pension reform in 2015 increased the contribution rate and determined the statutory retirement ages for men and women to gradually rise and equalise to 65 years of age by 2037. The increase in the retirement age put in place in 2015 was more gradual than the 2011 reform it replaced. The retirement age is due to be linked to increases in life expectancy after it reaches 65 in 2037. Participants under the second pillar were given the possibility under the reform to opt out and transfer their individual savings from management by private pension funds to the State Pension Fund (first pillar). Given that the ageing population and shrinking workforce are set to result in a growing social security deficit, a faster equalisation of the male and female retirement age, an immediate linkage of the retirement age and life expectancy rises, and further reforms, such as rises in contribution rates, would increase the sustainability of the pension system.

The difficult circumstances faced by many older people due to low incomes could increase social pressures to increase the adequacy of retirement incomes. Total public pension benefits compared to the last average wage earned, i.e. the replacement rate, are relatively low at 29% compared to 43% on average in the EU in 2016 (European Commission, 2018a). Current pension benefits are insufficient to protect the population from poverty. Nearly half of those over 65 years of age are at risk of poverty or social exclusion and a high share live in households that suffer from severe material deprivation. The government has made efforts to increase the basic pension to raise living standards for the most vulnerable old-age groups in recent years (European Commission, 2018b). However, pension rises have lagged behind the high wage increases seen in recent years given that indexation is based on 50% of the increase in the consumer price index and 50% of insurable income growth. A return to strong wage growth as the economy recovers from COVID-19 would further increase the gap between the incomes of the most vulnerable pensioners and the average worker. The EU ageing baseline projections assume that the benefit ratio will decrease over time, i.e. that pensions will fall relative to the average wage. However, given that a large share of the population faces low incomes on retiring, pressure is likely to mount to increase the living standards of the growing older population.

Box 1.4. Composition of government revenues

Tax pressure is relatively low compared to the OECD and EU, with a tax-to-GDP ratio of 30% in 2018 (Figure 1.9, Panel A). Indirect taxes such as VAT and excise taxes contribute more to tax revenues than on average in the OECD (Figure 1.9, Panels A and B). Taxes from income and property are relatively low (Figure 1.9, Panels A and C). A flat tax of 10% on personal and corporate incomes was put in place in 2008. It puts Bulgaria among the most competitive corporate tax regimes (Figure 1.9, Panel D), but results in much lower corporate tax revenues that on average in the OECD. The flat tax combined with having no personal allowances available to reduce taxable income results in a lack of progressivity in income taxes. In its Medium-term Budget Framework, the government has committed to continuing to reduce tax fraud and evasion, an important priority given growing spending needs.

Figure 1.9. Revenues are low and rely on indirect taxation



Note: CEEC is an unweighted average of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.
Source: OECD, Global Revenue Statistics and Corporate Tax Statistics databases.

StatLink https://stat.link/7hlcdn

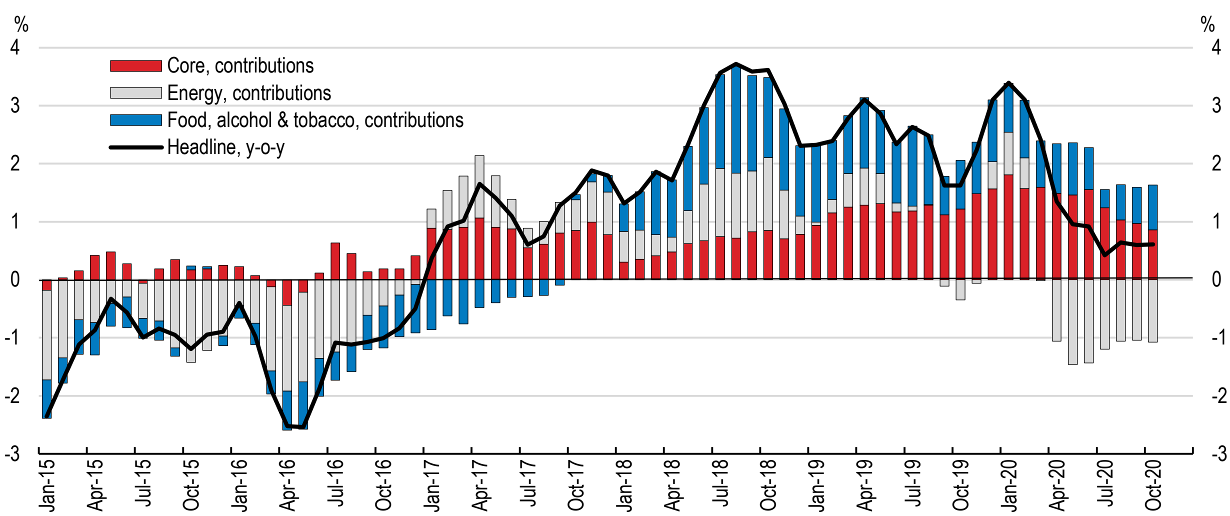
The currency board is a cornerstone for macroeconomic stability

A currency board arrangement, put in place in July 1997 in the aftermath of the banking crisis and period of very high inflation, fixes the national currency to the euro. Backed by prudent fiscal policy and low public debt, it has endured several crisis and proved to be an important anchor for macroeconomic stability. The Bulgarian lev was included in the European Exchange Rate Mechanism II (ERM II) in July 2020 and the ECB and the Bulgarian National Bank have established a close cooperation over bank supervision. By mutual agreement, the finance ministers of the euro area countries, the President of the ECB, and the finance ministers and central bank governors of Denmark, Bulgaria and Croatia decided to include the Bulgarian lev in ERM II. The Bulgarian National Bank unilaterally commits to keep in place its currency board arrangement without imposing any additional obligations on the ECB or the other participants in the mechanism.

Prior to COVID-19, inflationary pressures had emerged from strong domestic demand driven by high real wage growth, and hikes in the prices of food and services. Price dynamics for inflation have been volatile in recent years driven by energy and food prices (Figure 1.10). Core inflation has tended to be below headline values in recent years, even though the gap between the two measures was narrowing as energy prices fell. Annual inflation has moderated from 3.4% at the beginning of 2020 to 0.6% in October 2020, driven not only by the fall in international energy prices, but also by the slowdown in core inflation and the cut in regulated natural gas and heating prices.

Figure 1.10. Inflation was stabilising prior to the COVID-19 shock

Harmonised index of consumer price



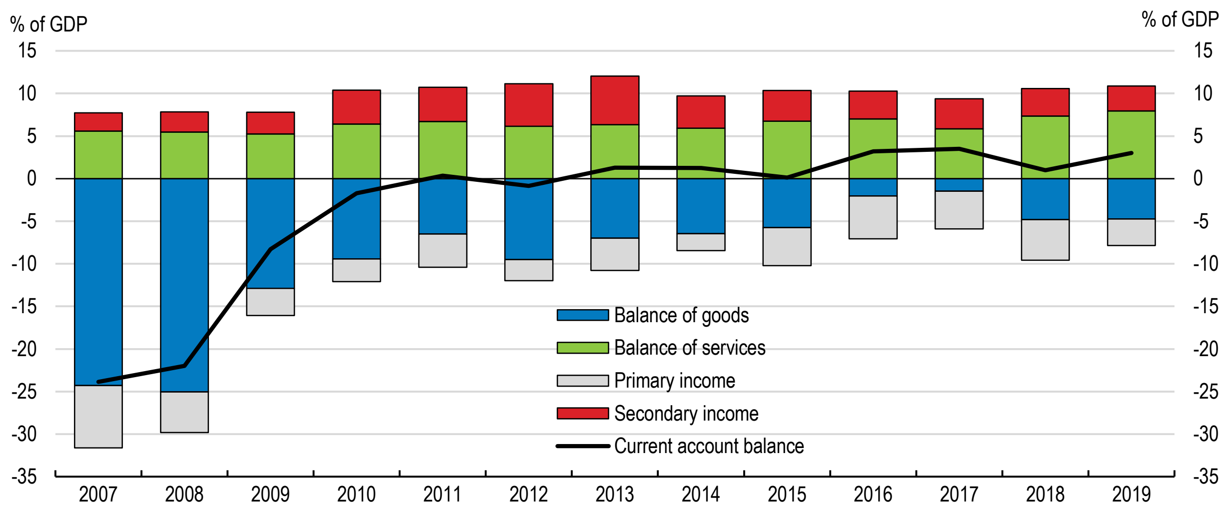
Source: Eurostat.

StatLink https://stat.link/bcfzh5

The recovery from COVID-19 is likely to bring renewed price pressures resulting in higher inflation than the euro area given that income per capita and price levels are substantially lower in Bulgaria. The monetary inflexibility implied by the currency board will require continued prudent fiscal and sound macro prudential policies. To avoid the accumulation of excessive price pressures and macroeconomic imbalances, appropriate structural reforms will be needed to boost productivity convergence (Chapter 2) and ensure wage growth is matched by productivity improvements, particularly for non-tradable goods.

The economy has been running current account surpluses for nearly ten years. The current and capital account position of the country has substantially improved in the last decade. A reduction in the trade deficit helped drive current account surpluses based on export-led growth and constrained import demand in the recovery year following the 2008 global financial crisis. Current account surpluses of 1% and 3% of GDP were recorded in 2018 and 2019, respectively (Figure 1.11). At the same time, there has been a large drop in net financial inflows (Figure 1.12). Net direct investment inflows have fallen significantly from 2007, when there were substantial foreign investment inflows for real estate, financial and insurance services. The external debt of the banking sector has fallen since 2007/2008 contributing to a large drop in gross external debt to 58% of GDP in 2019.

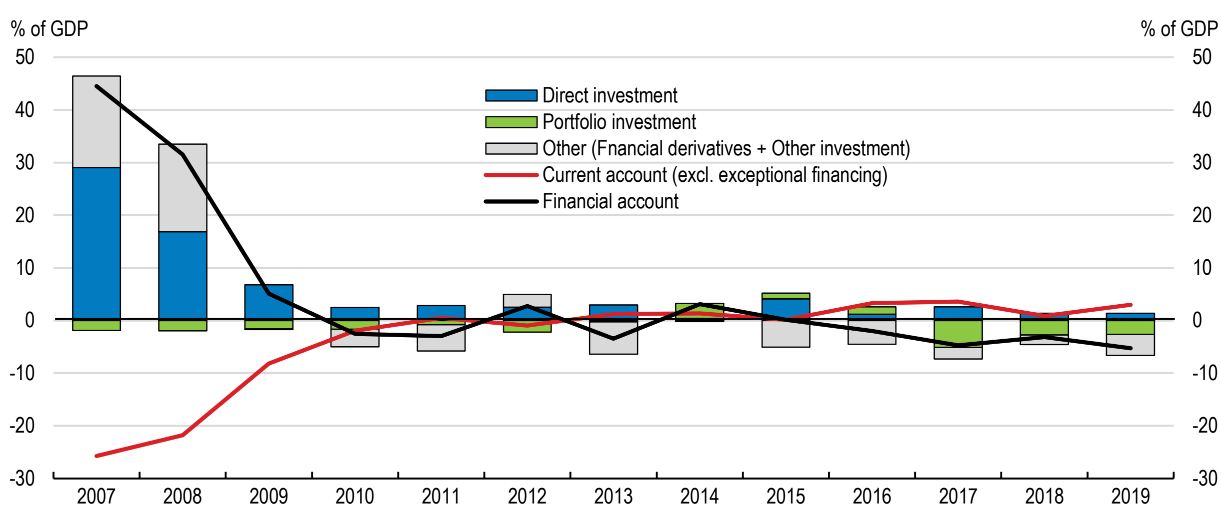
Figure 1.11. Current account surpluses have been driven by a reduction in the trade deficit



Source: OECD, Economic Outlook database.

StatLink https://stat.link/nua7zg

Figure 1.12. Net international investment has fallen substantially



Source: IMF, International Financial Statistics database.

StatLink https://stat.link/j3berz

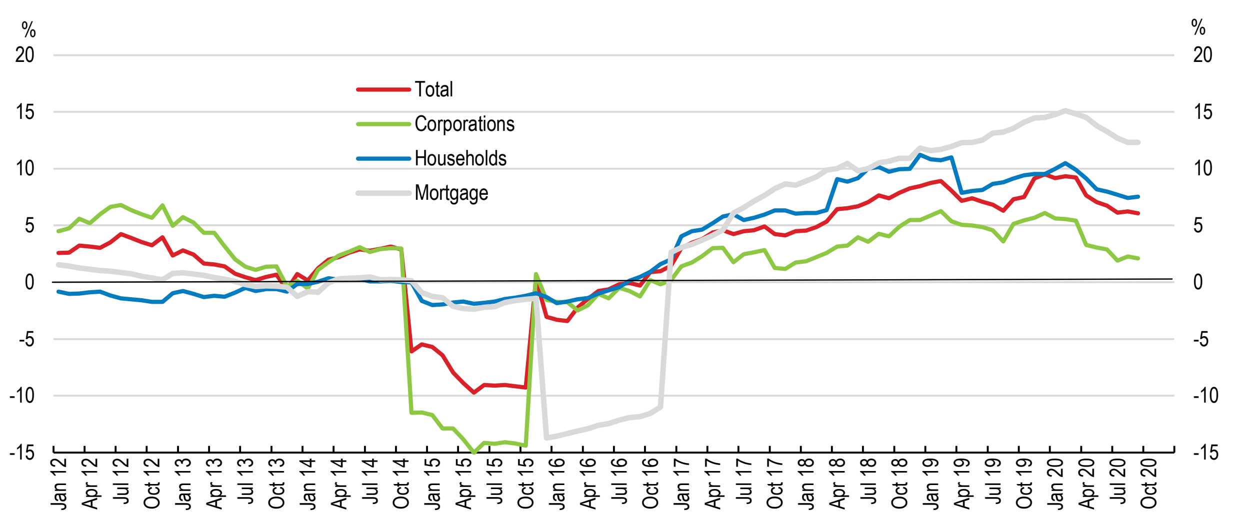
Bulgaria is in a good position to make the most of the opportunities offered by joining the euro zone. The country has maintained through its currency board a fixed exchange rate, initially to the German mark, and then the euro, since 1997. There has been no deviation from the fixed exchange rate. In this period, the monetary arrangement survived a series of domestic and external shocks, underpinned by prudent fiscal policy and declining public debt. It approaches euro zone entry with low debt and a record of containing fiscal deficits, putting the country in a stronger position than many former entrants. Bulgaria had to deal with a surge in unsustainable foreign inflows, similar to that experienced by some euro zone countries, prior to the 2008 global financial crisis. In the wake of this and the 2014 bank failure, much attention has been put on strengthening macroprudential norms and financial sector supervision. The long-term interest rate differential with the euro has fallen already to zero and the country is unlikely to face a flood of speculative funds following euro accession.

The financial sector has been fortified, but non-performing loans remain high

Banks dominate the financial system, with the capital market limited in size and non-bank players representing a relatively small share of activity. The five largest banks are responsible for 62% of banking system assets. Market shares are 72% for EU bank subsidiaries, 22% for domestic banks, and 4% for EU bank branches. Exposure of the financial system to external financing is low: the loan-to-deposit ratio stood at 73% at end-March 2020 and financing is covered by residential deposits, which made up 93% of banking system deposits at end-2019. Private sector credit had been growing prior to the COVID-19 shock following what was a period of muted activity since the 2008 global financial crisis and the one-off negative shock to credit that occurred following the collapse of the Corporate Commercial Bank AD (KTB) in 2014 (Figure 1.13).

Figure 1.13. Credit growth had picked up

Credit to non-MFIs, year-on-year percentage change



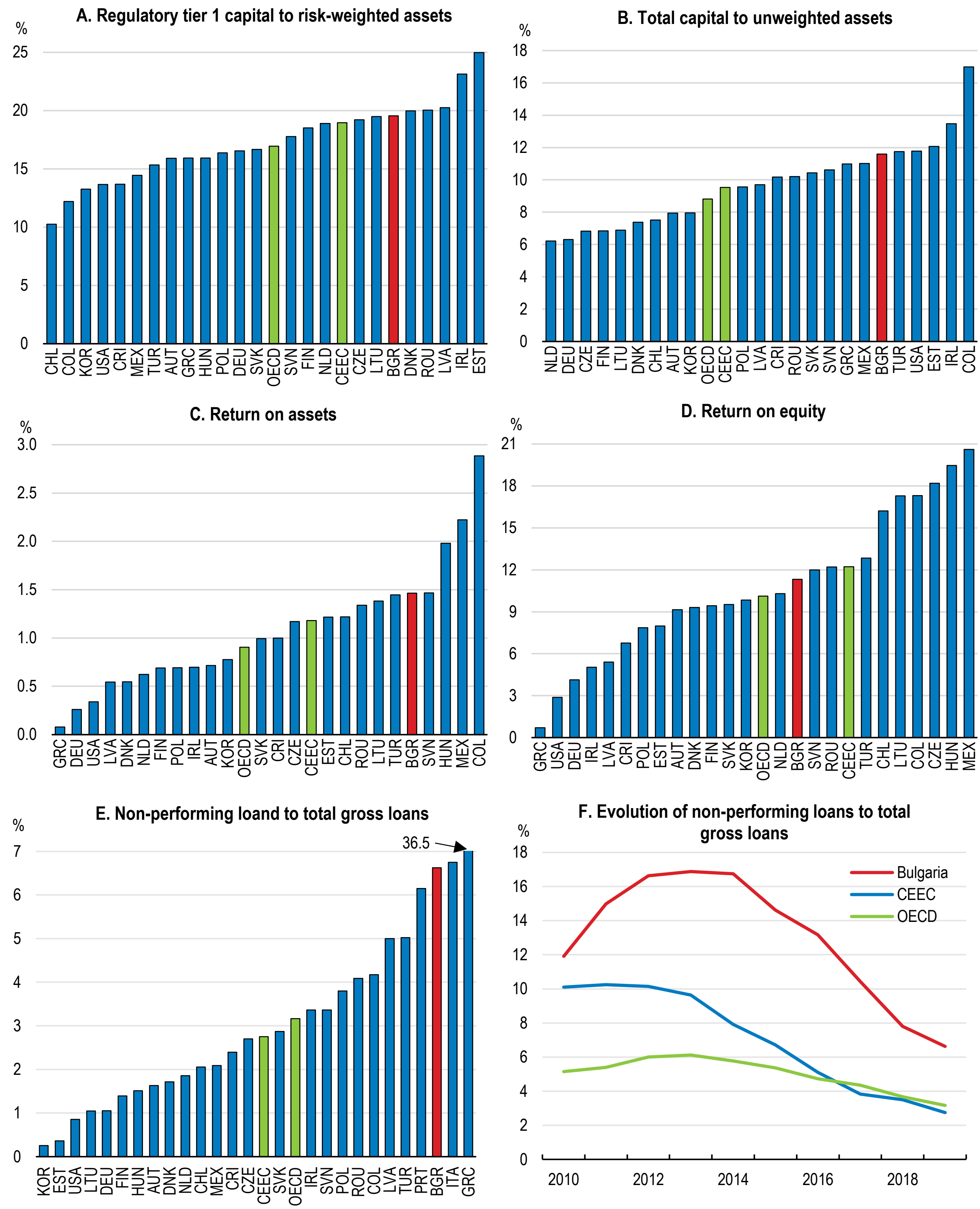
Source: ECB Statistical Data Warehouse.

StatLink https://stat.link/l6f9tu

The authorities consider that the banking sector entered the COVID-19 pandemic well-capitalised, with adequate liquidity and increased profitability. Regulatory tier 1 capital is relatively high compared to the OECD average (Figure 1.14, Panel A). The overall leverage ratio is above the OECD average (Figure 1.14, Panel B). Bank profitability has increased, and the return on assets (Figure 1.14, Panel C) and equity (Figure 1.14, Panel D) is higher than on average for the OECD. Non-performing loans have fallen over time (Figure 1.14, Panel E), but remain well above OECD and CEEC levels (Figure 1.14, Panel F).

Figure 1.14. Financial sector health had improved

2019 or latest available year



Note: CEEC is the unweighted average of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia, except in panel B where Hungary data is unavailable.
Source: IMF, Financial Soundness Indicators database.

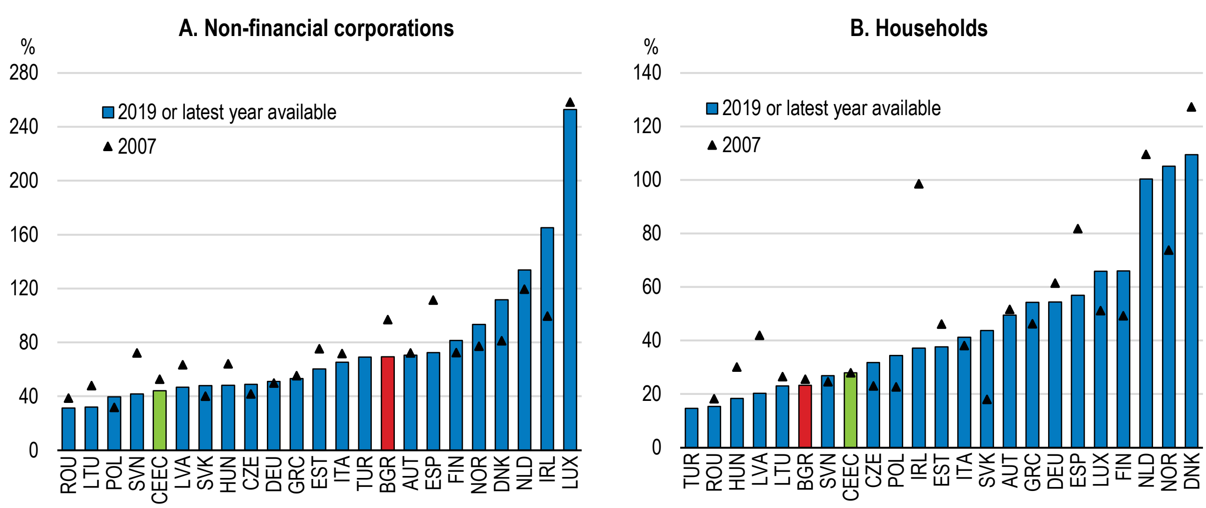
StatLink https://stat.link/wb1vg2

Prior to the pandemic, measures had been put in place to further improve capital adequacy and asset quality of the banking sectors. The ECB carried out an asset quality review and stress test of the six banks based on a point-in-time assessment as of end-2018, publishing the results in 2019 (European Central Bank, 2019). Four of the assessed banks were found not to have any capital shortfalls. Two domestically-owned banks had capital needs, as revealed by the adverse scenario in the stress tests, and as a result were further recapitalised in 2020.

Credit risk from loans to households is likely to be lower than that from non-financial corporations. Non-financial corporation debt to GDP had fallen to just above the EU average (Figure 1.15 Panel A). Service sectors impacted by COVID-19 are among those with the lowest liquidity buffers, namely real estate activities and accommodation and food service activities that have loan to deposit ratios of 313% and 210%, respectively (Bulgarian National Bank, 2020). Indicators at the sectoral level only give a general indication of the level of indebtedness and liquidity position of firms due to the heterogeneity of individual firms within the sectors. Faced with a decline in activity, firms in the sectors most impacted by COVID-19 may begin to feel pressure with making loan repayments when the current debt moratorium runs out. Household debt is one of the lowest in the EU at 23% of GDP and mostly comprises bank loans (Figure 1.15, Panel B). Households' bank deposits have grown over December 2019-July 2020 as in most EU countries, but the increase is on the lower end (OECD, 2020b). Non-financial corporations have not experienced the rise in bank deposits seen in many other EU countries (OECD, 2020b). Government support for households and the business sector diminishes default risks as long as measures remain in place.

Figure 1.15. Household indebtedness is low, while non-financial corporation debt had been falling

Debt in per cent of GDP



Note: Consolidated data. Panel B also includes non-profit institutions serving households.
Source: Eurostat (online code nasa_10_f_bs).

StatLink https://stat.link/r9qz1e

The COVID-19 crisis presents the banking system with the challenge of keeping credit flowing, often with the support of government programmes to the corporate sector, while managing rising risks. The view of the Bulgarian authorities is that the banking sector is facing these challenges in good condition, with a solid capital and liquidity position allowing the management of the rising risks. At the onset of the COVID-19 confinement, the Bulgarian National Bank took measures aimed at preserving the stability of the banking system and strengthening its flexibility. These include an increase in banking system liquidity by EUR 3.6 billion (BGN 7 billion) through a reduction in foreign exposure of commercial banks, full capitalisation of profits in the banking system, the cancellation of the increase in the counter cyclical capital buffer planned for 2020 and 2021 (totalling 0.6% of 2019 GDP). Depending on how the COVID-19 crisis unfolds, further measures may have to be considered if there is a rise in non-performing loans. The ECB and the Bulgarian National Bank put in place a precautionary swap line of EUR 2 billion to provide euro liquidity in April. A moratorium on loan repayments for debtors hit by COVID-19 has been put in place. The scheme is set to run until March 2021 allowing borrowers to submit loan deferral requests until end-September 2020. Over 80 000 loans totalling about EUR 3 billion (BGN 6 billion) benefitted from the programme in the first three months of its implementation (Association of Banks in Bulgaria, 2020). Additional firm and household credit support has been put in place, using commercial banks as intermediaries, but with the Bulgarian Development Bank providing 80% guarantees in the case of firms and 100% guarantees for household credit (Box 1.1).

Under the action plan to prepare for ERM II, the authorities have carried out impressive reforms to strengthen financial sector supervision and the macroprudential framework, and to improve the legal frameworks for the governance of state-owned enterprises and anti-money laundering. The government has identified gaps in the insolvency framework and put together a roadmap to address them and revise legislation (Chapter 2). Achieving membership of the European Banking Union should reinforce the resilience of the financial system given that a large share of foreign-owned subsidiaries come from Banking Union countries and that being part of the Banking Union supervisory and resolution arrangements should assist to maintain confidence in the financial system. The ECB will be responsible for the direct supervision of the significant financial institutions, oversight of less significant institutions and procedures for all supervised entities from October 2020.

Strengthening the recovery

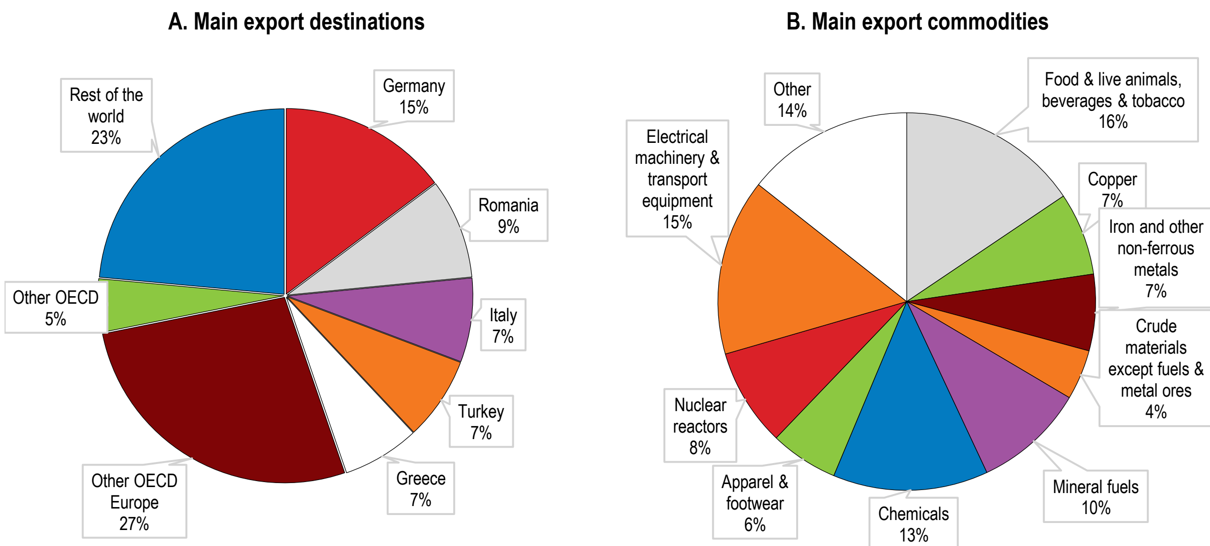
Making the most of the export sector

A small, highly open economy, the degree of robustness of external demand will be an important driver of the speed of the recovery from COVID-19. Trade grew strongly from the early 2000s through EU membership and beyond: exports and imports of goods and services increased from 78% to 124% of GDP over 2000-2019. However, at 64% of GDP, exports of goods and services remain lower than for many faster converging CEEC peers. About two-thirds of exported goods are destined for the EU with Germany, Romania, Italy, Turkey and Greece being the most important markets (Figure 1.16, Panel B). Services make up around a quarter of exports, with about 38% of total service exports consisting of travel services – hard hit by the current pandemic – and a fifth by transportation and storage services. Business services have become increasingly important, including a dynamic computer and information services sector. Goods exports rely on a high share of primary exports, including copper, iron and other metals, and petroleum products, and a lower share of higher value-added goods (Figure 1.16, Panel B). Boosting growth of the more dynamic exports sectors, not only in services activities, but also in higher value-added manufacturing (see Chapter 3 on the agricultural sector), will be important to increase convergence.

Bulgaria has successfully integrated into regional and global value chains and now faces the challenge of boosting the domestic value added of gross exports generated through this activity. Participation in global value chains is at a similar level to CEEC countries. The importing of foreign inputs to produce exported goods and services, i.e. "backward participation", features more strongly than the exportation of domestically-produced inputs to foreign downstream producers ("forward participation") (Figure 1.17). There are some niche fast-growing service sectors involved in global value chain activities, but they far from dominate. In general, this activity results in low value added content as the country participates in highly-fragmented global value chains, frequently involving processing and assembly of foreign inputs in manufacturing activities like the refinement of petroleum products, production of basic metals and machinery, electrical and transport machinery (Ivanova and Ivanov, 2017). Local subsidiaries of multinationals dominate in the export of inputs to producers abroad, with a low share for domestic firms participating in exports (Taglioni and Winkler, 2016).

Figure 1.16. Exports by destination and commodity

Share of total exports, 2019

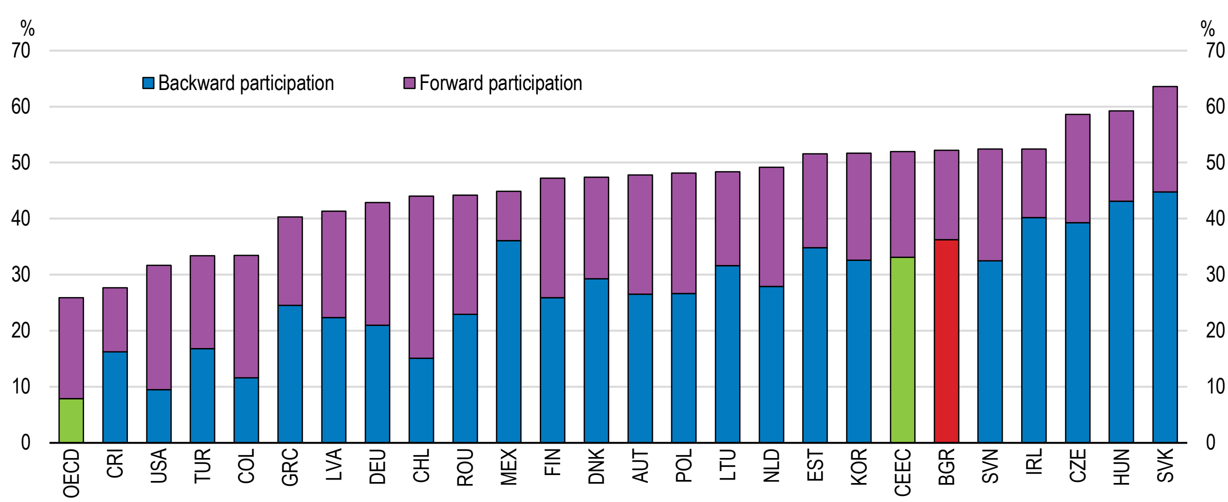


Source: National Statistical Institute and UN Comtrade database.

StatLink https://stat.link/py1ume

Figure 1.17. Integration in global value chains is high

Percentage share in total gross exports, 2015



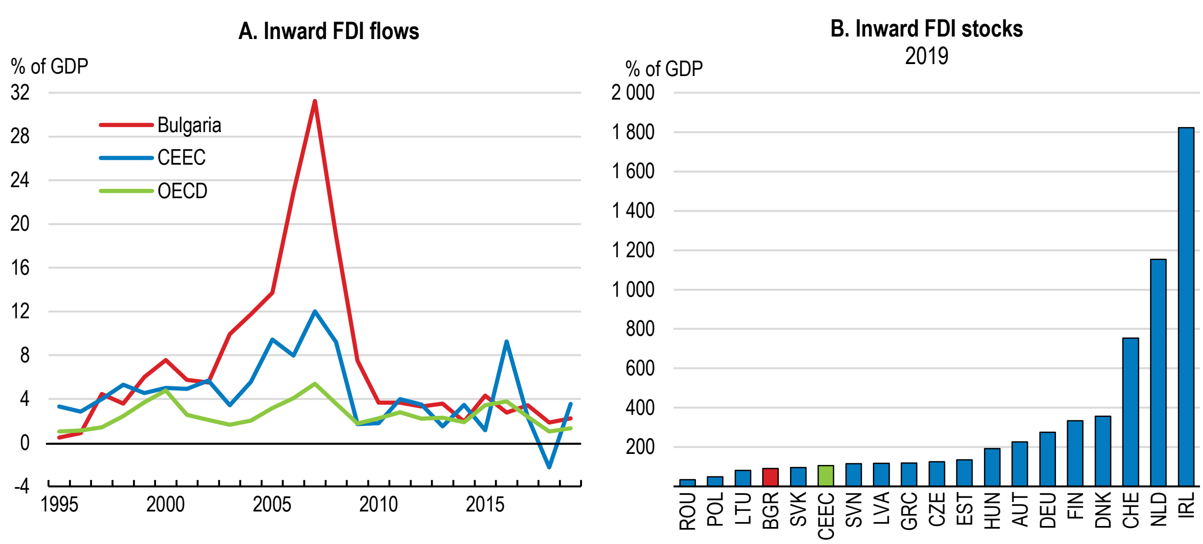
Note: Forward participation is the domestic value added in foreign exports as a share of gross exports, and backward participation is the foreign value added share in gross exports.
Source: OECD, Trade in Value Added (TiVA) database.

StatLink https://stat.link/csohzk

While increased global value chain integration has been correlated with value-added gains (Taglioni and Winkler, 2016), the contribution to convergence would be increased by moving up the value chain and increasing the spillovers to domestic firms. Boosting the domestic value-added from exports and further increasing global value chain insertion involves putting in place complementary business environment reforms. Kummritz et al. (2017) point out the economy-wide reforms that would assist Bulgaria in maximising benefits from global insertion. These encompass reforms from increasing innovation to improving logistics performance and reducing red tape to enhancing skills (Chapter 2). There is evidence from Ireland that supplying inputs to multinationals can be an important pathway for knowledge and technology transfers. Domestic firm productivity is negatively associated with purchases from foreign firms for downstream activities (Di Ubaldo et al., 2018). R&D investment is found to be an important channel for productivity spillovers. This suggests that Bulgaria should focus innovation support on domestic firms engaging in the supply of inputs to multinational/foreign firms rather than companies that concentrate on processing and assembling foreign inputs.

Foreign direct investment had a big role in expanding the exports sector, but spillovers to domestic enterprises could be increased. Continuing to attract foreign investment that is directed at increasing value-added in the manufacturing and services sector will be important to increase capital investment in firms and to contribute to raise business sector productivity (IMF, 2019a). Foreign direct investment averaged about 3.1% of GDP over 2012-2018, similar to the levels seen on average in CEEC and OECD countries (Figure 1.18, Panels A and B). However, the nature of foreign investment has been very different to that seen in many CEEC countries. Rather than being destined to a large degree for the manufacturing sector, the stock of foreign direct investment has been concentrated in real estate and, financial and insurance activities sectors. These non-manufacturing sector investment surged in pre-2008 global financial crisis years, driving up overall investment but abruptly falling after 2007. There has been some positive shift in the structure of FDI flows towards more trade-related sectors, as these inflows proved more resilient after 2008. The share of investment in manufacturing and other tradeable sectors has increased in recent years.

Figure 1.18. Foreign direct investment is close to the CEEC average



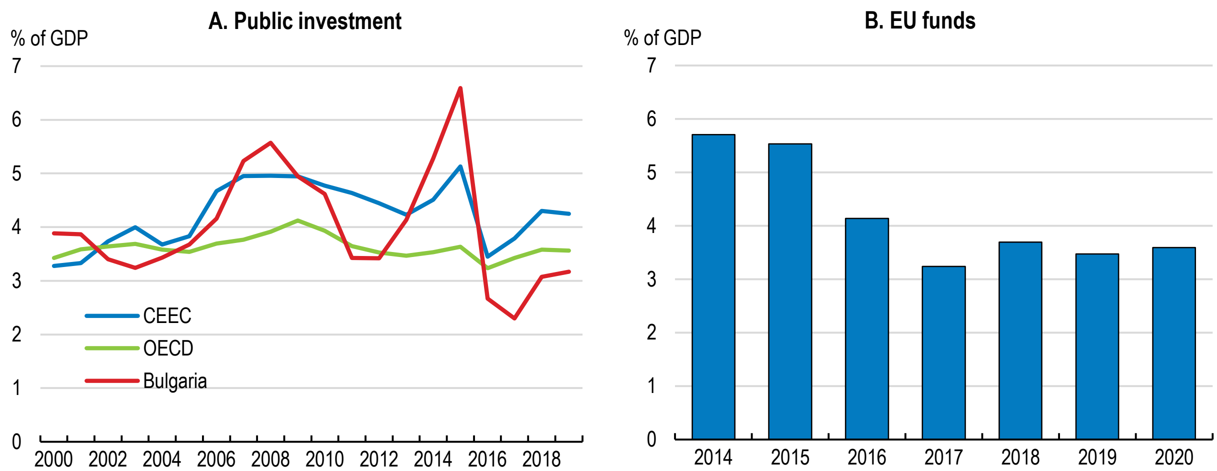
Source: World Bank, World Development Indicators database; Eurostat (online code bop_iip6_q).

StatLink https://stat.link/i1gh8s

Public investment should be increased

Public investment has been volatile and has fallen below CEEC peers. Protecting public investment during the COVID-19 downturn will be important for the recovery and to improve key housing and transport infrastructure and innovation to increase potential growth. Capital spending has been found to have the largest multiplier of any government spending component for Bulgaria (Muir and Weber, 2013). In the aftermath of the 2008 global financial crisis, public investment fell and in recent years has remained well-below pre-crisis levels (Figure 1.19, Panel B). Troughs and peaks in public investment can be largely explained by the EU funding cycle, with strong peaks at the beginning of the 2014-2020 programming period (Figure 1.19, Panel B). Bulgaria is one of the largest beneficiaries of EU support (European Commission, 2020b). European Union funding is to continue to be high with strong investments expected at the beginning of the next programming period in 2021 and substantial resources to come from the European Union Recovery and Resilience Facility (about 10% of pre-crisis GDP). It will be important to strengthen public investment management to ensure an effective and rapid use of the large available European Union resources.

Figure 1.19. Public investment has fallen below CEEC peers



Note: Forecast for the 2020 data in panel B.
Source: OECD, Economic Outlook database; Ministry of Finance, Bulgaria.

StatLink https://stat.link/o4z06k

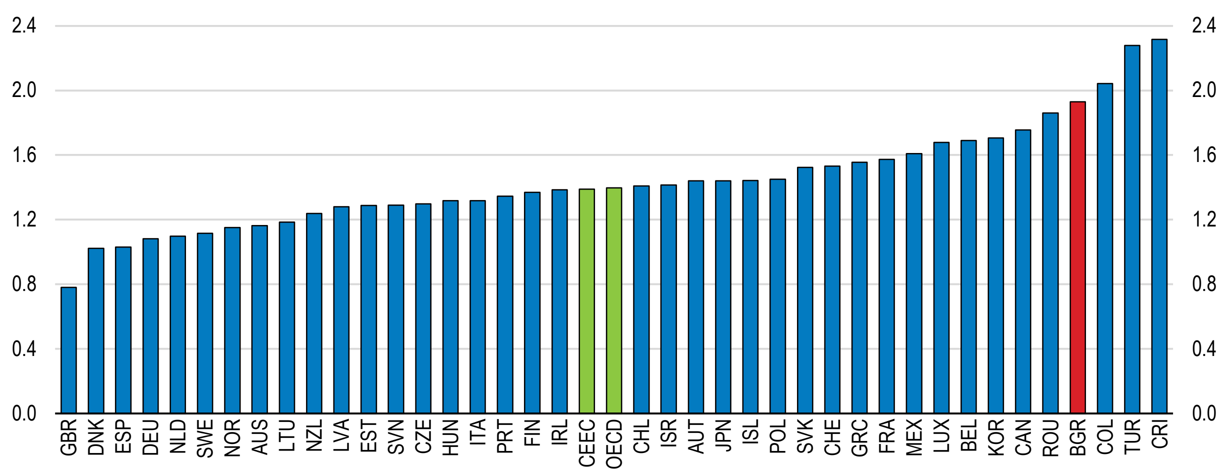
The economy has investment gaps in infrastructure, the housing stock and innovation that will need to be closed to support greater economic convergence. Transport infrastructure needs to be improved to allow the country to have better connectivity with its neighbours, to increase its attractiveness as a transit zone and to better connect its regions (Chapter 3). The road and rail network require substantial investment, and there remain gaps in the broadband network in some regions. Limited access to affordable housing creates a barrier to mobility of workers within the country. The housing stock also is of poor quality and suffers from low energy efficiency. Investment also would need to focus on continued support for the growing digital economy, including improving access in lagging regions, assisting further digitalisation for firms and the government, and developing digital skills. Innovation in the economy is low, and publicly-financed research and innovation is underfunded and its efficiency could be improved (Chapter 2). A large-scale public investment programme in these areas would be timely to boost the recovery from COVID-19 and potential growth.

Removing barriers to competition

Reducing the high regulatory barriers to competition could give a substantial boost to productivity by supporting a more efficient allocation of resources in the economy. The OECD's product market regulation indicators show that the regulatory barriers to competition in Bulgaria are higher than for all OECD countries, with the exception of Colombia and Turkey, based on the economy-wide 2018 product market regulation measure (Figure 1.20) (Chapter 2). This measure examines the alignment of a country's regulatory framework with international best practice. There are high administrative requirements and an onerous licensing regime for new businesses, which if eased would encourage the creation of new businesses and the entry of competitors into new business areas. There is extensive public ownership of large operators in key network sectors, with incumbent companies completely owned by the state in sectors such as electricity generation, gas import and retail supply, and rail transport. The large presence of the state in these sectors, even though they are open to competition, can generate distortions and affect the incentives for private firms to enter and expand their presence in the sector. The barriers to entering legal professions (lawyers and notaries) are higher than in any OECD or CEEC country.

Figure 1.20. Barriers to competition are high

Overall Product Market Regulation indicator, index scale of 0-6 from least to most restrictive, 2018



Note: Information refers to laws and regulation in force on 1 January 2019. The OECD average does not include the United States.
Source: OECD, 2018 Product Market Regulation Indicators database.

StatLink https://stat.link/ke92y7

Increased public investment as well as structural reforms to improve the business environment and governance have a large potential to boost incomes. If the main reforms presented in this *Assessment* are adopted, the boost to GDP per capita would be substantial and with limited fiscal impact (Box 1.5).

Box 1.5. Quantifying the impact of selected policy recommendations

The following estimates roughly quantify the growth and fiscal impact of selected structural reform recommendations. The fiscal estimates give a costing for longer-term structural reforms that are likely to be delayed until the post-crisis recovery period. The estimated fiscal effects include only the direct impact and exclude behavioural responses that occur due to a policy change.

Table 1.3. Illustrative GDP impact of recommended reforms

Difference in GDP per capita level, %

Measure	Description	Effect after 10 years
Business environment		
Lower regulatory barriers (PMR)	Closing half of the gap to the OECD average	2.3
Increased spending on public investment and innovation	Move to CEEC average	0.5
Improvement of public integrity and institutional quality	Closing half of the gap to the OECD average for the control of corruption indicator	4.7
Labour market inclusion		
Increased spending on active labour market policies	Closing half of the gap to the OECD average	1.0
Increased female legal retirement age	Acceleration of equalising the legal retirement age of women and men (+0.5 year in average age)	0.5

Note: Model simulations based on the framework of Égert and Gal (2017). Scenarios depict the effect on the level of GDP per capita as compared to a baseline scenario with no policy changes. Not all recommended reforms, including some included in the fiscal quantification, can be quantified based on available cross-country evidence.
Source: OECD staff estimates.

Table 1.4. Illustrative fiscal impact of post-recovery recommended reforms

Annual fiscal balance effect of selected reforms, % of GDP

Measure	Description	Effect after 10 years
Deficit-increasing measures		**2.7**
Business environment		
Increased spending on public investment and innovation	Move to CEEC average	0.6
Strengthened capacity for insolvency and rehabilitation framework		0.1
Increased resources for integrity and anti-corruption institutions		0.1
Labour market inclusion and social reforms		
Provide universal access for 4-year olds to early childhood education		0.2
Increased spending on active labour market policies	Closing half of the gap to the OECD average	0.2
Increased spending on social safety net	Move to CEEC average	0.5
Increased spending on health and long-term care	Closing half of the gap to the OECD average	1.0
Deficit-reducing measures		**2.0-2.1**
Tax and subsidy reforms		
Improved tax compliance and higher taxation after recovery	Move towards CEEC average	1.5
Phasing out subsidies for fossil fuels		0.3
Labour market inclusion		
Increased female legal retirement age		0.2-0.3

Note: Estimations for selected reforms showing only direct budget impacts.
Source: OECD calculations.

Decarbonising the economy

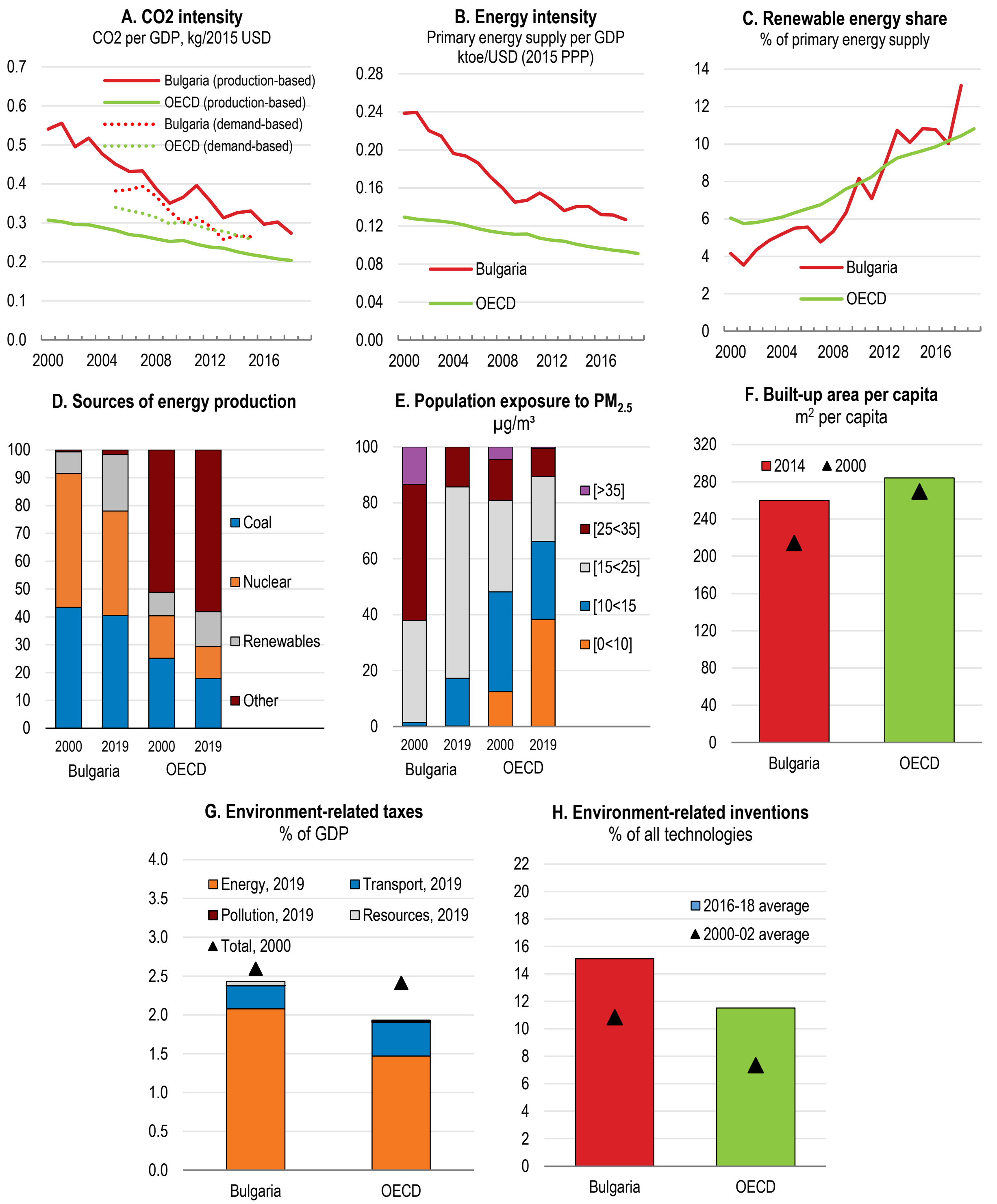
Environmental performance has improved, but the economy remains more carbon- and energy-intensive than most OECD countries (Figure 1.21). Renewable energy from hydro, wind and solar increased substantially upon EU accession, but since 2013 expansion has almost stopped. By contrast, policy initiatives have accelerated biofuels supply in recent years and contributed to bring the share of renewables in energy supply above the OECD average (Panel C). Nonetheless, coal continues to account for almost half of energy production and generates large greenhouse gas emissions. The coal-fired power plants are also an important source of poor air quality, along with high use of solid fuels for heating and the transport sector. Bulgaria has more pollution-related deaths than any OECD country with 827 deaths per 1 million inhabitants in 2017, well above the OECD average of 326.

As an EU Member State, Bulgaria's emissions from the energy sector is regulated through the EU Emissions Trading System (ETS). For the sectors outside ETS, Bulgaria has a national 2030 target of keeping emissions no higher than their 2005 level (0% reduction). According to the national energy and climate plan for 2021-2030 submitted to the EU (BME and BMEW, 2020), the economy is on track to reach its 2030 emission and energy targets. However, the new ambitious EU emission target agreed in December 2020 will be a serious challenge to Bulgaria's long-term strategy that does not yet include a phase-out plan for coal.

The recovery from COVID-19 presents an opportunity to accelerate the transition to low-carbon energy sources (OECD, 2020c) and tap into abundant financial resources for green infrastructure investments, including EU Green Deal funds. The transition will be a challenge as Bulgaria accounts for 7% of total EU coal production. The mining of coal and lignite sector directly employed 15 700 people in 2019 (LFS, Eurostat), representing less than 0.5% of the labour force but strongly concentrated in two regions (Stara Zagora and Kyustendil). Measures will thus be needed for reskilling and reallocating these workers (JRC, 2018; SE3Tnet, 2020). Although Bulgaria intends to continue using coal, it has requested to participate in the EU programme for Coal Regions in Transition, which is welcome.

Coal-fired power plants are already becoming unprofitable (European Commission, 2020b; SE3Tnet, 2020) and renewables are now often more cost-competitive in advanced countries (IEA, 2019). Market forces and a rise in the price of ETS allowances will thus eventually force Bulgaria's coal industry to close (SE3Tnet, 2020). It already benefits from substantial state-aid, which should be removed gradually to not obstruct decarbonisation. As a low-income EU Member State, Bulgaria is allowed to distribute free ETS allowances to existing power plants under the condition that similar amounts are invested in modernising the electricity sector (54 million allowances were allocated during 2013-2020, BME and BMEW, 2020). Ten countries will maintain this right until 2030, but only Bulgaria, Hungary and Romania have decided to use it. Bulgaria also supports coal power plants through payments for cold reserve capacity for times of peak demand (rarely activated) and by preferential electricity prices for plants producing district heating as well (EU-approved state-aid scheme for efficient cogeneration). Removing all this public support would free estimated EUR 450 million annually (0.7% of GDP), which could be used to invest in renewables and for compensating consumers for temporarily higher electricity prices during the transition (SE3Tnet, 2020).

Figure 1.21. Energy intensity and reliance on coal remain high



Source: OECD (2020), OECD Environment Statistics database (Green Growth Indicators; Patents); OECD National Accounts database; IEA (2020), IEA Energy Prices and Taxes database; World Bank, World Development Indicators database.

StatLink https://stat.link/5914ps

Cost-benefit analysis should be applied to plan the phase-out of support, taking into account reduced energy security. Bulgaria is currently a large net exporter of electricity and maximum use of its (lignite) coal reserves would ensure energy supply for many years. At the same time, the government plans to develop its nuclear power programme with the construction of two new units (BME and BMEW, 2020) that would help ensure energy security and achieve cost-efficient decarbonisation (NEA, 2020). The use of a new generation of nuclear installations is also being considered, which is welcome since this would improve security of energy supplies. The two operating reactors are around 30 years old, but an upgrade and extension of operating lifetime to 60 years were completed in 2019. Having institutions and procedures in place to ensure the highest safety standards and vigilance is vital, including e.g. regular risk assessment of seismic hazards and measures to secure a high safety culture. In this respect, Bulgaria will benefit from best practice sharing by joining the Nuclear Energy Agency from January 2021.

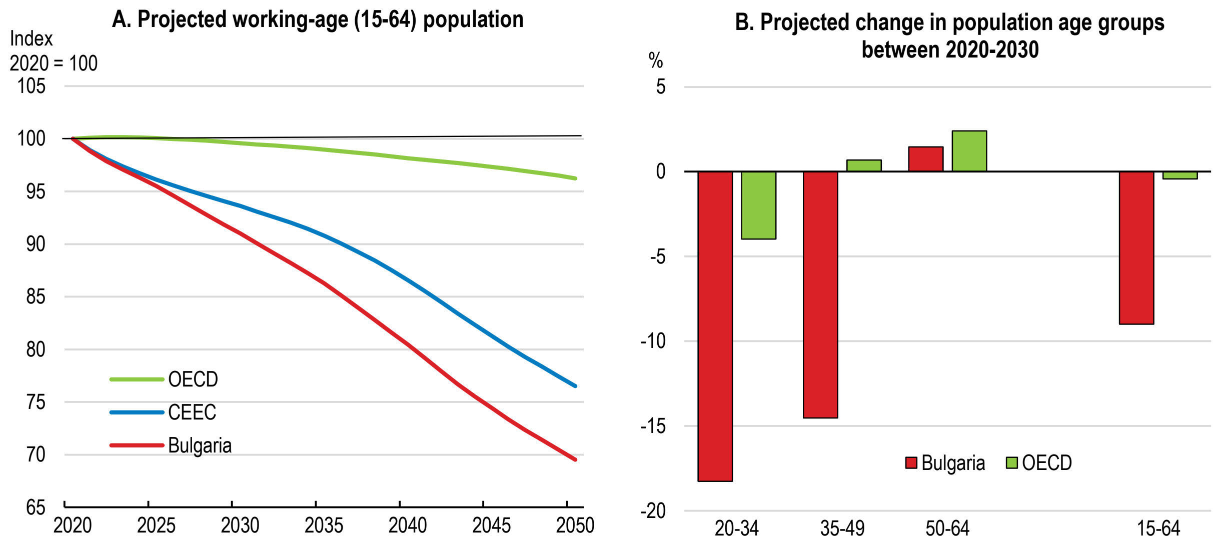
Reducing energy demand through efficiency improvements would also alleviate decarbonisation. The potential to improve energy efficiency is huge and stronger action could deliver large cost-savings in addition to the environmental gains. Large subsidies for energy renovation has helped to improve efficiency in residential buildings, but targeting to low-income households could be improved (Chapter 3). The government should also step up the use of information campaigns to inform households about the benefits of energy saving investments as a means to improve efficiency. Although the tax revenue from environmental taxes is above the OECD average, it mainly reflects the high energy consumption relative to GDP. In fact, the implicit tax rate on energy use (the energy tax revenue relative to energy consumption) was the lowest in the EU in 2018. Using fiscal incentives, notably through well-designed energy taxes, could thus be considered to enhance efficiency when the economy is well into a post-COVID-19 recovery.

Aligning pricing of greenhouse gas emissions from sectors outside the EU ETS, notably buildings, transport, agriculture and waste, should also be a priority to achieve cost-efficient decarbonisation. Bulgaria overachieved its target for 2020 under the Effort Sharing Regulation (ESR), but further efforts will be needed to reach the 2030 zero reduction target. Carbon pricing of e.g. transportation and waste is the most efficient way to achieve emission reductions and a surplus under ESR can be traded with other EU countries and generate additional revenue. For instance, vehicle taxes are comparatively low and recycling of municipal waste is lower than in most EU countries, with municipal waste collection fees not based on the amount of waste generation (European Commission, 2020b). Implementation of carbon pricing should be complemented by social measures to protect poorer households.

Ageing demographics will influence future growth

The population is ageing and shrinking rapidly. After losing more than one fifth of its population since the late 1980s due to high emigration and declining fertility, Bulgaria is set to see its population fall by further 30% by 2060 – the highest population decrease in the world according to the latest UN Population Division projections. The ageing and shrinking of the population is due to high emigration and a fall in fertility leaving the age structure increasingly top heavy compared to OECD countries. The working-age population (aged 15 to 64) is set to decline by one fifth in the next 20 years. The decline already has begun (Figure 1.22, Panel A) and the workforce will become older as younger age groups shrink dramatically in the next decade (Figure 1.22, Panel B).

Figure 1.22. The working-age population is shrinking and ageing quickly



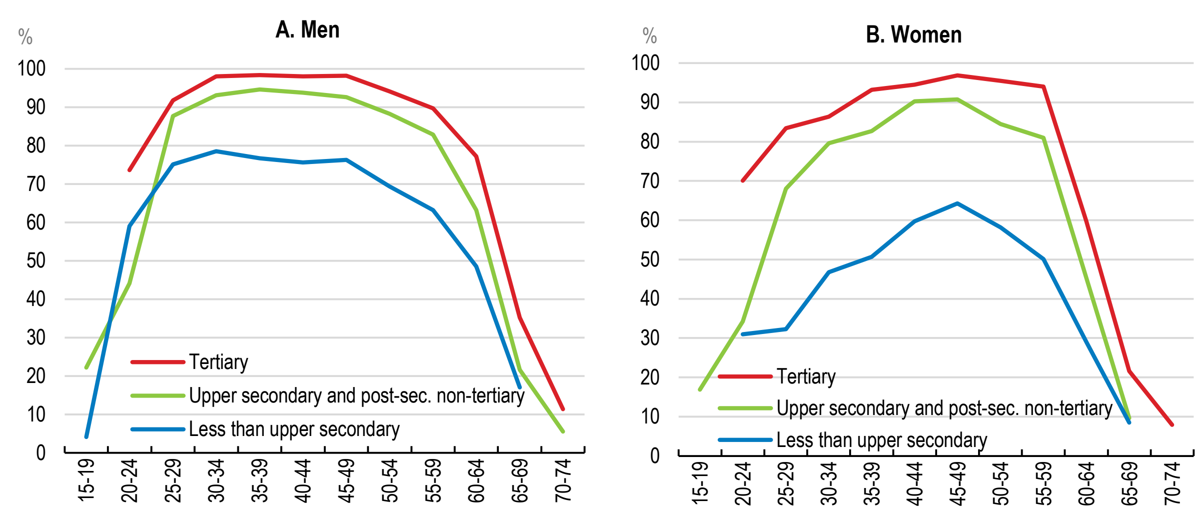
Source: United Nations, Department of Economic and Social Affairs, Population Division (2019), World Population Prospects 2019, Online Edition. Rev. 1.

StatLink https://stat.link/2l3t9f

An economy facing such a stark ageing and shrinking of the workforce needs to maximise the population's benefits from education and training throughout the lifecycle from early childhood education onwards (Chapter 2). Participation in lifelong learning is low, which is of concern for productivity given the shrinking and ageing workforce. On-the-job and formal training can stop the erosion of skills over the lifecycle (OECD, 2017a) and prepares workers for changing skills needs. The education level achieved early in life can determine whether you work more and longer (Figure 1.23).

Figure 1.23. Higher educated people work more and longer

Labour force participation rate by gender, age and educational attainment, 2019



Source: Eurostat, EU-LFS database.

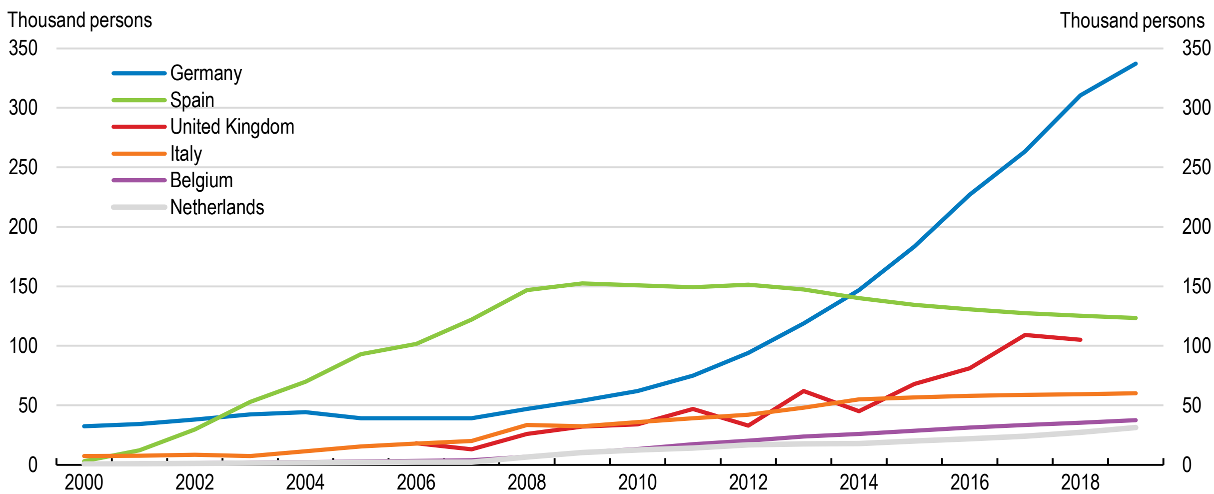
StatLink https://stat.link/pgirdy

Rising wages have contributed towards a substantial rise in participation in recent years, especially among older age groups. Nevertheless, accelerating the closure of the three-year gap in statutory retirement ages for men and women would not only bolster public finances, but also help to boost long-term growth.

Supporting the continued return of Bulgarians from abroad and attracting skilled immigrants also provides an opportunity to alleviate skill shortages. Emigration has slowed from the high rates seen in the 1990s to the early 2000s and there are a growing number of Bulgarians returning to the country as economic opportunities have improved. With just over 13% of Bulgarian immigrants in OECD countries having tertiary education (ISCED 5 and 6) (OECD, Migration Statistics database), Bulgarians abroad are an important asset for the country (Figure 1.24). Policies should be deepened to attract and smooth the transition of return migrants into the labour market.

Figure 1.24. A large proportion of Bulgarian nationals are living abroad

Numbers of Bulgarian nationals living in another EU country



Source: OECD, International Migration database.

StatLink https://stat.link/ovhwbz

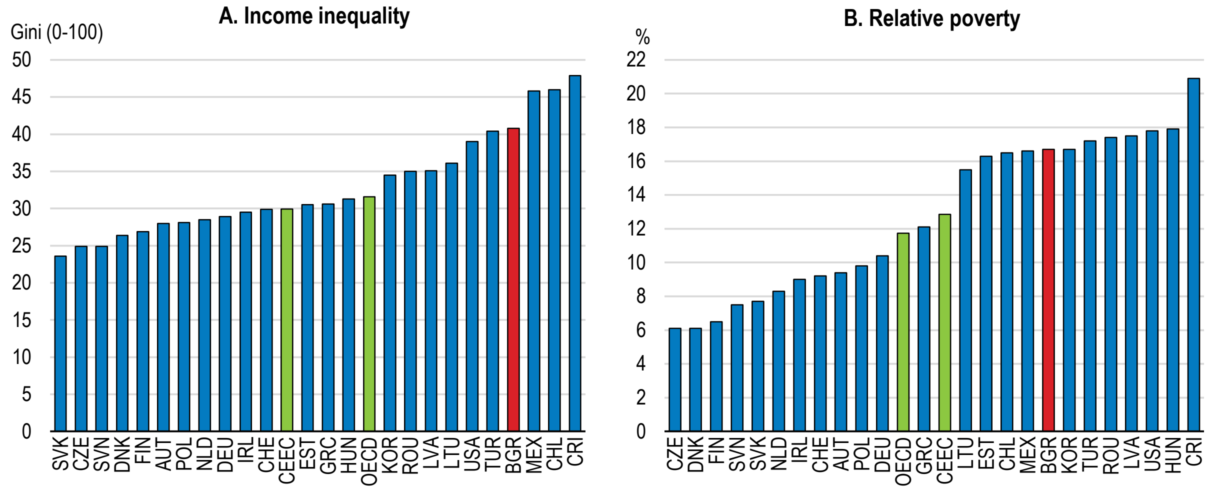
Non-Bulgarian immigrants are few and, according to National Statistical Institute data, just over 13 000 non-EU nationals entered the country in 2019 – a year when there was substantial skills shortages. While progress was made in the 2016 Labour Migration and Labour Mobility Act, further could be done to reduce employment restrictions, the administrative burden for immigrants and employers, and to smooth the accreditation process for vocational and educational qualifications.

Ensuring equal opportunities for all

Income inequality, measured by the Gini coefficient, is higher than in almost all OECD countries (Figure 1.25) and stands out as the highest in the EU. Incomes of the top 20% of the population was 8.1 times higher than the bottom 20% in 2018, well above the OECD average of 5.4. While estimates suggest that Bulgaria entered the post-communist transition period with higher inequality than most other Eastern European countries (Solt, 2020), continued increasing inequality is worrying for people's wellbeing and for retaining young people in the country. Over the latest decade, the Gini coefficient has increased by almost eight points (Figure 1.26, Panel A), contrasting with slightly declining inequality in OECD and peer countries.

Figure 1.25. Income inequality and poverty are high

Household disposable income, 2018 or latest year available

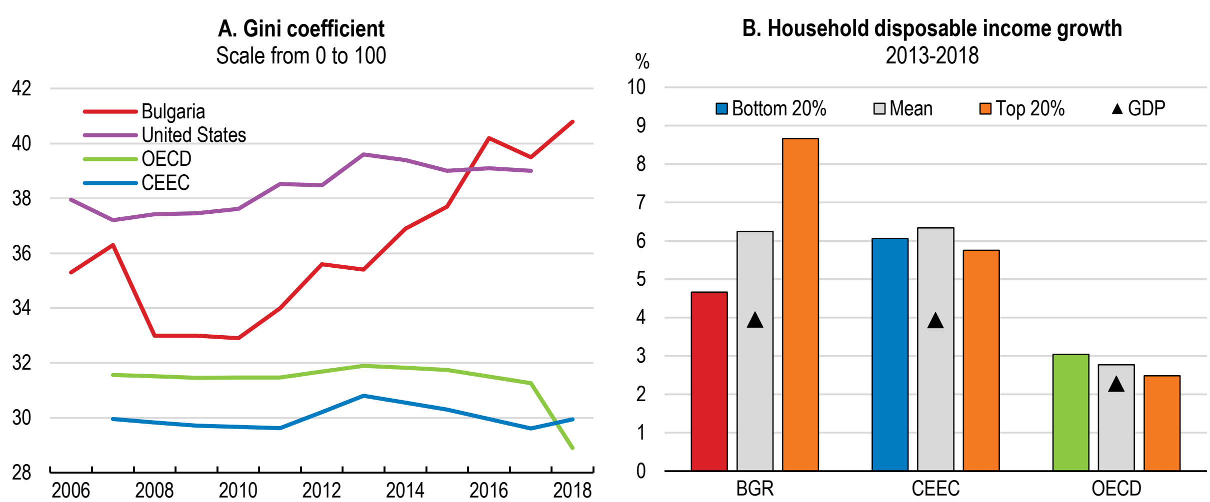


Note: The Gini coefficient has a range from zero (when everybody has identical income) to 100 (when all income goes to only one person). Relative poverty refers to the proportion below 50% of median household disposable income.
Source: OECD, Income Distribution database.

StatLink https://stat.link/yvp9fc

The lowest incomes in Bulgaria have still converged as income growth for the bottom 20% exceeded average real income growth across OECD countries during 2013-2018 (Figure 1.26, Panel B). Nevertheless, Bulgarian top 20% incomes grew almost twice as fast, thus capturing the bulk of economic development. Making growth more inclusive will require policy measures to address inequalities in education (Chapter 2), include more people in the labour market and boost earnings for lower income earners as well as improving the tax and transfer system to work for all. In this respect, addressing undeclared work, mainly by the widespread use of envelope payments, remains a key challenge (Box 1.3).

Figure 1.26. Income inequality has risen fast because growth mainly benefitted top incomes

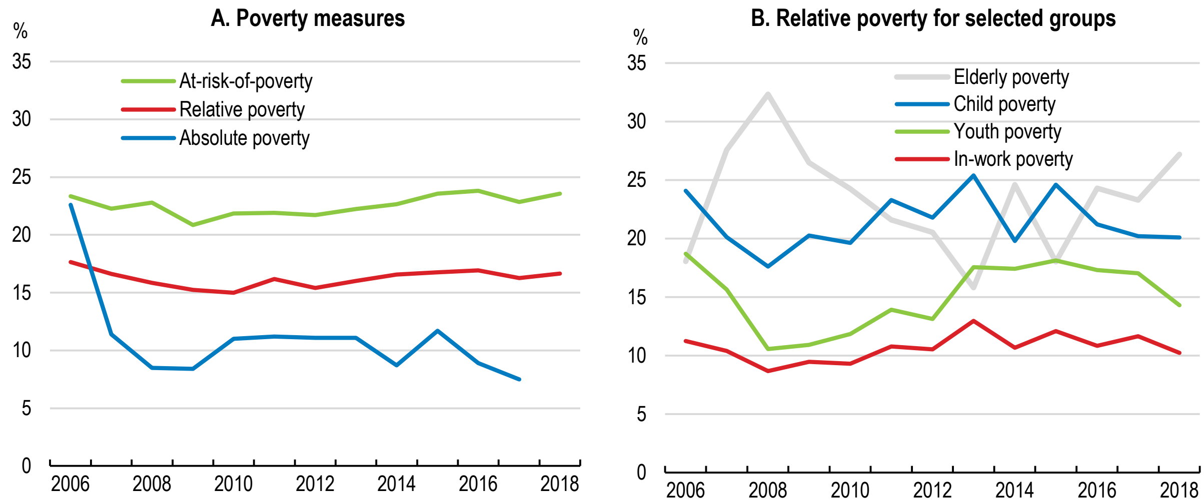


Note: Panel B shows annualised real growth of equivalised household disposable incomes for the bottom 20%, the mean and the top 20% of the income distribution. GDP refers to average annual growth in GDP per capita. OECD is an unweighted average across 31 countries with available data.
Source: OECD, Income Distribution and National Accounts databases.

StatLink https://stat.link/snip75

Poverty remains worryingly high according to all available measures (Figure 1.27, Panel A). While relative poverty is slightly lower than in Hungary, Latvia and Romania (Figure 1.25), it has stayed close to 16% of the population since the late 2000s. More than a quarter of the elderly and one fifth of children live in relative poverty (Figure 1.27, Panel B). Although the persistently high levels partly reflects strong growth in median disposable income that lifts the poverty threshold, more proactive measures are urgent to help the most vulnerable. Poverty is particularly high among the Roma population, the low educated, the elderly, and people with disabilities and in rural areas (World Bank, 2019; National Statistical Institute, 2018).

Figure 1.27. Poverty has remained at a high level, notably among children and elderly



Note: Absolute poverty refers to the proportion below the World Bank's upper middle-income poverty line of USD 5.5 a day in 2011 PPP. Relative poverty (respectively at-risk-of-poverty) refers to proportion below 50% (respectively 60%) of median household disposable income.
Source: OECD, Income Distribution database; World Bank, World Development Indicators database.

StatLink https://stat.link/be7ohr

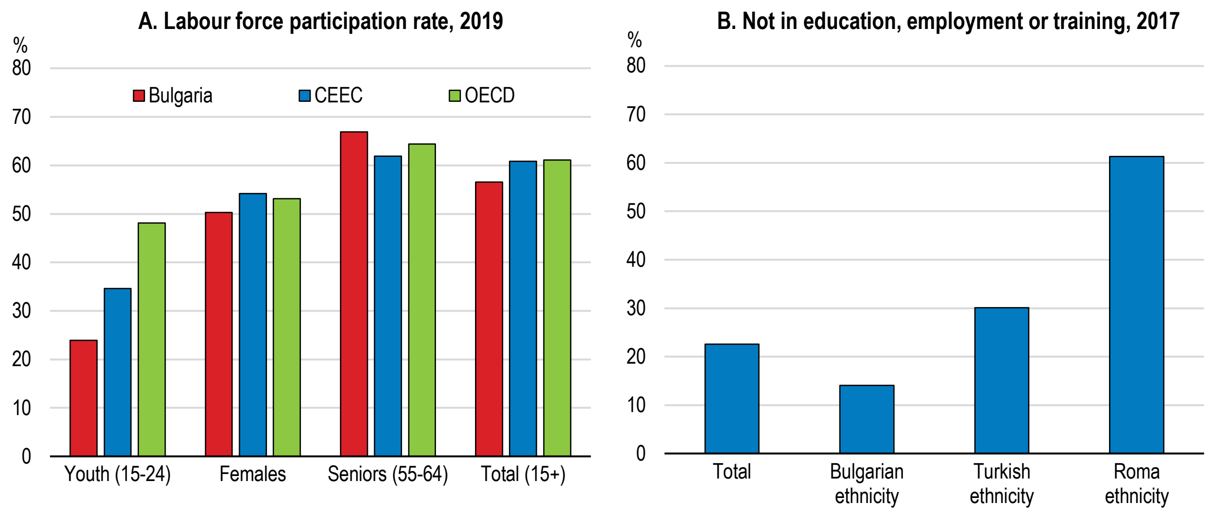
The high levels of poverty and soaring top incomes hold back the Bulgarian middle class from expanding and thriving (Stoilova and Staneva, 2018). The presence of a strong and prosperous middle class is vital for a healthy economy and society (OECD, 2019b), since their investment in education and support for quality public services, trust and intolerance of corruption are key drivers of inclusive growth. Opportunities for social advancement in Bulgaria are weak according to a range of social mobility measures and available studies point to declining intergenerational mobility (Eurofound, 2017). The severe economic depression in the late 1990s led to a sharp decline in educational performance of children from less well-off families (Hertz et al., 2009) and high negative correlation between educational attainment and poverty, labour force inactivity and social exclusion persist (European Commission, 2020b).

The government recently set ambitious policy goals to reduce inequality by more than seven Gini points (to 33) and to reduce the share at-risk-of-poverty by more than five percentage points (to 18%) by 2030 (Bulgarian Government, 2019). Such targets can be useful for policy-making, yet back in 2010, the former government set similar ambitious poverty goals for 2020 that were far from accomplished (Bulgarian Government, 2013). This suggest a need for more focus on implementation and evaluation of measures taken.

Improving labour market policies for higher participation and better jobs

A well-functioning labour market is key to deliver inclusive growth (OECD, 2018a). Total labour market participation (age 15+) is almost 5 percentage points below the OECD average (Figure 1.28, Panel A), mainly reflecting low participation of youth and the compositional impact of an ageing population. A strong culture of full-time work, with less than 2% working part-time, may be an obstacle for certain groups' labour market participation, such as youth combining studying and part-time work as in many OECD countries or seniors prolonging work life through a gradual withdrawal. While prime age women (age 25-54) and seniors (age 55-64) have participation rates above the OECD and EU averages, there is still a gap to the upper half of OECD countries across all sex and age groups. Women's participation is held back by a comparatively long maternity leave and insufficient access to childcare (World Bank, 2019). Specific measures are needed to address very low participation of Roma, composing around 10% of the population, especially Roma women facing multiple entry barriers (Chapter 3).

Figure 1.28. Labour market participation is low for youth and Roma



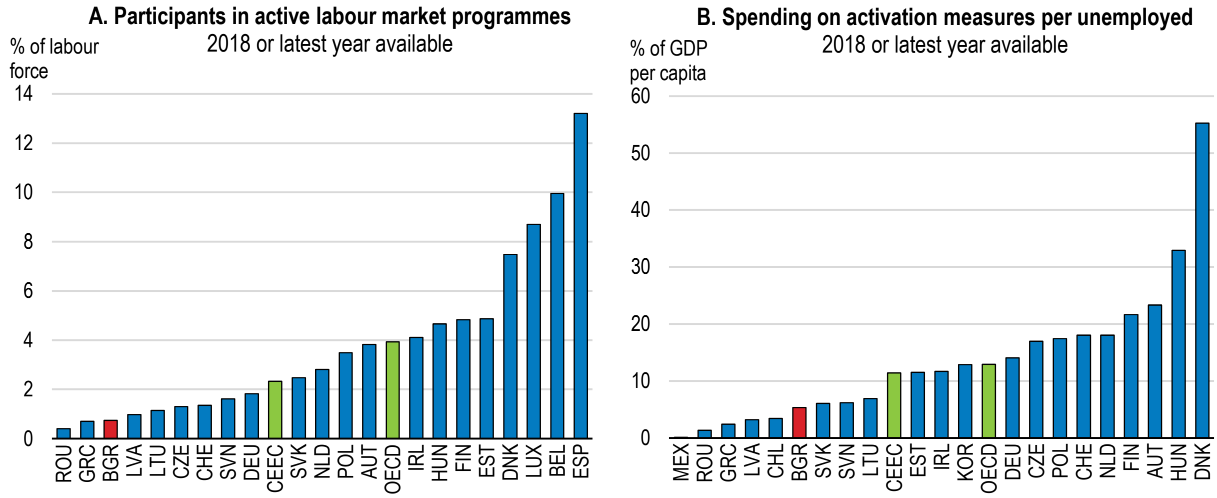
Note: Panel B refers to age 15-34.
Source: OECD, Labour Force Statistics database; Institute for Market Economics (IME) (2019), "Assessment of the People not in Employment, Education and Training (NEETs) in Bulgaria and Policy Measures to Effectively Address their Integration", European Commission, VC/2019/017.

StatLink https://stat.link/fi54le

Particularly concerning are extremely high rates of youth not in education, (formal) employment or training (NEETs) among the Turkish and Roma populations (Figure 1.28, Panel B), whereas the share of NEETs among ethnic Bulgarians is close to the EU average. Strong labour demand prior to the COVID-19 outbreak helped to bring the overall share of NEETs down by more than 8 percentage points from 2013 to 2019. However, the share of early school leavers remains high at 14% and it has not improved towards the government's target of 11% by 2020 set out in the national strategy to reduce early school leaving (BMES, 2013). The government has appointed youth and Roma mediators to promote labour market participation and implemented mobile labour offices to reach rural and remote areas. Such targeted measures are welcome and have a positive impact on employment according to available reviews (IME, 2019). The Youth Guarantee programme initiated by the European Commission has also had some success in fostering employment or training for youth, but since it targets unemployed, it only reached around 10% of NEETs who are vastly inactive (European Commission, 2020c). Outreach of current support should be strengthened and consideration given to extend the Youth Guarantee to cover all young adults with only secondary education or less.

Overall coverage and spending on active labour market policies lag behind other countries (Figure 1.29). Improving design and access to support would not only help to boost participation, but is also needed to strengthen opportunities for upskilling and lifelong learning. Unemployment and inactivity are strongly concentrated among low skilled, while people with disabilities have one of the lowest employment rates in the EU.

Figure 1.29. Use of active labour market policies is low



Note: Covers activation measures in category 20-70.
Source: OECD Labour Force Statistics; European Commission.

StatLink https://stat.link/tmh0b3

The current patchwork of many small activation programmes and evaluations based on surveys of self-reported outcomes (BMLSP, 2019) should be streamlined to make better use of resources. First, there is a need for better monitoring as workers move through the stages of inactivity, unemployment and employment to provide appropriate follow up with programme participants and perform proper quantitative evaluations. For instance, the Nordic countries use digital tools to track worker status from social benefit and tax records. Second, systematic evaluations of activation measures should be implemented to align programmes with labour market needs and ensure efficient allocation of resources. In this respect, reducing red tape and strengthening coordination across public services units and with employers are essential for successful employment outcomes. Estonia and Lithuania have reformed and increased spending on active labour market measures in recent years, helping to increase participation of more disadvantaged groups.

Quality jobs with high earnings and low insecurity is a key aspect of the new *OECD Jobs Strategy* (OECD, 2018a), in addition to raising employment and inclusion. Job quality in Bulgaria is low due to high earnings inequality and strict entitlement criteria for unemployment insurance, partly reflecting the widespread use of envelope payments (Box 1.3). The real minimum wage has increased by more than 8% per year on average since 2010, but at EUR 312 per month in 2020, it is still the lowest minimum wage in the EU and lower than in most OECD countries, also when taking into account lower living costs. Available estimates suggest that almost 9% of workers earned the minimum wage or less in 2014. Bulgaria has no legislation to set criteria or targets for updating the minimum wage. A welcome decision was reached with social partners in June 2020 to resume ongoing work to establish a transparent minimum wage setting mechanism.

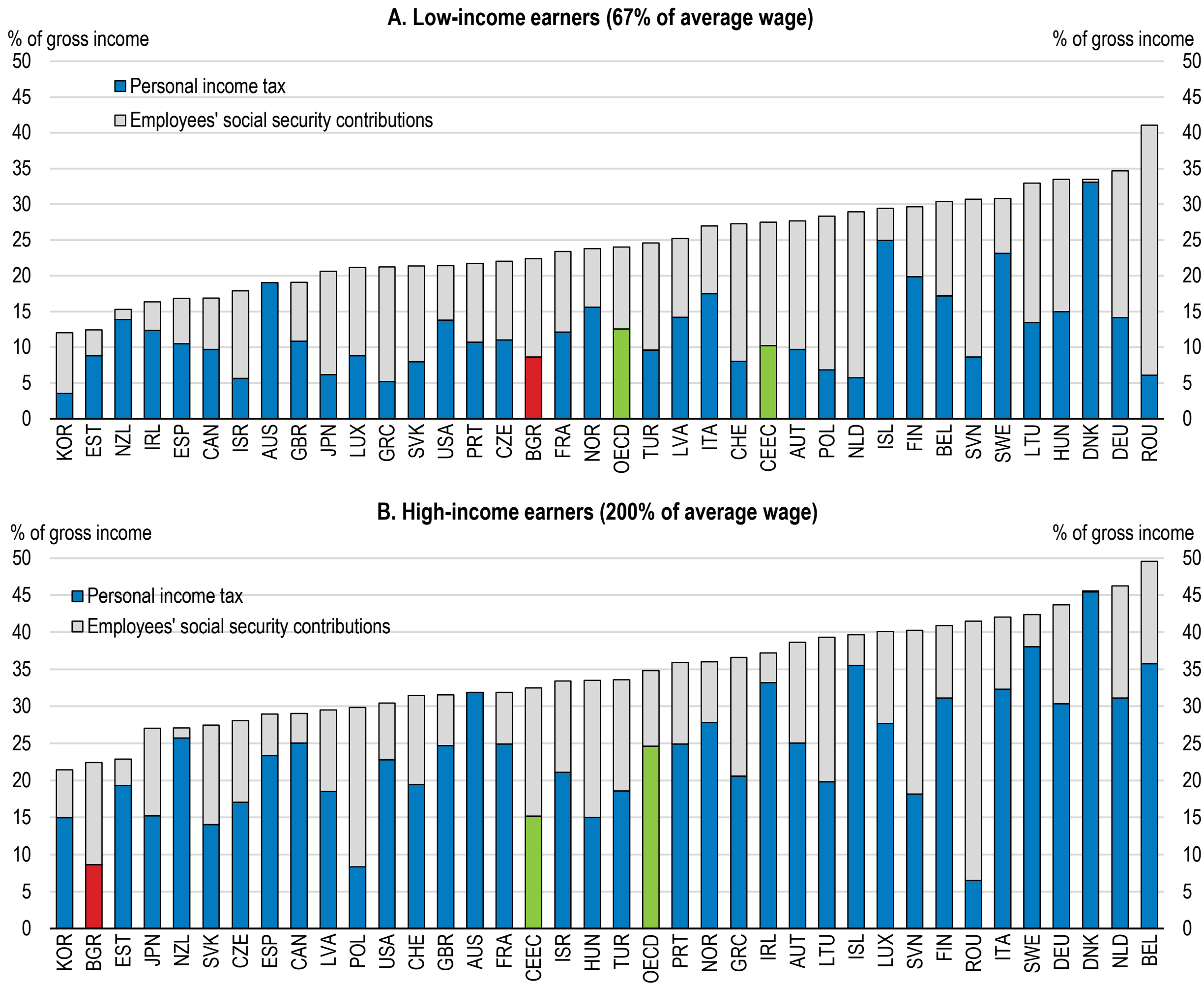
Improving educational outcomes and adult learning to boost skills for all is the prime tool to foster more quality jobs and reduce earnings inequality (Chapter 2). Nevertheless, strengthening wage-setting institutions and reforming tax-benefit systems would support a broader sharing of productivity gains (OECD, 2018b). Collective bargaining in Bulgaria covers only 20-30% of employees, lower than in many OECD countries but is still among the highest in Central and Eastern Europe (Kirov, 2019). As in most OECD countries, eroding bargaining reflects falling trade union membership to less than 15% of employees in 2016. Many employers likewise avoid membership of organisations, limiting collective bargaining mainly to the public sector and heavy industry. The labour code allows for administrative extension of sector-level collective agreements, but the mechanism has not been used since 2016. The government has limited options to influence wage setting, but through minimum wage and unemployment benefit levels it can help to strengthen workers' bargaining power.

Making the tax and benefit system work for all

Incentives to work from the tax and benefit system are comparatively strong, reflecting both low tax rates and very modest social minimum benefits to those out of work. Bulgaria has a flat income tax of 10%, introduced in 2008 to complement a similar flat corporate tax, with the aim of boosting growth by attracting investment and high-skilled workers as well as strengthening tax collection. However, social security contributions amount to 13.8% for employees and 19.2% for employers in 2019. As a result, labour income is in effect taxed at a high and proportional rate (average tax wedge 43%), while low and proportional taxation apply to capital income (see Figure 3.14 in Chapter 3). This results in a dual tax system with strong incentives for incorporation. Moreover, the combined average tax rate from income taxation and employees' social security contributions is close to the OECD average for low-income workers, but comparatively low for high-income workers (Figure 1.30). This is inefficient as it reduces labour demand for low-skilled workers and hampers inclusion through income redistribution (Brys et al., 2016).

Figure 1.30. No basic tax allowance results in tax rates for low incomes close to the OECD average

Average tax rate from personal income and social security contributions, 2019



Note: The average tax rate is calculated for a single household without children and housing costs at 20% of the average wage.
Source: OECD staff calculations using OECD TaxBen models.

StatLink https://stat.link/gmducv

Many Eastern European countries have used flat tax systems, but gradually introduced more progressivity as living standards improved. Latvia and Lithuania have replaced their flat tax with progressive taxation, while Estonia has increased the basic tax allowance substantially. Bulgaria provides a tax allowance of EUR 100 per child (Table 1.5), but has no basic tax allowance. Consideration should be given to reducing the tax burden for lower-income households in the medium or longer term since this would support job creation and labour market participation of low-skilled groups. Recent evidence across OECD countries suggests that having more tax progressivity for lower-middle income levels is associated with higher long-term output (Akgun et al., 2017). A tax reform focusing on reducing the tax burden for lower incomes could be combined with an increase in the standard personal income tax rate to finance other recommendations to boost growth and well-being in this *Assessment*. However, a possible tax increase should be delayed until the recovery from the COVID-19 crisis is well advanced.

Table 1.5. Tax allowances in flat tax countries

Annual allowances in personal income taxation, EUR, 2019

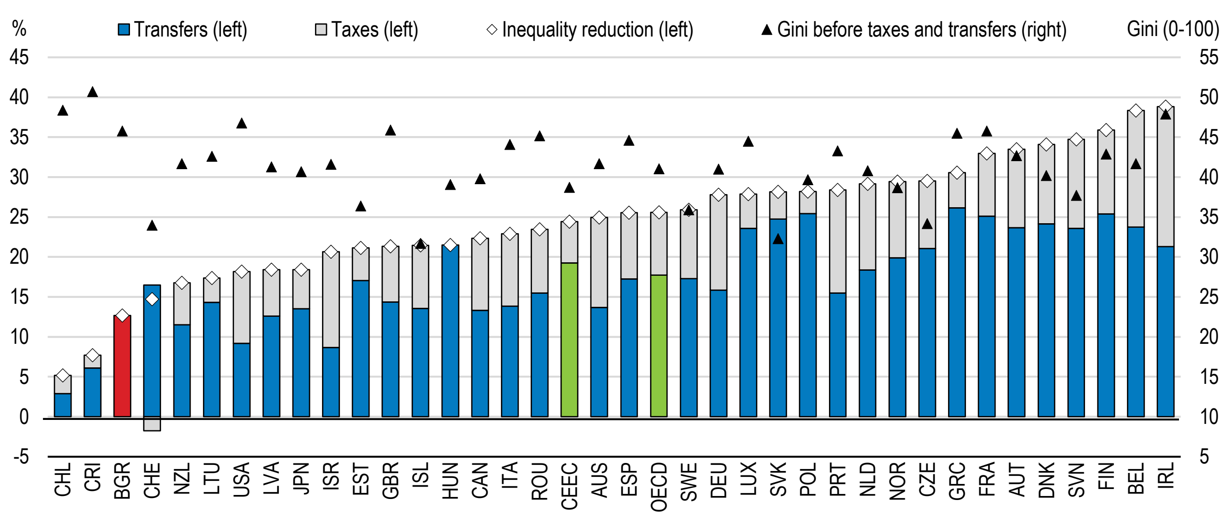
	Bulgaria	Romania	Hungary	Estonia
Basic tax allowance	No	1 285	No	6 000
Income phase-out in place	-	Yes	-	Yes
Family or children allowance	100 per child	403 per person in care (child or family member)	2 160 per child (higher for two or more children)	1 848 per child (from the second child)
Income phase-out in place	No	Yes	No	No
Flat income tax rate	10%	10%	15%	20%

Source: OECD TaxBen models.

Reducing the tax burden for lower-income groups would also have an important impact on income inequality. Combined income taxes, employees' social contributions and social cash benefits currently do little to support low-income households and reduce high income inequality (Figure 1.31; Hallaert, 2020). The inequality-reducing effect is quantified by comparing the Gini coefficient for household incomes before and after taxes and transfers for the working-age population. Bulgaria has comparatively high income inequality before taxes and transfers with a Gini coefficient above 45. Cash transfers reduces the Gini coefficient by a decent 13%, which given high ageing in Bulgaria may partly reflect the influence of public pensions to pensioners that are still included in the working-age population (age 15-65). On the tax side, there is almost no inequality reduction through personal income taxes and employees' social security contributions. Simulations based on the EUROMOD model suggest that an annual basic tax allowance of EUR 2 800 for low incomes financed by an increase in the statutory tax rate could reduce relative poverty by around 0.6 percentage point and inequality by 0.8 Gini points (Barrios et al., 2020).

Figure 1.31. Taxes and transfers do little to reduce high market income inequality

Percentage reduction in inequality by taxes and transfers, working-age population, 2018 or latest available year



Note: Inequality reduction is measured as the difference between Gini coefficients before and after taxes and transfers scaled by the Gini coefficient for household incomes before taxes and transfers, see Causa and Hermansen (2017). The split between transfers and taxes is computed using the Gini coefficient for income after transfers and before taxes. Taxes compose personal income taxes and employees' social security contributions, while transfers only include cash social benefits. Working-age population refers to age 18-65.
Source: OECD, Income Distribution database.

StatLink https://stat.link/5e3lpm

Nonetheless, the current flat income tax system has several advantages, which need to be weighed against the potential gains from a reform. Having no exemptions ensures simplicity and transparency and provides a robust tax base that has grown at a faster rate than the economy after the global financial crisis. Introducing, for example, a basic tax allowance, could require a sizeable increase in the personal income tax rate to be revenue neutral, although a phase out of the tax allowance for those with higher incomes as in Estonia and Romania would reduce the revenue lost. Thorough cost-benefit analysis is thus warranted when considering a reform of the flat tax system.

Public cash transfer schemes are in need of reform as well, not least to address persistently high poverty. Spending on social cash benefits, excluding pensions, was only 3.1% of GDP in 2018, well below most EU and OECD countries (Table 1.6). In addition, targeting of benefits is dire; only 15% of total cash transfers went to the bottom 20% of the working-age population in 2018, well below the OECD average of 24%. The main reasons are high rates of non-take up among the poorest households combined with limited and ineffective use of means-tested benefits. One study found that more than 40% of intended benefit recipients did not take up the benefits to which they were entitled (Tasseva, 2016). At the same time, more than 60% of social assistance claimants received benefits they were not entitled to as they could not pass the income-test based on the information they subsequently reported in the study. Available cross-country evidence suggests that these problems are similar or worse in Bulgaria compared to other Central and Eastern European countries (Avram, 2013; Fonayet et al., 2020).

Table 1.6. Spending on social protection benefits is low

Social protection benefits, excluding old age and survivor, per cent of GDP, 2018

	Bulgaria	CEEC	EU27
Cash and in kind			
Cash benefits	3.1	3.7	5.5
In kind benefits	5.4	5.2	8.8
Means-testing			
Means-tested benefits	0.5	0.6	2.4
Non means-tested benefits	8.0	8.4	11.9
Function			
Sickness and health care	4.9	5.1	7.8
Disability	1.2	1.3	2.0
Family and children	1.7	1.8	2.2
Unemployment	0.5	0.4	1.2
Housing	0.0	0.1	0.4
Social exclusion not classified elsewhere	0.2	0.2	0.6
Total social protection benefits to working-age population	**8.4**	**8.9**	**14.4**
Memorandum: Old age and survivors benefits	8.0	8.3	12.3

Source: Eurostat, Social protection database (ESSPROS).

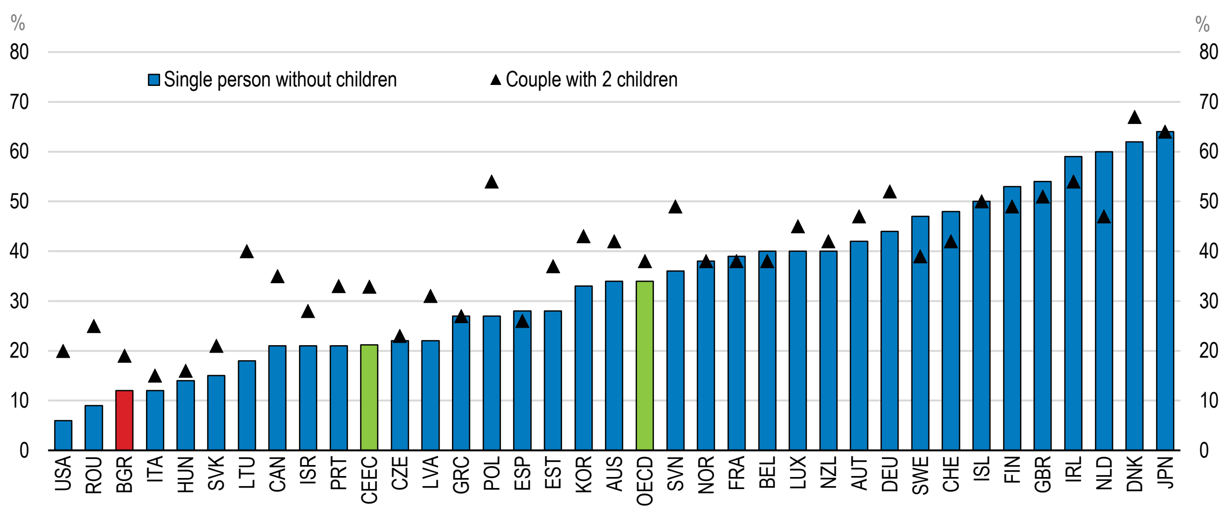
The benefit system in Bulgaria is fragmented, lacks coordination and targets individuals rather than families (World Bank, 2019). There are no fewer than 15 different transfers created through different laws and operated under different agencies and rules. The main non-contributory benefit schemes are:

- *Social Assistance based on the Guaranteed Minimum Income (GMI)*: This is a last resort benefit granted to low income households, conditional on income and assets tests and differentiated by age, family and housing arrangements. The benefit formula is complex and depends on income for the preceding month. For 2020, the GMI is EUR 38 per month and a typical family with two children would be entitled to EUR 46 per month, which is substantially below the poverty line and other countries (Figure 1.32).

- *Heating Allowance*: Additional social assistance for heating is available for five months of the year during winter. Entitlement criteria and benefit level follow a similar complex formula as for the GMI. For 2019/2020, the base allowance is EUR 48 per month with actual benefits varying according to the heating source, which can discourage investments to improve energy efficiency.
- *Benefits for Families with Children*: A monthly allowance for bringing up a child until age 20 or completion of secondary school is available for low-income families (less than EUR 250 per month). Benefit provision is conditional on school attendance, but evidence suggest that sanctions are rarely imposed. The maximum monthly benefit amount is EUR 20 per child in 2019. Other targeted benefits and one-offs are also available, for instance for lone parents, upon childbirth, adoption and first grade enrolment.

Figure 1.32. Minimum-income benefits are low

Guaranteed minimum income benefits, as a percentage of median disposable income, 2019



Note: Includes the heating allowance for Bulgaria.
Source: OECD, Benefits, Taxes and Wages database.

StatLink https://stat.link/zrcfwh

Qualitative analysis has found that the high complexity of programmes causes confusion for social workers, dealing with large amounts of paper work (Bogdanov and Zahariev, 2009). Similarly, claimants report that the application process is long and cumbersome and that the benefit amount is too low to provide sufficient income support.

The contributory benefit schemes, notably unemployment insurance, are likewise hard to access and with short duration. At least 12 months of employment during the latest 18 months are required to qualify for unemployment benefits and right to the maximum benefit period of 12 months requires no less than 15 years of employment. With less than three years of work, only four months of benefits can be claimed. These maximum durations are lower than in most OECD countries and penalises especially the youth and those with unstable careers. The benefit level is generally 60% of previous gross income with an upper ceiling of EUR 825 and a minimum level of EUR 100 per month, resulting in a comparatively high net replacement rate about 77% for low-wage earners. However, around 30% of the unemployed receive insurance benefits of less than EUR 250 per month insufficient to escape relative poverty, reflecting that they previously only worked part-time or part of the year (Stoilova and Staneva, 2018).

Because of low and hard accessible benefits, many families are strongly dependent on private transfers from relatives working abroad. Aggregate remittances inflow amounted to 3.4% of GDP in 2019 (World Bank), higher than in any OECD country. While remittances help to secure a living, there are indications that they may harm incentives for labour market participation (IME, 2019). Moreover, such income streams can stop abruptly as the COVID-19 shock has shown.

Bulgaria should reform the social benefit system by easing entitlement criteria and increasing generosity, while improving incentives and active support for labour market participation. For instance, a family of three living in a flat with more than two rooms is not eligible for social assistance, independent of the size of each room. A 2016 reform made some progress by combining all benefits for children with disabilities into one scheme. Several Eastern European countries have reformed their tax-benefit systems to strengthen inclusion, including Lithuania in 2017-2018 with a New Social Model reform that increased coverage and generosity of unemployment benefits and raised tax progressivity (OECD, 2018c). Simplification of benefit schemes could also be considered as in the United Kingdom, which replaced six means-tested schemes with the Universal Credit. Combining some of the many available benefits for children in Bulgaria could help to ease the administrative burdens. At the very least, there is a need to uprate social benefits more systematically to inflation. Currently, adjustment is irregular and can be delayed for a long time, for instance the GMI was nominally fixed from 2009 to 2017.

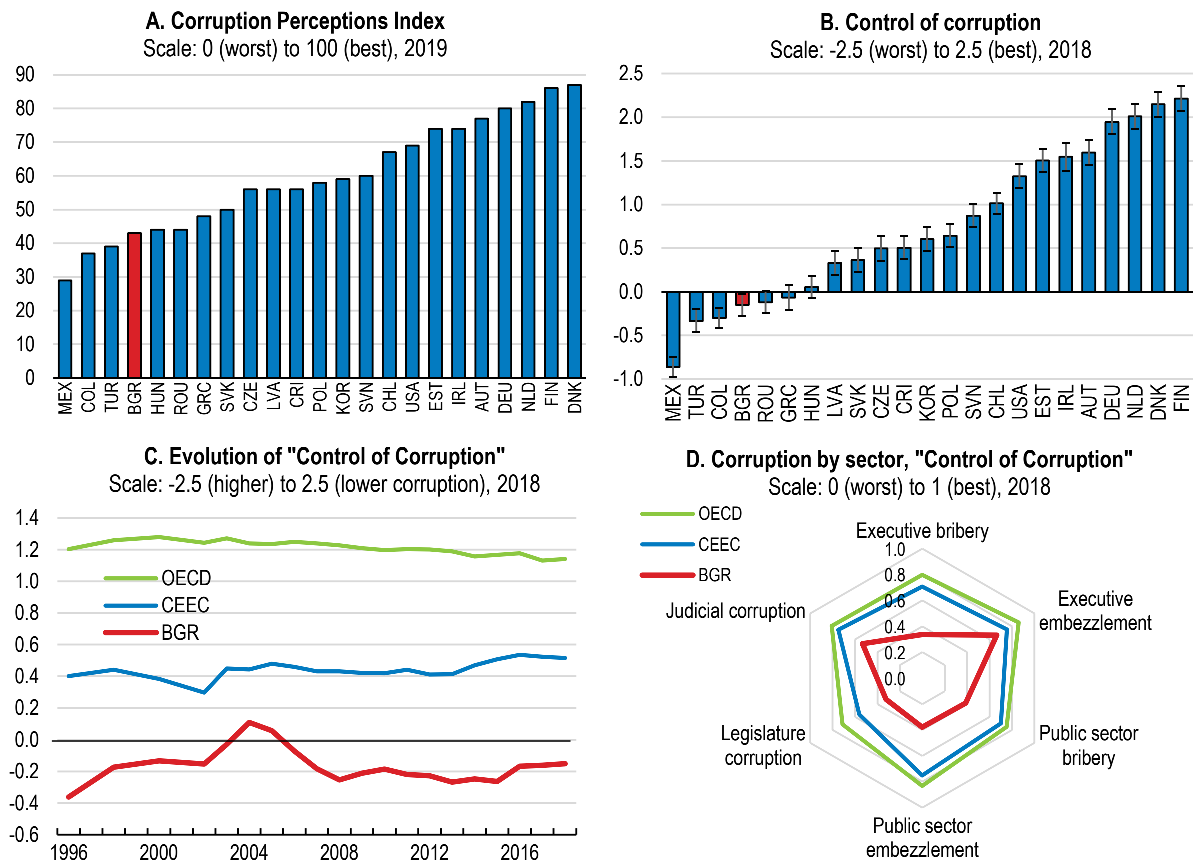
Promoting public integrity and succeeding in the fight against corruption

Over the past decade, Bulgaria has made substantial progress by consolidating its legal and institutional framework concerning administrative and judicial reform, and by strengthening the fight against corruption and tackling organised crime. In 2020, charges have been brought in a number of high-level investigations of corruption (European Commission, 2020d). Although corruption perception has declined since the late 1990s and despite many reforms, it has stagnated at a high level compared to OECD countries and remains an issue for both the public (Figure 1.33; European Commission, 2020e) and companies operating in the country (WEF, 2018; Worldwide Governance Indicators, 2019; GAN Integrity, 2017). While it takes time for reforms to show results and change perceptions, Bulgaria has not yet established a coherent public integrity system and it still lacks a solid record of convictions in high-level corruption cases (European Commission, 2019a; 2020d; Anti-Corruption Fund, 2020). Moreover, some appointment procedures to the anti-corruption institutions and judiciary caused public controversy and anti-corruption street protests have been ongoing since early July 2020 (Hope, 2020). Building public trust and gaining a reputation of independence and professionalism of the anti-corruption and judiciary institutions will thus be essential for the governance reforms to succeed.

The impact of corruption on economic performance is significant, as it affects the business climate, distorts markets and impedes effective service delivery (Chapter 2; IMF, 2019b). Corruption has also been found to be among the factors that discourage labour market participation and incentivise emigration (Cooray and Dzhumashev, 2018; Cooray and Schneider, 2016), both critical constraints for growth in Bulgaria. By building on the implemented governance reforms, Bulgaria could reduce the economic costs of corruption and accelerate income convergence. Estimates based on cross-country evidence suggest that closing half of the gap to the OECD average for the control of corruption indicator (Figure 1.33, Panel C) would boost GDP per capita by almost 5% in 10 years (Box 1.5). While such estimates are uncertain and the indicator captures institutional quality in a broad sense, the magnitude is nevertheless larger than all other quantified reforms combined.

According to the 2019 monitoring report under the EU's Cooperation and Verification Mechanism, Bulgaria has made sufficient progress in all its six focus areas to exit the mechanism (European Commission, 2019b). It was set up at the time of EU accession to ensure continued reform progress of the judiciary and in the fight against corruption and organised crime. The Commission likewise assessed advancements on governance of state-owned enterprises (Chapter 2) and implementation of anti-money laundering framework to be sufficient to allow entry into ERM II by July 2020 (cf. above). However, the recent EU rule of law assessment pointed to continued challenges in delivering concrete results (European Commission, 2020d) and the Commission has not yet formally closed the Cooperation and Verification mechanism for Bulgaria.

Figure 1.33. Corruption is perceived as high



Note: Panel B shows the point estimate and the margin of error. Panel D shows sector-based subcomponents of the "Control of Corruption" indicator by the Varieties of Democracy Project.
Source: Panel A: Transparency International; Panels B & C: World Bank, Worldwide Governance Indicators; Panel D: Varieties of Democracy Institute; University of Gothenburg; and University of Notre Dame.

StatLink https://stat.link/1as95z

The reforms have strengthened the roles of the specialised prosecutors, the anti-corruption agency, the internal inspectorates and the chief inspectorate under the Prime Minister's office in implementing integrity standards (European Commission, 2019b). However, to ensure that institutional responsibilities of the various bodies do not result in fragmented action and undermine implementation, the government should continue to use coordination mechanisms between entities at the national and subnational levels, such as formal councils, informal exchange of information or networks, as well as build on defined reporting procedures. Moreover, ensuring that key oversight actors, including the anti-corruption agency and the National Anti-Corruption Policy Council have the necessary financial and human resources will also be critical to ensure they fulfil their mandate.

To safeguard judicial independence and the rule of law, Bulgaria should implement accountability mechanisms for the Prosecutor General and improve the governance of judges (Council of Europe, 2020;

Venice Commission, 2020). Specifically, concerns have been raised regarding the Prosecutor General's power to influence cases and essential immunity from criminal investigation of himself (Council of Europe, 2020; European Commission, 2020d). In 2020, the Constitutional Court clarified that a Prosecutor General cannot exert his supervisory and methodological guidance role in cases against himself. However, in practice a criminal investigation against the Prosecutor General is unlikely to be opened since all investigators and prosecutors are subordinated to him and no practical possibility for suspending the Prosecutor General exists (Venice Commission, 2019; 2020). Reform is ongoing to address this long-standing issue by appointing a special prosecutor, following recommendations by the Venice Commission (2019; 2020). Resolving all concerns raised, including on appointment procedures (European Commission, 2020d), will be vital to signal commitment and build public trust. A draft law on accountability of the Prosecutor General is pending at the National Assembly and will be discussed upon receiving the Venice Commission's Opinion.

Internal control functions of public agencies have been improved, including the use of corruption risk assessments in the development and implementation of sectoral plans. Following an assessment, agencies are required to assign responsibilities, mandates and measures to address the corruption risks. The Anti-Corruption Commission prepares an analysis of all anti-corruption plans of ministries and state agencies. The National Anti-corruption Policy Council monitors their implementation and issues decisions with recommendations. Effective implementation of the risk assessment plans and the Council's recommendations would contribute to embedding a robust risk management culture, and improving fraud prevention and detection within public institutions. By increasing resilience to fraud and corruption, public institutions ensure taxpayers' money and public funds are not diverted from their intended use, thus contributing to strengthening socio-economic development and building trust in the government's actions.

In recent years, several cases of policy capture by private interests have been identified, such as the bankruptcy of the Corporate Commercial Bank in 2014, which was at the centre of an informal network of business and political elites (BTI Project, 2018), and is still being considered by the court. Several high-ranking officials, including the head of the anti-corruption agency, resigned in 2019 following allegations of acquisition of real estate below market prices, but subsequent inspections did not lead to claims of conflict of interest (Anti-Corruption Fund, 2020). Coupled with these cases, 78% of citizens surveyed feel that political connections are essential for business success. These relations negatively affect public decisions and the business environment, as a large majority (84%) agreed or tended to agree that "too close links between business and politics in Bulgaria lead to corruption" (European Commission, 2020e).

Established companies may have an interest in creating entry barriers to the markets or maintaining a status quo. They may invest into building and maintaining networks of reciprocity with public officials to influence public decision-making processes (OECD, 2017b). This may contribute to discouraging new businesses and innovators who lack the knowledge of administrative processes and contacts in the public administration (OECD, 2017b; SGI, 2018). Strengthening transparency on media ownership in a country that ranks 111 out of 180 countries on the World Press Freedom Index (Reporters Without Borders, 2020), down from 87 in 2013, and where media has significant influence on political life (Ganev et al., 2018; BTI Project, 2018; European Commission, 2020d) would contribute to improving the integrity of public decision-making processes. To mitigate risks of policy capture and undue influence, the government should also introduce legislation to regulate lobbying activities. This legislation could aim to enhance transparency of interests and influences affecting the design, assessment, monitoring and reform of public decisions. To improve detection of possible integrity breaches, procedures and protection of whistle-blowers likewise need strengthening. Bulgaria will implement the EU Directive on whistle-blower protection by 2022 and it should use this opportunity to encourage officials to use the mechanisms and enhance people's acceptance of whistle-blower activities.

Table 1.7. Recommendations on macroeconomic and selected structural policies

MAIN FINDINGS	RECOMMENDATIONS (key recommendations are in bold)
Fiscal and financial policy to mitigating the impact of COVID-19	
Bulgaria entered the pandemic in a strong fiscal position and has put in place a fiscal support package during the pandemic.	**Extend the duration of fiscal support measures to families and firms, and expand them in case of a resurgence of the pandemic.** **Ensure an effective and rapid use of the available European Union funding to support the recovery.** **Once the recovery is well underway, move back towards a balanced budget by increasing revenues and improving spending efficiency, and longer term continue ensuring fiscal sustainability.**
The 60:40 wage subsidy scheme has protected jobs and household incomes from the impact of the COVID-19 shock. The health system will need to increase capacity to deal with the large growth in COVID-19 infections and to prepare for the COVID-19 vaccination programme.	**Establish additional benefit and employment programmes to protect those not covered by the social safety net and help people move to new jobs.** Strengthen capacity of the health system to deal with the COVID-19 pandemic and rapidly implement the vaccination programme.
Non-performing loans have been reduced, but remain well above OECD average levels. Deteriorating economic prospects are expected to adversely affect asset quality in view of the potential worsening of the financial situation of firms and households as a result of COVID-19 pandemic.	**Deepen liquidity support to firms and households through the financial sector, if warranted.**
After integrating into regional and global value chains, the challenge is now to boost the domestic value added of gross exports generated through this activity.	Focus innovation support on domestic firms engaging in the supply of inputs to multinational/foreign firms.
Spending pressures related to the ageing population could rise by more than expected. Low retirement incomes could lead to growing social pressure to increase their adequacy.	Accelerate the equalisation of the pension age for women and men. Increase the retirement age to link it to improvements in life expectancy.
Supporting decarbonisation of the economy	
Coal accounts for almost half of energy production and is an important source of high air pollution and greenhouse gas emissions. Pricing of the environmental costs of fossil fuels is uneven across sectors.	**Gradually remove support for fossil fuels and align carbon prices for sectors outside of the EU Emissions Trading System (ETS), while protecting poorer households.** **Support reskilling and relocation of displaced workers in coal regions.**
Energy efficiency is lower than in most OECD countries, notably in the residential building sector.	**Continue to support housing renovation and improve targeting to low-income groups.** **Provide information about the benefits of energy saving investments to households.**
Improving inclusiveness	
The share of youth not in education, employment or training is high, especially among the Turkish and Roma populations.	Improve outreach of current support services and expand the Youth Guarantee Programme.
Coverage and spending on active labour market programmes are low.	**Invest more in coverage and quality of active labour market policies.** Implement systematic impact assessment of active labour market programmes to focus funding on those that are effective.
Collective bargaining has declined and only covers 20-30% of employees. While the minimum wage has increased robustly, it remains low at just EUR 312 per month in 2020 and has no target or indexation mechanism to ensure future increases.	Collaborate with social partners to install a transparent and objective minimum wage setting mechanism to reflect inflation and productivity growth.
The flat personal income tax of 10% with no basic tax allowance combined with social security contributions places a high tax burden on lower-income households compared to other countries. Nonetheless, potential gains from a reform need to be weighed against the advantages of the current tax system.	**Consideration should be given to reducing the tax burden for lower-income individuals in the medium or longer term.**
Spending on social protection benefits is comparatively low and benefits are poorly targeted to the lowest income households, reflecting high non-take up combined with limited and ineffective means testing.	**Relax entitlement criteria and increase generosity of social benefits.** **Streamline and simplify multiple and complex means-tested social benefit schemes, notably for families with children.**
Improving governance for a stronger post-COVID-19 recovery	
In spite of significant governance reforms, key integrity and anti-corruption institutions are not forming a coherent public integrity system, resulting in fragmented action and limited impact.	**Provide the integrity and anti-corruption institutions with the necessary responsibilities, coordination mechanisms and resources to fulfil their role.**

Judicial reform has made substantial progress, but accountability needs further strengthening and judicial independence needs to be safeguarded.	**Implement an effective and transparent accountability mechanism for the Prosecutor General in line with international standards.** **Enhance judicial independence in relation to the probation period in appointing judges and the composition of the Supreme Judicial Council.**
Several cases of vested interests between businesses and political elites have been identified in recent years. There is no regulation of lobbying activities and international rankings suggest challenges in ensuring media freedom.	**Introduce lobbying regulation, including a code of conduct for the engagement of lobbyists with members of Parliament.** **Protect the independence of media to ensure the integrity of public decision-making processes.**
Whistle-blowing mechanisms and protections are comparatively weak.	**Implement the EU whistle-blower Directive and launch a campaign to enhance officials and the public's acceptance of whistle blowing.**

References

Akgun, O., B. Cournède and J.M. Fournier (2017), "The effects of the tax mix on inequality and growth", *OECD Economics Department Working Papers*, No. 1447, OECD Publishing, Paris, https://doi.org/10.1787/c57eaa14-en.

Anti-Corruption Fund (2020), *Anti-Corruption Institutions: Activity Without Visible Results*.

Association of Banks in Bulgaria (2020), *Quarterly Bulletin*, Issue 62, July 2020.

Avram, S. (2013), "Outcomes of social assistance in Central and Eastern Europe: A pre-transfer post-transfer comparison", *ISER Working Paper Series*, No. 2013-18.

Barrios, S. et al. (2020), "Progressive Tax Reforms in Flat Tax Countries", *Eastern European Economics*, Vol. 58/2, pp. 83-107.

BME and BMEW/Bulgarian Ministry of Energy and Ministry of Environment and Water (2020), *Integrated Energy and Climate Plan of the Republic of Bulgaria, 2021-2030*.

BMES/Bulgarian Ministry of Education and Science (2013), *Strategy for reducing the share of early school leavers (2013-2020)*.

BMLSP/Bulgarian Ministry of Labour and Social Policy (2019), *Elaboration of a subsequent assessment of the effect of the active labour market policy financed by state budget resources at individual level (net effect) of the programs and measures, included in the national employment action plan for 2017*.

Bogdanov, V. and Zahariev, B. (2009), *Analysis of the situation in relation to minimum income schemes in Bulgaria. A study of national policies*, European Commission.

Brys, B. et al. (2016), "Tax design for Inclusive Economic Growth", *OECD Taxation Working Papers*, No. 26, OECD Publishing, Paris, https://doi.org/10.1787/5jlv74ggk0g7-en.

BTI Project (2018), *Bulgaria Country Report*, Bertelsmann Transformation Atlas, Bertelsmann Stiftung.

Bulgarian Government (2019), *Bulgaria 2030: National Development Programme*.

Bulgarian Government (2013), *National strategy for reducing poverty and promoting social inclusion 2020*.

Bulgarian National Bank (2020), Economic Review, Issue 1/2020.

Causa, O. and M. Hermansen (2017), "Income redistribution through taxes and transfers across OECD countries", *OECD Economics Department Working Papers*, No. 1453, OECD Publishing, Paris, https://doi.org/10.1787/18151973

Cooray, A. and F. Schneider (2016), "Does corruption promote emigration? An empirical examination", *Journal of Population Economics*, Vol. 29/1, pp. 293-310.

Cooray, A. and R. Dzhumashev (2018) "The effect of corruption on labour market outcomes", *Economic Modelling*, August, pp. 207-218.

Council of Europe (2020), Decision by the Committee of Ministers of the Council of Europe on Kolevi v. Bulgaria, 3 September 2020, CM/Del/Dec(2020)1377bis/H46-9.

Di Ubaldo, M., M. Lawless and I. Siedschlag (2018), "Productivity spillovers from multinational activity to local firms in Ireland", *OECD Productivity Working Papers*, No. 16, OECD Publishing, Paris, https://doi.org/10.1787/58619717-en.

Égert, B. and P. Gal (2017), "The quantification of structural reforms in OECD countries: A new framework", *OECD Economics Department Working* Papers, No. 1354, OECD Publishing, Paris, https://doi.org/10.1787/2d887027-en.

Eurofound (2017), *Social Mobility in the EU*.

European Central Bank (2019), *ECB concludes comprehensive assessment of six Bulgarian banks*, Press Release, 26 July 2019.

European Commission (2020a), “Undeclared Work in the European Union”, *Special Eurobarometer 498 – September 2019*.

European Commission (2020b), *Country Report Bulgaria 2020*.

European Commission (2020c), *Youth Guarantee country by country: Bulgaria.*

European Commission (2020d), *2020 Rule of Law Report: Country Chapter on the rule of law situation in Bulgaria*.

European Commission (2020e), “Corruption”, *Special Eurobarometer 502 – June 2020.*

European Commission (2019a), *Progress in Bulgaria under the Cooperation and Verification Mechanism*, Technical report.

European Commission (2019b), *Progress in Bulgaria under the Cooperation and Verification Mechanism*, Progress report.

European Commission (2018a), The 2018 Ageing Report: Economic and Budgetary Projections for the EU Member States (2016-2070), *Institutional Paper*, No. 79.

European Commission (2018b), Volume I: Current and future income adequacy in old age in the EU, *Pension Adequacy Report 2018*.

European Commission (2017), “Impact of fiscal policy on income distribution”, *Report on Public Finances in EMU 2017*, pp. 71-131.

Fonayet, F., Á. Eraso and J. Sánchez (2020), “Efficiency of Social Expenditure Levels in Reducing Poverty Risk in the EU-28”, *Poverty & Public Policy*, Vol. 12/1, pp. 43-62.

GAN Integrity (2017), *Bulgaria Corruption Report*.

Ganev, G., M. Popova and F. Bönker (2018), *Bulgaria Report, Sustainable Governance Indicators*, Bertelsmann Stiftung.

Guillemette, Y., et al. (2017), "A revised approach to productivity convergence in long-term scenarios", *OECD Economics Department Working Papers*, No. 1385, OECD Publishing, Paris, https://doi.org/10.1787/0b8947e3-en.

Hallaert, J.-J. (2020), “Inequality, Poverty, and Social Protection in Bulgaria”, *IMF Working Paper*, No. 20/147.

Hertz, T., M. Meurs and S. Selcuk (2009), “The Decline in Intergenerational Mobility in Post-Socialist Bulgaria”, *World Development*, Vol. 37/3, pp. 739-752.

Hope, K. (2020), “Bulgarian PM under pressure amid anti-corruption protests”, *Financial Times*, 16 July 2020.

IEA (2019), *World Energy Outlook 2019*, OECD Publishing, Paris, https://doi.org/10.1787/caf32f3b-en.

IMF (2019a), “Corporate Productivity in Bulgaria”, *Selected Issues, IMF Country Report*, No. 19/84.

IMF (2019b), “Bulgaria’s Governance Reforms”, *Selected Issues, IMF Country Report*, No. 19/84.

IME/Institute for Market Economics (2019), *Assessment of the people not in employment, education and training (NEETs) in Bulgaria and policy measures to effectively address their integration*, European Commission, VC/2019/017.

Ivanova, N., and E. Ivanov (2017), “The role of Bulgaria in global value chains”, *Bulgarian National Bank Discussion Paper*, DP/105/2017.

JRC/Joint Research Centre (2018), *EU coal regions: Opportunities and challenges ahead*, JRC Science for Policy Report.

Kirov, V. (2019), “Bulgaria: collective bargaining eroding, but still existing”, Chapter 4 in Müller, T. et al. (eds.), *Collective bargaining in Europe: towards and endgame*, Vol. I, European Trade Union Institute (ETUI).

Kummritz, V., D. Taglioni and D. Winkler (2017), “Economic upgrading through global value chain participation : which policies increase the value added gains?”, *Policy Research Working Paper*, No. 8007, World Bank Group.

Medina, L. and F. Schneider (2017), “Shadow Economies Around the World: New Results for 158 Countries Over 1991-2015”, *CESifo Working Paper Series*, No. 6430.

Muir, D. and A. Weber (2013), “Fiscal Multipliers in Bulgaria: Low But Still Relevant”, *IMF Working Papers*, No. 13/49.

National Statistical Institute (2018), *Poverty mapping in the Republic of Bulgaria*.

NEA (2020), *Nuclear power and the cost-effective decarbonisation of electricity systems*, NEA Policy Brief.

OECD (2020a), *OECD Economic Outlook, Interim Report September 2020*, https://doi.org/10.1787/34ffc900-en.

OECD (2020b), *OECD Economic Outlook, Volume 2020 Issue 2*, No. 108, OECD Publishing, Paris, https://doi.org/10.1787/39a88ab1-en.

OECD (2020c), *COVID-19 and the low-carbon transition. Impacts and possible policy responses*, OECD Policy Responses to Coronavirus (COVID-19), OECD Publishing, Paris.

OECD (2019a), *OECD Review of the Corporate Governance of State-Owned Enterprises: Bulgaria*.

OECD (2019b), *Under Pressure: The Squeezed Middle Class*, OECD Publishing, Paris, https://doi.org/10.1787/689afed1-en

OECD (2018a), *Good Jobs for All in a Changing World of Work: The OECD Jobs Strategy*, OECD Publishing, Paris, https://doi.org/10.1787/9789264308817-en.

OECD (2018b), *OECD Employment Outlook 2018*, OECD Publishing, Paris, http://dx.doi.org/10.1787/empl_outlook-2018-en.

OECD (2018c), *OECD Economic Surveys: Lithuania 2018*, OECD Publishing, Paris, https://doi.org/10.1787/eco_surveys-ltu-2018-en.

OECD (2017a), *Preventing Ageing Unequally*, OECD Publishing, Paris, https://doi.org/10.1787/9789264279087-en.

OECD (2017b), *Preventing Policy Capture: Integrity in Public Decision Making*, OECD Public Governance Reviews, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264065239-en.

Reporters Without Borders (2020), *Bulgaria: Black sheep of the European Union*.

Schneider, F. (2016), “Estimating the Size of the Shadow Economies of Highly-developed Countries: Selected New Results”, *CESifo DICE Report*, Vol. 14/4, pp. 44-53.

SE3Tnet (2020), *Accelerated lignite exit in Bulgaria, Romania and Greece*.

SGI/Sustainable Governance Indicators Network (2018), *Bulgaria Report, Sustainable Governance Indicators 2018*, Bertelsmann Stiftung.

Solt, F. (2020), “Measuring Income Inequality Across Countries and Over Time: The Standardized World Income Inequality Database”, *Social Science Quarterly*, Vol. 101/3, pp. 1183-1199.

Stoilova, R. and M. Staneva (2018), *The Middle Class in Bulgaria*, in: Siegmann, A. and M. Schäfer (eds.), *No Robots: The Position of Middle-Class Households in Nine European Countries*, Nieuwe Haagsche.

Taglioni, D. and D. Winkler (2016), *Making global value chains work for development*, The World Bank.

Tasseva, I. (2016), “Evaluating the performance of means-tested benefits in Bulgaria”, *Journal of Comparative Economics*, Vol. 44/4, pp. 919-935.

Venice Commission (2020), *Urgent interim opinion on the draft new constitution*, Opinion No. 1002/2020.

Venice Commission (2019), *Opinion on draft amendments to the Criminal Procedure Code and the Judicial System Act, concerning criminal investigations against top magistrates*, Opinion No. 968/2019.

WEF/World Economic Forum (2018), *The Global Competitiveness Report 2018*.

Williams, C. and J. Yang (2017), “Tackling Falsely-Declared Salaries in Bulgaria: Evidence from a 2015 Survey”, *Economic Alternatives*, Issue 3, pp. 333-351.

World Bank (2019), *Harmonizing services for inclusive growth: Improving access to essential services for vulnerable groups in Bulgaria*, Technical report.

2 Structural reforms to raise productivity and boost convergence

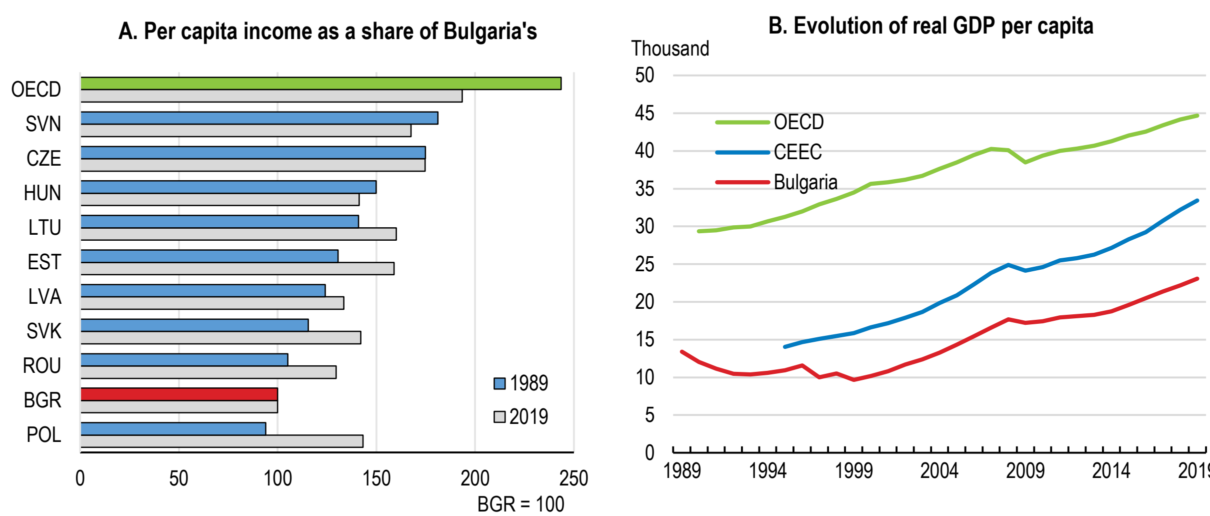
Bulgaria has achieved the transition from high economic volatility to a stable economy with a strong performance in recent history of weathering external and domestic shocks. However, convergence to average EU incomes has been slower than for better-performing Central and Eastern European peers. The focus here is on economy-wide measures that would improve the business environment, stimulate productivity and boost growth. These include decreasing regulatory barriers to firm entry and exit, reducing the cost of red tape, and improving skills and innovation. Increasing competition in the economy is a priority given that regulatory barriers to competition are high compared to the EU and most OECD countries. Ensuring competition principles are entrenched in broader public policies, particularly public procurement, will be important to increase competitive practices in the economy. Improving the performance of SOEs through corporate governance and ownership practices is of critical importance given their large role in providing electricity and transport services. These structural reforms will be particularly important to recover from the COVID-19 shock. A large reallocation of production factors will be needed to move away from industries suffering from long-lasting damages to those that will benefit from strong growth. Such reforms would also help a successful integration in the euro area.

Income convergence needs to accelerate

Bulgaria's strong macroeconomic policy framework has assisted the economy to withstand the COVID-19 crisis. Nevertheless, convergence has been less rapid than for better-performing Central and Eastern European peers (CEEC). The CEEC countries with per capita incomes closest to Bulgaria in 1989—Poland, Romania, Slovakia, Latvia, Estonia and Lithuania—have grown faster, widening their income gap with Bulgaria (Figure 2.1, Panel A). Bulgaria's slower convergence is to a large degree due to underperformance in the 1990s, when the country suffered a series of economic contractions, with detrimental impacts on labour productivity (Table 2.1). Performance has been stronger since 2000, with the convergence with OECD countries rising since 2014 (Figure 2.1, Panel B) and further implementation of structural reforms would ensure that this trend will continue.

Figure 2.1. Bulgaria's income growth has lagged behind other CEEC countries

Real GDP in constant 2017 USD PPP



Note: Panel A shows the real GDP per capita of the CEE countries and Baltic States that had incomes closest to that of Bulgaria in 1989. These were the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia, defined later on as CEEC.
Source: OECD; World Bank, World Development Indicators database.

StatLink https://stat.link/4fzrcw

Bulgaria has carried out an impressive range of reforms in recent years. These include measures to strengthen financial sector supervision and to improve the legal frameworks for State-Owned Enterprises (SOE) governance and anti-money laundering required to join the European Exchange Rate Mechanism II (ERM II) and the Banking Union. The Bulgarian lev was included in the ERM II in July 2020, and the European Central Bank and the Bulgarian National Bank have established close cooperation over bank supervision. The simultaneous joining of the ERM II and the Banking Union paves the way for future euro area membership. Current productivity growth rates of around 3% will not be sufficient to deliver rapid convergence with euro area incomes given that Bulgaria has the lowest per capita income in the EU. Still-high real wage differentials with the euro area means that wage growth will need to keep in line with productivity growth to ensure competitiveness and keep down inflation. The large decline in the working-age population that is due to occur increases the possibility that the substantial wage pressures seen in recent years will re-emerge.

Table 2.1. Recent labour productivity growth exceeds the OECD, catching up with CEEC peers

Output per worker growth and its components

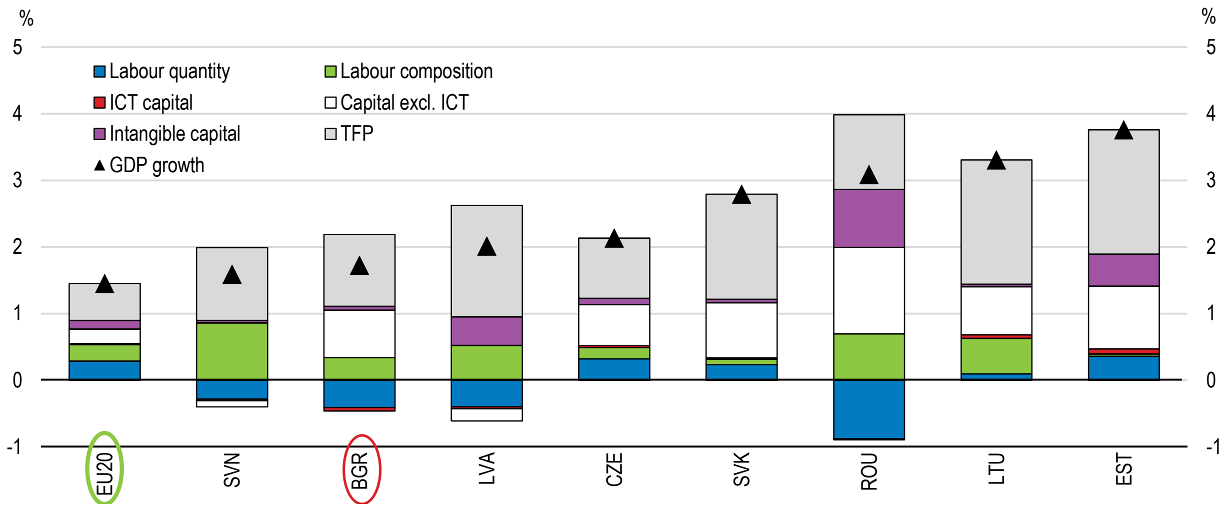
		Output per worker growth	Output per hour worked growth	Average hours worked growth
	1995-2019	**2.3**	**2.5**	**-0.2**
Bulgaria	1995-2000	-0.4	0.5	-0.8
	2000-2007	3.9	3.7	0.1
	2010-2019	2.7	2.7	0.0
	1995-2019	**1.2**	**1.4**	**-0.2**
OECD	1995-2000	2.0	2.1	-0.1
	2000-2007	1.4	1.8	-0.4
	2010-2019	0.8	0.9	-0.1
	1995-2019	**3.4**	**3.7**	**-0.2**
CEEC	1995-2000	4.0	3.9	0.1
	2000-2007	4.9	5.2	-0.3
	2010-2019	2.5	2.9	-0.3

Note: CEEC is the average of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
Source: OECD, Productivity database.

Intangible capital and multifactor productivity need to become more important growth drivers to increase convergence and compensate for the shrinking labour force. The largest contributions to growth in recent years have come from multifactor/total factor productivity growth and capital deepening (Figure 2.2). Multifactor productivity has played less of a role in driving growth than in the fastest converging CEEC peer countries, indicating that growth could be speeded up by larger improvements in the overall efficiency of economy. Capital deepening could strengthen if foreign investment inflows to the manufacturing sector rebounded towards early 2000s highs (Key Policy Insights). Labour quantity has negatively impacted on growth, while the changing composition of labour or quality of the labour force has been positive but of smaller magnitude than several CEEC countries. Intangible capital contributes far too little to growth. This consists of the growth in spending on R&D, software, databases, copyrights, designs, trademarks, and organisation and distribution networks, and has become an increasing driver of productivity growth in OECD countries (Demmou, Stefanescu and Arquie, 2019).

Figure 2.2. Intangible capital needs to be boosted to increase growth

Contributions to GDP growth, average 2010-2017 or latest year available

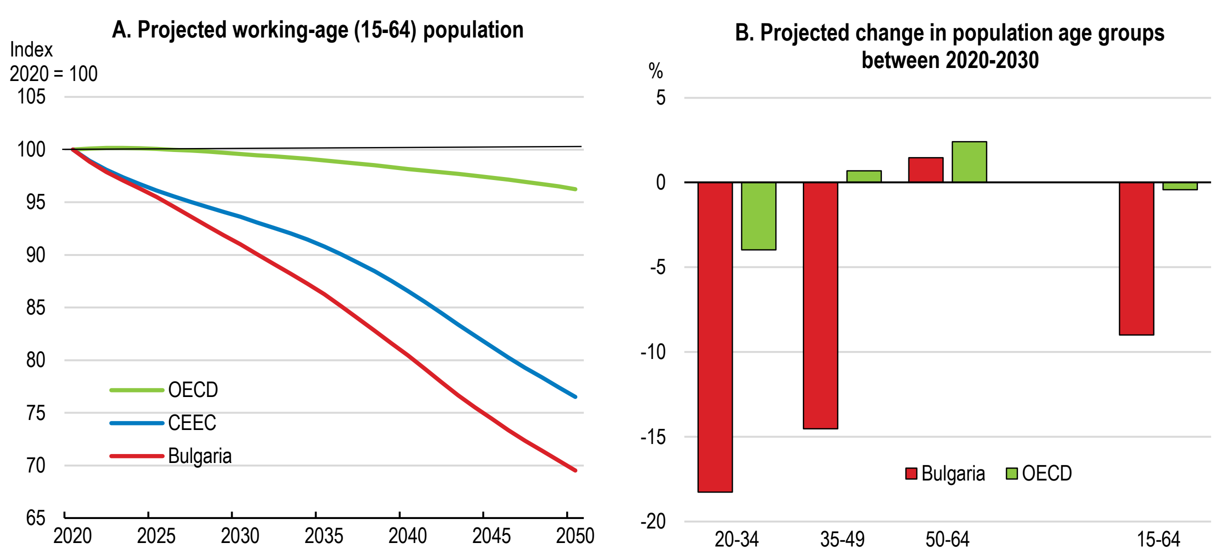


Source: EU KLEMS database, 2019 release; Stehrer, R., et al. (2019), "Industry level growth and productivity data with special focus on intangible assets", wiiw Statistical Report No. 8.

StatLink https://stat.link/wgu9qy

The working-age population is set to shrink by a quarter in less than 20 years. The decline in the working-age population has already begun (Figure 2.3 Panel A) and the economy prior to COVID-19 had been hit by a shortage of workers. Workers are set to become older as younger age groups shrink substantially in the next decade (Figure 2.3 Panel B). It is critical to make the most of the working-age population by maximising labour-force participation (Key Policy Insights) and skills for an ageing workforce. This makes it important that the population benefits from education and training throughout the lifecycle.

Figure 2.3. The working-age population is shrinking and ageing quickly



Source: United Nations, Department of Economic and Social Affairs, Population Division (2019), World Population Prospects 2019, Online Edition. Rev. 1.

StatLink https://stat.link/5ulixp

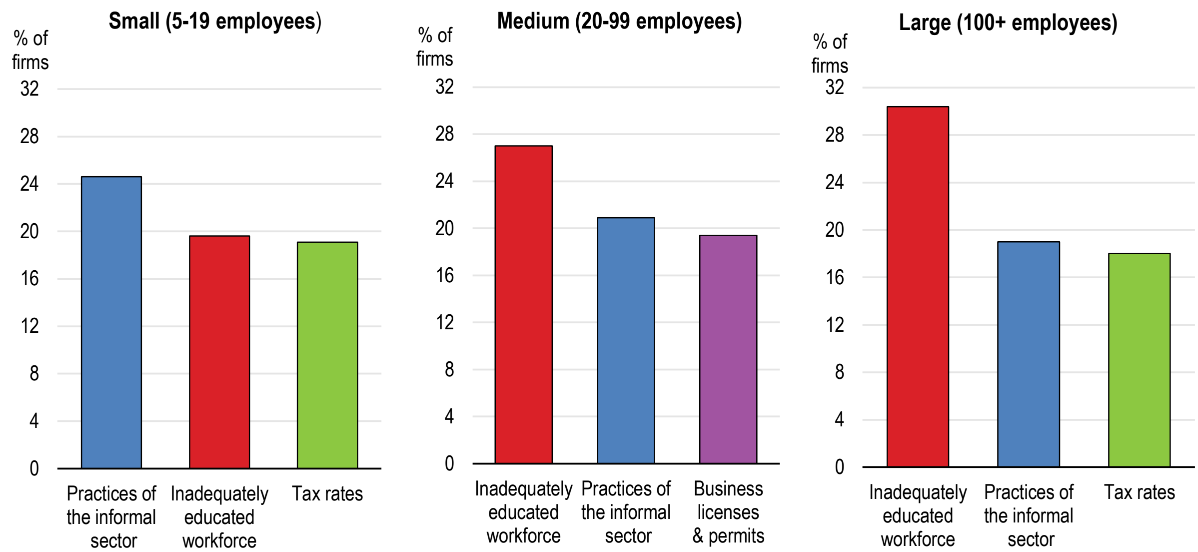
Skills and innovation will need to take on an increasing role in driving productivity given the declining workforce. Poor PISA progress, high dropout rates in secondary education, and the large proportion of NEETs (young people neither in employment nor in education or training) are worrying indicators for a country facing ever-shrinking younger cohorts. Innovation is held back by the low levels of R&D public and private spending, and much lower than average EU employment and export share in high and medium tech manufacturing. Increasing digitalization and the use of information and communication technologies (ICT) to improve products and processes is important to raise firm productivity.

Investment has declined and firms devote a lower share of capital to R&D and ICT activities than on average in the EU. The gross investment rate of non-financial corporations was 23.8% in 2017, falling from over 30% prior to 2013 (Eurostat). While this is close to the EU average, increasing investment, particularly on R&D and ICT, will be important to increase firm productivity. Attracting foreign direct investment could contributed to further develop the export sector and increase value-added (Key Policy Insights). The proportion of firms that invest is the lowest of any EU economy. Two-thirds of companies invested in the last financial year compared to 85% on average in the EU and in the United States according to the *2019 EIB Group Survey on Investment and Investment Finance (EIBIS, 2019)*. Enterprises invest mostly in machinery and equipment and put substantially lower investment shares into intangible inputs like R&D and ICT compared to the EU average. Firms cited the top two barriers to investment as the availability of skilled staff and uncertainty on future prospects (EIBIS, 2019). The use of internal funds to finance investment (69%) is above the EU average (62%), though firms do not report a large problem with accessing credit. The measures focused on in this chapter are aimed at improving the investment climate for firms. The OECD's forthcoming *Investment Policy Review of Bulgaria* report will give an in-depth assessment of the barriers and opportunities in the country.

A shortage of appropriately skilled workers comes out as the biggest business environment constraint faced by firms in multiple surveys pre-COVID-19. An inadequately educated workforce and competition from informal firms came out as the top two obstacles to business growth in the 2019 World Bank's Enterprise Survey, with skills ranking as more important for larger firms and informal practices for small and medium-sized firms (Figure 2.4). Both these factors are given more importance by firms than in OECD countries on average. While tax rates feature as the third largest hindrance overall, when examined the tax burden on firms appears comparatively low. The corporate tax flat rate of 10% is the second lowest in the EU. Employer contributions to social security at just under 20%—the incidence of which falls more on labour than on firms—are relatively low in the EU context.

Figure 2.4. Informality and inadequate skills are the top two constraints for businesses

Top three business constraints by firm size, 2019



Source: World Bank, Enterprise Surveys, https://www.enterprisesurveys.org.

StatLink https://stat.link/py84k1

Informal practices of concern in Bulgaria are tax evasion and the high incidence of under declared work. The informal economy is relatively large compared to EU countries, but has contracted over time and its size is in line with the country's level of development (Key Policy Insights). Informal employment does not occur because people work without a contract, but instead is due to workers receiving an additional payment not included in their contract. Taxes, health and social insurance are not paid on this additional informal payment ("under declared work"). The country has made progress in reducing the size of the informal economy and increasing tax compliance, with a strong emphasis on employing a range of detection and deterrence measures to fight tax evasion and ensure registration of labour contracts. The motivation for accepting under declared work on the side of employees appears to be strongly related to wanting to increase take-home incomes, low tax morale and wide acceptance of the practice rather than avoiding excessive bureaucracy (European Commission, 2019a).The current crisis is likely to lead to increased informality given deteriorating labour market conditions.

The chapter goes on to focus on economy-wide structural reforms to enhance the business environment, raise productivity in the enterprise sector and increase convergence. These cover increasing competition, reducing red tape for enterprises, easing firm exit and rehabilitation, and enhancing skills and innovation. Improving infrastructure, further supporting financial development, and reducing corruption are important and dealt with elsewhere in the Economic Assessment (Key Policy Insights and Chapter 3).

Improving the regulatory framework for enterprise activity

Reducing regulatory barriers to competition

Regulatory barriers to competition are generally high and reducing them can raise productivity by supporting a more efficient allocation of resources in the economy, a challenge that becomes all the more pressing in the wake of COVID-19. The OECD's product market regulation indicators measure how competition friendly a country's regulatory environment is by assessing the alignment of its laws and regulations with international best practice. The regulatory barriers to competition in Bulgaria are higher than for all OECD countries, with the exception of Colombia and Turkey, based on the results for the economy-wide 2018 product market regulation indicators (Figure 1.20, Panel A). Breaking down the economy-wide measure indicates that Bulgaria is notable for high administrative requirements and an onerous licensing regime for new businesses and extensive public ownership of large operators in network sectors (Figure 1.20, Panel B). As an EU member, the barriers to trade and inward foreign direct investment are low relative to the OECD average (Figure 1.20, Panel B).

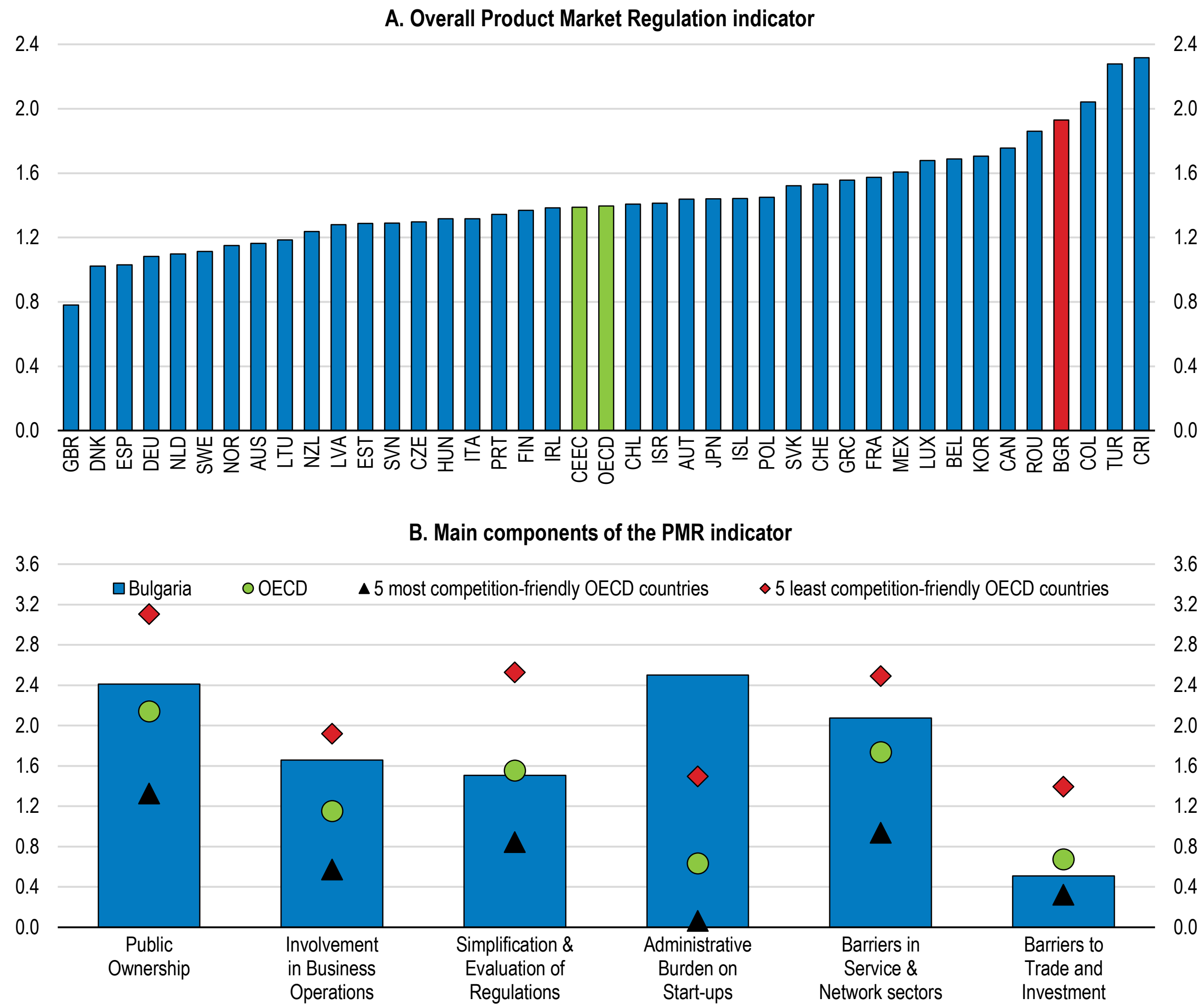
The incumbent companies in some key network sectors, such as electricty generation, gas import and retail supply, and rail transport, are completely owned by the state. Such an extensive presence of the state in sectors, even if they are open to competition, can generate distortions and affect the incentives for private firms to enter and expand their presence in these. The energy sector in general has undergone increased scrutiny by EU and and Bulgaria has recently embarked on a series of reforms, including: the setting up of a power exchange and steps for opening the retail market to competition. E-communications, a sector with limited state involvement, is open to competition compared to most OECD countries and has a regulatory environment that is close to international best practice. This provides a supportive basis for the acceleration of the development of the digital economy in response to COVID-19.

The electricity sector is composed of a regulated segment where prices/tariffs are set by an independent regulator (by reference price or formula), the Energy and Water Regulatory Commission (EWRC), and a liberalised segment with free pricing between producers and consumers. The sector is dominated by a few key players and in practice there are geographical monopolies in supply. Natural gas markets are also concentrated and consumers have been prevented from having a choice of suppliers. The European Commission fined the state-owned Bulgarian Energy Holding (BEH)—the holding company for a number of enterprises involved in electricity generation, supply and transmission, natural gas storage, transmission and supply, and coal mining—and two subsidiaries for blocking access to other wholesale gas suppliers to its gas infrastructure in 2018. The Bulgarian Commission on Protection of Competition is putting a strong focus on investigating anti-competitive practices in the energy sector and increased measures are expected to open up the sector. Further opening up the network sectors to new entrants could lead to improved productivity. Firm-level analysis for Bulgaria has shown that improved network service sector performance can enhance downstream firm performance (World Bank, 2015).

There also are very high barriers to entry in the legal professions (lawyers and notaries) as indicated by the product market regulation indicators, which show that restrictions, especially in terms of conduct, are higher than in most other OECD or CEEC countries. This is consistent with a recent assessment by the European Commission that found across all the professions studied, restrictiveness is highest for lawyers in Bulgaria (European Commission, 2017). The restrictiveness of these professions is related to high barriers to entry, but in particular due to very restrictive conduct regulations. In particular, legal firms cannot be set up as companies and not even as limited liability partnerships, fees are still regulated and there is a prohibition to cooperate with any other professions. As for notaries, these are heavily regulated in most European countries, and entry restrictions are very high. In Bulgaria, this is further reinforced by extensive restrictions also on the conduct of these professionals, ranging from all fees being regulated to prohibition of any form of advertising and the permission to operate only in a sole proprietorship with no limited liability. The government is aiming to ease entry to the notary profession with a law drafted to ease restrictions on age and nationality but there are no plans to address the extensive conduct restrictions. The product market regulation indicators measuring restrictions for architects and civil engineers, while higher than the OECD average, are not as onerous. The accountancy and real estate professions are completely deregulated, achieving the best possible score in terms of lack of barriers to entry.

Figure 2.5. Bulgaria stands out for its high barriers to competition

Index scale of 0-6 from least to most restrictive, 2018



Note: Information for OECD countries refers to laws and regulation in force on 1 January 2018, while for the five EU member states that are not OECD members refers to laws and regulation in force on 1 January 2019. The OECD average does not include the United States.
Source: OECD, 2018 Product Market Regulation Indicators database.

StatLink https://stat.link/s6j1f9

Easing the restrictions on regulated professions has been found to facilitate greater competition. For example, Greece had some of the highest regulatory barriers for regulated professions in the OECD and from 2010 put in place reforms to ease the restrictiveness of regulated professions by removing restrictive entry and conduct regulations. Preliminary analysis suggests that the reform had a positive effect on employment and there are some indications of a fall in the prices for consumers of legal services, accounting and tax consulting services and physiotherapy services. Real estate agent and notary services exhibited price reductions, especially in the case of notary fees for high value real estate transactions (Athanassiou et al., 2015).

Decreasing the red tape required to set up a firm

The administrative burden for opening joint-stock companies and personally-owned enterprises, including getting all necessary permits, is relatively according to the OECD’s 2018 Product Market Regulation indicators (Figure 1.20 Panel B). The added burden in Bulgaria is mostly explained by the need to get multiple certifications and approvals from state bodies compared to countries with a lower administrative burden for opening a new enterprise. Rather than being due to fees or license outlays, it is the high cost in terms of time taken to fulfil administrative requirements that results in Bulgaria scoring poorly. Estimates are that it takes 23 days for somebody to complete the necessary procedures versus 9.2 days on average in advanced OECD economies (World Bank, 2020). Higher entry costs for new businesses have been found to reduce output per worker and total factor productivity (Barseghyan, 2008).

A priority is to get rid of the necessity for a business start-up to contact multiple agencies. Nine public and private bodies typically need to be contacted to start a personally-owned enterprise with up to nine employees, compared with two in Romania (OECD, 2018a). To achieve this Bulgaria could extend the one-stop shop to cover the issuing of all licences and permits, and to accept all notifications necessary to open up a business. It could reduce the steps required to open up a business by removing the requirement to open a bank account and deposit the EUR 2 minimum symbolic required capital as part of the preregistration requirements; reducing the number of certifications that have to be provided by a lawyer/notary; reducing the VAT registration time (currently taking 12-14 days), or allowing for simultaneous business and VAT registration; and eliminating the need to physically visit the Commercial Registry to collect the (newly) registered company’s certificates. In addition the country could also adopt a ‘’silent is consent’’ rule to speed up the approval process for all permits and licences.

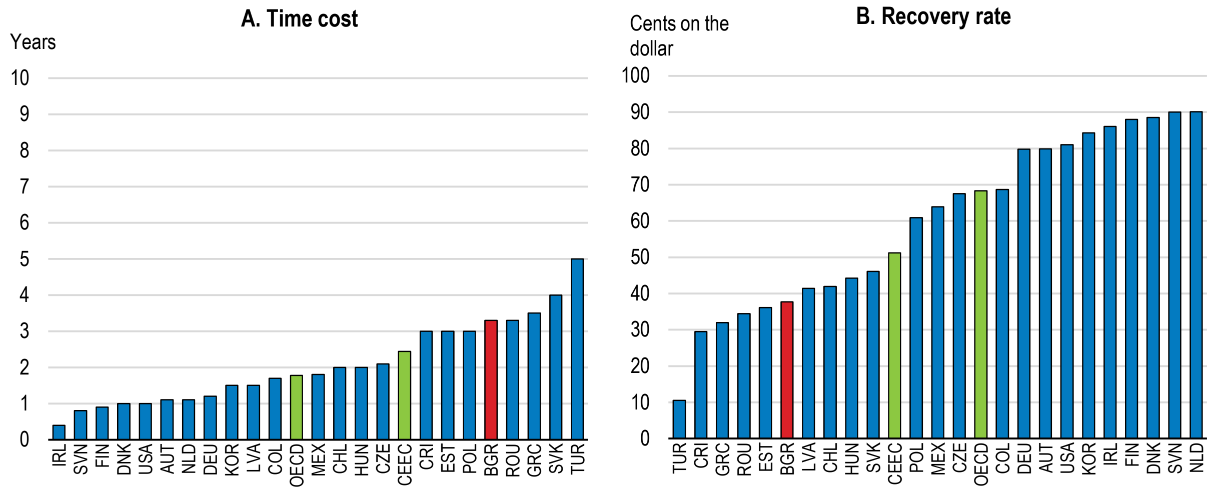
Facilitating firm exit and rehabilitation for viable enterprises

A more rapid and effective bankruptcy framework would spur on the exit of non-viable firms in financial difficulties or the restarting of activity of firms requiring a restructuring of financial obligations, thereby ensuring resources are allocated to more productive firms. Insolvency in Bulgaria is a relatively lengthy and complex process resulting in low asset recovery. Insolvency tends to be implemented late into enterprises getting into financial difficulties and so is used to liquidate firms rather than to engage in restructuring proceedings to help viable companies stay in business. Opening an insolvency proceeding on the side of the creditor is often a long and arduous task given that the judicial practice is for financial expertise to be required to examine a variety of insolvency ratios rather than the liquidity or cash-flow test outlined in the law (World Bank, 2016a). Bankruptcy is most likely to end up in liquidation of company assets piecemeal, with very few firms making it through insolvency proceedings intact. This not only makes it longer for companies to wind down operations, but also inhibits the sale of firms that remain viable. Creditors do not view bankruptcy proceedings as effective for debt collection (World Bank, 2016a).

It takes 3.3 years on average to resolve a bankruptcy compared to 1.7 years in advanced OECD economies (Figure 2.6, Panel A). A low recovery rate of 38 cents per dollar is achieved compared to the 70 cents achieved in advanced OECD economies (Figure 2.6, Panel B). While the recovery rate has improved from 34 cents per dollar in 2004, the time taken for creditors to recover their credit has not changed. The cost of insolvency proceedings is slightly lower than the high-income OECD average of 9% of the estate (World Bank, 2020).

Figure 2.6. Insolvency is relatively lengthy and results in a low recovery of assets for creditors

Resolving insolvency, 2020



Note: The World Bank is conducting a review and assessment of data changes after a number of irregularities have been reported regarding changes to the data in the Doing Business 2018 and Doing Business 2020 reports. This may affect the data presented in these figures.
Source: World Bank, Doing Business Database 2020, https://www.doingbusiness.org/.

StatLink https://stat.link/wi4ojn

Increasing the use of business restructuring proceedings by debtors and creditors before a business becomes insolvent is a priority. Part of the reason that rehabilitations are relatively unusual in Bulgaria is that there is a substantial degree of distrust in the bankruptcy process reported on the side of creditors and debtors (World Bank, 2016). New legislation was introduced in 2016 to allow firms to restructure their debts outside of insolvency proceedings. The aim of this reform was to allow an enterprise in temporary financial difficulties to re-negotiate its debts with its creditors, thereby enabling the enterprise to restart its business activities. To increase the use of firm rehabilitation proceedings by debtors, the plan is to put in place an early warning system to encourage debtors to take early action to avoid insolvency and establish a debt forgiveness procedure. In addition, rehabilitation proceedings are to be improved to ease access and mechanisms are to be introduced to protect new and interim funding received by enterprises engaged in a rehabilitation process. Deepening reforms that encourage the preservation of viable companies in financial difficulties could save jobs as well as reduce costs. This is all-the-more relevant given the current COVID-19 pandemic situation.

Easing discharge from debt is important to provide a fresh start to entrepreneurs. Many will have used their own assets and credits to set up a business. In Bulgaria, bankruptcy does not give entrepreneurs the right to discharge all their personal debt related to the insolvent business and entrepreneurs who go into insolvency do not have access to debt settlement procedures. Debtors get certain relief from personal liability for specific types of debts, but not all. It is of course necessary to ensure that any reforms do not result in abuse of the system to get out of personal debt not necessarily connected with the business being wound down.

The government has identified gaps in the insolvency framework and come up with a timeline for implementing changes. Bulgaria's Council of Ministers adopted a road map for legislative and procedural reform to make the bankruptcy and rehabilitation framework more effective in July 2019 (Box 2.1). Legislative changes are to be put in place in 2021, with ongoing implementation support including capacity building for the judiciary and other involved professionals, enhancement of the judicial infrastructure and an upgrading of electronic communication and data collection systems. The successful implementation of the proposed reform depends on the active participation of all stakeholder groups at each stage of development of the amended framework. With this in view, the government has planned a detailed plan for stakeholder engagement and consultation.

The implementation of the planned insolvency and restructuring reforms by 2021 will make it easier to carry out restructurings of viable firms and to ease bankruptcy procedures for firms that will not survive the crisis. Key reforms include setting formal requirements for the insolvency petition by a debtor to open a proceeding; and using a cash flow or liquidity criteria as the test of insolvency when a creditor makes an application for a debtor's insolvency. To accelerate proceedings, multiple applications for bankruptcy of the same debtor should not be required to be consolidated in order to declare insolvency. Allowing multiple creditors to file applications separately and dealing with them in parallel, rather than delaying a bankruptcy application because of the introduction of new filings, would also speed up the process. Creditors would need to have cost-effective and timely access to the claims recognition and resolution procedure. The exceptions to the stay on enforcement by creditors with special pledges and state claims should be eliminated. Having such exceptions threatens the negotiation and drafting of a rehabilitation or insolvency plan if it means part of the assets are sold beforehand to meet prioritised obligations. It will be important for the success of the reform to implement complementary policies on judicial efficiency, taxation and regulation.

Pushing forward insolvency reforms will be important to support the recovery from the COVID-19 crisis, particularly the reallocation away from activities that are less viable in the medium term. Given the relatively high NPLs in Bulgaria, reforms would increase creditor recovery of losses, thereby supporting the growth of credit markets. In looking at the options for responding to a rise in insolvency and debt overhang due to COVID-19, recent OECD work identifies a priority being to rapidly put in place to legislation measures to enable the rehabilitation of viable enterprises in financial difficulties through preventative restructuring or pre-insolvency framework (OECD, 2020a). The advice is that such a framework could be developed to be in line with the *EU Directive on Preventive Restructuring Frameworks and Second Chance*. This could be complemented by tax or other incentives to restructure debts. In the case of Bulgaria, this would require a revision to legislation to allow firms to proceed to preventative restructuring without fully opening an insolvency proceeding. On SMEs, Bulgaria could follow the OECD recommendation to move towards best practice by simplifying formal insolvency procedures and promoting informal arrangements for SMEs (OECD, 2020c).

Bulgaria suspended all procedural deadlines for ongoing court litigations, arbitrations and executions not under the Penal Code as part of its response to COVID-19, including those related to insolvency, during the state of emergency from 13 March to 13 May 2020. This may lead to a backlog of work for courts also facing a rise in caseload due to COVID-19. The capacity of the insolvency regime to deal with this rise in caseload due to COVID-19 may require additional resources to improve judicial infrastructure.

Ensuring appropriate access to credit through crisis support programmes can prevent viable firms from going into arrears/late payments until debt restructuring can be carried out. If crisis endures for some hard-hit sectors, the challenge will be to strike the right balance between supporting viable jobs and enterprises through continued financing, and not inhibiting the re-allocation of workers into new jobs.

Box 2.1. Bulgaria's Insolvency Reform Roadmap, 2019-2022

The government adopted the roadmap to address the gaps in the insolvency framework in June 2019. The roadmap incorporates the transposition of EU Directive 2019/1023 on Restructuring and Discharge of Debt, which has a transposition period of two years that begun in July 2019. Wide stakeholder consultations on the changes are being undertaken with representatives of government agencies, the judiciary, the legal professions and experts/academics. The following summarises the timeline and main provisions of the roadmap.

Timeline for legislative changes. The Ministry of Justice set up a working group to draft the legislative amendments by end-November 2020. Consultations are to take place until end-December 2020 and the updated bill is to be included in the legislative program of the Council of Ministers in January 2021. The amended and supplementary by-laws are due to be prepared and consulted on, and put in place from October 2021 onwards. Capacity-building and training programmes to complement the reform are being carried out from September 2019 to August 2022.

Improving access to insolvency. The legislative changes aim at easing and making faster access to insolvency proceedings and stabilization procedures, including shortening procedural deadlines. This includes having a single process for processing applications within the same insolvency proceedings; reforming the submission and acceptance phase; establishing accelerated procedures for small businesses; setting out objective grounds for initiating proceedings; increasing efficiency of property liquidation; and compulsory imposition of an insolvency plan between classes of creditors.

Workout and rehabilitation. Planned actions include the establishment of an early warning system with the aim of getting debtors to take action to avoid insolvency; and a debt forgiveness procedure. The reforms also will put in place a comprehensive overhaul of rehabilitation proceedings and introduce new mechanisms to protect new and interim funding.

Enhancing governance and capacity building. Governance is to be improved through putting in place a comprehensive framework on the duties and responsibilities of managers/directors, better regulation of the profession of trustees and officials in the bankruptcy arena; and additional safeguards to prevent bad faith of parties involved in insolvency and stabilization proceedings. The capacity of the regulator is to be enhanced through the provision of the human and financial resources needed for effective regulation.

Judicial infrastructure. Improved judicial infrastructure is critical for the success of the reform. The reform involves changing the rules governing local jurisdiction; regulating the role of experts, putting place special procedural rules for appeals, and providing the opportunity for judges to delegate administrative tasks to assistants. Bankruptcy and stabilization proceedings are due to be made smoother through the promotion of the use of electronic communication throughout the process. A code of ethics and professional standards is to be prepared for professionals involved in proceedings.

Training and communication. An updated training needs assessment is being carried out. The aim is to provide specialised trainings for bankruptcy and stabilization judges and legal personnel, including trustees, on the amended legal framework and new processes. A handbook is to be prepared on bankruptcy and stabilisation procedures, including templates for reporting activities. Systems are be put in place to implement electronic means of communication for insolvency and stabilisation proceedings, and to improve the quality and availability of statistical data.

Source: Government of Bulgaria, 2019, Roadmap for implementation of the recommendations concerning the frame for bankruptcy and stabilization in Bulgaria, Adopted by Council of Ministers on June 19, 2019, https://www.minfin.bg/upload/41380/CoM%20-%20Roadmap%20on%20Insolvency%20Framework%20Reform%20in%20BG.pdf

Improving corporate governance of SOEs

The leading role SOEs take in providing electricity, ports and railway infrastructure makes the recent government efforts to improve corporate governance important for the competitiveness of the economy. There are about 233 SOEs held by the central government, excluding the healthcare and social service SOE entities largely made up of state and municipal hospitals. The overall SOE sector represents 6.6% of total employment (OECD, 2019a). Prior to the recent reform, Bulgaria performed behind the OECD average and most CEEC countries, except for Lithuania, on the insulation of SOEs from market discipline and political interference in the management of SOE in terms of ensuring a level playing field between SOES and their private competitors, as measured by the OECD's product market regulation indicator.

Bulgaria undertook a reform to improve the governance of SOEs by reviewing and aligning legislation with the OECD Guidelines on Corporate Governance of SOEs as part of its commitments to join the ERM II and the Banking Union. The country fulfilled its commitment through the revision of legislation on public enterprises in 2019 and now adheres to the OECD Guidelines on Corporate Governance of SOEs. The recent corporate governance reforms establish a framework to provide stronger ownership coordination and monitoring, including through a new centralised coordination unit; better disclosure for SOEs and the state, and independently- and transparently-nominated boards with qualified members (OECD, 2019a). SOEs that are engaged in commercial activities are to take on the same legal form as private companies in order to reduce unfair competition.

The new legal framework puts in place the basis to address the most important concerns on SOE governance. The government has established the necessary by-laws and is finalising the implementing arrangements for relevant public agencies, including municipal bodies. The 2019 OECD Review of the Governance of SOEs (OECD, 2019a) sets out recommendations for near-term implementation. The highly decentralised ownership arrangements whereby 17 ministries have oversight over SOEs is to be augmented by the establishment of a centralised ownership coordination unit. The coordination unit will require sufficient autonomy and resources (qualified staff, finance and institutional authority) to carry out its mandate. The implementing rules will need to ensure the submission of all necessary financial and non-financial information to the new coordination unit, the Ministry of Finance and the line ministries. The new legislation establishes the educational and professional qualifications for board members and standards they should fulfil to ensure independence and integrity. The new law harmonises the SOE nomination process for the appointment of independent Boards of Directors in SOEs.

The new legislation on public enterprises represents an important element in the reform of the legal and regulatory environment for SOEs, but further aspects remain to be tackled. Bulgaria is retaining its current decentralised ownership arrangements under the new framework. The government may consider granting the coordination unit direct ownership over some SOEs given that decentralised ownership arrangements may lead to an insufficient separation of ownership and regulatory functions (OECD, 2019a). Currently, most large SOEs apply International Financial Reporting Standards, but the legislation does allow for them to choose whether to use these standards or to report according to national law. A further strengthening of accounting and disclosure requirements could occur if all large SOEs were required to adopt International Financial Reporting Standards (IFRS) and use the same disclosure norms as listed companies (OECD, 2019a). The impartiality of boards of directors to political influence could be increased by permitting more than the currently allowed maximum 50% share of independent members and allowing the SOE board of directors to appoint and remove CEOs (OECD, 2019a).

Continuing regulatory efforts to support competition

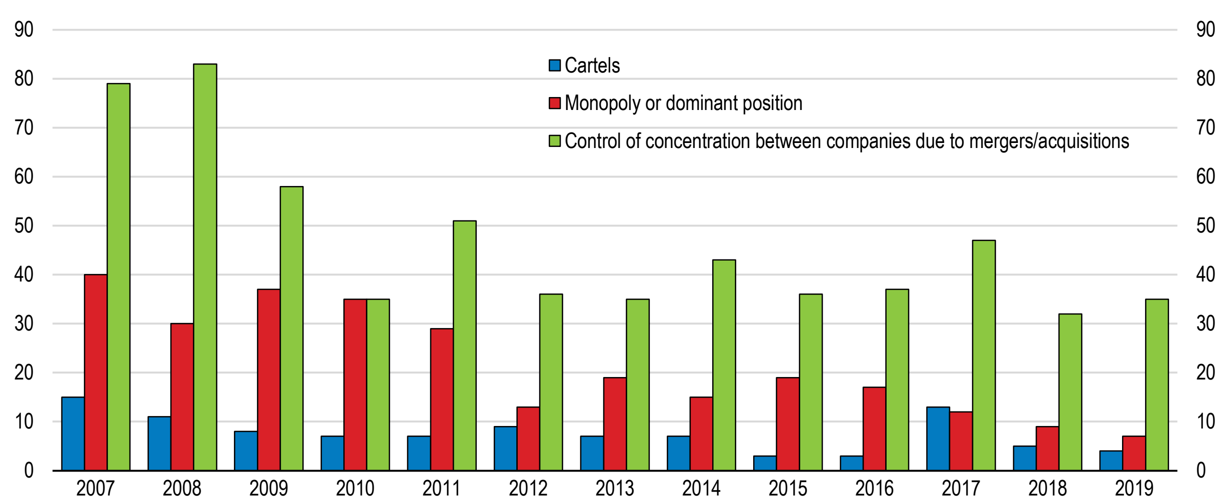
The Commission on Protection of Competition (CPC) is an independent institution with a staff of 117 (OECD, 2020a), including the seven elected members of the commission, which compares favourably to staffing in EU countries with a similar population (41 in Austria and 74 in Portugal) (Global Competition Review, 2019). The budget of the CPC was adequate at EUR 2.6 million in 2019, though lower than in

Austria (EUR 3.8 million) and Portugal (EUR 9 million). A leniency regime was introduced in 2011 for cartels and was used for the first time in 2019 to allow three companies involved in bid rigging for public tenders to provide information in return for one company receiving immunity and the other two reductions in fines (as set out by the law). The CPC is preparing legal amendments to strengthen further the leniency program. The CPC also conducts market studies, which are a powerful competition advocacy tool, as they allow the CPC to identify threats or obstacles to competition, which are not violations of competition law, and recommends actions to remove them.

The CPC strongly focuses on the protection of competitive practices due to mergers/acquisitions, but there has been a decline in the numbers of decisions taken related to cartels and monopoly/dominant positions. Looking at the evolution of decisions issued by the CPC, there were 35 decisions related to mergers/acquisitions in 2019, in line with recent years but down on the higher activity of a decade ago (Figure 2.7). The CPC blocked two mergers and imposed conditions on several mergers in 2019 (OECD, 2020a). Decisions on anti-cartel enforcement and abuse of dominant positions have been falling since the peak of activity seen after joining the EU in 2007 (Figure 2.7). On cartels, the CPC's efforts in 2019 were aimed at concluding a large proceeding related to the participation of over 40 entities in bid-rigging cartels for public procurement processes under the national programme for energy efficiency of multi-family dwellings (Chapter 3). The CPC sanctioned 27 undertakings related to these infringements (OECD, 2020a). There was an increase in the number of sector inquiries initiated in 2018, which addressed key sectors like the electricity market, the media market, the provision of bank services, and the production and sale of gasoline and diesel fuel in 2018. The energy sector has been a strong focus of the CPC and going forward there is an opportunity to boost competition in the sector with its decisions. The work has begun to show dividends with three local units of energy group CEZ fined (EUR 2.2 million) in June 2020 for abuse of dominant market position in negotiations with a payment services provider.

Figure 2.7. Activity related to confronting cartels and monopoly/dominant positions has declined

Decisions issued by Bulgaria's *Commission on Protection of Competition*, 2007-2019



Note: Data from Fora and Bugnar (2017) for 2007-2014 and OECD (2020b) thereafter.
Source: A. F. Fora and N. G. Bugnar (2017), "Implementing Competition Policy. Comparative Study - Romania and Bulgaria", *Annals of Faculty of Economics,* University of Oradea, Faculty of Economics, Vol. 1(2), pp. 319-327; OECD (2020b), "Annual Report on Competition Policy Developments in Bulgaria 2019", Report submitted by Bulgaria to the Competition Committee, DAF/COMP/AR(2020)40.

StatLink https://stat.link/8g6mt7

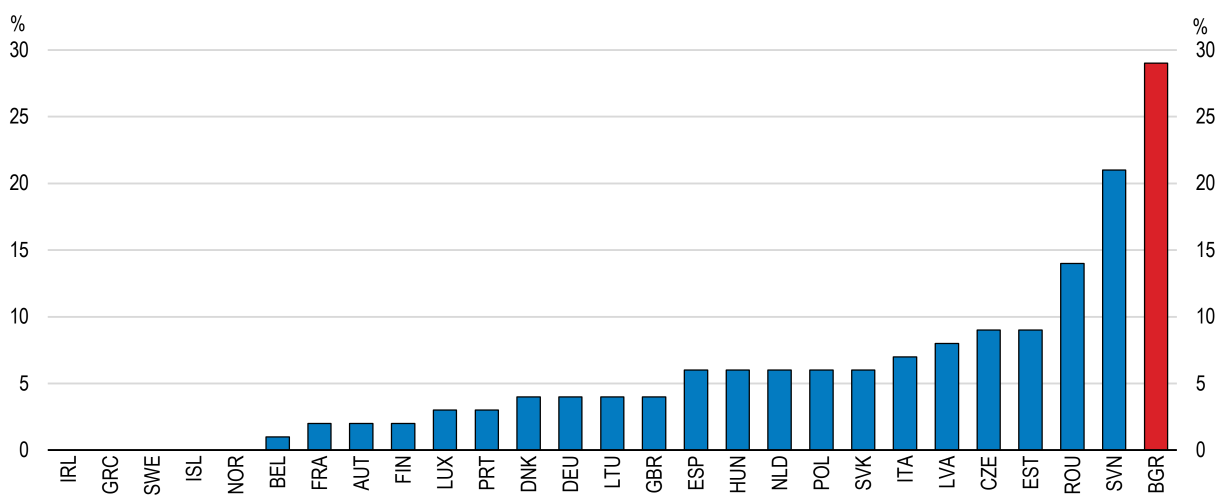
Creating a level playing field for public contracting

Efforts have been made to improve public procurement in recent years. A big push to modernise was made with the 2014 public procurement strategy and the adoption of legislation in 2016 that transposed the 2014 EU Procurement Directives into national legislation. The Public Procurement Agency has been confronting the challenge of modernising a system that made limited use of electronic procedures. The agency has implemented a centralised online portal on which all public procurement notices are posted and where each purchasing agency publishes procurement documents. The use of the centralised electronic platform for public procurement became mandatory for all government agencies and municipalities on 1 April 2020. Reform progress was positively assessed by the 2019 Cooperation and Verification Mechanism Report (European Commission, 2019b).

Further reforms are needed to continue to improve procurement outcomes. The World Bank carried out a review of public procurement procedures in 2019, which included follow-up actions and ex post checks and examined cases of conflicts of interest or corruption as part of the recommendations of the Cooperation and Verification Mechanism (World Bank, 2019b). The recommendations to address continued challenges include putting in place more targeted measures to fight fraud, corruption and conflict of interest. Assessment activities to detect illicit practices need to be increased and rely on detailed data analysis. This can be helped by information provided by the new electronic system. For example, Bulgaria has the highest proportion of “no bid” procurement processes in the EU and unlike most countries these have grown over time (Figure 2.8). Here, in-depth analysis to find out the reasons behind no bid or single bid processes and looking at relevant international practices would be useful to limiting the incidence of such cases.

Figure 2.8. Too high a share of public procurement occurs without a call for bids

Proportion of procurement procedures that were negotiated with a company without any call for bids, 2019



Source: European Commission, EU’s Tenders Electronic Daily (TED) database.

StatLink https://stat.link/xvr4pk

Capacity building is a continued issue for public procurement in Bulgaria. The authorities plan to keep focusing efforts here, including to combat corrupt practices and to increase strategic capacity to conduct high quality analysis of procurement data and sector issues. Unfortunately, there is a high turnover of procurement officials at the local and national level and building capacity will involve retaining high-capacity staff. Overall, anti-corruption efforts need to result in criminal prosecutions (Key Policy Insights). The procurement system can help by implementing the World Bank’s recommendations to strengthen the reporting channels for corruption and conflict of interest, improve the complaints procedure and offer stronger protection to whistle-blowers.

Increasing skills and innovation

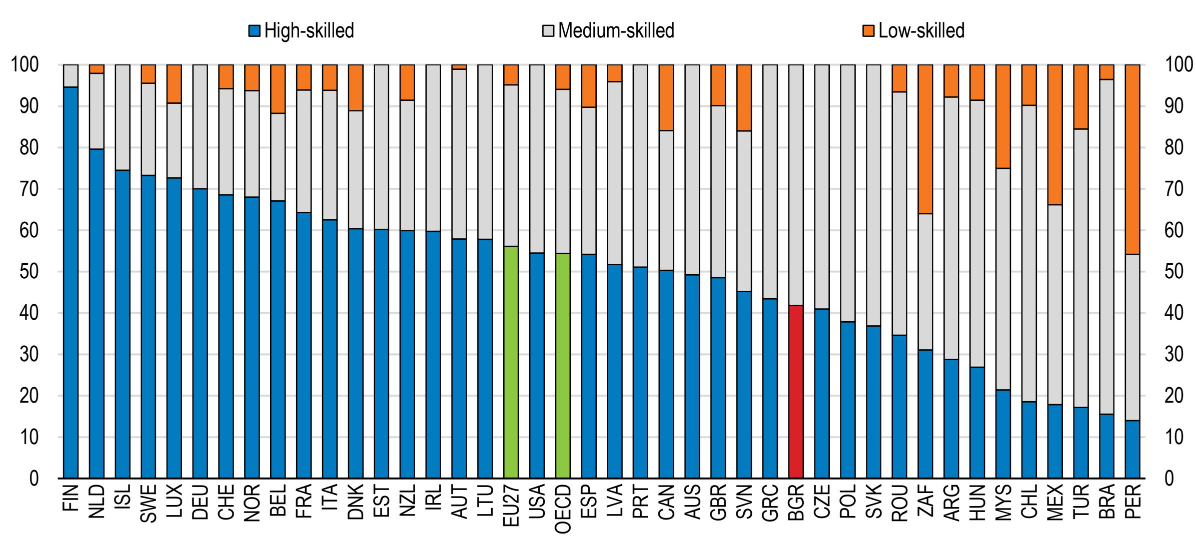
Increasing the availability of skilled workers is a key priority for enterprises

A shortage of skilled workers emerged as the biggest obstacle to business activity in surveys of Bulgarian firms pre-COVID-19 as the economy moved towards full employment. An inadequately educated workforce is the main constraint in the business environment reported by 30% of large and 27% medium-sized firms (World Bank Enterprise Survey, 2019). The 2019 Manpower Talent Shortage Survey found that 71% of large (250+) and 69% of medium-sized companies (50-250) report difficulty in filling positions putting Bulgaria in the category of countries where employers are reporting the highest skills shortages (ManpowerGroup, 2019). The difficulty in filling positions has been growing over time (up from 42% overall for firms in 2011) as the economy recovered from the 2008-09 crisis (which had a big impact on employment) and the labour force continued to shrink. As the economy recovers from the COVID-19 crisis and the workforce continues to shrink, the shortage of higher skilled workers may remerge as an obstacle for firm growth, particularly in the exports sector.

Pre-COVID-19, there was a shortage of workers with medium-to-high skills whereas there were no shortages for those in low-skilled occupations. The *OECD Skills for Jobs Database 2018* indicates that shortages existed for high- (42%) and medium-skilled (58%) occupations (Figure 2.9). Demand for high-skilled employees was under the OECD average. In the future if the convergence process speeds up, then the demand for higher-skilled occupations would be expected to increase. Enterprises in the information and communications sector have struggled the most to find appropriate talent. Construction and agriculture, forestry and fishing, which typically employ lower-skilled labour, had a surplus of workers.

Figure 2.9. Shortages are for medium- and higher-skilled employees

Share of employment in high demand by skill level



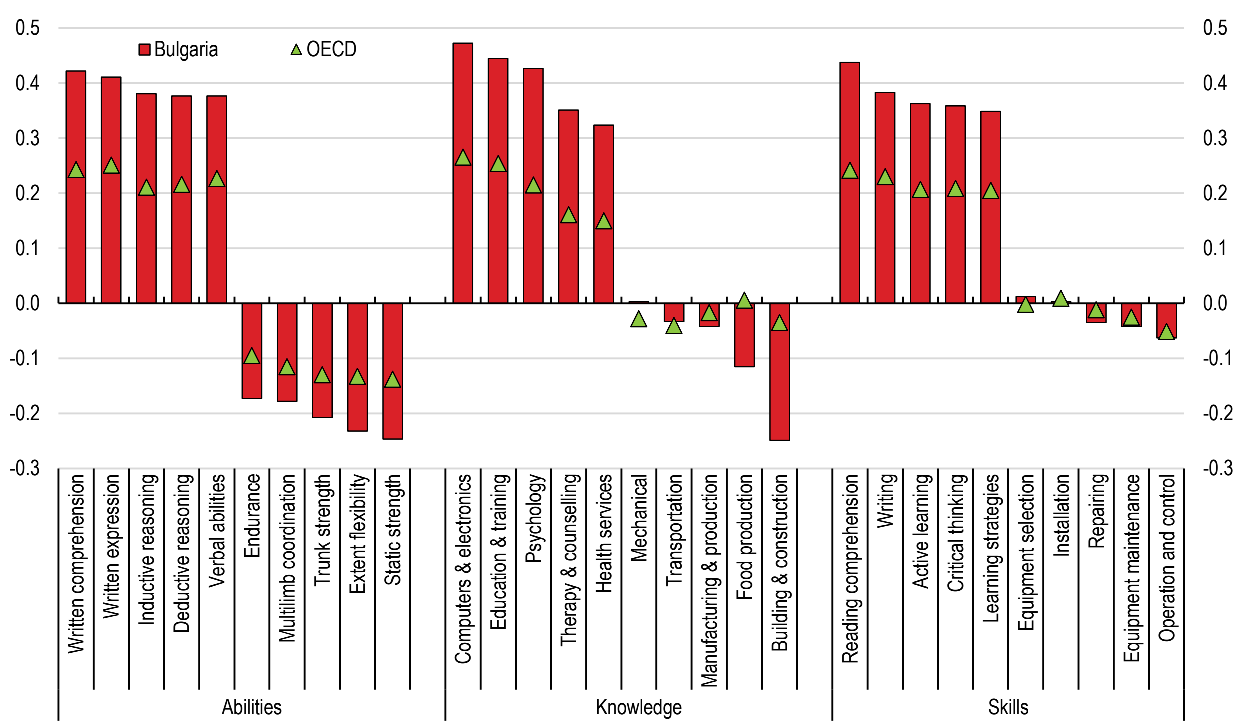
Note: High-, medium- and low-skilled occupations are ISCO occupational groups 1 to 3, 4 to 8 and 9 respectively. Shares of employment in each skill tier are computed as the corresponding employment in each group over the total number of workers in shortage in each country. Data refer to the latest year for which information is available.
Source: Elaborations based on the OECD Skills for Jobs Database (2018).

StatLink https://stat.link/fivaow

The types of competencies that were most in demand in Bulgaria pre-COVID-19 were those connected to complex, non-routine activities relevant to key growth sectors and for the new economy. The *OECD Skills for Jobs* indicators translate occupations that are in high demand into a measure of skills in shortage using the occupational skills classification database, O*NET. Competencies in the *OECD Skills for Jobs Database* are broken down into three categories. *Abilities* refer to the capacity to perform an activity not necessarily linked to a specific job task, such as trunk strength or the ability of abdominal and lower back muscles to support bodily movement over time. *Knowledge* represents faculties acquired by individuals through education or training, such as knowledge of computer programming for an IT specialist. *Skills* developed through both experience and education/training that the individual can bring to job or real life situations, such as critical thinking. Across the three categories, Bulgaria had a surplus of workers with competencies in routine manual and physical skills and abilities, often in excess of the OECD average (Figure 2.10). Shortages were highest in the knowledge of computer hardware and software, programming and applications, and education and training. Cognitive abilities such as reading comprehension, written comprehension and expression, and critical reasoning are in strong demand across occupations. As with technological change in the past (Autor et al., 2003), further moves towards digitalisation, robotics and artificial intelligence are likely to continue the shift in skills demand away from the routine and physical/manual tasks to more complex competencies. It is likely that it is these higher-skilled workers whose jobs will be more protected from the impact of the COVID-19 crisis.

Figure 2.10. Large shortages exist for complex and non-routine competencies

Knowledge, skills and abilities with the largest shortages and surplus, 2015



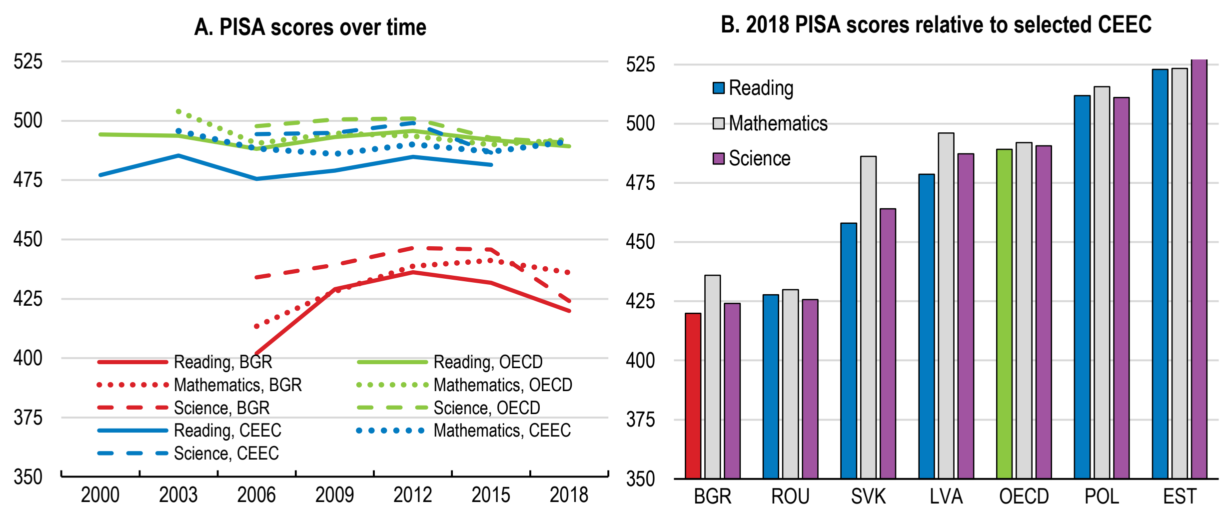
Note: Positive values represent shortages (e.g. unsatisfied demand in the labour market for the analysed dimension). Negative values represent surpluses (supply exceeds demand in the labour market for the analysed dimension). Results are presented on a scale from -1 to +1. The maximum value represents the strongest shortage observed in Bulgaria per area. Abilities refer to the competence to perform an observable activity (e.g. ability to plan and organise work; attentiveness; endurance). Knowledge areas refer to the body of information that makes adequate performance of the job possible (e.g. knowledge plumbing of a plumber; knowledge of mathematics for an economist). Skills refer to the proficient manual, verbal or mental manipulation of data or things (e.g. complex problem solving; social skills).
Source: OECD Skills for Jobs Database (2018).

StatLink https://stat.link/zd2cu8

Basic education is not providing a firm foundation for skills

A better foundation for skills needs to be set early in life. Performance in the OECD's Programme for International Student Assessment (PISA), which evaluates competencies in reading, mathematics, and science among 15-year-olds, is well below OECD and CEEC averages (Figure 2.11). Students ranked lowest in the EU in science and reading, and second last (in front of Romania) in mathematics. Science performance in 2018 dropped below the level of 2012 and 2015, experiencing one of the largest falls over 2015-2018 among PISA participants. Of concern is the large share (41%) of 15-year-olds who were assessed as functionally illiterate by the PISA reading test in 2018 (below level 2) (Figure 2.12). Having such a large proportion of students who have problems moving beyond a very basic interpretation of text poses a large mismatch between the more complex skills demanded by the labour market and will make difficult future lifelong learning participation. Only a small share of students perform at the highest level of proficiency in PISA tests, 2% in reading in 2018 compared to 7% in CEEC and 9% in OECD countries. School dropout rates are high with 14% of early leavers from education and training in 2019, a one-percentage point increase since 2014. This is the fourth highest rate in the EU after Spain, Malta and Romania. Roma students have a particularly high likelihood of not finishing school (Chapter 3). Early childhood education participation (aged 4 and over) is low at 82% in 2018 compared to an EU (27) average of 95% and has fallen in the past five years from 89% in 2014.

Figure 2.11. PISA education scores lag behind the OECD and CEEC



Note: CEEC is an unweighted average of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.
Source: OECD (2019b), *PISA 2018 Results (Volume I): What Students Know and Can Do*, https://dx.doi.org/10.1787/5f07c754-en.

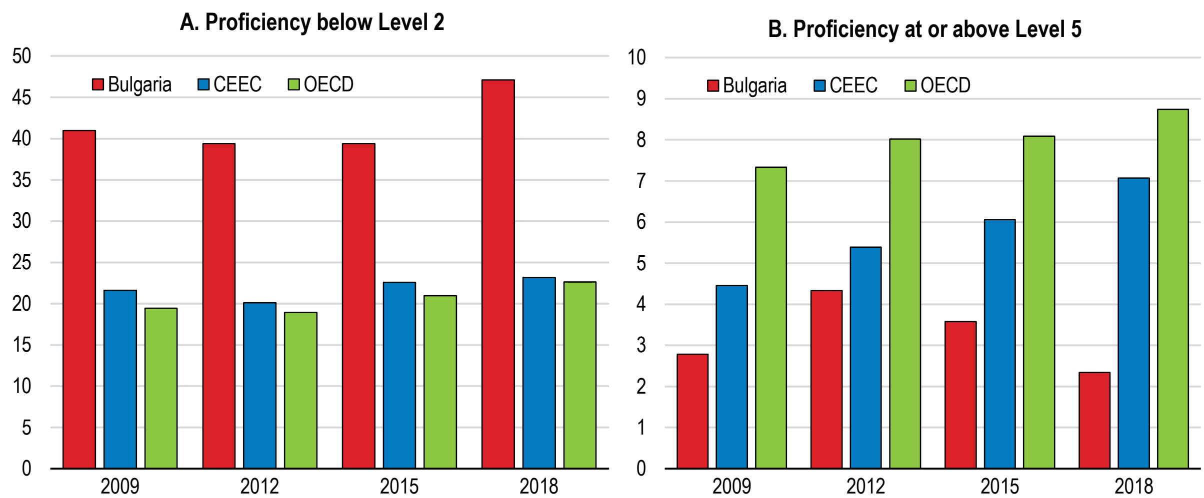
StatLink https://stat.link/084pwk

Recent education reforms passed in 2016, which aim to reorient the curriculum and assessment framework to improve student learning, go in the right direction. Apart from implementing a new syllabus that puts an emphasis on mathematics, science, and literacy and digital skills, there are plans to introduce an external student assessment based on new learning standards in the 7th and 10th grade. Language support also is to be extended for pupils who do not have Bulgarian as their first language—a group who underperform in PISA. Using the results of the new external assessments to help monitor implementation of the new curricula and inform teaching and learning practices will be critical to achieving a better performance.

A big challenge is to attract and train large numbers of new teachers in the next decade, with 51% of all teachers aged 50 and above (OECD average 34%) according to the OECD's Teaching and Learning International Survey (TALIS) (OECD, 2019c). The recent moves to increase teacher salaries over time will be important to ensure qualified candidates enter and stay in the profession. Providing adequate training for new teachers and continued professional development will help to raise education standards and increase teacher satisfaction. Training in teaching special needs students is the area where the highest share of teachers report a particularly high need in Bulgaria: 27% of teachers have not received training in special needs as part of their professional development activity compared to 23% on average in the OECD and higher than all EU countries for which there is data with the exception of Estonia and Romania. Teachers report in TALIS that they have a high need for continued training is in ICT (23% compared to OECD average of 18%), knowledge of the curriculum (20% compared to an OECD average of 8%) and their subject field (19% compared to OECD average of 9%). Teachers cite the high expense, lack of time and incentives as the main obstacles to participation in professional development (OECD, 2019c). The need for resources for teacher training and professional development is likely to continue to grow for both in-service teachers and new entrants to the profession.

Figure 2.12. A growing share of 15-years olds lack basic proficiency and few perform at a high level

Proficiency level in reading



Note: The low achievers are defined as those with less than 407.47 score points (Level 2) and the top performers are those with 625.61 score points (Level 5) or above.
Source: OECD (2019b), *PISA 2018 Results (Volume I): What Students Know and Can Do*, Table I.B1.7, https://dx.doi.org/10.1787/5f07c754-en.

StatLink https://stat.link/6b7d32

Improving the performance of the less socioeconomically advantaged will be key to driving up national performance given the much larger inequity in performance at the top and bottom in Bulgaria. This involves tackling the rural-urban divide and ethnic disadvantage (see Chapter 3). Partly this involves ensuring poorer municipalities have adequate resources for educational activities and infrastructure modernisation (European Commission, 2019c). Continuing efforts to track and prevent school dropouts is key to prevent future labour market vulnerability. Expanding preschool education to have universal coverage, especially for the most disadvantaged children and those in rural areas, would provide a basis to narrow the skills gap. A study of PISA performance found that the provision of two years' preschool education would increase the scores of low achievers and minorities by up to 10 and 19 points, respectively (World Bank, 2016b). Implementing the draft law covering preschool school education to provide support to municipalities that lag behind in provision to those aged 4 and older would go some way to open up access. Eliminating fees for preschool is an important step for the socially vulnerable.

Vocational education and training could better meet labour market demands

Improved vocational education and training (VET) outcomes are important to provide needed occupation-specific skills and to meet changing skills demand. Over half of upper secondary students (51% in 2017) attend a VET programme (Eurostat). While the employment rate of recent VET graduates has increased, at 66% in 2018 it is still substantially below the EU average of about 80% (European Commission, 2019). There could be further moves to strengthen the links between employers and VET. VET provision mostly is based in schools with some practical learning in workshops and workplace assignments. More links should be sought between local employers and the VET system, such as the dual apprenticeship pilot currently underway. Adult enrolment in VET in Bulgaria is low and increasing adult access and take up of VET is a priority given the growing skills deficits.

Given that a third of VET graduates do not gain a VET qualification (Bergseng, 2019), a welcome reform is that from 2022 sitting a state examination for a VET qualification will be compulsory for students. The recent introduction of technical qualifications for study after the age of 16 in the United Kingdom is an example of developing a technical pathway that is of equivalent standing of the academic qualification A-level route. The T-level (technical-level) technical qualification in the United Kingdom is to be introduced over 2020/21-2022/23 and is to be taken by students at age 18 after two years of study encompassing a technical qualification, other occupation-specific requirements, a placement in industry, and training in maths, English language and digital skills (United Kingdom's Department of Education, 2019). The plan is to replace a large number of technical qualifications with T-levels in 25 subject areas. The aim of introducing T-levels is to put technical education on an equal footing with the academic education option—the Advanced-level or A-level. A-levels are subject-based qualifications that U.K. students obtain following the last two years of secondary schooling, generally at 16-18 years of age, and are used by universities to assess the qualifications of applicants for admission. One T-level is to be equivalent to the usual qualification of three A-levels in the academic stream. Recipients of the qualification could go directly into employment, pursue further technical education, such as an apprenticeship, or opt to go into higher education.

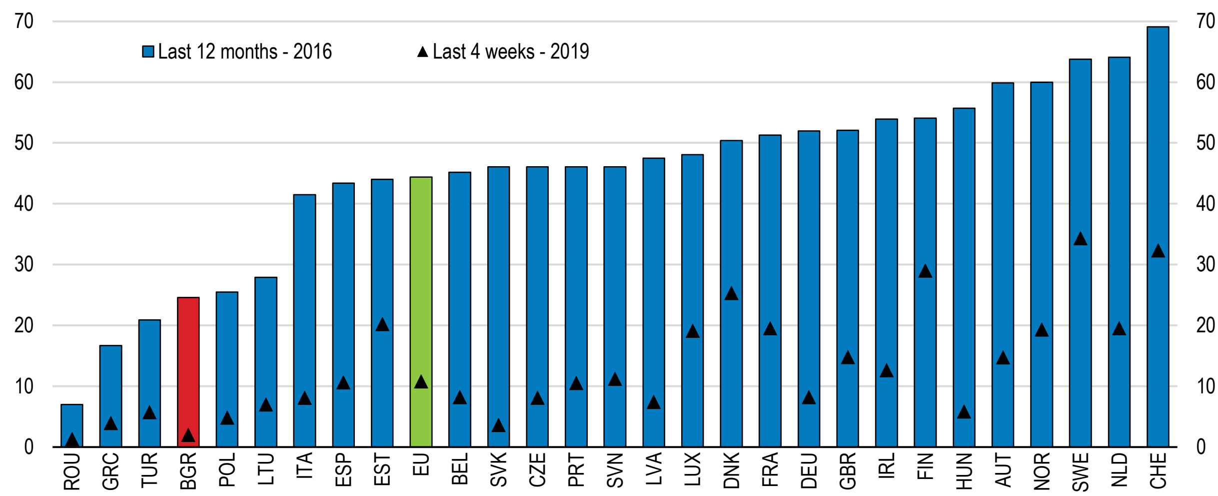
While Bulgaria involves social partners in VET policy decision-making at the national level, the system could increase its focus on local labour market conditions by involving much more closely with local employers, union representatives and local government officials. Decision-making autonomy should be incrementally increased at the subnational level for those institutions that have proven capacity to deliver on increased responsibility (Bergseng, 2019). This would allow providers to link much more closely to local labour demand. Moving responsibility away from the national level also would make sense to remove the heavy administrative burden that falls on the Ministry of Education from its direct ownership and management of the country's VET schools. This would free resources to allow the Ministry to concentrate on its core functions of policy planning, monitoring and reviewing the country's learning programmes. Putting in place the necessary capacity among local actors to take up these responsibilities will be a challenge as currently municipalities and schools have limited involvement in VET governance. A strong quality assurance system would need to be put in place for providers that ensures fulfilment of national policy objectives.

Adult learning is low

Participation in adult learning is low, which is of concern for productivity given the shrinking and ageing workforce. On-the-job and formal training can stop the erosion of skills over the lifecycle () and prepare workers for changing skills needs. Bulgaria has among the lowest participation rates in formal and non-formal education and training for adults aged 25-64 in the EU, with only 2% having benefitted in the last four weeks (2019) and 25% in the last twelve months (2016) (Figure 2.13). Participation has not increased much over time. Individuals with lower educational attainment are much less likely to participate in lifelong learning: only 7.6% of those with lower secondary or less participating in the last 12 months in 2016 compared to 22.3% of individuals with upper secondary or post-secondary education and 38.2% with tertiary education. Older workers also are much less likely to engage in learning (only 14.7% of 55-64 year olds participated in 2016).

Figure 2.13. Participation in lifelong learning is low

Participation rate in education and training, as a percentage of persons aged 25-64



Source: Eurostat database (trng_lfse_01 and trng_aes_100).

StatLink https://stat.link/tcylh1

Creating a culture of lifelong learning in Bulgaria is a large challenge given the low level of participation. Setting a better basis for learning early in life is a priority. The foundation for lifelong learning starts at a young age, with educational attainment being a strong predictor of the likelihood individuals will continue to learn during their working lives. Continued efforts need to be made, building on the *National Strategy for Life-long Learning 2014-2020*, to deepen coordination between employers, ministries, different levels of government and other relevant stakeholders. Encouraging employers to provide training and career guidance on training needs, and to give employees time to take up opportunities will be important to increase participation. Employers provide two-thirds of lifelong learning and have an important role in providing incentives to employees to participate. Adult training should be better aligned with the skills needs of employers through the incorporation of skills assessment information into programme design. Bulgaria has moved in this direction by adopting a formal mechanism to include the results of projected supply and demand of labour into the formulation of government policies.

There is a need for a training and assessment system for teachers in adult education to be set up and to increase the supply of qualified teachers and trainers (European Commission, 2019). The quality and impact of training should be assessed and quality information on courses and provides made public. One such example is the Korean Skills Quality Authority, which evaluates vocational training providers, training programmes and trainees and assigns grades based on evaluations (OECD, 2019d). Training programmes in Korea are screened for quality of inputs and outcomes and government funding is performance-based. More financing for programmes needs to be put in place in Bulgaria, which may require greater public incentives for employers, particularly in the case of SMEs. Any increased public financing should be linked to results as in the example of Korea.

There is a challenge in assessing progress in adult education and it is an area where evidence is less developed than for other education levels. The United Kingdom conducted a review of evidence on what works in further education and adult learning, and found that there is a paucity of minimum quality studies compared to the schools sector. Evidence is limited on the effectiveness of interventions, the impact on different groups and in different contexts, and there is little information on the cost-effectiveness of interventions (United Kingdom's Social Mobility Commission, 2020). The complexity of the sector in terms of providers, learners and measuring outcomes contributes to the difficulty in evaluating programmes. The 2020 recommendation in the case of the United Kingdom is to create an independent group, a "What Works Centre," that gathers rigorous evidence on what works for further education and adult learning for both classroom and work-based training that is then to be used in developing policy.

Fostering return migration and skilled immigration

Targeting the continued return of Bulgarians from abroad and attracting skilled immigrants provides an opportunity to alleviate skill shortages. Emigration has slowed from the high rates seen in the 1990s to the early 2010s and there are a growing number of Bulgarians returning to the country as economic opportunities have improved. With just over 13% of Bulgarian immigrants in OECD countries having tertiary education (ISCED 5 and 6), Bulgarians abroad are an important asset for the country. There is some evidence that return migrants experience difficulties in finding employment and that this can increase their incentives to migrate again (Martin and Dragos, 2012; Mintchev and Boshnakov, 2018). Policies should be deepened to attract and smooth the transition of return migrants into the labour market, and to make the most of emigrants' contribution to economic and cultural activities in Bulgaria.

Ireland, a country with a large share of its citizens living abroad, has a number of initiatives to support emigrants thinking of returning and strengthening links with the Irish diaspora. The Citizens Information Board supports return migrants on financial issues, residency, education and getting access to social welfare services. Ireland launched its Diaspora Policy in 2015, which aims to increase links with the Irish aboard in partnership with civic society and the private sector (Irish Department of Foreign Affairs and Trade, 2017). Measures aim to strengthen the institutional basis for networks through, for example, arranging more structured and more frequent network meetings, and supporting Irish community organizations to achieve independently validated quality assurance standards. As well as focusing on cultural activities, part of the Diaspora programme is directed at supporting business networks and creating opportunities for emigrants to return home. The next stage includes identifying and removing barriers for those wishing to return home.

Non-Bulgarian immigrants are few and, according to NSI data, just over 13 000 non-EU nationals entered the country in 2019—a year when there was substantial skills shortages. While progress was made in the 2016 Labour Migration and Labour Mobility Act, further could be done to reduce employment restrictions, the administrative burden for immigrants and employers, and to smooth the accreditation process for vocational and educational qualifications. The example of Canada's pre-departure services shows what can be done to smooth the transition for migrants. Canada has had these services in place since 1998 and they encompass information dissemination and orientation sessions. Needs assessments are carried out and can be used to refer future migrants to services on arrival. For migrants hoping to practice a regulated occupation, these services can advise on how to go about obtaining Canadian licensing (OECD, 2020c).

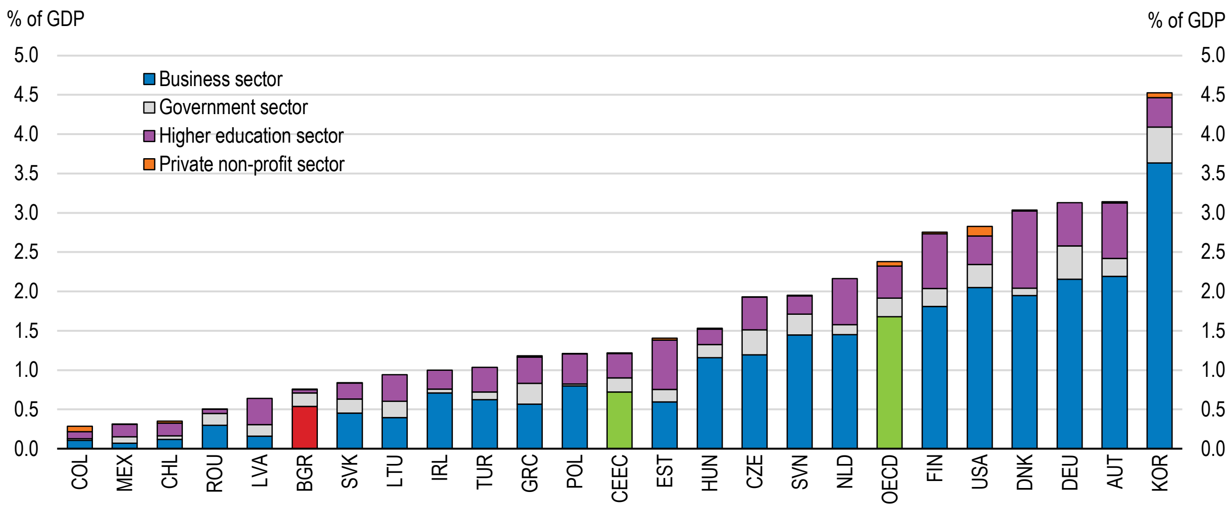
Promoting innovation

While growing, the level of innovation in the economy remains low. Bulgaria is termed a modest innovator, ahead of only Romania in the EU, in the *European Innovation Scoreboard 2020*, but its performance is improving and the country scored well (above the EU average) on employment in fast-growing enterprises in innovative sectors, and on intellectual assets related to design and trademark applications.. There is a low intensity of R&D in the economy: gross R&D expenditure was 0.75% of GDP in 2017 compared to spending of over 3% found in the EU countries with the highest R&D intensity (Figure 2.14). Spending has grown over time, almost doubling from 0.4% of GDP in 2007. The business sector accounts for the majority of spending (0.5% of GDP or 44% of the total), with the government spending just 0.2% of GDP. R&D

expenditure in the higher education sector is the lowest in the EU at 0.04% of GDP compared to the EU28 average of 0.45%. Innovation activity of firms is low, but growing. The share of firms who reported innovation activity has increased, following a decline after the GFC, from 27% in 2016 to 30% in 2018 (National Statistical Institute).

Figure 2.14. R&D intensity is low and relies on the business sector

Gross domestic expenditure on R&D by sector, 2018



Source: Eurostat, Statistics on Research and Development database (rd_e_gerdtot); OECD, Research and Development Statistics database.

StatLink https://stat.link/tv5kq8

Large multinational companies are responsible for half of the business sector's R&D spending. Bulgaria has the largest share of funding coming from abroad of all EU countries, with a 34.2% share sourced from foreign sources compared to 10% on average for the EU28. Foreign-funded R&D started to grow substantially in 2009, when its share of overall funding equalled 8.4% in 2009. It has been concentrated in "Professional, scientific and technical activities; administrative and support service activities" and in particular scientific research and development. This includes a wide range of activities such as clinical trials run in the country by foreign multinationals, EU-funded projects and foreign R&D investments in firms (Soete et al., 2015).

The underfunding of publicly-financed research and innovation, particularly in higher education, is not sustainable if the economy is to boost its research potential. The low level of public resources inhibits the development of cooperation with the private sector and is an obstacle for attracting researchers. Bulgaria had set a target for R&D investment of 1.5% of GDP as part of its European 2020 Strategy and to move towards this the country is planning to double its public research budget as part of its 2017-2030 Strategy for the Development of Scientific Research. More resources should go to recruit and retain young researchers by providing opportunities for doctoral degree holders and postgraduates given the need to renew the ageing research community. COVID-19 provides an opportunity to attract well-qualified Bulgarian and foreign talent into the sector. This will necessitate putting in place competitive salaries for researchers.

The government has begun to target research funding to public institutions based on performance. Apart from suffering from low resources, the public research and innovation system is fragmented with funding spread across a large number of universities and research institutes, which are poorly connected to enterprise activity (Soete et al., 2015). Resources should be directed to support the high-performing activities that are of most strategic relevance. Such an expansion of funding would need to be backed by strong monitoring and evaluation, where results are publicly disclosed. The trend in OECD countries has been for a rising share of public funding to go to co-operative research efforts between research institutions and industry (OECD, 2015). Directing additional funds to these activities will be vital in Bulgaria given the gap that exists between research and enterprise activity. Ties with multinational companies who are big innovators are important to exploit for national firms and researchers.

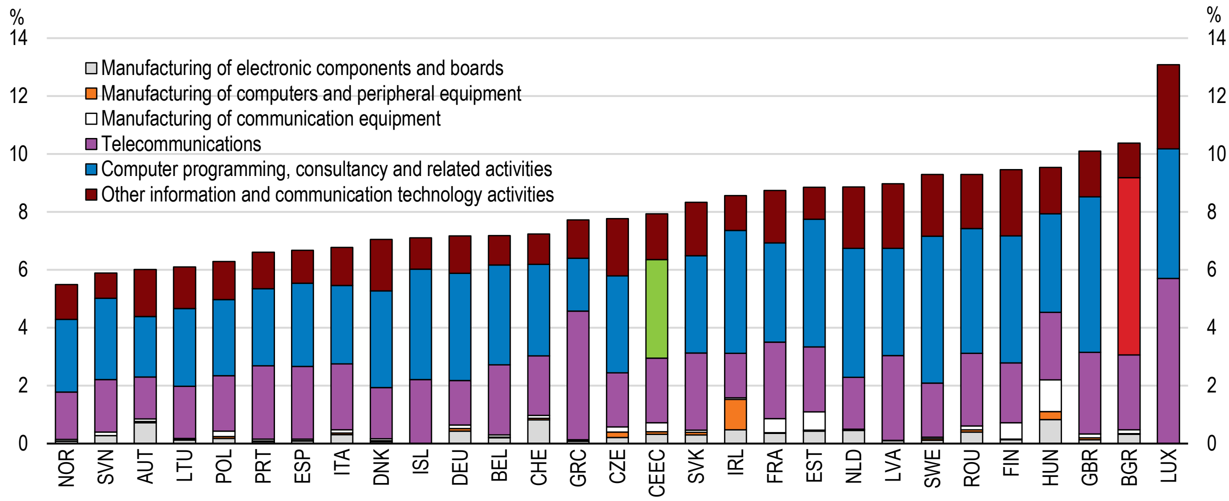
Direct support to enterprises for innovation goes beyond the scope of pure R&D, encompassing helping firms to develop new products from their R&D and to apply the results of external R&D/innovation to their in business activities. Direct subsidies are most appropriate when the objective is to target specific activities or firm types, e.g. new entrants or specific types of SMEs (OECD, 2015). Such support can take the form of grants, subsidised credits, mentoring/advisory services, government contracts or support for the development of networks or clusters. In the case of Bulgaria, there are some indications that firms that are not innovating could benefit from support to help them adopt new practices. At the firm level, support that helps with knowledge transfer could increase the innovative capacity of firms. Any allocation of direct support should be non-automatic and take place through a competitive, objective and transparent process (OECD, 2015). Selection processes need to be designed to avoid excessive bureaucracy, protect from rent seeking and ensure the highest potential firms benefit. There is zero tax relief for R&D expenditure. This is fitting given that support through tax incentives for firm innovation is less relevant in the Bulgaria case given its inconsistency with the low flat corporate tax system that has limited tax incentives. The introduction of these types of incentives could undermine revenue collection efforts.

Supporting growth of the digital economy

The growing ICT sector is a success story. The ICT sector is responsible for a high share of the non-financial business economy value added (10% in 2017) (Figure 2.15). Over half of this activity is in computer programming, consultancy and related activities. While it should be noted that value added activity makes up a comparatively lower share of the economy, further ICT sector growth is an opportunity for the country. Apparent labour productivity in the ICT sector is more than twice as high as the average recorded for the non-financial business economy. The sector is providing a growing number of high-paid jobs, accounting for just under 5% of non-financial business economy employment in 2017 according to Eurostat data and with an average salary in the software sector over three times higher than the national average (BASSCOM, 2019). Outsourcing activity has greatly expanded in the last decade with both major international companies like IBM, SAP and WMware, and an expanding number of domestic providers. There has been a growth in start-ups that provide digital products rather than outsourced services. A big challenge for the sector going forward is to expand the supply of skilled workers to keep up with demand.

Figure 2.15. The ICT sector is responsible for a high share of value-added activity

Share of the ICT sector in non-financial business economy value added, 2018 or latest year available



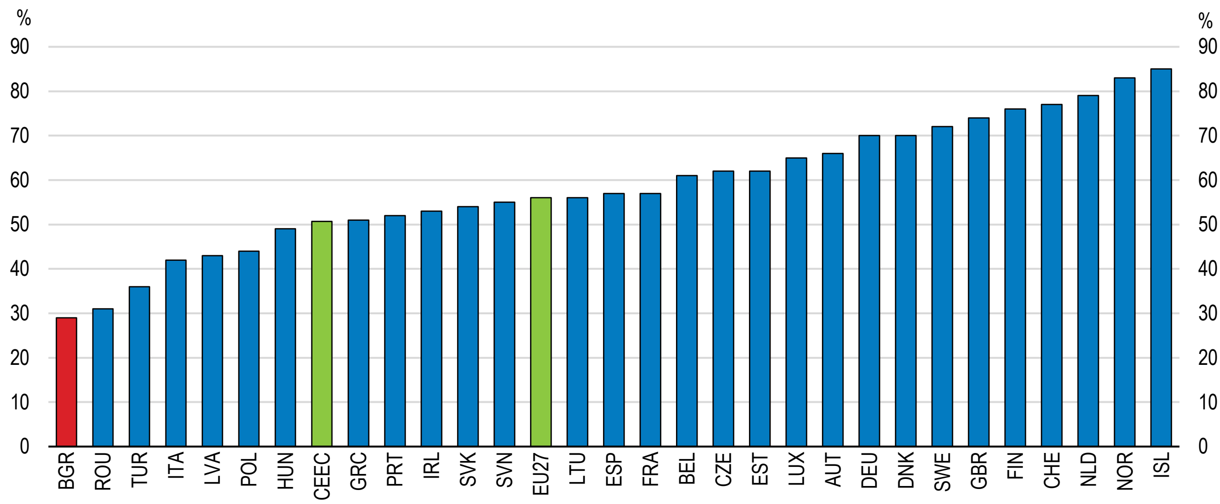
Note: The non-financial business economy is defined as NACE Sections B-N and Division 95, excluding NACE Section K.
Source: Eurostat (online data codes sbs_vna_sca_r2, sbs_na_ind_r2, sbs_na_dt_r2 and and sbs_na_1a_se_r2).

StatLink https://stat.link/4a0f27

There is a stark contrast between the position of the high-performing ICT sector and that of most SMEs, which face strong constraints for participation in the digital economy. Infrastructure performs relatively well and access has been improving. According to cable.co.uk broadband speed league data, Bulgaria ranked 39th globally, out of 221 countries, in 2020. While internet access for households remains the lowest among EU member states (75%), the country has achieved the most rapid expansion in access with an increase of 42 percentage points over 2010-2019 according to Eurostat data. To build on the digital promise shown by the economy, it will be important to increase digital skills in the workforce and knowhow among SMEs. Basic digital skills of individuals are low (Figure 2.16). A small share of enterprises participate in the digital economy, for example, only 2% of total turnover generated by web sales (Figure 2.17). Increasing participation in the digital economy is an important component of increasing the resilience of the enterprise sector to withstand the turbulence created by the COVID-19 shock. Japan has implemented a support programme to assist non-high-tech firms that have difficulties accessing platforms and lack knowledge resources. This includes establishing space and online platforms for business matching, and ICT training pitched to the different digital skill levels of target companies (OECD, 2020b).

Figure 2.16. A priority is to increase digital skills

Individuals who have basic or above basic overall digital skills, % of individuals aged 16-74, 2019

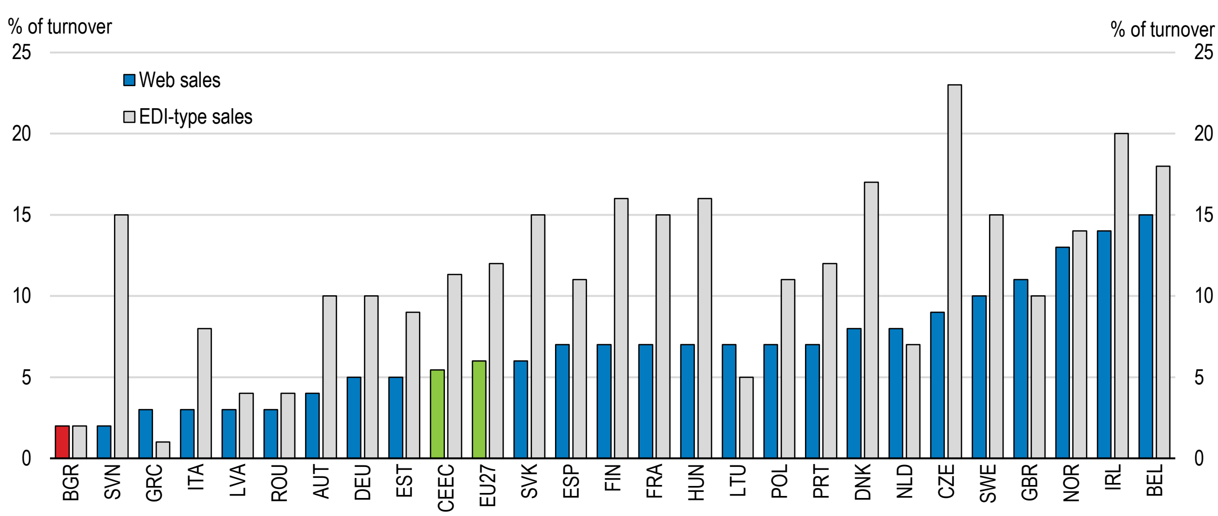


Source: Eurostat (online data code isoc_sk_dskl_i).

StatLink https://stat.link/ade3gz

Figure 2.17. Firms have a low share of e-sales

Turnover from e-sales, via web and electronic data interchange (EDI), by type of order, 2019, % of total turnover



Source: Eurostat (online data code isoc_ec_evaln2).

StatLink https://stat.link/30g6np

Table 2.2. Recommendations

Main findings	Recommendations (key recommendations in bold)
Improving the regulatory framework for enterprise activity	
Competition in product markets is low, with regulatory barriers to competition that are higher than in nearly all OECD countries.	**Increase the Competition Authority's detection and enforcement of sanctions on cartels and firms abusing monopoly/market dominant positions.** Decrease regulatory barriers to entry for the legal professions.
The leading role SOEs take in providing electricity, ports and railway infrastructure makes the 2019 legislative reform to improve SOE corporate governance important for the competitiveness of the economy. An important part of the reform was to establish a new centralised coordination unit to be responsible for stronger ownership coordination and monitoring of SOEs.	**Put in place the implementing arrangements for the 2019 Law on Public Enterprises for the relevant public agencies, including municipal bodies.** Ensure the centralised ownership coordination unit has sufficient autonomy and resources (qualified staff, finance and institutional authority) to carry out its responsibilities.
There is some evidence of limited competition in public procurement outcomes. The Public Procurement Agency has been confronting the challenge of modernising a procurement system that made limited use of electronic procedures. Assessment activities to detect illicit practices need to be increased and to rely on detailed data analysis, including from the new centralised electronic procurement system.	Increase resources for capacity building and recruitment of key experts in the area of procurement to implement the new centralised system. Increase assessment activities to detect illicit practices. Use detailed data analysis, including information provided by the new electronic system, for increased risk-based analysis. Strengthen the reporting channels for corruption and conflict of interest, improve the complaints procedure and offer stronger protection to whistle-blowers.
A lengthy and complex insolvency process results in low asset recovery. Pre-insolvency processes to restore financial viability to enterprises in out-of-court workouts are underdeveloped.	Implement the roadmap on the insolvency framework adopted in June 2019, including the amending of insolvency legislation to accelerate and make more effective insolvency proceedings. Rapidly put in place improvements to legislation to ease access to insolvency or in the case of viable enterprise in financial difficulties to rehabilitation (pre-insolvency) proceedings. Implement complementary policies on judicial efficiency, taxation and regulation.
The administrative burden for opening an enterprise is high.	Extend reforms put in place with the operationalisation of the One-Stop Shop to cover the issuing all licences and permits, and to accept all notifications necessary to open up a business. Adopt "silent is consent" rule to speed up the approval process.
Increasing skills and innovation	
Increasing the availability of skilled workers is a key priority for enterprises. Basic education is not providing a firm foundation for skills The VET system could better respond to labour demand	**Provide universal access for four-year olds to early childhood education.** **Increase secondary school teacher training for teaching special needs students.** **Deepen the role of workplace training in vocational education and training provision.** Build on the dual apprenticeship pilot to roll out a national programme. Incrementally increase decision-making at the subnational level for VET institutions to allow local management and increase the involvement of local employers.
Lifelong learning is critical to retain the skills of workers and prepare an ageing workforce for longer working lives.	Set up a training and assessment system for teachers in adult education to increase the supply of qualified teachers and trainers.
Emigration has slowed substantially and a growing number of Bulgarians are returning to the country.	Increase efforts to attract and smooth the transition of return migrants into the labour market through pre-arrival integration services.
Skilled immigration, particularly from non-EU countries, could provide needed workers for the ageing economy.	Reduce further employment restrictions and the administrative burden for immigrants and their employers. Smooth the accreditation process for non-EU vocational and educational qualifications.
While growing, the level of innovation in the economy remains low.	Increase the level and efficiency of investment in publicly financed research and innovation. Integrate systematic evaluation into public funding mechanisms for innovation.
A small share of enterprises participate in the digital economy.	Broaden support through firm capacity and management support programmes to assist non-high-tech firms that have difficulties accessing platforms and lack knowledge resources.

References

Acemoglu, D., Akcigit, U., Alp, H., Bloom, N., and Kerr, W. (2018), Innovation, reallocation, and growth. *American Economic Review*, *108*(11), 3450-91.

Adalet McGowan, M. and D. Andrews (2018), “Design of Insolvency Regimes across Countries”, *OECD Economics Department Working Papers*, forthcoming.

Adalet McGowan, M., D. Andrews and V. Millot (2017a), "Insolvency regimes, zombie firms and capital reallocation," *OECD Economics Department Working Papers* 1399, OECD Publishing.

Adalet McGowan, M., D. Andrews and V. Millot (2017b), "The Walking Dead?: Zombie Firms and Productivity Performance in OECD Countries," *OECD Economics Department Working Papers* 1372, OECD Publishing.

Andrews, D. and F. Petroulakis (2017), “Breaking the Shackles: Zombie Firms, Weak Banks and Depressed Restructuring in Europe”, OECD Economics Department Working Papers, No. 1433.

Anghel, I., and G. Goschin (2015), The R&D and innovation systems in Romania and Bulgaria in the EU context. *Procedia Economics and Finance*, *32*, 1804-1826.

Athanassiou, E., N. Kanellopoulos, R. Karagiannis, and A. Kotsi (2015), The Effects of Liberalization of Professional Requirements in Greece. *Centre for Planning and Economic Research*.

Autor, D., F. Levy, and R.J. Murnane (2003), The skill content of recent technological change: an empirical exploration, *Quarterly Journal of Economics*, 118 (4) (2003), pp. 1279-1333.

Barseghyan, L. (2008), “Entry costs and cross-country differences in productivity and output,” *Journal of Economic Growth*, June 2008, Volume 13, Issue 2, pp 145–167.

Bergseng, B. (2019), *Vocational Education and Training in Bulgaria: Governance and Funding*, OECD Reviews of Vocational Education and Training, OECD Publishing, Paris, https://doi.org/10.1787/25bad018-en.

Bloom, N., H. Schweiger and J. Van Reenen (2012), The land that Lean manufacturing forgot? Management practices in transition countries, *Economics of Transition*, 20(4), 569-785.

Braconier, H., G. Nicoletti and B. Westmore (2014), “Policy challenges for the next 50 years”, OECD *Economic Policy Papers*, No. 9, OECD Publishing, Paris, http://dx.doi.org/10.1787/5jz18gs5fckf-en.

Bulgarian Association of Software Companies (BASSCOM) (2019), *BASSCOM Barometer 2019*, https://www.basscom.org/RapidASPEditor/MyUploadDocs/BASSCOM_Barometer_2019_BG.pdf

Deming, D.J. (2017), The Growing Importance of Social Skills in the Labor Market. *Quarterly Journal of* Economics, 132 (4) (2017), pp.1593-1640.

Demmou, L., I. Stefanescu and A. Arquie (2019), "Productivity growth and finance: The role of intangible assets - a sector level analysis", OECD Economics Department Working Papers, No. 1547, OECD Publishing, Paris, https://doi.org/10.1787/e26cae57-en.

Irish Department of Foreign Affairs and Trade (2017), *Review of Implementation of Global Irish—Ireland’s Diaspora Policy*, Irish Abroad Unit, Annual Report 2017. https://www.dfa.ie/media/dfa-2017/globalirish/20180606---Diaspora-Policy-Review-Final.pdf

Eurostat (2016), *Community Innovation Survey*.

European Commission (2020), *European Innovation Scoreboard 2020.*

European Commission (2019a), “Undeclared Work in the European Union.” *Special Eurobarometer* 498 – September 2019, Published February 2020.

European Commission (2019b), *Technical report accompanying the document report from the Commission to the European Parliament and the Council on progress in Bulgaria under the cooperation and verification mechanism*, Commission Staff Working Document, Brussels, 22.10.2019.

European Commission (2019c), *Education and Training Monitor 2019 Bulgaria Report*, Luxembourg: Publications Office of the European Union, 2019. https://ec.europa.eu/education/sites/education/files/document-library-docs/et-monitor-report-2019-bulgaria_en.pdf

European Commission (2017), Detailed information on the assessment of regulation in professional services, *Commission staff working document* https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016SC0436&from=DE).

European Investment Bank (2019), 2019 *EIB Investment Survey*.

Fora, A. F., and N. G. Bugnar (2017), Implementing competition policy. Comparative study-Romania and Bulgaria. *The Annals of the University of Oradea*, 319.

Gal, P., G. Nicoletti, T. Renault, S. Sorbe, and C. Timiliotis (2019), Digitalisation and productivity: In search of the holy grail–Firm-level empirical evidence from EU countries, *International Productivity Monitor*, (37), 39-71.

Global Competition Review (2019), *GCR Rating Enforcement 2019: The annual ranking of the world's top antitrust authorities*, 04 September 2019. https://globalcompetitionreview.com/edition/1001376/rating-enforcement-2019

IMF (2016), *Bulgaria: State-owned enterprises in a regional perspective*, Bulgaria selected issues paper, IMF Country Report No. 16/345.

Levin, V., S. Guallar Artal, and A. Safir (2016). *Skills for work in Bulgaria: the relationship between cognitive and socioemotional skills and labor market outcomes* (English). Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/508441467991943114/Skills-for-work-in-Bulgaria-the-relationship-between-cognitive-and-socioemotional-skills-and-labor-market-outcomes

ManpowerGroup (2019), Talent Shortage Survey 2019, https://go.manpowergroup.com/hubfs/Talent%20Shortage%202019/2019_TSS_Infographic-Bulgaria.pdf https://go.manpowergroup.com/talent-shortage

Mintchev, V., and V. Boshnakov (2018), The choice of Bulgarian migrants-stay or leave again? *Economic studies*, *27*(2).

Paccagnella, M. (2016). Age, ageing and skills. OECD, 22 Apr 2016, No. 132, https://doi.org/10.1787/5jm0q1n38lvc-en.

OECD (2020a), Insolvency and debt overhang following the COVID-19 outbreak: assessment of risks and policy responses, ECO working paper.

OECD (2020b), *Annual Report on Competition Policy Developments in Bulgaria 2019*, Report submitted by Bulgaria to the Competition Committee, DAF/COMP/AR(2020)40.

OECD (2020c), "How to make Integration Policies Future-Ready?" *Migration policy debates*, No. 21, January 2020. http://www.oecd.org/els/mig/migration-policy-debates-20.pdf

OECD (2019a), *OECD Review of the Corporate Governance of State-Owned Enterprises: Bulgaria*.

OECD (2019b), PISA 2018 Results (Volume I): What Students Know and Can Do, Table I.B1.7, https://dx.doi.org/10.1787/5f07c754-en

OECD (2019c), *Teaching and Learning International Survey (TALIS) 2018*, Paris: OECD. https://doi.org/10.1787/23129638.

OECD (2019d), *Getting Skills Right: Future-Ready Adult Learning Systems*, Getting Skills Right, OECD Publishing, Paris, https://doi.org/10.1787/9789264311756-en.

OECD (2018a), *Product Market Regulation Indicators database*.

OECD (2018b), *Skills for Jobs database*.

OECD (2017a), *Getting Skills Right: Skills for Jobs Indicators*, Getting Skills Right, OECD Publishing, Paris, https://doi.org/10.1787/9789264277878-en.

OECD (2015), *The Innovation Imperative: Contributing to Productivity, Growth and Well-Being*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264239814-en.

Reiner, M., and D. Radu (2012). Return Migration: The Experience of Eastern Europe. *International Migration*. 50. 10.1111/j.1468-2435.2012.00762.x.

Sandu, S., Goschin, Z., Anghel, I., and Goschin, G. (2015), The R&D and innovation systems in Romania and Bulgaria in the EU context. *Procedia Economics and Finance*, *32*, 1804-1826. Sandu, S., Goschin, Z.,

Soete, L., M. Gaczynski, C. E. Garcia, L. Henriques, L. Langfeldt, A. Mahr, C. O'Carroll, S. Preissler, S. Sorčan, and L. Cowey (2015), *Peer Review of the Bulgarian Research and Innovation system*. Horizon 2020 Policy Support Facility.

United Kingdom's Social Mobility Commission, (2020), Investing in 'what works' activity in further education and adult learning, Policy Brief https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/859091/SMC_FE_policy_briefing.pdf

United Kingdom's Department of Education, (2019), *T Level Action Plan 2019*, October 2019. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/907415/T_Level_Action_Plan_2019.pdf

Westmore, B. (2013), "R&D, Patenting and Growth: The Role of Public Policy," OECD Economics Department Working Papers 1047, OECD Publishing. http://dx.doi.org/10.1787/5k46h2rfb4f3-en

World Bank (2020), *Doing Business 2020*. Washington, DC: World Bank. DOI:10.1596/978-1-4648-1440-2.

World Bank (2019a), Bulgaria Enterprise Survey, www.enterprisesurveys.org.

World Bank (2019b), *Assessment of the Public Procurement System in Republic of Bulgaria*, February 2019.

World Bank (2016a), *Report on the Observance of Standards and Codes (ROSC), Insolvency and Creditor/Debtor Regimes*, June 2016.

World Bank (2016b), *Bulgaria - PISA 2015 brief (English).* Programme for International Student Assessment (PISA) brief. Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/932461485945004426/Bulgaria-PISA-2015-brief

World Bank (2015), *Productivity in Bulgaria: Trends and Options*.

3 Reducing regional disparities for inclusive growth

Regions with large cities are driving growth in Bulgaria, while many rural regions suffer from depopulation and rapid ageing. Improving living standards across all regions will require better coverage and access to public services, notably in health and long-term care. Policy action to integrate the Roma, around one-tenth of the population most of which live in poverty and socially excluded neighbourhoods, would help to tackle labour shortages in the medium term in addition to improving well-being. Investments in infrastructure and housing reform are needed to boost mobility and strengthen linkages to national and international supply chains. This would also benefit agriculture that accounts for almost a third of employment in lagging regions and has undergone a rapid restructuring, polarising and distorting the sector towards low-value added products. While the coronavirus outbreak has hit the tourism industry hard, the diverse Bulgarian landscape offers opportunities for developing profitable experience-based tourism, when international travel resumes.

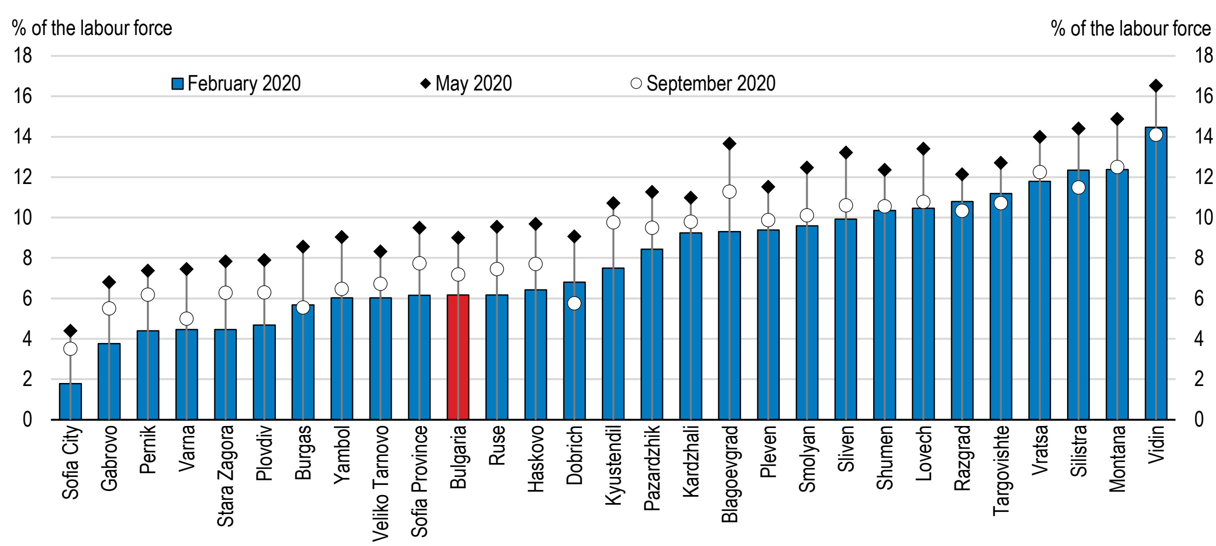
Cities are driving growth, while lagging regions are depopulating fast

Regional income disparities are large in Bulgaria. The Sofia City region, home to one fifth of the population, has a GDP per capita corresponding to the United Kingdom's in purchasing power parities. By contrast, the poorest regions in the northwest are also the poorest in the entire European Union (EU) and compare to Colombia by GDP per capita. Bulgaria has a strong north-south gap, with the northern regions generating only 25% of GDP even though 35% of the population resides there. Many OECD countries are concerned with how to foster inclusive regional development. Bulgaria faces many similar challenges such as out-migration, underutilisation of labour resources and diverging productivity growth between urban and rural areas. These overall trends are perhaps even more acute for Bulgaria's lagging regions, especially some rural regions in the northwest. They struggle with rapid depopulation and stark ageing, having experienced disappointing convergence in living standards not only to the EU average, but also to more prosperous Bulgarian regions such as Sofia and Plovdiv.

The coronavirus outbreak has hit employment in all regions and increased already high unemployment rates in some rural regions even further (Figure 3.1). In Sofia and other thriving regions, such as Gabrovo, Plovdiv and Stara Zagora with many manufacturing jobs, the situation has deteriorated from remarkably low unemployment and severe skill shortages prior to the shock. The Varna and Burgas regions by the Black Sea are heavily dependent on tourism and it will likely take a long time for them to recover (OECD, 2020a). Almost one third of all jobs in the northern regions are in agriculture, which although less affected by containment measures, could face longer-lasting shocks to supply chains (OECD, 2020b). The large and socially excluded Roma population faced particular difficulties in coping with containment measures, among others due to poor access to sanitation. While the medium and longer-term implications of the crisis remain highly uncertain, addressing the multiple regional challenges will likely become even more pressing. At the same time, new opportunities for regional economic development could arise, for instance from changing tourism demand or reshoring of production to within EU borders.

Figure 3.1. Unemployment rates vary much across regions, also after the COVID-19 outbreak

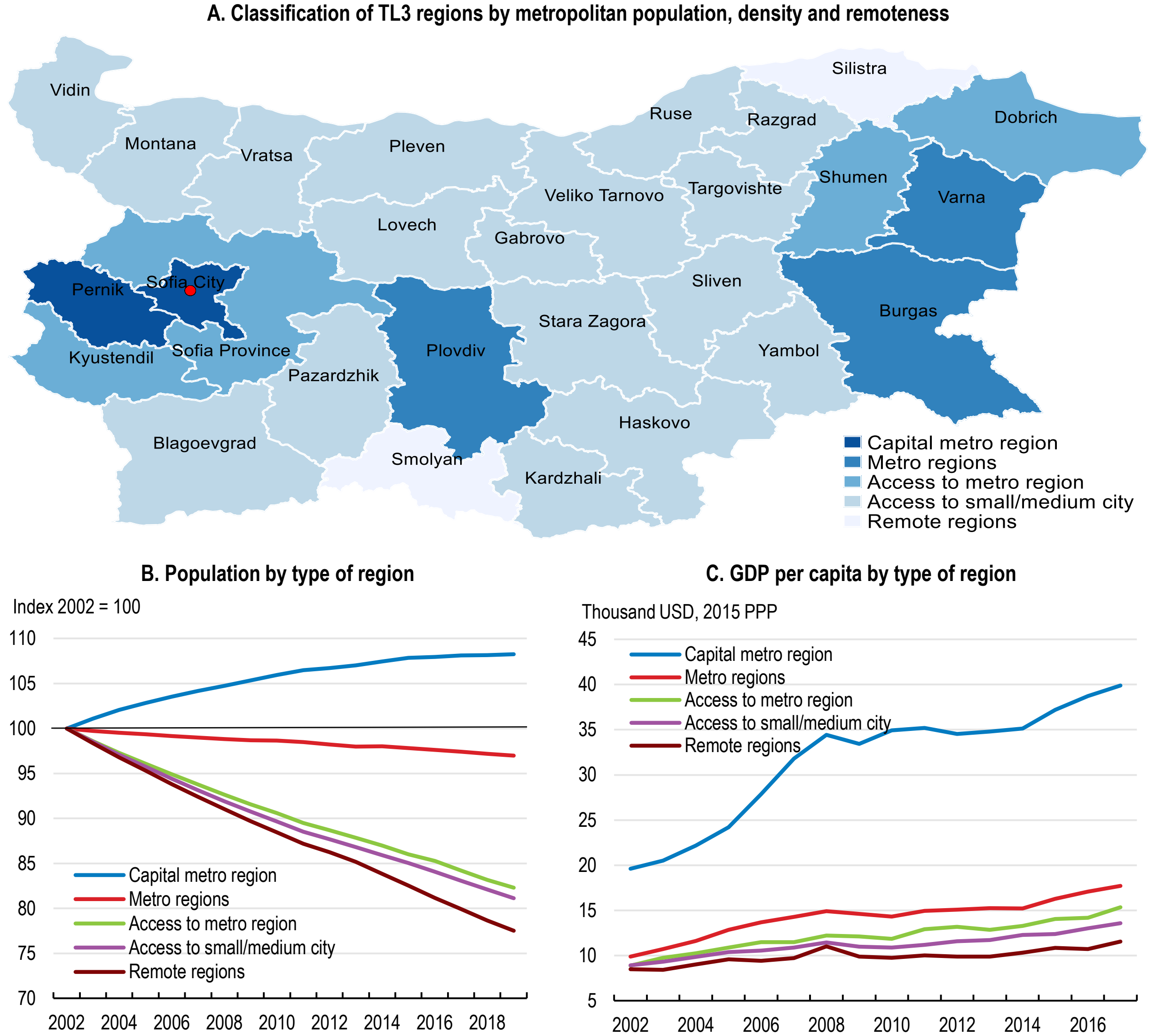
Unemployment rate by region, not seasonally adjusted



Note: Based on registrations at Labour Offices, likely resulting in underreporting of the real number of unemployed.
Source: Bulgarian Employment Agency.

StatLink https://stat.link/83av9s

Figure 3.2. The population is moving to metro regions with higher output and growth



Note: A large metro region (the capital metro region) has more than 50% living in a functional urban area (FUA) with at least 1.5 million people. A metro region has at least 50% living in a FUA of at least 250 000 people. Access to metro region (to small/medium city) are regions with more than 50% of the population living within 60 minutes drive from a FUA of at least 250 000 people (of between 50 000 and 250 000 people). Remote regions are regions with more than 50% of its population not having access to any FUA within 60 minutes drive. Panel B and C display country aggregates of the 28 regions.

Source: OECD calculations based on OECD Regional Statistics and the typology by Fadic et al. (2019), "Classifying small (TL3) regions based on metropolitan population, low density and remoteness", OECD Regional Development Working Papers, No. 2019/06, https://dx.doi.org/10.1787/b902cc00-en.

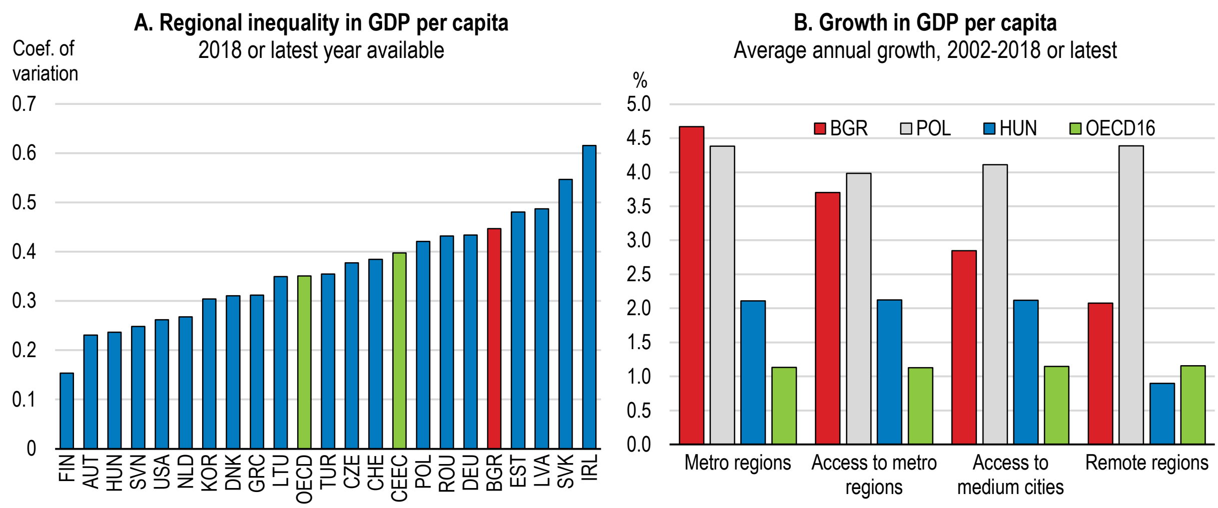
StatLink https://stat.link/gn5yd7

The shrinking population is strikingly visible in some regions, suffering from a rising number of ghost towns (Stern and Dimitrov, 2020). Over the last two decades, more than 10 out of 28 regions have lost at least 20% of the population. Many have emigrated or moved to larger cities and the population in the Sofia City region has increased by more than 10% during the same period. Recent OECD work proposes a new typology of regions based on the presence of larger cities (functional urban areas with at least 250 000 inhabitants) and the extent to which such cities are accessible by the population living in each region (Fadic et al., 2019). Applying this classification to Bulgaria points to strong urbanisation and agglomeration effects (Figure 3.2). The population living in the four identified metropolitan regions (Sofia, Plovdiv, Varna and

Burgas) has increased from 35% to 41% during 2002-2019, while regional GDP per capita ranks higher and has increased faster the better access is to cities (Panel C). Productivity tends to increase with city size in OECD countries, but there is also evidence of lower levels of productivity in cities with fragmented governance structures (Ahrend et al., 2017; OECD, 2021).

Regional income differences in Bulgaria are larger than in most OECD countries and have increased more across the different types of regions over the last two decades (Figure 3.3). Most of the divergence took place during the boom prior to the global financial crisis, but persists even though all regions experienced robust income growth from 2014 until the COVID-19 outbreak (Figure 3.2, Panel C).

Figure 3.3. Regional disparities are larger than in most OECD countries



Note: The coefficient of variation is a standard measure of dispersion defined as the ratio of the standard deviation to the mean. GDP per capita refers to the TL3 regional level. CEEC refers to an unweighted average of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia in all figures in the Chapter, unless otherwise noted. In Panel A, the OECD aggregate includes 29 countries. See Figure 3.2 for the regional typology applied in Panel B.
Source: OECD, Regional Statistics database.

StatLink https://stat.link/ojrwct

Regional policy needs to act across many different areas, both to recover after COVID-19 and to foster regional development in the longer term. This chapter focuses on the basic issue of how to improve living standards for people across all regions. A first part looks at the challenge of providing equal access to and quality public services across municipalities. The Roma population is given particular attention since many live in isolated communities and very low labour market participation poses missed opportunities both for Roma and for regional growth and finances of municipalities. The second part addresses the question on how to foster growth in lagging regions, notably by improving infrastructure and housing and by realising the potential from specialisations in agriculture and tourism. Accompanying OECD work will provide an in-depth review of governance at the municipal and regional levels (OECD, 2021).

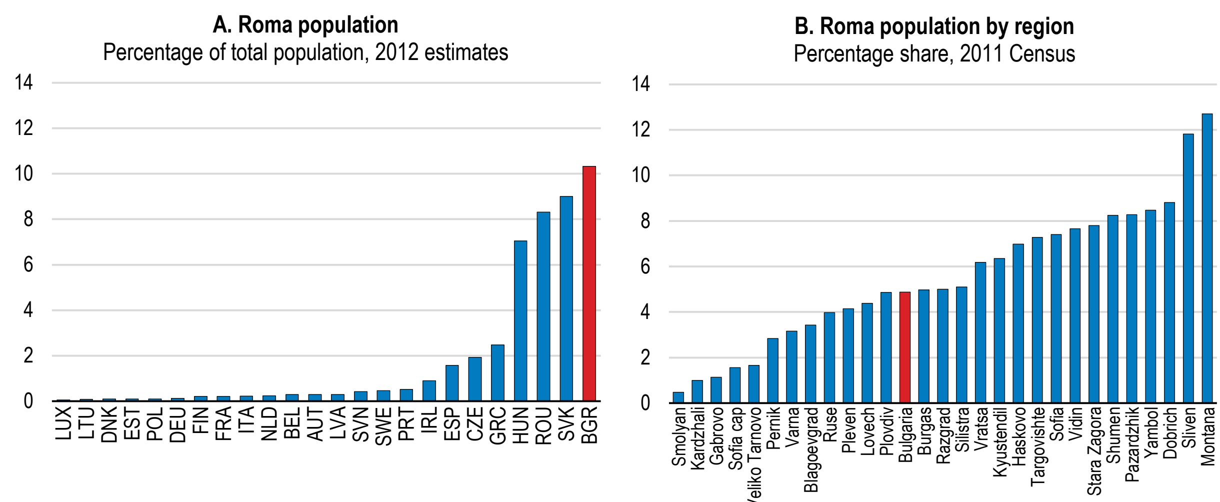
Supporting living standards in lagging regions

Raising living standards in lagging regions requires improving municipalities' delivery and individuals' take-up of social benefits and services, notably among the Roma population and other minorities. This will require innovative approaches and enhanced collaboration among municipalities. The government has taken important steps and formulated targets and measures in national strategies and action plans, but implementation needs to be accelerated to deliver on promises. Reforming health and long-term care is particularly urgent given the coronavirus outbreak and the ageing challenge.

Including the Roma population in the economy

Disadvantaged Roma communities are in need of particular support to mitigate extreme inequalities and foster economic and social inclusion. Without action, there is a risk that the pandemic shock will hit these communities the hardest in the medium term given poor access to health care and sanitation as well as limited digital tools and skills. International estimates suggest the Roma represent 10% of the population in Bulgaria, the largest share across EU countries (Figure 3.4, Panel A). In the 2011 national census only around 5% of the population self-identified as Roma, while almost 9% declared Turkish ethnic origin. Living standards vary enormously across ethnic groups. Almost 65% of Roma were at-risk-of-poverty in 2018, while the Turkish ethnic group also lagged behind at 31.6% and a moderate 16.7% of the population with Bulgarian ethnicity were at-risk-of-poverty (EU-SILC).

Figure 3.4. The Roma population is large and concentrated in some regions



Note: Panel A is based on averages across different sources. Panel B is based on self-reported ethnicity in the 2011 national Census.
Source: Council of Europe, Roma Inclusion by EU Country; Bulgaria National Statistical Institute.

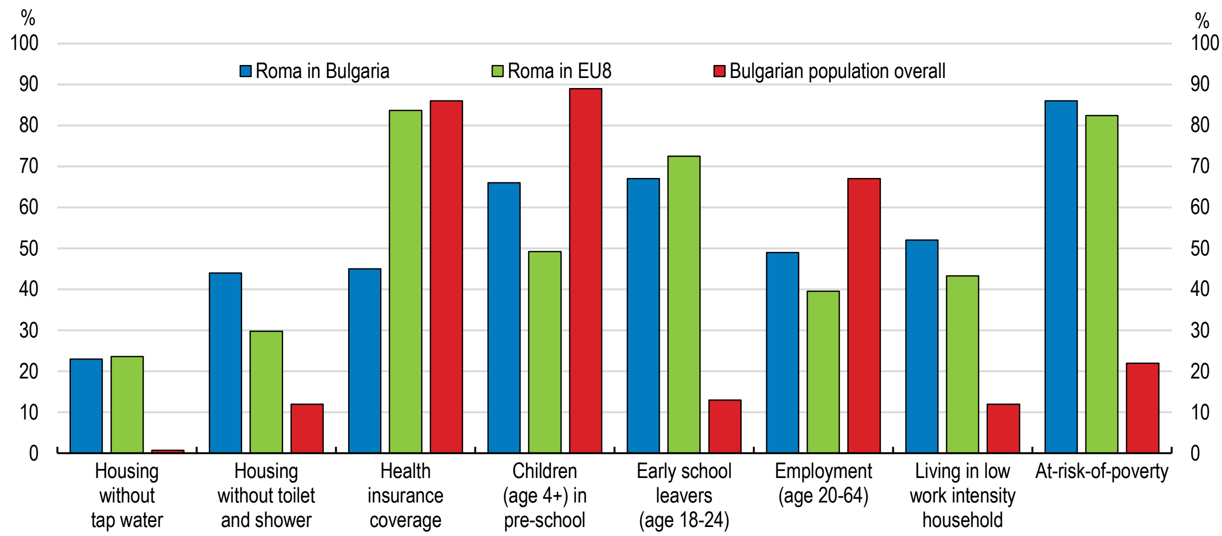
StatLink https://stat.link/fe7bx3

Without improvement in the economic integration of minorities, income convergence towards the EU average will face strong demographic headwinds in addition to that posed by ageing (Chapter 2). The Roma population share could rise markedly since fertility rates are much higher than among ethnic Bulgarians (3.0 vs 1.1; Koytcheva and Dimiter, 2008), who also emigrate at a higher rate. Calculations for the Slovak Republic show that GDP could increase by 12% if employment and productivity of Roma would converge towards the levels of the general population by 2060 (OECD, 2019a). The economic gains are nonetheless secondary to the need for addressing social exclusion, worrying health outcomes and severe material deprivation among Roma (Figure 3.5).

Most Roma lack proper housing and almost 25% of houses in segregated Roma neighbourhoods remain illegal (European Commission, 2019a). Without proof of property rights, many Roma cannot obtain identity cards, nor access healthcare services and social benefits. In addition, overcrowded housing in Roma settlements makes physical distancing to cope with COVID-19 next to impossible. Some municipalities have legalised Roma housing (Kyustendil, Dupnitsa and Peshtera), but often local authorities have opted for demolitions (European Commission, 2019a). The grave housing problems for Roma are part of an ineffective housing sector in need of reform (cf. below). Resolving property rights is essential. It requires technical, legal and financial support to municipalities to update plans and assess property rights and to Roma households to reach agreement with legal landowners.

Figure 3.5. Living conditions of Roma lag far behind

Share of population groups, 2014-2016



Note: Employment refers to "any paid work done in the last four weeks", including self-employment and occasional work. EU8 is an unweighted average of Roma outcomes in Croatia, Czech Republic, Greece, Hungary, Portugal, Romania, Slovak Republic and Spain; all countries with sizeable Roma populations and thus included in the dedicated survey.
Source: EU FRA (2016), Second European Union Minorities and Discrimination Survey, Roma: Selected findings.

StatLink https://stat.link/ys4og1

Less than half of Roma have health insurance coverage, much lower than the general population and Roma in other EU countries (Figure 3.5). This restricts access to health care, which is further limited by a lack of general practitioners in the Roma communities. A network of health mediators has improved the situation, with 215 mediators working in 117 municipalities in 2017, and supported by establishment of mobile healthcare units. This is welcome as evidence suggests having mediators is the most promising way to address Roma health issues effectively (Gatti et al., 2016), including awareness-raising campaigns about the coronavirus as carried out in the Slovak Republic (European Commission, 2020). Nonetheless, as for housing, insufficient access to health care in many areas is not restricted to Roma and needs to be addressed as part of a comprehensive healthcare reform (cf. below).

Pre-school attendance and enrolment in primary school has been a political priority and is improving among Roma. A welcome reform in 2016 made pre-school mandatory from the age of five and prohibited the formation of segregated classes in ethnically mixed schools. However, 27% of Roma children (age 6-15) attend schools in which all schoolmates are Roma, the highest share across EU countries, amplifying extensive school segregation among the general population (EU FRA, 2016). A sustained effort is needed to reduce the very high rate of early school leavers (Figure 3.5) as well as enhanced activation policies to address the very high rate of Roma youth not in employment, training or education (Key Policy Insights). This is a particular concern for young Roma women, often having children at a young age, and facing multiple barriers for labour market participation (EU FRA, 2016).

Formal employment of Roma improved somewhat with the labour shortages prior to COVID-19, but nonetheless lags far behind the general population. A national programme, Activating the Inactive, motivated more than 5000 inactive Roma to register at Labour Offices in 2018 through Roma labour mediators. Nonetheless, as discussed in Key Policy Insights, overall resources for employment and training services are low and capacity need to be increased significantly. Successful experiences in some regions and a comparatively low share of Roma reporting discrimination when looking for work suggest substantial returns to such investment (EU FRA, 2016).

Roma policy initiatives in Bulgaria are mainly driven and funded by the European Union. The National Strategy for Roma Integration 2012-2020 aims for equal opportunities and equal access to rights and services for all, no matter ethnic origin. Line ministries and local governments are responsible for implementation under coordination and advice by the National Council for Cooperation on Ethnic and Integration Issues. A deputy prime minister chairs the Council, but its powers are limited and many Roma organisations refuse to collaborate with the Council since 2013 (Integro Association, 2017). The Council reported progress on strategic goals with respect to education, employment and anti-discrimination in the most recent assessment (European Commission, 2019a). Civil society groups also report improvements in education of Roma and use of EU funds, while pointing to deteriorating governance and rising anti-Roma rhetoric (Amalipe, 2019).

Municipalities and committed political leadership or administration often drive successful Roma inclusion (Gatti et al., 2016). The size of Roma populations varies much across regions (Figure 3.4, Panel B), with some concentration in rural regions, making the reliance on regional and municipal strategies and councils appropriate. In many places, Roma leaders or organisations participate in local policy-making, being essential for development and implementation of inclusion policies. However, small municipalities often lack the capacity to apply for programmes and develop specific policies targeted to local communities. For instance, 71 municipalities had not adopted a Roma action plan in 2016 and many municipalities with plans lacked funding (European Commission, 2019a). A more systematic approach should be adopted at the national level with stronger coordination across line ministries and with local governments, including strengthening project preparation and facilitation of EU funds. This would help to reduce disruptions in public support to Roma since EU-funded projects often run for a few years followed by lengthy breaks before new funding becomes available.

Experience from OECD countries with Indigenous people, such as Australia, Canada, Mexico, New Zealand and the United States, can also provide useful inspiration for Roma policies. A recent OECD review demonstrates the importance of establishing and strengthening governance structures that empower Indigenous communities to drive their own economic development (OECD, 2019b). Activating these opportunities should start by improving Indigenous statistics and data to inform decisions. Targeted policies to create Indigenous entrepreneurship and small business development can help to foster development at the local level. In Canada, the Frog Lake First Nation community set up their own company for oil and gas extraction, creating employment opportunities and integrating into the industry through joint ventures with other companies (OECD, 2019b). Involving Indigenous-led organisations in policy-making is crucial and can be improved by providing resources and tools to strengthen their capacity and creating opportunities for meaningful participation in government decision-making. Australia and New Zealand have created economic development partnerships with Indigenous people, focusing on more involvement and localised approaches (OECD, 2019b).

Ensuring equal access to public services

The Bulgarian welfare system has undergone sizeable transformations since the fall of Communism. Until the late 1990s, the state continued to provide and finance all general social services, such as social security, childcare and employment services. After the 1997 crisis, large reforms changed the system towards a more employment-based insurance model (Cerami and Stanescu, 2009). Although, this mainly influenced access to social benefits, provision of services also underwent changes, notably for health care (cf. below). Welfare reforms were nevertheless slower than in most Eastern European countries and the provision of social services remains relatively centralised (Box 3.1).

Box 3.1. Subnational government organisation

Bulgaria has a two-tier system with a central government and 265 municipalities as the only decentralised administrative units. The three largest cities (Sofia, Plovdiv and Varna) are divided into smaller wards and other municipalities into smaller towns (mayoralties) and villages, totalling around 5250 units of which around half are governed by elected mayors. At the intermediate level, 28 territorial districts were re-established in 1999 and are headed by a Governor, appointed by the Council of Ministers, who is supported by a small office. In addition, six larger regions were created in 1999 and extended with regional development councils in 2008, mainly for disbursement of EU structural funds. Members of district and regional development councils are appointed by the central government or are representatives from municipalities and other stakeholders.

Municipal responsibilities are divided into two categories: i) state-delegated responsibilities, including education, social protection and health care; ii) exclusive responsibilities, including housing and community amenities, economic affairs and transport, environmental protection, utilities, culture, etc. Municipalities also run municipality-owned enterprises, of which there are around 800.

With the decentralisation strategy for 2016-2025, the government plans to establish regional institutions and strengthening their administrative capacity. A revised Regional Development Act was adopted in March 2020, strengthening the role and organisation of regional development councils and focusing on a more integrated regional development approach (OECD, 2021).

Today, the welfare system is fragmented and overregulated with sometimes unclear distribution of functions between central and local levels, resulting in incomplete coverage and weak support to vulnerable groups (World Bank, 2019). For instance, some municipalities offer no services for people with disabilities, while in other cases, capacity is lower than demand or long-waiting periods apply. These problems add to the sizeable coverage gaps of cash social benefits (Key Policy Insights) and are equally important for addressing poverty and social exclusion.

Bulgaria has taken long-awaited action to improve delivery and quality of social services with a new Social Services Act in 2019 (Box 3.2). The Act completes an ongoing focus on development of community-based and home-based services, replacing the former institutional model of care with planned closures of all medical and social care homes for children and of homes for adults with disabilities. The current service provision has suffered from legal barriers, requiring that every measure or action as well as each possible exception had to be explicitly listed in a law or regulation (World Bank, 2019). Separation of policies for each service, typically by line ministries, have also caused problems of uncoordinated legislation and regulation. The new Act is based on sound principles of equal access to high-quality services across the country and right to detailed individual case management. Ensuring that every municipality has the resources to do so will be challenging and makes successful implementation of the Act a crucial and difficult task. Particular attention will now have to be given to plan and update the scale of services across municipalities as envisaged by the development of a National Map of Social Services (Box 3.2). The reform introduces common licensing of all private service providers, while municipal services will have to meet the same high-quality standards (Bogdanov and Zahariev, 2019). The licensing regime aims at easing the current administrative burdens and will require renewal of licences every five years. This should be evaluated in follow-up reviews since experience from OECD countries indicate little impact of licensing on quality of services and large potential costs to employment and productivity (OECD, 2020c; Bambalaite et al., 2020). Burdens that restrict supply and reduce competition could be particularly costly in low-density areas.

Box 3.2. The 2019 Social Services Act

The parliament adopted a new Social Services Act in 2019, which after some delay entered into force from July 2020. Social services are broadly defined all support to prevent or overcome social exclusion, focusing mainly on assistance services, notably for people with disabilities. The Act aims to improve access to social services and enhance efficiency, while addressing longstanding problems of underfinancing and uneven distribution of funds across territories. A new Agency for Quality of Social Services will monitor service delivery and issue licences, mandatory for all private service providers. From 2022, a National Map of Social Services is envisaged to provide information on available services and on the needs of target groups throughout the country. This will form the basis to plan the local delivery of services and allocation of state budget funds, taking into account the demographic profile of the population.

The Act obliges municipalities to provide free assistance to children and people without income, while user fees apply to everybody else, except for some services made universally available (e.g. support for development of parental skills).

Enhancing municipalities' autonomy and capacity to improve service delivery

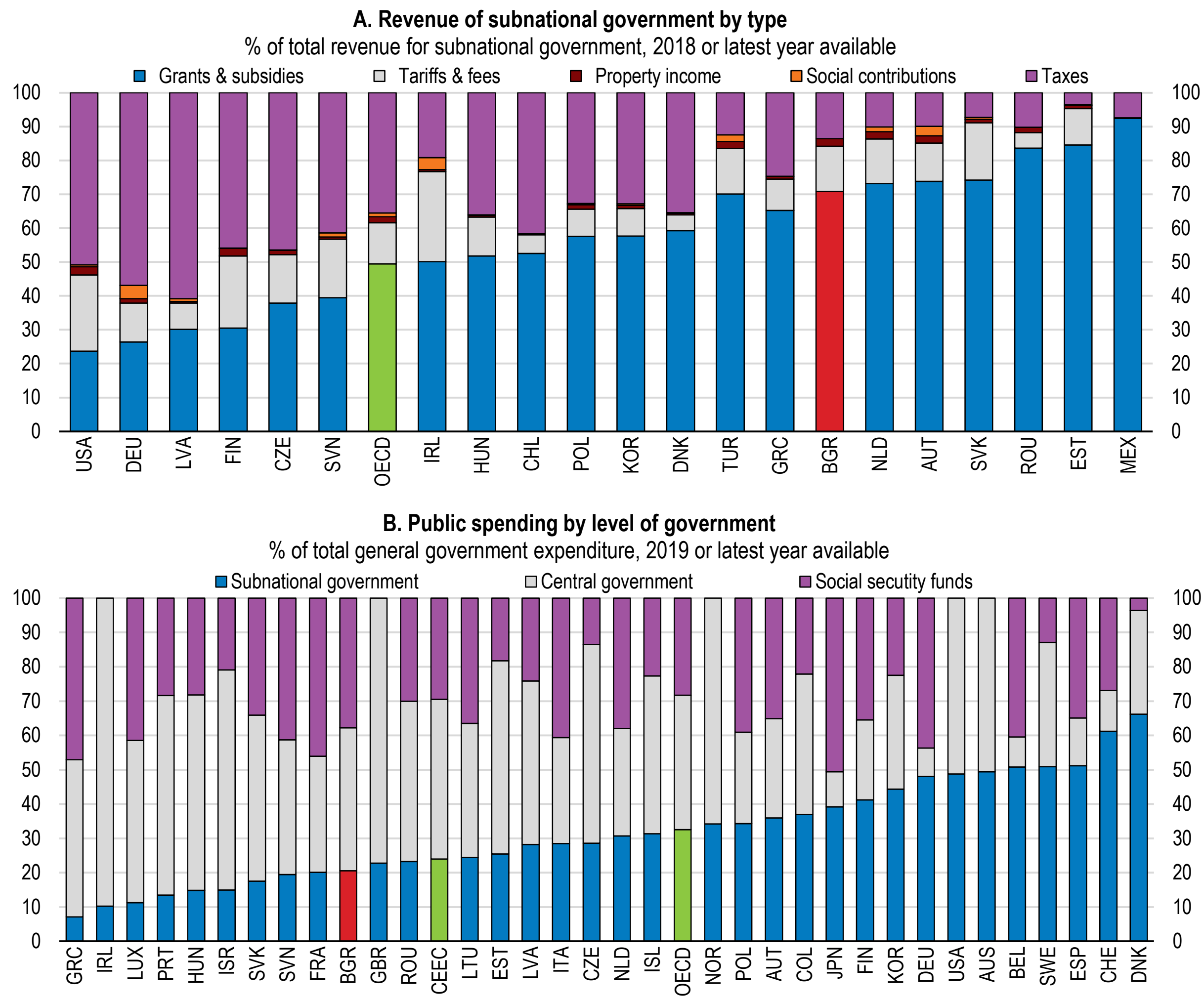
The rapid depopulation is increasing the number of small municipalities fast, making it harder to maintain and build efficient administrative capacity. The share of municipalities with less than 6 000 inhabitants, the national lower bound for establishing a new municipality, has increased from 21% in 2010 to 29% in 2019, while the median size has declined from 12 100 to 9 800 inhabitants over the same period. Nevertheless, municipal size is less of an issue than in many OECD countries and only 3% has fewer than 2000 inhabitants, much below the OECD average of 28% of municipalities (OECD, 2018a).

The main problems for efficient service provision at the local level are lack of sharing best practices and weak collaboration across municipalities. The National Statistical Institute publishes few indicators at the municipal level, ruling out quantitative benchmarking. Inter-municipal co-operation through partnerships and associations for service delivery are underdeveloped due to multiple barriers from strict regulation, weak municipal governance and lack of support from the central government (OECD, 2021; World Bank, 2019).

Revenues of municipalities mainly rest on earmarked subsidies and grants from the state, while local taxes on property, vehicles and waste can be set freely within a range but only contribute modestly (Figure 3.6, Panel A). For 2020, the year after local elections, more than one third of municipalities have increased local taxes even though the economy was in a boom when decisions were made, stressing issues of underfunding and electoral cycles (IME, 2020). Municipalities are responsible for a relatively small share of public spending (Figure 3.6, Panel B), which combined with limited discretion, leaves little scope for developing service delivery and long-term local projects to boost growth. Evidence across OECD countries shows that balanced tax and revenue decentralisation is associated with lower regional disparities (Bartolini et al., 2016). The high regional disparities in Bulgaria may thus partly derive from the comparatively high fiscal centralisation (OECD, 2021).

Implementing the decentralisation strategy (Box 3.1) step by step and strengthening municipalities administrative capacity should be a first priority. Subsequently, municipalities could be given greater autonomy in tax and spending planning and in the provision and organisation of services to better respond to local needs (OECD, 2021; 2019c), for instance by sharing tax revenue or by replacing earmarked grants with block grants as in Norway. This would create incentives for spending efficiency, but needs balancing against costly public service delivery and high administrative costs in sparsely populated areas. Setting up a formal system for inter-municipal co-operation, for instance for utilities, social services and some administrative functions, would help to achieve economies of scale (OECD, 2019c). Such arrangements are well developed in many OECD countries with high diversity in the degree of co-operation (OECD, 2017a). France, for instance, uses formalised contractual arrangements that stipulate co-decision and co-financing of interventions and inter-municipal co-operative units can have their own sources of tax revenue. Finland applies fiscal rewards to encourage municipal collaboration.

Figure 3.6. Municipalities collect little revenue and account for a low share of public spending



Note: Panel B: For more details, see OECD (2019).
Source: OECD-UCLG World Observatory on Subnational Government Finance and Investment database; OECD (2019), Government at a Glance 2019, Figure 2.44 and National Accounts database; Eurostat, Government Revenue, Expenditure and Main Aggregates database.

StatLink https://stat.link/ujhati

Improving municipal governance is equally important for more efficient service delivery and is a prerequisite for successful decentralisation reform (OECD, 2021). Monitoring mechanisms by districts and regions are currently very limited and could be strengthened. At the central government level, decentralisation reform would help to free resources from detailed policy analysis and implementation to more traditional supervision of local governments, ensuring that devolution of powers lead to improved outcomes (Phillips, 2018). In this respect, the existing mechanism for fiscal equalisation across municipalities should be strengthened (OECD, 2021) and used to address negative effects of greater tax autonomy in disadvantaged areas.

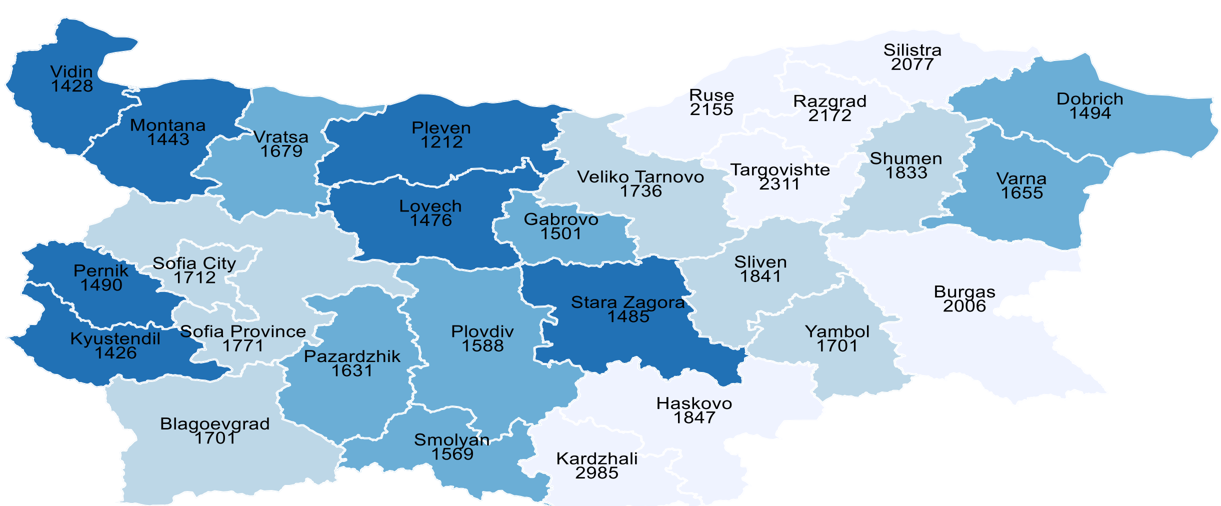
Consolidating the healthcare sector to cover all

A well-resourced and responsive healthcare sector has proven more vital than ever with the coronavirus outbreak. Bulgaria has a large hospital capacity that ensured sufficient bed places for COVID-19 patients during the first wave, but came under pressure during the second wave of the pandemic. Primary care is underdeveloped and there are significant entry barriers from incomplete health insurance coverage and large out-of-pocket payments (OECD/European Observatory on Health Systems and Policies, 2019a). Until 2000, there was unconditional universal access to health care financed through taxes, but the system suffered from central planning and mismanagement. Nowadays, everybody is in principle insured through the National Health Insurance Fund or by the state, as is the case for children and pensioners, and there are multiple public and private providers. However, people lose their health insurance coverage if they have failed to pay more than three monthly contributions in the previous 36 months. To restore health insurance rights, settling all contributions for the last 60 months is required. While precise data on coverage is lacking, estimates suggest that up to 14% of the population is de facto uninsured (EAMA, 2017), with much variation across regions and almost half of Roma uninsured (Figure 3.5). The government responded firmly to the coronavirus outbreak by fully covering testing and hospital treatment of COVID-19 patients for the uninsured.

Out-of-pocket payments, mainly on pharmaceutical care, accounted for almost 40% of current healthcare expenditures in 2018, among the highest shares in the EU. Total healthcare expenditure as a share of GDP (7.4%) is among the highest in Central and Eastern European countries, although per capita health expenditure in purchasing power parities remains low compared to most EU countries. Patients need to pay for many services not covered by the benefit package, including most dental and long-term care, as well as co-payments for prescription medicines. Healthcare affordability is a particular concern among the poorest, with 5.6% of those with low incomes reporting unmet medical needs in 2017. The situation has nevertheless improved substantially over the latest decade and overall self-reported unmet needs is now close to the EU average.

Figure 3.7. Access to general practitioners is unequal across regions

Population per general practitioner, 2019



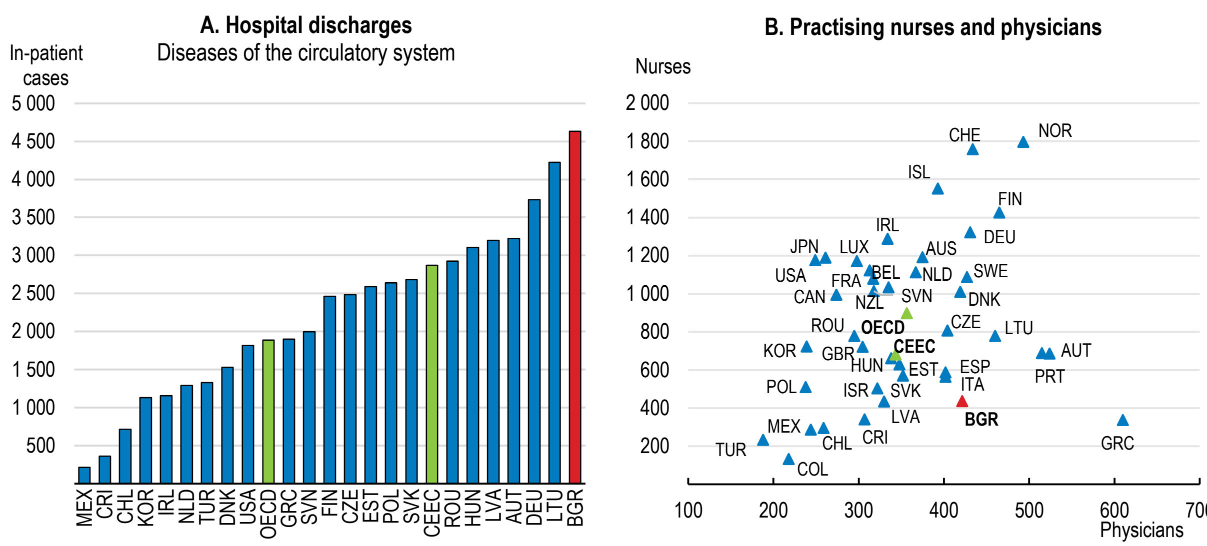
Source: OECD calculations based on Bulgarian National Statistical Institute.

Access to health care is restricted in many regions by a lack of general practitioners. The population per general practitioner varies from almost 3 000 in the southern Kardzhali region to 1 200 in Pleven, which has a large medical university (Figure 1.5). This also makes it harder to contain the coronavirus outbreak, not least since a test need to be prescribed by a general practitioner or emergency care unit to be covered by the state budget. As in most OECD countries, the general practitioners act as gatekeepers and a referral is needed for (covered) specialist or hospital care. However, the lack of primary care and monthly quotas for patient referrals forces many people to bypass and make direct payments, for instance by going directly to hospital emergency units to receive services that are actually covered (Figure 3.8, Panel A). Frequent hospital visits are also a result of many being admitted only for tests and check-ups due to lack of outpatient care (Dimova et al., 2018).

The number of specialist physicians per population is by contrast higher than in many EU countries, while nurses are in short supply with a ratio to physicians close to one (Figure 3.8, Panel B). It is urgent to address these medical staff imbalances as more than 60% of general practitioners are above age 55 and approaching retirement. The general practitioners and nurse professions should be made more attractive, for instance by increasing salaries as has been done for teachers (Chapter 2). Likewise, current financial incentives, notably a monthly allowance for practicing in remote settlements or areas with poor infrastructure may have to be strengthened further. Other non-financial policy options include provisions to admit rural students to medical schools, expanding the responsibilities of doctors and nurses, establishing multi-disciplinary services units and promoting telemedicine (OECD, 2020d).

Figure 3.8. Demand for hospital services is high but supply of nurses is low

Cases/density per 100 000 population, 2019 or latest year available



Note: For missing data in some countries, practising nurses/physicians are proxied by professionally active nurses/physicians or nurses/physicians licensed to practice.
Source: OECD. Health Statistics database; Eurostat (online data hlth_co_disch2, hlth_rs_prsns and hlth_rs_prsrg).

StatLink https://stat.link/jbmfne

Hospital capacity has increased in recent years, reaching a total of 319 hospitals and 7.6 beds per 1 000 population, well above the OECD average of 4.7. The increasing overcapacity is driven by private hospitals and the government recently started to apply stricter licensing rules for new hospitals using a National Health Map developed to align regional demand and supply. Nevertheless, further consolidation of the hospital sector is needed to address inefficient use of financial resources and raise quality. For instance, the Plovdiv region has 34 hospitals to cover just around 650 000 inhabitants. Latvia faced similar problems but has made substantial progress in consolidating its hospital sector and shifting the focus from inpatient to outpatient care (OECD/European Observatory on Health Systems and Policies, 2019b).

Resources are needed to expand underdeveloped long-term care services, including addressing regional differences. Bulgaria has less than 30 beds per 100 000 population in nursing and residential facilities, much lower than in Romania (201) and the Slovak Republic (774), while spending on long-term care at 0.4% of GDP is much below the EU average of 1.6% in 2016. Since long-term care is excluded from the health benefit package, family members provide informal care for many older people. With the rapid ageing, accessible and affordable long-term care will become increasingly needed. The government adopted a National Strategy for Long-Term Care in 2014 and presented an accompanying action plan in 2018 to develop integrated services, quality standards and focus on prevention and outreach work. Making progress on implementation and development of community- and home-based long-term care services supported by additional resources should be a key priority and will require a comprehensive and holistic approach to succeed (Bogdanov and Georgieva, 2018).

Since the mid-2000s, several governments have attempted to implement ambitious reforms to increase efficiency and decentralisation in the healthcare sector. Substantial changes to introduce a model with basic and complementary benefit packages as well as transforming some inpatient services to ambulatory settings were adopted by parliament. However, the Supreme Court has overruled almost all the substantial reforms, following lawsuits mainly by stakeholders from the medical professions (Dimova et al., 2018). This suggests that involvement of all stakeholders is crucial for the success of much needed healthcare reform.

Enabling reallocation and fostering regional growth

The recovery from the COVID-19 shock will require a large reallocation of resources, including across regions. A range of structural reforms would ensure lagging regions make the most of required changes and new opportunities. Bringing quality jobs to people in less developed areas requires infrastructure to facilitate integration with the rest of the country. Improving supply chains through better transport, education and links to other economic sectors can also help to attract foreign direct investment, revive the volume of international trade and generate agglomeration effects. Oppositely, bringing people to high-productive jobs requires adequate and affordable housing, especially in cities. This would help to boost mobility and attract scarce labour resources from low-productive jobs, in particular from the agricultural sector, employing more than one third of workers in many rural regions. At the same time, sectors such as agriculture and tourism have a large potential to boost long-term regional growth through development of higher-value added products.

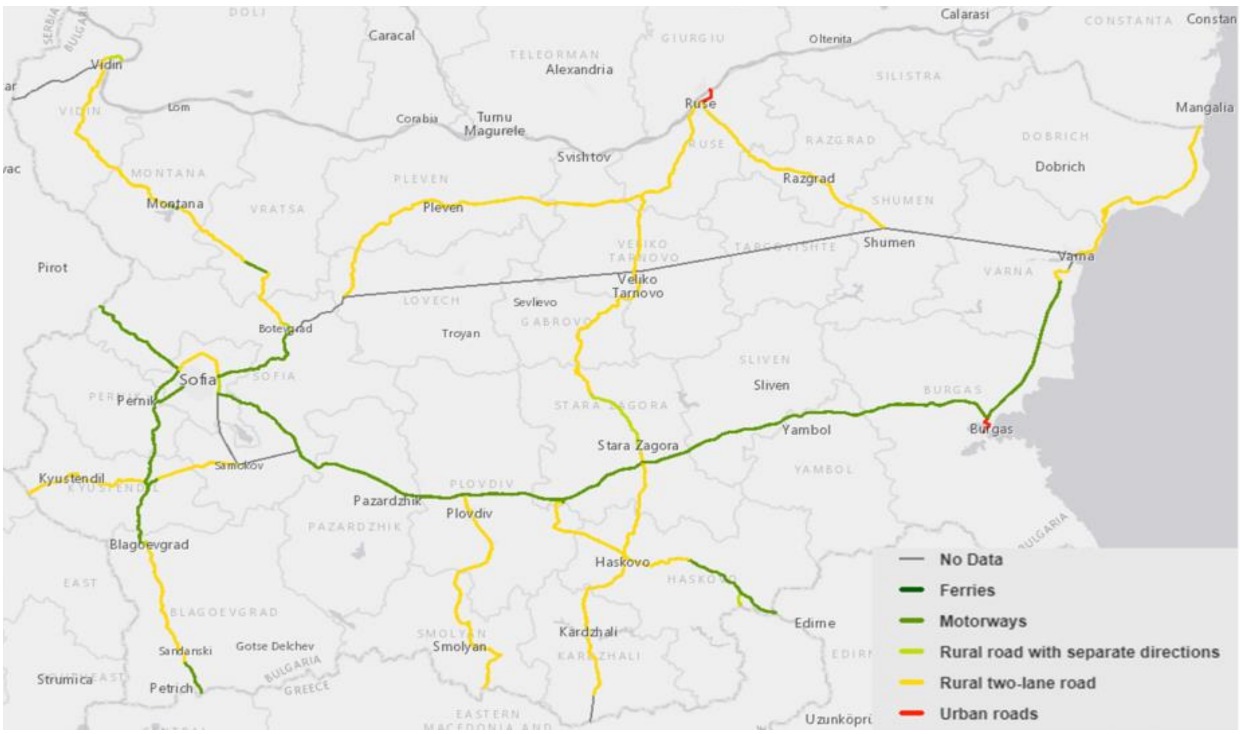
Better infrastructure and housing to support mobility

Bulgaria benefits from a strategic geographic location at the intersection between Europe and Asia. However, low transport infrastructure development and poor quality of existing road and railways are barriers to benefit from being a transit country as well as for internal integration of regions (European Commission, 2019b). The railway network suffers from slow modernisation and significant maintenance backlog. Further investment is needed to improve connectivity with neighbouring countries and complete Bulgaria’s part of the Trans-European Transport Network. Most of the rolling stock is more than three decades old and 75-80 km/h in average speed of movement is among the lowest in Europe (BMTITC, 2017). The railway sector continues to be dominated by the state incumbent. Financial problems and the lack of competition (Chapter 2) have resulted in very poor service delivery and a declining number of passengers. Problems also persist with respect to ticketing systems, access to platforms and lack of consistency in timetables for trains and busses. All these issues have likely contributed to increased use of cars and busses as the main vehicles for transportation across the country.

Absorption of EU funds has accelerated motorway construction in recent years, bringing the total network to around 800 km and with more to open in the coming years (Figure 3.9). Yet, much remains to upgrade the rest of the road network and improve connectivity, especially between the north and south. Only around

40% of all national roads have good quality surface (Figure 3.10, Panel A). Lack of road maintenance is particularly pronounced in some northern regions, increasing travel time and risks. Across the country, there were 86 road fatalities per million population in 2018, higher than in almost all OECD countries (average of 53).

Figure 3.9. Motorway construction is improving but upgrading is far from complete

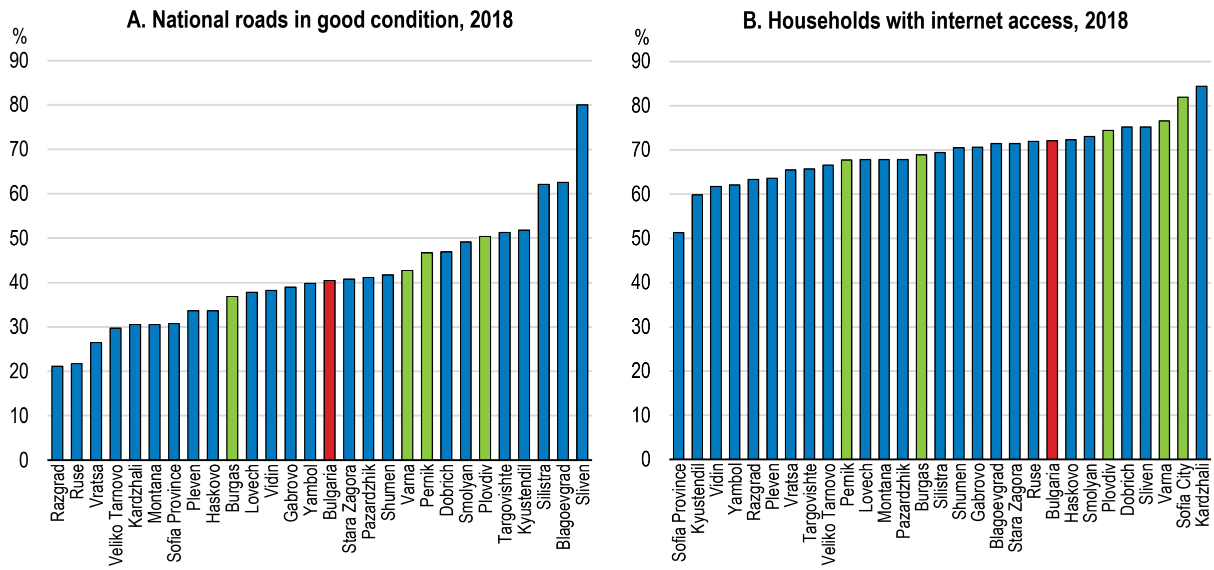


Note: The map shows motorways and express roads part of the Trans-European Transport Network. The horizontal grey road (no data) refers to the Hemus motorway under construction.
Source: European Commission, https://ec.europa.eu/transport/infrastructure/tentec/tentec-portal/map/maps.html.

A state agency is responsible for the almost 20 000 km national road network of motorways and secondary roads (Class I-III), while municipalities are in charge of local roads. Despite large injections from EU funds and revenue from a user fee system (electronic vignettes), the current budget covers less than one third of the investment need, according to the government's transport strategy (BMTITC, 2017). EU infrastructure funds are reserved for construction of new roads and parts of existing roads, but are not available for maintenance. There is thus a need for prioritising additional public funds (see Key Policy Insights) to maintain and upgrade existing roads, preferably through rigorous cost-benefit analysis for project selection. Such analysis should consider also wider socio-economic benefits of individual projects, since transport connections have a potential to decrease inequalities (Roberts et al., 2020).

Digital infrastructure has improved rapidly and can contribute to regional growth if the right framework conditions are in place. Connectivity is relatively good, the broadband network covers 95% of households and ultrafast broadband is available to 75% of households (EU average 60%, European Commission, 2019c). Nonetheless, household take-up is still relatively low and in some regions only around 60% of households have access to internet (Figure 3.10, Panel B). For households the main reason is lack of digital skills, emphasised by more than 27% of Bulgarians reporting never to have used the internet and with particularly low uptake in northern and rural areas. Digitalisation is also lacking among businesses (Chapter 2), only 6% of SMEs sell online well below the EU average of 17%. The government has drafted a national programme for "Digital Bulgaria 2025" aimed at supporting further digitalisation and development of digital skills.

Figure 3.10. Roads are in bad condition and internet access is lagging in many regions



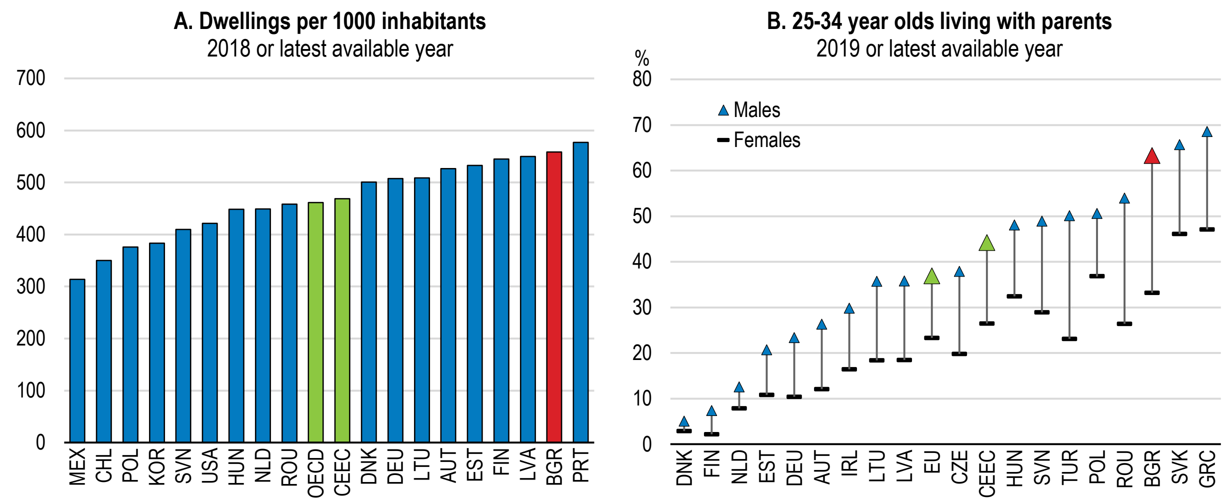
Note: Road conditions not available for the Sofia City region. Metro and capital metro regions are shown in green, see Figure 3.2, Panel A.
Source: Institute for Market Economics.

StatLink https://stat.link/if63zh

An ineffective housing market hampers mobility and well-being

Residential mobility is very low in comparison with OECD countries and even among Eastern European Union Member States, only Romania has lower mobility (Causa and Pichelmann, 2020; Eurostat based on EU-SILC). Just 3% of the Bulgarian population reported having moved to another dwelling during 2007-2012 (EU average 16%) and with little variation across urban and rural areas. While sizeable emigration during this period likely causes underestimation, low mobility among stayers can amplify regional disparities and skill mismatches by limiting job opportunities for people and employers. Moreover, the shrinking population generates oversupply of housing, which could improve well-being if an effective housing market existed to facilitate reallocation. Paradoxically, Bulgaria has a comparatively high number of dwellings per capita (Figure 3.11, Panel A), but suffers from overcrowding and very high shares of young adults, especially men, living with their parents (Figure 3.11, Panel B). The dwelling surface per population is rising fast in rural regions (Figure 3.12, Panel A), while housing stock growth has been slow in the capital in recent years, resulting in the fastest increase in house prices (Figure 3.12, Panel B). However, only 41% of dwellings in rural areas have access to sewage and only 70% have a toilet installed, causing major health risks, a particular problem facing the Roma (Figure 3.5). Addressing data gaps for the housing sector would help to assess usability of the vacant housing stock and the need for renovation. This is critical since holiday homes and hotels are not identifiable in the current data on uninhabited dwellings, and much of the housing stock is rapidly deteriorating due to lack of maintenance.

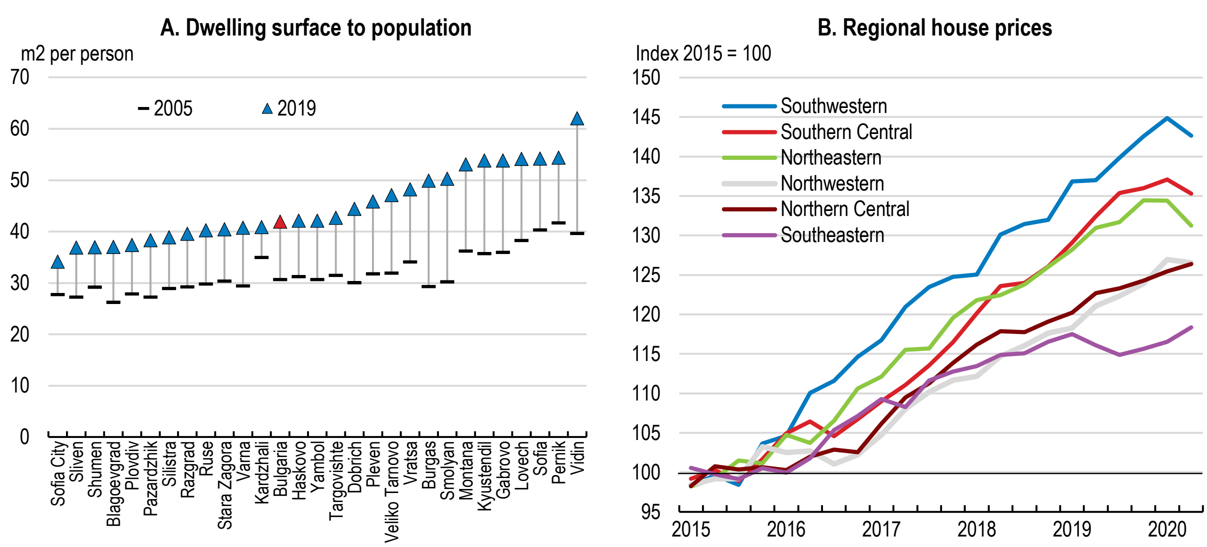
Figure 3.11. Housing supply is vast but poorly utilised



Note: Dwellings include primary as well as holiday homes.
Source: OECD, Affordable Housing database, Table HM1.1.1b; and Eurostat database (ilc_lvps08).

StatLink https://stat.link/2ocp14

Figure 3.12. Regional differences in housing stock and housing prices have increased



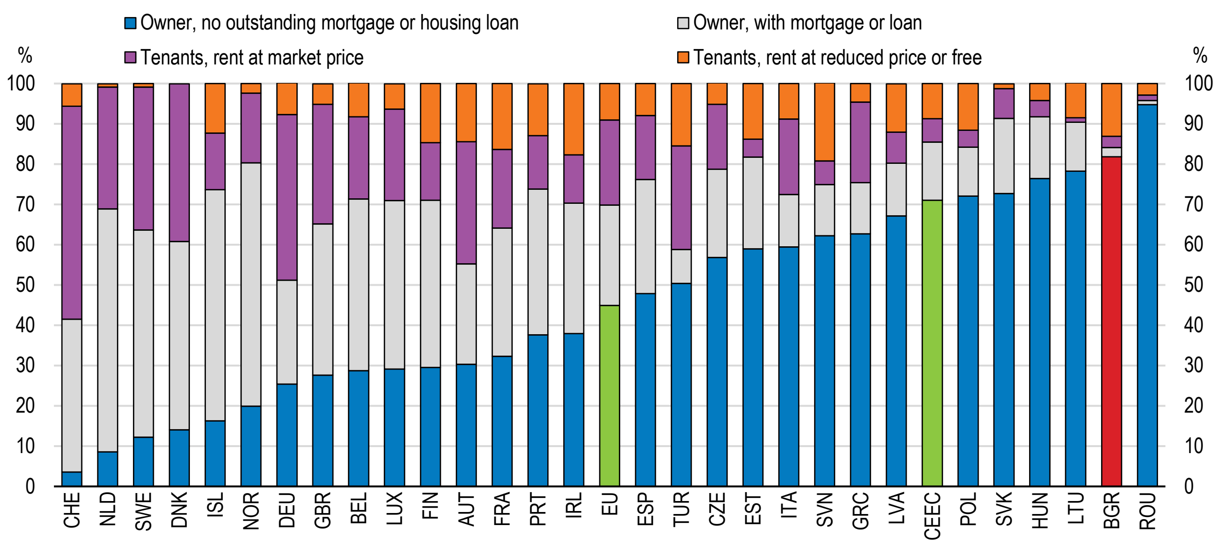
Source: Bulgarian National Statistical Institute.

StatLink https://stat.link/alxrn0

High homeownership and low affordability are the main obstacles to boosting residential mobility and resolving housing market imbalances. Studies have shown that homeowners are much less inclined to move compared to renters and residential mobility declines quickly as people get older (Causa and Pichelmann, 2020). More than 80% of the population live in owner-occupied housing with no outstanding loan (Figure 3.13), the result of substantial homeownership already during Communism and sale of public rented housing in the early 1990s. Nonetheless, housing-related costs exceeds 40% of disposable income for 38% of the low-income group (the bottom 40% of the population) compared to 22% in Romania and 21% in Hungary. Surprisingly, the incidence of ownership with no loans is equally high for people below as above the at-risk-of-poverty line. High housing costs mainly reflect excessive expenses for heating, electricity and water relative to incomes, elevated by lack of thermal insulation in 3.3 million homes (BMRDPW, 2017) and the widespread lack of maintenance.

Figure 3.13. Most Bulgarians are outright homeowners

Distribution of population by tenure status, 2019 or latest year available



Note: Tenants renting at subsidised rent are lumped together with tenants renting at private rent in Denmark and the Netherlands, and are not capturing the full extent of coverage in Sweden due to data limitations.
Source: Eurostat.

StatLink https://stat.link/630uya

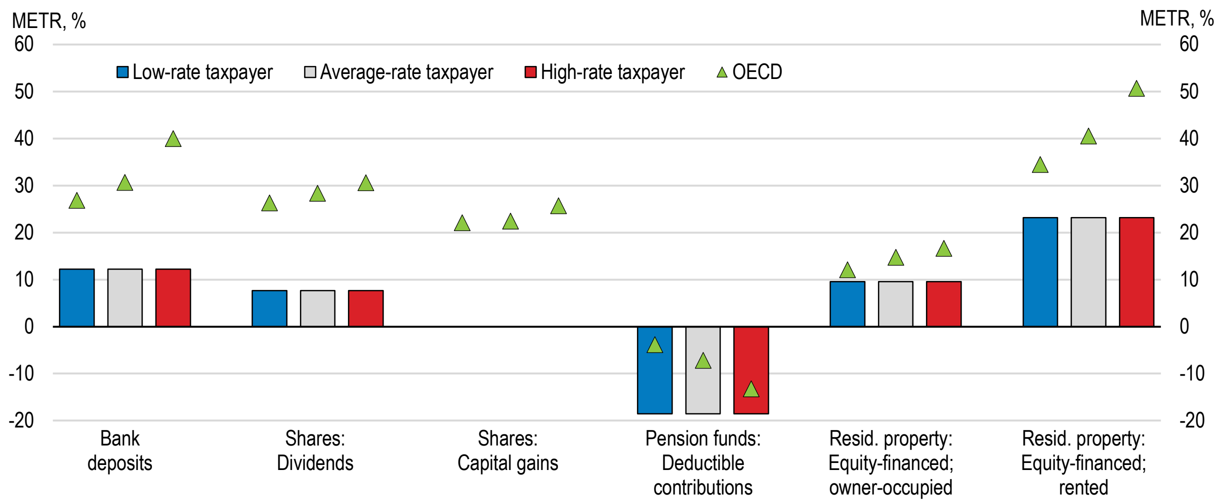
The government attempted to formulate policies to address the challenges in a draft National Housing Strategy 2018-2030, released in 2018 after thorough analysis (World Bank, 2017; BMRDPW, 2017). However, more than two years later the strategy has still not been adopted and little action has been taken in this respect. The proposed strategy includes many welcome initiatives and envisages annual public spending of around EUR 130 million (0.2% of GDP). Priorities include the creation of funds to support massive renovation, a new housing data system, tax changes to improve incentives and measures to expand affordable housing. Such large-scale investment would be timely to boost the recovery from COVID-19 and could attract support from the EU green funds, as envisaged in France.

Most OECD countries use housing allowances and social housing to enhance affordability for low-income households, both of which are vastly underdeveloped in Bulgaria. The heating allowance was increased substantially in 2019 and provides support to a large group of people (Key Policy Insights) but nonetheless remains the only support programme of significant size and distorts incentives for energy renovation. Social housing accounts for just 2.4% of the inhabited housing stock and the government estimates an additional need of 80 000 units (BMRDPW, 2017). Municipalities are in charge of social housing, but incentives to expand the sector are weak and one third of municipalities have no social housing at all (World Bank, 2017). The eligibility criteria set by municipalities vary and often favour those already residing in the municipality and exclude the poorest households. In some areas, tenants have a right to buy the unit after a certain period of time, which puts further pressure on the limited stock and makes it difficult to manage the sector efficiently. Legislative barriers also discourages development of new social housing by requiring municipalities to construct dwellings, excluding private sector developers and public private partnerships. There is a large potential for converting vacant housing units into social housing, but signing such agreements with property owners requires legislation that is absent for the moment (World Bank, 2017).

The absence of a formal private rental market is a major barrier to labour mobility and cities are missing out on important agglomeration effects (Ahrend et al., 2017). The limited stock results in high costs of market-based rental that holds back demand. From private investors' point of view, the tax system discourages rental of residential property compared to other types of investments (Figure 3.14; OECD, 2018b). Informal rental agreements are thus quite common. In contrast to many OECD countries, rental regulation is lenient and mainly governed by civil law. Reviewing rental legislation would be welcome to clarify terms and ensure an equitable balance between tenant and landlord rights, including setting up a quick and low-cost system to resolve disputes.

Figure 3.14. Taxation of household savings differs across asset types and has no progressivity

Marginal effective tax rate (METR) across asset types, 2016



Note: See source for methodology. All reported measures apply the OECD average inflation. Low-rate taxpayer is represented by those at 67% of the average wage (AW); the average-rate taxpayer is the one at 100% AW and the high-rate taxpayer at 500% AW.
Source: OECD (2018), "Taxation of Household Savings", OECD Tax Policy Studies, No. 25, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264289536-en.

StatLink https://stat.link/f3xlkc

The owner-occupied housing market segment would benefit from reforms to remove tax breaks and targeting of subsidy schemes. The tax system encourages homeownership by allowing married couples below age 35 at the time of signing the mortgage contract to deduct mortgage interest expenses on the first EUR 50 000 of the loan. Recurrent taxes on residential property are low (0.01-0.45% of estimated value with a 50% discount on the primary dwelling) and without progressivity (Figure 3.14). The total tax revenue from property taxes is well below the OECD average and lower than in peer countries (see Box 1.3 in Key Policy Insights). Constructing a new housing data system as envisaged in the housing strategy could allow for updating housing valuations and increased taxation of immovable property. Higher taxation of second homes should also be considered as a means to incentivise larger use of the uninhabited housing stock (BMRDPW, 2018).

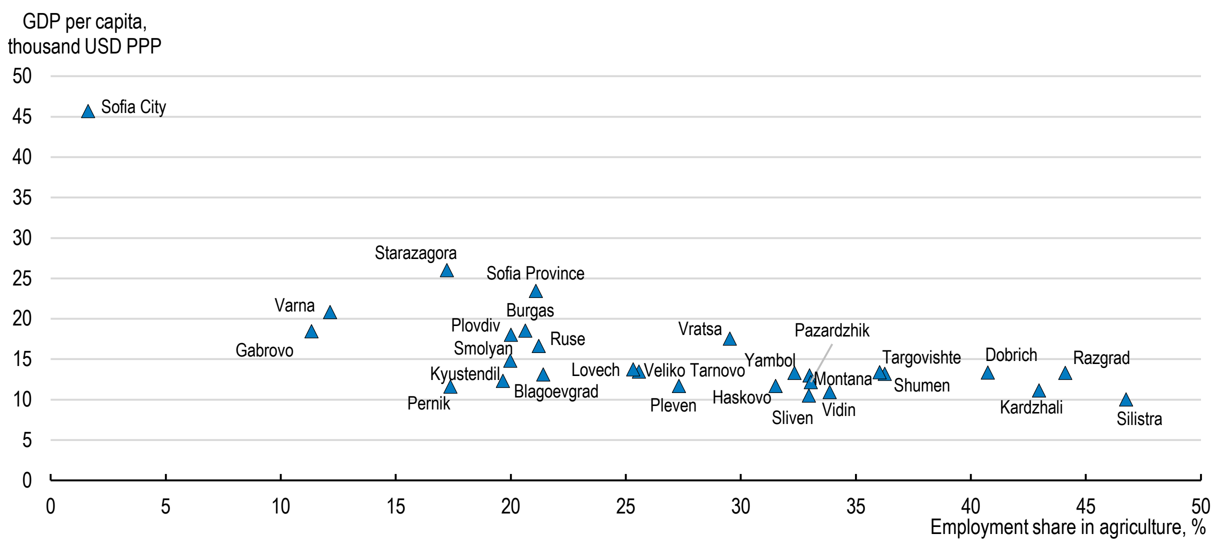
Since 2015 homeowners in multifamily buildings have received sizeable subsidies for renovation through the EUR 1 billion (1.7% of GDP) National Program for Energy Efficiency in Residential Buildings. This has been very successful in improving energy efficiency and promoted establishment of 6 800 homeowner associations (World Bank, 2018). However, subsidies are available to everybody on a first-come, first-serve basis, adding to already high inequalities. Revisions are ongoing for the next phase of the program and should consider targeting to low-income households and disadvantaged municipalities (World Bank, 2018).

Realising the potential of the agricultural sector

The agricultural sector employs more than one third of workers in the poorest regions (Figure 3.15) and accounts for 15-20% of the regional economies. With almost half of the Bulgarian land used for agriculture, the primary sector also remains important for the national economy (Figure 3.16, Panel A). However, labour productivity in the sector is low and has increased only modestly since the mid-2000s (Figure 3.16, Panel B), in contrast to the Slovak Republic, Lithuania, Latvia and Romania that have agricultural sectors of similar importance (around 4% of total gross value added). Improving the growth potential through sustainable restructuring and higher value-added specialisation would help to free up labour resources and increase living standards in the rural regions.

Figure 3.15. Regions with high agricultural employment have the lowest incomes

Agricultural employment and GDP per capita by region, 2017

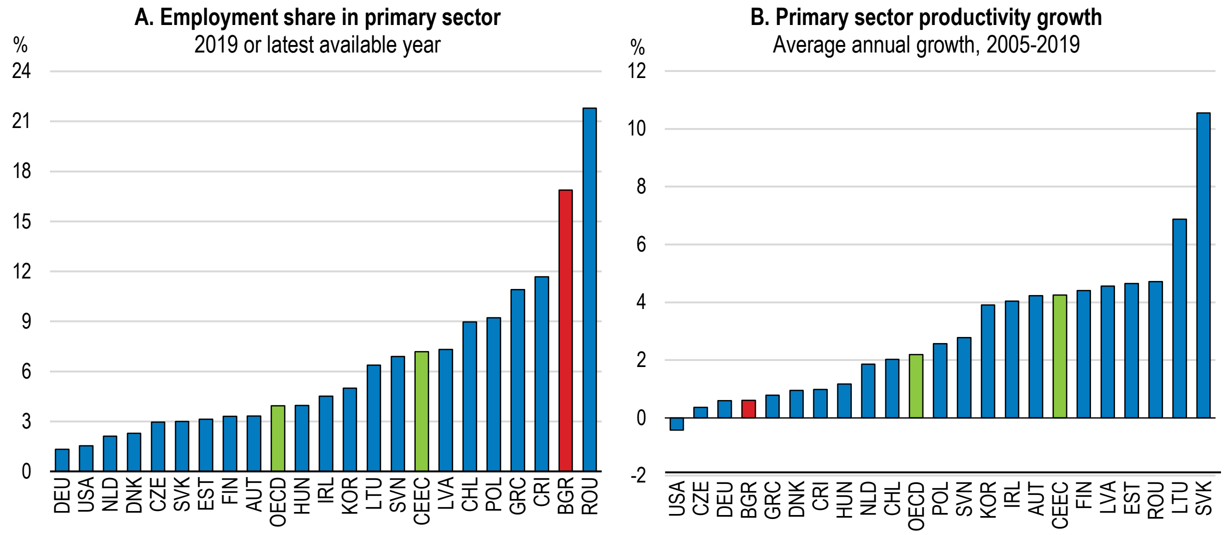


Note: Data per TL3 regions refer to 2017, with the national accounts employment concept of headcounts and a regional nominal GDP per capita in current USD and current PPP. Agriculture employment is significantly lower according to the Labour Force Survey (6.6% at the national level vs 17.7% by national accounts). The reason is incomplete coverage of the self-employed, especially in family farms, in the LFS.
Source: OECD, Regional Statistics database.

StatLink https://stat.link/rwcg03

The Bulgarian agricultural sector is extremely polarised (Figure 3.17), reflecting a rapid consolidation partly driven by the European Common Agriculture Policy (Beluhova-Uzunova et al., 2018). The number of farms has declined by more than 60% since 2005 and increased the average farm size more than fourfold, one of the most rapid restructurings in the EU. On the one hand, a limited number of large-scale farms now control most of the land and specialises mainly in intensive and export-oriented crop production (ERI-BAS, 2016). On the other hand, 65% of all farms remain very small (less than 2 hectare) and contribute less than 8% to agricultural output, retaining more than half of agricultural employment. Moreover, the large farms are mainly located in the deprived north with little industry, while the small farms are concentrated in the southcentral and southwest regions with better employment options. Although subsistence farming has disappeared according to official statistics, most of the small units are family farms producing for self-consumption as a supplement to income from part-time employment and often renting part of the land to a larger farm holding. More than 40% of agricultural employees are family members, often unpaid and without health and pension insurance. Providing these workers with a legal employment status and entitlement to social security would help to address large exposure to poverty risks.

Figure 3.16. The primary sector employs many workers and suffers from weak productivity growth

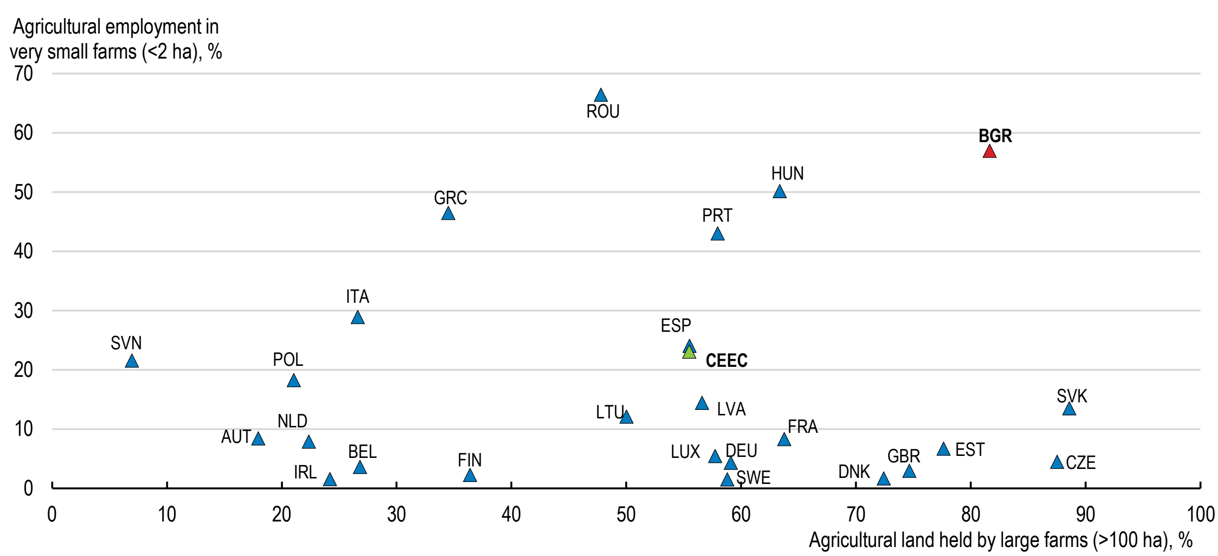


Note: The primary sector is composed of agriculture, forestry and fishing as defined by the national accounts. Productivity is measured as gross value added per worker.
Source: OECD, National Accounts and Productivity databases.

StatLink https://stat.link/w4y9fn

Figure 3.17. The farm structure has become extremely polarised

Large farms hold most of the land while very small farms employ most of the labour, 2016



Source: Eurostat.

StatLink https://stat.link/3dnaje

The polarisation of farms has shifted the structure of agricultural production towards unprocessed products with lower value added. Upon EU accession, Bulgaria was a net exporter of vegetables, fruit and dairy products, but is now a net importer even though natural conditions are favourable for growing fruit and vegetables and labour costs are low. Instead, Bulgaria has become a large exporter of cereals, mainly wheat, sunflower and maize (BMAFF, 2020). This development took place in most Central and Eastern European countries, but Bulgaria may be the country with the most profound transition.

During 2007-2013, EU subsidies in the form of direct payments to farmers were distributed on a per-hectare basis with no upper cap, providing a strong incentive for the large-scale crop production (Atanassova-Kalaydzhieva, 2019). Estimates suggest that some 100 agricultural entities received as much as 75% of the EU support (ERI-BAS, 2016). For 2014-2020, the Bulgarian authorities implemented more targeting of subsidies and imposed an upper cap at EUR 300 000 (European Commission, 2017). Nonetheless, the smaller farms often lack resources to apply for subsidies and tend to be too fragmented to form co-operatives. Mega-farms with local territorial monopolies can also use their power to rent or acquire land from small producers at very low prices, making it difficult to ensure a level playing field and rewind the concentration. Illegal land expropriations, stolen harvest and abuse of EU funds have been reported (Gebrekidan et al., 2019) and several cases of fraud have or are being prosecuted (OLAF, 2019). Improving enforcement of property rights, legal regulations and controls with the agricultural sector should thus be a key priority.

The agricultural sector is more vulnerable to climate change than in most EU countries. More frequent droughts, occurrence of extreme rainfalls and unusual temperatures pose risks to the livelihoods and incomes of farmers. At the same time, the preservation of biodiversity, water resources and other environmental concerns are rising on the political agenda. More than one third of Bulgarian land is protected by Natura 2000 classification, the third largest share in the EU and with around one fifth used for agriculture. The most recent assessment shows that many habitats and species face unfavourable conditions in Bulgaria (EEA, 2018), albeit this is an issue shared with most EU countries. Conversion of large areas of grassland into arable land is a main reason conservation of habitats has deteriorated.

Future agricultural policy should focus on improving long-term productivity and sustainability. Local agricultural employment can be supported by developing more labour-intensive forms of agriculture, such as fruit, vegetables and animal farming, which would improve diversification as well. The poor rural road infrastructure discussed above is a barrier for linking rural producers to consumers in cities, e.g. by farmers' markets, farm shops etc. Altogether, better infrastructure would facilitate development of such short supply chains and stronger integration into national supply chains. As part of the European digitalisation agenda, the government has adopted a strategy for digitalisation of agriculture 2021-2027 (Bulgarian Government, 2019). The strategy contains many welcome elements for improving broadband access, digital skills and introducing new technologies in agriculture. Still, resources for implementation awaits the outcome of the next round of EU Rural Development Funds.

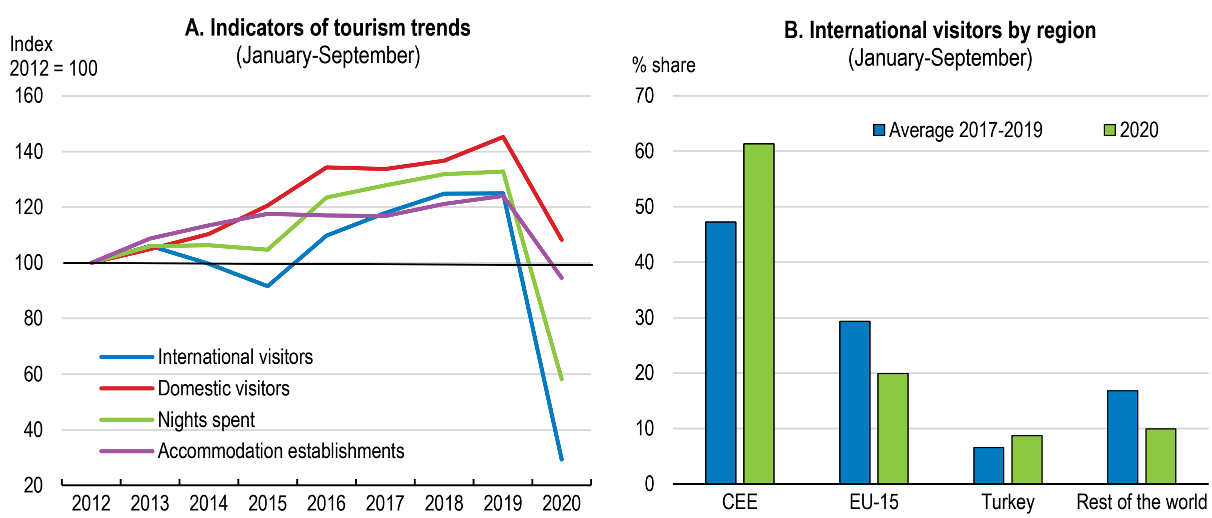
The government should also take measures to reap the full benefits from the 2021-2027 period of the Common Agriculture Policy. Since 2007, the EU funds and access to European markets have boosted trade, investment, modernisation and use of new technologies. However, as discussed above subsidies have also contributed to distort production strongly towards crop production. In recent years, Bulgaria has made use of the available flexibility and for instance maximised the amount of coupled support that is conditional on specific products (15% of direct payments) and established a support scheme targeting small farmers (OECD, 2019d). Looking ahead, the priority should be to strike a balance between simple and non-distortionary measures and avoiding further polarisation and concentration among mega-farms. For instance, phasing out production-based payments, such as per animal head, would help to achieve long-term competitiveness and productivity gains (OECD, 2017b). The severe problems of poverty and social needs in agriculture are better addressed directly with social policies (Key Policy Insights).

Employment prospects for the many agricultural workers can also be improved through development of alternative income streams linked to niche products and rural tourism. Organic farming is evolving, but covered less than 3% of the agricultural land in 2017, lower than the EU average of 7%. Bulgaria also has a small wine industry, but despite better trade conditions, the area used for vineyards has declined by more than one third over the last decade, in contrast to Chile, which benefitted from an expanding wine industry. By contrast, Bulgaria remains a leader in the export of rose oil, used mainly for perfumery, accounting for 70% of world production. These niche areas already have related tourism activities, such as culinary tours, wine tourism and rose festivals. Further investment and development of experience-based tourism could help to boost growth in rural areas.

Reviving tourism for future regional growth

The landscape in Bulgaria offers notable diversity and opportunities for tourism, ranging from almost 400 km mild and sunny Black Sea coast to mountains with alpine climate. The coronavirus outbreak has hit the growing tourism industry hard (Figure 3.18, Panel A); available information for 2020 suggest a 77% drop in international visitors and a 25% drop of domestic visitors compared to the same period for 2019, resulting in a reported reduction in accommodation establishments by 24%. Almost 6 million international tourist visitors arrived in 2019, up by 50% over the last decade and with a similar increase in domestic visitors in tourist sites. However, international visitors have mainly increased from lower-income countries and top markets for visitors with a holiday purpose are Romania, Germany and North Macedonia. The neighbouring countries accounted for an even larger share of the few international visitors during 2020 (Figure 3.18, Panel B), although the higher-income EU-15 countries (including the United Kingdom) still composed one fifth. Tourism from emerging economies, such as China, was growing but from low levels. Emerging markets were expected to be one of the megatrends driving international tourism over the coming decades (OECD, 2019e) and attracting more of these often higher value-added visitors when international travel resumes could help to boost regional growth.

Figure 3.18. The coronavirus outbreak has hit the growing tourism industry hard



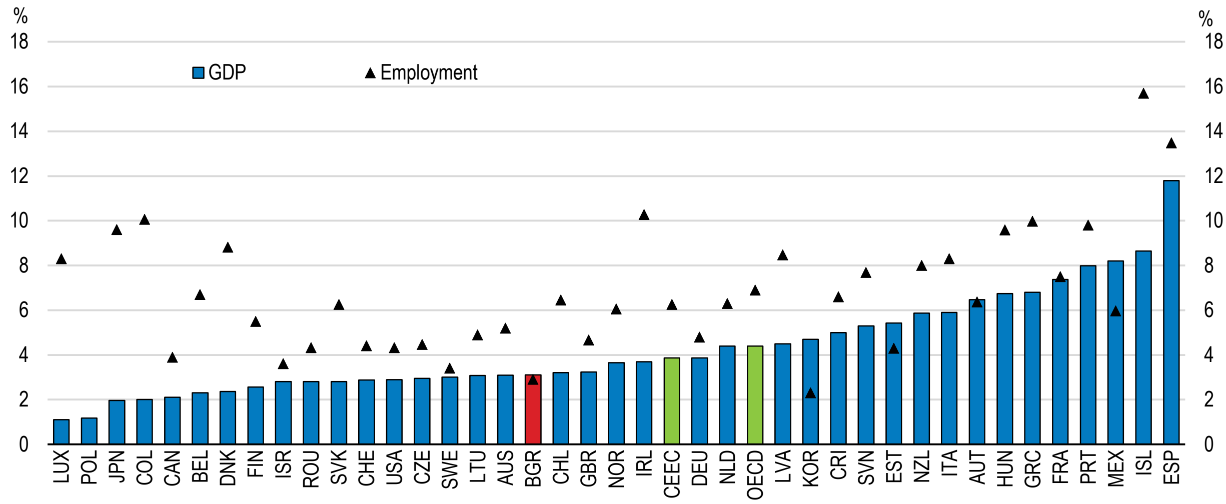
Note: All indicators report the sum of monthly information from January to September to ensure comparability. International visitors compose visitors with holiday and recreation purpose. Domestic visitors, total nights and capacity supply are based on accommodation establishments with 10+ permanent beds. CEE includes Croatia, Czech Republic, Hungary, Poland, North Macedonia, Romania, Russian Federation, Serbia, Slovak Republic, Slovenia and Ukraine. EU-15 composes the old EU countries, including the United Kingdom, except Luxembourg.
Source: Bulgarian National Statistical Institute.

StatLink https://stat.link/e8wvzk

By OECD standards, the tourism industry made a modest direct contribution to GDP with 3.1% and only accounts for 2.9% of employment (Figure 3.19). Including indirect contributions increases these shares to 11.7% and 11%, respectively (WTTC, 2019). The direct economic importance may also be substantially underestimated because of high informality and undeclared income in the tourism industry. Even so, tourism is important for exports and a key driver of the trade balance surplus with net travel services standing at almost 4% of GDP in recent years. In sum, these figures reflect an industry still mainly focused on traditional forms of tourism, particularly mass tourism in large resorts with low value-added services.

Figure 3.19. The tourism industry's direct contribution to the economy is moderate

Direct contribution of tourism to GDP and employment, 2018 or latest year available



Note: Employment is measured in full time equivalent; CEEC employment data does not include Poland.
Source: OECD (2020e), *Tourism Trends and Policies 2020*.

StatLink https://stat.link/se2543

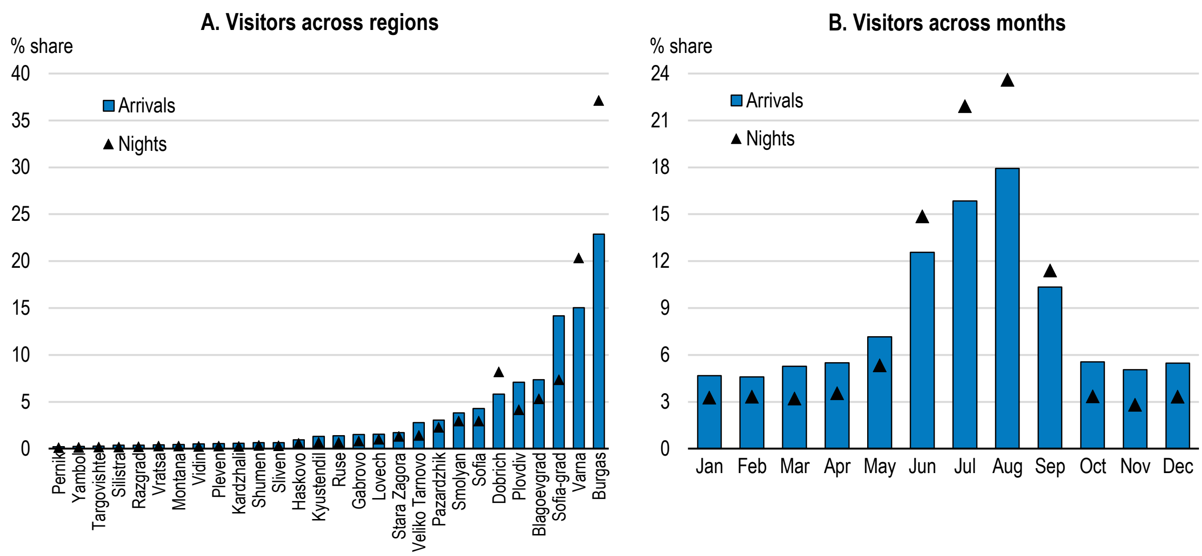
The government has taken several steps to support the tourism industry during the COVID-19 crisis. Many employers used the job retention scheme (*60/40 aid scheme*, see Key Policy Insights), which was later made more generous for the tourism industry (80/20 split). From July, a targeted wage subsidy scheme was established for hiring of unemployed in hotels, restaurant and tour operator businesses (*Employment x 3*), covering the minimum wage and social insurance expenses for up to three months. It has a total budget of EUR 80 million, allocated to municipalities based on registered unemployment figures. During May-December 2020, a state subsidy of EUR 35 per visitor was provided to tour operators if the travel package included a flight into Bulgaria. Firms in tourism have also benefitted from the loan guarantees, corporate tax deferral and compensation for large revenue losses available to all firms (Key Policy Insights).

While the future for international tourism remains uncertain, Bulgaria should maintain support as long as the industry is constrained by significant containment and travel restrictions and build on the growing domestic market. At the same time, a revival of tourism could present an opportunity for adaptation to attract new segments. The main challenge for developing tourism is strong geographic and seasonal concentration (Figure 3.20). The three regions by the Black Sea and Sofia attract almost 60% of all visitors and account for three-fourths of overnight stays (Panel A). Likewise, more than 60% of visits and almost 80% of overnight stays take place from May to September (Panel B). The annual occupancy rate for hotels and similar accommodation is thus only 42%, and although it has increased, still among the lowest in EU countries.

The strong dependence on foreign mass tourism need not be a problem. In Spain, mass tourism has evolved to become a cornerstone of the economy (Figure 3.19) and policies are increasingly focused on sustainability and innovation (OECD, 2020e). However, the need for many seasonal workers was a bottleneck in Bulgaria already (Cheresheva, 2017) and will only accelerate as the population shrinks further. The government has taken some steps to ease the conditions for hiring foreign non-EU workers, e.g. from Ukraine and Moldova, with the Labour Migration and Labour Mobility Act in 2016 and 2018. Yet, restrictions remain on the maximum share of non-EU employees firms can hire (35% of overall staff for SMEs and 20% for large enterprises), which limit the supply of seasonal workers and can incite use of informal work. Another issue is the risk exposure from the short season and dependence on large mass tour operators. The Bulgarian tourism industry suffered large losses from the Thomas Cook bankruptcy in 2019 and may face a detrimental shock from the ongoing coronavirus crisis.

Figure 3.20. Tourism was strongly concentrated in a few regions and during summer months

Total arrivals and accommodation nights across regions and month of visit, 2019



Note: Includes both domestic and international visitors. Nights based on accommodation establishments with 10+ permanent beds.
Source: Bulgarian National Statistics Institute.

StatLink https://stat.link/1ps83g

Tourism policies and regulation are abundant and many actors are involved, at both the national and the regional level (OECD, 2020e). The Ministry of Tourism is responsible for regulation and implementation of policies, while the National Tourism Council act as a consultative body of stakeholders. From 2014, legislation established nine tourism regions responsible for local tourism development and marketing. The idea is to develop a unique brand for each region, such as mountain and health tourism in the Rhodope region. However, the regional entities do not match any other regional structure (Box 3.1), the division is mostly related to geographical characteristics and nine different brands appear to be a high number given the current concentration of tourism (Yancheva et al., 2018). Anchoring tourism zoning and branding with the six territorial regions could make better use of resources and ease coordination, e.g. by avoiding the need for multiple applications for EU funds because of overlapping regional structures.

The tourism strategy has a 2030 horizon and sets out four main objectives: sustainable development of tourism; a more competitive sector; positioning of Bulgaria in the World market; and a more balanced tourist development across regions (BMT, 2017). It targets an ambitious increase of over-night visits by more than 40% from 2016 to 2030 and an increase in the tourist sector’s share to 17% of both the economy and employment. Implementation rests on action plans with the next plan for 2021-2025 underway. In addition to operationalise the welcome strategic objectives, more focus could be given to remove regulatory burdens and streamline procedures. Removing permanent tax breaks to support tourism-related activities should also be considered as has been recommended in several *Economic Surveys* (e.g. OECD, 2017c; 2019f). The VAT rate on hotel services is 9%, less than half of the standard 20% VAT rate, distorting relative prices and creating an uneven playing field between companies in different sectors. The reduced rate was temporarily extended to restaurants, sport facilities and tour holidays in response to COVID-19. Letting these VAT measures expire should be a priority as they easily risk becoming a permanent distortion of the economy.

To promote regional tourism the government has developed *tourist routes* highlighting cultural, congress, spa and wellness, eco- and rural tourism. Diversifying the supply of tourism offers to make them more distinctive and tailored to different types of tourists can help to boost regional tourism. Moreover, visitor demands are likely to change significantly as populations age and new consumer groups emerge. Surveys indicate that emerging generations (those born after 1980) take more, but shorter trips annually and prefer to pick travel experiences that they consider to be "authentic" and "living like a local" (Foresight Factory, 2016). A challenge for developing regional tourism, particularly in poor areas, is that it requires a range of policies, including providing adequate infrastructure and upgrading human skills, which necessitates a large degree of coordination across policies and government levels. Norway and Latvia have used a cluster approach to develop tourism clusters in less-known areas, by facilitating co-operation across industries and involving educational programmes (OECD, 2020e). In this context, the lack of co-operation between Bulgarian municipalities and the multiple regional structures may hold back the development of modern experience-based tourism. Local tourism units may also not know or underestimate potential attractions and the scope for creating new tourism services (OECD, 2014), such as communist heritage tourism (Ivanov, 2009) or using sustainable agriculture to promote eco- and culinary tourism (Velikova and Tzvetkova, 2018).

Many OECD countries have international tourism promotion strategies to attract high-spending visitors (OECD, 2012; 2014). Experience suggests that successful tourism promotion and policies focus on integrating sectors and spatial development rather than targeting individual sectors or areas (Haxton, 2015). Identifying unique Bulgarian tourism products and developing a stronger international brand with cultural authenticity could help to change the perception as a predominantly cheap destination providing low quality products (Yancheva et al., 2018).

Tourism promotion and use of digital technologies are lacking in Bulgaria and need to be upgraded according to the revised tourism strategy. However, the Ministry of Tourism's annual budget for marketing is just around EUR 7.5 million, substantially lower than e.g. Greece and Portugal with budgets of EUR 20 and 45 million, respectively (OECD, 2020e). The official tourist portal (bulgariatravel.org) is static and outdated in design, providing no synchronisation between national and local promotion efforts, nor any information about upcoming events. Likewise, the presence on social media is weak an uncoordinated. The Ministry of Tourism is currently developing a digital information tool to become the basis for data sharing, monitoring and communication with a wide range of public and private tourism stakeholders. This will be a valuable tool for boosting promotion and performance of the tourism industry. Consideration could also be given to exploit the new system to develop location-based apps for visitors.

The sharing economy is held back by stiff regulation

Digital platforms for the sharing economy, such as accommodation and ride-sharing services, can be effective complements to tourism promotion. However, Bulgarian policymakers have pushed back on the sharing economy by shielding traditional service providers through regulation. In December 2019, the government amended the Tourism Act and the Tax Code to include owners of short-term rental property under the same terms as hotels and guesthouses. With the new regulation, they have to satisfy minimum requirements, register with local authorities and pay tourist taxes. If non-registered properties are found on online platforms such as AirBnB or Booking, owners are subject to sizeable fines and ultimately the Minister has the right to require a temporary ban of the platform in Bulgaria. Ensuring that sharing economy activities are regulated and pay taxes is a good principle, but a less cumbersome approach should be considered. For instance through co-operation with the platform providers to exchange data for regular income taxation as e.g. in Denmark. Making short-term rental of property as easy as possible should be a priority to help make use of the abundant property in Bulgaria and boost the development of regional tourism.

The regulatory framework for taxi services likewise excludes ride-sharing platforms such as Uber and limits competition through price and entry regulation (OECD, 2018c). Some of these platforms have operated in Bulgarian, but in 2015 a Supreme Court case ruled their activities to be unfair competition. Reforming the taxi sector to embrace new players and new business models should be considered as this could increase quality of services and provide benefits to consumers. Like accommodation platforms, information exchange with platform providers can ensure compliance with regular income taxation, which would also help to address extensive undeclared work in the regular taxi sector. The use of minimum and maximum prices for taxi services should be removed since the maximum price easily risks becoming a coordination mechanism to market participants. Likewise, restrictions on the number of taxi licences by municipality should be removed to not limit competition.

Table 3.1. Recommendations

Main findings	Recommendations (key recommendations are in bold)
Ensuring equal access to public services	
A new Social Services Act entered into force in July 2020, improving the framework for service delivery and setting quality standards for all service providers.	Implement the Social Services Act with particular focus on improving coordination and integration of services delivery.
Municipalities have limited opportunities and incentives to collaborate on efficiency-improving service delivery.	**Improve the system for inter-municipal co-operation by reducing regulatory barriers and enhancing fiscal incentives for efficiency improvements**. Publish more statistics at the municipal level to improve monitoring and benchmarking.
Up to 14% of the population, and almost half among Roma, lacks health insurance coverage, while out-of-pocket payments, mainly on medicine, are among the highest in the EU.	**Increase effectiveness of public healthcare spending to improve coverage and reduce out-of-pocket payments for low-income and vulnerable groups.** Increase the use of health mediators among the Roma population.
Hospital capacity is large, while primary care is underdeveloped and some regions have acute needs of more general practitioners. The number of nurses is low and the profession lacks status.	**Gradually consolidate the hospital sector and shift focus from inpatient to outpatient care.** Raise the wages for general practitioners and nurses working in rural areas.
Long-term care is underdeveloped and not covered by the basic health insurance package. Action on a national strategy adopted in 2014 has been limited.	Develop accessible and affordable long-term care.
Improving economic integration of the Roma population	
Coordination of Roma policies across line ministries is weak and projects are highly dependent on EU-funding. The mandate and capacities of the National Council for Cooperation on Ethnic and Integration Issues are weak.	**Enhance the governance and capacities of the National Council in coordinating policies for integration of Roma and involve all relevant stakeholders.** Develop statistics to monitor and evaluate the effectiveness of Roma support programmes.
Many Roma households live in illegal housing and local authorities often resort to demolitions.	**Provide technical, legal and financial support to municipalities and Roma households to resolve property rights.**
Improving infrastructure and housing	
Transport infrastructure is underdeveloped and lacks maintenance. The number of traffic fatalities is high.	**Promote the connection of remote regions to national and international supply chains with investment in transport infrastructure and digital connectivity.** Prioritise funds for road maintenance and use cost-benefit analysis that includes wider socio-economic impacts for project selection.
Residential mobility is very low. Homeownership is high and favoured by a number of tax breaks. The private rental market is tiny and suffers from unclear regulation and informal rental.	Implement the draft National Housing Strategy 2018-2030. Remove tax breaks favouring homeownership when the recovery from COVID-19 is well advanced. Review and clarify rental regulation to ensure an equitable balance between landlords and tenants, including a system to resolve disputes.
Social housing is very limited and municipalities have weak incentives and limited resources for development. Housing allowances are small, untargeted and restricted to heating support.	Revise government support to make it financially viable for municipalities to develop social housing and stop sale of social housing. Use recurrent means testing to better target the provision of social housing. Introduce a housing allowance targeted to households with the lowest incomes.
Developing agriculture and tourism as future regional growth drivers	
The agricultural sector is extremely polarised with large-scale farms holding almost all land while very small farms employ the majority of the labour, much of which is (unpaid) family workers.	Minimise use of production-distorting support to farmers. Strengthen enforcement of property rights, legal regulations and controls with the agricultural sector, including allocation of EU funds. Provide a legal status to agricultural family labour and adjust tax, social security and pension systems accordingly.
The tourism industry is strongly geographically and seasonally concentrated and was hit hard by the coronavirus outbreak. Tourism policy is anchored in tourist regions that do not match any other regional structure.	Maintain support to the tourism industry as long as significant containment and travel restrictions apply. Evaluate the regional tourism structure and consider harmonising the tourism zoning with the six territorial regions. Enhance international marketing to boost regional and experience-based tourism. Remove the reduced value-added tax rate for hotel services and let temporary reductions expire.
The sharing economy is underdeveloped, partly due to stiff regulation. Competition in the taxi market is weak.	Embrace the sharing economy and remove measures aimed at shutting out platforms for ride and accommodation sharing. Remove entry and price regulation of taxi services.

References

Ahrend, R. et al. (2017), "What Makes Cities More Productive? Agglomeration economies and the role of urban governance: Evidence from 5 OECD Countries", *OECD Productivity Working Papers*, No. 2017-06, OECD Publishing, Paris, https://doi.org/10.1787/2ce4b893-en.

Amalipe Center for Interethnic Dialogue and Tolerance (2019), *Civil society monitoring report on implementation of the national Roma integration strategy in Bulgaria*, European Commission.

Atanassova-Kalaydzhieva, T. (2019), "Agricultural Enterprises in Bulgaria: Structural Features and Development", *Trakia Journal of Sciences*, Vol. 17/1, pp. 334-343.

Bambalaite, I., G. Nicoletti and C. von Rueden (2020), "Occupational Entry Regulations and their Effects on Productivity in Services: Firm-Level Evidence", *OECD Economics Department Working Papers*, No. 1605, OECD Publishing, Paris, https://doi.org/10.1787/c8b88d8b-en.

Bartolini, D., S. Stossberg and H. Blöchliger (2016), "Fiscal Decentralisation and Regional Disparities", *OECD Economics Department Working Papers*, No. 1330, OECD Publishing, Paris, https://dx.doi.org/10.1787/5jlpq7v3j237-en.

Beluhova-Uzunova, R., K. Hristov and M. Shishkova (2018), "Structure of Bulgarian Agriculture 10 years after the Accession to the EU", *Scientific Papers Series Management, Economic Engineering in Agriculture and Rural Development*, Vol. 18/2, pp. 29-34.

BMAFF/Bulgarian Ministry of Agriculture, Food and the Forestry (2020), *Annual Report on the State and Development of Agriculture 2019*.

BMRDPW/Bulgarian Ministry of Regional Development and Public Works (2018), *Draft National Housing Strategy*.

BMRDPW/Bulgarian Ministry of Regional Development and Public Works (2017), *Annex 1: Analysis of the state of the housing sector*.

BMT/Bulgarian Ministry of Tourism (2017), *National Strategy for Sustainable Development of Tourism in the Republic of Bulgaria, 2014-2030, Updated version*.

BMTITC/Bulgarian Ministry of Transport, Information Technology and Communications (2017), *Integrated Transport Strategy for the Period Until 2030*.

Bogdanov, G. and L. Georgieva (2018), *ESPN Thematic Report on Challenges in long-term care: Bulgaria*, European Social Policy Network, European Commission.

Bogdanov, G. and B. Zahariev (2019), *New Social Services Act finally adopted in Bulgaria*, ESPN Flash Report 2019/37.

Bulgarian Government (2019), *Digitalisation Strategy for Agriculture and Rural Areas of the Republic of Bulgaria*.

Causa, O. and J. Pichelmann (2020), "Should I Stay or Should I Go? Housing and Residential Mobility across OECD Countries", *OECD Economics Department Working Papers*, No. 1626, OECD Publishing, Paris, https://doi.org/10.1787/d91329c2-en.

Cerami, A. and S. Stanescu (2009), "Welfare State Transformations in Bulgaria and Romania", in: Cerami, A. and P. Vanhuysse (eds.), *Post-Communist Welfare Pathways*, Palgrave Macmillan, London.

Cheresheva (2017), "Bulgaria Imports Cheap Regional Labour to Save Tourism Boom", *BalkanInsight*, 23 May 2017.

Dimova et al. (2018), "Bulgaria: Health system review", *Health Systems in Transition*, Vol. 20/4, European Observatory on Health Systems and Policies.

EAMA/Executive Agency Medical Audit (2017), *Annual Report on Condition and Overall Activity of the Health Insurance in Republic of Bulgaria for 2016*, Bulgarian Ministry of Health.

EEA/European Environmental Agency (2018), *Natura 2000 Barometer*.

ERI-BAS/Institute for Economic Research, Bulgarian Academy of Social Sciences (2016), *Annual Report 2016: Economic Development and Policies in Bulgaria*.

European Commission (2020), *Overview of the impact of coronavirus measures on the marginalised Roma communities in the EU*.

European Commission (2019a), *Roma inclusion measures reported under the EU Framework for NRIS, Report on the implementation of national Roma integration strategies 2019*.

European Commission (2019b), *Transport in the European Union: Current Trends and Issues*.

European Commission (2019c), *Digital Economy and Society Index (DESI): 2019 Country Report Bulgaria*.

European Commission (2017), *CAP in your country: Bulgaria*.

EU FRA/ European Union, Agency for Fundamental Rights (2016), *Second European Union Minorities and Discrimination Survey, Roma: Selected findings*.

Fadic, M. et al. (2019), "Classifying small (TL3) regions based on metropolitan population, low density and remoteness", *OECD Regional Development Working Papers*, No. 2019/06, OECD Publishing, Paris, https://dx.doi.org/10.1787/b902cc00-en.

Foresight Factory (2016), *millennial traveller report: why millennials will shape the next 20 years of travel*, Expedia.

Gatti, R. et al. (2016), *Being Fair, Faring Better, Promoting Equality of Opportunity for Marginalized Roma*, World Bank, Washington, DC.

Gebrekidan, S., M. Apuzzo and B. Novak (2019), "The Money Farmers: How Oligarchs and Populists Milk the E.U. for Millions", *New York Times*, 3 November 2019.

Haxton, P. (2015), "A Review of Effective Policies for Tourism Growth", *OECD Tourism Papers*, 2015/01, OECD Publishing, Paris, http://dx.doi.org/10.1787/5js4vmp5n5r8-en.

IME/Institute for Market Economy (2020), "Municipal taxes are going up sharply in 2020", *Review of Economic Policy*, No. 996, Institute for Market Economy, Sofia.

Integro Association (2017), *Why does Roma integration fail in Bulgaria?*

Ivanov, S. (2009), "Opportunities for Developing Communist Heritage Tourism in Bulgaria", *Tourism*, Vol. 57/2, pp. 177-192.

Koytcheva, E. and P. Dimiter (2008), "Bulgaria: Ethnic differentials in rapidly declining fertility", *Demographic Research*, Vol. 19/13, pp. 361-402.

OECD (2021), *OECD Multi-level Governance Studies: Making multi-level governance and decentralisation work for regional development in Bulgaria*, OECD Publishing, Paris, forthcoming.

OECD (2020a), *Tourism Policy Responses to the coronavirus (COVID-19)*, OECD Policy Responses to Coronavirus (COVID-19), OECD Publishing, Paris.

OECD (2020b), *COVID-19 and the Food and Agriculture Sector: Issues and Policy Responses*, OECD Policy Responses to Coronavirus (COVID-19), OECD Publishing, Paris.

OECD (2020c), *OECD Economic Surveys: United States 2020*, OECD Publishing, Paris, https://doi.org/10.1787/12323be9-en.

OECD (2020d), *Policies for present and future service delivery across territories*, CFE/RDPC/RUR(2020)6.

OECD (2020e), *OECD Tourism Trends and Policies 2020*, OECD Publishing, Paris, https://doi.org/10.1787/6b47b985-en.

OECD (2019a), *OECD Economic Surveys: Slovak Republic 2019*, OECD Publishing, Paris, https://doi.org/10.1787/eco_surveys-svk-2019-en.

OECD (2019b), *Linking Indigenous Communities with Regional Development*, OECD Rural Policy Reviews, OECD Publishing, Paris, https://doi.org/10.1787/3203c082-en.

OECD (2019c), *Making Decentralisation Work: A Handbook for Policy-Makers*, OECD Multi-level Governance Studies, OECD Publishing, Paris, https://doi.org/10.1787/g2g9faa7-en.

OECD (2019d), *Innovation, Agricultural Productivity and Sustainability in Latvia*, OECD Food and Agricultural Reviews, OECD Publishing, Paris, https://doi.org/10.1787/9789264312524-en.

OECD (2019e), *OECD Regional Outlook 2019: Leveraging Megatrends for Cities and Rural Areas*, OECD Publishing, Paris, https://doi.org/10.1787/9789264312838-en.

OECD (2019f), *OECD Economic Surveys: Hungary 2019*, OECD Publishing, Paris, https://doi.org/10.1787/eco_surveys-hun-2019-en.

OECD (2018a), *Subnational governments in OECD countries: Key data* (brochure), OECD, Paris, http://dx.doi.org/10.1787/region-data-en.

OECD (2018b), *Taxation of Household Savings*, OECD Tax Policy Studies, No. 25, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264289536-en.

OECD (2018c), Taxi, ride-sourcing and ride-sharing services – Note by Bulgaria, DAF/COMP/WP2/WD(2018)14.

OECD (2017a), *Multi-level Governance Reforms: Overview of OECD Country Experiences*, OECD Publishing, Paris, https://doi.org/10.1787/9789264272866-en.

OECD (2017b), *Evaluation of Agricultural Policy Reforms in the European Union: The Common Agricultural Policy 2014-20*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264278783-en.

OECD (2017c), *OECD Economic Surveys: Iceland 2017*, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_surveys-isl-2017-en

OECD (2014), *Tourism and the Creative Economy*, OECD Studies on Tourism, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264207875-en.

OECD (2012), *Food and the Tourism Experience: The OECD-Korea Workshop*, OECD Studies on Tourism, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264171923-en.

OECD/European Observatory on Health Systems and Policies (2019a), *Bulgaria: Country Health Profile 2019*, State of Health in the EU, OECD Publishing, Paris/European Observatory on Health Systems and Policies, Brussels, https://doi.org/10.1787/34781ac1-en.

OECD/European Observatory on Health Systems and Policies (2019b), *Latvia: Country Health Profile 2019*, State of Health in the EU, OECD Publishing, Paris/European Observatory on Health Systems and Policies, Brussels, https://doi.org/10.1787/b9e65517-en.

OLAF/European Anti-Fraud Office (2019), *The OLAF report 2018*, European Commission.

Phillips, L. (2018), "Improving the Performance of Sub-national Governments through Benchmarking and Performance Reporting", *OECD Working Papers on Fiscal Federalism*, No. 22, OECD Publishing, Paris, https://dx.doi.org/10.1787/ffff92c6-en.

Roberts, M. et al. (2018), "Transport Corridors and Their Wider Economic Benefits: A Critical Review of the Literature", *Policy Research Working Paper*, No. 830, World Bank, Washington, DC.

Stern, D. and M. Dimitrov (2020), "As Eastern Europe shrinks, rural Bulgaria is becoming a ghostland", *Los Angeles Times*, 21 July 2020.

Velikova, E. and S. Tzvetkova (2018), "Options for Overcoming Seasonality in Bulgarian Tourism", *European Journal of Economics and Business Studies*, Vol. 4/2, pp. 187-196.

World Bank (2019), *Harmonizing services for inclusive growth: Improving access to essential services for vulnerable groups in Bulgaria*, Technical report.

World Bank (2018), *Bulgaria National Program for Energy Efficiency in Residential Buildings: Program Design Report for the Second Phase*.

World Bank (2017), *Bulgaria Housing Sector Assessment: Final Report*, report prepared for Ministry of Regional Development and Public Works.

WTTC/World Travel & Tourism Council (2019), *Bulgaria: 2019 Annual Research: Key Highlights.*

Yancheva, K., T. Dyankov and V. Krastev (2018), "Evaluation of Brand Identity of Bulgaria as a Tourist Destination", *Tourism*, Vol. 66/1, pp. 19-34.

OECD Economic Surveys

BULGARIA

ECONOMIC ASSESSMENT

The COVID-19 outbreak abruptly stopped several years of robust economic growth in Bulgaria. Public finances are sound and the government took rapid action to support firms and households. Coping with the pandemic and strengthening the recovery will require continued fiscal support, public investment and the advancement of priority reforms. Bulgaria also faces the challenge of how to sustain and ultimately enhance improvements in living standards for all to tackle rising inequality and persistently high poverty. Tackling obstacles to business sector growth will be key to attracting investment, boosting productivity and providing people with skills to take advantage of new job opportunities. Many rural regions are suffering from depopulation and rapid ageing. Regional income differences in Bulgaria are larger than in most OECD countries and growth has been lower in regions without larger cities. Investments in infrastructure and housing reform would help to boost mobility and strengthen links to national and international supply chains.

SPECIAL FEATURES: STRUCTURAL REFORMS TO RAISE PRODUCTIVITY AND BOOST CONVERGENCE; REDUCING REGIONAL DISPARITIES FOR INCLUSIVE GROWTH

PRINT ISBN 978-92-64-72268-2
PDF ISBN 978-92-64-40666-7

ISSN 0376-6438
2021 SUBSCRIPTION
(18 ISSUES)

9 789264 722682

Volume 2021/3
January 2021